

*Annual Report:  
Budget Review*

*Board of Governors of the Federal Reserve System*

*1999*

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# Contents

## *Introduction*

- 1 FEDERAL RESERVE BUDGET PROCESSES AND OPERATIONAL AREAS
- 1 Background on the Federal Reserve
- 1 Summary of 1998 income and expenditures
- 2 Budget processes
- 4 Operational areas

## *Part I The Budgets*

### *Chapter 1*

- 11 FEDERAL RESERVE SYSTEM
- 11 Net expenses
- 13 Trends in expenses and employment
- 15 Operational areas
- 15 1999 budget initiatives

### *Chapter 2*

- 17 BOARD OF GOVERNORS
- 17 Overview of the Board's budget
- 19 Reductions in the cost of programs
- 20 Program requests
- 21 The operations budget
- 27 The capital budget
- 28 Trends in expenses and employment
- 29 Extraordinary items

### *Chapter 3*

- 31 FEDERAL RESERVE BANKS
- 31 Major initiatives
- 33 1999 budget objective
- 34 Budget by operational area
- 39 Budget by object of expense
- 41 Capital outlays
- 42 Trends in expenses and employment
- 44 Volume and unit costs
- 44 1998 budget performance

## *Part II Special Analysis*

### *Chapter 4*

- 47 THE FEDERAL RESERVE'S RESPONSE TO THE YEAR 2000 PROBLEM
- 47 Efforts at the Federal Reserve
- 49 Supervisory program and results
- 50 International initiatives

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## *Appendixes*

### *Appendix A*

- 53 SPECIAL CATEGORIES OF SYSTEM EXPENSE
- 53 Priced services
- 56 Capital outlays
- 56 Currency printing and circulation

### *Appendix B*

- 61 SOURCES AND USES OF FUNDS

### *Appendix C*

- 63 FEDERAL RESERVE SYSTEM AUDITS
- 63 Independent audit
- 63 General Accounting Office
- 68 Office of Inspector General

### *Appendix D*

- 71 EXPENSES AND EMPLOYMENT  
AT THE FEDERAL RESERVE BANKS
- 77 MAPS OF THE FEDERAL RESERVE SYSTEM

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*Introduction**Federal Reserve Budget Processes  
and Operational Areas*

To improve its effectiveness in addressing priorities and allocating resources, the Board of Governors in 1997 converted its annual budgeting and planning process to a two-year budget cycle and a four-year planning cycle.

The multiyear process involves the Board members more actively and earlier in the discussion of alternative expenditures and thus allows the Board and the staff to concentrate less on detailed budgeting and more on planning and the allocation of resources among activities. In particular, the Board can now better define and implement its longer-term strategies across functional areas. The longer budget cycle also promises to be less burdensome to the participants and more comprehensible to observers. The first budget produced under the new system covers calendar years 1998 and 1999.

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

**Background on the Federal Reserve**

The Federal Reserve System consists of the seven-member Board of Governors in Washington, D.C., the twelve Federal Reserve Banks with their twenty-five Branches distributed throughout the nation, the Federal Open Market Committee (FOMC), and three advisory groups—the Federal Advisory Council, the Consumer Advisory Council, and the Thrift Institutions Advisory Council. The System was created in 1913 by the Congress to establish a safe

and flexible monetary and banking system. Over the years, the Congress has given the Federal Reserve more authority and responsibility for achieving broad national economic and financial objectives.

As the nation's central bank, the Federal Reserve has many, varied responsibilities: It acts to ensure growth of the nation's economy consistent with price stability; it serves as the nation's lender of last resort, with responsibility for forestalling national liquidity crises; and it is involved in bank supervision and regulation, with responsibilities for bank holding companies, state-chartered banks that are members of the Federal Reserve System, the foreign activities of U.S. banks, and the U.S. activities of foreign banks. The Federal Reserve also administers the nation's consumer credit protection laws.

The Federal Reserve System plays a major role in the nation's payments mechanism. The Reserve Banks distribute currency and coin, provide wire and automated clearinghouse transfers of funds and securities, and process domestic checks. In addition, the Federal Reserve Banks serve as the fiscal agents of the United States and provide a variety of financial services for the Treasury and other government agencies.

**Summary of 1998 Income and Expenditures**

In carrying out its responsibilities in 1998, the Federal Reserve System incurred an estimated \$1.1 billion in net

operating expenses. Total spending of an estimated \$2.3 billion was offset by an estimated \$1.1 billion in revenue from priced services, reimbursements, and other income.

The major source of Federal Reserve income is earnings on the portfolio of U.S. government securities in the System Open Market Account, estimated at \$26.8 billion in 1998. Earnings in excess of expenses, dividends, and surplus are transferred to the U.S. Treasury—in 1998 an estimated \$26.5 billion. (These earnings are treated as receipts in the U.S. budget accounting system and as anticipated earnings projected by the Office of Management and Budget in the U.S. budget.)

### **Budget Processes**

The following sections give an overview of the separate budgets and budgeting processes followed by the Board of Governors and the Reserve Banks.

#### **Board of Governors**

The Board's budget covers a two-year period. The first year of the budget cycle—the even-numbered year—is used to update the strategic plan for the next four years, and the second year is used to develop the budget for the next two years. As the first under the new system, the 1998–99 budget and 1998–2002 plan were prepared and approved entirely in 1997.

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

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

After consulting with the Board-level Committee on Board Affairs for final guidance, the staff updates the strategic plan and, ultimately, a preliminary budget objective that identifies the level and allocation of resources needed to support the plan. The Committee on Board Affairs reviews the plan and preliminary budget objective, clarifies outstanding planning issues with the Staff Planning Group and division directors, and by early summer of odd numbered years develops a final budget objective for consideration by the Board.

The divisions use the budget objective approved by the Board to complete their budgeting under the approved plan. The Board's Committee on Board Affairs, under authority delegated by the Chairman, oversees the process until the budget is submitted to the Board for action at an open meeting in August of the odd-numbered year.

The Board of Governors budgets its activities across four operational areas (described below). Costs for data processing are charged as a direct expense to each of the four areas, according to actual usage at rates derived from the cost of resources needed to provide the services and agreed upon before the budget year starts; expenses for other elements of support and overhead are distributed among the operational areas in proportion to the share of direct costs attributable to each area.

The Board, in accordance with generally accepted accounting principles, capitalizes certain assets and depreciates their value over appropriate periods

instead of expensing them in their year of purchase. Hence, the Board has both an operating budget and a capital budget.

After it is approved by the Board, the budget is converted to an operating plan that allocates expenditures by month; the operating plan is also the vehicle for subsequent adjustments within the budget. Also at this point, the cash requirement for the first half of the calendar year is estimated and the amount is raised by an assessment on each of the Reserve Banks in proportion to its capital stock and surplus. The cash requirement for the second half of each year is estimated in June and another assessment is made in July.

The Board accounts for extraordinary items separately from the operations budget so that unique, one-time requirements do not compete with regular operations and so that expenses in those operations can be readily compared across years without distortion. As discussed more fully in chapter 2, the extraordinary items budget for 1998–99 consists of funds to bring the Board’s computing environment into compliance with the century date change and support for two periodic surveys, one on consumer finances and the other on small business finances.

The Board’s Office of Inspector General (OIG), in keeping with its statutory independence, prepares its proposed budget apart from the Board’s budget. The OIG presents its two-year budget directly to the Chairman for action by the Board of Governors, also at an open meeting in November.

## Reserve Banks

Each year the Federal Reserve Banks establish major operating goals for the coming year, devise strategies for their attainment, estimate required resources, and monitor results. The process begins

with development of a budget guideline. The Board of Governors reviews the proposed level of spending and communicates the budget objective to the Reserve Banks for their guidance. Each Bank then develops its own budget. The budgets are reviewed at the Board by a committee of three governors—the Committee on Federal Reserve Bank Affairs—both as separate documents and in light of Systemwide issues and the plans of the other Banks, before they are presented to the full Board of Governors for final action at an open meeting in December.

The Banks’ budgets are also structured in four operational areas (described below), with support and overhead charged to these areas. Special projects are approved separately from the operations budgets; these projects are long-range research and development efforts that have the potential to make major improvements in the nation’s payments mechanism or in the Federal Reserve’s ability to provide services.

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

The operations and financial performance of the Reserve Banks are monitored throughout the year via a cost-accounting system, the Planning and Control System (PACS). Under PACS, the costs of all Reserve Bank services, both priced and nonpriced, are grouped by operational area, and the costs of support and overhead are charged to the four areas. PACS makes it possible to compare budgets with actual expenses and enables the Board of Governors to compare the financial and



operating performances of the Reserve Banks.

## **Operational Areas**

The Board of Governors and the Reserve Banks account for their activities in four major operational areas. Three of the areas—monetary and economic policy, supervision and regulation of financial institutions, and services to financial institutions and the public—are common to the Board and the Banks. The Banks' fourth operational area is services to the U.S. Treasury and other government agencies, and the Board's fourth area is System policy direction and oversight.

### **Monetary and Economic Policy**

The monetary and economic policy operational area encompasses Federal Reserve actions to influence the availability and cost of money and credit in the nation's economy. These actions include setting reserve requirements, setting the discount rate (which affects the cost of borrowing), and conducting open market operations.

A vast amount of banking and financial data flows through the Reserve Banks to the Board, where it is compiled and made available to the public. The research staffs at the Board and the Reserve Banks use these data, along with information collected by other public and private institutions, to assess the state of the economy and the relationships between the financial markets and economic activity. Staff members provide background information for the Board of Governors and for each meeting of the FOMC by preparing detailed economic and financial analyses and projections for the domestic economy and international markets. They also

conduct longer-run economic studies on regional, national, and international issues.

### **Supervision and Regulation**

The Federal Reserve System plays a major role in the supervision and regulation of banks and bank holding companies. The Board of Governors adopts regulations to carry out statutory directives and establishes System supervisory and regulatory policies; the Reserve Banks conduct on-site examinations and inspections of state member banks and bank holding companies, review applications for mergers, acquisitions, and changes in control from banks and bank holding companies, and take formal supervisory actions. In 1998 the Federal Reserve conducted approximately 515 examinations of state member banks and approximately 970 inspections and 2,640 risk assessments of bank holding companies, and it acted on 3,662 international and domestic applications.

The Board also enforces compliance by state member banks with the federal laws protecting consumers in their use of credit. In 1998 the System conducted 365 compliance examinations, of which 269 covered state member banks and 96 covered foreign banking organizations.

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

## Services to Financial Institutions and the Public

The Federal Reserve System plays a central role in the nation's payments mechanism, which is composed of many independent systems that move funds among financial institutions across the country. The Reserve Banks obtain currency and coin from the Bureau of Engraving and Printing and from the Mint and distribute it to the public through depository institutions; they receive deposits of currency and coin from depository institutions; and they identify counterfeits and destroy currency that is unfit for circulation. In 1998 the Reserve Banks received \$419.2 billion in currency and \$4.3 billion in coin from depository institutions, distributed \$454 billion in currency and \$5.4 billion in coin, and destroyed \$94.9 billion in unfit currency.

The Reserve Banks (along with their Branches and regional centers) also process checks for collection—approximately 17 billion commercial checks in 1998, with a total value of nearly \$14 trillion.

The Federal Reserve also plays a central role in the nation's payment mechanism through its wire funds transfer system, Fedwire. Through Fedwire, depository institutions can draw on their deposit accounts at the Reserve Banks and transfer funds anywhere in the country. Approximately 8,300 depository institutions use Fedwire through direct computer connections with Reserve Banks, and another 1,740 institutions use Fedwire through off-line means such as telephone. In 1998 approximately 98 million transfers valued at about \$329 trillion were sent over Fedwire, an average of \$3 million per transfer and \$1.3 trillion per day.

The Federal Reserve allows participants in private clearing arrangements to

exchange and settle transactions on a net basis through deposit account balances. Users of net settlement services include check clearinghouse associations, automated clearinghouse (ACH) networks, credit card processors, automated teller machine networks, and national and regional funds transfer networks.

During the first quarter of 1999, the Reserve Banks will offer an enhanced settlement service that will allow the agents of private-sector clearing arrangements to submit files to a Reserve Bank through a Fedline terminal or a computer interface connection. Compared with the current net settlement services, the new service will improve operational efficiency and reduce settlement risk to participants by granting finality on settlement day. It will also enable Reserve Banks to manage and limit risk by incorporating risk controls that are as robust as those used currently in the Fedwire funds transfer service. The Reserve Banks will continue to offer the current "settlement sheet" and Fedwire-based settlement services. The settlement sheet service will be phased out, however, and all participating arrangements must complete their migration to the enhanced service by year-end 2001.

Approximately 27,900 entities participate in the Federal Reserve's ACH service, which allows them to send or receive payments electronically. The institutions use the ACH service for credit and debit transactions. In 1998 the Reserve Banks processed approximately 3 billion ACH transactions valued at about \$12 trillion; approximately 20 percent of the transactions were for the federal government, and the rest were for commercial establishments.

Reserve Banks provide securities services for the handling of book-entry securities and the collection of physical (interest) coupons and miscellaneous items. The book-entry service, begun in

1968, enables the holders of Treasury and government agency securities to transfer the securities electronically to other institutions throughout the country. In 1998 the Reserve Banks processed approximately 14 million securities transfers valued at \$198 trillion. The noncash collection service, through which maturing coupons and bonds are presented for collection, processed about 887,000 items in 1997 and about 755,000 items in 1998.

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

The Reserve Banks provide fiscal agency and depository services to the U.S. government. Through deposit accounts at Reserve Banks, the government issues checks, makes payments, and collects receipts. The Reserve Banks also process transfers of funds over the Federal Reserve's Fedwire network, handle automated clearinghouse payments, and give the Treasury daily statements of account activity. Reserve Banks bill the Treasury and other government agencies for the full cost of providing these services; in 1998, reimbursement was received or expected for most of the expenses billed.

As fiscal agents, Reserve Banks provide the Department of the Treasury with services related to the federal debt. For example, Reserve Banks issue, transfer, reissue, exchange, and redeem marketable Treasury securities and savings bonds; they also process, over Fedwire, transfers of securities that are initiated by depository institutions in the secondary market. The Reserve Banks operate two book-entry (computer-based) securities systems for the custody of Treasury securities—Fedwire and Treasury Direct. Almost all book-

entry Treasury securities are maintained on Fedwire, which also provides the nation's principal securities transfer mechanism; the rest are maintained on Treasury Direct.

As depositories of the U.S. government, Reserve Banks collect and disburse federal government funds. The Reserve Banks maintain the Treasury's funds account, accept deposits of federal taxes and fees, pay checks drawn on the Treasury's account, and make electronic payments on behalf of the Treasury. In 1998 the Treasury continued to encourage electronic payments and to reduce payments made by check.

Depository institutions that are authorized to receive tax payments may either place the collected funds in a Treasury tax and loan (TT&L) account or remit the funds directly to a Reserve Bank. When a depository institution sends tax payments to the Federal Reserve, the Federal Reserve processes the payment and credits the Treasury's account. The Federal Reserve holds collateral to secure TT&L deposits.

The Reserve Banks also provide fiscal agency and depository services to other domestic and international government agencies. Depending on the authority under which the services are provided, the Reserve Banks may maintain book-entry accounts of government agency securities; provide custody for the stock of unissued, definitive (paper) securities; maintain and update balances of outstanding book-entry and definitive securities for issuers; and maintain funds accounts for government agencies. The Reserve Banks also provide various payment services for government agencies, including the processing and disposal of redeemed food coupons for the U.S. Department of Agriculture.

**System Policy Direction and Oversight**

This operational area encompasses activities by the Board of Governors

in supervising Board and Reserve Bank programs. Expenses for these activities are considered overhead expenses of the System and are therefore allocated across the other operational areas. ■

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*Part I*

*The Budgets*

## Chapter 1

# Federal Reserve System

For 1999, the Federal Reserve System has budgeted net operating expenses of \$1,205.9 million. Revenue from priced services provided to depository institutions is expected to total \$843.6 million, or 35.8 percent of total budgeted operating expenses. The budget for total operating expenses is \$2,353.5 million, an increase of 3.8 percent over estimated 1998 expenses. Of this total, \$2,159.2 million is for the Reserve Banks and \$194.3 million is for the Board of Governors (tables 1.1 and 1.2).<sup>1</sup>

Not included in operational costs is the cost of currency, budgeted at \$500.1 million, an increase of 22.3 percent over the 1998 estimated cost of \$419.1 million.<sup>2</sup> The distribution of expenses is similar to that in previous years, with the Reserve Banks accounting for approximately three-fourths of the total (chart 1.1).

System employment is budgeted at 24,949 for 1999, an increase of 276 from the estimated 1998 level (details are given in chapters 2 and 3).

### Net Expenses

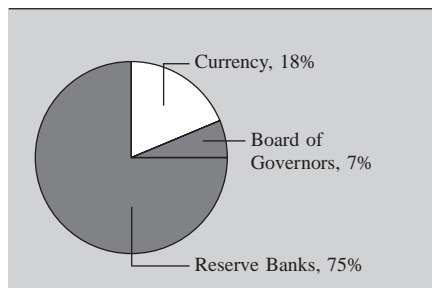
The System expects to recover 48.8 percent of its budgeted 1999 operating expenses through revenue from priced services, other income, and claims for

reimbursement. When these items are deducted from budgeted 1999 operating expenses, the net expenses of the System show an increase of 7.3 percent over estimated 1998 net operating expenses (table 1.1).

The increase in net expenses is primarily due to expense growth in the monetary policy function and the supervision and regulation function relative to the priced service and Treasury functions.

As required by the Monetary Control Act of 1980, revenue from priced services represents fees set to recover, over the long run, all direct and indirect costs of providing the services plus imputed costs, such as taxes that would have been paid and return on capital that would have been earned had the services been provided by a private business. Table 1.3 provides details on projected revenue from priced services; the constraints imposed on Federal Reserve budgets by the need to keep such services competitive and the calculation of fees are discussed in appendix A.

Chart 1.1  
Distribution of Expenses of the  
Federal Reserve System, 1999



NOTE. See text notes 1 and 2.

1. The Board of Governors now budgets on a two-year cycle (see chapter 2); in this chapter, 1999 values shown for the System and the Board reflect the approximate second-year effect of the Board's 1998-99 budget.

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

“Other income” (table 1.1) comes from services provided on behalf of the U.S. Treasury that are paid for by the depository institutions using the services; included are fees for such

services as the settlement of transfers among depository institutions and the wire transfer of funds between depository institutions and the Treasury.

Table 1.1

Operating Expenses of the Federal Reserve System Net of Receipts and Claims for Reimbursement, 1997–99

Millions of dollars except as noted

Item	1997 actual	1998 estimate	1999 budget	Percentage change	
				1997 to 1998	1998 to 1999
Total System operating expenses .....	2,172.2	2,266.9	2,353.5	4.4	3.8
LESS					
Revenue from priced services .....	818.8	839.2	843.6	2.5	.5
Other income <sup>1</sup> .....	5.6	5.7	5.6	1.8	-1.8
Claims for reimbursement <sup>2</sup> .....	223.7	298.3	298.4	33.3	.0
<b>EQUALS</b>					
<b>Net System operating expenses .....</b>	<b>1,124.1</b>	<b>1,123.7</b>	<b>1,205.9</b>	<b>.0</b>	<b>7.3</b>

NOTE. In this and subsequent tables in this volume, components may not sum to totals and may not yield percentages shown because of rounding.

Operating expenses reflect all redistributions for support and allocations for overhead, and they exclude capital outlays (as well as Reserve Bank special projects, which are shown separately).

1. Funds settlement fees.

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

Table 1.2

Expenses of the Federal Reserve System for Operations, Special Projects, and Currency, 1997–99

Millions of dollars except as noted

Entity and type of expense	1997 actual	1998 estimate	1999 budget	Percentage change	
				1997 to 1998	1998 to 1999
Reserve Banks <sup>1</sup> .....	2,002.6	2,079.6	2,159.2	3.8	3.8
Personnel .....	1,260.1	1,306.1	1,373.2	3.6	5.1
Nonpersonnel .....	742.5	773.5	786.0	4.2	1.6
Board of Governors <sup>2</sup> .....	169.6	187.3	194.3	10.4	3.7
Personnel .....	128.7	129.9	134.7	.9	3.7
Nonpersonnel .....	40.9	57.4	59.6	40.3	3.8
<b>Total System operating expenses .....</b>	<b>2,172.2</b>	<b>2,266.9</b>	<b>2,353.5</b>	<b>4.4</b>	<b>3.8</b>
<b>Personnel .....</b>	<b>1,388.8</b>	<b>1,436.0</b>	<b>1,507.9</b>	<b>3.4</b>	<b>5.0</b>
<b>Nonpersonnel .....</b>	<b>783.4</b>	<b>830.9</b>	<b>845.6</b>	<b>6.1</b>	<b>1.8</b>
Special projects .....	33.7	3.8	.0	-88.7	-100.0
Currency <sup>3</sup> .....	367.0	409.1	500.1	11.5	22.3

NOTE. See general note to table 1.1.

1. For detailed information, see chapter 3.

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

3. See text note 2 and appendix A.

Table 1.3

## Revenue from Priced Services, 1997–99

Millions of dollars

Service	1997 actual	1998 estimate	1999 budget
Funds transfers and net settlement .....	97.8	94.1	71.0
Automated clearinghouse .	72.7	68.2	65.4
Commercial checks .....	621.6	651.7	685.3
Book-entry securities transfers .....	17.2	18.9	16.7
Noncash collection .....	4.4	3.7	2.6
Special cash services .....	5.1	2.6	2.6
<b>Total .....</b>	<b>818.8</b>	<b>839.2</b>	<b>843.6</b>

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

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

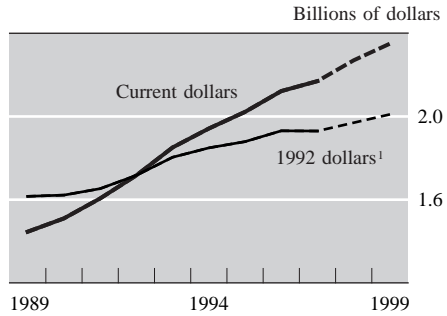
### Trends in Expenses and Employment

From actual 1989 to budgeted 1999 amounts, the operating expenses of the Federal Reserve System (excluding special projects) have increased an average of 5.0 percent per year (2.2 percent per year when adjusted for inflation) (chart 1.2); total System expenditures (including special projects) have increased an average of 4.9 percent per year. Over the same period, nondefense discretionary spending by the federal government has increased an average of 5.0 percent (chart 1.3). Federal Reserve System employment, including staff working on special projects and Federal Reserve Information Technology, has decreased 276 over the same period (chart 1.4).

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

Chart 1.2

## Operating Expenses of the Federal Reserve System, 1989–99



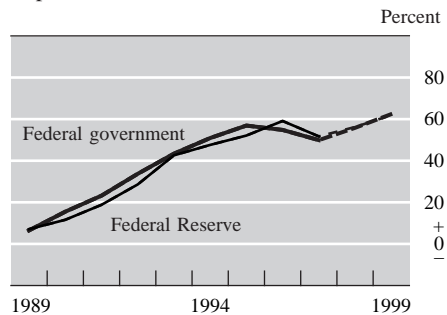
NOTE. For 1998, estimate; for 1999, budget (see also text note 1).

1. Calculated with the GDP price deflator.

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

Chart 1.3

## Cumulative Change in Federal Reserve System Expenses and Federal Government Expenses, 1989–99

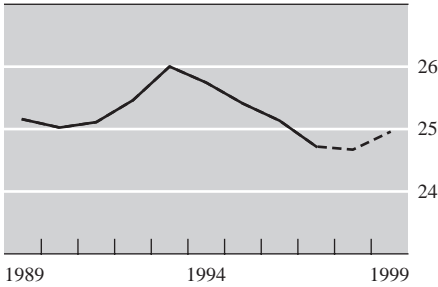


NOTE. Federal Reserve System expenses are operating expenses plus the cost of special projects; federal government expenses are discretionary spending less expenditures on defense. See also general note to chart 1.2.



Chart 1.4

Employment in the Federal Reserve System, 1989–99  
Thousands of persons



NOTE. Includes Federal Reserve Information Technology staff. See also general note to chart 1.2.

financial institutions and the public and in the support and overhead service lines.

The Expedited Funds Availability Act, which requires the Federal Reserve to issue regulations to ensure the prompt availability of funds and the expeditious return of checks, became effective in 1988. Increases in staff throughout the System in 1988 and 1989 resulted from implementation of the provisions of this legislation. From 1991 through 1998, spending on bank supervision was expanded to meet the increase in the number and complexity of examinations, the greater attention to problem institutions, and the requirements of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 and the Federal Deposit Insurance Corporation Improvement Act of 1991. The System partially offset these increases by reducing staff in other

Table 1.4

Operating Expenses of the Federal Reserve System, by Operational Area, 1997–99

Millions of dollars except as noted

Operational area and entity	1997 actual	1998 estimate	1999 budget	Percentage change	
				1997 to 1998	1998 to 1999
Monetary and economic policy .....	231.2	252.2	269.4	9.1	6.8
Reserve Banks .....	144.1	153.6	167.1	6.6	8.8
Board of Governors .....	87.1	98.6	102.3	13.2	3.8
Services to the U.S. Treasury and other government agencies <sup>1</sup> .....	207.1	223.3	222.7	7.8	-3
Services to financial institutions and the public .....	1,219.5	1,255.0	1,297.0	2.9	3.4
Reserve Banks .....	1,215.1	1,250.6	1,292.5	2.9	3.4
Board of Governors .....	4.4	4.4	4.5	.0	2.3
Supervision and regulation .....	514.5	536.5	564.4	4.3	5.2
Reserve Banks .....	436.4	452.2	476.9	3.6	5.5
Board of Governors .....	78.1	84.3	87.5	7.9	3.8
<b>Total .....</b>	<b>2,172.2</b>	<b>2,266.9</b>	<b>2,353.5</b>	<b>4.4</b>	<b>3.8</b>
<b>  Reserve Banks .....</b>	<b>2,002.6</b>	<b>2,079.6</b>	<b>2,159.2</b>	<b>3.8</b>	<b>3.8</b>
<b>  Board of Governors<sup>2</sup> .....</b>	<b>169.6</b>	<b>187.3</b>	<b>194.3</b>	<b>10.4</b>	<b>3.7</b>

NOTE. Operating expenses reflect all redistributions for support and allocations for overhead, and they exclude capital outlays and special projects. The operational area unique to the Board of Governors, System policy direction and oversight, which is shown separately in chapter 2, has been allocated across the operational areas listed here. As a result, the numbers for the operational

areas in chapter 2 are not the same as the numbers shown in this table.

1. Reserve Banks only; the Board of Governors does not provide these services.

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

operational areas, mainly in services to the U.S. Treasury and in services to financial institutions and the public. Staffing for 1999 is projected to increase slightly primarily because of volume increases in the operational areas and continued automation initiatives.

### **Operational Areas**

The expenses of the Federal Reserve are classified according to the four major operational areas of the System (table 1.4). The costs of support and overhead (including Board expenditures for System policy direction and oversight, considered an overhead expense of the System) are redistributed or allocated to these four areas.

### **1999 Budget Initiatives**

Several major initiatives that affect System budgets will continue or begin in 1999:

- Century date change compliance (see chapter 4)
- Installation of equipment and software to support the image processing and archiving of commercial and Treasury checks
- Research and development efforts for retail payment initiatives
- Facilities repair and maintenance.

Partly offsetting the greater expenditures associated with these initiatives are the lower costs made possible by several reengineering initiatives and programs to increase efficiency in Federal Reserve operations. In addition, an accounting change to capitalize software developed for internal use will result in a one-time expense reduction of \$18.1 million in 1999; these costs were previously charged to current expenses. ■

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## Chapter 2

# Board of Governors

As noted in the introduction to this volume, the 1998–99 budget for the Board of Governors is the first to cover two years (calendar years 1998 and 1999). During 1998, the first year of the new process, only minor reallocations were made within the approved 1998–99 operations budget, as follows: The capital budget was increased \$7.0 million, and an additional \$1.4 million was transferred from other sources, for necessary infrastructure enhancements to the facilities that were in the planning stages when the budget was first prepared. Also, \$7.6 million was added to the extraordinary items budget to support significant growth in workload and higher costs for contract labor associated with the Board’s century date change (CDC) compliance program.

The 1998–99 budget for the Board of Governors, approved in 1997, provides \$352.3 million for operations, \$23.0 million for extraordinary items (projects of a unique nature), and \$6.4 million for the Office of Inspector General. The Board has authorized 1,711 staff positions for operational areas and 29 positions for the Office of Inspector General; no positions are required for the extraordinary items. The total, 1,740 positions, is a decrease of 40 from the number authorized at the end of 1997.

The Board accounts for extraordinary items separately from the operations budget so that unique, one-time requirements do not compete with regular operations and so that expenses in those operations can be readily compared across years without distortion. The budget of the Office of Inspector General is prepared separately in keeping with the independence of the office.

## Overview of the Board’s Budget

In the course of the following discussion, the 1998–99 budget is compared with the immediately preceding “two-year actuals,” which are the sum of final expenses for 1996 and 1997.

Average annual changes in operating expenses are also presented to allow comparisons with earlier (annual) budgets and expenses. It is important to understand that the Board budget covers two-years; it is not two one-year budgets. Thus, the figures in the charts for 1998 and 1999 expenses are estimates of the portion of the two-year budget that will be spent in each year.

Because of the changes in the budgets for capital expenditures and extraordinary items and the fact that the 1997 initial budget figures were used in last year’s report (*Annual Report: Budget Review: 1998–99*), the comparisons given here of 1996–97 expenses with the 1998–99 budget usually differ from those in last year’s report.

## Board Operations

The \$352.3 million operations budget covers the Board’s four operational areas (described in the introduction to this volume) for calendar years 1998 and 1999; it is 8.4 percent (\$27.4 million) greater than the 1996–97 actuals.<sup>1</sup> The average annual change in expenses for the two-year period is 4.1 percent.

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1. An accounting change that took effect in 1998 is responsible for \$4.9 million, or 1.5 percentage points, of this increase. The threshold for capitalizing assets increased from \$1,000 to \$5,000 on January 1, 1998.

The 1998–99 budget reflects major changes to support the plans developed in 1997 as part of a revised planning process. The \$27.4 million net increase in the budget relative to the two-year actuals is a result of \$40.4 million in higher costs less \$13.0 million in savings. The increases arise from \$12.8 million in merit pay increases and \$1.7 million in other salary increases and over the two years; investments in programs and automation amounting to \$11.3 million; \$9.8 million in costs resulting from policy decisions in 1996 and 1997 and a 1998 accounting change; and \$4.7 million from increases in insurance premiums and other costs paid on behalf of employees and from higher prices for goods and services. The \$13.0 million in savings came from reductions in programs of \$11.4 million plus administrative actions to reduce the cost of benefits by \$1.6 million.

The \$12.8 million for merit salary raises is the largest component of the budget increase for 1998–99; the raises, which reflect the market for skills required by the Board, average 3.8 percent in 1998 and 4.2 percent in 1999.

Policy changes adopted in 1996 and 1997 account for \$4.9 million of increased spending in 1998–99. The new policies consist of a change in the method of funding the Federal Reserve System’s Office of Employee Benefits; an expanded cash award program to recognize excellent performance by individual employees; revised System accounting for communication costs under Federal Reserve Automation Services; funding for recruitment and training of a small number of welfare recipients to prepare them for employment at the Federal Reserve; a change in the Board’s accounting policy that raised the threshold for capital purchases from \$1,000 to \$5,000; and an increase in the

scope and frequency of the external audits of the Reserve Banks.

The \$4.7 million increase associated with benefits and inflation consist of rate increases for federal health and life insurance and other standard benefits plus a higher wage base for the social security tax; and a 2.7 percent price increase for goods and services as projected in the federal budget.

### Extraordinary Items

In the past, certain periodic or one-time expenses produced undue volatility in the Board’s budget, creating competition for funds to carry out the Board’s basic mission. To address this problem, funding for such “extraordinary items” has, for the past several years, been set apart from the Board’s operating budget. For 1998–99, \$15.7 million in operating funds<sup>2</sup> and \$3.1 million in capital have been budgeted for work on software to ensure its operation after the century date change, and \$7.3 million has been budgeted for two major economic surveys. Details on these projects appear at the end of the chapter.

### Office of Inspector General

The 1998–99 budget of \$6.4 million for the Office of Inspector General (OIG) represents an average annual increase of 3.6 percent over the OIG’s combined 1996 and 1997 actual expenses of \$6.0 million. The budget for the OIG is prepared in a manner that is administratively consistent with the preparation of the Board’s operating budget. However, in conformance with the statutory independence of the office, the OIG presents its budget directly to the Chair-

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2. Increased from \$8.1 million because of changes in reporting and testing requirements made after the budget was approved.

man of the Board of Governors for consideration by the Board.

### **Reductions in the Cost of Programs**

During the planning process, the Committee on Board Affairs asked each division director to look for ways to improve efficiency (that is, generate savings and eliminate lower-priority work without reducing the effectiveness of operations). Ultimately, in conjunction with the Voluntary Retirement Incentive Program, directors identified program reductions worth \$11.4 million over the 1998–99 budget period.<sup>3</sup>

### **Monetary Policy**

Reductions in the monetary policy function amounted to \$0.6 million and twelve positions, six of which were for summer interns. The savings resulted from rearranging tasks to reduce clerical requirements, efforts to improve the capture and distribution of data on financial futures and options, and filling positions vacated by the retirement incentive program at lower salary levels.

### **Supervision and Regulation**

Reductions in the supervision and regulation function were more substantial and reflect improvements in the health of the financial industry.

Reorganization of the Division of Banking Supervision and Regulation reduced expenses by \$1.0 million and eliminated twelve positions (ten of them in late 1997). The restructuring realigns

and simplifies the division's major line functions and improves coordination and consistency, particularly with respect to large interstate and foreign organizations. The reorganization also improves the use of automation and information technology and changes the management structure to improve the development of supervisory policies and procedures.

The Legal Division was able to eliminate three positions and reduce expenses by \$0.4 million because of reductions in workload associated with the health of the industry. Finally, the Regulatory Planning and Review Section in the Office of the Secretary was abolished; absorbing its work in the line divisions eliminated five positions and saved \$0.5 million.

### **System Policy Direction and Oversight**

The budget for the System policy direction and oversight function reflects the elimination of five positions and a savings of \$1.1 million. In the Division of Reserve Bank Operations and Payment Systems, the financial examination and automation management areas shifted to the use of outside auditors and consolidated the information systems staff with the information technology staff. These actions reduced authorized staffing by three positions and costs by \$0.4 million. The remaining \$0.7 million in savings arose from the consolidation of EEO activities, which eliminated two positions, and from the replacement, at lower salary levels, of staff members accepting the retirement incentive.

### **Other Savings**

Program changes that eliminated activity or revised procedures resulted in

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3. The Voluntary Retirement Incentive Program offered employees already eligible to retire a financial incentive to move up their retirement date. Approximately 100 employees accepted the offer.

division-specific reallocations (discussed below under "Program Requests") amounting to \$5 million. Additional management actions to adjust program activities reduced administrative costs and yielded gains in efficiency that account for the remainder of the \$11.4 million in program savings. Among the management actions were the elimination of fourteen positions and \$2.4 million of expense by merging the Office of the Controller with the Division of Human Resources Management and steps taken in the Division of Support Services to streamline procedures, implement new automation, and reduce some services. Miscellaneous efforts in other divisions to gain efficiencies yielded another \$0.4 million in savings.

### Current Issues

A number of efficiency issues raised in the budget process are still under review. The more significant of these concern the philosophy of the Board's oversight of the Reserve Banks, the flow of information from the Board to the public, the advisory group structure, data collection initiatives, and the Board's use of automated data sources. As the reviews are completed, any changes in funding that arise will be incorporated in the budget.

### Program Requests

During the planning process, division directors identified approximately \$16.0 million in opportunities for new or expanded programs. The Committee on Board Affairs found most of these to be worthwhile but did not fund approximately \$4.7 million of the requests. Of the remaining \$11.3 million in requested activities, the Board followed the Budget Committee's recommendation in pro-

viding new funding in the amount of \$6.3 million and encouraging division directors to indirectly fund the remaining \$5 million in requested activities through reallocations from lower-priority areas and savings.

### Reallocations

For research on the domestic economy (primarily in the Division of Research and Statistics and the Division of Monetary Affairs), resources were reallocated to enhance the efficacy of policy rules, manage the transition to a new data system for monetary aggregates, study competitive forces in banking markets, improve coordination of changes in the implementation of interest rates, analyze the mutual funds industry, better utilize financial market data, and study explicit inflation targets and loan and deposit rates.

For research on the international economy (primarily the Division of International Finance), resources were transferred to better understand the opportunities and risks of the continuing globalization of the U.S. economy, increase analysis of financial linkages, and upgrade country analyses (including additional attention to Asia).

The Division of Reserve Bank Operations and Payment Systems reallocated funds to expand efforts to ensure the safety and efficiency of the payments system; these efforts include the study of potentially useful regulatory or policy changes and the examination of electronic money issues, multicurrency clearinghouses and settlement services, and new net settlement services for retail payment systems.

Management in the Division of Consumer and Community Affairs redirected some resources to data systems to better handle the high volume of requests for interpretive information

arising from revisions to the Community Reinvestment Act. Other responsibilities, such as unifying the regulations implementing the Truth in Lending Act and the Real Estate Settlement Procedures Act will be met by expanding the involvement of Reserve Bank personnel. Should such resources not be available, the division may have difficulty in accomplishing the regulatory unification.

### New Funding

The Board approved the Budget Committee's recommendations for \$6.3 million in additional funding for programs.<sup>4</sup> The majority of the funds, \$4.1 million, are for Boardwide automation activities that contribute to the standardization of automation tools throughout the System and that advance the ability of the staff to quickly manipulate large quantities of data.

In addition, \$1.0 million was provided in the monetary policy function; most of it, \$0.7 million, is for data to improve the measurement of prices, output, productivity, and aggregate resource utilization. The remainder was for four positions to further study the process of inflation and assess whether developments in the labor and product markets have altered it.

To assist the Division of Banking Supervision and Regulation in operating effectively with a smaller staff in a rapidly changing environment, \$0.3 million was allocated for improved training of division staff, additional domestic and

international travel for division business generally, and additional travel to assist in the training of foreign supervisors.

Investments in facilities and equipment of \$0.8 million are intended to maintain the quality of work life and improve productivity in various Board operations; productivity improvements include advances in electronic printing and the preparation of electronic manuals available to System staff and financial institutions. Minor investments account for the \$0.1 million remainder of the \$6.3 million total.

### Requests Not Recommended

The remainder of the \$16.0 million in requested increases, approximately \$4.7 million, were recommended neither for funding nor for reallocations. Among these were program requests that the Budget Committee found to be of interest; most of them were offered for longer-term consideration rather than immediate implementation. Automation and facilities projects were also among the requests that were not recommended. The Boardwide plan to increase bandwidth to employees' desktop computers by installing fiber optic cable was delayed until the infrastructure improvements in the Board building are accomplished beginning in mid-1999. Requests for upgrades and replacements for furniture and equipment, including a plan to replace in all offices the furniture that accommodates computers and their peripheral devices, were deferred.

### The Operations Budget

Presented here are the Board's operating expenses and authorized positions for 1998-99 in comparison to those for 1996-97. Expenses and authorized positions by organizational unit appear in tables 2.1 and 2.2. Discussed below

4. Recent amendments to the Freedom of Information Act became effective at various times during 1997, most recently in November of that year. The amendments require agencies to provide electronic access to information without limiting other forms of access. Additional resources may be required to comply with the amendments, but the resource implications were not fully known at the time the budget was completed.



are expenses by account classification (table 2.3) and operational area (table 2.4) and the number of authorized positions by operational area (table 2.5).

**By Account Classification**

The largest dollar increase in the 1998–99 budget by account classification is in personnel costs (table 2.3). The total cost of personnel (which consists of salaries, retirement, and insurance) increased \$11.1 million, or 2.2 percent, over the 1996–97 actuals; projected salary increases more than offset declines

from lower staffing and from administrative actions to reduce health insurance costs.

For goods and services, the increase of \$16.3 million, or 10.1 percent, came from furniture and equipment because of an accounting change, software investments to improve standardization and ensure year 2000 compliance, higher telecommunications costs associated with an accounting change, and investments in training. Higher costs for contractual professional services were offset by added income from reimbursement for those services.

*Table 2.1*

Operating Expenses of the Board of Governors, by Division, Office, or Special Account, 1996–97 to 1998–99

Thousands of dollars except as noted

Division, office, or special account	1996–97 actual <sup>1</sup>	1998–99 budget	Change	
			Amount	Percent
Board Members .....	8,544	8,873	328	3.8
Secretary .....	8,602	8,443	-159	-1.8
Research and Statistics .....	52,160	57,052	4,892	9.4
International Finance .....	19,727	20,788	1,061	5.4
Monetary Affairs .....	17,238	18,530	1,293	7.5
Banking Supervision and Regulation .....	49,733	55,143	5,410	10.9
Consumer and Community Affairs .....	13,424	14,995	1,571	11.7
Legal .....	15,931	17,101	1,170	7.3
Reserve Bank Operations and Payment Systems .....	27,148	29,973	2,824	10.4
Staff Director for Management .....	4,406	2,252	-2,154	-48.9
Controller .....	6,578	6,925	347	5.3
Human Resources Management .....	10,364	9,240	-1,124	-10.8
Support Services .....	57,029	57,945	916	1.6
Information Resources Management (IRM) ..	56,827	74,501	17,671	31.1
IRM income account <sup>2</sup> .....	-32,332	-45,210	-12,878	-39.8
Publications Committee .....	-181	2,951	3,132	-1,727.2
Special projects .....	9,654	12,751	3,097	32.1
<b>Total, Board operations .....</b>	<b>324,853</b>	<b>352,255</b>	<b>27,402</b>	<b>8.4<sup>3</sup></b>
Extraordinary items .....	4,196	23,010	...	...
Office of Inspector General .....	5,975	6,419	443	7.4 <sup>3</sup>

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

The budget was approved as shown above. Effective January 1, 1998, the Office of the Controller, the Division of Human Resources Management, the Equal Employment Opportunity Program in the Office of the Staff Director for Management, and the Procurement Sec-

tion of the Division of Support Services were combined in a new Management Division.

1. The sum of actual expenses in 1996 and 1997.

2. Income from various Board divisions for use of central IRM resources.

3. Average annual percentage change from 1997 to 1999 is 4.1 for Board operations and 3.6 for the Office of Inspector General.

... Not applicable.



## By Operational Area

The Board's budget supports four major functions: monetary and economic policy, supervision and regulation, services to financial institutions and the public, and System policy direction and oversight. Expense data for the four operational areas include overhead and support costs. Factors affecting all operational areas—including the largest one, merit pay and benefits—have already been discussed. Detailed below are the major factors affecting cost changes that are unique to each function (tables 2.4 and 2.5).

## Monetary and Economic Policy

The 1998–99 budget for the monetary and economic policy function is \$152.0 million, an increase of \$15.5 million, or 11.4 percent (5.5 percent annually), from 1996–97. Activities in this area relate to the Board's role in the management of the nation's monetary policy; they include monitoring and analysis of developments in the money and credit markets, setting of reserve requirements, and approval of changes in the discount rate.

The increase in this function is primarily the result of investments in

Table 2.2

Positions Authorized at the Board of Governors, by Division, Office, or Special Account, 1997 to 1998–99

Division, office, or special account	1996–97 base <sup>1</sup>	1998–99 budget	Change
Board Members .....	42	39	-3
Secretary .....	62	54	-8
Research and Statistics .....	275	273	-2
International Finance .....	113	109	-4
Monetary Affairs .....	66	64	-2
Banking Supervision and Regulation .....	225	223	-2
Consumer and Community Affairs .....	71	71	0
Legal .....	87	84	-3
Reserve Bank Operations and Payment Systems .....	125	129	4
Staff Director for Management .....	7	19	12
Controller .....	35	31	-4
Human Resources Management .....	44	32	-12
Concern <sup>1</sup> .....	31	31	0
Support Services .....	263	247	-16
Information Resources Management (IRM) .....	279	279	0
Special projects .....	1	1	0
<b>Subtotal .....</b>	<b>1,726</b>	<b>1,686<sup>2</sup></b>	<b>-40</b>
Reimbursable IRM support <sup>3</sup> .....	25	25	0
<b>Total, Board operations .....</b>	<b>1,751</b>	<b>1,711</b>	<b>-40</b>
Office of Inspector General .....	32	29	-3

NOTE. See general note to table 2.1 regarding creation of a Management Division effective January 1, 1998.

1. EEO summer intern and youth positions managed by the Division of Human Resources Management.

2. Includes 20 temporary (two-year) positions that will be abolished by year-end 1999.

3. Positions that provide IRM support to the Federal Financial Institutions Examination Council for processing data collected under the Home Mortgage Disclosure Act and the Community Reinvestment Act.

Table 2.3

## Operating Expenses of the Board of Governors, by Account Classification, 1988–89 to 1998–99

Thousands of dollars except as noted

Account classification	1988–89	1990–91	1992–93	1994–95
<i>Personnel services</i>				
Salaries .....	117,432	143,130	169,265	190,210
Retirement .....	7,328	9,662	13,366	15,564
Insurance .....	8,116	11,429	14,407	16,862
Subtotal .....	132,876	164,222	197,039	222,637
<i>Goods and services</i>				
Travel .....	6,489	6,864	8,453	9,399
Postal and other package delivery .....	2,226	2,347	2,327	2,483
Telecommunications .....	3,114	3,364	3,665	4,168
Printing and binding .....	2,200	2,238	2,237	2,866
Publications .....	-764	406	2,212	2,976
Stationery and supplies .....	1,467	1,668	1,635	1,755
Software .....	5,017	4,529	5,615	6,453
Furniture and equipment .....	1,211	1,521	2,442	2,497
Rentals .....	474	-282	3,156	7,202
Books and subscriptions .....	1,087	1,187	1,451	1,913
Utilities .....	3,170	3,388	3,683	4,145
Building repairs and alterations .....	1,893	1,945	3,402	3,273
Furniture and equipment repairs and maintenance .....	3,906	3,734	4,072	4,198
Contingency Processing Center .....	142	327	465	206
Contractual professional services .....	6,482	5,355	9,666	13,797
Tuition/registration and membership fees .....	1,077	1,273	1,823	2,394
Subsidies and contributions .....	1,110	1,168	1,504	1,433
Depreciation .....	14,269	11,489	12,574	14,347
Other .....	-2,228	-4,635	-8,309	-16,175
Subtotal .....	52,343	47,986	62,074	69,330
<b>Total, Board operations .....</b>	<b>185,219</b>	<b>212,208</b>	<b>259,113</b>	<b>291,967</b>
Extraordinary items .....	0	0	0	0
Office of Inspector General .....	139	227	780	239

automation, taking on some responsibilities for the Regulatory Planning and Review activities formerly housed in the supervision and regulation function, and a small addition to staff to study causes of inflation and better analyze the resulting data. These costs offset savings from more efficient deployment of staff members who are analyzing monetary aggregates and from reductions of temporary resources that had been budgeted for international economic analyses.

*Supervision and Regulation*

The 1998–99 budget for the supervision and regulation function is \$129.9 mil-

lion, an increase of \$7.8 million, or 6.4 percent (3.2 percent annually), from 1996–97. Supervision includes review of the Reserve Banks' examination reports on state member banks and of their inspection reports on bank holding companies, special studies related to international applications, the direction of enforcement actions, and oversight of trust activities. Regulation includes the formulation of regulations, oversight of mergers and foreign banking activities, enforcement of consumer protection regulations, and the regulation of securities credit.

The rate of increase in this area is less than that for the Board as a whole. The lower rate reflects the elimination of

Table 2.3  
Continued

Thousands of dollars except as noted

Account classification	1996-97 actual	1998-99 budget	Average annual change (percent)	
			1997-99	1989-99
<i>Personnel services</i>				
Salaries .....	211,005	226,012	3.5	6.8 <sup>1</sup>
Retirement .....	18,015	19,089	2.9	10.0
Insurance .....	19,196	14,244	-13.9	5.8
Subtotal .....	248,215	259,345	2.2	6.9
<i>Goods and services</i>				
Travel .....	9,391	10,236	4.4	4.7
Postal and other package delivery .....	2,261	2,455	4.2	1.0
Telecommunications .....	4,367	5,334	10.5	5.5
Printing and binding .....	2,829	2,573	-4.6	1.6 <sup>1</sup>
Publications .....	2,544	2,947	7.6	. . . <sup>1</sup>
Stationery and supplies .....	1,756	2,061	8.3	3.5 <sup>1</sup>
Software .....	7,865	10,471	15.4	7.6
Furniture and equipment .....	2,568	8,015	76.7	20.8 <sup>2</sup>
Rentals .....	8,648	8,616	-2	33.7 <sup>1</sup>
Books and subscriptions .....	1,904	2,061	4.0	6.6
Utilities .....	3,995	4,255	3.2	3.0
Building repairs and alterations .....	2,996	3,315	5.2	5.8
Furniture and equipment repairs and maintenance .....	3,285	3,597	4.6	-8
Contingency Processing Center .....	0	0	. . .	. . .
Contractual professional services .....	19,438	29,089	22.3	16.2
Tuition/registration and membership fees .....	2,311	3,225	18.1	11.6
Subsidies and contributions .....	1,299	1,418	4.5	2.5
Depreciation .....	17,683	20,625	8.0	3.8
Other .....	-18,502	-27,385	21.7	28.5
Subtotal .....	76,638	92,910	10.1	5.9
<b>Total, Board operations .....</b>	<b>324,853</b>	<b>352,254</b>	<b>4.1</b>	<b>6.6</b>
Extraordinary items .....	4,196	23,010	. . .	. . .
Office of Inspector General .....	5,975	6,419	3.6	46.7

1. Accounting for income in performance reports changed during the period. Until 1991, income was netted against expenses in the appropriate cost center and program; since then, income has been captured in the "all other" account. The change has had only a minor effect on the 1989-99 percentage change in the accounts for salaries, printing and binding, and stationery and supplies, but in the accounts for publications and rentals, it has made a measurement of the 1989-99 change meaningless.

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

. . . Not applicable.

twelve positions in the Division of Banking Supervision and Regulation (ten in late 1997 and two in 1998) and three in the Legal Division, all of which were permitted by the healthy state of the financial industry. Changes to the Regulatory Planning and Review function mentioned above also affected the

rate of increase. The budget provides for additional computer hardware and software to help offset the effect of the position reductions; greater spending on information technology is also directed at the workstation project to improve efficiency in supervising foreign banking organizations.

*Services to Financial Institutions and the Public*

The 1998–99 budget for services to financial institutions and the public is \$6.8 million, a decrease of \$0.1 million,

or 1.4 percent, from 1996–97. This function covers the Board’s oversight and control with regard to services provided by the Reserve Banks and Branches for check payments; for electronic payments; and for the handling

Table 2.4

Expenses of the Board of Governors for Operational Areas, Extraordinary Items, and Office of Inspector General, 1996–97 to 1998–99

Thousands of dollars except as noted

Operational area	1996–97 actual	1998–99 budget	Change	
			Amount	Percent
Monetary and economic policy .....	136,450	151,955	15,505	11.4
Supervision and regulation .....	122,121	129,894	7,773	6.4
Services to financial institutions and the public .....	6,884	6,787	–97	–1.4
System policy direction and oversight .....	59,400	63,619	4,219	7.1
<b>Total, Board operations .....</b>	<b>324,855</b>	<b>352,255</b>	<b>27,400</b>	<b>8.4<sup>1</sup></b>
Extraordinary items .....	4,196	23,010	...	...
Office of Inspector General .....	5,975	6,419	444	7.4 <sup>1</sup>

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

1. Average annual percentage change from 1997 to 1999 is 4.1 for Board operations and 3.6 for the Office of Inspector General.  
 ... Not applicable.

Table 2.5

Positions Authorized at the Board of Governors for Operational Areas, Support and Overhead, and Office of Inspector General, 1996–99

Activity	1996–97 actual	1998–99 budget	Change
Monetary and economic policy .....	434	426	–8
Supervision and regulation .....	379	374	–5
Services to financial institutions and the public ..	22	22	0
System policy direction and oversight .....	160	173	13
Support and overhead <sup>1</sup> .....	731	691	–40
<b>Subtotal .....</b>	<b>1,726</b>	<b>1,686</b>	<b>–40</b>
Reimbursable IRM support <sup>2</sup> .....	25	25	0
<b>Total, Board operations .....</b>	<b>1,751</b>	<b>1,711</b>	<b>–40</b>
Office of Inspector General .....	32	29	–3

1. Includes 17 youth positions, 11 summer intern positions, and 20 temporary (two-year) positions that will be abolished by year-end 1999.

2. Positions that provide IRM support to the Federal Financial Institutions Examination Council for processing data collected under the Home Mortgage Disclosure Act and the Community Reinvestment Act.

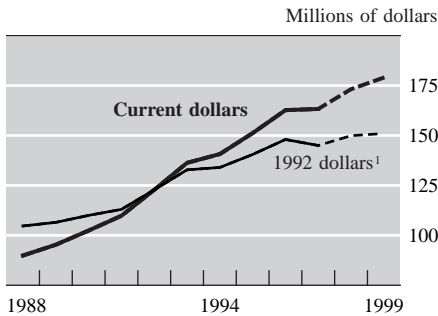
of currency, coin, and food coupons. The 1997 completion of automation projects is the primary cause of the decrease in this operational area.

*System Policy Direction and Oversight*

The 1998–99 budget for System policy direction and oversight is \$63.6 million, an increase of \$4.2 million, or 7.1 percent (3.5 percent annually), from 1996–97. This operational area covers oversight, direction, and supervision of System and Board programs, including the work of Board members in overseeing Reserve Bank operations; budgeting and accounting; financial examinations;

*Chart 2.1*

Operating Expenses of the Board of Governors, 1988–99



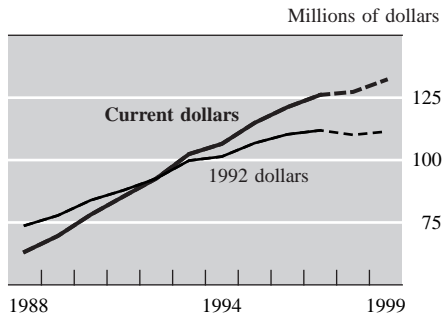
Year	Millions of dollars	
	Current dollars	1992 dollars <sup>1</sup>
1988	89.9	104.7
1989	95.3	106.5
1990	102.4	110.0
1991	109.8	113.0
1992	122.8	122.8
1993	136.3	132.8
1994	140.7	134.0
1995	151.2	140.5
1996	162.7	148.0
1997	163.3	145.0
1998	173.2	149.9
1999	179.0	151.0

NOTE. Excludes the Office of Inspector General and extraordinary items. The values for 1998 and 1999 are the approximate calendar-year effects of the two-year budget.

1. Calculated with the GDP price deflator.

*Chart 2.2*

Expenses for Personnel Services at the Board of Governors, 1988–99



NOTE. See notes to chart 2.1.

audit and operations reviews; and automation and communications.

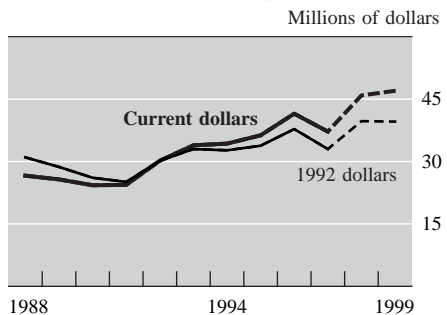
The rate of increase in this operational area is less than that for the Board as a whole. The rate was held down by a reduction in the program for the internal examination of Reserve Banks in favor of outside audits of the Banks. To ensure their independence, the audits were budgeted in this operational area.

**The Capital Budget**

The Board’s 1998–99 capital budget is \$20.0 million,<sup>5</sup> an increase of \$2.9 million, or 17.0 percent, from the 1996–97

*Chart 2.3*

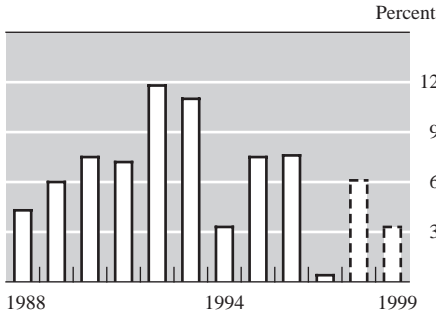
Expenses for Goods and Services at the Board of Governors, 1988–99



NOTE. See notes to chart 2.1.

Chart 2.4

Annual Change in Operating Expenses of the Board of Governors, 1988–99



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

actuals. The budgeted amount provides for improvements in office automation and the automation infrastructure; security; and other facility elements. The capital budget also funds design work for major repairs to the facility infrastructure and the first phase of the repairs.

### Trends in Expenses and Employment

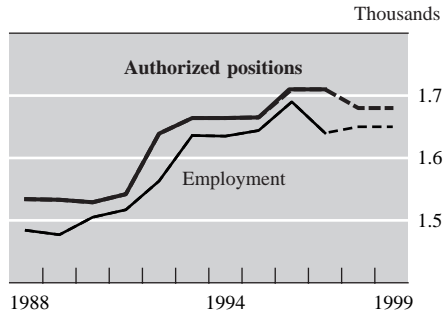
The 1998–99 budget increased 4.1 percent on an annual basis. In comparison, 1997 budgeted expenses were 2.5 percent higher than 1996 actual expenses. The increase from 2.5 percent to 4.1 percent is largely the result of salary increases, which rose from 3.0 percent for 1997 to 3.8 percent for 1998. The 4.1 percent average annual increase in operations expenses between 1996–97 and 1998–99 is, however, significantly less than the 6.6 percent average annual rise over the ten years from 1988–89 to 1998–99 (table 2.3). The slower rate of increase is largely attributable to moderating growth in the supervision

and regulation function and to aggressive steps to streamline operations and reduce costs.

Approximately 73.6 percent of Board operating expenses is for personnel (salaries, retirement, and insurance benefits); consequently, any discussion of expense trends involves trends in staffing. Over the ten years between 1989 and 1999, the number of authorized positions at the Board has increased by 152 (a total of 9.7 percent), from 1,559 to 1,711. Most of the increase—107 positions—was in the supervision and

Chart 2.5

Employment and Authorized Positions at the Board of Governors, 1988–99



Year	Employment	Authorized positions
1988	1,484	1,534
1989	1,477	1,533
1990	1,505	1,529
1991	1,517	1,542
1992	1,563	1,639
1993	1,636	1,664
1994	1,635	1,664
1995	1,644	1,665
1996	1,686	1,712
1997	1,638	1,713
1998	1,650	1,680
1999	1,650	1,680

NOTE: Year-end data. Excludes summer intern and youth positions as well as positions for the Office of Inspector General. For 1998–99 these positions number 31 and 29 respectively; figures for 1993–97 also include positions that provide support to the Federal Financial Institutions Examination Council for processing data collected under the Home Mortgage Disclosure Act and the Community Reinvestment Act.

5. Includes \$7.0 million, added in mid-1998, for the first phase of the Eccles Building Infrastructure Enhancement Project.

regulation function. The decrease of 40 positions between 1997 and the 1998–99 budget is the result of automation investments, adjustments to programs and services, streamlining and mergers affecting administrative functions, and careful reviews by division directors of the resources needed to support each function.

Early in the 1989–99 period, the number of positions at the Board hit a low—1,529 in 1990. From 1990 to 1995 the number of authorized positions rose to meet an increasing workload driven in large part by expanded statutory responsibilities and requirements. Passage of legislation emphasizing safety and soundness, regulation, and consumer issues significantly increased staffing requirements in these areas. The increase in positions over the past several years has been moderate. The advent of the century date change problem caused a temporary increase of 20 positions, which began in 1997 and will be reversed by 2001 once Board systems are compliant and work deferred to provide additional resources for the CDC effort has been completed. As discussed earlier 40 positions were eliminated as part of the 1998–99 budget.

While the number of positions at the Board has fluctuated during the ten-year period, the salary budget (not including retirement and insurance benefits) has remained relatively stable at roughly 65 percent of operating expenses. The portion of operating expenses devoted to retirement and insurance has increased as a result of increases in health insurance costs, a change in the law to apply Medicare costs to federal employees, a growing proportion of Board employees covered by OASDI (social security), and increases in the Board contribution rate for the employee thrift plan. The increases were partially offset by factors

eliminating the necessity for contribution to the Board retirement plan and the transfer of most employees in the Civil Service Retirement Plan to the Board Retirement Plan. Actions to reduce the rate of increase in insurance costs have been successful, and the Board terminated its insurance program in late 1998 in favor of the Federal Employees Health Benefits Program.

### **Extraordinary Items**

The 1998–99 budget for extraordinary items, summarized at the outset of the chapter, includes \$15.7 million in operating funds and \$3.1 million in capital to bring the Board's software into compliance with the century date change. The Federal Reserve accelerated work on its century date change project in 1997 in order to complete all critical systems by year-end 1998. The largest cost is for labor, particularly contractor support. Some of the labor will be provided through reallocations from lower-priority work. Associated hardware costs are for test environments that will parallel the production environments. The Board is sharing mainframe resources with Federal Reserve Automation Services where possible.

The budget for extraordinary items also provides \$4.3 million to conduct a Survey of Consumer Finances (SCF) in 1998. The SCF is designed to gather data from households on their income, assets, debts, pensions, employment, use of financial services, and other characteristics. The survey, which is part of a series begun in 1983, provides the only representative microlevel data for the United States on the structure of household finances and household uses of financial services, and the results are often used by the Federal Reserve in responding to requests from the Congress and federal agencies. The surveys are

used in long-term research to support the Board's objectives as well as in policy analyses relating to consumer debt, the "unbanked" public, the effects of large price movements in the stock market, and projections of household data by income groups.

Last, the extraordinary-items budget provides \$3.0 million for the National Survey of Small Business Finances (NSSBF). The survey gathers data from small businesses on their financial relationships, credit experiences, lending terms and conditions, income, balance sheets, location and types of financial institutions used, and other characteristics. Similar surveys were conducted in 1987 and 1993. The new

survey will be conducted in 1999 for data as of year-end 1998. The NSSBF provides the only substantial financial services information regarding the scope of geographic and product markets for small businesses. The survey is used in analyzing the competitive effect of bank mergers, benchmarking of other data series (such as the noncorporate sector of the flow of funds accounts), as input to the quinquennial small business report mandated by section 227 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, and for research and policy analyses of a wide variety of issues in small business finances. ■



## Chapter 3

# Federal Reserve Banks

The 1999 operating budgets approved by the Board of Governors for the twelve Reserve Banks total \$2,159.2 million, an increase of \$75.8 million, or 3.6 percent, over 1998 expenditures (table 3.1). The 1999 budgets include no special projects.

Employment, including the staff associated with FRIT (Federal Reserve Information Technology), is budgeted at 23,271 ANP (average number of personnel), an increase of 276 ANP, or 1.2 percent, from estimated 1998 employment.<sup>1</sup> Reserve Bank employment is expected to increase 242 ANP and FRIT employment will increase 34 ANP.<sup>2</sup>

Expenses for personnel (salaries and benefits) account for \$1,373.2 million, or 64 percent, of the 1999 operations budget, an increase of \$67.1 million, or 5.1 percent, over estimated 1998 personnel expenses (table 3.2). Nonpersonnel expenses (mainly building and automation projects) are budgeted at \$786.0 million, an increase of \$12.5 million, or 1.6 percent, over estimated 1998 nonpersonnel expenses.

The following two sections discuss major initiatives and the budget objective for the Reserve Banks in 1999. Subsequent sections provide details

on the four operational areas and on objects of expense, capital outlays, and long-term trends. Appendix A gives more information on capital outlays and other special categories of expense; appendix D gives additional data by District and operational area.

## Major Initiatives

The 1999 Reserve Banks budgets provide for the following initiatives (table 3.3):

### *System-defined*

- Installation of equipment and software to support check image processing and archiving
- Research and development in the retail payments area
- Century date change compliance
- Capitalization of software developed for internal use that was expensed in previous years

### *District-defined*

- Initiatives in support of fiscal services.

Reserve Bank budgets reflect a continued commitment to expand the check imaging business. Expenses for the ongoing check imaging initiative are budgeted at \$38.0 million, an increase of approximately \$10.0 million over estimated 1998 expenditures. This projection also includes costs associated with the national check image archive at the Boston Reserve Bank. Currently, the national archive supports the imaging and retrieval of government checks for the U.S. Department of the Treasury. In 1999, services will be expanded

1. FRIT encompasses Federal Reserve Automation Services (FRAS) and Information Technology Planning and Standards.

2. The term *average number of personnel* describes levels and changes in employment at the Reserve Banks. ANP is the average number of employees in terms of full-time positions for the period. For instance, a full-time employee who starts work on July 1 counts as 0.5 ANP for that calendar year; two half-time employees who start on January 1 count as 1 ANP.

to include commercial checks, postal money orders, and E-Z Clear savings bonds.

Marketing and research and development initiatives in retail payments account for a year-over-year increase of \$3.8 million. Costs associated with these initiatives are expected to be \$8.7 million. All Reserve Bank budgets include funding for a national automated clearinghouse (ACH) marketing and education effort and for research on payment issues. The enterprise-wide adjustments system (EWA) for checks will be a nationwide, integrated check

adjustment processing platform that will replace stand-alone applications currently located throughout the System.

Reserve Banks continue to devote resources to Year 2000 projects. Year-over-year costs are projected to decrease \$6.8 million, from \$35.9 million in the 1998 estimate to \$29.1 million in the 1999 budget. Total ANP devoted to the Year 2000 initiatives is expected to decrease from 303 in 1998 to 276 in 1999. The majority of the 1999 projection represents a reallocation of current resources. Resources are also provided for consulting services and contract

Table 3.1

Expenses and Employment at the Federal Reserve Banks, 1998–99

Category	1998 estimate	1999 budget	Change	
			Amount	Percent
<i>Expenses (millions of dollars)</i>				
Operations <sup>1</sup> .....	2,079.6	2,159.2	79.6	3.8
Special project <sup>2</sup> .....	3.8	.0	-3.8	-100.0
<b>Total</b> .....	<b>2,083.4</b>	<b>2,159.2</b>	<b>75.8</b>	<b>3.6</b>
<i>Employment (average number of personnel)<sup>3</sup></i>				
Operations <sup>1</sup> .....	22,409	22,652	242	1.1
Federal Reserve Information Technology .....	585	619	34	5.8
<b>Total</b> .....	<b>22,995</b>	<b>23,271</b>	<b>276</b>	<b>1.2</b>

NOTE. See general note to table 1.1, chapter 1. Excludes capital outlays.

1. Includes support and overhead (see appendix D, table D.3, note 1, for definitions).

2. The Automation Consolidation special project began in 1992 and ended in 1998.

3. See text note 2 for definition.

Table 3.2

Operating Expenses of the Federal Reserve Banks, by Object, 1997–99

Millions of dollars except as noted

Object	1997 actual	1998 estimate	1999 budget	Percentage change	
				1997 to 1998	1998 to 1999
Personnel .....	1,259.0	1,306.1	1,373.2	3.7	5.1
Nonpersonnel .....	752.8	773.5	786.0	2.7	1.6
<b>Total</b> .....	<b>2,011.8</b>	<b>2,002.6</b>	<b>2,159.2</b>	<b>3.4</b>	<b>3.8</b>

NOTE. Includes support and overhead (see appendix D, table D.3, note 1, for definitions). The data for 1997 and

1998 exclude the special projects for those years; no special project is budgeted for 1999.

programmers. In addition to Reserve Bank expense projections, the FRIT budget includes an estimate of \$8.2 million and 45 ANP in 1999.

District-defined fiscal initiatives totaling \$10.0 million are included in the 1999 budget projection, an increase of \$4.4 million over 1998 estimates. Major initiatives at the St. Louis, Richmond, and New York Banks account for most of this total. Initiatives such as the Automated Standard Applications for Payments system (ASAP), the Treasury Investment Program (TIP), Treasury Offset Program (TOP), Treasury Tax and Loan Paper (PATAX), Treasury International Capital Flows (TIC) surveys, and TIP/PATAX consolidation are aimed at maintaining high-quality services to the Treasury. Costs for these projects are fully reimbursable by the Treasury.

Expenses for these major initiatives are partially offset by a decrease of \$18.1 million resulting from the Reserve Banks' interpretation of new account-

ing standards; the interpretation requires the capitalization of computer software developed for internal use.<sup>3</sup> Under this new accounting treatment, software previously charged to expense will be capitalized.

### 1999 Budget Objective

The approved 1999 budget objective for Reserve Banks was \$2,146.0 million, an increase of \$86.7 million, or 4.2 percent, from the 1998 budget of \$2,059.3 million. Excluding the 1998 special project expense, the target was \$91.3 million, or 4.4 percent, higher than the 1998 budget. The 1999 budget objective included funding for ongoing Year 2000 efforts and several multiyear strategic initiatives within financial services: to move paper check processing toward

3. The Federal Reserve will implement Statement of Position (SOP) 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.

Table 3.3

Contribution of Change in Major Initiatives to the Change in Operating Expenses of the Federal Reserve Banks, 1998 to 1999

Millions of dollars except as noted

Initiative	1998 estimate	1999 budget	Contribution of change to change in total operating expenses, 1998 to 1999	
			Amount	Percentage points
<i>System-defined</i>				
Check imaging .....	28.0	38.0	10.0	.5
Retail R&D .....	4.9	8.7	3.8	.2
Century date change (total) .....	35.9	29.1	-6.8	-.3
Software capitalization .....	. . .	-18.1	-18.1	-.9
<i>District-defined</i>				
Fiscal services .....	5.6	10.0	4.4	.2
<b>Total</b> .....	<b>74.4</b>	<b>67.7</b>	<b>-6.7</b>	<b>-.3</b>
MEMO				
Other operating expenses .....	2,005.2	2,091.5	86.3	4.1
<b>Total operating expenses</b> .....	<b>2,079.6</b>	<b>2,159.2</b>	<b>79.6</b>	<b>3.8</b>

imaging and electronics, to increase the use of the ACH, and to conduct research and development on new payment strategies. The budget objective also included resources to respond to an expected increase in customer demand for check and currency services, to continue the development of applications for Treasury, and to provide competitive compensation to officers and employees. The staffing target reflected the first projected ANP increase since 1993. Higher employment was projected primarily because of higher workloads in the check and currency areas.

The 1999 budget objective was evaluated against the approved 1998 budget. The current estimate of 1998 spending (\$2,079.6 million) is \$24.9 million higher than the approved 1998 budget. The budget objective, when compared with the higher base of the 1998 estimate, reflects expense growth of \$66.4 million or 3.2 percent, excluding the special project expense for 1998 (table 3.4).

The approved 1999 budget objective assumed a spending level of \$2,146.0

million; the Reserve Banks 1999 budgets total \$2,159.2 million, or \$13.2 million more than the budget objective.

Two factors, identified as unquantifiable risks when the budget objective was developed, accounted for most of the difference. First, the budget objective process did not include the \$27 million increase in expenses added in 1998 to process unanticipated check and currency volume. Second, as a partial offset to this increase, the budget objective did not reflect the \$18.1 million expense reduction resulting from the accounting change to capitalize software developed for internal use.

Total Reserve Bank and FRIT employment is projected to be 23,271 ANP, 267 ANP higher than projected in the budget objective. Higher employment levels in priced services produced 255 ANP of this variance and are due to higher demand for traditional check and new imaging products.

### Budget by Operational Area

Tables 3.5 and 3.6 summarize employment and expenses for the Reserve Banks' four operational areas. Tables 3.7 through 3.11 provide details for each area.

Table 3.4

Change in Budget Objective and Budget of the Federal Reserve Banks, 1998 to 1999

Percent

Item	1999 budget objective <sup>1</sup>	1999 budget <sup>2</sup>
Operating expenses .....	3.8	3.2
System-defined initiatives <sup>3</sup> .....	.6	.6
Total, excluding special project .....	4.4	3.8
Special project .....	-.2	-.2
<b>Total, including special project .....</b>	<b>4.2</b>	<b>3.6</b>

1. As a change from 1998 budget.

2. As a change from 1998 estimated expenses.

3. Check imaging, retail research and development, century date change, and software capitalization.

### Monetary and Economic Policy

The monetary and economic policy budget is \$167.1 million, \$13.6 million, or 8.8 percent, higher than the 1998 estimate. Its growth rate is the highest of the four operational areas and largely results from a 1999 cost accounting change in the allocation of protection costs for property, assets, and staff. Employment in this area is projected to be 728 ANP, an increase of 16 ANP, or 2.2 percent, and reflects the effects of turnover and lags in filling open positions during 1998. Initiatives in this

service line include continued investment in automation that will expand information retrieval and delivery systems and improve data management processes. Other initiatives in this area include increasing the visibility of, and access to, District research products for relevant audiences; expanding partnerships with local universities and other academic organizations; and increasing research on international issues.

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

Expenses for services to the Department of the Treasury and other government agencies are budgeted at \$222.7 million, a decrease of \$0.6 million, or 0.3 percent, from the 1998 estimate. The 1999 capitalization of software developed for internal use results in a one-time reduction in expenses of approximately

Table 3.5

### Employment at the Federal Reserve Banks, by Activity, 1997–99

Average number of personnel except as noted<sup>1</sup>

Activity	1997 actual	1998 estimate	1999 budget	Percentage change	
				1997 to 1998	1998 to 1999
<i>Operational areas</i>					
Monetary and economic policy .....	718	712	728	-.8	2.2
Services to the U.S. Treasury and other government agencies .....	1,438	1,422	1,394	-1.1	-2.0
Services to financial institutions and the public .....	7,954	8,096	8,138	1.8	.5
Supervision and regulation .....	2,980	2,890	2,927	-3.0	1.3
<i>Support and overhead<sup>2</sup></i>					
Support .....	4,572	4,552	4,691	-.4	3.0
Overhead .....	4,821	4,737	4,774	-1.7	.8
<b>Total .....</b>	<b>22,483</b>	<b>22,410</b>	<b>22,652</b>	<b>-.3</b>	<b>1.1</b>

NOTE. Excludes Federal Reserve Information Technology. The costs of the special project in 1997 and 1998 do not involve personnel; the special project ended during 1998.

1. See text note 2 for definition.

2. See appendix D, table D.3, note 1, for definitions.

Table 3.6

### Operating Expenses of the Federal Reserve Banks, by Operational Area, 1997–99

Thousands of dollars except as noted

Operational area	1997 actual	1998 estimate	1999 budget	Percentage change	
				1997 to 1998	1998 to 1999
Monetary and economic policy .....	144,103	153,559	167,125	6.6	8.8
Services to the U.S. Treasury and other government agencies .....	207,079	223,309	222,735	7.8	-.3
Services to financial institutions and the public .....	1,215,069	1,250,554	1,292,505	2.9	3.4
Supervision and regulation .....	436,392	452,178	476,857	3.6	5.5
<b>Total .....</b>	<b>2,002,643</b>	<b>2,079,600</b>	<b>2,159,222</b>	<b>3.8</b>	<b>3.8</b>

NOTE. Includes support and overhead (see appendix D, table D.3, note 1, for definitions). The data for 1997 and

1998 exclude the special projects for those years; no special project is budgeted for 1999.

\$5.9 million. Total 1999 employment is 1,394 ANP, down 28 ANP, or 2.0 percent, from the 1998 estimate.

The Reserve Banks continue to research, develop, and implement applications to improve and expand funds collection and disbursement processes for the Treasury and other government agencies and to eliminate paper-based products and processing. For example, the Reserve Banks are working with the Bureau of the Public Debt to archive paid savings bonds, to expand web-based applications for savings bonds and Treasury Direct, and to deploy

optical scanning technology to collect savings bond data previously entered manually.

The effects of technology and regulatory changes are particularly evident in the processing of food coupons. Resource requirements in this area are projected to decline \$2.8 million (11.3 percent) and 13 ANP because of the electronic benefits transfer program.

Efforts to align resources with changing technology and volumes through re-engineering and other realignment programs continue in several Districts.

Table 3.7

Expenses of the Federal Reserve Banks for Monetary and Economic Policy, 1997–99

Thousands of dollars except as noted

Service	1997 actual	1998 estimate	1999 budget	Percentage change	
				1997 to 1998	1998 to 1999
Economic policy determination .....	112,741	120,605	131,305	7.0	8.9
Open market trading .....	31,362	32,954	35,820	5.1	8.7
<b>Total .....</b>	<b>144,103</b>	<b>153,559</b>	<b>167,125</b>	<b>6.6</b>	<b>8.8</b>

NOTE. The data for 1997 and 1998 exclude the special projects for those years; no special project is budgeted for 1999.

Table 3.8

Expenses of the Federal Reserve Banks for Services to the U.S. Treasury and Other Government Agencies, 1997–99

Thousands of dollars except as noted

Service	1997 actual	1998 estimate	1999 budget	Percentage change	
				1997 to 1998	1998 to 1999
Centralized operations—savings bonds ....	59,030	72,103	72,972	22.1	1.2
Other Treasury issues .....	14,569	14,839	12,425	1.9	-16.3
Centralized operations— other Treasury issues .....	1,984	1,639	3,742	-17.4	128.3
Centrally provided Treasury and agency services .....	35,051	36,266	37,241	3.5	2.7
Government accounts .....	34,022	36,046	35,733	5.9	-9
Food coupons .....	25,210	25,002	22,165	-8	-11.3
Other .....	37,213	37,414	38,457	.5	2.8
<b>Total .....</b>	<b>207,079</b>	<b>223,309</b>	<b>222,735</b>	<b>7.8</b>	<b>-3</b>

NOTE. See general note to table 3.7.

## Services to Financial Institutions and the Public

Expenses for services to financial institutions and the public, an area that includes both priced and nonpriced services, is budgeted at \$1,292.5 million, an increase of \$42.0 million, or

3.4 percent, over the 1998 estimate. Expense growth in two areas, currency and check processing, accounts for \$40.9 million of this increase. Staffing is budgeted at 8,138 ANP, an increase of 42 ANP, or 0.5 percent, from the 1998 estimate, with approximately one-half of this increase coming from currency

Table 3.9

### Expenses of the Federal Reserve Banks for Services to Financial Institutions and the Public, 1997–99

Thousands of dollars except as noted

Service	1997 actual	1998 estimate	1999 budget	Percentage change	
				1997 to 1998	1998 to 1999
Currency .....	248,474	261,246	275,763	5.1	5.6
Coin .....	28,845	31,618	24,242	9.6	-23.3
Special cash .....	4,491	2,468	2,474	-45.0	.2
Commercial check .....	577,226	603,745	630,102	4.6	4.4
Other check .....	41,870	38,665	41,128	-7.7	6.4
Funds transfer .....	66,732	65,202	64,633	-2.3	-9
Automated clearinghouse .....	66,375	66,697	69,721	.5	4.5
Book-entry securities transfer .....	38,220	33,803	32,485	-11.6	-3.9
Other securities and noncash collection ...	6,919	4,840	4,015	-30.0	-17.0
Loans to member banks and others .....	23,878	22,960	23,185	-3.8	1.0
Public programs .....	74,964	82,018	85,963	9.4	4.8
Other .....	37,075	37,292	38,794	.6	4.0
<b>Total .....</b>	<b>1,215,069</b>	<b>1,250,554</b>	<b>1,292,505</b>	<b>2.9</b>	<b>3.4</b>

NOTE. See general note to table 3.7.

Table 3.10

### Expenses of the Federal Reserve Banks for Services to the U.S. Treasury and Other Government Agencies and to Financial Institutions and the Public, 1997–99

Thousands of dollars except as noted

Service	1997 actual	1998 estimate	1999 budget	Percentage change	
				1997 to 1998	1998 to 1999
U.S. government services <sup>1</sup> .....	291,650	294,806	295,239	1.1	.1
Cash services .....	277,319	292,864	300,006	5.6	2.4
Priced services .....	690,744	738,145	767,955	6.9	4.0
Other .....	162,435	148,048	152,040	-8.9	2.7
<b>Total .....</b>	<b>1,422,148</b>	<b>1,473,863</b>	<b>1,515,240</b>	<b>3.6</b>	<b>2.8</b>

NOTE. See general note to table 3.7.

1. The amounts shown here do not include expenses in this service that are recorded in the monetary and economic policy operational area. For 1997 these expenses were \$673 thousand, for 1998 they are estimated

at \$1,227 thousand, and for 1999 they are budgeted at \$1,438 thousand. These expenses increase the total costs of services provided by the Reserve Banks as fiscal agents and depositories of the United States.

processing and one-fourth from check processing.

Customer demand for currency and check processing increased unexpectedly in several Districts during 1998 and is projected to continue expanding at that rate through 1999. Estimated volume growth in these two areas accounts for an additional \$4.5 million in the 1999 budget.

Higher expenses in the 1999 budget are being generated not only by increases in traditional demand but also by several strategic initiatives to provide a consistent product to the increasing number of national customers and to provide efficiencies in the development and management of applications and products: expanding the application of imaging to commercial checks, postal money orders, and government checks; stimulating demand for electronic check presentment and the electronic cash letter; and moving toward System-standard check automation platforms and applications.

The Reserve Banks continue to seek efficiencies by consolidating the loca-

tion of services that use highly centralized electronic applications such as funds transfer, book-entry securities, and ACH. The latest example is consolidation of the twelve sites providing off-line processing for funds and book-entry securities into two sites

by the end of 1999.

Priced service costs are projected to be \$738.1 million in 1998 and \$768.0 million in 1999. All of these costs, plus the private sector adjustment factor, are budgeted for recovery through fees to depository institutions and others that use the services. The Reserve Banks' recovery rate is estimated to be 103.9 percent for 1998 and 101.2 percent for 1999.

### Supervision and Regulation

Supervision and regulation expenses are budgeted to be \$476.9 million in 1999, an increase of \$24.7 million, or 5.5 percent, over the 1998 estimate. The 1999 change in accounting of the allocation of protection costs for property, assets, and staff is a significant

Table 3.11  
Expenses of the Federal Reserve Banks for Supervision and Regulation, 1997-99

Thousands of dollars except as noted

Service	1997 actual	1998 estimate	1999 budget	Percentage change	
				1997 to 1998	1998 to 1999
Supervision of large multistate, multi-District banking organizations . . . . .	. . .	70,975	76,355	. . .	7.6
Supervision of domestic regional and community banking organizations . . . . .	. . .	165,507	174,822	. . .	5.6
Supervision of foreign banking organizations . . . . .	. . .	57,069	60,641	. . .	6.3
Administration of laws and regulations related to banking . . . . .	. . .	89,093	91,544	. . .	2.8
Supervision activities benefiting the banking system . . . . .	. . .	46,976	49,395	. . .	5.1
Studies of banking and financial markets . . . . .	. . .	22,558	24,100	. . .	6.8
<b>Total</b> . . . . .	<b>436,393</b>	<b>452,178</b>	<b>476,857</b>	<b>3.6</b>	<b>5.5</b>

NOTE. Expenses in 1997 for this operational area were recorded under a structure redefined as of 1998. The data

for 1997 and 1998 exclude the special projects for those years; no special project is budgeted for 1999.



source of the budgeted increase in this area. The size of the cost increases varies by District and ranges from 0.5 percent to 10.8 percent. The range of expense changes reflects the response to District-specific environmental factors and the degree of efficiencies realized through risk-focused examinations and improved automation.

Employment is projected to be 2,927 ANP, an increase of 37 ANP, or 1.3 percent, over the 1998 estimate. Only three Districts are projecting declines in staffing. Several Districts were hesitant to reduce staffing in this area because of uncertainty regarding the level of support needed for century date change (CDC) efforts in 1999.

Along with ongoing examination responsibilities, CDC is expected to remain a high priority during the com-

ing year. In addition, the supervision and regulation area continues to broaden the application of technology to streamline the examination process, expedite information retrieval capabilities and lessen the on-site burden to financial institutions, and reduce the internal administrative burden through the automation of tracking and scheduling functions.

### Budget by Object of Expense

Personnel expenses are projected to increase 5.1 percent, while nonpersonnel-related expenses are increasing 1.6 percent. Personnel expenses include officer and employee salaries, other compensation to personnel, and retirement and other benefits, and account for 64 percent of Reserve Bank expenses (table 3.12).

Table 3.12

#### Operating Expenses of the Federal Reserve Banks, by Object, 1997–99

Thousands of dollars except as noted

Object	1997 actual	1998 estimate	1999 budget	Percentage change	
				1997 to 1998	1998 to 1999
<i>Personnel</i>					
Officers' salaries .....	105,185	114,354	123,400	8.7	7.9
Employees' salaries .....	850,825	874,630	929,563	2.8	6.3
Other <sup>1</sup> .....	40,992	44,694	34,976	9.0	-21.7
Retirement and other benefits .....	263,141	272,377	285,247	3.5	4.7
Total .....	1,260,142	1,306,056	1,373,185	3.6	5.1
<i>Nonpersonnel</i>					
Forms and supplies .....	53,406	52,738	52,292	-1.3	-8
Equipment .....	171,500	177,806	196,557	3.7	10.5
Software .....	35,322	39,425	41,304	11.6	4.8
Shipping .....	79,278	77,918	78,881	-1.7	1.2
Travel .....	42,853	44,085	45,594	2.9	3.4
Buildings .....	174,843	174,762	186,695	.0	6.8
Recoveries .....	-53,764	-66,398	-60,769	23.5	-8.5
Other <sup>2</sup> .....	239,064	273,207	245,483	14.3	-10.1
Total .....	742,502	773,544	786,037	4.2	1.6
<b>Total .....</b>	<b>2,002,644</b>	<b>2,079,600</b>	<b>2,159,222</b>	<b>3.8</b>	<b>3.8</b>

NOTE. See general note to table 3.7.

1. Certain contractual arrangements and miscellaneous other personnel expenses.

2. Communications, fees, contra-expenses, shared costs distributed and received, excess capacity, and miscellaneous other expenses.

Salaries and other personnel expenses account for about 50 percent of 1999 budgeted expense, and anticipated growth is \$54.3 million, or 5.2 percent. Salaries for officers and employees are expected to increase \$64.0 million, or 6.5 percent. Merit programs averaging 4.2 percent will increase salary expenses by \$41.2 million. Also contributing to higher salary expenses are staff increases, promotions and reclassifications, and structure and market adjustments. These increases are partially offset by a \$9.7 million decrease in other personnel expenses, which reflects a decline in the use of outside agency help and reduced severance and retention payments. Also offsetting the increase in salaries are a \$4.2 million reduction in overtime and a \$4.9 million decrease in costs associated with short-term position vacancies or lags in hiring.

Retirement and other benefits expenses, which account for 13 percent of Reserve Bank budgets, are anticipated to increase \$12.9 million, or 4.7 percent, in 1999. Contributing factors include increases in salary-related benefits, such as social security and the thrift plan. Health care costs are estimated to increase by 5.5 percent in 1999 because of an expected increase in medical insurance costs. To minimize future increases in the cost of health care, the Banks are collectively seeking consolidated purchasing of employee and retiree benefits.

Nonpersonnel expenses account for 36 percent of Reserve Bank expenses and are projected to increase 1.6 percent in 1999.

Equipment expenses are expected to increase \$18.8 million, or 10.5 percent, and account for 9 percent of total expenses in 1999. In addition to 1999 purchases, the variance in equipment expense is driven primarily by an increase in depreciation (\$14.9 million)

and maintenance costs (\$4.2 million). The increase in depreciation results from the full-year effect of 1998 purchases of equipment for check imaging, voice mail, and PBX; local area network upgrades required for CDC compliance; and the effect of capital purchases planned for 1999. Increases in maintenance costs are primarily driven by local area networks (LANs), servers, and hardware equipment contracts.

Shipping expenses account for 4 percent of Reserve Bank expenses and are expected to increase \$1.0 million, or 1.2 percent, primarily because of higher rates for courier contracts and shipping.

Within the travel budget, expenditures on foreign travel are projected to be \$4.4 million in 1999 and account for 0.2 percent of total 1999 expenses. Foreign travel expenses budgeted for 1999 are \$0.5 million, or 13.2 percent, higher than 1998; the increase covers, in part, an anticipated rise in foreign examinations, the consolidation of System examinations, and a rise in targeted visitations at troubled institutions, where extra monitoring is required.

Building expenses, which account for 8.6 percent of total expenses, are expected to increase \$11.9 million, or 6.8 percent, in 1999. The increase is driven by higher real estate taxes, primarily in Cleveland, Minneapolis, and San Francisco; higher property depreciation associated with the completion of building improvements and renovations; and higher rental expenses resulting from several lease agreements.

Other nonpersonnel expenses are projected to decrease \$27.7 million, or 10.1 percent. Of the decrease, \$18.1 million is due to the Reserve Banks' implementation of the new accounting standards that require the capitalization of computer software developed or obtained for internal use.

## Capital Outlays

The 1999 capital budget submitted by the twelve Reserve Banks and FRIT totals \$405.6 million, a \$129.3 million increase over the 1998 estimated levels (table 3.13). The budget consists of \$366.9 million for the Banks and \$38.6 million for FRIT.

The 1999 capital budgets developed by the Reserve Banks and FRIT include funding for a number of projects that support the strategic direction outlined in the Banks' plans. These strategic directions include improving operational efficiency and effectiveness, promoting customer service, and providing a quality work environment. In support of these strategies, the 1999 budget identifies four major categories of capital outlay: building and facility improvements, automation-related initiatives, check and other payment service improvements, and building security enhancements.

The proposed capital budget includes \$182.8 million for building-related projects. These projects are geared toward renovation and modernization of physical facilities, replacement or upgrading of critical systems, energy conservation, and compliance with the Americans with Disability Act. More than 71 percent of the 1999 budget comprises six major projects: four in the New York District (improvements to 33 Maiden Lane, head office modernization, stone facade restoration, and tenant improvements at the East Rutherford Operations Center) and two in the Atlanta District (head office building and Birmingham Branch building). These six projects have a total estimated cost of \$377.2 million (\$76.3 million before 1999, \$130.3 million in 1999, and \$170.6 million in later years). Funding is also provided for the replacement of routine building-related equipment as well as replacements of furniture and fixtures.

Table 3.13

### Capital Outlays of the Federal Reserve Banks, by Class, 1997–99

Thousands of dollars except as noted

Class	1997 actual	1998 estimate	1999 budget	Percentage change	
				1997 to 1998	1998 to 1999
Data processing and data communications equipment <sup>1</sup> .....	70,714	111,952	140,167	58.3	25.2
Buildings .....	72,726	67,863	114,970	-6.7	69.4
Furniture, furnishings, and fixtures .....	23,299	23,364	29,562	.3	26.5
Other equipment <sup>2</sup> .....	30,337	23,414	24,140	-22.8	3.1
Land and other real estate .....	4,695	3,044	9,551	-35.2	213.8
Building machinery and equipment .....	16,528	24,183	22,279	46.3	-7.9
Leasehold improvements .....	1,889	8,166	15,985	332.3	95.8
Software <sup>3</sup> .....	5,548	14,301	48,902	157.8	241.9
<b>Total</b> .....	<b>225,736</b>	<b>276,287</b>	<b>405,556</b>	<b>22.4</b>	<b>46.8</b>
MEMO					
FRIT .....	21,356	34,722	38,641	62.6	11.3

1. For Federal Reserve Information Technology (FRIT), includes capital of \$18,848 thousand in 1997, \$32,291 thousand in 1998, and \$29,698 thousand in 1999.

2. For FRIT, includes \$28 thousand in 1997, \$20 thousand in 1998, and \$20 thousand in 1999.

3. For FRIT, includes \$2,481 thousand in 1997, \$2,412 thousand in 1998, and \$8,894 thousand in 1999.

The proposed capital budget includes \$122.3 million in funding for automation initiatives. Approximately \$18 million of this total is attributable to the capitalization of software. These initiatives do not include the automation components of building projects, check and payment services, or security projects that are discussed separately. The strategic directions outlined in the budgets of the individual Reserve Banks include enhanced technological capabilities, the continued implementation of LAN technology, the development of common office environments and web-based applications, and various improvements and replacements to ensure CDC compliance.

Aside from the \$38.6 million included for FRIT, the major automation-related projects are \$3.8 million for the Consolidated Process Encryption Center, \$2.7 million for the continued development of the Statistics and Reserves System, and \$2.6 million for the Foreign/Domestic Trading, Analysis, and Accounting System. The largest share of the remaining funds supports the Districts' strategies for distributed technology and PC replacement. A majority of the Banks are operating under a three-year replacement schedule and continue to push for the conversion of mainframe applications to a LAN environment and, to a lesser extent, to web-based solutions.

The 1999 capital budget includes \$75.5 million for initiatives to improve check operations and other payment services. Nearly every District is funding reader/sorter/endorser upgrades and high-speed imaging projects. In addition, several projects are aimed at improving savings bond operations in the consolidation sites, and others are for currency-related initiatives throughout the System.

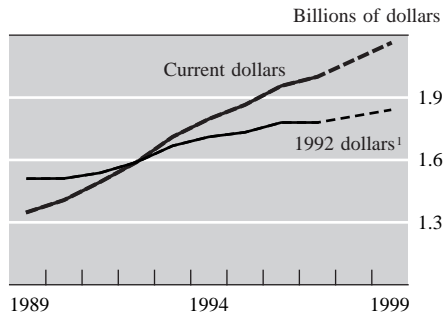
District-specific initiatives include the Unisys check support hosted by the Cleveland District, the continued development of an electronic check presentation environment in the Minneapolis District, and a number of Treasury-related projects in the Richmond District.

The last major category of capital expenditures included in the 1999 budget is for projects to improve security within the Reserve Banks. These projects include upgrades and replacements of building security features, including video surveillance systems, card readers and access systems, and fire alarms, for a total of \$11.9 million. Tables 10 and 11 in the statistical appendix provide additional data on capital expenditures.

### Trends in Expenses and Employment

Over the ten years ending with the 1999 budget, Reserve Bank expenses have increased an average of 4.8 percent per year (chart 3.1), and the average number of employees at the Reserve Banks (including FRAS) has decreased 426, from 23,697 in 1989 to 23,271 in 1999

Chart 3.1  
Operating Expenses of the Federal Reserve Banks, 1989-99



NOTE. See general note to table 3.7. For 1998, estimate; for 1999, budget.

1. Calculated with the GDP price deflator.

(chart 3.2). Since 1989, staff levels have decreased in the commercial check service (746 ANP), the overhead service (199 ANP), securities safekeeping and noncash services (183 ANP), the ACH and funds transfer services (317 ANP), services to the Treasury and other government agencies (377), and the monetary policy service (55 ANP). These staff reductions have been due largely to consolidation of operations and increased operational efficiencies throughout the System.

Partly offsetting the decreases are additions to the staff in supervision and regulation (730 ANP), needed mainly because of implementation of the Federal Deposit Insurance Corporation Improvement Act and the Community Reinvestment Act; in data services (494 ANP) because of an increase in LAN applications; and in public programs (130 ANP) because of efforts to enhance consumer education and communications with the public.

The average annual growth of operating expenses, which has slowed in recent years, is projected to be 3.7 percent over the five years ending with the 1999 budget. Mainly because of produc-

tion charges from FRIT, nonpersonnel costs have been increasing at a faster rate than personnel costs, 4.2 percent compared with 3.2 percent, as the Reserve Banks downsize labor-intensive and computer operations and substitute technology for labor.

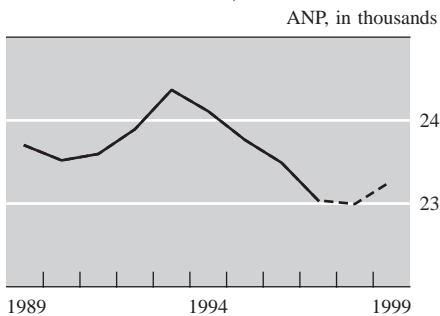
Over this five-year period, the average annual increases in expenses by service line have been the highest for monetary and economic policy (6.7 percent) and supervision and regulation (5.7 percent). Expenses in both functional areas have been affected by the 1999 change in the method for allocating protection costs and by increases from various support areas. Expenses in the supervision and regulation function have also been affected by the ongoing changes in the financial services industry and century date change issues. Expenses for services to financial institutions and the public grew 3.2 percent per year, primarily because of increases in currency and check volumes.

The average number of employees at the Reserve Banks decreased 975 ANP, from 23,627 ANP in 1994 to 22,652 ANP in 1999. Overall, decreases in employment are due largely to the consolidation of operations, the realization of operational efficiencies throughout the Reserve Banks, and reduced check volumes following the 1994 implementation of the same-day settlement rule under the Federal Reserve's Regulation CC.

Employment in services to Treasury and other government agencies has decreased primarily because of the continuing rollout of the electronic benefits transfer program and centralization efforts for savings bonds. In services to financial institutions and the public, employment has decreased because of efficiencies gained in check processing, reduced check volumes, more efficient currency processors, and centralization

Chart 3.2

Employment at the  
Federal Reserve Banks, 1989–99



NOTE. See general note to table 3.5. For 1998, estimate; for 1999, budget. See text note 2 for definition of ANP.

in funds and book-entry processing. The increase in the support service area is primarily due to additional staff needed to support ongoing information technology requirements.

**Volume and Unit Costs**

The volume of measured services in 1999 is budgeted to increase 3.9 percent over estimated 1998 volume, and the unit cost is expected to decrease 1.9 percent (table 3.14). The decrease in expected unit costs reflects net decreases for retail payments, wholesale payments, and cash services. A 0.6 percent decline in unit cost is anticipated in the commercial checks area, the largest component in the overall index.

*Table 3.14*  
Change in Volumes and Unit Costs of Measured Federal Reserve Bank Services, 1998 to 1999

Percent		
Service	Volume	Unit cost
Payments .....	3.7	-1.2
Commercial check .....	2.8	-6
Automated clearinghouse ....	10.0	-5.0
Cash <sup>1</sup> .....	5.8	-3.2
Fiscal .....	.8	.2
Wholesale payments .....	2.8	-4.5
Transfer of reserve account balances .....	5.8	-6.3
Book-entry securities .....	-3.0	-5
<b>All measured services .....</b>	<b>3.9</b>	<b>-1.9</b>

1. Currency, coin, and food coupon services.

**1998 Budget Performance**

The Reserve Banks estimate that 1998 expenses will be \$2,079.6 million, which represents an increase of \$24.9 million, or 1.2 percent, from the approved 1998 budget of \$2,054.7 million. The 1998 budgets, which were approved by the Board in December 1997, resulted in an increase of \$43.1 million or 2.1 percent over estimated 1997 expenses. At the 1998 estimated level of spending, the increase over the actual 1997 level would be 3.8 percent.

Nine Banks expect to exceed their approved 1998 budget, six of them by 1.0 percent or more. The three largest overruns are expected at Boston (2.0 percent), Atlanta (6.4 percent) and St. Louis (6.3 percent). Boston’s overall budget has increased because of higher-than-anticipated costs for the national government check image archive and because of Interdistrict Transportation System costs associated with check shipments; both are Systemwide expenses retained in Boston’s budget. Atlanta’s projected overrun is due primarily to staffing additions necessitated by increased check and cash volumes. In addition, the Atlanta District has worked aggressively to address issues arising from a 1997 staff “Vision” survey that found a need to staff functions appropriately, reduce overtime and turnover, and compensate in accordance with the market. The overrun at St. Louis is due primarily to check write-offs and increased overtime in the check area. ■

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*Part II*

*Special Analysis*

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## Chapter 4

# *The Federal Reserve's Response to the Year 2000 Problem*

The Year 2000 problem poses a major challenge to the financial system. In meeting that challenge, the Federal Reserve has committed itself to a rigorous program of industry testing and contingency planning. Financial institutions have made significant progress in renovating their systems; through its supervisory initiatives, the Federal Reserve is focusing on those institutions that most need further work on Year 2000 readiness.

The Federal Reserve is completing the work necessary to make its own mission-critical applications Year 2000 ready. To further reduce risk, the Federal Reserve will significantly limit any changes to its computer hardware and software and to related policy and operational areas during late 1999 and early 2000.

### **Efforts at the Federal Reserve**

For 1999 the Federal Reserve has committed \$45.8 million and 353 person-years to the Year 2000 problem, to be used for the continuation of internal testing and certification, customer testing, planning for business resumption and event management to minimize the effect of Year 2000 disruptions, and for outreach to the financial industry.

#### **Internal Testing and Certification**

As of year-end 1998, the Federal Reserve had renovated where necessary, tested, and certified as Year 2000 compliant virtually all of its mission-critical appli-

cations. Among the key applications already certified are Fedwire funds and securities transfer—the applications most critical to the nation's payment system; the automated clearinghouse (Fed ACH); and supporting accounting systems. In addition, as of year-end 1998, more than 50 percent of the Federal Reserve's noncritical applications have been certified as compliant.

The Federal Reserve must also address the readiness of its telecommunications network, called Fednet

and special-purpose computers at Reserve Banks. The Federal Reserve has independently tested approximately 79 percent of Fednet's hardware and software components and certified them as Year 2000 compliant. The Federal Reserve is conducting independent testing to verify the Year 2000 readiness of products from vendors of the remaining 21 percent of Fednet's components. The Federal Reserve conducted independent testing of the hardware and software at the data centers to certify the mainframe environment as Year 2000 compliant, and it is continuing to test product upgrades. The Federal Reserve continues to upgrade or replace special-purpose computers.

#### **Customer Testing**

As of June 29, 1998, the Federal Reserve began offering its customers the opportunity to test future-dated transactions for Fedwire funds and securities transfer, Fed ACH, the integrated



accounting system, Treasury tax and loan accounts, checks, and other services involving electronic data exchanges.

All Federal Reserve customers with electronic access to Fedwire funds transfer are required to test that service, and large-volume customers of other Federal Reserve services are strongly encouraged to test those services. As of the end of February 1999, more than 7,000 institutions, as well as the U.S. Treasury and other government agencies, had tested transactions with the Federal Reserve. In July and August 1998, the Federal Reserve and Treasury's Financial Management Service jointly tested social security payments, and such testing for international social security payments was begun in the first quarter of 1999. None of the tests has revealed significant problems.

The Federal Reserve will continue to schedule testing dates through year-end 1999. In the second half of 1999, testing schedules will include opportunities for the revalidation of application readiness and the testing of contingency procedures.

### Business Resumption Planning

The Federal Reserve continues to consider its own Year 2000 business resumption preparations to be among its highest priorities. A team of Federal Reserve senior managers from the technical and business areas oversees plans and efforts to support internal business resumption. The Federal Reserve's Year 2000 business resumption plans build on existing contingency plans that have proved successful through testing and actual experience. The new plans address three areas: (1) disruptions to the Federal Reserve's internal operations, (2) disruptions that reduce the ability of Federal Reserve customers to conduct business with the Federal

Reserve, and (3) problems that threaten to hamper the payment system or the safety and soundness of the financial services industry. In addition, the Federal Reserve and Treasury are working together to ensure that the Year 2000 contingency plans of each agency are aligned.

With regard to the private sector, the Federal Reserve recognizes and emphasizes that each financial institution is responsible for implementing sound Year 2000 contingency measures. Nonetheless, as part of its responsibilities in maintaining the integrity of the payment system, the Federal Reserve is reviewing options for assisting depository institutions to prepare and implement contingency measures. Steps taken thus far include providing opportunities for contingency testing, planning for adequate supplies of currency, and providing guidance to customers on the Federal Reserve's planning for Year 2000 operational contingencies. Throughout 1999 the Federal Reserve will continue to refine its business resumption plans in response to lessons learned through testing and changes in its internal and external environments.

### Year 2000 Event Management

The Federal Reserve is organizing the resources needed to address unforeseen problems during the most critical period of vulnerability, that is, the several days centered on the century rollover and the several days centered on February 29 (2000 is a leap year). The Federal Reserve has established a team to coordinate the planning of responses to defined but unexpected problems as well as to as-yet undefined problems that may arise during the critical period and to coordinate the documentation of actions taken during the date-change period.

## Change Management

The Federal Reserve has established guidelines to significantly limit changes to its internal policies and operations and to its hardware and software during late 1999 and early 2000. This "change management" approach addresses an important potential source of risk and complexity in managing the century date change. The imposition of limits on changes will provide a stable internal processing environment during the transition to the Year 2000 and will also minimize changes that Federal Reserve customers and other affected parties could be required to make to their own applications. The Federal Reserve is emphasizing to other organizations that typically generate policy and operational changes in the financial industry that requiring implementation of such changes during late 1999 and early 2000 may introduce significant Year 2000 risks.

## Outreach Initiatives

Federal Reserve officials speak frequently to banks, financial service bureaus, vendors, and other financial firms on the Year 2000 issue. During 1998 the Federal Reserve has sponsored or participated in more than 265 programs for more than 17,000 bankers and other attendees. In December 1998, the Federal Reserve sponsored an interactive videoconference with its depository institution customers to discuss its contingency planning for the Year 2000.

The Federal Reserve also provides forums, such as the March 1998 meetings on Year 2000 testing of wholesale payments, to direct industry attention to key aspects of Year 2000 preparedness. In addition, the Federal Reserve participates in numerous work groups addressing Year 2000 issues, such as those sponsored by the Securities Industry

Association, the New York Clearing House, and sector groups of the President's Council on Year 2000 Conversion. A Board official chairs the council's Financial Institutions Sector Group, a broad-based task force that has been instrumental in advancing the Year 2000 readiness of financial institutions.

The Federal Reserve has issued six bulletins, the latest in February 1999, to inform customers of its internal readiness activities and of the process and schedule for testing with the Federal Reserve. These bulletins, along with a public web site (<http://www.federalreserve.gov/y2k/>) and newsletter, have been the Federal Reserve's key means of communicating detailed Year 2000 information to its customers.

A major element of the Federal Reserve's outreach activities in 1999 will concern planning for responses to potential Year 2000 problems. The Federal Reserve will continue to inform the public of its Year 2000 plans and readiness activities throughout 1999.

## Supervisory Program and Results

The Year 2000 supervisory program of the member agencies of the Federal Financial Institutions Examination Council (FFIEC) has three phases.<sup>1</sup> The first phase, Awareness and Assessment, ended June 30, 1998. It focused on evaluating the ability of institutions to understand the myriad Year 2000 issues and their progress in identifying required changes to their computer programs; work in this phase also emphasized to institutions the importance of Year 2000 readiness

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1. The member agencies are the Board, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

among their service providers and software vendors.

The second phase, Renovation and Validation, began on July 1, 1998, and continued through March 31, 1999. During this phase, examiners assessed the progress of institutions toward making and testing the required changes identified in phase 1.

The third phase, Implementation, is under development for the period beginning April 1, 1999, and running into 2000. It will be devoted to assessing the adequacy of the institutions' final testing and contingency planning.

During 1998 the Reserve Banks assigned Year 2000 issues to about 225 examiners, who worked about 115 person-years to review the Year 2000 readiness of financial institutions. The volume of such work is expected to rise in 1999.

To assist institutions in their understanding of the various Year 2000 regulatory guidance statements and the Year 2000 review process, the FFIEC agencies have conducted hundreds of outreach programs throughout the country. These programs focused on supervisory expectations and also served to convey a consistent message from the regulatory agencies.

### **International Initiatives**

The Federal Reserve has continued its active role in international Year 2000

efforts through several venues: the Joint Year 2000 Council, chaired by Federal Reserve Board member Roger W. Ferguson, Jr.;<sup>2</sup> the Year 2000 task force of the Basle Committee on Banking Supervision; international conferences; and discussions with foreign bank supervisors.

Among the initiatives of the Joint Year 2000 Council have been the publication of bulletins and guidance papers and the hosting of regional meetings to raise the awareness of financial market regulators throughout the world of the risks posed by the Year 2000 problem.

The Federal Reserve met with representatives of foreign central banks to provide information on programs to prepare for the Year 2000. In addition, the Federal Reserve has briefed a number of foreign delegations on the Year 2000 strategies and programs it has employed, and it has made such information available to supervisory authorities throughout the world. ■

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2. The council consists of representatives from the Basle Committee on Banking Supervision, the Committee on Payment and Settlement Systems of the central banks of the Group of Ten, the International Association of Insurance Supervisors, and the International Organization of Securities Commissions. The Bank for International Settlements, in Basle, Switzerland, is the council's secretariat. The Group of Ten consists of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States.

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# *Appendixes*

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*Appendix A**Special Categories of System Expense*

Fees for priced services and the treatment of capital outlays are explained in this appendix. Also described are the Federal Reserve's expenses for currency printing.

**Priced Services**

The Monetary Control Act of 1980 requires the Federal Reserve to make available to all depository institutions, for a fee, certain services that the Federal Reserve had previously provided without explicit charge and only to member banks. As the act requires, the fees charged for providing these priced services are based on the cost of providing the services, including all direct and indirect costs, the interest on items credited before actual collection (float), and the private sector adjustment factor (PSAF). The PSAF takes into account the return on capital that would have been provided, and the taxes that would have been paid, had the services been furnished by a private business firm.

**Annual Pricing Process**

To meet the requirement for the full recovery of costs, the Federal Reserve has developed an annual pricing process involving a review of Reserve Bank expenses in addition to the review required by the System's budget processes. Use of the budgets is an integral part of the pricing exercise because most of the recoverable costs of priced services are direct and indirect costs as determined by the budgets. To assist depository institutions in their plan-

ning to provide or use correspondent banking services, the Federal Reserve usually sets each year's prices only once, in the fourth quarter of the preceding year.

Fees for Federal Reserve services must be approved by the product director for the respective service, by the Financial Services Policy Committee, and ultimately by the Board of Governors.<sup>1</sup> If fees for any service are set so that the full recovery of costs is not anticipated, the Board announces the rationale.

The cost of float is estimated by applying the current federal funds rate to the level of float expected to be generated in the coming year. Estimates of income taxes and the return on capital are based on tax and financing rates derived from a model of the fifty largest U.S. bank holding companies; these rates are applied to the assets the Federal Reserve expects to use in providing priced services in the coming year. The other components of the PSAF are derived from the budgets of the Reserve Banks and the Board: the imputed sales tax (based on budgeted outlays for materials, supplies, and capital assets); the imputed assessment for insurance by the Federal Deposit Insurance Corporation (FDIC) (based on expected

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1. The product directors are the first vice presidents at selected Reserve Banks with responsibility for day-to-day policy guidance over specific Systemwide priced services. The Financial Services Policy Committee comprises the presidents of three Reserve Banks, the first vice presidents of three other Reserve Banks, and, as liaison, the director of the Board's Division of Reserve Bank Operations and Payment Systems.

clearing balances and amounts deferred to depository institutions for items deposited for collection with the Reserve Banks); and the portion of the expenses of the Board of Governors that is directly related to the development of priced services.

The intent of the PSAF calculation is to require the Federal Reserve to include in the costs of its priced services the costs that would have been incurred had the services been provided by a private-sector firm.

Calculation of the PSAF for 1999

In 1998 the Board approved a 1999 private sector adjustment factor for Reserve Bank priced services of \$115.8 million, an increase of \$7.3 million, or 6.7 percent, from the PSAF of \$108.5 million targeted for 1998.

Asset Base

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

Table A.1

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

Millions of dollars

Item	1998	1999
<b>ASSETS</b>		
<i>Short-term assets</i>		
Imputed reserve requirement on clearing balances .....	750.4	757.7
Investment in marketable securities .....	6,753.5	6,819.6
Receivables <sup>1</sup> .....	69.0	69.1
Materials and supplies <sup>1</sup> .....	4.3	4.1
Prepaid expenses <sup>1</sup> .....	14.1	20.2
Items in process of collection .....	<u>2,922.8</u>	<u>3,470.7</u>
Total short-term assets .....	10,514.1	11,141.4
<i>Long-term assets</i>		
Premises <sup>1,2</sup> .....	360.4	386.6
Furniture and equipment <sup>1</sup> .....	145.2	150.3
Leasehold improvements and long-term prepayments <sup>1</sup> .....	23.3	21.1
Total long-term assets .....	<u>528.9</u>	<u>558.1</u>
<b>Total assets</b> .....	<b>11,043.0</b>	<b>11,699.5</b>
<b>LIABILITIES</b>		
<i>Short-term liabilities</i>		
Clearing balances and balances arising		
from early credit of uncollected items .....	7,503.9	7,577.3
Deferred-credit items .....	2,922.8	3,470.7
Short-term debt <sup>3</sup> .....	<u>87.4</u>	<u>93.4</u>
Total short-term liabilities .....	10,514.1	11,141.4
<i>Long-term liabilities</i>		
Long-term debt <sup>3</sup> .....	<u>185.1</u>	<u>207.6</u>
Total long-term liabilities .....	<u>185.1</u>	<u>207.6</u>
Total liabilities .....	10,699.2	11,349.0
Equity <sup>3</sup> .....	<u>343.8</u>	<u>350.5</u>
<b>Total liabilities and equity</b> .....	<b>11,043.0</b>	<b>11,699.5</b>

NOTE. Data are averages for the year.

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

2. Includes allocations of Board of Governors' assets

to priced services of \$0.5 million for 1998 and \$0.4 million for 1999.

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

1999 is estimated at \$11,699.5 million (table A.1). The value of assets assumed to be financed through debt and equity in 1999 is \$651.4 million, an increase of \$35.1 million, or 5.7 percent, from 1998

(table A.2); the increase results from a building project in one District, offset somewhat by a lower asset base associated with Federal Reserve Information Technology.

Table A.2

Derivation of the Private Sector Adjustment Factor (PSAF), 1998 and 1999

Millions of dollars except as noted

Item	1998	1999
<b>PSAF COMPONENTS</b>		
<i>Assets to be financed</i> <sup>1</sup>		
Short-term .....	87.4	93.4
Long-term <sup>2</sup> .....	528.9	558.1
Total .....	616.3	651.4
<i>Cost of capital (percent)</i> <sup>3</sup>		
Short-term debt .....	5.1	5.1
Long-term debt .....	6.8	6.6
Pretax return on equity <sup>4</sup> .....	22.4	23.5
Weighted average long-term cost of capital .....	16.9	17.2
<i>Capital structure (percent)</i>		
Short-term debt .....	14.2	14.3
Long-term debt .....	30.0	31.9
Equity .....	55.8	53.8
Tax rate (percent) .....	32.1	32.0
<b>REQUIRED PSAF RECOVERIES</b>		
<i>Capital costs</i> <sup>5</sup>		
Short-term debt .....	4.5	4.8
Long-term debt .....	12.5	13.7
Equity .....	77.0	82.4
Total .....	94.0	100.8
<i>Other costs</i>		
Sales taxes .....	9.1	8.7
Assessment for federal deposit insurance .....	2.6	2.8
Expenses of Board of Governors .....	2.8	3.4
Total .....	14.5	14.9
<b>Total PSAF recoveries</b>		
<b>Millions of dollars</b> .....	<b>108.5</b>	<b>115.8</b>
<b>As a percentage of capital</b> .....	<b>17.6</b>	<b>17.8</b>
<b>As a percentage of expenses</b> <sup>6</sup> .....	<b>18.1</b>	<b>18.2</b>

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

2. Consists of total priced long-term assets, including the priced portion of Federal Reserve Information Technology assets.

3. All short-term assets are assumed to be financed with short-term debt. Of the total 1998 long-term assets, 35 percent are assumed to be financed with long-term debt and 65 percent with equity; for 1999, the proportions are 37.2 percent with long-term debt and 62.8 percent with equity. The data are average rates paid by the fifty largest (by asset size) bank holding companies.

4. The pretax rate of return on equity is based on average after-tax rates of return on equity, adjusted by the effective tax rate to yield the pretax rate of return on equity for each bank holding company for each year. These data are then averaged over the five years 1993-97 to yield the pretax return on equity for use in the PSAF.

5. The calculations underlying these data use the dollar value of assets to be financed, divided as described in note 3, and the rates for the cost of capital.

6. Systemwide expenses for priced services, less shipping, were budgeted at \$598.1 million for 1998 and \$636.9 million for 1999.

### *Cost of Capital, Taxes, and Other Imputed Costs*

For 1999, a pretax rate of return on equity of 23.5 percent, or \$82.4 million, is planned. Other required PSAF recoveries for 1999—imputed sales taxes, the imputed FDIC insurance assessment, and Board expenses—total \$14.9 million (table A.2).

### **Capital Outlays**

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

The Banks capitalize and depreciate all assets that cost \$1,500 or more; they may either capitalize or expense assets costing less. The capitalization guideline for the Board is \$5,000.

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

### **Currency Printing and Circulation**

The Department of the Treasury's Bureau of Engraving and Printing (BEP) prints U.S. currency; the Federal Reserve

*Table A.3*

Currency in Circulation, New Notes Issued, and Notes Destroyed, 1998

Millions of pieces

Dollar denomination	Notes in circulation <sup>1</sup>	New notes issued <sup>2</sup>	Notes destroyed
1 .....	6,785	3,899	3,550
2 .....	579	22	5
5 .....	1,569	821	789
10 .....	1,379	731	687
20 .....	4,415	1,787	1,580
50 .....	982	377	301
100 .....	3,147	649	338
<b>Total .....</b>	<b>18,856</b>	<b>8,285</b>	<b>7,251</b>

1. As of November 1998.

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

Banks put it into circulation through depository institutions and destroy it as it wears out (table A.3). Under authority delegated by the Board, the Director of the Division of Reserve Bank Operations and Payment Systems submits an order for new currency to the BEP each July. Upon reviewing the order, the BEP establishes a billing rate for new currency, which the Board's staff uses to prepare the annual budget for new currency. Once the Board establishes the currency budget, it assesses the Federal Reserve Banks through an accounting procedure similar to that used in assessing the Banks for the Board's operating expenses.

Estimated currency expenditures for 1998 total \$409.1 million, which is \$38.7 million, or 10.5 percent, greater than the budgeted amount (table A.4). Note production for the fourth quarter of 1998 was increased by 665 million notes for Year 2000 contingency purposes. The 1999 budget for new currency is \$500.15 million, or 22.3 percent more than 1998 estimated expenditures (chart A.1).



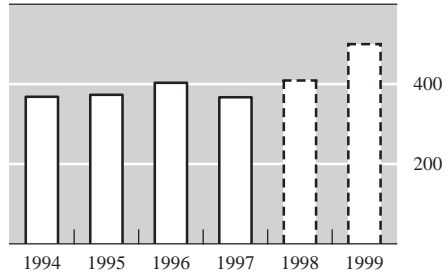
Printing of Federal Reserve Notes

The budget for printing the 11.1 billion new notes set for 1999 is \$485.4 million, or 97 percent of the total 1999 currency budget. For January through September, the calendar 1999 portion of the federal government's fiscal year 1999, production is set at 8.7 billion notes. The Board's staff estimates that provisions for an additional supply cushion for the century date change will mean that, for October through December 1999, production could be 2.4 billion notes, which is 20 percent more than is typical for those months. The 1999 budget for note production is based on the projected destruction of 8 billion notes received from circulation, an estimated 1 billion increase in the number of notes in circulation, and an increase of 2 billion notes in Reserve Bank inventories. Much of the rise in inventories is to cover potential Year 2000 demand (chart A.2).

The BEP charges the Board separately for each of the three types of currency produced, new-design, threaded, and unthreaded (table A.5 and chart A.3).

Chart A.1

Federal Reserve Budget for Supplying U.S. Currency, 1994-99  
Millions of dollars



NOTE. For 1998 estimate; for 1999, budget.

The average price charged to the Board by the BEP for producing all three types of notes will increase 8.6 percent in 1999, from \$40.26 per thousand notes printed to \$43.73. During 1999, 50 percent of the notes produced will be the new-design Series 1996 (\$20s, \$50s, and \$100s), 14 percent will be other threaded currency (\$5s and \$10s), and the remaining 36 percent will have no thread (\$1s).

The billing rate for each type blends the costs of producing the notes at

Table A.4

Federal Reserve Costs of Supplying Currency, 1998 and 1999

Thousands of dollars except as noted

Item	1998 estimate	1999 budget	Percentage change
Printing of new Federal Reserve notes .....	397,000	485,390	22.3
Shipment of new notes .....	7,300	8,500	16.4
Shipment of fit notes within the System .....	2,000	3,000	50.0
Counterfeit deterrence research .....	...	525	...
Extended custodial inventory program <sup>1</sup> .....	150	0	-100.0
Return of currency pallets to Bureau of Engraving and Printing <sup>2</sup> .....	30	30	0.0
Reimbursement to the U.S. Treasury .....	2,600	2,700	3.8
<b>Total cost of currency .....</b>	<b>409,080</b>	<b>500,145</b>	<b>22.3</b>

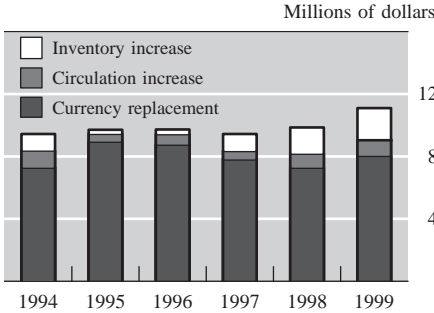
1. Funding for this program has now been assumed by the Federal Reserve Bank of New York, which has budgeted \$260,000 for it in 1999.

... Not applicable.

2. Aluminum pallets, on which the BEP stores and ships currency to Reserve Bank offices, facilitate efficient handling and storage of the notes. The pallets remain at the Reserve Bank offices until the currency is paid into circulation.

Chart A.2

Use of Currency Printed, 1994–99



NOTE. For 1998, estimates; for 1999, projections.

the Washington, D.C., and Fort Worth, Texas, facilities of the BEP (chart A.3). The Washington facility will print all the new-design \$100 and \$50 notes during 1999, and both facilities will produce the \$1, \$5, \$10, and \$20 denominations.

### Shipment of Currency

The 1999 budget for currency transportation is \$8.5 million, or 16.4 percent more than 1998 estimated expenditures. The increase in the cost of shipping notes from the BEP’s facilities is due to the 12.5 percent increase in volume of notes shipped plus an estimated 3 percent increase both in the cost of airline freight and in the base price of the armored carriers.

Using competitive bidding, the Board contracts with armored carriers to

transport new currency from the Washington and Fort Worth printing facilities to the Federal Reserve Banks and Branches; much of the transport is by air. Intra-System shipments of currency are budgeted at \$3.0 million for 1999, 50 percent more than 1998 estimated expenditures. Traditionally, intra-System shipments are used to move currency from offices with excess fit currency, primarily \$100 notes at New York and Los Angeles, to offices that otherwise would require new currency from the BEP.

The additional currency ordered for the period around the century date change will likely exceed the vault capacity of several Reserve Bank offices, and the BEP cannot store new currency for the full length of the expected contingency period. Therefore, the System will warehouse the additional new currency at Bank offices with excess storage capacity and redistribute it later; the redistribution will increase the transportation cost for intra-System shipments in 1999.

In addition, the BEP and some Reserve Bank offices are holding inventories of the new-design \$50s that contain notes whose quality is unacceptable for circulation. The System will ship these inventories of \$50s to the Baltimore Branch, where the defective notes will be destroyed; the System will ship the acceptable \$50 notes from

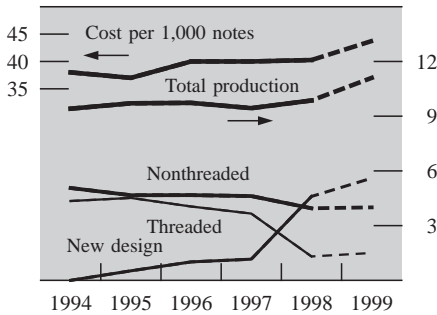
Table A.5

Projected Cost of Printing New Notes, by Type of Note, 1999

Type of currency	Number of notes (millions)	Percentage of total notes	Cost per thousand notes (dollars)	Total cost (thousands of dollars)
New design (\$20s, \$50s, \$100s).....	5,600	50	56.65	317,240
Threaded (\$5s, \$10s) .....	1,500	14	36.10	54,150
Nonthreaded (\$1s) .....	4,000	36	28.50	114,000
<b>Total</b> .....	<b>11,100</b>	<b>100</b>	<b>43.73</b>	<b>485,390</b>

Chart A.3

Production of Currency, by Type, and Unit Cost of Total Production, 1994–99  
Dollars Billions of notes



NOTE. Left scale is cost; right scale is production volume. Total production is the sum of nonthreaded, threaded, and new design. For 1998, estimates; for 1999, projections.

Baltimore to other Reserve Bank offices for future distribution.

### Counterfeit Deterrence Research

Through the SSG-2 (Special Studies Group, second incarnation), which operates under the direction of the Group of Ten central banks, the Federal Reserve works on the deterrence of counterfeiting in cooperation with the issuing authorities and banknote printers of twenty-three other nations. Under its mandate from the G-10 central banks, SSG-2 is focusing its 1999 research on counteracting the counterfeiting threat posed by inexpensive scanners, computers, and printers. The 1999 currency budget includes \$525 thousand for such research.

### Extended Custodial Inventory Program

Since 1996 the Board has included the cost of the extended custodial inventory (ECI) program in the new currency budget. The ECI program was established to provide an efficient means of introducing the new-design \$100 notes to the international banknote market; since then, the program's purpose has shifted to developing ways to enhance the international system for distributing banknotes. To further that end, expenses of the program are now being covered within the budget of the Federal Reserve Bank of New York, which manages the program and is expanding it. The Bank has provided \$260,000 for the 1999 ECI program, or about 75 percent more than the \$150,000 budgeted in 1998.

### Treasury's Office of Currency Standards

The Board reimburses the Department of the Treasury for the operation of the department's Office of Currency Standards. The 1999 currency budget contains \$2.7 million, or 3.8 percent more than 1998 estimated costs, for such reimbursement. The Office of Currency Standards prescribes procedures to the Federal Reserve Banks for canceling, destroying, and accounting for unfit currency. As a public service, the BEP processes claims for the redemption of damaged or mutilated currency that is turned over to the Reserve Banks. ■

## Appendix B

### Sources and Uses of Funds

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

The System derives its income primarily from earnings on U.S. government securities that the Federal Reserve has acquired through open market operations, one of the tools of monetary policy. These earnings account for approximately 95 percent of current income (table B.1).

The current expenses of the Reserve Banks consist of their operating expenses and the costs of the earnings credits granted to depository institutions on clearing balances held with the Reserve Banks (table B.2). The Reserve Banks record extraordinary adjustments to current net income in a profit and loss account. The primary entries in the account are for gains or losses on the sale of U.S. government securities and for gains or losses on assets denominated in foreign currencies that result either

from the sale of those assets or from their revaluation at market exchange rates.

The Reserve Banks maintain a surplus account to absorb unexpected losses, much as commercial establishments retain earnings. The Board of Governors requires that the surplus account at year-end be an amount equal to the capital paid in by the member banks. Since the end of 1964, the Board's policy has been to transfer to the U.S. Treasury all net income after paying the statutory dividend to member banks and the amount necessary to equate surplus to paid-in capital. The amount transferred is classified as interest on Federal Reserve notes. Such payments were \$20.7 billion for 1997 and are estimated to be \$26.5 billion for 1998. In addition to these payments, a special transfer of surplus of \$107 million on October 1, 1997, was statutorily required. ■

Table B.1

Income of the Federal Reserve System,  
1997 and 1998

Millions of dollars

Source	1997 actual	1998 estimate
Loans .....	14.6	8.6
U.S. government securities ...	25,699.0	26,842.4
Foreign currencies .....	375.4	434.0
Priced services .....	789.1	817.1
Other .....	39.2	45.1
<b>Total .....</b>	<b>26,917.2</b>	<b>28,147.2</b>

Table B.2

## Distribution of the Income of the Federal Reserve Banks, 1997 and 1998

Millions of dollars

Item	1997 actual	1998 estimate
Current income <sup>1</sup> .....	26,917	28,147
LESS		
<i>Current expenses of Reserve Banks</i> <sup>2</sup>		
Operating expenses .....	1,618	1,497
Cost of earnings credits .....	359	348
EQUALS		
Current net income .....	24,941	26,303
PLUS		
Net additions to, or deductions from (-), current net income <sup>3</sup> .....	-2,577	1,915
LESS		
Cost of unreimbursed Treasury services <sup>4</sup> .....	35	8
<i>Assessments by the Board</i>		
Board expenses .....	174	178
Cost of currency .....	364	409
<i>Other distributions</i>		
Dividends paid to member banks <sup>5</sup> .....	300	343
Transfers to, or from (-), surplus <sup>6,7</sup> .....	832	732
EQUALS		
<b>Payment to U.S. Treasury</b> <sup>7</sup> .....	<b>20,659</b>	<b>26,549</b>

1. See table B.1.

2. Net of reimbursements due from the U.S. Treasury and other government agencies. Also reflects reductions in credits for net periodic pension cost amounting to \$200.1 million in 1997 and \$288.4 million in 1998.

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

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

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

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

7. Does not reflect the special transfer of surplus from the Federal Reserve System to the Treasury of \$107 million on October 1, 1997.

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## *Appendix C*

### *Federal Reserve System Audits*

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

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

#### **Independent Audit**

The Board of Governors contracts with an external audit firm, currently PricewaterhouseCoopers L.L.P., for an annual financial audit of the combined Reserve Bank financial statements and the financial statements of each of the twelve Reserve Banks. The Reserve Banks are also audited by each Bank's internal audit function and by the Board's financial examiners.

#### **General Accounting Office**

The 1978 passage of the Federal Banking Agency Audit Act (Public Law 95-320) brought most of the operations of the Federal Reserve System under the purview of the General Accounting Office (GAO). The GAO, which currently has 15 projects in various stages of completion, since 1979 has completed 169 reports on selected aspects of Federal Reserve operations (tables C.1 and C.2). The GAO has also involved the Federal Reserve in about 94 other reviews not directly related to the System and has terminated 54 others before completion. The reports are available directly from the GAO.

*Table C.1*

## Active GAO Projects Relating to the Federal Reserve

Subject	Date initiated
On-line banking effect .....	8-28-97
SBA section 7(a) loans .....	11-19-97
Regulatory discretion .....	4-20-98
1998 consolidated financial statements .....	4-21-98
Bank mergers and fair lending .....	6-9-98
Risk based supervision .....	7-27-98
On-line banking phase II .....	8-4-98
Emerging markets .....	8-24-98
FR Systems' Year 2000 computer efforts .....	9-1-98
Year 2000 risks of international activities .....	9-17-98
Social security reform .....	9-21-98
Long-Term Capital Management .....	10-15-98
Effects of megabank mergers .....	10-30-98
Financial operations of the International Monetary Fund .....	11-25-98
Surveys of small businesses .....	12-10-98

*Table C.2*

## Completed GAO Reports Relating to the Federal Reserve System

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

Table C.2  
Continued

Report	Number	Date issued
Financial Institution Regulatory Agencies Should Perform Internal Audit Reviews of their Examination and Supervision Activities .....	GGD-82-5	10-19-81
Information on Selected Aspects of Federal Reserve System Expenditures .	GGD-82-33	2-12-82
Federal Review of Intrastate Branching Can Be Reduced .....	GGD-82-31	2-24-82
Despite Improvements, Recent Bank Supervision Could Be More Effective and Less Burdensome .....	GGD-82-21	2-26-82
Issues to Be Considered while Debating Interstate Bank Branching .....	GGD-82-36	4-9-82
The Federal Reserve Should Move Faster to Eliminate Subsidy of Check-Clearing Operations .....	GGD-82-22	5-7-82
Information about Depository Institutions' Ancillary Activities Is Not Adequate for Policy Purposes .....	GGD-82-57	6-1-82
Bank Merger Process Should Be Modernized and Simplified .....	GGD-82-53	8-16-82
An Analysis of Fiscal and Monetary Policies .....	PAD-82-45	8-31-82
Bank Examination for Country Risk and International Lending .....	ID-82-52	9-2-82
Credit Insurance Disclosure Provisions of the Truth-in-Lending Act Consistently Enforced Except When Decisions Appealed .....	GGD-83-3	10-25-82
Survey of Investor Protection and the Regulation of Financial Intermediaries .....	GGD-83-30	7-13-83
Financial Institutions Regulatory Agencies Can Make Better Use of Consumer Complaint Information .....	GGD-83-13	8-25-83
Expediting Tax Deposits Can Increase the Government's Interest Earnings .....	GGD-84-14	11-21-83
Unauthorized Disclosure of the Federal Reserve's Monetary Policy Decision .....	GGD-84-40	2-3-84
Federal Financial Institutions Examination Council Has Made Limited Progress toward Accomplishing Its Mission .....	GGD-84-4	2-3-84
Control Improvements Needed in Accounting for Treasury Securities at the Federal Reserve Bank of New York .....	AFMD-84-10	5-2-84
Statutory Requirements for Examining International Banking Institutions Need Attention .....	GGD-84-39	7-11-84
Supervisory Examinations of International Banking Facilities Need to Be Improved .....	GGD-84-65	9-30-84
An Examination of Concerns Expressed about the Federal Reserve's Pricing of Check-Clearing Activities .....	GGD-85-9A	1-14-85
Difficulties in Evaluating the Effectiveness of the Community Reinvestment Act .....	OCE-86-1	11-4-85
International Coordination of Bank Supervision: The Record to Date ...	NSIAD-86-40	2-6-86
Implementation of the Export Trading Company Act of 1982 .....	NSIAD-86-42	2-27-86
Information on Independent Public Accountant Audits of Financial Institutions .....	GGD-84-44FS	4-21-86
An Analysis of Two Types of Pooled Investment Funds .....	GGD-86-63	5-12-86
How the Markets Are Developed and How They Are Regulated .....	GGD-86-26	5-15-86
U.S. Banking Supervision and International Supervisory Principles .....	NSIAD-86-93	7-25-86
Financial Institution Regulators' Compliance Examination .....	GGD-86-94	8-1-86
The Market's Structure, Risks, and Regulation .....	GGD-86-80BR	8-20-86
Dealer Views on Market Operations and Federal Reserve Securities Transfer System .....	GGD-86-147FS	9-29-86
Questions about the Federal Reserve's Securities Transfer System .....	GGD-87-15BR	10-20-86
Federal Reserve Board Opposition to Credit Card Interest Rate Limits .	GGD-87-38BR	4-7-87
Insulating Banks from the Potential Risk of Expanded Activities .....	GGD-87-35	4-14-87
The Federal Reserve Response Regarding Its Market-Making Standard .	GGD-87-55FS	4-21-87
Change in Fees and Deposit Account Interest Rates since Deregulation .	GGD-87-70	7-13-87
An Examination of Views Expressed about Access to Brokers' Services .	GGD-88-8	12-18-87



Table C.2

## Completed GAO Reports Relating to the Federal Reserve System—Continued

Report	Number	Date issued
Issues Related to Repeal of the Glass-Steagall Act .....	GGD-88-37	1-22-88
Preliminary Observations on the October 1987 Crash .....	GGD-88-38	1-26-88
Supervision of Overseas Lending Is Inadequate .....	NSIAD-88-87	5-5-88
Competitive Concerns of Foreign Financial Firms in Japan, the United Kingdom and the United States .....	NSIAD-88-171	6-2-88
Administrative Expenses at FHLBB and FRB for 1985 and 1986 .....	AFMD-88-33	6-15-88
Government in the Sunshine Act Compliance at Selected Agencies .....	GGD-88-97	7-20-88
Trends in Commercial Bank Performance, December 1976–June 1987 ..	GGD-88-106BR	7-28-88
U.S. Commercial Banks' Securities Activities in London .....	NSIAD-88-238	9-8-88
Lending to Troubled Sectors .....	GGD-88-126BR	9-26-88
Government Check-Cashing Issues .....	GGD-89-12	10-7-88
Conflict of Interest: Abuses in Commercial Banking Institutions .....	GGD-89-35	1-27-89
Competitive Fairness Is an Elusive Goal .....	GGD-89-61	5-12-89
Independent Audits Needed to Strengthen Internal Control and Bank Management .....	AFMD-89-25	5-31-89
Information on the System's Check Collection Service .....	GGD-90-17	12-15-89
Oversight of Critical Banking Systems Should Be Strengthened .....	IMTEC-90-14	1-14-90
Activities of Securities of Bank Holding Companies .....	GGD-90-48	3-14-90
The Stock, Options, and Futures Markets Are Still at Risk .....	GGD-90-33	4-11-90
Update on U.S. Commercial Banks' Securities in London .....	NSIAD-90-98	5-7-90
U.S. Financial Services' Competitiveness under the Single Market Program .....	NSIAD-90-99	5-21-90
Limited Public Demand for New Dollar Coin or Elimination of Pennies .	GGD-90-88	5-23-90
Oversight of Automation Used to Clear and Settle Trades Is Uneven ...	IMTEC-90-47	7-12-90
The Government's Exposure to Risks .....	GGD-90-97	8-15-90
Office of Inspector General Operations at Financial Regulatory Agencies .	AFMD-90-55FS	8-24-90
Additional Reserves and Reform Needed to Strengthen the Fund .....	AFMD-90-100	9-11-90
More Transaction Information and Investor Protection Measures Are Needed .....	GGD-90-114	9-14-90
Issues Relating to Banks Selling Insurance .....	GGD-90-113	9-25-90
Implementation of Risk-Based Capital Adequacy Standards .....	NSIAD-91-80	1-25-91
Overview of Six Foreign Systems .....	NSIAD-91-104	2-22-91
Deposit Insurance: A Strategy for Reform .....	GGD-92-26	3-4-91
Bank Supervision: Prompt and Forceful Regulatory Actions Needed ....	GGD-91-69	4-15-91
Many Federal Agencies Collect and Disseminate Information .....	NSIAD-91-173	5-1-91
Money Laundering: The U.S. Government Is Responding to the Problem .	NSIAD-91-130	5-16-91
A Framework for Limiting the Government's Exposure to Risks .....	GGD-91-90	5-22-91
Treasury Tax and Loan Activity at Two Troubled Banks .....	AFMD-91-87	9-12-91
OCC's Supervision of the Bank of New England Was Not Timely or Forceful .....	GGD-91-128	9-16-91
Bank Holding Company Securities Subsidiaries' Market Activities Update .....	GGD-91-131	9-20-91
Time Limits on Holding Deposits Generally Met but More Oversight Needed .....	GGD-91-132	9-30-91
Legislation Needed to Strengthen Bank Oversight .....	AFMD-92-19	10-21-91
Contracting Practices with Data Processing Servicers .....	GGD-92-19	2-5-92
Challenges to Harmonizing International Capital Standards Remain ....	GGD-92-41	3-10-92
Assessing the Need to Regulate Additional Financial Activities .....	GGD-92-70	4-21-92
Call Report Automation .....	IMTEC-92-60R	5-28-92
Flexible Accounting Rules Lead to Inflated Financial Reports .....	AFMD-92-52	6-1-92
Cross-Border Information Sharing Is Improving, but Obstacles Remain .	GGD-92-110	7-28-92
Changes in Collateral Practices Could Reduce the Federal Government's Risk of Loss .....	AFMD-92-54	9-14-92
Initial Assessment of Certain BCCI Activities in the U.S. ....	GGD-92-96	9-30-92
Appraisal Reform: Implementation Status and Unresolved Issues .....	GGD-93-19	10-30-92

Table C.2  
Continued

Report	Number	Date issued
Bank and Thrift Criminal Fraud: The Federal Commitment Could Be Broadened .....	GGD-93-48	1-8-93
FRB Examinations and Inspections Do Not Fully Assess Bank Safety and Soundness .....	AFMD-93-13	2-16-93
Improvements Needed in Examination Quality and Regulatory Structure Personnel Engaged in Public and Congressional Affairs in Federal Agencies .....	AFMD-93-15	2-16-93
Credit Availability Guidance .....	GGD-93-71FS	3-8-93
Treasury Automation: Automated Auction May Not Achieve Benefits or Operate Properly .....	GGD-93-15R	3-30-93
IRS Can Improve the Federal Tax Deposit System .....	IMTEC-93-28	4-27-93
Funding Foreign Bank Examinations .....	AFMD-93-40	4-28-93
Preliminary Information Related to a Futures Transaction Fee .....	GGD-93-35R	5-4-93
The Business Environment in the United States, Japan, and Germany .....	GGD-93-108	5-17-93
Regulatory Impediments to Small Business Lending Should Be Removed .....	GGD-93-124	8-9-93
Recent Developments in Foreign Exchange Markets .....	GGD-93-121	9-7-93
Benefits and Risks of Removing Regulatory Restrictions .....	GGD-93-154	9-24-93
Regulatory Burden: Recent Studies, Industry Issues, and Agency Initiatives .....	GGD-94-26	11-2-93
Strengthening the Framework for Supervising International Banks .....	GGD-94-28	12-13-93
Insider Problems and Violations Indicate Broader Management Deficiencies .....	GGD-94-68	3-21-94
U.S. Credit Card Industry: Competitive Developments Need to be Closely Monitored .....	GGD-94-88	3-30-94
Better Guidance Is Needed for Real Estate Evaluations .....	GGD-94-23	4-28-94
Treasury Securities Auction .....	GGD-94-144	5-24-94
Divergent Loan Loss Methods Undermine Usefulness of Financial Reports .....	AIMD-94-165R	8-25-94
Interstate Banking: Experiences in Three Western States .....	AIMD-95-8	10-31-94
Lessons Learned from Resolving First City Bancorporation of Texas ...	GGD-95-35	12-30-94
Investment of Trust Assets in Bank Proprietary Mutual Funds .....	GGD-95-37	3-15-95
Status Report on the Initiative to Improve Economic Statistics .....	GGD-95-21	3-16-95
Mandated Studies to Review Costly Bank and Thrift Failures .....	GGD-95-98	7-7-95
Differences in Screening Bank Executives .....	GGD-95-126	7-31-95
Banks' Securities Activities: Oversight Differs Depending on Activity and Regulator .....	GGD-95-181R	8-17-95
Mutual Funds: Impact on Bank Deposits and Credit Availability .....	GGD-95-214	9-21-95
Bank Mutual Funds: Sales Practices and Regulatory Issues .....	GGD-95-230	9-22-95
Challenges Remain to Successfully Implement CRA .....	GGD-95-210	9-27-95
Foreign Banks: Assessing Their Role in the U.S. Banking System .....	GGD-96-23	11-28-95
Federal Reserve Banks: Internal Control, Accounting, and Auditing Issues .....	GGD-96-26	2-7-96
Mexico's Financial Crisis: Origins, Awareness, Assistance, and Initial Efforts to Recover .....	AIMD-96-5	2-9-96
Counterfeit U.S. Currency Abroad: Issues and U.S. Deterrence Efforts ..	GGD-96-56	2-23-96
Money Laundering: A Framework for Understanding U.S. Efforts Overseas .....	GGD-96-11	2-26-96
Federal Reserve System: Current and Future Challenges Require Systemwide Attention .....	GGD-96-105	5-24-96
Fair Lending: Federal Oversight and Enforcement Improved but Some Challenges Remain .....	GGD-96-128	6-17-96
Federal Reserve Banks: Inaccurate Reporting of Currency at the Los Angeles Branch .....	GGD-96-145	8-13-96
	AIMD-96-146	9-30-96

Table C.2  
Completed GAO Reports Relating to the Federal Reserve System—Continued

Report	Number	Date issued
Implementation of the Foreign Bank Supervision Enhancement Act of 1991	GGD-96-187	9-30-96
Financial Derivatives: Actions Taken or Proposed since May 1994	GGD-AIMD-97-8	11-1-96
Inspectors General: Mandated Studies to Review Costly Bank and Thrift Failures	GGD-97-4	11-7-96
Regulatory Burden: Measurement Challenges and Concerns Raised by Selected Companies	GGD-97-2	11-18-96
Bank Oversight Structure: U.S. and Foreign Experience May Offer Lessons for Modernizing U.S. Structure	GGD-97-23	11-20-96
Implementation of FDICIA's Prompt Regulatory Action Provisions	GGD-97-18	11-21-96
Bank Regulatory Structure: Japan	GGD-97-5	12-27-96
Bank Data: Material Loss of Oversight Information from Interstate Banking Is Unlikely	GGD-97-49	3-26-97
The Commodity Exchange Act: Legal and Regulatory Issues Remain	GGD-97-50	4-7-97
Treasury's Plan to Study Genuine and Counterfeit U.S. Currency Abroad	NSIAD-97-104	4-11-97
Bank Oversight: Few Cases of Tying Have Been Detected	GGD-97-58	5-8-97
Foreign Banks: Opportunities Exist to Enhance Supervision Programs as Implementation Proceeds	GGD-97-80	5-9-97
Four Financial Crises in the 1980s	GGD-97-96	5-21-97
Payments, Clearance, and Settlement: A Guide to the Systems, Risks, and Issues	GGD-97-73	6-20-97
International Financial Crises: Efforts to Anticipate, Avoid, and Resolve Sovereign Crises	GGD-NSIAD-97-168	7-7-97
Federal Reserve Banks: Internal Controls Over Cash at Atlanta, Los Angeles, and Philadelphia Banks	AIMD-97-127	8-28-97
Foreign Banks: Internal Control and Audit Weaknesses in U.S. Branches	GGD-97-181	9-29-97
OTC Derivatives: Additional Oversight Could Reduce Costly Sales Practice Disputes	GGD-98-5	10-2-97
Information on Private Banking and Its Vulnerability to Money Laundering	GGD-98-19R	10-30-97
Electronic Banking: Experiences Reported by Banks in Implementing On-line Banking	GGD-98-34	1-15-98
Regulatory Oversight of Offshore Private Banking Activities	GGD-98-154	6-29-98
Year 2000 Computing Crisis: Actions Needed on Electronic Data Exchanges	AIMD-98-124	7-1-98
Experience With Electronic Check Presentment	GGD-98-145	7-14-98
Risk-Based Capital: Regulatory and Industry Approaches to Capital and Risk	GGD-98-153	7-20-98
High-Loan-To-Value Lending: Information on Loans Exceeding Home Value	GGD-98-169	8-13-98
Live Loan Checks: Information on Unsolicited Consumer Loans for Preapproved Borrowers	GGD-98-176	8-14-98
Year 2000 Computing Crisis: Federal Reserve Is Acting to Ensure Financial Institutions Are Fixing Systems But Challenges Remain	AIMD-98-248	9-17-98
Federal Reserve Banks: Areas for Improvements in Computer Controls	AIMD-99-5	10-14-98
The Results Act: Observations on the Federal Reserve's 1998-99 Biennial Performance Plan	GGD-99-9R	11-9-98

**Office of Inspector General**

The Board's Office of Inspector General functions in accordance with the Inspector General Act of 1978, as amended. The OIG plans and conducts audits and

investigations of the programs and operations of the Board and its delegated functions at the Federal Reserve Banks. The OIG also reviews existing and proposed legislation and regulations for economy and efficiency. It recom-

Table C.3

## Completed OIG Reports Relating to the Federal Reserve System, 1998

Report	Number	Month issued
Audit of the Federal Reserve System's Application Commitment Processing ..	A9710	January
Audit Scoping Review of the FFIEC's Operations .....	A9802	February
Audit of the Board's Compliance with the Service Pricing Provisions of the Monetary Control Act .....	A9703	March
Audit of the Division of Reserve Bank Operations and Payments Systems' Distributed Processing Environment .....	A9707	March
Audit of the Federal Reserve's Implementation of the Risk-Focused Approach to Supervising Community Banks .....	A9709	March
InterFed Security and Controls Audit .....	A9711	March
Assistance to Financial Statement Audit of the Federal Reserve Employee Benefits System (years ended 12-31-97 and 12-31-96) .....	A9804	March
Audit of the FFIEC's Financial Statements (years ended 12-31-97 and 12-31-96) .....	A9801	March
Audit of the Board's Financial Statements (years-ended 12-31-97 and 12-31-96) .....	A9801	March
Review of Internal Controls in the Board's Protocol Office .....	A9805	May
Control Self-Assessment of Information Resources Management's Central Automation and Telecommunications Operations Center .....	P9717	July
Interim Assessments on the Board's Year 2000 Readiness Activities (Advisory Letters) <sup>1</sup> .....	...	March, July, and September
Advisory Letter to the Board's Federal Reserve Bank Affairs Committee Regarding the System's Approach to Allocating Certain Corporate Overhead Costs Among Priced Services .....	A9703	September

1. These assessments consolidated information from separate audits of the three components of the Board's response to the Year 2000 problem: oversight of financial institution efforts by the Division of Banking Supervision and Regulation (A9713), Board systems (A9803), and monitoring of Reserve Bank efforts by the Division of

Reserve Bank Operations and Payment Systems (A9807). On Sept. 17, the Inspector General provided written testimony to the Committee on Banking and Financial Services, U.S. House of Representatives, regarding the status of the Federal Reserve's Year 2000 work.

... Not applicable.

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

In addition, it coordinates its efforts with other governmental and nongovernmental agencies to promote economy and efficiency and to detect and prevent fraud and abuse in activities administered or financed by the Board. The OIG

keeps the Congress and the Chairman of the Board fully informed about serious abuses and deficiencies and about the status of any corrective actions.

During 1998, the OIG publicly reported on fifteen audits, reviews, and assessments (table C.3) and conducted a number of follow-up reviews to evaluate action taken on earlier recommendations. In addition, the OIG closed three investigations and performed numerous legislative and regulatory reviews. ■

Appendix D

*Expenses and Employment  
at the Federal Reserve Banks*

Table D.1

Operating Expenses of the Federal Reserve Banks, by District, 1998 and 1999

Thousands of dollars except as noted

District	1998 estimate	1999 budget	Change	
			Amount	Percent
Boston <sup>1</sup> .....	146,466	117,948	-28,518	-19.5
New York .....	433,081	448,748	15,667	3.6
Philadelphia .....	107,323	111,473	4,150	3.9
Cleveland .....	122,427	126,283	3,857	3.2
Richmond .....	159,073	166,190	7,116	4.5
Atlanta <sup>1</sup> .....	204,424	247,232	42,808	20.9
Chicago .....	211,503	219,156	7,653	3.6
St. Louis .....	108,544	112,452	3,908	3.6
Minneapolis .....	105,005	108,556	3,551	3.4
Kansas City .....	126,075	130,888	4,813	3.8
Dallas .....	127,948	132,699	4,751	3.7
San Francisco .....	227,731	237,599	9,867	4.3
<b>Total, all Districts</b> .....	<b>2,079,600</b>	<b>2,159,222</b>	<b>79,622</b>	<b>3.8</b>
<i>Special project</i>				
Automation Consolidation .....	3,801	0	-3,801	-100
<b>Total</b> .....	<b>2,083,401</b>	<b>2,159,222</b>	<b>75,821</b>	<b>3.6</b>

NOTE. Excludes capital outlays.

1. Boston's 1998 estimate and Atlanta's 1999 budget include expenses for the transportation of commercial checks by the Federal Reserve's Interdistrict Transpor-

tation System (\$32,808 in 1998 and \$33,120 in 1999). When these expenses are excluded, Boston's year-over-year increase is 3.8 percent and Atlanta's year-over-year is 4.7 percent.

Table D.2

## Employment at the Federal Reserve Banks, by District, 1998 and 1999

Average number of personnel except as noted<sup>1</sup>

District	1998 estimate	1999 budget	Change	
			Amount	Percent
Boston .....	1,221	1,235	14	1.1
New York .....	3,917	3,833	-85	-2.2
Philadelphia .....	1,245	1,254	9	.7
Cleveland .....	1,325	1,366	41	3.1
Richmond .....	2,093	2,130	37	1.8
Atlanta .....	2,561	2,612	51	2.0
Chicago .....	2,104	2,159	55	2.6
St. Louis .....	1,218	1,265	47	3.8
Minneapolis .....	1,227	1,216	-11	-.9
Kansas City .....	1,494	1,535	41	2.7
Dallas .....	1,487	1,500	13	.9
San Francisco .....	2,517	2,549	32	1.3
<b>Total, all Districts</b> .....	<b>22,409</b>	<b>22,652</b>	<b>242</b>	<b>1.1</b>
Federal Reserve Information Technology <sup>2</sup> .....	585	619	34	5.8
<b>Total</b> .....	<b>22,995</b>	<b>23,271</b>	<b>276</b>	<b>1.2</b>

1. See chapter 3, note 2, for definition of average number of personnel.

2. The ANP associated with FRIT excludes the Information Technology Planning and Standards staff

located in San Francisco (13 ANP in the 1998 estimate and 11 ANP in the 1999 budget).

Table D.3

## Expenses of the Federal Reserve Banks, by Operational Area, 1998 and 1999

Thousands of dollars except as noted

Operational area	1998 estimate	1999 budget	Change	
			Amount	Percent
Monetary and economic policy .....	153,559	167,125	13,566	8.8
Services to the U.S. Treasury and other government agencies .....	223,309	222,735	-574	-.3
Services to financial institutions and the public .....	1,250,554	1,292,505	41,951	3.4
Supervision and regulation .....	452,178	476,857	24,679	5.5
<b>Total</b> .....	<b>2,079,600</b>	<b>2,159,222</b>	<b>79,622</b>	<b>3.8</b>
MEMO <sup>1</sup>				
Support .....	764,587	801,934	37,347	4.9
Overhead .....	544,108	555,831	11,722	2.2

1. The costs of support and overhead are included in the expenses by operational area shown above. Support refers to activities, such as data processing, for which costs can be charged to users according to the amount of

use. Overhead refers to activities, such as auditing, for which costs are charged according to the users' shares of total direct costs.

Table D.4

Expenses of the Federal Reserve Banks  
for Salaries of Officers and Employees, by District, 1998 and 1999

Thousands of dollars except as noted

District	1998 estimate	1999 budget	Change	
			Amount	Percent
Boston .....	59,089	62,317	3,228	5.5
New York .....	215,104	225,498	10,394	4.8
Philadelphia .....	52,114	54,873	2,760	5.3
Cleveland .....	51,441	56,180	4,739	9.2
Richmond .....	80,881	87,427	6,545	8.1
Atlanta .....	94,089	101,269	7,180	7.6
Chicago .....	95,571	103,167	7,596	7.9
St. Louis .....	47,741	51,893	4,152	8.7
Minneapolis .....	48,677	50,409	1,732	3.6
Kansas City .....	60,230	63,797	3,567	5.9
Dallas .....	62,214	65,094	2,879	4.6
San Francisco .....	121,834	131,040	9,206	7.6
<b>Total .....</b>	<b>988,985</b>	<b>1,052,963</b>	<b>63,978</b>	<b>6.5</b>

Table D.5

Factors in the Change from 1998 to 1999 in the Salaries  
of Officers and Employees of the Federal Reserve Banks, by District

Percentage points

District	Merit adjust- ment	Structure adjust- ment	Promotion and reclassi- fication	Change in staffing	Turnover and lag <sup>1</sup>	Overtime	Other	Total change
Boston .....	3.3	.5	1.0	1.8	-6	-5	.0	5.5
New York .....	4.4	.4	.8	-4	-1	-4	.1	4.8
Philadelphia .....	4.1	.3	.3	1.3	-5	-2	.0	5.3
Cleveland .....	4.4	.3	.8	4.9	-4	-7	.0	9.2
Richmond .....	4.2	.9	1.0	3.7	-1.2	-5	.0	8.1
Atlanta .....	4.1	.2	1.0	2.8	-2	-4	.0	7.6
Chicago .....	4.0	.4	1.3	3.8	-1.4	-3	.1	7.9
St. Louis .....	4.3	.4	1.0	4.8	-7	-1.0	.0	8.7
Minneapolis .....	4.0	.0	.5	-3	-5	-1	.0	3.6
Kansas City .....	4.0	.5	1.1	2.8	-1.5	-1.0	.0	5.9
Dallas .....	3.8	.2	.7	1.1	-2	-9	.1	4.6
San Francisco .....	4.4	.4	.7	1.8	.2	.0	.0	7.6
<b>Total .....</b>	<b>4.2</b>	<b>.4</b>	<b>.8</b>	<b>1.9</b>	<b>-5</b>	<b>-4</b>	<b>.0</b>	<b>6.5</b>

1. Turnover is the replacement of a departing employee with one having a lower pay grade.  
Lag is the time during which a position remains vacant.

Table D.6

## Capital Outlays of the Federal Reserve Banks, by District, 1998 and 1999

Thousands of dollars except as noted

District	1998 estimate	1999 budget	Change	
			Amount	Percent
Boston .....	10,789	11,138	350	3.2
New York .....	46,610	96,392	49,782	106.8
Philadelphia .....	7,219	8,242	1,023	14.2
Cleveland .....	47,398	21,957	-25,442	-53.7
Richmond .....	15,858	28,082	12,224	77.1
Atlanta .....	39,999	109,541	69,541	173.9
Chicago .....	15,346	19,086	3,740	24.4
St. Louis .....	9,391	16,135	6,743	71.8
Minneapolis .....	5,758	7,340	1,582	27.5
Kansas City .....	9,175	6,165	-3,010	-32.8
Dallas .....	9,189	7,442	-1,747	-19.0
San Francisco .....	24,832	35,396	10,564	42.5
<b>Total, all Districts .....</b>	<b>241,564</b>	<b>366,914</b>	<b>125,350</b>	<b>51.9</b>
Federal Reserve Information Technology .....	34,722	38,641	3,919	11.3
<b>Total .....</b>	<b>276,287</b>	<b>405,556</b>	<b>129,269</b>	<b>46.8</b>

Table D.7

Budget Performance of the Federal Reserve Banks,  
Operating Expenses, by District, 1998

Thousands of dollars except as noted

District	1998 budget	1998 estimate	Change	
			Amount	Percent
Boston .....	143,620	146,466	2,846	2.0
New York .....	437,029	433,081	-3,948	-.9
Philadelphia .....	107,196	107,323	127	.1
Cleveland .....	122,869	122,427	-443	-.4
Richmond .....	158,140	159,073	933	.6
Atlanta .....	192,194	204,424	12,230	6.4
Chicago .....	210,927	211,503	577	.3
St. Louis .....	102,138	108,544	6,406	6.3
Minneapolis .....	103,988	105,005	1,017	1.0
Kansas City .....	124,017	126,075	2,058	1.7
Dallas .....	127,955	127,948	-7	.0
San Francisco .....	224,600	227,731	3,132	1.4
<b>Total, all Districts .....</b>	<b>2,054,671</b>	<b>2,079,600</b>	<b>24,928</b>	<b>1.2</b>
<i>Special project</i> Automation Consolidation .....	4,649	3,801	-848	-18.2
<b>Total .....</b>	<b>2,059,321</b>	<b>2,083,401</b>	<b>24,080</b>	<b>1.2</b>

NOTE. Excludes capital outlays.



Table D.8

Budget Performance of the Federal Reserve Banks,  
Employment, by District, 1998Average number of personnel except as noted<sup>1</sup>

District	1998 budget	1998 estimate	Change	
			Amount	Percent
Boston .....	1,233	1,221	-12	-1.0
New York .....	3,917	3,917	0	.0
Philadelphia .....	1,246	1,245	-1	-.1
Cleveland .....	1,325	1,325	0	.0
Richmond .....	2,085	2,093	8	.4
Atlanta .....	2,335	2,561	226	9.7
Chicago .....	2,105	2,104	-1	-.1
St. Louis .....	1,212	1,218	6	.5
Minneapolis .....	1,201	1,227	25	2.1
Kansas City .....	1,509	1,494	-15	-1.0
Dallas .....	1,516	1,487	-29	-1.9
San Francisco .....	2,472	2,517	45	1.8
<b>Total, all Districts .....</b>	<b>22,156</b>	<b>22,409</b>	<b>254</b>	<b>1.1</b>
Federal Reserve Information Technology .....	598	585	-13	-2.1
<b>Total .....</b>	<b>22,754</b>	<b>22,995</b>	<b>241</b>	<b>1.1</b>

1. See chapter 3, note 2, for definition of average number of personnel.

Table D.9

## Operating Expenses of the Federal Reserve Banks, by Operational Area, 1994-99

Thousands of dollars except as noted

Year	Monetary and economic policy	Services to the U.S. Treasury and other government agencies	Services to financial institutions and the public	Supervision and regulation	Total
1994 .....	120,869	209,453	1,105,140	361,458	1,796,920
1995 .....	128,303	216,790	1,127,320	392,294	1,864,707
1996 .....	138,649	215,609	1,177,444	424,402	1,956,104
1997 .....	144,103	207,079	1,215,069	436,392	2,002,643
1998 estimate .....	153,559	223,309	1,250,554	452,178	2,079,600
1999 budget .....	167,125	222,735	1,292,505	476,857	2,159,222
MEMO Average annual change (percent) .....	6.7	1.2	3.2	5.7	3.7

NOTE. Excludes special project.

*Table D.10*

Employment at the Federal Reserve Banks, by Operational Area, 1994–99

Average number of personnel except as noted<sup>1</sup>

Year	Monetary and economic policy	Services to the U.S. Treasury and other government agencies	Services to financial institutions and the public	Supervision and regulation	Support <sup>2</sup>	Overhead <sup>2</sup>	Total
1994 .....	729	1,754	8,301	3,079	4,603	5,162	23,627
1995 .....	737	1,683	8,209	3,073	4,511	4,949	23,162
1996 .....	734	1,543	8,083	3,111	4,537	4,901	22,909
1997 .....	718	1,438	7,954	2,980	4,572	4,821	22,483
1998 estimate .....	712	1,422	8,096	2,890	4,552	4,737	22,410
1999 budget .....	728	1,394	8,138	2,927	4,691	4,774	22,652
<b>MEMO</b>							
Average annual change (percent) .....	.0	-4.5	-4	-1.0	-4	-1.5	-8

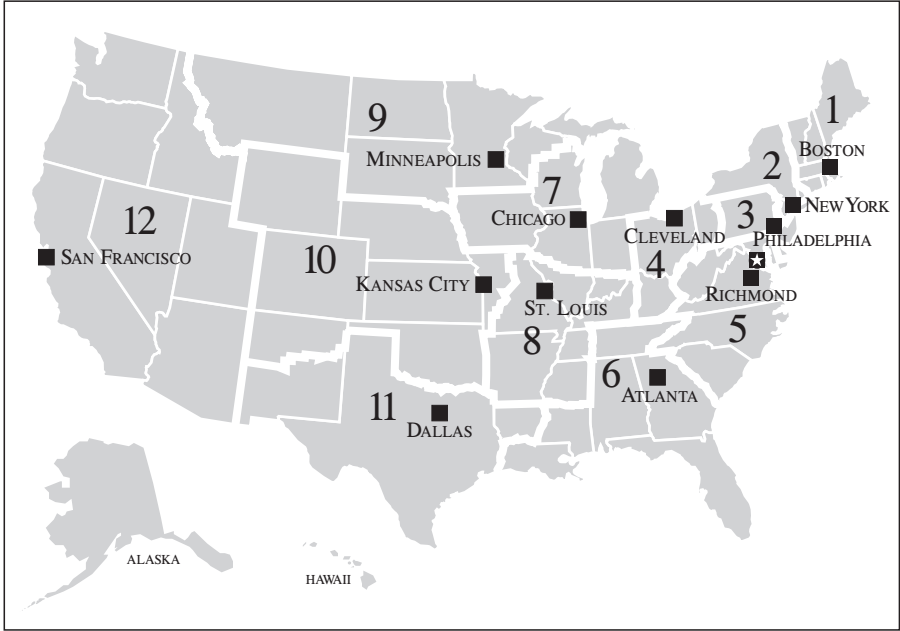
1. Excludes special projects and Federal Reserve Information Technology. See chapter 3, note 2, for definition of average number of personnel.

2. See table D.3, note 1, for definition.

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*Maps of the  
Federal Reserve System*

# The Federal Reserve System



## LEGEND

*Both pages*

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

*Facing page*

- Federal Reserve Branch city
- Branch boundary

## NOTE

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

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

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

Bank serves the Commonwealth of Puerto Rico and the U.S. Virgin Islands; the San Francisco Bank serves American Samoa, Guam, and the Commonwealth of the Northern Mariana Islands. The maps show the boundaries within the System as of year-end 1998.

