Federal Reserve System Audits

Audits of the Federal Reserve System

The Board of Governors, the Federal Reserve Banks, and the Federal Reserve System as a whole are all subject to several levels of audit and review. The Board's financial statements, and its compliance with laws and regulations affecting those statements, are audited annually by an outside auditor retained by the Board's Office of Inspector General. The Office of Inspector General also conducts audits, reviews, and investigations relating to the Board's programs and operations as well as to Board functions delegated to the Reserve Banks.

The Reserve Banks' financial statements are audited annually by an independent outside auditor retained by the Board of Governors. In addition, the Reserve Banks are subject to annual examination by the Board. As discussed in the chapter ''Federal Reserve Banks,'' the Board's examination includes a wide range of ongoing oversight activities conducted on and off site by staff of the Board's Division of Reserve Bank Operations and Payment Systems.

Federal Reserve operations are also subject to review by the Government Accountability Office. ■

Board of Governors Financial Statements

The financial statements of the Board for 2007 were audited by Deloitte & Touche LLP, independent auditors.

Deloitte.

INDEPENDENT AUDITORS' REPORT

The Board of Governors of the Federal Reserve System:

We have audited the accompanying balance sheet of the Board of Governors of the Federal Reserve System (the "Board") as of December 31, 2007, and the related statements of revenues and expenses and changes in cumulative results of operations, and cash flows for the year then ended. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Board for the year ended December 31, 2006 were audited by other auditors whose report, dated April 17, 2007, expressed an unqualified opinion on those statements and included an explanatory paragraph related to adoption of the Financial Accounting Standard Board Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans.*

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Board's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such 2007 financial statements present fairly, in all material respects, the financial position of the Board of Governors of the Federal Reserve System as of December 31, 2007, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards,* we have also issued our report dated March 19, 2008 on our consideration of the Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards,* and should be considered in assessing the results of our audit.

Deloitte + Touche LLP

March 19, 2008
Washington, D.C.

BALANCE SHEETS

	Year ending December 31, 2007	2006
ASSETS		
CURRENT ASSETS		
Cash	$ 44,613,728	$ 60,030,706
Accounts receivable	2,996,318	2,625,907
Prepaid expenses and other assets	4,653,684	3,916,608
Total current assets	52,263,730	66,573,221
NONCURRENT ASSETS		
Property and equipment, net (Note 4)	153,350,880	151,205,386
Other assets	166,119	343,899
Total noncurrent assets	153,516,999	151,549,285
Total assets	$205,780,729	$218,122,506
LIABILITIES AND CUMULATIVE RESULTS OF OPERATIONS		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$ 20,400,282	$ 10,950,470
Accrued payroll and related taxes	5,647,053	5,421,666
Accrued annual leave	18,429,601	16,334,512
Capital lease payable (current portion)	108,755	327,663
Unearned revenues and other liabilities	702,122	366,304
Total current liabilities	45,287,813	33,400,615
LONG-TERM LIABILITIES		
Capital lease payable (non-current portion)	0	108,755
Accumulated retirement benefit obligation (Note 5)	2,201,675	1,354,662
Accumulated postretirement benefit obligation (Note 6)	7,972,469	8,111,829
Accumulated postemployment benefit obligation (Note 7)	8,855,613	6,515,301
Total long-term liabilities	19,029,757	16,090,547
Total liabilities	64,317,570	49,491,162
CUMULATIVE RESULTS OF OPERATIONS		
Working capital	7,084,672	33,500,269
Unfunded long-term liabilities	(17,542,943)	(14,325,986)
Net investment in assets	153,408,244	151,112,867
Accumulated other comprehensive income (loss) (Note 8)	(1,486,814)	(1,655,806)
Total cumulative results of operations	141,463,159	168,631,344
Total liabilities and cumulative results of operations	$205,780,729	$218,122,506

See accompanying notes to financial statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF REVENUES AND EXPENSES
AND CHANGES IN CUMULATIVE RESULTS OF OPERATIONS

	Year ending December 31, 2007	2006
BOARD OPERATING REVENUES		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures	$296,124,700	$301,013,500
Other revenues	10,365,414	8,508,949
Total operating revenues	306,490,114	309,522,449
BOARD OPERATING EXPENSES		
Salaries	197,656,442	182,239,595
Retirement and insurance	39,451,541	35,853,297
Contractual services and professional fees	36,300,185	23,944,564
Depreciation, amortization, and net losses on disposals	13,557,498	13,058,667
Utilities	8,998,496	9,185,840
Travel	8,619,615	8,820,503
Software	6,678,514	6,637,765
Postage and supplies	8,836,143	4,560,368
Repairs and maintenance	3,890,191	2,634,459
Printing and binding	1,976,765	1,505,470
Other expenses	7,861,901	7,435,067
Total operating expenses	333,827,291	295,875,595
RESULTS OF OPERATIONS	(27,337,177)	13,646,854
CURRENCY COSTS		
Assessments levied on Federal Reserve Banks for currency costs	576,306,073	491,962,202
Expenses for printing, transporting, and retiring Federal Reserve Notes	576,306,073	491,962,202
CURRENCY ASSESSMENTS OVER (UNDER) EXPENSES	0	0
TOTAL RESULTS OF OPERATIONS	(27,337,177)	13,646,854
CUMULATIVE RESULTS OF OPERATIONS, Beginning of period	168,631,344	156,640,296
OTHER COMPREHENSIVE INCOME		
Adjustment to initially apply SFAS No. 158 (Note 8)	0	(1,655,806)
Amortization of prior service cost	(23,831)	0
Amortization of net actuarial loss	113,142	0
Net actuarial loss arising during the year	79,681	0
Total Other Compehensive Income	168,992	(1,655,806)
CUMULATIVE RESULTS OF OPERATIONS, End of period	$141,463,159	$168,631,344

See accompanying notes to financial statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF CASH FLOWS

	Year ending December 31, 2007	2006
Cash Flows from Operating Activities		
Results of Operations	$(27,337,177)	$13,646,854
Adjustments to reconcile results of operations to net cash provided by (used in) operating activities:		
Depreciation	13,433,306	13,047,064
Net losses on disposals of property and equipment	124,192	11,603
Increase (decrease) in assets:		
Accounts receivable, prepaid expenses and other assets	(929,708)	(812,482)
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	9,449,812	(5,955,880)
Accrued payroll and related taxes	225,387	561,094
Accrued annual leave	2,095,089	878,028
Unearned revenues and other liabilities	335,818	(417,407)
Accumulated retirement benefit obligation	847,013	541,165
Accumulated postretirement benefit obligation	(139,360)	1,874,539
Accumulated postemployment benefit obligation	2,340,312	1,403,936
Accumulated other comprehensive income	168,992	(1,655,806)
Net cash provided by operating activities	613,676	23,122,708
Cash Flows from Investing Activities		
Proceeds from disposals	65,988	7,212
Capital expenditures	(15,768,979)	(8,829,712)
Net cash used in investing activities	(15,702,991)	(8,822,500)
Cash Flows from Financing Activities		
Capital lease payments	(327,663)	(239,937)
Net cash used in financing activities	(327,663)	(239,937)
Net Increase (Decrease) in Cash	(15,416,978)	14,060,271
Cash Balance, Beginning of period	60,030,706	45,970,435
Cash Balance, End of period	$ 44,613,728	$60,030,706

See accompanying notes to financial statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOTES TO FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDING
DECEMBER 31, 2007 AND 2006

(1) Structure

The Federal Reserve System (System) was established by Congress in 1913 and consists of the Board of Governors (Board), the Federal Open Market Committee, the twelve regional Federal Reserve Banks, the Federal Advisory Council, and the private commercial banks that are members of the System. The Board, unlike the Reserve Banks, was established as a federal government agency and is supported by Washington, DC based staff numbering approximately 1,900, as it carries out its responsibilities in conjunction with other components of the Federal Reserve System.

The Board is required by the Federal Reserve Act to report its operations to the Speaker of the House of Representatives. The Act also requires the Board, each year, to order a financial audit of each Federal Reserve Bank and to publish each week a statement of the financial condition of each such Reserve Bank and a consolidated statement for all of the Reserve Banks. Accordingly, the Board believes that the best financial disclosure consistent with law is achieved by issuing separate financial statements for the Board and for the Reserve Banks. Therefore, the accompanying financial statements include only the results of operations and activities of the Board. Combined financial statements for the Federal Reserve Banks are included in the Board's annual report to the Speaker of the House of Representatives.

(2) Operations and Services

The Board's responsibilities require thorough analysis of domestic and international financial and economic developments. The Board carries out those responsibilities in conjunction with other components of the Federal Reserve System. The Board also supervises and regulates the operations of the Federal Reserve Banks, exercises broad responsibility in the nation's payments system, and administers most of the nation's laws regarding consumer credit protection. Policy regarding open market operations is established by the Federal Open Market Committee. However, the Board has sole authority over changes in reserve requirements, and it must approve any change in the discount rate initiated by a Federal Reserve Bank.

The Board also plays a major role in the supervision and regulation of the U.S. banking system. It has supervisory responsibilities for state-chartered banks that are members of the Federal Reserve System, bank holding companies, foreign activities of member banks, and U.S. activities of foreign banks.

(3) Significant Accounting Policies

Basis of Accounting—The Board prepares its financial statements in accordance with accounting principles generally accepted in the United States of America.

Revenues—The Board assesses the Federal Reserve Banks for operating expenses and additions to property, which are based on expected cash needs.

Currency Costs—Federal Reserve Banks issue new and fit currency to the public and destroy currency already in circulation as it becomes unfit or when a new design is issued. Each year, the Board orders new currency from the U.S. Department of Treasury's Bureau of Engraving and Printing. The Board incurs expenses and assesses the Federal Reserve Banks for printing, transporting, and retiring Federal Reserve Notes. These expenses and assessments are reported separately from the Board's operating transactions in the Board's Statement of Revenues and Expenses and Cumulative Results of Operations.

Allowance for Doubtful Accounts—Accounts receivable considered uncollectible are charged against the allowance account in the year they are deemed uncollectible. The allowance for doubtful accounts is adjusted monthly, based upon a review of outstanding receivables.

Property, Equipment, and Software—The Board's property, buildings, equipment, and software are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are calculated on a straight-line basis over the estimated useful lives of the assets, which range from three to ten years for furniture and equipment, ten to fifty years for building equipment and structures, and two to ten years for software. Upon the sale or other disposition of a depreciable asset, the cost and related accumulated depreciation or amortization are removed from the accounts and any gain or loss is recognized.

The Board complies with Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, which requires that certain costs incurred in the development of internal use software be capitalized and amortized over its useful life.

Art Collections—The Board has collections of works of art, historical treasures, and similar assets. These collections are maintained and held for public exhibition in furtherance of public service. Proceeds from any sales of collections are used to acquire other items for collections. As permitted by Statement of Financial Accounting Standards (SFAS) No. 116, Accounting for Contributions Received and Contributions Made, the cost of collections purchased by the Board is charged to expense in the year purchased and donated collection items are not recorded. The value of the Board's collections has not been determined.

Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications—Certain 2006 amounts have been reclassified to conform with 2007 presentation.

SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—The Board initially applied the provisions of SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans,* at December 31, 2006. This accounting standard requires recognition of the overfunded or underfunded status of a defined benefit postretirement plan in the Balance Sheets, and recognition of changes in the funded status in the years in which the changes occur through comprehensive income. The transition rules for implementing the standard required applying the provisions as of the end of the year of initial implementation, and the effect as of December 31, 2006 is recorded as "Adjustment to initially apply SFAS No. 158" in the Statements of Revenues and Expenses and Changes in Cumulative Results of Operations.

(4) Property and Equipment

The following is a summary of the components of the Board's property and equipment, at cost, net of accumulated depreciation and amortization.

	2007	2006
Land	$ 18,640,314	$ 18,640,314
Buildings and improvements	149,968,504	147,504,169
Furniture and equipment	55,625,014	47,271,434
Software in use	14,745,157	13,681,508
Software in process	2,064,438	941,912
Construction in process	1,550,565	360,967
	242,593,992	228,400,304
Less accumulated depreciation and amortization	(89,243,112)	(77,194,918)
Property and equipment, net	$153,350,880	$151,205,386

Construction in process includes costs incurred in 2007 and 2006 for long-term security projects and building enhancements.

The Board entered into capital leases for printing equipment, which terminate in 2008. Furniture and equipment includes $1,230,000 in 2007 and 2006 for capitalized leases. Accumulated depreciation includes $1,123,000 and $867,000 for capitalized leases as of 2007 and 2006, respectively. The Board paid interest related to these capital leases in the amount of $31,000 and $54,000 for 2007 and 2006, respectively.

The future minimum lease payments required under the capital leases and the present value of the net minimum lease payments as of December 31, 2007, are as follows:

	2008
Total minimum lease payments	$ 138,279
Less: Amount representing maintenance	(26,743)
Net minimum lease payments	111,536
Less: Amount representing interest	(2,781)
Present value of net minimum lease payments	108,755
Less: Current maturities of capital lease payments	(108,755)
Long-term capital lease obligations	$ 0

(5) Accumulated Retirement Benefits

Substantially all of the Board's employees participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan). The System Plan provides retirement benefits to employees of the Board, the Federal Reserve Banks, and the Office of Employee Benefits of the Federal Reserve System (OEB). The Federal Reserve Bank of New York, on behalf of the System, recognizes the net asset and costs associated with the System Plan in its financial statements. Costs associated with the System Plan are not redistributed to other participating employers.

Employees of the Board who became employed prior to 1984 are covered by a contributory defined benefits program under the System Plan. Employees of the Board who became employed after 1983 are covered by a noncontributory defined benefits program under the System Plan. Contributions to the System Plan are actuarially determined and funded by participating employers. Based on actuarial calculations, it was determined that employer funding contributions were not required for the years 2007 and 2006, and the Board was not assessed a contribution for these years.

Effective January 1, 1996, Board employees covered under the System Plan are also covered under a Benefits Equalization Plan (BEP). Benefits paid under the BEP are limited to those benefits that cannot be paid from the System Plan due to limitations imposed by Sections 401(a)(17), 415(b) and 415(e) of the Internal Revenue Code of 1986. Activity for the BEP for 2007 and 2006 is summarized in the following tables:

	2007	2006
Change in projected benefit obligation		
Benefit obligation, beginning of year	$1,354,662	$ 536,339
Service cost	329,282	185,483
Interest cost	87,837	45,004
Plan participants' contributions	0	0
Plan amendments	0	0
Actuarial (gain)/loss	453,526	596,114
Benefits paid	(23,632)	(8,278)
Benefit obligation, end of year	$2,201,675	$1,354,662
Accumulated benefit obligation, end of year	$ 685,170	$ 546,854
Weighted-average assumptions used to determine benefit obligation as of December 31		
Discount rate	6.25%	5.75%
Rate of compensation increase	5.00%	4.50%
Change in plan assets		
Fair value of plan assets, beginning of year	$ 0	$ 0
Employer contributions	23,632	8,278
Plan participants' contributions	0	0
Benefits paid	(23,632)	(8,278)
Fair value of plan assets, end of year	$ 0	$ 0

	2007	2006
Reconciliation of funded status, end of year		
Funded status	$(2,201,675)	$(1,354,662)
Net actuarial (gain) loss	1,006,257	580,386
Prior service (credit) cost	(233,404)	(247,417)
Prepaid (Accrued) pension cost	$(1,428,822)	$(1,021,693)
Amounts recognized in the financial statements consist of		
Prepaid benefit cost	$ 0	$ 0
Accrued benefit liability	(1,428,822)	(1,021,693)
Intangible asset	0	0
Accumulated other comprehensive income	(772,853)	(332,969)
Net amount recognized	$(2,201,675)	$(1,354,662)
Components of net periodic benefit cost		
Service cost—benefits earned during the period	$ 329,282	$ 185,483
Interest cost on projected benefit obligation	87,837	45,004
Expected return on plan assets	0	0
Amortization of prior service (credit) cost	(14,013)	(14,013)
Amortization of (gains) losses	27,655	0
Amortization of initial (asset) obligation	0	0
Net periodic benefit cost (credit)	$ 430,761	$ 216,474
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31		
Discount rate	6.00%	5.75%
Rate of compensation increase	4.50%	4.50%
Expected cash flows		
Expected employer contributions:		
2008	$ 82,134	
Expected benefit payments:		
2008	$ 82,134	
2009	96,170	
2010	109,602	
2011	120,750	
2012	127,690	
2013–2017	724,518	

	2007	2006
Estimated amounts that will be amortized from accumulated other comprehensive income into net periodic benefit cost (credit) in 2008 are shown below:		
Net actuarial (gain)/loss	$ 79,561	
Prior service (credit)/cost	(14,013)	
Total	$ 65,548	

A relatively small number of Board employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). These defined benefit plans are administered by the U.S. Office of Personnel Management, which determines the required employer contribution levels. The Board's contributions to these plans totaled $316,000 and $334,000 in 2007 and 2006, respectively. The Board has no liability for future payments to retirees under these programs and is not accountable for the assets of the plans.

Employees of the Board may also participate in the Federal Reserve System's Thrift Plan. Board contributions to members' accounts are based upon a fixed percentage of each member's basic contribution and were $9,542,000 and $8,964,000 in 2007 and 2006, respectively.

(6) Accumulated Postretirement Benefits

The Board provides certain life insurance programs for its active employees and retirees. Activity for 2007 and 2006 is summarized in the following tables:

	2007	2006
Change in benefit obligation		
Benefit obligation, beginning of year	$8,111,829	$8,273,831
Service cost	198,791	230,567
Interest cost	479,903	470,256
Plan participants' contributions	0	0
Plan amendments	0	0
Actuarial (gain) loss	(533,208)	(603,500)
Benefits paid	(284,846)	(259,325)
Benefit obligation, end of year	$7,972,469	$8,111,829
Weighted-average assumptions used to determine benefit obligation as of December 31		
Discount rate	6.25%	6.00%
Change in plan assets		
Fair value of plan assets, beginning of year	$ 0	$ 0
Employer contribution	284,846	259,325
Plan participants' contributions	0	0
Benefits paid	(284,846)	(259,325)
Fair value of plan assets, end of year	$ 0	$ 0

	2007	2006
Reconciliation of funded status at end of year		
Benefit obligations	$(7,972,469)	$(8,111,829)
Unrecognized net actuarial (gain) loss	0	0
Unrecognized prior service cost	0	0
Amount recognized, end of year	$(7,972,469)	$(8,111,829)
Amounts recognized in the financial statements consist of		
Liability:		
Accrued benefit cost	$(7,972,469)	$(8,111,829)
Accumulated other comprehensive income	0	0
Net amount recognized	0	0
	$(7,972,469)	$(8,111,829)
Amounts recognized in accumulated other comprehensive income consist of:		
Net actuarial loss (gain)	$ 803,702	$ 1,422,398
Prior service cost (credit)	(89,741)	(99,560)
Transition obligation (asset)	0	0
Deferred curtailment (gain) loss	0	0
	$ 713,961	$ 1,322,838
Components of net periodic benefit cost		
Service cost—benefits earned during the period	$ 198,791	$ 230,567
Interest cost on projected benefit obligation	479,902	470,256
Expected return on plan assets	0	0
Amortization of prior service (credit) cost	(9,818)	(9,818)
Amortization of (gains) losses	85,487	120,022
Amortization of initial (asset) obligation	0	0
Net periodic benefit cost (credit)	$ 754,362	$ 811,027
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31		
Discount rate	5.75%	5.50%

	2007	2006
Expected cash flows		
Expected employer contributions:		
2008	$ 293,767	
Expected benefit payments:		
2008	$ 293,767	
2009	326,227	
2010	352,683	
2011	368,728	
2012	384,026	
2013–2017	2,300,954	
Estimated amounts that will be amortized from accumulated other comprehensive income into net periodic benefit cost (credit) in 2008 are shown below:		
Net actuarial (gain) loss	$ 7,425	
Prior service (credit) cost	(9,818)	
Total	$ (2,393)	

The above accumulated postretirement benefit obligation is related to the Board-sponsored life insurance programs. The Board has no liability for future payments to employees who continue coverage under the federally sponsored life and health programs upon retiring. Contributions for active employees participating in federally sponsored health programs totaled $10,311,000 and $9,607,000 in 2007 and 2006, respectively.

(7) Accumulated Postemployment Benefits

The Board provides certain postemployment benefits to eligible former or inactive employees and their dependents during the period subsequent to employment but prior to retirement. Postemployment costs were actuarially determined using a December 31 measurement date and discount rates of 5.75 percent as of December 31, 2007 and 2006. The accrued postemployment benefit costs recognized by the Board for the years ended December 31, 2007 and 2006, were $3,055,000 and $1,963,000, respectively.

(8) Accumulated Other Comprehensive Income

Following is a reconciliation of beginning and ending balances of accumulated other comprehensive income.

	Amount related to defined benefit retirement plans	Amount related to postretirement benefits other than pensions
Balance at January 1, 2006	$ 0	$ 0
Adjustment to initially apply SFAS No. 158	332,969	1,322,837
Balance at December 31, 2006	$ 332,969	$ 1,322,837
Change in funded status of benefit plans:		
Amortization of prior service costs	14,013	9,818
Amortization of net actuarial gain (loss)	(27,655)	(85,487)
Net actuarial (gain) loss arising during the year	453,526	(533,207)
Change in funded status of benefit plans—other comprehensive income gain (loss)	439,884	(608,876)
Balance at December 31, 2007	$ 772,853	$ 713,961

	Total accumulated other comprehensive income (loss)
Balance at January 1, 2006	$ 0
Adjustment to initially apply SFAS No. 158	(1,655,806)
Balance at December 31, 2006	$ (1,655,806)
Change in funded status of benefit plans:	
Amortization of prior service costs	(23,831)
Amortization of net actuarial gain (loss)	113,142
Net actuarial (gain) loss arising during the year	79,681
Change in funded status of benefit plans—other comprehensive income gain (loss)	168,992
Balance at December 31, 2007	$(1,486,814)

Additional detail regarding the classification of accumulated other comprehensive income is included in notes 5 and 6.

(9) Commitments and Contingencies

Leases

The Board has entered into several operating leases to secure office, training and warehouse space. Minimum annual payments under the operating leases having an initial or remaining noncancelable lease term in excess of one year at December 31, 2007, are as follows:

2008	$ 1,623,970
2009	1,961,223
2010	2,013,281
2011	1,944,142
After 2011	9,118,887
	$16,661,503

Rental expenses under the operating leases were $539,000 and $193,000 in 2007 and 2006, respectively.

Deferred Leases

The Board's operating leases contain rent abatements and scheduled rent increases. According to accounting principles generally accepted in the United States of America, rent abatements and scheduled rent increases must be considered in determining the annual rent expense to be recognized. The deferred rent represents the difference between the actual lease payments and the rent expense recognized. The current balance of deferred rent is $318,000 and $8,000 in 2007 and 2006, respectively.

Commitments

The Board has entered into an agreement with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, through the Federal Financial Institutions Examination Council (the Council) to fund a portion of enhancements and maintenance fees for a central data repository project through 2013. The estimated total Board expense to support this effort is $7.5 million.

In 2007, the Council began a rewrite of the Home Mortgage Disclosure Act processing system, for which the Board provides data processing services. The estimated total Board expense to support this effort is $3.2 million through 2010.

Litigation

The Board is subject to contingent liabilities which include litigation cases. These contingent liabilities arise in the normal course of operations and their ultimate disposition is unknown. Based on information currently available to management, it is management's opinion that the expected outcome of these matters, individually or in the aggregate, will not have a materially adverse effect on the financial statements. Management believes the Board has substantial defenses and that the likelihood of an adverse judgment is remote.

(10) Federal Financial Institutions Examination Council

The Board is one of the five member agencies of the Council, and currently performs certain management functions for the Council. The five agencies which are represented on the Council are the Board, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision. The Board's financial statements do not include financial data for the Council. Activity related to the Board and Council for 2007 and 2006 is summarized in the following table:

	2007	2006
Council expenses charged to the Board		
Assessments for operating expenses	$ 108,163	$ 109,760
Central Data Repository	1,167,449	740,003
Uniform Bank Performance Report	192,026	204,617
Total Council expenses charged to the Board	$1,467,638	$1,054,380
Board expenses charged to the Council		
Data processing related services	$4,457,647	$3,429,499
Administrative services	190,800	183,000
Total Board expenses charged to the Council	$4,648,447	$3,612,499

	2007	2006
Accounts receivable due from the Council	$384,142	$395,551
Accounts payable due to the Council	$ 64,087	$ 54,870

(11) Federal Reserve Banks

The Board performs certain functions for the Reserve Banks in conjunction with its responsibilities for the System, and the Reserve Banks provide certain administrative functions for the Board. Activity related to the Board and Reserve Banks for 2007 and 2006 is summarized in the following table:

	As of December 31,	
	2007	2006
Reserve Bank expenses charged to the Board		
Data processing and communication	$ 2,064,110	$ 2,161,298
Contingency site	1,152,166	1,087,429
Total Reserve Bank expenses charged to the Board	$ 3,216,276	$ 3,248,727
Board expenses charged to the Reserve Banks		
Assessments for currency costs	$576,306,073	$491,962,202
Assessments for operating expenses of the Board	296,124,700	301,013,500
Data processing	704,840	731,999
Total Board expenses charged to the Reserve Banks	$873,135,613	$793,707,701
Accounts receivable due from Federal Reserve Banks	$ 1,270,582	$ 854,142
Accounts payable due to the Reserve Banks	$ 10	$ 12,417

(12) The Office of Employee Benefits of the Federal Reserve System

OEB administers certain System benefit programs on behalf of the Board and the Reserve Banks, and costs associated with the OEB's activities are assessed to the Board and Reserve Banks. The Board was assessed $2,866,676 and $2,380,474 in 2007 and 2006, respectively.

Deloitte.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Board of Governors of the Federal Reserve System:

We have audited the financial statements of the Board of Governors of the Federal Reserve System (the "Board") as of and for the year ended December 31, 2007, and have issued our report thereon dated March 19, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Board's internal control over financial reporting as a basis for designing our audit procedures for the purposes of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Board's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Board's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Board's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Board's financial statements that is more than inconsequential will not be prevented or detected by the Board's internal controls. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Board's internal control.

During our audit, we noted certain control deficiencies within the general computer control environment within the Board of Governors related to logical access controls, which affect several financial system platforms supporting the Board's financial statements. These deficiencies individually are not considered significant deficiencies, however, when considered collectively, aggregate to a significant deficiency. We have considered these matters in conjunction with our audit of the financial statements and noted no material misstatements or omissions in the Board's financial statements that were caused by these various control deficiencies. Management has taken steps to address these deficiencies by correcting the cause of a deficiency and/or by implementing additional compensating controls and processes. Due to the sensitive nature of these deficiencies, the technical details related to these deficiencies have been provided to Board of Governors' management in a separate, limited distribution communication.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we do not believe that the significant deficiency described above is a material weakness.

We have communicated to management, in a separate communication dated March 19, 2008, other control deficiencies involving the Board's internal control over financial reporting and other matters that we identified during our audit.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Board's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

Distribution

This report is intended solely for the information and use of the Board, management, and others within the organization, the Office of Inspector General, and the United States Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLP

March 19, 2008
Washington, D.C.

Federal Reserve Banks Combined Financial Statements

The combined financial statements of the Federal Reserve Banks were audited by Deloitte & Touche LLP, independent auditors, for the year ended December 31, 2007, and by PricewaterhouseCoopers LLP, independent auditors, for the year ended December 31, 2006.

Deloitte.

REPORT OF INDEPENDENT AUDITORS

To the Board of Governors of the Federal Reserve System
and the Boards of Directors of the Federal Reserve Banks:

We have audited the accompanying combined statement of condition of the Federal Reserve Banks (the "Reserve Banks") as of December 31, 2007 and the related combined statements of income and comprehensive income, and changes in capital for the year then ended, which have been prepared in conformity with accounting principles established by the Board of Governors of the Federal Reserve System. These combined financial statements are the responsibility of the Reserve Banks' management. Our responsibility is to express an opinion on these combined financial statements based on our audit. The combined financial statements of the Reserve Banks for the year ended December 31, 2006 were audited by other auditors whose report, dated March 30, 2007, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 3 to the combined financial statements, the Reserve Banks have prepared these combined financial statements in conformity with accounting principles established by the Board of Governors of the Federal Reserve System, as set forth in the *Financial Accounting Manual for Federal Reserve Banks,* which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The effects on such combined financial statements of the differences between the accounting principles established by the Board of Governors of the Federal Reserve System and accounting principles generally accepted in the United States of America are also described in Note 3.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of the Reserve Banks as of December 31, 2007, and the combined results of their operations for the year then ended, on the basis of accounting described in Note 3.

Deloitte + Touche LLP

March 31, 2008
Washington, D.C.

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
1800 Tysons Boulevard
McLean, VA 22102-4261
Telephone (703) 918 3000
Facsimile (703) 918 3100

Report of Independent Auditors

To the Board of Governors of the Federal Reserve System
and the Board of Directors of the Federal Reserve Banks

We have audited the accompanying combined statement of condition of the Federal Reserve Banks (the "Reserve Banks") as of December 31, 2006 and the related combined statement of income and changes in capital for the year then ended, which have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System. These combined financial statements are the responsibility of the Reserve Banks' management. Our responsibility is to express an opinion on these combined financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 3, these combined financial statements were prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System. These principles, policies, and practices, which were designed to meet the specialized accounting and reporting needs of the Federal Reserve System, are set forth in the *Financial Accounting Manual for Federal Reserve Banks* and constitute a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of the Reserve Banks as of December 31, 2006 and the combined results of their operations for the year then ended, on the basis of accounting described in Note 3.

PricewaterhouseCoopers LLP

March 30, 2007

FEDERAL RESERVE BANKS
COMBINED STATEMENTS OF CONDITION

(in millions)

	December 31, 2007	December 31, 2006
ASSETS		
Gold certificates	$ 11,037	$ 11,037
Special drawing rights certificates	2,200	2,200
Coin	1,179	801
Items in process of collection	1,804	3,486
Loans to depository institutions	48,636	67
Securities purchased under agreements to resell	46,500	40,750
U.S. government securities, net	745,629	783,619
Investments denominated in foreign currencies	47,295	20,482
Accrued interest receivable	6,410	6,761
Bank premises and equipment, net	2,539	2,376
Other assets	1,900	1,785
Total assets	$915,129	$873,364
LIABILITIES AND CAPITAL		
LIABILITIES		
Federal Reserve notes outstanding, net	$791,691	$783,019
Securities sold under agreements to repurchase	43,985	29,615
Deposits:		
Depository institutions	20,767	18,699
U.S. Treasury, general account	16,120	4,708
Other deposits	363	349
Deferred credit items	1,811	3,813
Interest on Federal Reserve notes due to U.S. Treasury	1,532	908
Accrued benefit costs	1,281	1,314
Other liabilities	679	291
Total liabilities	878,229	842,716
CAPITAL		
Capital paid-in	18,450	15,324
Surplus (including accumulated other comprehensive loss of $1,524 million and $1,849 million at December 31, 2007 and 2006, respectively)	18,450	15,324
Total capital	36,900	30,648
Total liabilities and capital	$915,129	$873,364

The accompanying notes are an integral part of these combined financial statements.

FEDERAL RESERVE BANKS
COMBINED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(in millions)

	For the year ended December 31, 2007	For the year ended December 31, 2006
Interest income		
Interest on U.S. government securities	$40,298	$36,452
Interest on investments denominated in foreign currencies	575	369
Interest on loans to depository institutions	71	12
Total interest income	40,944	36,833
Interest expense		
Interest expense on securities sold under agreements to repurchase	1,688	1,342
Net interest income	39,256	35,491
Other operating income		
Income from services	878	908
Reimbursable services to government agencies	458	426
Foreign currency gains, net	1,886	1,186
Other income	166	144
Total other operating income	3,388	2,664
Operating expenses		
Salaries and other benefits	2,093	1,880
Occupancy expense	247	240
Equipment expense	203	212
Assessments by the Board of Governors	872	793
Other expenses	838	835
Total operating expenses	4,253	3,960
Net income prior to distribution	38,391	34,195
Change in funded status of benefit plans	325	...
Comprehensive income prior to distribution	$38,716	$34,195
Distribution of comprehensive income		
Dividends paid to member banks	$ 992	$ 871
Transferred to surplus and change in accumulated other comprehensive loss	3,126	4,272
Payments to U.S. Treasury as interest on Federal Reserve notes	34,598	29,052
Total distribution	$38,716	$34,195

The accompanying notes are an integral part of these combined financial statements.

FEDERAL RESERVE BANKS
COMBINED STATEMENTS OF CHANGES IN CAPITAL
for the years ended December 31, 2007 and 2006

(in millions)

		Surplus			
	Capital Paid-In	Net Income Retained	Accumulated Other Comprehensive Loss	Total Surplus	Total Capital
Balance at January 1, 2006 (270 million shares)	$13,536	$12,901	$ . . .	$12,901	$26,437
Net change in capital stock issued (36 million shares)	1,788	. . .	. . .	. . .	1,788
Transferred to surplus	. . .	4,272	. . .	4,272	4,272
Adjustment to initially apply SFAS No. 158	. . .	. . .	(1,849)	(1,849)	(1,849)
Balance at December 31, 2006 (306 million shares)	$15,324	$17,173	$(1,849)	$15,324	$30,648
Net change in capital stock issued (63 million shares)	3,126	. . .	. . .	. . .	3,126
Transferred to surplus and change in accumulated other comprehensive loss	. . .	2,801	325	3,126	3,126
Balance at December 31, 2007 (369 million shares)	$18,450	$19,974	$(1,524)	$18,450	$36,900

The accompanying notes are an integral part of these combined financial statements.

Notes to the Combined Financial Statements of the Federal Reserve Banks

(1) Structure

The twelve Federal Reserve Banks ("Reserve Banks") are part of the Federal Reserve System ("System") created by Congress under the Federal Reserve Act of 1913 ("Federal Reserve Act"), which established the central bank of the United States. The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics.

In accordance with the Federal Reserve Act, supervision and control of each Reserve Bank is exercised by a board of directors. The Federal Reserve Act specifies the composition of the board of directors for each of the Reserve Banks. Each board is composed of nine members serving three-year terms: three directors, including those designated as chairman and deputy chairman, are appointed by the Board of Governors of the Federal Reserve System ("Board of Governors") to represent the public, and six directors are elected by member banks. Banks that are members of the System include all national banks and any state-chartered banks that apply and are approved for membership in the System. Member banks are divided into three classes according to size. Member banks in each class elect one director representing member banks and one representing the public. In any election of directors, each member bank receives one vote, regardless of the number of shares of Reserve Bank stock it holds.

The System also consists, in part, of the Board of Governors and the Federal Open Market Committee ("FOMC"). The Board of Governors, an independent federal agency, is charged by the Federal Reserve Act with a number of specific duties, including general supervision over the Reserve Banks. The FOMC is composed of members of the Board of Governors, the president of the Federal Reserve Bank of New York ("FRBNY"), and on a rotating basis four other Reserve Bank presidents.

(2) Operations and Services

The Reserve Banks perform a variety of services and operations. Functions include participation in formulating and conducting monetary policy; participation in the payments system including large-dollar transfers of funds, automated clearinghouse ("ACH") operations, and check collection; distribution of coin and currency; performance of fiscal agency functions for the U.S. Treasury, certain federal agencies, and other entities; serving as the federal government's bank; provision of short-term loans to depository institutions; service to the consumer and the community by providing educational materials and information regarding consumer laws; and supervision of bank holding companies, state member banks, and U.S. offices of foreign banking organizations. Certain services are also provided to foreign and international monetary authorities, primarily by the FRBNY.

The FOMC, in the conduct of monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and annually issues authorizations and directives to the FRBNY for its execution of transactions. The FRBNY is authorized and directed by the FOMC to conduct operations in domestic markets, including the direct purchase and sale of U.S. government securities, the purchase of securities under agreements to resell, the sale of securities under agreements to repurchase, and the lending of U.S. government securities. The FRBNY executes these open market transactions at the direction of the FOMC and holds the resulting securities and agreements in the portfolio known as the System Open Market Account ("SOMA").

In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes and directs the FRBNY to execute operations in foreign markets for major currencies in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC in carrying out the System's central bank responsibilities. The FRBNY is authorized by the FOMC to hold balances of, and to execute spot and forward foreign exchange ("FX") and securities contracts for, nine foreign currencies and to invest such foreign currency holdings ensuring adequate liquidity is maintained. The FRBNY is authorized and directed by the FOMC to maintain reciprocal currency arrangements ("FX swaps") with four central banks and "warehouse" foreign currencies for the U.S. Treasury and Exchange Stabilization Fund ("ESF") through the Reserve Banks. In connection with its foreign currency activities, the FRBNY may enter into transactions that contain varying degrees of off-balance-sheet market risk that result from their future settlement and counter-party credit risk. The FRBNY controls credit risk by obtaining credit approvals, establishing transaction limits, and performing daily monitoring procedures.

Although the Reserve Banks are separate legal entities, in the interests of greater efficiency and effectiveness they collaborate in the delivery of certain operations and services. The collaboration takes the form of centralized operations and product or function offices that have responsibility for the delivery of certain services on behalf of the Reserve Banks. Various operational and management models are used and are supported by service agreements between the Reserve Bank providing the service and the other eleven Reserve Banks. In some cases, costs incurred by a Reserve Bank for services provided to other Reserve Banks are not shared; in other cases, the Reserve Banks are billed for services provided to them by another Reserve Bank.

(3) Significant Accounting Policies

Accounting principles for entities with the unique powers and responsibilities of the nation's central bank have not been formulated by accounting standard-setting bodies. The Board of Governors has developed specialized accounting principles and practices that it considers to be appropriate for the nature and function of a central bank, which differ significantly from those of the private sector. These accounting principles and practices are documented in the *Financial Accounting Manual for Federal Reserve Banks* ("Financial Accounting Manual"), which is issued by the Board of Governors. All of the Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the Financial Accounting Manual and the financial statements have been prepared in accordance with the Financial Accounting Manual.

Differences exist between the accounting principles and practices in the Financial Accounting Manual and generally accepted accounting principles in the United States ("GAAP"), primarily due to the unique nature of the Banks' powers and responsibilities as part of the nation's central bank. The primary difference is the presentation of all securities holdings at amortized cost, rather than using the fair value presentation required by GAAP. U.S. government securities and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Amortized cost more appropriately reflects the Reserve Banks' securities holdings given the System's unique responsibility to conduct monetary policy. While the application of current market prices to the securities holdings may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Reserve Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold prior to maturity. Decisions regarding securities and foreign currency transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, market values, earnings, and any gains or losses resulting from the sale of such securities and currencies are incidental to the open market operations and do not motivate decisions related to policy or open market activities.

In addition, the Board of Governors and the Reserve Banks have elected not to present a Statement of Cash Flows because the liquidity and cash position of the Reserve Banks are not a primary concern given their unique powers and responsibilities. A Statement of Cash Flows, therefore, would not provide additional meaningful information. Other information regarding the Reserve Banks' activities is provided in, or may be derived from, the Statements of Condition, Income and Comprehensive Income, and Changes in Capital. There are no other significant differences between the policies outlined in the Financial Accounting Manual and GAAP.

The preparation of the financial statements in conformity with the Financial Accounting Manual requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Certain amounts relating to the prior year have been reclassified to conform to the current-year presentation. Unique accounts and significant accounting policies are explained below.

(a) Gold and Special Drawing Rights Certificates

The Secretary of the U.S. Treasury is authorized to issue gold and special drawing rights ("SDR") certificates to the Reserve Banks.

Payment for the gold certificates by the Reserve Banks is made by crediting equivalent amounts in dollars into the account established for the U.S. Treasury. The gold certificates held by the Reserve Banks are required to be backed by the gold of the U.S. Treasury. The U.S. Treasury may reacquire the gold certificates at any time and the Reserve Banks must deliver them to the U.S. Treasury. At such time, the U.S. Treasury's account is charged, and the Reserve Banks' gold certificate accounts are reduced. The value of gold for purposes of backing the gold certificates is set by law at $42 2/9 a fine troy ounce. The Board of Governors allocates the gold certificates among Reserve Banks once a year based on the average Federal Reserve notes outstanding in each Reserve Bank.

SDR certificates are issued by the International Monetary Fund ("Fund") to its members in proportion to each member's quota in the Fund at the time of issuance. SDR certificates serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for United States participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates somewhat like gold certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the U.S. Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding year. There were no SDR transactions in 2007 or 2006.

(b) Loans to Depository Institutions

Depository institutions that maintain reservable transaction accounts or nonpersonal time deposits, as defined in regulations issued by the Board of Governors, have borrowing privileges at the discretion of each of the Reserve Banks. Borrowers execute certain lending agreements and deposit sufficient collateral before credit is extended. The Reserve Banks offer three discount window programs to depository institutions: primary credit, secondary credit, and seasonal credit, each with its own interest rate. Interest is accrued using the applicable discount rate established at least every fourteen days by the board of directors of the Reserve Bank, subject to review and determination by the Board of Governors.

In addition, depository institutions that are eligible to borrow under the Reserve Banks' primary credit program are also eligible to participate in the temporary Term Auction Facility ("TAF") program. Under the TAF program, the Reserve Banks conduct auctions for a fixed amount of funds, with the interest rate determined by the auction process, subject to a minimum bid rate. All advances under the TAF must be fully collateralized.

Outstanding loans are evaluated for collectibility, and currently all are considered collectible and fully collateralized. If loans were ever deemed to be uncollectible, an appropriate reserve would be established.

(c) U.S. Government Securities and Investments Denominated in Foreign Currencies

Interest income on U.S. government securities and investments denominated in foreign currencies comprising the SOMA is accrued on a straight-line basis. Gains and losses resulting from sales of securities are determined by specific issues based on average cost. Foreign-currency-denominated assets are revalued daily at current foreign currency market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on investments denominated in foreign currencies are reported as "Foreign currency gains, net" in the Statements of Income and Comprehensive Income.

Activity related to U.S. government securities, including the premiums, discounts, and realized and unrealized gains and losses, is allocated to each of the Reserve Banks on a percentage basis derived from an annual settlement of the interdistrict settlement account that occurs in April of each year. The settlement also equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding in each District. Activity related to investments denominated in foreign currencies is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31.

(d) Securities Purchased Under Agreements to Resell, Securities Sold Under Agreements to Repurchase, and Securities Lending

The FRBNY may engage in tri-party purchases of securities under agreements to resell ("tri-party agreements"). Tri-party agreements are conducted with two commercial custodial banks that manage the clearing and settlement of collateral. Collateral is held in excess of the contract amount. Acceptable collateral under tri-party agreements primarily includes U.S. government securities, pass-through mortgage securities of the Government National Mortgage Association, Federal Home Loan Mortgage Corporation, and Federal National Mortgage Association, STRIP securities of the U.S. Government, and "stripped" securities of other government agencies. The tri-party agreements are accounted for as financing transactions, with the associated interest income accrued over the life of the agreement.

Securities sold under agreements to repurchase are accounted for as financing transactions and the associated interest expense is recognized over the life of the transaction. These transactions are reported in the Statements of Condition at their contractual amounts and the related accrued interest payable is reported as a component of "Other liabilities."

U.S. government securities held in the SOMA are lent to U.S. government securities dealers in order to facilitate the effective functioning of the domestic securities market. Securities-lending transactions are fully collateralized by other U.S. government securities and the collateral taken is in excess of the market value of the securities loaned. The FRBNY charges the dealer a fee for borrowing securities and the fees are reported as a component of "Other income."

Activity related to securities sold under agreements to repurchase and securities lending is allocated to each of the Reserve Banks on a percentage basis derived from an annual settlement of the interdistrict settlement account. On February 15, 2007 the FRBNY began allocating to the other Reserve Banks the activity related to securities purchased under agreements to resell.

(e) FX Swap Arrangements and Warehousing Agreements

FX swap arrangements are contractual agreements between two parties, the FRBNY and an authorized foreign central bank, to exchange specified currencies, at a specified price, on a specified date. The parties agree to exchange their currencies up to a pre-arranged maximum amount and for an agreed-upon period of time (up to twelve months), at an agreed-upon interest rate. These arrangements give the FOMC temporary access to the foreign currencies it may need to support its international operations and give the authorized foreign central bank temporary access to dollars. Drawings under the FX swap arrangements can be initiated by either party and must be agreed to by the other party. The FX swap arrangements are structured so that the party initiating the transaction bears the exchange rate risk upon maturity. Foreign currencies received pursuant to these agreements are reported as a component of "Investments denominated in foreign currencies" in the Statements of Condition.

Warehousing is an arrangement under which the FOMC agrees to exchange, at the request of the U.S. Treasury, U.S. dollars for foreign currencies held by the U.S. Treasury or ESF over a limited period of time. The purpose of the warehousing facility is to supplement the U.S. dollar resources of the U.S. Treasury and ESF for financing purchases of foreign currencies and related international operations.

FX swap arrangements and warehousing agreements are revalued daily at current market exchange rates. Activity related to these agreements, with the exception of the unrealized gains and losses resulting from the daily revaluation, is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. Unrealized gains and losses resulting from the daily revaluation are recorded by FRBNY and not allocated to the other Reserve Banks.

(f) Bank Premises, Equipment, and Software

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, which range from two to fifty years. Major alterations, renovations, and improvements are capitalized at cost as additions to the asset accounts and are depreciated over the remaining useful life of the asset or, if appropriate, over the unique useful life of the alteration, renovation, or improvement. Maintenance, repairs, and minor replacements are charged to operating expense in the year incurred.

Costs incurred for software during the application development stage, either developed internally or acquired for internal use, are capitalized based on the cost of direct services and materials associated with designing, coding, installing, or testing software. Capitalized software costs are amortized on a straight-line basis over the estimated useful lives of the software applications, which range from two to five years. Maintenance costs related to software are charged to expense in the year incurred.

Capitalized assets including software, buildings, leasehold improvements, furniture, and equipment are impaired when events or changes in circumstances indicate that the carrying amount of assets or asset groups is not recoverable and significantly exceeds their fair value.

(g) Federal Reserve Notes

Federal Reserve notes are the circulating currency of the United States. These notes are issued through the various Federal Reserve agents (the chairman of the board of directors of each Reserve Bank and their designees) to the Reserve Banks upon deposit with such agents of specified classes of collateral security, typically U.S. government securities. These notes are identified as issued to a specific Reserve Bank. The Federal Reserve Act provides that the collateral security tendered by the Reserve Bank to the Federal Reserve agent must be at least equal to the sum of the notes applied for by such Reserve Bank.

Assets eligible to be pledged as collateral security include all of the Reserve Banks' assets. The collateral value is equal to the book value of the collateral tendered, with the exception of securities, for which the collateral value is equal to the par value of the securities tendered. The par value of securities pledged for securities sold under agreements to repurchase is deducted.

The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the Federal Reserve notes. To satisfy the obligation to provide sufficient collateral for outstanding Federal Reserve notes, the Reserve Banks have entered into an agreement that provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes issued to all Reserve Banks. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, Federal Reserve notes are obligations of the United States government.

"Federal Reserve notes outstanding, net" in the Statements of Condition represents the Federal Reserve notes outstanding, reduced by the Reserve Banks' currency holdings of $218,571 million and $175,661 million at December 31, 2007 and 2006, respectively.

At December 31, 2007, all Federal Reserve notes were fully collateralized. All gold certificates, all special drawing right certificates, $743,126 million of domestic securities and securities purchased under agreements to resell, and $35,328 million of loans were pledged as collateral. At December 31, 2007, no investments denominated in foreign currencies were pledged as collateral.

(h) Items in Process of Collection and Deferred Credit Items

Items in process of collection in the Statements of Condition primarily represents amounts attributable to checks that have been deposited for collection and that, as of the balance sheet date, have not yet been presented to the paying bank. Deferred credit items are the counterpart liability to items in process of collection, and the amounts in this account arise from deferring credit for deposited items until the amounts are collected. The balances in both accounts can vary significantly.

(i) Capital Paid-In

The Federal Reserve Act requires that each member bank subscribe to the capital stock of the Reserve Banks in an amount equal to 6 percent of the capital and surplus of the member bank. These shares are nonvoting with a par value of $100 and may not be transferred or hypothecated. As a member bank's capital and surplus changes, its holdings of Reserve Bank stock must be adjusted. Currently, only one-half of the subscription is paid-in and the remainder is subject to call. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

By law, each Reserve Bank is required to pay each member bank an annual dividend of 6 percent on the paid-in capital stock. This cumulative dividend is paid semiannually. To reflect the Federal Reserve Act requirement that annual dividends are deducted from net earnings, dividends are presented as a distribution of comprehensive income in the Statements of Income and Comprehensive Income.

(j) Surplus

The Board of Governors requires the Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31 of each year. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks would be required to call on member banks for additional capital.

Accumulated other comprehensive income is reported as a component of surplus in the Statements of Condition and the Statements of Changes in Capital. The balance of accumulated other comprehensive income is comprised of expenses, gains, and losses related to defined benefit pension plans and other postretirement benefit plans that, under accounting standards, are included in other comprehensive income, but excluded from net income. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 8, 9, and 10.

The Reserve Banks initially applied the provisions of SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, at December 31, 2006. This accounting standard requires recognition of the overfunded or underfunded status of a defined benefit postretirement plan in the Statements of Condition, and recognition of changes in the funded status in the years in which the changes occur through comprehensive income. The transition rules for implementing the standard required applying the provisions as of the end of the year of initial implementation, and the effect as of December 31, 2006 is recorded as "Adjustment to initially apply SFAS No. 158" in the Statements of Changes in Capital.

(k) Interest on Federal Reserve Notes

The Board of Governors requires the Reserve Banks to transfer excess earnings to the U.S. Treasury as interest on Federal Reserve notes, after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in. This amount is reported as "Payments to U.S. Treasury as interest on Federal Reserve notes" in the Statements of Income and Comprehensive Income and is reported as a liability, or as an asset if overpaid during the year, in the Statements of Condition. Weekly payments to the U.S. Treasury may vary significantly.

In the event of losses or an increase in capital paid-in at a Reserve Bank, payments to the U.S. Treasury are suspended and earnings are retained until the surplus is equal to the capital paid-in.

In the event of a decrease in capital paid-in, the excess surplus, after equating capital paid-in and surplus at December 31, is distributed to the U.S. Treasury in the following year.

(l) Income and Costs Related to U.S. Treasury Services

The Reserve Banks are required by the Federal Reserve Act to serve as fiscal agents and depositories of the United States. By statute, the Department of the Treasury is permitted, but not required, to pay for these services. During the years ended December 31, 2006 and 2007, the Reserve Banks were reimbursed for substantially all services provided to the Department of Treasury.

(m) Assessments by the Board of Governors

The Board of Governors assesses the Reserve Banks to fund its operations based on each Reserve Bank's capital and surplus balances as of December 31 of the prior year. The Board of Governors also assesses each Reserve Bank for the expenses incurred for the U.S. Treasury to prepare and retire Federal Reserve notes based on each Reserve Bank's share of the number of notes comprising the System's net liability for Federal Reserve notes on December 31 of the prior year.

(n) Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property and sales taxes on certain construction projects. Real property taxes were $33 million for each of the years ended December 31, 2007 and 2006, and are reported as a component of "Occupancy expense."

(o) Restructuring Charges

The Reserve Banks recognize restructuring charges for exit or disposal costs incurred as part of the closure of business activities in a particular location, the relocation of business activities from one location to another, or a fundamental reorganization that affects the nature of operations. Restructuring charges may include costs associated with employee separations, contract terminations, and asset impairments. Expenses are recognized in the period in which the Bank commits to a formalized restructuring plan or executes the specific actions contemplated in the plan and all criteria for financial statement recognition have been met.

Note 11 describes the Reserve Banks' restructuring initiatives and provides information about the costs and liabilities associated with employee separations and contract terminations. The costs associated with the impairment of certain of the Reserve Banks' assets are discussed in Note 6. Costs and liabilities associated with enhanced pension benefits in connection with the restructuring activities for all of the Reserve Banks are recorded on the books of the FRBNY as discussed in Note 8. Costs and liabilities associated with enhanced postretirement benefits are discussed in Note 9.

(p) Recently Issued Accounting Standards

In September, 2006, the FASB issued SFAS No. 157, Fair Value Measurements ("SFAS No. 157"). SFAS No. 157 establishes a single authoritative definition of fair value, sets out a framework for measuring fair value, and expands on required disclosures about fair value measurement. SFAS No. 157 is generally effective for the Reserve Banks on January 1, 2008, though the effective date of some provisions is January 1, 2009. The provisions of SFAS No. 157 will be applied prospectively and are not expected to have a material effect on the Reserve Banks' financial statements.

(4) U.S. Government Securities, Securities Purchased Under Agreements To Resell, Securities Sold Under Agreements To Repurchase, and Securities Lending

The FRBNY, on behalf of the Reserve Banks, holds securities bought outright in the SOMA.

The securities held in the SOMA at December 31, were as follows (in millions):

	2007	2006
Par value		
U.S. government:		
Bills	$227,840	$277,019
Notes	401,776	402,367
Bonds	110,995	99,528
Total par value	740,611	778,914
Unamortized premiums	7,988	8,708
Unaccreted discounts	(2,970)	(4,003)
Total	$745,629	$783,619

At December 31, 2007 and 2006, the fair value of the U.S. government securities held in the SOMA, excluding accrued interest, was $777,141 million and $795,900 million, respectively, as determined by reference to quoted prices for identical securities.

Although the fair value of security holdings can be substantially greater or less than the recorded value at any point in time, these unrealized gains or losses have no effect on the ability of the Reserve Banks, as central bank, to meet their financial obligations and responsibilities, and should not be misunderstood as representing a risk to the Reserve Banks, their shareholders, or the public. The fair value is presented solely for informational purposes.

Financial information related to securities purchased under agreements to resell and securities sold under agreements to repurchase for the year ended December 31, 2007 was as follows (in millions):

	Securities purchased under agreements to resell	Securities sold under agreements to repurchase
Contract amount outstanding, end of year	$46,500	$43,985
Weighted average amount outstanding, during the year	35,073	34,846
Maximum month-end balance outstanding, during the year	51,500	43,985
Securities pledged, end of year	...	44,048

At December 31, 2006, the total contract amount of securities sold under agreements to repurchase was $29,615 million. The total par value of SOMA securities that were pledged for securities sold under agreements to repurchase at December 31, 2006 was $29,676 million.

The contract amounts for securities purchased under agreements to resell and securities sold under agreements to repurchase approximate fair value.

The maturity distribution of U.S. government securities bought outright, securities purchased under agreements to resell, and securities sold under agreements to repurchase that were held in the SOMA at December 31, 2007, was as follows (in millions):

	U.S. government securities (par value)	Securities purchased under agreements to resell (contract amount)	Securities sold under agreements to repurchase (contract amount)
Within 15 days	$ 27,294	$46,500	$43,985
16 days to 90 days	149,727	...	...
91 days to 1 year	152,267	...	...
Over 1 year to 5 years	240,562	...	...
Over 5 years to 10 years	81,947	...	...
Over 10 years	88,814	...	...
Total	$740,611	$46,500	$43,985

At December 31, 2007 and 2006, U.S. government securities with par values of $16,649 million and $6,855 million, respectively, were loaned from the SOMA.

(5) Investments Denominated in Foreign Currencies

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and with the Bank for International Settlements and invests in foreign government debt instruments. Foreign government debt instruments held include both securities bought outright and securities purchased under agreements to resell. These investments are guaranteed as to principal and interest by the issuing foreign governments.

Total investments denominated in foreign currencies, including accrued interest, valued at foreign currency market exchange rates at December 31, were as follows (in millions):

	2007	2006
Euro:		
Foreign currency deposits	$27,488	$ 6,242
Securities purchased under agreements to resell	2,548	2,214
Government debt instruments	4,666	4,074
Japanese Yen:		
Foreign currency deposits	2,811	2,601
Government debt instruments	5,708	5,351
Swiss Franc:		
Foreign currency deposits	4,074	...
Total	$47,295	$20,482

At December 31, 2007, the total amount of foreign currency deposits held under FX contracts was $24,381 million. At December 31, 2006, there were no open foreign exchange contracts.

At December 31, 2007 and 2006, the fair value of total System investments denominated in foreign currencies, including accrued interest was $47,274 million and $20,434 million, respectively. The fair value of government debt instruments was determined by reference to quoted prices for identical securities. The cost basis of foreign currency deposits and securities purchased under agreements to resell, adjusted for accrued interest, approximates fair value. Similar to the U.S. government securities discussed in Note 4, unrealized gains or losses have no effect on the ability of a Reserve Bank, as central bank, to meet its financial obligations and responsibilities.

The maturity distribution of investments denominated in foreign currencies at December 31, 2007, was as follows (in millions):

	Euro	Japanese Yen	Swiss Franc	Total
Within 15 days	$ 4,999	$2,991	$ . . .	$ 7,990
16 days to 90 days	23,103	404	4,074	27,581
91 days to 1 year	2,756	2,009	. . .	4,765
Over 1 year to 5 years	3,844	3,115	. . .	6,959
Total	$34,702	$8,519	$4,074	$47,295

At December 31, 2007 and 2006, the authorized warehousing facility was $5,000 million, with no balance outstanding.

(6) Bank Premises, Equipment, and Software

Bank premises and equipment at December 31 was as follows (in millions):

	2007	2006
Bank premises and equipment:		
Land	$ 323	$ 306
Buildings	1,878	1,817
Building machinery and equipment	416	393
Construction in progress	380	220
Furniture and equipment	1,118	1,156
Subtotal	4,115	3,892
Accumulated depreciation	(1,576)	(1,516)
Bank premises and equipment, net	$ 2,539	$ 2,376
Depreciation expense, for the year ended December 31	$ 185	$ 186

The Federal Reserve Bank of Kansas City is constructing a new building to replace its head office. At December 31, 2007 approximately $38 million of costs associated with the acquisition of land and site preparation for the new building are included in the "Land" account, and approximately $217 million of costs associated with the construction of the new building are included in the "Construction in progress" account.

Bank premises and equipment at December 31 included the following amounts for capitalized leases (in millions):

	2007	2006
Leased premises and equipment under capital leases	$ 21	$12
Accumulated depreciation	(11)	(6)
Leased premises and equipment under capital leases, net	$ 10	$ 6

Depreciation expense related to leased premises and equipment under capital leases was $4 million for the year ended December 31, 2007.

Certain of the Reserve Banks lease space to outside tenants with remaining lease terms ranging from one to thirteen years. Rental income from such leases was $27 million and $25 million for the years ended December 31, 2007 and 2006, respectively, and is reported as a component of "Other income." Future minimum lease payments that the Bank will receive under noncancelable lease agreements in existence at December 31, 2007, are as follows (in millions):

2008	$27
2009	26
2010	26
2011	22
2012	21
Thereafter	68
Total	$190

The Reserve Banks have capitalized software assets, net of amortization, of $158 million and $155 million at December 31, 2007 and 2006, respectively. Amortization expense was $62 million and $66 million for the years ended December 31, 2007 and 2006, respectively. Capitalized software assets are reported as a component of "Other assets" and the related amortization is reported as a component of "Other expenses."

Several of the Reserve Banks impaired check equipment, leasehold improvements, and furniture assets as a result of the System's restructuring plans, as discussed in Note 11. Asset impairment losses of $32 million and $15 million for the periods ending December 31, 2007 and 2006, respectively, were determined using fair values based on quoted market values or other valuation techniques and are reported as a component of "Other expenses."

(7) Commitments and Contingencies

At December 31, 2007, the Reserve Banks were obligated under noncancelable leases for premises and equipment with remaining terms ranging from one to approximately sixteen years. These leases provide for increased rental payments based upon increases in real estate taxes, operating costs, or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance and maintenance when included in rent), net of sublease rentals, was $29 million and $31 million for the years ended December 31, 2007 and 2006, respectively. Certain of the Reserve Banks' leases have options to renew.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2007 are as follows (in millions):

	Operating
2008	$10
2009	9
2010	7
2011	7
2012	6
Thereafter	95
Future minimum rental payments	$134

Future minimum rental payments under noncancelable capital leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2007 were not material.

At December 31, 2007, the Reserve Banks had unrecorded unconditional purchase commitments and long-term obligations extending through the year 2017 with a remaining fixed commitment of $312 million. Purchases of $59 million and $92 million were made against these commitments during 2007 and 2006, respectively. These commitments represent goods and services for maintenance of currency processing machines, for licenses and maintenance of check software and hardware, and have variable and/or fixed components. The variable portion of the commitments is for additional services above fixed contractual service limits. The fixed payments for the next five years under these commitments are as follows (in millions):

	Fixed Commitment
2008	$20
2009	41
2010	30
2011	31
2012	31

At December 31, 2007, the Reserve Banks had commitments of approximately $66 million for the construction of additional building space at the Federal Reserve Bank of St. Louis, and security enhancements and an employee parking deck at the Federal Reserve Bank of Richmond. Expected payments related to these commitments are $57 million and $9 million for the years ending December 31, 2008 and 2009, respectively.

The Reserve Banks are involved in certain legal actions and claims arising in the ordinary course of business. Although it is difficult to predict the ultimate outcome of these actions, in management's opinion, based on discussions with counsel, the aforementioned litigation and claims will be resolved without material adverse effect on the financial position or results of operations of the Reserve Banks.

(8) Retirement and Thrift Plans

Retirement Plans

The Reserve Banks currently offer three defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the Reserve Banks', Board of Governors, and the Office of Employee Benefits of the Federal Reserve Systems' employees participate in the Retirement Plan for Employees of the Federal Reserve System ("System Plan"). Employees at certain compensation levels participate in the Benefit Equalization Retirement Plan ("BEP") and certain Reserve Bank officers participate in the Supplemental Employee Retirement Plan ("SERP").

The System Plan provides retirement benefits to employees of the Federal Reserve Banks, the Board of Governors, and the Office of Employee Benefits of the Federal Reserve Employee Benefits System. The FRBNY, on behalf of the System, recognizes the net asset and costs associated with the System Plan in its financial statements. Costs associated with the System Plan are not redistributed to other participating employers.

Following is a reconciliation of the beginning and ending balances of the System Plan benefit obligation (in millions):

	2007	2006
Estimated actuarial present value of projected benefit obligation at January 1	$5,147	$4,785
Service cost—benefits earned during the period	146	134
Interest cost on projected benefit obligation	317	278
Actuarial (gain) loss	(46)	132
Contributions by plan participants	3	3
Special termination benefits loss	22	3
Benefits paid	(264)	(254)
Plan amendments	...	66
Estimated actuarial present value of projected benefit obligation at December 31	$5,325	$5,147

Following is a reconciliation showing the beginning and ending balances of the System Plan assets, the funded status, and the prepaid pension benefit costs (in millions):

	2007	2006
Estimated fair value of plan assets at January 1	$ 6,330	$ 5,868
Actual return on plan assets	535	713
Contributions by plan participants	3	3
Benefits paid	(264)	(254)
Estimated fair value of plan assets at December 31	$ 6,604	$ 6,330
Funded status and prepaid pension benefit costs	$ 1,279	$ 1,183
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	$ (163)	$ (191)
Net actuarial loss	(1,135)	(1,301)
Total accumulated other comprehensive loss	$(1,298)	$(1,492)

Prepaid pension benefit costs are reported as "Other assets" in the Statements of Condition.

The accumulated benefit obligation for the System Plan, which differs from the estimated actuarial present value of projected benefit obligation because it is based on current rather than future compensation levels, was $4,621 million and $4,522 million at December 31, 2007 and 2006, respectively.

The weighted-average assumptions used in developing the pension benefit obligation for the System Plan as of December 31 are as follows:

	2007	2006
Discount rate	6.25%	6.00%
Rate of compensation increase	5.00%	4.50%

Net periodic benefit expenses are actuarially determined using a January 1 measurement date. The weighted-average assumptions used in developing net periodic benefit expenses for the System Plan for the years at January 1 were as follows:

	2007	2006
Discount rate	6.00%	5.75%
Expected asset return	8.00%	8.00%
Rate of compensation increase	4.50%	4.50%

Discount rates reflect yields available on high-quality corporate bonds that would generate the cash flows necessary to pay the plan's benefits when due. The expected long-term rate of return on assets was based on a combination of methodologies including the System Plan's historical returns; surveys of what other plans' expected rates of return are; building a projected return for equities and fixed income investments based on real interest rates, inflation expectations and equity risk premiums; and surveys of expected returns in equity and fixed income markets.

The components of net periodic pension benefit expense for the System Plan for the years ended December 31 are shown below (in millions):

	2007	2006
Service cost—benefits earned during the period	$ 146	$ 134
Interest cost on accumulated benefit obligation	317	278
Amortization of prior service cost	29	23
Amortization of net loss	79	75
Expected return on plan assets	(496)	(460)
Net periodic pension benefit expense	75	50
Special termination benefits loss	22	3
Total periodic pension benefit expense	$ 97	$ 53

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic pension benefit expense in 2008 are shown below:

Prior service cost	$29
Net actuarial loss	50
Total	$79

The recognition of special termination benefits losses is the result of enhanced retirement benefits provided to employees during the restructuring described in Note 11.

Following is a summary of expected benefit payments excluding enhanced retirement benefits (in millions):

	Expected benefit payments
2008	$273
2009	284
2010	296
2011	309
2012	324
2013−2017	1,871
Total	$3,357

The Federal Reserve System's pension plan weighted-average asset allocations at December 31, by asset category are as follows:

	2007	2006
Equities	65.7%	64.3%
Fixed income	33.2%	34.4%
Cash	1.1%	1.3%
Total	100.0%	100.0%

The System's Committee on Investment Performance ("CIP") selects investment managers who are responsible for implementing the System Plan's investment policies. The managers' performance is measured against a trailing 36-month benchmark of 60 percent of a market value weighted index of predominantly large capitalization stocks trading on the New York Stock Exchange, the American Stock Exchange, and the National Association of Securities Dealers Automated Quotation National Market System and 40 percent of a broadly diversified investment-grade fixed income index (rebalanced monthly). The managers invest plan funds within CIP-established guidelines for investment in equities and fixed income instruments. Equity investments can range between 40 percent and 80 percent of the portfolio. Investments, however, cannot be concentrated in particular industries and equity securities holdings of any one company are limited. Fixed income securities must be investment grade and the effective duration of the fixed income portfolio must remain within a range of 67 percent and 150 percent of a broadly diversified investment-grade fixed income index. CIP guidelines prohibit margin, short sale, foreign exchange, and commodities trading as well as investment in bank, bank holding company, savings and loan, and government securities dealers stocks. In addition, investments in non-dollar denominated securities are prohibited; however, a small portion of the portfolio can be invested in American Depositary Receipts/Shares and foreign-issued dollar-denominated fixed income securities.

Contributions to the System Plan may be determined using different assumptions than those required for financial reporting. The System does not expect to make a cash contribution during 2008.

The Reserve Banks' projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2007 and 2006, and for the years then ended, were not material.

Thrift Plan

Employees of the Reserve Banks may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Reserve Banks' Thrift Plan contributions totaled $69 million and $66 million for the years ended December 31, 2007 and 2006, respectively, and are reported as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income. The Reserve Banks match employee contributions based on a specified formula. For the years ended December 31, 2007 and 2006, the Banks matched 80 percent on the first 6 percent of employee contributions for employees with less than five years of service and 100 percent on the first 6 percent of employee contributions for employees with five or more years of service.

(9) Postretirement Benefits Other Than Pensions and Postemployment Benefits

Postretirement Benefits other than Pensions

In addition to the Reserve Banks' retirement plans, employees who have met certain age and length-of-service requirements are eligible for medical benefits and life insurance coverage during retirement.

The Reserve Banks fund benefits payable under the medical and life insurance plans as due and, accordingly, have no plan assets.

Following is a reconciliation of the beginning and ending balances of the benefit obligation (in millions):

	2007	2006
Accumulated postretirement benefit obligation at January 1	$1,164	$947
Service cost-benefits earned during the period	41	27
Interest cost on accumulated benefit obligation	69	54
Net actuarial (gain) loss	(93)	188
Curtailment gain	(10)	...
Special termination benefits loss	3	...
Contributions by plan participants	13	13
Benefits paid	(69)	(64)
Medicare Part D subsidies	4	4
Plan amendments	(1)	(5)
Accumulated postretirement benefit obligation at December 31	$1,121	$1,164

At December 31, 2007 and 2006, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 6.25 percent and 5.75 percent, respectively.

Discount rates reflect yields available on high-quality corporate bonds that would generate the cash flows necessary to pay the plan's benefits when due.

Following is a reconciliation of the beginning and ending balances of the plan assets, the unfunded postretirement benefit obligation, and the accrued postretirement benefit costs (in millions):

	2007	2006
Fair value of plan assets at January 1	$ ...	$ ...
Contributions by the employer	52	47
Contributions by plan participants	13	13
Benefits paid, net of Medicare Part D subsidies	(65)	(60)
Fair value of plan assets at December 31	$ ...	$ ...
Unfunded obligation and accrued postretirement benefit cost	$1,121	$1,164
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	$ 60	$ 85
Net actuarial loss	(292)	(443)
Deferred curtailment gain	6	1
Total accumulated other comprehensive loss	$ (226)	$ (357)

Accrued postretirement benefit costs are reported as a component of "Accrued benefit costs" in the Statements of Condition.

For measurement purposes, the assumed health care cost trend rates at December 31 are as follows:

	2007	2006
Health care cost trend rate assumed for next year	8.00%	9.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2013	2012

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2007 (in millions):

	One Percentage Point Increase	One Percentage Point Decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	$ 15	$ (13)
Effect on accumulated postretirement benefit obligation	123	(107)

The following is a summary of the components of net periodic postretirement benefit expense for the years ended December 31 (in millions):

	2007	2006
Service cost—benefits earned during the period	$ 41	$ 27
Interest cost on accumulated benefit obligation	69	54
Amortization of prior service cost	(22)	(23)
Amortization of net actuarial loss	48	22
Total periodic expense	136	80
Special termination benefits loss	3	...
Net periodic postretirement benefit expense	$139	$ 80
Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2008 are shown below:		
Prior service cost	$ (20)	
Net actuarial loss	25	
Total	$ 5	

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2007 and 2006, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 5.75 percent and 5.50 percent, respectively.

Net periodic postretirement benefit expense is reported as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income.

The recognition of special termination benefits losses is primarily the result of enhanced retirement benefits provided to employees during the restructuring described in Note 11. Deferred curtailment gains were recorded in 2007 and 2006 as a component of accumulated other comprehensive loss; the gains will be recognized in net income in future years when the related employees terminate employment.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 established a prescription drug benefit under Medicare ("Medicare Part D") and a federal subsidy to sponsors of retiree health care benefit plans that provide benefits that are at least actuarially equivalent to Medicare Part D. The benefits provided under the Reserve Banks' plans to certain participants are at least actuarially equivalent to the Medicare Part D prescription drug benefit. The estimated effects of the subsidy, retroactive to January 1, 2004, are reflected in actuarial loss in the accumulated postretirement benefit obligation and net periodic postretirement benefit expense.

There were no receipts of federal Medicare Part D subsidies in the year ended December 31, 2006. Receipts in the year ending December 31, 2007, related to benefits paid in the years ended December 31, 2006 and 2007 were $3 million for each of the years. Expected receipts in 2008, related to benefits paid in the years ended December 31, 2006 and 2007 are $1 million, respectively.

Following is a summary of expected postretirement benefit payments (in millions):

	Without Subsidy	With Subsidy
2008	$ 66	$ 61
2009	72	66
2010	77	72
2011	83	76
2012	87	80
2013–2017	496	446
Total	$881	$801

Postemployment Benefits

The Reserve Banks offer benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical and dental insurance, survivor income, and disability benefits. The accrued postemployment benefit costs recognized by the Reserve Banks at December 31, 2007 and 2006 were $124 million and $126 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Statements of Condition. Net periodic postemployment benefit expense included in 2007 and 2006 operating expenses were $15 million and $20 million, respectively, and is recorded as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income.

(10) Accumulated Other Comprehensive Income and Other Comprehensive Income

Following is a reconciliation of beginning and ending balances of accumulated other comprehensive loss (in millions):

	Amount related to defined benefit retirement plan	Amount related to postretirement benefits other than pensions	Total accumulated other comprehensive loss
Balance at January 1, 2006	...	...	...

	Amount related to defined benefit retirement plan	Amount related to postretirement benefits other than pensions	Total accumulated other comprehensive loss
Adjustment to initially apply SFAS No. 158 . .	$(1,492)	$(357)	$(1,849)
Balance at December 31, 2006	$(1,492)	$(357)	$(1,849)
Change in funded status of benefit plans:			
Prior service costs arising during the year . .	. . .	(3)	(3)
Net actuarial gain arising during the year . .	86	103	189
Deferred curtailment gain	. . .	5	5
Amortization of prior service cost	29	(22)	7
Amortization of net actuarial loss	79	48	127
Change in funded status of benefit plans—other comprehensive income	194	131	325
Balance at December 31, 2007	$(1,298)	$(226)	$(1,524)

Additional detail regarding the classification of accumulated other comprehensive loss is included in Notes 8 and 9.

(11) Business Restructuring Charges

2007 Restructuring Plans

In 2007, the Reserve Banks announced a restructuring initiative to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure will involve consolidation of operations into four regional Reserve Bank processing sites in Philadelphia, Cleveland, Atlanta, and Dallas. Additional announcements in 2007 included restructuring plans associated with the U.S. Treasury's Collections and Cash Management Modernization initiative.

2006 Restructuring Plans

In 2006, the Reserve Banks announced restructuring plans related to check and cash operations.

2005 and Prior Restructuring Costs

The Reserve Banks incurred various restructuring charges prior to 2006 related to the restructuring of check, cash, purchasing, and Treasury operations.

Following is a summary of financial information related to the restructuring plans (in millions):

	2005 and prior restructuring plans	2006 restructuring plans	2007 restructuring plans	Total
Information related to restructuring plans as of December 31, 2007:				
Total expected costs related to restructuring activity	$ 32	$ 8	$ 45	$ 85
Estimated future costs related to restructuring activity	$ . . .	$ . . .	$ 6	$ 6
Expected completion date	2008	2008	2011	
Reconciliation of liability balances:				
Balance at January 1, 2006	$ 17	$ . . .	$ . . .	$ 17
Employee separation costs and adjustments	2	7	. . .	9
Payments . . .	(12)	. . .	. . .	(12)
Balance at December 31, 2006	$ 7	$ 7	$ . . .	$ 14
Employee separation costs	. . .	1	40	41
Adjustments .	(4)	(1)	. . .	(5)
Payments . . .	(3)	(3)	(1)	(7)
Balance at December 31, 2007	$ . . .	$ 4	$ 39	$ 43

Employee separation costs are primarily severance costs for identified staff reductions associated with the announced restructuring plans. Separation costs that are provided under terms of ongoing benefit arrangements are recorded based on the accumulated benefit earned by the employee. Separation costs that are provided under the terms of one-time benefit arrangements are generally measured based on the expected benefit as of the termination date and recorded ratably over the period to termination. Restructuring costs related to employee separations are reported as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income.

Adjustments to the accrued liability are primarily due to changes in the estimated restructuring costs and are shown as a component of the appropriate expense category in the Statements of Income and Comprehensive Income.

Restructuring costs associated with the impairment of certain of the Reserve Banks' assets, including software, buildings, leasehold improvements, furniture, and equipment, are discussed in Note 6. Costs associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY as discussed in Note 8. Costs associated with enhanced postretirement benefits are disclosed in Note 9.

(12) Subsequent Events

In March 2008, the Board of Governors announced several initiatives to address liquidity pressures in funding markets and promote financial stability, including increasing the Term Auction Facility (see Note 3b) to $100 billion and initiating a series of term repurchase transactions (see Notes 3d and 4) that may cumulate to $100 billion. In addition, the Reserve Banks' securities lending program (see Notes 3d and 4) was expanded to lend up to $200 billion of Treasury securities to primary dealers for a term of 28 days, secured by federal agency debt, federal agency residential mortgage-backed securities, agency collateralized mortgage obligations, non-agency AAA/Aaa-rated private-label residential mortgage-backed securities, and AAA/Aaa-rated commercial mortgage-backed securities. The FRBNY was also authorized to establish a primary dealer credit facility (PDCF) to provide secured overnight funding to primary dealers. The primary dealers may pledge U.S. government securities, federal agency securities and agency mortgage-backed securities, and investment-grade corporate, municipal, mortgage-backed and asset-backed securities for which a price is available, as collateral under the PDCF. In connection with the announced purchase of The Bear Stearns Companies Inc. by JPMorgan Chase & Co. (JPMorgan Chase), the Board also authorized the FRBNY to enter into a financing arrangement with JPMorgan Chase for up to $30 billion. The FOMC also authorized increases in its existing temporary reciprocal currency arrangements (see Notes 3e and 5) with specific foreign central banks. These initiatives will affect 2008 activity related to loans, securities purchased under agreements to resell, U.S. government securities, net, and investments denominated in foreign currencies, as well as income and expenses. The effects of the initiatives do not require adjustment to the amounts recorded as of December 31, 2007.

In March 2008, the FRBNY announced it will close the Buffalo Branch, effective October 31, 2008. Restructuring charges associated with this closure are not expected to be material. The Federal Reserve Bank of St. Louis sold the facility in Little Rock for $4 million on March 11, 2008, which included the sale of associated furnishings. In February 2008, the Federal Reserve Bank of San Francisco's Seattle Branch office was relocated to a new facility in the Seattle area. The former facility was vacated and the property, including related furnishings, will be available for sale in 2008.

Office of Inspector General Activities

The Board of Governors' Office of Inspector General (OIG) functions in accordance with the Inspector General Act of 1978, as amended. The OIG plans and conducts audits, attestations, inspections, evaluations, investigations, and law and regulation reviews relating to the Board's programs and operations and to those functions that the Board has delegated to the Federal Reserve Banks. In addition, it retains an independent auditor each year to audit the Board's financial statements. The OIG also makes recommendations and conducts activities to promote economy and efficiency, enhance policies and procedures, and prevent and detect waste, fraud, and abuse in Board and Board-delegated programs and operations. The OIG keeps the Congress and the Chairman of the Board of Governors fully informed about serious abuses and deficiencies and about the status of any corrective actions.

During 2007, the OIG completed twelve audits, attestations, inspections, evaluations, and other assessments and conducted a number of follow-up reviews to evaluate action taken on prior recommendations. The OIG also closed six investigations and performed numerous legislative and regulatory reviews.

OIG Audits, Attestations, Inspections, and Evaluations Completed during 2007

Report title	Month issued
Security Control Review of the Internet Electronic Submission System (Internal Report)	February
Agreed-Upon Procedures Attestation—Bank Plan Service Credit Data	February
Agreed-Upon Procedures Attestation—Statement of Financial Accounting Standards No. 87	February
Agreed-Upon Procedures Attestation—Statement of Financial Accounting Standards No. 106	February
Audit of Configuration Settings (Internal Report)	March
Audit of the Board's Compliance with Overtime Requirements of the Fair Labor Standards Act	March
Agreed-Upon Procedures Attestation—Statement of Financial Accounting Standards No. 112	March
Audit of the Federal Financial Institutions Examination Council Financial Statements (Year Ended December 31, 2006)	March
Audit of the Board's Financial Statements (Year Ended December 31, 2006)	April
Audit of the Board's Information Security Program	September
Inspection of the Board's Protective Services Unit (Internal Report)	September
Inspection of Federal Reserve Examination Practices for Assessing Financial Institutions' Office of Foreign Asset Control Compliance Programs	September

Government Accountability Office Reviews

Under the Federal Banking Agency Audit Act (Public Law 95–320), most Federal Reserve System operations are under the purview of the Government Accountability Office (GAO). In 2007, the GAO completed eight reports on selected aspects of Federal Reserve operations (table). In addition, nine projects concerning the Federal Reserve were in various stages of completion at year-end (table). The Federal Reserve also provided information to the GAO during the year on numerous other GAO investigations, including eight other completed reviews and six other ongoing reviews.

The reports are available directly from the GAO.

Reports Completed during 2007

Report title	Report number	Month issued (2007)
Risk-Based Capital: Bank Regulators Need to Improve Transparency and Overcome Impediments to Finalizing the Proposed Basel II Framework	GAO-07-253	February
Deposit Insurance: Assessment of Regulators' Use of Prompt Corrective Action Provisions and FDIC's New Deposit Insurance System	GAO-07-242	February
Financial Market Regulation: Agencies Engaged in Consolidated Supervision Can Strengthen Performance Measurement and Collaboration	GAO-07-154	March
Financial Market Preparedness: Significant Progress Has Been Made, but Pandemic Planning and Other Challenges Remain	GAO-07-399	March
Comparability of Compensation among the FRB and Other Federal Financial Regulatory Agencies	Internal report	April
Credit Derivatives: Confirmation Backlogs Increased Dealers' Operational Risks, but Were Successfully Addressed after Joint Regulatory Action	GAO-07-716	June
Financial Regulators: Agencies Have Implemented Key Performance Management Practices, but Opportunities for Improvement Exist	GAO-07-678	June
Financial Regulation: Industry Trends Continue to Challenge the Federal Regulatory Structure	GAO-08-32	October

Projects Active at Year-End 2007

Subject of project	Month initiated
Hedge funds and federal regulatory oversight	October 2006
Bank fees	January 2007
Coin production and distribution	April 2007
Basel II global and domestic issues	July 2007
Federal Reserve's Regulation B	September 2007
Check 21 Act mandate	September 2007
Suspicious Activity Reports (SAR) process	September 2007
Inspector Generals' role in federal entities	September 2007
Bank Secrecy Act (BSA) compliance and enforcement	October 2007