

*Annual Report:
Budget Review*

Board of Governors of the Federal Reserve System

1996–97

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Introduction

Federal Reserve Budget Process and Operational Areas

The Federal Reserve System comprises the seven-member Board of Governors in Washington, D.C., the twelve Federal Reserve Banks with their twenty-five Branches in Districts around 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 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 serves as the fiscal agent

for the U.S. Treasury and provides a variety of other financial services for the Treasury and other government agencies.

In carrying out its responsibilities in 1996, the Federal Reserve System spent an estimated \$1.1 billion in net operating expenses. Total spending of an estimated \$2.1 billion was offset by an estimated \$1.0 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 \$23.9 billion in 1996. Earnings in excess of expenses, dividends, and surplus—in 1996 an estimated \$20.1 billion—are transferred to the U.S. Treasury. (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.)

The Budget Process

The Board of Governors and the Reserve Banks have separate budgets and budgeting processes.

Board of Governors

All levels of Board management are involved in a planning and budgeting process that begins in the spring with development of a budget guideline and extends through November of each year. The administrative governor, under

authority delegated by the Chairman, oversees the process until the budget is submitted to the Board for action at an open meeting in November. The Board is currently planning to move to a two-year budget cycle, commencing with the 1998–99 budget, in conjunction with a four-year planning cycle.

The Board budget is structured in four operational areas (described in the next section). Costs for data processing are distributed to the four areas according to use; expenses for other elements of support and overhead are allocated to the four 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 time periods instead of expensing them in their year of purchase. Hence, the Board has both an operations budget and a capital budget.

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 budget is also presented to the Board of Governors for action at an open meeting in November. (The OIG is discussed in chapter 2 and appendix C.)

After the Board budget is approved, 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 the year is estimated in June, and the second assessment is made in July.

Reserve Banks

Each year the Federal Reserve Banks, like the Board, establish major operating goals for the coming year, devise strat-

egies for their attainment, estimate required resources, and monitor results. As with the Board, 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 in the next section), with support and overhead charged to the operational areas. Approved separately from the operations budgets are special projects, which 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 special project for 1997 is described in appendix A).

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), which was implemented by the Banks in 1977. Under PACS, the costs of all Reserve Bank services, both priced and non-priced, are grouped by operational area, and the costs of support and overhead are charged to the four areas. (The services assigned to each of the operational areas are listed in chapter 3, tables 3.7–3.9 and 3.11.) 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

For budgeting purposes, 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 1996 the Federal Reserve conducted approximately 606 state member bank examinations and approximately 1,922 bank holding company inspections and acted on a total of 4,390 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 1996 the System conducted approximately 589 compliance examinations.

The Board's supervisory responsibilities also extend to the foreign operations of U.S. banks and, under the International Banking Act, to the U.S. operations of foreign banks.

Beyond these activities, the Federal Reserve maintains continuous oversight of the banking industry to ensure the overall safety and soundness of the financial system. This broader responsibility is reflected in the System's presence in financial markets, through open market operations, and in the Federal Reserve's role as lender of last resort.

Services to Financial Institutions and the Public

The Federal Reserve System plays a central role in the nation's 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 also identify counterfeits and destroy currency that is unfit for circulation. In 1996 the Reserve Banks distributed \$406.2 billion in currency and \$4.7 billion in coin and destroyed \$148.4 billion in unfit currency.

The Reserve Banks (along with their Branches and regional centers) also process checks for collection—approximately 15 billion checks in 1996 with a total value of more than \$11 trillion.

The Federal Reserve also plays a central role in the nation's payments mechanism through its wire transfer system, Fedwire. Through Fedwire, depository institutions can draw on their reserves or clearing accounts at the Reserve Banks and transfer funds anywhere in the country. Approximately 7,900 depository institutions use Fedwire through direct computer connections with Reserve Banks, and another 2,100 institutions use Fedwire through off-line means such as telephone. In 1996, approximately 82 million transfers valued at about \$246 trillion were sent over Fedwire, an average of \$3 million per transfer and \$983 billion per day.

The Federal Reserve allows participants in private clearing arrangements to exchange and settle transactions on a net basis through reserve or clearing account balances. Users of net settle-

ment services include local check clearinghouse associations, automated clearinghouse (ACH) networks, credit card processors, automated teller machine networks, and national and regional funds transfer and securities transfer networks.

Approximately 28,600 depository institutions participate in the Federal Reserve's ACH service, which allows them to send or receive payments electronically instead of by check. The institutions use the ACH service for credit and debit transactions. As of September 1996, all of the approximately 8,190 ACH endpoints had electronic connections with the Federal Reserve. In 1996 the Reserve Banks processed approximately 3.04 billion ACH transactions valued at about \$9.9 trillion; approximately 21 percent of the transactions were for the federal government, and the rest were for commercial establishments.

The securities services provided by the Reserve Banks include the handling of book-entry and definitive securities and the collection of coupons and miscellaneous items. The book-entry service, begun in 1968, enables holders of Treasury and government agency securities to transfer the securities electronically to other institutions throughout the country. In 1996 the Reserve Banks processed approximately 14.2 million securities transfers valued at \$170 trillion. The noncash collection service, through which maturing coupons and bonds are presented for collection, processed about 1.2 million transactions in 1995 and about 1.6 million transactions in 1996.

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

The U.S. government uses the Federal Reserve as its bank. Through deposit accounts at the Reserve Banks, the

government issues checks and payments and collects receipts. The Reserve Banks also process wire transfers of funds and automated clearinghouse payments and give the Treasury daily statements of account activity.

Beyond these typical depository activities, the Reserve Banks provide several unique services to the federal government. They monitor the tax receipts deposited in the more than 11,000 tax and loan accounts that are maintained by depository institutions designated to perform this function, they hold the collateral that those institutions pledge to support these and other government deposits, and they transfer funds to the Treasury's account at its request. The Reserve Banks assist the Treasury in its financing of the public debt by issuing, servicing, and redeeming all marketable Treasury securities as well as all U.S. savings and retirement plan bonds. The Reserve Banks also redeem food coupons for the U.S. Department of Agriculture and destroy redeemed coupons.

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. ■

Part I

The 1997 Budgets

Chapter 1

Federal Reserve System

For 1997, the Federal Reserve System has budgeted net operating expenses of \$1,139.4 million. Revenue from priced services provided to depository institutions is expected to total \$810.4 million, or 37.4 percent of total budgeted operating expenses. Total operating expenses are budgeted at \$2,168.6 million, an increase of 2.1 percent over estimated 1996 expenses. Of this total, \$1,997.2 million is for the Reserve Banks and \$171.4 million is for the Board of Governors (table 1.1).

Not included in the budget for operations is a Reserve Bank special project for automation consolidation, which is budgeted at \$34.7 million for 1997, down from \$38.4 million estimated for 1996.¹ Also excluded is the cost of currency, budgeted at \$405.6 million for 1997, an increase of 0.8 percent over the estimated 1996 cost of \$402.4 million.² 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 (including staff for the special project) is budgeted at 24,916 for 1997, a decline of 321 from

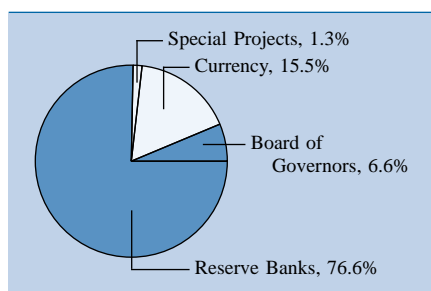
the estimated 1996 level. (Details are given in chapters 2 and 3.)

Net Expenses

The System expects to recover 47.5 percent of its budgeted 1997 operating expenses through revenue from priced services, other income, and claims for reimbursement. After these items are deducted from budgeted 1997 operating expenses, the net expenses of the System show an increase of 2.3 percent over estimated 1996 net operating expenses (table 1.2).

Revenue from priced services represents fees that are set so as to recover the full cost of providing the services (as required by the Monetary Control Act of 1980), including the imputed cost of float and the return on capital that would have been received, and the taxes that would have been paid, had a commercial entity in the private sector furnished the services. Projected revenue from priced services is detailed in table 1.3; the constraint imposed on Federal Reserve

Chart 1.1
Distribution of Expenses of the
Federal Reserve System, 1997¹



1. See text notes 1 and 2.

1. As research and development efforts, special projects are separate from the continuing operations of the System and are therefore not included in the System's operations budget. These relatively costly, short-term projects are expected to benefit both the System and the banking industry as a whole. The special project approved for 1997 is described in appendix A.

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.

budgets by the need to keep such services competitive and the calculation of fees are discussed in appendix A. “Other income” 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. Claims for reimburse-

Table 1.1

Expenses of the Federal Reserve System for Operations, Special Projects, and Currency, 1995–97¹

Millions of dollars, except as noted

Entity and type of expense	1995 actual	1996 estimate	1997 budget	Percentage change	
				1995 to 1996	1996 to 1997
<i>Operating expenses</i> ²					
Reserve Banks ³	1,864.7	1,959.3	1,997.2	5.1	1.9
Personnel	1,183.5	1,228.0	1,252.3	3.8	2.0
Nonpersonnel	681.2	731.3	744.9	7.4	1.9
Board of Governors ⁴	157.0	165.6	171.4	5.5	3.5
Personnel	117.4	122.7	127.8	4.5	4.2
Nonpersonnel	39.6	42.9	43.6	8.3	1.6
Total System operating expenses	2,021.7	2,124.9	2,168.6	5.1	2.1
Personnel	1,300.9	1,350.7	1,380.1	3.8	2.2
Nonpersonnel	720.8	774.2	788.5	7.4	1.8
Special projects ⁵	43.7	38.4	34.7	-12.1	-9.7
Currency ⁶	369.9	402.4	405.6	8.8	.8

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

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

3. For detailed information, see chapter 3.

4. Includes extraordinary items and expenses of the Office of Inspector General. For detailed information, see chapter 2.

5. See text note 1 and appendix A.

6. See text note 2 and appendix A.

Table 1.2

Operating Expenses of the Federal Reserve System, Net of Receipts and Claims for Reimbursement, 1995–97

Millions of dollars, except as noted

Item	1995 actual	1996 estimate	1997 budget	Percentage change	
				1995 to 1996	1996 to 1997
Total System operating expenses	2,021.7	2,124.9	2,168.6	5.1	2.1
LESS					
Revenue from priced services	765.2	791.4	810.4	3.4	2.4
Other income	5.8	5.8	5.8	*	*
Claims for reimbursement ¹	221.4	213.5	213.0	-3.6	-2
EQUALS					
Net System operating expenses	1,029.3	1,114.3	1,139.4	8.3	2.3

1. Cost of fiscal agency and depository services provided to the U.S. Treasury and other government agencies that are billed to these agencies. In practice, not all these claims are paid.

* Less than 0.05.

Table 1.3
Revenue from Priced Services, 1995–97

Millions of dollars

Service	1995 actual	1996 estimate	1997 budget
Funds transfers and net settlement	90.6	90.5	97.3
Automated clearinghouse services	75.6	78.4	79.8
Commercial checks	574.0	595.2	605.1
Book-entry securities transfers	15.9	15.7	16.9
Noncash collection	4.0	4.8	5.6
Special cash services	5.2	6.8	5.7
Total	765.2	791.4	810.4

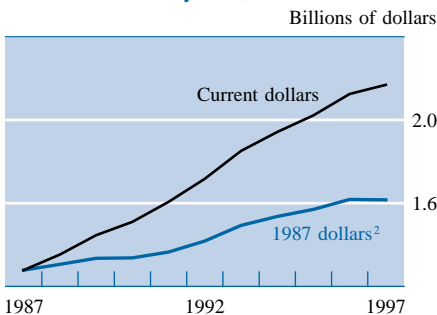
ment represent the expenses incurred by the Reserve Banks in providing fiscal agency and depository services to the Treasury and other government agencies that are billed to these agencies.

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

Trends in Expenses and Employment

From actual 1987 to budgeted 1997 amounts, the operating expenses of the Federal Reserve System (excluding special projects) have increased an

Chart 1.2
Operating Expenses of the
Federal Reserve System, 1987–97¹

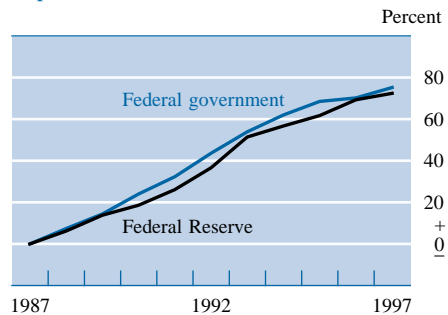


1. For 1996, estimate; for 1997, budget.
2. Calculated with the GDP price deflator.

average of 5.4 percent a year (2.4 percent a year when adjusted for inflation) (chart 1.2) and total System expenditures (including special projects) have increased an average of 5.6 percent a year (2.5 percent a year when adjusted for inflation). Over the same period, nondefense discretionary spending by the federal government has increased an average of 5.8 percent a year (chart 1.3). Federal Reserve System employment, including staff working on special projects and Federal Reserve Automation Services (FRAS), has increased by 420 over the period (chart 1.4).

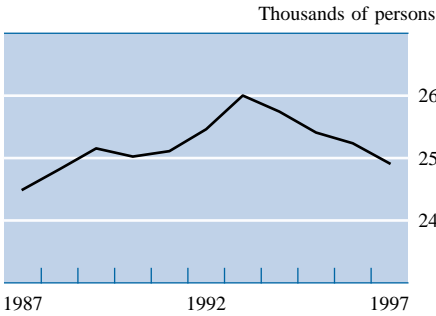
From 1982, when the transition to the requirements of the Monetary Control Act of 1980 was completed, through 1984, System expenses remained essentially flat when adjusted for inflation, and employment declined. In 1985, the staffing level was increased in a pronounced effort to strengthen supervision and regulation of member banks and bank holding companies. The System was able to partially offset the increase in staff through reductions in employment in other areas, mainly

Chart 1.3
Cumulative Change in Federal Reserve
System Expenses and Federal Government
Expenses, 1987–97¹



1. Federal Reserve System expenses are operating expenses plus the cost of special projects; federal government expenses are discretionary spending less expenditures on defense. For 1996, estimate; for 1997, budget.

Chart 1.4
**Employment in the
 Federal Reserve System, 1987-97¹**



1. Includes FRAS staff.

services to financial institutions and the public, support, and overhead.

In 1988, 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. Increases in staff throughout the System in 1988 and 1989 resulted from implementation of the provisions of this legislation. In 1991 and continuing through projected 1997, spending on bank supervision has expanded, reflecting an increase in the number and complexity of examinations, greater attention to problem institutions, and the requirements of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) and the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). The System has been able to partially offset these increases by reducing staff in other operational areas, mainly services to the U.S. Treasury and services to financial institutions and the public.

Table 1.4
Operating Expenses of the Federal Reserve System, by Operational Area, 1995-97¹

Millions of dollars, except as noted

Operational area and entity	1995 actual	1996 estimate	1997 budget	Percentage change	
				1995 to 1996	1996 to 1997
Monetary and economic policy	211.7	226.4	235.2	7.0	3.9
Reserve Banks	128.3	138.1	145.7	7.7	5.5
Board of Governors	83.4	88.3	89.5	5.9	1.4
Services to the U.S. Treasury and other government agencies ²	216.8	217.2	213.1	.2	-1.9
Services to financial institutions and the public	1,131.0	1,181.6	1,198.2	4.5	1.4
Reserve Banks	1,127.3	1,177.6	1,194.0	4.5	1.4
Board of Governors	3.7	4.0	4.2	8.1	5.0
Supervision and regulation	462.2	499.7	522.1	8.1	4.5
Reserve Banks	392.3	426.4	444.4	8.7	4.2
Board of Governors	69.9	73.3	77.7	4.9	6.0
Total	2,021.7	2,124.9	2,168.6	5.1	2.1
Reserve Banks	1,864.7	1,959.3	1,997.2	5.1	1.9
Board of Governors³	157.0	165.6	171.4	5.5	3.5

1. Operating expenses reflect all redistributions for support and allocations for overhead and 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.

2. Reserve Banks only. The Board of Governors does not provide these services.

3. Includes expenses of the Office of Inspector General and extraordinary items.

Operational Areas

For budgeting purposes, 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.

Major Projects for 1997

Several major projects that have an impact on Board or Reserve Bank budgets will continue or begin in 1997:

- Consolidation of System automation
- Installation of high-speed currency processors
- Installation of equipment and software to support the image processing of commercial and Treasury checks and the archival of Treasury checks
- Extraordinary repairs to and maintenance of facilities.

Partly offsetting the greater expenditures associated with these projects are lower costs associated with staff reductions made possible by several reengineering initiatives and programs to increase efficiency in Federal Reserve operations. ■

Chapter 2

Board of Governors

The 1997 budget for the Board of Governors provides \$165.6 million for operations, \$2.9 million for extraordinary items (projects of a unique nature), and \$3.0 million for the Office of Inspector General. The Board has authorized 1,746 staff positions for operational areas and 32 positions for the Office of Inspector General; no positions are required for the extraordinary items. The total of 1,778 positions is an increase of 14 over the number authorized at the end of 1996 and includes 16 temporary positions that will be abolished in 1998.

Overview of the Budget

Board Operations

The 1997 operations budget of \$165.6 million is 2.8 percent larger than estimated 1996 expenses. Despite increases in salaries and the costs of goods and services, expenses to maintain core operations at the 1996 level were more than offset by reductions in core level activities, resulting in a net decrease of 0.3 percentage point in the cost of core activities. Initiatives to improve customer service and to increase operating efficiency through the enhancement of automation systems, projects to maintain facilities, and various smaller projects increased the budget 3.1 percentage points, for an overall increase of 2.8 percent.

Extraordinary Items

Inclusion of certain periodic or one-time expenses in the Board's operations budget can result in undue volatility in the size of the budget. Therefore, funds for

such extraordinary items are set apart from the operations budget. For 1997, \$2.9 million in operating funds and \$420,000 in capital funds have been budgeted for three extraordinary items: modification or replacement of software to ensure its operation after the century date change and two major economic surveys. These projects are discussed in detail at the end of this chapter.

Office of Inspector General

The 1997 budget for the Office of Inspector General of \$3.0 million is 0.8 percent higher than estimated 1996 expenses.

Highlights of the Budget

Decreases for Core Level Activities

Initial division budget requests to support core level activities in 1997 were reduced by approximately \$3.5 million to provide funding for higher-priority initiatives. Eleven positions were eliminated; funding for travel, training, and automation labor was reduced; and several facilities maintenance projects were deferred. The largest reductions in core level activity will occur in the Divisions of Information Resources Management, Banking Supervision and Regulation, Support Services, Research and Statistics, and Reserve Bank Operations and Payment Systems.

Major Automation Enhancements

Division Automation Systems

The 1997 budget provides approximately \$1.0 million in operating funds and

\$2.7 million in capital funds to improve division information systems. The improvements include replacement of outdated personal computers, an increase in disk capacity, expansion of memory, and upgrading of operating systems and other software. The majority of the funds (\$0.6 million in operating funds and \$1.8 million in capital funds) will be used for four divisions: Banking Supervision and Regulation, Information Resources Management, Research and Statistics, and Monetary Affairs.

Boardwide Network

Approximately \$0.3 million in operating funds and \$1.0 million in capital funds are provided to maintain the reliability and efficiency of existing network devices and services. This investment is necessary to handle growing distributed system requirements, including provisions for restoring operations in the event of a catastrophic failure.

Mainframe Computer

The 1997 budget also provides \$0.3 million in operating funds and \$0.7 million in capital funds to upgrade the Board's mainframe computer. The upgrade will improve access to mainframe databases such as those used for the National Information Center (NIC) and for administration of Home Mortgage Disclosure Act (HMDA) responsibilities. Additional direct access storage will be made available to clients and for such activities as providing distributed data backup on the mainframe, moving frequently used financial data to and from tape, and implementing the new System Statistics and Reserves (STAR) system, a centralized software system that will provide financial and statistical data for the administration of the Board's monetary, regulatory, and supervisory policies.

Boardwide Cable Plant

Approximately \$0.2 million in operating funds and \$2.2 million in capital funds are included in the budget to cover the 1997 costs of a multiyear project to replace the Board's cable plant. Designed in accordance with decade-old standards for voice systems, the current cable plant uses copper cable, which supports only low-speed data transmission, while advances in information technology are driving network data communications to higher speed requirements. The recabling project will reduce downtime and help meet the demand for increased capacity.

Internet

In keeping with the federal government objective of improving access to information via electronic means, the 1997 budget includes approximately \$0.4 million in operating funds, \$0.3 million in capital funds, and one position to develop and maintain the Board's World Wide Web site. This initiative will provide immediate electronic access to data, documents, and publications that the public would otherwise have to obtain in paper form. It is expected that this effort will reduce demand for printed publications, eventually leading to lower printing and postage expenses.

Revisions to Bank and Bank Holding Company Reports

The 1997 budget provides approximately \$0.3 million in operating funds to implement changes to the automated systems that produce the quarterly Reports of Condition and Income (Call Reports) and Bank Holding Company Financial Statements (FR Y-9 and Y-11 reports). The Federal Financial Institutions Examination Council recently approved significant changes to the Call

Reports in order to reduce the reporting burden on financial institutions, improve the monitoring of interest rate risk, and move from the use of regulatory accounting principles (RAP) to the use of generally accepted accounting principles (GAAP). The Federal Reserve has recently proposed similar revisions to the bank holding company reports. The changes to both types of report stem in part from requirements of the Riegle Community Development and Regulatory Improvement Act of 1994.

Foreign Banking Organization Workstation

The 1997 budget provides approximately \$0.3 million in operating funds and \$0.1 million in capital funds for a major initiative to develop an automated system that will improve the supervision of the domestic activities of foreign banking organizations. The system will contain a docketing workflow module, a document management module, and a financial-analytical module that will allow the Board to better coordinate and further enhance the supervision of the U.S. operations of foreign financial institutions.

Home Mortgage Disclosure Act and Community Reinvestment Act

Approximately \$0.3 million is provided in the budget for a project to enhance the HMDA and CRA (Community Reinvestment Act) analysis systems used in fair lending and CRA examinations and to develop the compliance portion of the Board's examiner workstation software.

Facilities Improvements

Exterior Window Glass

The 1997 budget provides approximately \$0.8 million in capital funds to replace

window glass in critical areas of the Martin and Eccles Buildings with explosive-resistant safety glass. This is the first phase of a multiyear project in which all of the exterior glass in the complex will be replaced. The project is a response to Department of Justice recommendations on the safety and security of federal office buildings.

Air Handling System

The 1997 budget also provides approximately \$0.8 million in capital funds to continue a multiyear project to replace components of the Board's air handling system to improve efficiency and promote energy savings. In this phase of the project, ventilation will be improved and more efficient cooling will be provided for the lower levels of the Martin Building.

Martin Building Exterior

The 1997 operations budget provides approximately \$0.4 million for repairs to the exterior of the Martin Building. As a result of aging and weather exposure, moisture is entering the envelope of the building. Structural engineers have recommended that the seams in the stone facade and all of the windows be recaulked to prevent serious damage to the building.

Martin Building Roof

Included in the 1997 capital budget is approximately \$0.3 million to replace a portion of the Martin Building roofing membrane, which has begun to leak. The project will prevent serious water damage to the building.

Potential Requirements Not Funded in the 1997 Budget

Several issues that may have implications for funding are not addressed in the

1997 budget because the impact of new requirements has not been fully determined. The most significant of these issues stem from passage of the Electronic Freedom of Information Act Amendments of 1996. This legislation requires that federal agencies make information requested by the public available via electronic means such as the Internet. A task force is expected to make recommendations in 1997 on the resources needed to comply with the legislation.

Operations Budget by Division and Accounting Classification

The Board's overall operations budget is detailed by division in table 2.1, and the number of authorized staff positions for Board operations is shown in table 2.2. The ten-year trend in operating expenses, by accounting classification, is shown in table 2.3.

The largest increase in the 1997 budget is in the area of personnel services. The 1997 budget for personnel

Table 2.1

Expenses of the Board of Governors, by Division, Office, or Special Account, 1995–97

Thousands of dollars, except as noted

Division, office, or special account	1995 actual	1996 estimate	1997 budget	Change, 1995 to 1996		Change, 1996 to 1997	
				Amount	Percent	Amount	Percent
Board Members	4,218	4,592	4,600	373	8.8	9	.2
Secretary	4,180	4,265	4,419	85	2.0	154	3.6
Legal	7,501	8,056	8,572	555	7.4	516	6.4
Research and Statistics ..	24,629	26,412	26,375	1,783	7.2	-37	-.1
International Finance	9,346	9,782	9,986	435	4.7	204	2.1
Banking Supervision and Regulation	25,176	26,109	26,540	933	3.7	432	1.7
Human Resources Management	5,267	5,424	5,540	157	3.0	116	2.1
Support Services	26,485	28,473	28,186	1,988	7.5	-287	-1.0
Controller	2,805	3,264	3,320	459	16.4	56	1.7
Consumer and Community Affairs	6,000	6,504	7,173	504	8.4	669	10.3
Staff Director for Management	1,883	2,199	2,198	316	16.8	-1	*
Reserve Bank Operations and Payment Systems	13,129	13,664	13,855	536	4.1	191	1.4
Information Resources Management (IRM) ..	25,337	27,185	27,994	1,847	7.3	809	3.0
Monetary Affairs	8,453	8,795	8,817	342	4.0	22	.2
Special projects	2,037	2,457	3,367	420	20.7	910	37.0
IRM income account ¹ ...	-15,216	-16,081	-15,349	-865	5.7	732	-4.6
Total, Board operations	151,230	161,100	165,594	9,870	6.5	4,494	2.8
Extraordinary items	2,681	1,487	2,890	1,194	...	1,403	...
Office of Inspector General	3,060	2,941	2,965	-119	-3.9	24	.8

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

* Less than 0.05.

services (salaries, retirement, and insurance) is \$4.1 million, or 3.4 percent, greater than estimated 1996 expenses. The 1997 budget for goods and services is \$0.4 million, or 0.9 percent, greater than estimated 1996 expenses. The increase in the area of goods and services is attributable to a \$1.0 million, or 11.4 percent, increase in depreciation expenses associated with the capital portion of the automation system enhancement and facilities improvement initiatives described earlier, as well as increases for software and other items. Partially offsetting these increases are

reductions in core level activities in the areas of building repairs and alterations, travel, contractual professional services, and furniture and equipment and increased income from external clients for use of the mainframe computer.

Operations Budget by Operational Area

The Board's operations budget supports activities in four broadly defined areas: monetary and economic policy, supervision and regulation, services to financial

Table 2.2

Positions Authorized at the Board of Governors, by Division or Office, 1995–97

Division or office	1995 actual	1996 estimate	1997 budget	Change	
				1995 to 1996	1996 to 1997
Board Members	42	42	42	0	0
Secretary	62	63	63	1	0
Legal	83	84	84	1	0
Research and Statistics	274	275	275	1	0
International Finance	108	110	111	2	1
Banking Supervision and Regulation	244	243	236	-1	-7
Human Resources Management	50	47	47	-3	0
Concern ¹	22	21	21	-1	0
Support Services	261	261	263	0	2
Controller	34	35	35	1	0
Consumer and Community Affairs	65	66	69	1	3
Staff Director for Management	10	10	7	0	-3
Reserve Bank Operations and Payment Systems	125	125	125	0	0
Information Resources Management ²	247	259	277	12	18
Monetary Affairs	66	66	66	0	0
Subtotal³	1,693	1,707	1,721	14	14
Reimbursable IRM support ²	20	25	25	5	0
Total, Board operations	1,713	1,732	1,746	19	14
Office of Inspector General	31	32	32	1	0

1. EEO Concern positions managed by the Division of Human Resources Management.

2. Positions that provide IRM support to the Federal Financial Institutions Examination Council for HMDA processing on a reimbursable basis are shown separately, as reimbursable IRM support.

3. Includes eleven summer intern positions and seventeen youth positions; 1997 figure also includes sixteen temporary (two-year) positions that will be abolished by year-end 1998.

institutions and the public, and System policy direction and oversight. Data on expenses and positions for each operational area for 1995–97 are shown in tables 2.4 and 2.5.

Monetary and Economic Policy

The 1997 budget for the monetary and economic policy operational area is approximately \$70.4 million, an increase

Table 2.3
Operating Expenses of the Board of Governors, by Accounting Classification, 1987–97

Thousands of dollars, except as noted

Classification	1987 actual	1988 actual	1989 actual	1990 actual	1991 actual	1992 actual	1993 actual
<i>Personnel services</i>							
Salaries	53,897	56,149	61,283	68,565	73,814	79,624	87,600
Retirement	3,040	3,433	3,895	4,601	5,062	6,298	7,068
Insurance	3,361	3,704	4,412	4,931	6,498	6,701	7,706
Subtotal	60,298	63,286	69,590	78,097	85,374	92,623	102,374
<i>Goods and services</i>							
Travel	2,839	3,161	3,329	3,402	3,461	3,867	4,586
Postage and expressage	1,004	1,156	1,070	1,142	1,205	1,116	1,210
Telecommunications	1,590	1,571	1,543	1,758	1,605	1,799	1,866
Printing and binding	1,044	1,089	1,110	1,153	1,042	1,103	1,052
Publications	-554	-400	-364	-559	-928	-487	-335
Stationery and supplies	883	719	748	897	720	767	847
Software	2,698	2,511	2,506	2,101	2,428	2,789	2,826
Furniture and equipment	912	684	527	827	694	1,185	1,257
Rentals	1,077	527	-53	-965	-930	-923	231
Books and subscriptions	453	505	582	578	608	696	755
Utilities	1,606	1,599	1,571	1,702	1,686	1,805	1,878
Building repairs and alterations	1,146	1,044	849	943	1,002	2,071	1,331
Furniture and equipment repairs and maintenance	1,712	2,002	1,905	1,837	1,897	1,969	2,102
Contingency Processing Center expenses	0	0	142	237	191	264	201
Contractual professional services	2,263	3,128	3,354	2,686	2,669	4,491	5,175
Tuition/registration and membership fees	533	564	513	602	671	842	981
Subsidies and contributions	657	697	413	529	639	736	768
Depreciation	7,463	7,529	6,740	5,882	5,607	6,011	6,563
All other	-1,434	-1,447	-782	-452	168	85	632
Subtotal	25,893	26,640	25,703	24,302	24,435	30,187	33,929
Total, Board operations	86,192	89,925	95,293	102,399	109,809	122,810	136,303
Extraordinary items	0	0	0	0	373	3,147	436
Office of Inspector General	127	580	718	1,341	1,568	1,930	2,710

of \$1.0 million, or 1.5 percent, over estimated 1996 expenses. Activities in this operational area include the Board's monitoring and analysis of developments in the money and credit markets,

setting of reserve requirements, approval of changes in the discount rate, and other activities related to the management of the nation's monetary policy. The budget increase for this area is

Table 2.3
Continued

Thousands of dollars, except as noted

Classification	1994 actual	1995 actual	1996 estimate	1997 budget	Percentage change, 1996 to 1997	Average annual percentage change, 1987 to 1997
<i>Personnel services</i>						
Salaries	90,528	98,418	104,111	107,753	3.5	7.2
Retirement	7,535	8,029	7,984	8,438	5.7	10.8
Insurance	8,408	8,455	9,078	9,098	.2	10.5
Subtotal	106,470	114,902	121,174	125,289	3.4	7.6
<i>Goods and services</i>						
Travel	4,640	4,759	5,251	4,967	-5.4	5.8
Postage and expressage	1,247	1,236	1,122	1,081	-3.7	.7
Telecommunications	2,035	2,134	2,209	2,177	-1.5	3.2
Printing and binding	1,245	1,581	1,375	1,405	2.1	3.0
Publications	-16	1,460	1,642	1,547	-5.8	...
Stationery and supplies	802	949	952	957	.5	.8
Software	3,003	3,449	4,185	4,382	4.7	5.0
Furniture and equipment	1,178	1,320	1,309	1,091	-16.7	1.8
Rentals	554	3,854	4,365	4,350	-3	15.0
Books and subscriptions	923	989	1,096	1,104	.7	9.3
Utilities	2,124	2,021	2,005	2,035	1.5	2.4
Building repairs and alterations	1,743	1,530	1,585	1,229	-22.5	.7
Furniture and equipment repairs and maintenance	2,109	2,089	1,820	1,799	-1.2	.5
Contingency Processing Center expenses	185	21	0	0	...	...
Contractual professional services	6,306	7,491	10,354	10,089	-2.6	16.1
Tuition/registration and membership fees	1,055	1,339	1,425	1,385	-2.8	10.0
Subsidies and contributions	677	756	736	730	-9	1.1
Depreciation	6,968	7,379	8,358	9,309	11.4	2.2
All other	-2,511	-8,030	-9,863	-9,331	-5.4	20.6
Subtotal	34,267	36,328	39,926	40,304	.9	4.5
Total, Board operations	140,737	151,230	161,100	165,594	2.8	6.7
Extraordinary items	1,254	2,681	1,487	2,890	...	...
Office of Inspector General	2,821	3,060	2,941	2,965	.8	37.0

primarily the result of planned investments in automation.

Supervision and Regulation

The 1997 budget for supervision and regulation is approximately \$61.5 million, an increase of \$2.6 million, or 4.4 percent, over estimated 1996 expenses. Supervision includes the review of examination reports on state member banks and inspection reports on bank holding companies prepared by the Reserve Banks, preparation of special studies related to international applications, direction of enforcement actions, and regulation of trust activities. Regulation includes the formulation of regulations, oversight of mergers and foreign banking activities, enforcement of consumer protection regulations, and regulation of securities credit. The increase for this operational area is due largely to investments in automation and training and to the addition of staff positions. The budget provides increased funding for information systems hardware and software as well as for three new positions to meet expanded CRA

and HMDA requirements. Additional funds are also provided for training for Reserve Bank examiners in such areas as capital markets instruments, interest rate risk assessment, and asset and liability management. The foreign banking organization workstation project, a major new initiative to improve the supervision of foreign banking organizations (discussed earlier), is also contributing to the budget increase.

Services to Financial Institutions and the Public

The 1997 budget for services to financial institutions and the public is approximately \$3.4 million, an increase of \$0.2 million, or 6.2 percent, over estimated 1996 expenses. This operational area covers support to and oversight of the payment mechanism activities of the Reserve Banks and Branches (specifically, evaluation of the operational and pricing performance of their check payment activities); oversight of the electronic payments mechanism; and annual evaluation of the System's currency, coin, and food coupon operations. The budget

Table 2.4

Expenses of the Board of Governors for Operational Areas, Extraordinary Items, and Office of Inspector General, 1995–97¹

Thousands of dollars, except as noted

Type of expense	1995 actual	1996 estimate	1997 budget	Change, 1995 to 1996		Change, 1996 to 1997	
				Amount	Percent	Amount	Percent
Monetary and economic policy	63,348	69,363	70,389	6,015	9.5	1,026	1.5
Supervision and regulation .	56,677	58,907	61,488	2,230	3.9	2,581	4.4
Services to financial institutions and the public	2,986	3,208	3,408	222	7.4	200	6.2
System policy direction and oversight	28,219	29,622	30,309	1,403	5.0	687	2.3
Total, Board operations ...	151,230	161,100	165,594	9,870	6.5	4,494	2.8
Extraordinary items	2,681	1,487	2,890	-1,950	...	1,403	...
Office of Inspector General .	3,060	2,941	2,965	-119	-3.9	24	.8

1. Operating expenses include allocations for support and overhead.

increase for this area is due mainly to the full-year costs of 1996 salary actions and increased automation expenses.

System Policy Direction and Oversight

The 1997 budget for System policy direction and oversight is approximately \$30.3 million, an increase of \$0.7 million, or 2.3 percent, over estimated 1996 expenses. This operational area covers oversight, direction, and supervision of System and Board programs. Included are programs that directly support Board members in overseeing Reserve Bank operations, budgeting and accounting, financial examinations, audit and operations reviews, and automation and communications. The budget increase for this operational area is due mainly to increased investments in automation, including hardware, software, and other costs associated with implementing such

systems as the Financial Exams System for the Division of Reserve Bank Operations and Payment Systems.

Capital Budget

The Board's 1997 capital budget of \$12.2 million provides for automation infrastructure improvements, facility improvements, and office automation improvements (see "Highlights of the Budget").

Trends in Expenses and Employment

The increase in the 1997 operations budget, 2.8 percent, is lower than the estimated 6.5 percent increase from 1995 to 1996 mainly because of a smaller salary increase (3.0 percent for 1997 versus 4.0 percent for 1996) and continuing efforts to hold down costs. The 2.8 percent increase is also lower

Table 2.5

Positions Authorized at the Board of Governors for Operational Areas, Support and Overhead, and Office of Inspector General, 1995–97

Activity	1995 actual	1996 estimate	1997 budget	Change, 1995 to 1996		Change, 1996 to 1997	
				Amount	Percent	Amount	Percent
Monetary and economic policy	433	434	435	1	.2	1	.2
Supervision and regulation ...	392	393	389	1	.3	-4	-1.0
Services to financial institutions and the public	21	21	21	0	.0	0	.0
System policy direction and oversight	163	163	163	0	.0	0	.0
Support and overhead ¹	684	696	713	12	1.8	17	2.4
Subtotal	1,693	1,707	1,721	14	.8	14	.8
Reimbursable IRM support ² ..	20	25	25	5	25.0	0	.0
Total, Board operations	1,713	1,732	1,746	19	1.1	14	.8
Office of Inspector General ...	31	32	32	1	3.2	0	.0

1. Includes eleven summer intern positions and seventeen youth positions; 1997 figure also includes sixteen temporary (two-year) positions that will be abolished by year-end 1998.

2. Positions that provide IRM support to the Federal Financial Institutions Examination Council, on a reimbursable basis, for processing of HMDA data.

than the 6.2 percent average annual rate of increase over the past five years and the 6.7 percent average increase over the past ten years. The slowing of expense growth is largely attributable to moderating growth in the supervision and regulation operational area. Charts 2.1 through 2.5 show trends over 1987-97.

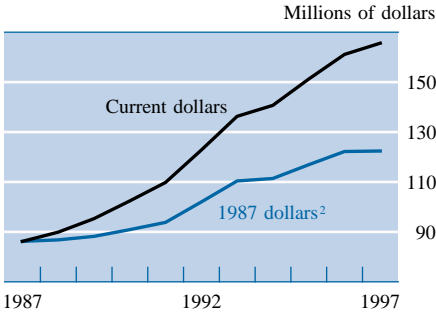
Because historically approximately three-fourths of the Board's operating expenses have been for personnel services, trends are closely related to staffing levels. As chart 2.5 shows, the number of positions authorized for Board operations over the past ten years has increased by 164 (10.7 percent), from 1,529 in 1987 to 1,693 in 1997. The increase has taken place mainly in

the supervision and regulation operational area (129 additional positions, an increase of 49.6 percent in that area).

In 1987 and 1990, the number of authorized positions was at a low of 1,529. The number increased significantly during the early 1990s, mainly because of an increasing workload due in large part to expanded responsibilities and requirements. Passage of legislation emphasizing regulatory and consumer issues has significantly increased staffing requirements in the areas of supervision and regulation and consumer and community affairs. Over the past several years, the increase in positions has been moderated by a program to reduce positions that eliminated more than 30 positions between 1993 and 1996. The 1997 increase is the result of the establishment of 16 temporary (two-year) positions in the Division of Information Resources Management to replace contract labor at an annual cost savings of \$350,000.

Although the number of authorized positions has fluctuated over the ten-year period, the proportion of the Board's budget devoted to salaries (excluding retirement and insurance benefits) has

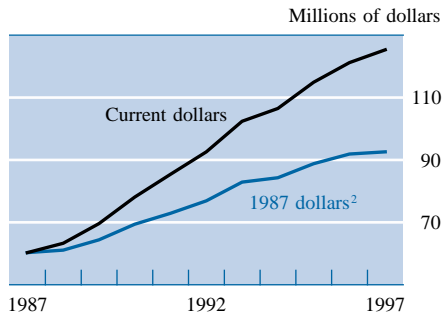
Chart 2.1
Operating Expenses of the Board of Governors, 1987-97¹



Year	Expenses in millions of	
	Current dollars	1987 dollars
1987	86.2	86.2
1988	89.9	86.8
1989	95.3	88.2
1990	102.4	90.9
1991	109.8	93.8
1992	122.8	102.0
1993	136.3	110.4
1994	140.7	111.4
1995	151.2	116.9
1996	161.1	122.2
1997	165.6	122.4

1. Excludes the Office of Inspector General and extraordinary items. For 1996, estimate; for 1997, budget.
2. Calculated with the GDP price deflator.

Chart 2.2
Expenses for Personnel Services at the Board of Governors, 1987-97¹



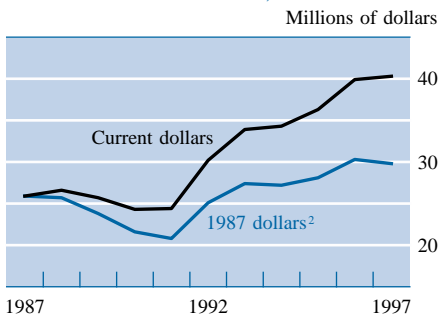
1. Excludes the Office of Inspector General and extraordinary items. For 1996, estimate; for 1997, budget.
2. Calculated with the GDP price deflator.

remained relatively stable at roughly 65 percent. The proportion devoted to retirement and insurance has increased as a result of increases in health insurance costs, a change in the law that applies Medicare costs to federal employees, and changes in the rate of the Board's contribution to the thrift plan. The increases have been partly offset by factors eliminating the Board's contribution to the retirement plan and the transfer of most employees in the Civil Service Retirement Plan to the Board Retirement Plan.

Extraordinary Items

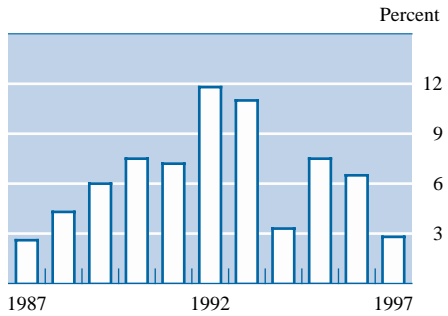
The 1997 extraordinary items budget provides \$2.9 million in operating funds and \$420,000 in capital funds for three unique projects. Included is \$2.4 million in operating funds and \$420,000 in capital funds to modify or replace software to ensure that it will operate properly after 1999. The century date change poses a significant challenge for the information systems industry. The problem is the absence in most information systems of the two-digit century value that distinguishes dates as either

Chart 2.3
Expenses for Goods and Services
at the Board of Governors, 1987-97¹



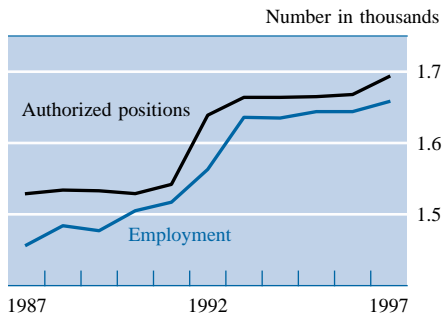
1. Excludes the Office of Inspector General and extraordinary items. For 1996, estimate; for 1997, budget.
2. Calculated with the GDP price deflator.

Chart 2.4
Annual Rate of Change in Operating
Expenses of the Board of Governors,
1987-97¹



1. Year-end data. Excludes the Office of Inspector General and extraordinary items. For 1996, estimate; for 1997, budget.

Chart 2.5
Employment and Authorized Positions
at the Board of Governors, 1987-97¹



Year	Employment	Authorized positions
1987	1,457	1,529
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	1,644	1,668
1997	1,658	1,693

1. Year-end data. Excludes summer intern and youth positions as well as positions for the Office of Inspector General, which for 1997 number 28 and 32 positions respectively; figures for 1993-97 also exclude positions that provide support to the FFIEC for processing of HMDA data.

the twentieth or the twenty-first century. Information systems for which dates are critical, such as regulatory reporting systems, deposit and loan systems, payments applications, and even building control systems, are subject to century date failure. Systems designed in recent years have addressed this problem, but older software applications must be evaluated and modified. The Board is participating in a Systemwide, multiyear project to make certain the Federal Reserve is prepared for the change by 1999.

The extraordinary items budget also provides \$350,000 for preliminary work on the 1998 Survey of Consumer Finances. The survey will gather information on the income, assets, debts, pensions, employment, use of financial services, saving behavior, and other financial characteristics of U.S. households. Cross-categorization of the data will make possible important statistical observations that are useful in a wide variety of economic studies.

Finally, the extraordinary items budget provides \$139,900 for the Board's portion of a Survey of Plant Capacity being conducted by the Bureau of the Census. The survey will obtain 1995 benchmarking data and 1996 capacity utilization estimates for manufacturing. This information will be published monthly in the Board's G.17 (410) statistical release, "Industrial Production and Capacity Utilization." ■

Chapter 3

Federal Reserve Banks

The 1997 budgets for the twelve Reserve Banks approved by the Board of Governors total \$2,031.9 million, an increase of \$34.2 million, or 1.7 percent, over estimated 1996 expenditures (table 3.1). Excluding the cost of the Automation Consolidation special project (\$34.7 million), the Reserve Banks' 1997 operating budgets total \$1,997.2 million, an increase of \$37.9 million, or 1.9 percent.¹

Employment, including the staff associated with FRAS, is budgeted at 23,258 ANP (average number of personnel), a decrease of 335 ANP, or 1.4 percent, from estimated 1996 employment.² Reserve Bank employment is expected to decline by 292 ANP, and FRAS employment by 43 ANP.

Expenses for personnel account for \$1,252.3 million, or 63 percent of the 1997 operations budget, an increase of \$24.3 million, or 2.0 percent, over

estimated 1996 personnel expenses (table 3.2). Nonpersonnel expenses (mainly for building and automation projects) are budgeted at \$744.9 million, an increase of \$13.6 million, or 1.9 percent, over estimated 1996 nonpersonnel expenses.

The following two sections discuss major projects and the budget objective for the Reserve Banks in 1997. Subsequent sections provide details for the four operational areas as well as for objects of expense, capital outlays, and long-term trends. Appendix A gives more information on capital outlays, the special project, and other special categories of expense, and appendix D gives additional data by Federal Reserve District and operational area.

Major Projects

The 1997 Reserve Bank budgets provide for the following major projects (table 3.3):

- Installation of new high-speed currency processors
- Installation of equipment and software to support image processing of commercial and government checks
- Building construction programs
- Office automation and upgrading of local area networks
- Reengineering programs
- Consolidation of data processing and data communications.

The ongoing project to replace older-generation currency processors that have been in use since 1978 with new high-speed processors is adding \$40.7 million to the 1997 operations

1. The budget for the Automation Consolidation special project includes transition expenses associated with the move to a centralized environment and expenses for FRAS (Federal Reserve Automation Services, the unit responsible for consolidated data processing and data communications for the Reserve Banks). FRAS charges to the Automation Consolidation special project in 1997 are budgeted at \$24.5 million.

2. *Average number of personnel* (ANP) is a measure of the number of employees in terms of full-time equivalents for the time 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. Because the Reserve Banks carry calculations related to employment to two decimal places but employment in this volume is expressed in whole numbers, rounding error may result in slight discrepancies in employment figures among the tables and charts in this volume.

budget, an increase of \$0.9 million over estimated 1996 expenditures. This project is in its final phase, and the last of the new processors will be installed in early 1997. In addition to the new processors, the project provides for the installation of reconciliation stations, sensors and detectors, and upgraded software to accommodate the newly designed currency. Of the total, \$0.8 million is associated with software upgrades, approximately the same amount as was budgeted for 1996.

Expenses for the ongoing check-imaging project are budgeted at \$15.8 million, an increase of approximately \$10.8 million over estimated 1996 expenditures. The budget increase for 1997 is associated with additional

equipment depreciation and maintenance, software amortization, and related programming and data processing requirements for both commercial and government check processing. Approximately 40 percent of the funds are earmarked for a government check-imaging project requested by the U.S. Treasury whereby the Federal Reserve will begin to provide image-supported check truncation services to the Treasury in early 1997. Also, in keeping with the System’s effort to expand the electronic delivery of check services, many Reserve Banks plan to offer imaging of commercial checks to depository institutions and are upgrading sorters and check-processing control software to make them image-capable.

Table 3.1
Expenses and Employment at the Federal Reserve Banks, 1996 and 1997¹

Category	1996 estimate	1997 budget	Change	
			Amount	Percent
<i>Expenses (millions of dollars)</i>				
Operations ²	1,959.3	1,997.2	37.9	1.9
Special project	38.4	34.7	-3.7	-9.7
Total	1,997.7	2,031.9	34.2	1.7
<i>Employment (average number of personnel)³</i>				
Operations ²	23,001	22,709	-292	-1.3
FRAS	592	549	-43	-7.3
Total	23,593	23,258	-335	-1.4

1. Excludes capital outlays.
2. Includes support and overhead (see appendix D, table D.3, note 1, for definitions).
3. See text note 2 for definition of average number of personnel.

Table 3.2
Operating Expenses of the Federal Reserve Banks, by Object, 1995–97¹

Millions of dollars, except as noted

Object	1995 actual	1996 estimate	1997 budget	Percentage change	
				1995 to 1996	1996 to 1997
Personnel	1,183.5	1,228.0	1,252.3	3.8	2.0
Nonpersonnel	681.2	731.3	744.9	7.4	1.9
Total	1,864.7	1,959.3	1,997.2	5.1	1.9

1. Excludes special projects.

A total of \$15.1 million has been budgeted for Board-approved building projects in Cleveland and Minneapolis, an increase of \$10.9 million over estimated 1996 expenditures.

Office automation projects are adding an additional \$3.2 million to the 1997 budget. Two Reserve Banks have identified plans to improve their local area networks (LANs) by improving the existing infrastructure and addressing backup and contingency needs; these projects account for \$2.0 million of the 1997 increase. Another Bank has budgeted \$1.2 million to convert the District's paper-based filing system to electronic images.

Several Reserve Banks are projecting savings, totaling \$9.7 million and 168 ANP, associated with reengineering projects (efforts to restructure business processes) and other operational improvements. While three Districts have identified initiatives to pursue opportunities to improve operations and reduce expenses, one District's projections are driving the savings. New York's reengineering program is expected to reduce expenses by \$7.8 million and 130 ANP

below estimated 1996 levels. A significant portion of these savings is due to the closing of the Jericho, New York, check-processing facility in October 1996.

Reserve Bank data processing and data communications operations have been consolidated at FRAS. Charges to the Reserve Banks by FRAS for these two services are expected to decrease \$6.9 million, or 4.3 percent, from estimated 1996 charges. The reduction is due to an overall cost reduction anticipated by FRAS as it moves closer to a steady-state environment.

1997 Budget Objective

In 1996 the Board approved a 1997 Reserve Bank budget objective that provided for an increase in total expenses, including special projects, of \$64.3 million, or 3.2 percent, over estimated 1996 expenditures. Excluding special project expenses, which were expected to decrease in 1997, the increase was projected to be 3.5 percent. The Board anticipated that within this guideline, expenses for continuing

Table 3.3
Major Federal Reserve Bank Projects, 1997

Million of dollars, except as noted

Project	1996 estimate	1997 budget	Change, 1996 to 1997	Contribution to total 1997 change in operations budget (percentage points)
Currency processors	39.8	40.7	.9	*
Check imaging projects	5.0	15.8	10.8	.6
Building construction programs	4.2	15.1	10.9	.6
Office automation/LAN upgrades	5.2	8.4	3.2	.2
Reengineering programs .....	. . .	-9.7	-9.7	-.5
FRAS production charges	159.7	152.8	-6.9	-.4
Total	213.9	223.1	9.2	.5
MEMO				
Total operating expenses	1,959.3	1,997.2	37.9	1.9

* Less than 0.05.

Table 3.4
Contribution to Total 1997 Change
in Reserve Bank Operations Budget

Percentage points

Item	Budget objective	Approved budget
Continuing operating expenses ...	2.6	1.1
Major projects .....	.9	.8
Total excluding special project ...	3.5	1.9
MEMO		
Special project	-3	-2
Total including special project ...	3.2	1.7

Reserve Bank operations (including the impact of an overall savings target of \$19.0 million) would increase 2.6 percent over estimated 1996 expenditures. Two major projects, check imaging and installation of new currency processors, were expected to account for \$18.0 million of the projected 1997 increase, and another project, building construction in two Districts, for \$8.3 million. Partly offsetting these increases would be a decrease of \$8.7 million due to lower FRAS production charges, for a net increase of \$17.6 million. Table 3.4 compares the 1997 budget objective with the approved 1997 budget.

The 1997 increase for continuing Reserve Bank operations (when the savings target is included) is \$28.5 million less than anticipated in the budget objective. The increase is less than the 2.6 percent target, by 1.5 percentage points, for two main reasons: Expenses for merit pay programs are budgeted at 1.2 percentage points less than projected (3.0 percent vs. 4.2 percent), and expenses for retirement and other benefits are budgeted at 2.5 percentage points less than projected (1.7 percent vs. 4.2 percent).

Major Reserve Bank projects are expected to contribute \$6.3 million less than the target approved by the Board. The decrease is due largely to a \$6.7 million decrease in costs for the currency-processing project resulting from a financial accounting change that extended the useful life of the equipment and to the renegotiation of the maintenance contract.

Offsetting the expected lower costs for the currency-processing project are higher-than-expected costs for building construction, which is adding \$10.9 million to the budget instead of the \$8.3 million anticipated in the budget objective. The increase over the budget objective is due primarily to the inclusion in the

Table 3.5
Operating Expenses of the Federal Reserve Banks, by Operational Area, 1995-97¹

Thousands of dollars, except as noted

Operational area	1995 actual	1996 estimate	1997 budget	Percentage change	
				1995 to 1996	1996 to 1997
Monetary and economic policy	128,303	138,143	145,693	7.7	5.5
Services to the U.S. Treasury and other government agencies	216,790	217,200	213,090	.2	-1.9
Services to financial institutions and the public	1,127,320	1,177,565	1,194,002	4.5	1.4
Supervision and regulation	392,294	426,385	444,431	8.7	4.2
Total	1,864,707	1,959,294	1,997,216	5.1	1.9

1. Includes the costs of support and overhead (see appendix D, table D.3, note 1, for definitions). Excludes special projects.

budget of real estate taxes for the new buildings in Minneapolis and Cleveland, the amounts for which were unknown at the time the budget objective was established. Also, FRAS production charges are declining less than anticipated in 1997 because a larger portion of expected long-term savings was realized in 1996.

The 1997 budget objective for the Automation Consolidation special project was \$33.0 million. The budgeted amount is \$34.6 million, somewhat more than the target but considerably less than estimated 1996 expenditures. Contributing to the 1997 budget are charges to the

special project of \$10.0 million by the New York Reserve Bank and \$24.5 million by FRAS.

Budget by Operational Area

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

Monetary and Economic Policy

The 1997 budget for the monetary and economic policy operational area is

Table 3.6

Employment at the Federal Reserve Banks, by Activity, 1995–97¹

Average number of personnel, except as noted²

Activity	1995 actual	1996 estimate	1997 budget	Percentage change	
				1995 to 1996	1996 to 1997
<i>Operational areas</i>					
Monetary and economic policy	737	728	731	-1.3	.5
Services to the U.S. Treasury and other government agencies	1,683	1,566	1,524	-7.0	-2.7
Services to financial institutions and the public	8,209	8,099	7,851	-1.3	-3.1
Supervision and regulation	3,074	3,126	3,100	1.7	-8
<i>Support and overhead³</i>					
Support	4,511	4,531	4,540	.4	.2
Overhead	4,949	4,952	4,963	.1	.2
Total	23,162	23,001	22,709	-.7	-1.3

1. Excludes special project and FRAS ANP.

2. See text note 2 for definition of average number of personnel.

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

Table 3.7

Expenses of the Federal Reserve Banks for Monetary and Economic Policy, 1995–97¹

Thousands of dollars, except as noted

Service	1995 actual	1996 estimate	1997 budget	Percentage change	
				1995 to 1996	1996 to 1997
Economic policy determination	100,616	108,864	113,805	8.2	4.5
Open market trading	27,687	29,279	31,887	5.8	8.9
Total	128,303	138,143	145,693	7.7	5.5

1. Excludes special projects.

\$145.7 million, an increase of \$7.5 million, or 5.5 percent, over estimated 1996 expenditures. The increase is due to merit pay increases, higher charges by FRAS, and higher costs for centralized end-user automation related to enhancing client-server platforms. The staffing level is increasing by 3 ANP, or 0.5 percent, over estimated 1996 employment, mainly because of the full-year

impact of filling positions that were vacant during part of 1996.

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

The 1997 budget for services to the U.S. Treasury and other government agencies of \$213.1 million is \$4.1 million, or 1.9 percent, below estimated 1996

Table 3.8

Expenses of the Federal Reserve Banks for Services to the U.S. Treasury and Other Government Agencies, 1995–97¹

Thousands of dollars, except as noted

Service	1995 actual	1996 estimate	1997 budget	Percentage change	
				1995 to 1996	1996 to 1997
Centralized operations—savings bonds	70,240	69,525	63,019	-1.0	-9.4
Other Treasury issues	22,493	21,855	14,412	-2.8	-34.1
Centralized operations—other Treasury issues	2,394	1,970	1,950	-17.7	-1.0
Centrally provided Treasury and agency services	29,552	26,343	34,348	-10.9	30.4
Government accounts	34,186	37,016	33,209	8.3	-10.3
Food coupons	24,202	25,789	26,659	6.6	3.4
Other	33,724	34,702	39,493	2.9	13.8
Total	216,790	217,200	213,090	.2	-1.9

1. Excludes special projects.

Table 3.9

Expenses of the Federal Reserve Banks for Services to Financial Institutions and the Public, 1995–97¹

Thousands of dollars, except as noted

Service	1995 actual	1996 estimate	1997 budget	Percentage change	
				1995 to 1996	1996 to 1997
Currency	224,729	246,513	248,101	9.7	.6
Coin	26,803	28,921	29,264	7.9	1.2
Special cash	5,155	5,600	4,943	8.6	-11.7
Commercial check	519,337	541,943	540,375	4.4	-3
Other check	38,656	37,887	41,876	-2.0	10.5
Funds transfer	68,361	62,001	68,352	-9.3	10.2
Automated clearinghouse	83,879	78,917	76,940	-5.9	-2.5
Book-entry securities transfer	38,338	37,396	38,972	-2.5	4.2
Other securities and noncash collection	7,710	8,041	7,201	4.3	-10.5
Loans to member banks and others	20,595	22,037	23,019	7.0	4.5
Public programs	64,159	74,184	78,313	15.6	5.6
Other	29,598	34,125	36,647	15.3	7.4
Total	1,127,320	1,177,565	1,194,002	4.5	1.4

1. Excludes special projects.

expenditures. The reduction is due mainly to staff reductions and lower charges by FRAS. These reductions are being partly offset by higher costs due to merit pay increases and for software being developed for the Treasury. Employment is projected to be 42 ANP, or 2.7 percent, lower than estimated 1996 employment. Staffing levels are being reduced in nearly all services. Staffing is declining by 15 ANP for the government accounts service as a result of anticipated lower volume associated with new tax filing requirements and by 10 ANP for the food coupon service as a result of expanded debit card programs. Reductions for other services are resulting from reengineering efforts in several Districts.

Services to Financial Institutions and the Public

Expenses for providing services to financial institutions and the public are budgeted at \$1,194.0 million, an increase of \$16.4 million, or 1.4 percent, over estimated 1996 expenditures. The budget for priced services is up \$5.5 million,

or 0.8 percent, over estimated 1996 expenditures, and the budget for non-priced services is up \$10.9 million, or 2.2 percent. Staffing is budgeted to decline by 248 ANP, or 3.1 percent, from estimated 1996 employment. Reductions are occurring in both priced and nonpriced services, including a decline of 173 ANP for the commercial check service due to the closing of the Jericho, New York, check-processing facility and improved efficiency at several Banks; a decline of 40 ANP resulting from efficiency gains as experience with the new currency processors increases; and a decline of 13 ANP for the ACH and funds transfer services due to improved efficiency resulting from the transition to centralized applications at FRAS. Partly offsetting these reductions are projected staff increases for public programs (21 ANP) in support of efforts to raise the Banks' visibility, improve the communication of economic policy, and expand community outreach programs.

Expenses for the commercial check and other check services are increasing \$2.4 million, or 0.4 percent, over estimated 1996 expenses. Offsetting the

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, 1995–97¹

Thousands of dollars, except as noted

Service	1995 actual	1996 estimate	1997 budget	Percentage change	
				1995 to 1996	1996 to 1997
U.S. government services ²	310,061	303,893	301,119	-2.0	-.9
Cash services	251,532	275,434	277,365	9.5	.7
Priced services	668,166	685,092	690,630	2.5	.8
Other	114,351	130,346	137,978	14.0	5.9
Total	1,344,109	1,394,765	1,407,093	3.8	.9

1. Excludes special projects

2. The Federal Reserve Banks also incur some expenses for the provision of services to the U.S. government that are recorded in the monetary and economic policy operational area. These expenses for 1995 were

\$647 thousand, bringing the total cost of services provided to U.S. government agencies by the Reserve Banks as fiscal agents and depositories of the United States to \$310,708 thousand.

savings associated with the staff reductions described above are greater expenses for the check-imaging project (\$5.3 million for commercial checks and \$5.5 million for government checks). Also increasing is the budget for the interdistrict transportation system (ITS), a result of network enhancements, higher fuel costs, and new contracts. The volume of commercial checks processed (including return items) is projected to increase 1.6 percent, with projections for individual Districts ranging from a decline of 2.4 percent to an increase of 7.8 percent. The volume of government checks processed is projected to decline 1.1 percent.

Expenses for the funds transfer service are budgeted to increase \$6.4 million, or 10.2 percent, over estimated 1996 expenditures, primarily because of higher charges by FRAS resulting from a change in the way data processing and data communications costs are redistributed (\$7.0 million). Expenses for the ACH service are budgeted to decrease \$2.0 million from estimated 1996 expenditures; reductions due to a decline in the staffing level (11 ANP) and lower software development costs are being partly offset by increased data processing and data communications expenses

associated with the change in the FRAS cost accounting methodology.

Supervision and Regulation

The 1997 budget for the supervision and regulation operational area is \$444.4 million, an increase of \$18.0 million, or 4.2 percent, over estimated 1996 expenditures. Changes in individual Reserve Bank budgets vary considerably from District to District and range from a decline of 4.2 percent to an increase of 14.2 percent. Overall, direct expenses are increasing 2.7 percent, mainly because of merit pay increases, more travel due to an increased number of foreign examinations, and greater expenses for equipment and software associated with a Systemwide effort to standardize and upgrade PC equipment and software. Support expenses are increasing 10.6 percent because of automation projects and higher occupancy costs. The staffing level is budgeted to decrease by 26 ANP, or 0.8 percent, from the estimated 1996 level; reductions associated with the supervision of District financial institutions are being partly offset by a slight increase associated with consumer affairs examinations.

Table 3.11
Expenses of the Federal Reserve Banks for Supervision and Regulation, 1995–97¹

Thousands of dollars, except as noted

Service	1995 actual	1996 estimate	1997 budget	Percentage change	
				1995 to 1996	1996 to 1997
Supervision of District					
financial institutions	234,029	251,974	263,526	7.7	4.6
Consumer affairs	37,257	44,884	48,617	20.5	8.3
Administration of laws and regulations					
related to banking	102,329	108,858	111,138	6.4	2.1
Studies of banking and financial					
market structures	18,679	20,669	21,151	10.7	2.3
Total	392,294	426,385	444,431	8.7	4.2

1. Excludes special projects.

Budget by Object of Expense

Personnel expenses—officer and employee salaries, other compensation to personnel, and retirement and other benefits—account for 63 percent of Reserve Bank operating expenses budgeted for 1997. The amount budgeted is 2.0 percent more than estimated 1996 personnel expenses (table 3.12).

Salaries and other personnel expenses, which account for 49 percent of budgeted 1997 operating expenses, are expected to be \$20.0 million, or 2.1 percent, greater than estimated 1996 expenses. Salaries for officers and employees are budgeted to increase \$23.1 million, or 2.5 percent. Contributing to the increase are merit increases (3.0 percent of salary liability, or \$28.6 million), promotions and reclassifications (\$8.5 million), and structure adjustments (\$0.8 million). Partly offsetting these increases are a

reduction in overtime (\$5.1 million), lower expenses resulting from short-term position vacancies or lag (\$6.2 million), and a decline in the staffing level of 292 ANP (\$3.7 million). The decrease in “other” personnel expenses (\$3.1 million) is due to a decline in the use of outside agency help.

Expenditures for retirement and other benefits, which account for 14 percent of budgeted 1997 operating expenses, are expected to increase \$4.4 million, or 1.7 percent, over estimated 1996 expenses. Benefits tied to salaries, such as social security payments and thrift plan contributions, are budgeted to increase 2.4 percent, and costs related to health care for active employees and retirees are budgeted to increase 1.0 percent. Other benefit expenses are increasing 0.9 percent.

Nonpersonnel expenses, which account for 37 percent of Reserve Bank operat-

Table 3.12
Operating Expenses of the Federal Reserve Banks, by Object, 1995–97¹

Thousands of dollars, except as noted

Object	1995 actual	1996 estimate	1997 budget	Percentage change	
				1995 to 1996	1996 to 1997
PERSONNEL					
Officers' salaries	94,919	100,585	106,026	6.0	5.4
Employees' salaries	803,188	837,473	855,118	4.3	2.1
Other personnel ²	33,895	26,694	23,565	-21.2	-11.7
Retirement and other benefits	251,543	263,230	267,624	4.6	1.7
Total personnel	1,183,545	1,227,982	1,252,332	3.8	2.0
NONPERSONNEL					
Forms and supplies	58,788	58,847	57,684	.1	-2.0
Equipment	152,027	164,683	180,534	8.3	9.6
Software	28,396	34,630	39,393	22.0	13.8
Shipping	78,067	79,028	79,932	1.2	1.1
Travel	45,463	46,728	45,229	2.8	-3.2
Buildings	156,610	167,163	176,000	6.7	5.3
Recoveries	-51,306	-52,069	-53,031	1.5	1.8
Other ³	213,119	232,302	219,144	9.0	-5.7
Total nonpersonnel	681,162	731,312	744,884	7.4	1.9
Total	1,864,707	1,959,294	1,997,216	5.1	1.9

1. Excludes special projects.

2. Expenses for certain contractual arrangements, and miscellaneous personnel expenses.

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

ing expenses budgeted for 1997, are projected to increase 1.9 percent over estimated 1996 nonpersonnel expenses.

Expenditures for equipment are expected to increase \$15.9 million, or 9.6 percent, accounting for 9 percent of budgeted 1997 operating expenses. Depreciation and maintenance costs are increasing for equipment related to major Reserve Bank projects, including check-imaging equipment and upgraded local area networks and end-user computing equipment. Expenses are also increasing as a result of depreciation on upgraded check-processing equipment, document-imaging equipment, and telephone and voice response upgrades.

Shipping expenses, which account for 4 percent of budgeted 1997 operating expenses, are expected to increase \$0.9 million, or 1.1 percent, mainly because of increased costs for the ITS network associated with new contracts, enhancements to the network, and the reinstatement of the federal airplane fuel user fee.

Building expenses, which account for 9 percent of budgeted 1997 operating expenses, are expected to increase \$8.8 million, or 5.3 percent. The increase is due partly to increased property depreciation subsequent to building improvements and renovations (\$3.6 million) and to increased real estate taxes (\$6.1 million) associated with building projects and with one-time credits in 1996 in two Districts for earlier overpayments. Also, the Cleveland Reserve Bank has budgeted an additional \$1.5 million for rent while its main building is being renovated.

“Other” nonpersonnel expenses are budgeted to decrease \$13.2 million from estimated 1996 expenses, accounting for 11 percent of budgeted 1997 operating expenses. The decrease is due mainly to lower charges by FRAS for data process-

ing and data communications services and to a reduction in fees paid to outside consultants.

Expenditures for foreign travel are budgeted at \$4.2 million, or 0.2 percent of budgeted 1997 operating expenses. The increase of \$0.6 million, or 15 percent, over estimated 1996 expenses is due largely to increased travel associated with the examination of foreign banks.

Capital Outlays

Capital outlays for 1997 are budgeted at \$346.4 million, a decrease of \$21.7 million, or 5.9 percent, from estimated 1996 expenses (table 3.13). The budget includes FRAS capital outlays of \$32.4 million, an increase of \$5.2 million, or 19.2 percent, over estimated 1996 expenses. The budgets of ten of the twelve Reserve Banks are below estimated 1996 outlays.

Building projects will continue to dominate the Reserve Banks’ capital budget over the next few years, with outlays for buildings budgeted at \$120.9 million, accounting for about 35 percent of total capital outlays budgeted for 1997. Included are funds for building projects in Minneapolis (\$26.2 million), Atlanta (\$5.5 million), and Birmingham (\$8.3 million) and funds for building renovation and a new operations center in Cleveland (\$44.0 million). Several major building refurbishment projects totaling approximately \$36.9 million are under way or planned for 1997, including a floor-by-floor renovation of the New York Reserve Bank building (\$7.9 million).

The building in Minneapolis will be ready for occupancy in July 1997, and occupancy of the operations center in Cleveland adjacent to the existing building is scheduled to begin in early 1997. Renovation of the existing Cleveland

building is scheduled for completion in 1998, and the building programs in Atlanta and for the Birmingham Branch should be completed around the end of the century.

Outlays for data processing and data communications equipment, budgeted at \$109.4 million, account for approximately 32 percent of capital outlays budgeted for 1997. Included in the budget is \$22.9 million for input devices, mainly personal computers and peripherals. More than \$14.0 million is earmarked for CPU equipment, largely for equipment at FRAS (\$10.7 million), including the acquisition of two processors (\$5.8 million), the upgrading of five processors (\$3.0 million), and the renewal of leases on two processors (\$1.9 million). The other significant CPU outlay (\$2.2 million) is related to government check operations in the Atlanta District. Storage devices account for \$12.4 million in the 1997 budget, including \$4.2 million for equipment at FRAS and \$7.7 million for government check image archive equipment. Other major data processing and data com-

munications outlays budgeted for 1997 include \$10.9 million for LAN equipment to replace existing equipment and to upgrade equipment in several Districts and \$9.1 million for check operations equipment unrelated to image services, mainly for replacement of medium- and high-speed sorters. The remaining data processing and data communications outlays include \$3.1 million for telephone systems and \$3.0 million for printers. In addition, FRAS has budgeted \$10.3 million for network operations equipment. Upgrading of backbone equipment (\$2.6 million) and data transport node (DTN) equipment (\$3.4 million) and expenditures on access equipment (\$3.0 million) will provide increased service levels and support for new customers. FRAS has also budgeted \$1.5 million for parallel sysplex equipment to help manage workloads more efficiently.

These figures reflect the \$16.7 million budgeted for check-imaging equipment, including \$7.6 million for the image archive and retrieval system and related equipment for government checks and

Table 3.13
Capital Outlays of the Federal Reserve Banks, by Class of Outlay, 1995–97

Thousands of dollars, except as noted

Class of outlay	1995 actual	1996 estimate	1997 budget	Percentage change	
				1995 to 1996	1996 to 1997
Data processing and data communications equipment ¹	97,474	97,528	109,414	.1	12.2
Buildings	89,086	110,951	120,864	24.5	8.9
Furniture, furnishings, and fixtures	11,991	23,098	35,412	92.6	53.3
Other equipment ²	77,360	81,135	28,578	4.9	-64.8
Land and other real estate	22,580	7,985	7,333	-64.6	-8.2
Building machinery and equipment	7,550	28,510	28,614	277.6	.4
Leasehold improvements	1,160	2,655	2,190	128.8	-17.5
Software ³	6,955	16,249	14,038	133.6	-13.6
Total	314,156	368,112	346,444	17.2	-5.9

1. Includes FRAS capital of \$38,826 thousand in 1995, \$23,556 thousand in 1996, and \$27,557 thousand in 1997.

2. Includes FRAS capital of \$2,884 thousand in 1995, \$107 thousand in 1996, and \$0 in 1997.

3. Includes FRAS capital of \$2,440 thousand in 1995, \$3,503 thousand in 1996, and \$4,812 thousand in 1997.

\$9.1 million for image-enabled sorters and other equipment for commercial checks.

Purchases of furniture and other equipment are budgeted at \$64.0 million, or about 18 percent of total capital outlays. The continuing installation of high-speed currency processors, reconciliation stations, and sensors and detectors and the upgrading of other equipment account for approximately 15 percent of the total (\$9.3 million). Another \$34.6 million is budgeted for new and replacement furniture and workstations associated mainly with the building projects in Cleveland and Minneapolis and the floor-by-floor renovation program in New York.

Building machinery and equipment outlays are budgeted at \$28.6 million, or about 8 percent of total capital outlays. Included are items related to the building projects in Cleveland (\$9.4 million) and Minneapolis (\$1.6 million) and replacements and upgrades in several Districts, including chiller replacements and upgrades (\$5.3 million) and elevator upgrades (\$2.7 million).

Software purchases in 1997 are budgeted at \$14.0 million. Check-image

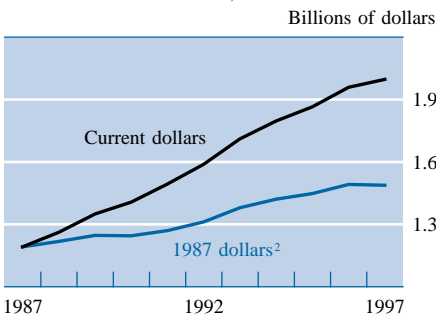
software accounts for about 35 percent of the total (\$5.0 million). FRAS has budgeted \$4.8 million for software associated mainly with the CPUs that will be upgraded. The New York Reserve Bank plans to replace its market data software (\$0.8 million), and the Banks also plan to purchase software for accounts payable systems, check and adjustment systems, and personnel systems.

Land and other real estate expenses are budgeted at \$7.3 million. The most significant outlay is associated with the building project in Birmingham (\$3.1 million).

Trends in Expenses and Employment

Over the ten years ending with the 1997 budget, Reserve Bank expenses have increased an average of 5.3 percent a year (chart 3.1). Over the same period, employment at the Reserve Banks (including FRAS) has increased by 248 ANP, from 23,010 in 1987 to 23,258 in 1997 (chart 3.2). Since 1987, staff increases have occurred in supervision and regulation mainly because of implementation of the Federal Deposit

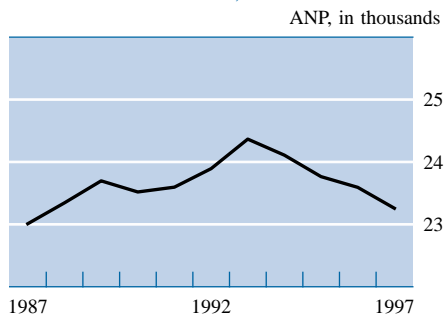
Chart 3.1
Operating Expenses of the Federal Reserve Banks, 1987–97¹



1. Excludes expenses for special projects. For 1996, estimate; for 1997, budget.

2. Calculated with the GDP price deflator.

Chart 3.2
Employment at the Federal Reserve Banks, 1987–97¹



1. Includes staff for special projects and FRAS. For 1996, estimate; for 1997, budget. See text note 2 for definition of ANP.

Insurance Corporation Improvement Act and the Community Reinvestment Act (952 ANP), in data services because of expanded automation requirements and the transition to consolidated processing at FRAS (444 ANP), in the currency service because of volume growth (80 ANP), and in public programs because of efforts to enhance consumer education and communications with the public (128 ANP). Partly offsetting these increases have been reductions in the commercial check service (610 ANP), the overhead services (61 ANP), the securities safekeeping and noncash services (184 ANP), the ACH and funds transfer services (270 ANP), services to the Treasury and other government agencies (312 ANP), and the monetary policy service (44 ANP). These staff reductions have been due largely to the consolidation of operations and increased operational efficiencies throughout the System.

The average annual growth of operating expenses has slowed in recent years and is projected to be 4.7 percent over the five years ending with the 1997 budget. Expanded bank supervision needs and the transition to a consolidated data processing and data communications environment at FRAS affected growth during this period. Mainly because of production charges from FRAS, nonpersonnel costs have been increasing at a faster rate than personnel costs—6.7 percent compared with 3.6 percent—as the Reserve Banks downsize labor-intensive and computer operations and substitute technology for labor. By operational area, expense increases over the five years have been highest for supervision and regulation (average annual increase of 10.0 percent), followed by monetary and economic policy (5.8 percent, reflecting increases in support and overhead services) and services to the Treasury and

other government agencies and services to financial institutions and the public (both 3.2 percent). The slowing of growth in recent years has resulted from several offsetting factors. Expenses for the currency service have increased an average of 8.7 percent a year, primarily because of the installation of new currency processors, and expenses for public programs have risen an average of 8.8 percent a year. Partly offsetting these increases have been decreases due to downsizing in the commercial check service resulting from declining volume and to centralization efforts in the funds transfer and ACH services.

Just over half of the expenses in the Reserve Banks' 1997 budget (about 52 percent) are recoverable through revenues or are reimbursable by the Treasury and other government agencies. The proportion of recoverable expenses is down from the 58 percent that was recoverable in 1992 because recoverable services are growing at a slower rate than nonrecoverable services: between 1992 and 1997, recoverable services have grown an average of 1.8 percent a year and nonrecoverable services an average of 7.5 percent a year.

Volume and Unit Costs

The volume of measured services in 1997 is expected to increase 1.4 percent over estimated 1996 volume, and the unit cost is expected to decrease 0.7 percent (table 3.14). Since 1992, volume has grown at an average annual rate of 1.6 percent and unit cost at an average annual rate of 0.9 percent. The decrease in unit cost between 1996 and 1997 reflects net decreases for the payments, cash, and fiscal services. Commercial checks, the largest component of the payments service (and of the overall index), anticipates a 2.4 percent decline in unit cost in 1997, and cash

Table 3.14
**Volume and Unit Cost of Measured
 Federal Reserve Bank Services**

Percentage change from 1996 to 1997

Service	Volume	Unit cost
Payments	1.9	-.8
Commercial check	1.6	-2.4
Funds transfer	4.2	5.8
Other checks	1.7	8.7
Cash ¹	1.6	-.7
Fiscal	1.8	-5.5
Securities and noncash	-7.0	9.1
All measured services	1.4	-.7

1. Includes currency and coin services.

services, the second largest component, a 0.7 percent decline.

1996 Budget Performance

In mid-1996 the Reserve Banks estimated that their expenses for the calendar year would be \$1,959.3 million—\$9.5 million, or 0.5 percent, less than the approved 1996 budget of \$1,968.8 million. The 1996 budget approved by the Board in December 1995 represented an increase of \$95.2 million, or 5.1 percent, over estimated 1995 expenses; at the estimated 1996 level of spending, the increase over actual 1995 expenditures would also be 5.1 percent.

Eight Reserve Banks expect to be under their approved 1996 District budgets, by as much as \$3.0 million. The other four banks expect overruns of less than 1.0 percent, none more than \$0.7 million. ■

Part II

Special Analysis

Chapter 4

Recent Changes in the Federal Reserve's Approach to Banking Supervision

The Federal Reserve has long had significant responsibilities for supervising and regulating the domestic and international activities of U.S. banking organizations, principally through its role in supervising state-chartered banks that are members of the Federal Reserve System, bank holding companies, and Edge Act and agreement corporations (corporations chartered to engage in international banking). In 1991, Congress expanded the Federal Reserve's supervisory authority over the U.S. activities of foreign banking organizations to fill certain gaps in their supervision and regulation and to ensure that the banking policies established by the Congress are implemented fairly and consistently with respect to all entities, domestic and foreign, that conduct banking business in the United States. That expanded authority, combined with trends within

the financial services industry, has led to refinements in the Federal Reserve's approach to banking supervision.

Growth of the Federal Reserve's Responsibilities

The recent increase in the Federal Reserve's supervisory responsibilities can best be illustrated by numbers showing the growth of financial assets subject to primary supervision by the Federal Reserve. From 1990 through 1995, aggregate assets under the Federal Reserve's supervision more than doubled, in large part because of the addition of the U.S. banking assets of foreign banking organizations to its jurisdiction (table 4.1). Moreover, the number of institutions supervised remained relatively stable, at approximately 7,000, despite a dramatic con-

Table 4.1

Assets Supervised by the Federal Reserve, by Type of Institution, 1990–95

Billions of dollars

Type of institution	1990	1991	1992	1993	1994	1995
State member banks	557	593	638	727	845	984
Bank holding companies (parent only)	328	337	370	423	454	507
Nonbank subsidiaries of bank holding companies ¹	174	169	179	217	237	266
Edge Act and agreement corporations ²	57	69	64	67	84	94
U.S. branches and agencies of foreign banking organizations ³	0	0	659	644	685	703
Total⁴	1,116	1,168	1,910	2,078	2,305	2,554

1. Includes nonbank subsidiaries of only those domestic bank holding companies that have material activity; excludes nonbank subsidiaries of foreign banking organizations.

2. Excludes the assets of such institutions that are subsidiaries of state member banks, which are included in the figures for state member banks; includes the

third-party assets of all other such institutions and their foreign subsidiaries.

3. Includes only state-licensed, uninsured branches and agencies of foreign banking organizations.

4. Excludes several hundred U.S. nonbank subsidiaries of foreign banking organizations, which at year-end 1995 had assets of approximately \$500 billion.

solidation within the U.S. banking system during that period (table 4.2). Third-quarter data (the latest available) suggest a continuation of these trends through last year.

State member banks account for a large portion of the Federal Reserve’s oversight responsibility. While the number of state member banks remained relatively stable between 1990 and 1995, at around 1,000, the assets of these banks increased 77 percent. The slight increase in the number of state member banks, about 3 percent, contrasts sharply with the 18 percent decline in the total number of insured commercial banks over the period. The stability in the number of state member banks was due in part to a greater number of mergers among national and state nonmember banks than among state member banks.

Although the number of bank holding companies and their nonbank subsidiaries declined between 1990 and 1995, the assets of these groups grew markedly over the period (54 percent); the securities activities of nonbank subsidiaries engaged in underwriting corporate securities, referred to as section 20 companies, accounted for most of the growth. Likewise, the assets of Edge Act and agreement corpora-

tions related to national banks, non-member state banks, and foreign banking organizations grew more than 60 percent between 1990 and 1995, despite a decline in the number of such institutions.

The Foreign Bank Supervision Enhancement Act of 1991 (FBSEA) greatly expanded the Federal Reserve’s oversight role by assigning it primary supervisory and regulatory authority over the U.S. operations of foreign banking organizations. The legislation increased the number of banking institutions for which the Federal Reserve has direct responsibility by more than 400, with assets at year-end 1995 of more than \$700 billion.¹ In addition (and not reflected in the tables), foreign banking organizations operate several hundred nonbank subsidiaries in the United States for which the Federal Reserve has supervisory responsibilities. Although comparable historical

1. Before passage of FBSEA, primary responsibility for supervising and examining the U.S. branches and agencies of foreign banking organizations lay with the licensing agencies—the states or the Office of the Comptroller of the Currency. In carrying out its responsibilities for foreign banking organizations before FBSEA, the Federal Reserve relied mainly on examinations conducted by the states.

Table 4.2
Number of Institutions Supervised by the Federal Reserve, by Type of Institution, 1990–95

Type of institution	1990	1991	1992	1993	1994	1995
State member banks	1,008	974	956	969	975	1,042
Bank holding companies (parent only) ¹	5,804	5,769	5,663	5,488	5,344	5,299
Nonbank subsidiaries of bank holding companies ²	244	251	227	206	199	180
Edge Act and agreement corporations ³	101	94	88	79	77	79
U.S. branches and agencies of foreign banking organizations ⁴	0	0	473	459	444	437
Total⁵	7,157	7,088	7,407	7,201	7,039	7,037

1. A significant number of bank holding companies are “shell” companies that require only periodic monitoring.
 2. See table 4.1, note 1.

3. Includes all such institutions.
 4. See table 4.1, note 3.
 5. See table 4.1, note 4.

data are not available for these entities, their assets are sizable, totaling approximately \$500 billion at year-end 1995.

The growth of the Federal Reserve's supervisory responsibilities has increased demands on the System's resources. The Federal Reserve is required by law to examine state member banks every twelve to eighteen months. Federal Reserve policy is to inspect annually those bank holding companies that have significant credit-extending non-bank subsidiaries or that have severe problems; in any case, all bank holding companies are monitored for regulatory compliance and to ensure that they do not present undue risks to their affiliated banks. Edge Act corporations are examined annually.

Supervision of the U.S. operations of foreign banking organizations is done within a comprehensive program that includes a review of the home country's financial system and significant accounting practices; an assessment of the strength of support a foreign bank can provide to its U.S. operations; and an assessment of the adequacy and appropriateness of the risk-management systems, operational controls, and regulatory compliance of the foreign bank's U.S. operations. The U.S. operations of foreign banking organizations, like those of U.S. insured commercial banks, must be examined every twelve to eighteen months. Under FBSEA, the Federal Reserve must also review and approve all applications by foreign banking organizations to acquire a U.S. bank or to establish a branch, agency, commercial lending company subsidiary, or representative office in the United States. As part of this process, a review is made of the degree to which the bank's home country regulator supervises the bank's worldwide operations on a consolidated basis.

A Changing Approach to Supervision

Examinations and inspections are conducted to evaluate the condition, management processes, and prospects of financial institutions; to identify deficiencies that may threaten their soundness; to assess compliance with applicable laws and regulations; and, when necessary, to develop recommendations for corrective action. In the past, examinations and inspections have focused on regulatory compliance and on assessing the financial strength of an institution by reconciling accounts, reviewing individual transactions, and analyzing the institution's financial condition.

In recent years, however, improved technology and financial innovations have enabled banks to develop financial products that can quickly alter their balance sheets and change their exposure to risk. As a result, supervisory authorities can no longer rely solely on periodic assessments of an institution's balance sheet position at a point in time, but must ensure that the institution has adequate procedures to identify, measure, monitor, and control its risk exposure. To meet these challenges, the Federal Reserve has reassessed and refined its approach to supervision to ensure that examinations and inspections are conducted efficiently and effectively, while taking into account new and emerging developments.

Important changes have been implemented or are in the process of being adopted based on a fundamental review of the Federal Reserve's examination procedures that included interviews with bank examiners and supervisors and with senior executives of banking organizations. These changes are intended to reflect the dramatic developments taking place in the financial services industry and to make the

examination process more risk-focused, burden-sensitive, and cost-effective. The changes include

- Refocusing on the areas of greatest risk to a bank and on an assessment of the bank's risk-management procedures and capabilities
- Customizing examinations to fit the size, activities, and risks of the institution
- Developing a streamlined examination program for smaller institutions
- Adapting the existing approach to examination, which is based on an institution's legal structure, to a framework based on the institution's functional or business lines
- Conducting a greater portion of an examination off-site
- Improving communications with examined institutions
- Cooperating more closely with internal auditors and outside accountants
- Placing greater emphasis on market discipline, and using positive incentives to encourage prudent oversight by management.

The Federal Reserve has adopted a risk-focused approach to examinations as the principal vehicle for implementing these changes. The risk-focused approach highlights the importance of the management process for identifying, measuring, monitoring, and controlling risk. It gives examiners more flexibility in planning and conducting examinations. The risk-focused approach also places more attention on an institution's internal controls and on analysis and planning before the on-site examination begins.

Other Changes in Federal Reserve Supervision

The Federal Reserve has taken a number of other steps to strengthen its super-

vision of U.S. banks, bank holding companies, and the U.S. operations of foreign banking organizations and to make its supervisory processes more efficient.

Use of Automation

To increase efficiency in the examination of state member banks, the Federal Reserve has applied new technology to many routine aspects of an examiner's work. This effort has led to development of an automated system, referred to as the Examiner Workstation, that automates much of the quantitative analysis of banking organizations, including sampling and evaluation of loan and investment portfolios. Automation has also been applied to the planning and documentation of examinations. These changes should help examiners identify and evaluate risks more efficiently.

To assist in the supervision of U.S. branches and agencies of foreign banking organizations (FBOs), the Federal Reserve is developing an automated system, referred to as the FBO Desktop, that provides information for use in off-site reviews, including information on foreign financial systems, foreign accounting standards, and the financial performance of FBOs with U.S. operations. Supervisory staff throughout the System will be able to access this information electronically and will be able to review and comment on performance reports online.

Coordination with Other Agencies

In preparing for the elimination of federal barriers to interstate banking, the Federal Reserve is working with the Conference of State Bank Supervisors, the Federal Deposit Insurance Corporation, and the various state banking agencies to develop a seamless, risk-

focused, and consistent supervisory program for state-chartered banks. In November 1996, the Federal Reserve, the Federal Deposit Insurance Corporation, and all of the state banking departments signed an agreement for coordinating the supervision and examination of state-chartered banks operating across state lines.

International Supervisory Policies

The Federal Reserve takes an active part in the international supervisory community as a member of the Basle Committee on Banking Supervision, operating under the auspices of the Bank for International Settlements in Basle, Switzerland. Representing the G-10 countries, the committee has developed numerous bank regulatory and supervisory standards that have strengthened bank operating practices throughout the world and have led to a more equitable basis for international competition.

The committee is currently focusing on evaluating the capital adequacy of banking organizations and on promoting more complete and consistent disclosure of information, improved accounting practices, and sound principles of risk management. The committee has also undertaken new initiatives with bank supervisors from non-G-10 countries to strengthen supervisory practices worldwide. A notable accomplishment in 1996 was the adoption of capital standards for market risk in trading and foreign exchange activities that rely on the results of a bank's internal risk-assessment models. Other efforts helped to promote greater public disclosure of bank trading and derivatives activities and standards for managing interest rate risk. ■

Appendixes

Appendix A

Special Categories of System Expense

Fees for priced services and the treatment of capital outlays are explained in this appendix. Also described are the Reserve Bank special project for 1996 and Federal Reserve 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 planning 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.¹ 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

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.

by the Federal Deposit Insurance Corporation (FDIC) (based on expected clearing balances and amounts deferred to depository institutions for items deposited for collection with the Reserve Banks); and the portion of the expenses of the Board of Governors that is directly related to the development of priced services.

The inclusion of all these costs means that the Federal Reserve offers its priced

services on a basis comparable with that in the private sector, and the discipline of the market ensures that the prices charged will be no higher than necessary.

Calculation of the PSAF for 1997

In 1996 the Board approved a 1997 private sector adjustment factor for Reserve Bank priced services of

Table A.1

Pro Forma Balance Sheet for Federal Reserve Priced Services, 1996 and 1997¹

Millions of dollars

Item	1996	1997
ASSETS		
<i>Short-term assets</i>		
Imputed reserve requirement on clearing balances	409.6	545.7
Investment in marketable securities	3,686.7	4,911.3
Receivables ²	64.4	64.3
Materials and supplies ²	8.6	11.6
Suspense and difference ² .....	.0	.0
Prepaid expenses ²	13.9	14.6
Items in process of collection	<u>2,413.2</u>	<u>2,548.2</u>
Total short-term assets	6,596.4	8,095.7
<i>Long-term assets</i>		
Premises ^{2,3}	346.4	348.0
Furniture and equipment ²	189.4	167.0
Leasehold improvements and long-term prepayments ²	14.6	18.0
Capital leases	<u>2.3</u>	<u>.7</u>
Total long-term assets	<u>552.7</u>	<u>533.7</u>
Total assets	7,149.1	8,629.4
LIABILITIES		
<i>Short-term liabilities</i>		
Clearing balances and balances arising		
from early credit of uncollected items	4,096.3	5,457.0
Deferred-credit items	2,413.2	2,548.2
Short-term debt ⁴	<u>86.8</u>	<u>90.5</u>
Total short-term liabilities	6,596.3	8,095.7
<i>Long-term liabilities</i>		
Obligations under capital leases	2.3	.7
Long-term debt ⁴	<u>182.7</u>	<u>180.5</u>
Total long-term liabilities	<u>185.0</u>	<u>181.2</u>
Total liabilities	6,781.3	8,276.9
Equity ⁴	<u>367.8</u>	<u>352.5</u>
Total liabilities and equity	7,149.1	8,629.4

1. Data are averages for the year.

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

3. Includes allocations of Board of Governors' assets

to priced services of \$0.5 million for both 1996 and 1997.

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

\$101.5 million, an increase of \$15.7 million, or 18.3 percent, over the PSAF of \$85.8 million targeted for 1996.

Asset Base

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

1997 is estimated at \$8,629.4 million (table A.1). The value of assets assumed to be financed through debt and equity in 1997 is \$623.5 million, a decrease of \$13.8 million, or 2.2 percent, from 1996 (table A.2); the decrease is due primarily to lower priced asset base levels at FRAS.

Table A.2

Derivation of the Private Sector Adjustment Factor (PSAF), 1996 and 1997

Millions of dollars, except as noted

Item	1996	1997
PSAF COMPONENTS		
<i>Assets to be financed</i> ¹		
Short-term	86.9	90.5
Long-term ²	550.4	533.0
Total	637.3	623.5
<i>Cost of capital (percent)</i> ³		
Short-term debt	3.9	5.2
Long-term debt	7.6	7.1
Pretax return on equity ⁴	14.2	19.1
Weighted average long-term cost of capital	12.0	15.1
<i>Capital structure (percent)</i>		
Short-term debt	13.6	14.5
Long-term debt	28.7	29.0
Equity	57.7	56.5
Tax rate (percent)	29.9	32.1
REQUIRED PSAF RECOVERIES		
<i>Capital costs</i> ⁵		
Short-term debt	3.4	4.7
Long-term debt	13.8	12.8
Equity	52.3	67.5
Total	69.5	85.0
<i>Other costs</i>		
Sales taxes	11.3	11.6
Assessment for federal deposit insurance	2.2	2.0
Expenses of Board of Governors	2.8	2.9
Total	16.3	16.5
Total PSAF recoveries		
Millions of dollars	85.8	101.5
As a percentage of capital	13.5	16.3
As a percentage of expenses	14.1	16.6

1. The asset base for priced services is directly determined.

2. Total long-term assets less capital leases that are self-financing.

3. All short-term assets are assumed to be financed by short-term debt. Of the total 1997 long-term assets, 33 percent are assumed to be financed by long-term debt and 67 percent by equity. The data are average rates paid by the fifty largest bank holding companies (determined by size).

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 1991–95 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.

Cost of Capital, Taxes, and Other Imputed Costs

For 1997, a pretax rate of return on equity of 19.1 percent, or \$67.5 million, is planned. Other required PSAF recoveries for 1997—imputed sales taxes, imputed FDIC insurance assessment, and Board expenses—total \$16.5 million (table A.2). The \$15.7 million increase in PSAF recoveries is attributable mainly to the increase in the pretax rate of return on equity, which in turn is a result of stronger 1995 bank holding company (BHC) financial performance included in the 1996 BHC model.

Capital Outlays

In accordance with generally accepted accounting principles (GAAP), the Federal Reserve System depreciates the cost of fixed assets over their estimated useful lives. In the federal government, where no requirement for depreciation accounting exists, the cost of fixed assets is typically recorded as an expense at the time of purchase. However, the *Policy and Procedures Manual for Guidance of Federal Agencies* of the General Accounting Office, which governs accounting procedures in the federal government, specifies in title 2 the use of depreciation accounting for business types of operations and for activities that recover costs from reimbursements or user charges. Certain activities of the Federal Reserve meet both these criteria. Under GAAP, the cost of acquiring an asset that is expected to benefit an entity over future periods should be allocated over those periods. Such treatment allows a more realistic measurement of operating performance.

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 \$1,000.

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 reviews capital expenditures for the Board.

Special Projects

Special projects are research and development activities that are expected to provide long-range benefits to the Federal Reserve System and the banking industry as a whole. Because spending on special projects is relatively high and short term, the Federal Reserve accounts for them separately from its operating expenses. For 1997, the Board of Governors has approved one special project.

Automation Consolidation

In 1992, the Federal Reserve System began to incur expenses for a major effort to consolidate all mainframe computer

The Automation Consolidation special project was created to capture the extraordinary costs associated with this effort. In 1992, work focused on establishing a project plan and on staffing and equipping the three data centers. In 1993 and 1994, the emphasis was on the conversion of District workloads and the transition of District EPS images to the production environment. In 1995, funds transfer processing was moved into the centralized environment, and the San Fran-

cisco and New York Reserve Banks completed the System’s move into the District-unique environment. In 1996, consolidation efforts centered around implementation of the centralized ACH and new book entry applications. In 1997, the banks will continue to implement the new book entry application, and the New York Bank will complete its transition to the centralized funds application.

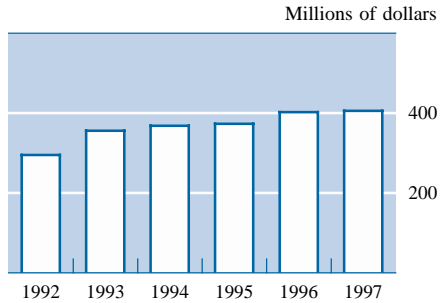
The 1997 budget provides \$34.7 million in support of these efforts. Including 1997 funding, expenditures on this special project to date total \$271.3 million.

Currency Printing and Circulation

The Department of the Treasury’s Bureau of Engraving and Printing prints U.S. currency; the Federal Reserve Banks put it into circulation through depository institutions and destroy it as it wears out (table A.3). The Board of Governors establishes the annual budget for the printing of new notes and ancillary costs and subsequently assesses the Federal Reserve Banks

Chart A.1

Federal Reserve Budget for Supplying U.S. Currency, 1992–97¹



1. For 1996, estimate; for 1997, budget.

through an accounting procedure similar to that used in assessing the Reserve Banks for Board operating expenses. In 1996, Federal Reserve expenditures related to supplying currency totaled an estimated \$402.4 million, about 9 percent less than the budgeted amount, primarily because fewer new notes were produced than originally projected. The 1997 currency budget is \$405.6 million, an increase of 0.8 percent over estimated 1996 expenditures (chart A.1).

Printing of Federal Reserve Notes

By far the largest expense in the currency budget is the cost of printing new Federal Reserve notes. The 1997 budget for the printing of new notes is \$392 million, a 0.6 percent increase over estimated 1996 expenditures (table A.4). Several factors influence the size of this portion of the currency budget. The most important is the number of notes printed. The 1997 budget provides for the printing of 9.8 billion notes. This figure is based on the anticipated destruction of an estimated 8.8 billion notes, an expected increase of about 625 million notes in circulation, and a planned increase of 375 million notes in Reserve Bank inventories (chart A.2).

Table A.3
Currency in Circulation, New Notes Issued, and Notes Destroyed, 1996

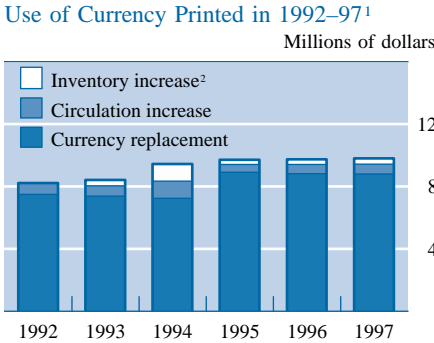
Millions of pieces

Dollar denomination	Notes in circulation ¹	New notes issued ²	Notes destroyed
1	6,219	4,441	4,097
2	538	32	9
5	1,464	1,008	923
10	1,351	883	865
20	4,103	2,085	1,733
50	941	269	176
100	2,523	1,044	876
Total	17,139	9,762	8,679

1. As of October 1996.

2. Figures for new notes issued do not include additions to inventory at the Reserve Banks.

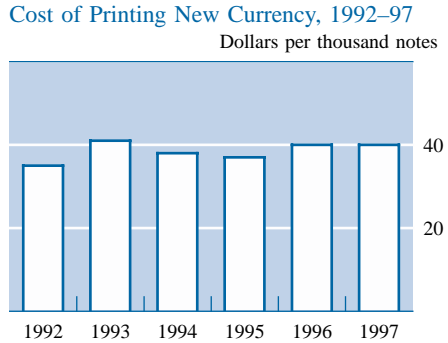
Chart A.2



1. For 1997, projections.
2. Reserve Bank inventories decreased in 1992.

The cost of printing the notes also influences the budget. The unit cost of producing Federal Reserve notes in 1997 will remain at the 1996 rate of \$40 per thousand notes (chart A.3). The unit cost, which is established by the Bureau of Engraving and Printing, is a blend of the costs of producing three types of notes. In 1997, 15 percent of the notes produced will be in the new design, 40 percent will be other threaded currency, and the remaining 45 percent will be \$1 notes, which have no thread. The unit cost also reflects the cost of a continuing initiative to educate the public about the new currency design. The amount budgeted for this program for 1997 is \$4 million, a decrease of

Chart A.3



57 percent from estimated 1996 expenditures on this program of \$9.5 million.

Shipment of Currency

The Board contracts with armored carriers to transport new currency from the Bureau of Engraving and Printing’s Washington, D.C., and Western facilities to the Federal Reserve Banks and their Branches. The 1997 budget for transporting new Federal Reserve notes is \$10 million, a 12.1 percent increase over estimated 1996 expenditures. The increase is due to a decrease in the standard size of air shipments and increases in air freight charges and in the number of notes shipped.

The 1997 currency budget also includes \$0.7 million for shipment of fit

Table A.4

Federal Reserve Costs of Supplying Currency, 1996 and 1997

Dollars, except as noted

Item	1996 estimate	1997 budget	Percentage change
Printing of new Federal Reserve notes	389,760,000	392,000,000	.6
Shipment of new notes	8,920,000	10,000,000	12.1
Shipment of fit notes within the System	658,000	700,000	6.4
Extended custodial inventory program	435,000	200,000	-54.0
Shipment of currency pallets to Bureau of Engraving and Printing	19,000	25,000	31.6
Reimbursement to the U.S. Treasury	2,600,000	2,700,000	3.9
Total cost of currency	402,392,000	405,625,000	.8

(usable) currency within the Federal Reserve System, an increase of 6.4 percent over estimated 1996 expenditures. Such shipments move currency from offices with excess fit currency to offices that would otherwise require new currency.

Extended Custodial Inventory Program

The extended custodial inventory (ECI) program was established in 1996 to facilitate the introduction of redesigned U.S. currency to the international U.S. banknote market. The Federal Reserve Bank of New York, which manages the program, maintains inventories of redesigned U.S. currency at several banks in selected locations abroad (currently London, Frankfurt, and Zurich). These banks verify and sort incoming deposits to assist in repatriation and destruction of pre-1996 series \$100 notes; they also work to develop an international market for fit Series 1996 \$100 notes.

The ECI program may be expanded, reduced, or discontinued in 1997 depending on the results of a review of its effectiveness. For purposes of the 1997 budget, expenses for the program are budgeted at \$0.2 million, 54 percent less than estimated 1996 expenditures. This amount represents the continuation of the ECI program at its current level of operation.

Return of Storage Pallets

The Bureau of Engraving and Printing stores currency in its vaults on aluminum pallets and uses the pallets in the shipment of currency to Federal Reserve offices. The pallets are also used in several Reserve Bank offices with automated currency vaults. The 1997 budget for returning empty pallets to the

Bureau of Engraving and Printing is \$25,000, an increase of 31.6 percent over estimated 1996 expenditures.

Reimbursement to the Treasury

Unfit currency is canceled, destroyed, and accounted for according to procedures prescribed by the U.S. Treasury's Office of Currency Standards. The Bureau of Engraving and Printing processes claims for redemption of damaged or mutilated currency. The Federal Reserve's 1997 currency budget includes \$2.7 million to reimburse the Treasury for this service, a 3.9 percent increase over estimated 1996 expenses. ■

Appendix B

Sources and Uses of Funds

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

The System derives its income primarily from earnings on U.S. government securities that the Federal Reserve has acquired through open market operations, one of the tools of monetary policy. These earnings account for approximately 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 \$23.4 billion for 1995 and are estimated to be \$20.1 billion for 1996. The latter figure does not include the special transfer of \$106 million of surplus from the Federal Reserve System to the Treasury on October 1, 1996, as statutorily required. ■

Table B.1

Income of the Federal Reserve System, 1995 and 1996

Millions of dollars

Source	1995 actual	1996 estimate
Loans	11.3	10.8
U.S. government securities ...	23,825.6	23,883.7
Foreign currencies	783.9	442.8
Priced services	738.8	787.7
Other	35.5	38.3
Total	25,395.1	25,163.3

Table B.2

Distribution of the Income of the Federal Reserve Banks, 1995 and 1996

Millions of dollars

Item	1995 actual	1996 estimate
Current income ¹	25,395	25,163
LESS		
<i>Current expenses of Reserve Banks</i> ²		
Operating expenses	1,568	1,641
Costs of earnings credits	251	307
EQUALS		
Current net income	23,577	23,215
PLUS		
Net additions to, or deductions from (-), current net income ³	896	-1,639
LESS		
Cost of unreimbursed Treasury services ⁴	38	37
<i>Assessments by the Board</i>		
Board expenses	161	163
Cost of currency	370	403
<i>Other distributions</i>		
Dividends paid to member banks ⁵	231	256
Transfers to, or from (-), surplus ^{6,7}	283	635
EQUALS		
Payment to U.S. Treasury ⁷	23,389	20,083

1. See table B.1.

2. Net of reimbursements due from the U.S. Treasury and other government agencies. Also reflects reductions of \$119.2 million in 1995 and \$139.5 million in 1996 in credits for net periodic pension cost.

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

7. Does not reflect the special transfer of \$106 million of surplus from the Federal Reserve System to the Treasury on October 1, 1996.

Appendix C

Federal Reserve System Audits

The Board of Governors, each of the Reserve Banks taken separately, 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, operations reviews, 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 last year expanded its audit contract with Coopers & Lybrand to include an annual financial audit of each of the twelve Federal Reserve Banks beginning in 1997. These audits will be in addition to the annual audit of the combined Reserve Bank financial statements that Coopers & Lybrand has done previously.

Since 1995, Coopers & Lybrand has conducted year-end audits of the combined Reserve Bank financial statement and of the individual financial statements of two or three Reserve Banks a year. The audit of the 1995 combined Reserve Bank financial statement represented the first such audit conducted by an independent accounting firm. On the basis of the success of that program, the Board decided to extend the outside audit to all twelve Reserve Banks. The Reserve Banks will continue to be 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 16 projects in various stages of completion, since 1979 has completed 147 reports on selected aspects of Federal Reserve operations (tables C.1 and C.2). The GAO has also involved the Federal Reserve in about 85 other reviews not directly related to the System and has terminated 52 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
Financial crises	10/27/92
OTC derivative sales practices	7/20/94
CFTC's exemptions	9/1/94
Interstate banking data	2/16/95
BHC Act prohibition on tying	3/20/95
Clearance and settlement systems	11/2/95
International financial crisis	3/6/96
International counterfeiting of U.S. currency	5/28/96
Proposed transfer of HUD responsibilities	6/10/96
Foreign bank internal/external controls	7/22/96
Foreign bank organization program	8/8/96
Expenditures for news subscriptions/services	10/16/96
Expenditures for Internet/Web site/bulletin board services	10/16/96
On-line banking services	10/16/96
Risk-based capital	11/6/96
Merger of bank and thrift charters	11/8/96

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
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

Table C.2
Continued

Report	Number	Date issued
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
Issues Related to Repeal of the Glass-Steagall Act	GGD-88-37	1/22/88
Preliminary Observations on the October 1987 Crash	GGD-88-38	1/26/88
Supervision of Overseas Lending Is Inadequate	NSIAD-88-87	5/5/88
Competitive Concerns of Foreign Financial Firms in Japan, the United Kingdom and the United States	NSIAD-88-171	6/2/88
Administrative Expenses at FHLBB and FRB for 1985 and 1986	AFMD-88-33	6/15/88

Table C.2

Completed GAO Reports Relating to the Federal Reserve System—Continued

Report	Number	Date issued
Government in the Sunshine Act Compliance at Selected Agencies	GGD-88-97	7/20/88
Trends in Commercial Bank Performance, December 1976–June 1987 ..	GGD-88-106BR	7/28/88
U.S. Commercial Banks' Securities Activities in London	NSIAD-88-238	9/8/88
Lending to Troubled Sectors	GGD-88-126BR	9/26/88
Government Check-Cashing Issues	GGD-89-12	10/7/88
Conflict of Interest: Abuses in Commercial Banking Institutions	GGD-89-35	1/27/89
Competitive Fairness Is an Elusive Goal	GGD-89-61	5/12/89
Independent Audits Needed to Strengthen Internal Control and Bank Management	AFMD-89-25	5/31/89
Information on the System's Check Collection Service	GGD-90-17	12/15/89
Oversight of Critical Banking Systems Should Be Strengthened	IMTEC-90-14	1/14/90
Activities of Securities of Bank Holding Companies	GGD-90-48	3/14/90
The Stock, Options, and Futures Markets Are Still at Risk	GGD-90-33	4/11/90
Update on U.S. Commercial Banks' Securities in London	NSIAD-90-98	5/7/90
U.S. Financial Services' Competitiveness under the Single Market Program	NSIAD-90-99	5/21/90
Limited Public Demand for New Dollar Coin or Elimination of Pennies ..	GGD-90-88	5/23/90
Oversight of Automation Used to Clear and Settle Trades Is Uneven ...	IMTEC-90-47	7/12/90
The Government's Exposure to Risks	GGD-90-97	8/15/90
Office of Inspector General Operations at Financial Regulatory Agencies ..	AFMD-90-55FS	8/24/90
Additional Reserves and Reform Needed to Strengthen the Fund	AFMD-90-100	9/11/90
More Transaction Information and Investor Protection Measures Are Needed	GGD-90-114	9/14/90
Issues Relating to Banks Selling Insurance	GGD-90-113	9/25/90
Implementation of Risk-Based Capital Adequacy Standards	NSIAD-91-80	1/25/91
Overview of Six Foreign Systems	NSIAD-91-104	2/22/91
Deposit Insurance: A Strategy for Reform	GGD-92-26	3/4/91
Bank Supervision: Prompt and Forceful Regulatory Actions Needed	GGD-91-69	4/15/91
Many Federal Agencies Collect and Disseminate Information	NSIAD-91-173	5/1/91
Money Laundering: The U.S. Government Is Responding to the Problem ..	NSIAD-91-130	5/16/91
A Framework for Limiting the Government's Exposure to Risks	GGD-91-90	5/22/91
Treasury Tax and Loan Activity at Two Troubled Banks	AFMD-91-87	9/12/91
OCC's Supervision of the Bank of New England Was Not Timely or Forceful	GGD-91-128	9/16/91
Bank Holding Company Securities Subsidiaries' Market Activities Update	GGD-91-131	9/20/91
Time Limits on Holding Deposits Generally Met but More Oversight Needed	GGD-91-132	9/30/91
Legislation Needed to Strengthen Bank Oversight	AFMD-92-19	10/21/91
Contracting Practices with Data Processing Servicers	GGD-92-19	2/5/92
Challenges to Harmonizing International Capital Standards Remain	GGD-92-41	3/10/92
Assessing the Need to Regulate Additional Financial Activities	GGD-92-70	4/21/92
Call Report Automation	IMTEC-92-60R	5/28/92
Flexible Accounting Rules Lead to Inflated Financial Reports	AFMD-92-52	6/1/92
Cross-Border Information Sharing Is Improving, but Obstacles Remain ..	GGD-92-110	7/28/92
Changes in Collateral Practices Could Reduce the Federal Government's Risk of Loss	AFMD-92-54	9/14/92
Initial Assessment of Certain BCCI Activities in the U.S.	GGD-92-96	9/30/92
Appraisal Reform: Implementation Status and Unresolved Issues	GGD-93-19	10/30/92
Bank and Thrift Criminal Fraud: The Federal Commitment Could Be Broadened	GGD-93-48	1/8/93
FRB Examinations and Inspections Do Not Fully Assess Bank Safety and Soundness	AFMD-93-13	2/16/93
Improvements Needed in Examination Quality and Regulatory Structure ..	AFMD-93-15	2/16/93
Personnel Engaged in Public and Congressional Affairs in Federal Agencies	GGD-93-71FS	3/8/93

Table C.2
Continued

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

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 recommends policies and 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 1996, the OIG publicly reported on thirteen audits (table C.3) and conducted a number of follow-up and other reviews. In addition, the OIG closed five investigations and performed numerous legislative and regulatory reviews. ■

Table C.3
Completed OIG Audit Reports Relating to the Federal Reserve System, 1996

Report	Number	Month issued
Audit of Board Oversight of Federal Reserve Automation Consolidation	A9405	2/96
Audit of the Division of Information Resources Management’s Change Control Process	A9505	2/96
Audit of the FFIEC’s Financial Statements (year ending 12/31/95)	A9601	2/96
Audit of the Board’s Financial Statements (year ending 12/31/95)	A9600	3/96
Assistance to Financial Statement Audit of the Federal Reserve Employee Benefits System (year ending 12/31/95)	A9605	3/96
Audit of the Board’s Consumer Compliance Examination Process	A9508	4/96
Audit of the Board’s InterFed Administration	A9607	6/96
Audit of the Division of Information Resources Management’s Operating System (MVS) and Access Control Software (CA-ACF2)	A9606	7/96
Audit of the Board’s Procurement and Contract Management Process	A9507-A	8/96
Audit of the Board’s Procurement and Contract Management Process: Credit Card Purchases	A9507-B	8/96
Audit of the Bank Holding Company Inspection Program	A9604	8/96
Report on the Failure of Guardian Bank	A9608	10/96
Audit of Board Oversight of Reserve Bank Procurement	A9603	12/96

Appendix D

*Expenses and Employment
at the Federal Reserve Banks*

Table D.1

Operating Expenses of the Federal Reserve Banks, by District, 1996 and 1997¹

Thousands of dollars, except as noted

District	1996 estimate	1997 budget	Change	
			Amount	Percent
Boston	132,045	132,180	135	.1
New York	407,930	424,390	16,460	4.0
Philadelphia	102,165	103,765	1,600	1.6
Cleveland	114,348	119,852	5,504	4.8
Richmond	148,378	152,560	4,182	2.8
Atlanta	182,654	184,192	1,538	.8
Chicago	212,587	213,222	635	.3
St. Louis	94,745	96,901	2,155	2.3
Minneapolis	98,668	104,157	5,488	5.6
Kansas City	127,466	124,917	-2,549	-2.0
Dallas	125,183	125,811	628	.5
San Francisco	213,125	215,272	2,147	1.0
Total, all Districts	1,959,294	1,997,216	37,922	1.9
<i>Special project</i>				
Automation Consolidation	38,385	34,667	-3,718	-9.7
Total	1,997,679	2,031,883	34,204	1.7

1. Excludes capital outlays.

*Table D.2***Employment at the Federal Reserve Banks, by District, 1996 and 1997**Average number of personnel, except as noted¹

District	1996 estimate	1997 budget	Change	
			Amount	Percent
Boston	1,255	1,241	-14	-1.1
New York	4,184	4,067	-117	-2.8
Philadelphia	1,259	1,254	-4	-.3
Cleveland	1,450	1,438	-12	-.8
Richmond	2,073	2,078	5	.3
Atlanta	2,298	2,299	2	.1
Chicago	2,310	2,244	-66	-2.9
St. Louis	1,191	1,210	18	1.5
Minneapolis	1,276	1,263	-13	-1.0
Kansas City	1,662	1,607	-56	-3.3
Dallas	1,549	1,545	-4	-.2
San Francisco	2,494	2,463	-31	-1.3
Total, all Districts	23,001	22,709	-292	-1.3
FRAS	592	549	-43	-7.3
Total	23,593	23,258	-335	-1.4

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

*Table D.3***Expenses of the Federal Reserve Banks, by Operational Area, 1996 and 1997**

Thousands of dollars, except as noted

Operational area	1996 estimate	1997 budget	Change	
			Amount	Percent
Monetary and economic policy	138,143	145,693	7,549	5.5
Services to the U.S. Treasury and other government agencies	217,200	213,090	-4,110	-1.9
Services to financial institutions and the public	1,177,565	1,194,002	16,437	1.4
Supervision and regulation	426,385	444,431	18,046	4.2
Total	1,959,294	1,997,216	37,922	1.9
MEMO ¹				
Support	717,176	732,993	15,818	2.2
Overhead	525,363	525,336	-27	*

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, whose costs can be charged to users according to the amount of use.

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

* Less than 0.05.

Table D.4

Expenses of the Federal Reserve Banks
for Salaries of Officers and Employees, by District, 1996 and 1997

Thousands of dollars, except as noted

District	1996 estimate	1997 budget	Change	
			Amount	Percent
Boston	56,247	57,880	1,633	2.9
New York	208,972	211,622	2,650	1.3
Philadelphia	49,605	50,829	1,224	2.5
Cleveland	51,285	52,978	1,692	3.3
Richmond	73,773	76,489	2,715	3.7
Atlanta	80,298	82,839	2,541	3.2
Chicago	97,583	99,844	2,261	2.3
St. Louis	42,642	45,060	2,418	5.7
Minneapolis	47,507	48,244	736	1.5
Kansas City	60,322	59,861	-461	-8
Dallas	58,662	60,653	1,992	3.4
San Francisco	111,162	114,847	3,685	3.3
Total	938,058	961,144	23,086	2.5

Table D.5

Factors in the 1996-to-1997 Change in 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 ¹	Overtime	Other	Total change
Boston	2.6	.0	1.0	.2	-.1	-.6	-.3	2.9
New York	3.2	.3	1.1	-1.4	-1.0	-.6	-.4	1.3
Philadelphia	2.9	.0	.7	.2	-.7	-.6	.0	2.5
Cleveland	2.7	.0	.3	1.6	-.7	-.5	.0	3.3
Richmond	2.9	.0	1.1	1.7	-1.3	-.8	.0	3.7
Atlanta	3.4	.0	.5	.2	-.4	-.6	.0	3.2
Chicago	3.5	.0	1.2	-2.0	-.6	-1.1	1.2	2.3
St. Louis	3.0	.0	.8	2.4	-.5	.0	.0	5.7
Minneapolis	2.5	.0	.5	-1.1	.0	.0	-.4	1.5
Kansas City	3.0	.2	1.1	-2.8	-1.4	-.8	.0	-8
Dallas	2.7	.1	.5	.0	.3	-.2	-.1	3.4
San Francisco	3.0	.0	1.0	-.1	-.5	-.2	.0	3.3
Total	3.0	.1	.9	-.4	-.7	-.5	.0	2.5

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, 1996 and 1997

Thousands of dollars, except as noted

District	1996 estimate	1997 budget	Change	
			Amount	Percent
Boston	15,828	13,057	-2,770	-17.5
New York	60,712	52,982	-7,731	-12.7
Philadelphia	13,990	10,212	-3,778	-27.0
Cleveland	45,308	74,866	29,558	65.2
Richmond	24,830	13,941	-10,889	-43.9
Atlanta	34,556	31,139	-3,417	-9.9
Chicago	14,197	20,742	6,545	46.1
St. Louis	9,176	9,045	-131	-1.4
Minneapolis	62,227	51,920	-10,308	-16.6
Kansas City	14,540	6,453	-8,087	-55.6
Dallas	14,693	7,460	-7,232	-49.2
San Francisco	30,892	22,259	-8,633	-27.9
Total, all Districts	340,947	314,074	-26,873	-7.9
FRAS	27,165	32,370	5,204	19.2
Total	368,112	346,444	-21,669	-5.9

Table D.7

Budget Performance of the Federal Reserve Banks,
Operating Expenses, by District, 1996¹

Thousands of dollars, except as noted

District	1996 budget	1996 estimate	Change	
			Amount	Percent
Boston	132,920	132,045	-875	-.7
New York	407,749	407,930	180	*
Philadelphia	104,343	102,165	-2,178	-2.1
Cleveland	114,712	114,348	-364	-.3
Richmond	147,841	148,378	537	.4
Atlanta	185,657	182,654	-3,003	-1.6
Chicago	214,923	212,587	-2,336	-1.1
St. Louis	94,085	94,745	660	.7
Minneapolis	98,688	98,668	-20	*
Kansas City	127,893	127,466	-427	-.3
Dallas	127,076	125,183	-1,893	-1.5
San Francisco	212,883	213,125	242	.1
Total, all Districts	1,968,770	1,959,294	-9,476	-.5
<i>Special project</i>				
Automation Consolidation	36,905	38,385	1,480	4.0
Total	2,005,675	1,997,679	-7,996	-.4

1. Excludes capital outlays.

* Less than 0.05.

Table D.8

Budget Performance of the Federal Reserve Banks,
Employment, by District, 1996Average number of personnel, except as noted¹

District	1996 budget	1996 estimate	Change	
			Amount	Percent
Boston	1,253	1,255	2	.2
New York	4,228	4,184	-44	-1.0
Philadelphia	1,289	1,259	-31	-2.4
Cleveland	1,451	1,450	-2	-.1
Richmond	2,094	2,073	-21	-1.0
Atlanta	2,366	2,298	-68	-2.9
Chicago	2,343	2,310	-33	-1.4
St. Louis	1,209	1,191	-18	-1.5
Minneapolis	1,294	1,276	-18	-1.4
Kansas City	1,668	1,662	-6	-.4
Dallas	1,568	1,549	-19	-1.2
San Francisco	2,497	2,494	-3	-.1
Total, all Districts	23,261	23,001	-260	-1.1
FRAS	563	592	29	5.1
Total	23,824	23,593	-231	-1.0

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, 1992-97¹

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
1992	109,954	182,307	1,020,974	276,038	1,589,272
1993	114,617	193,621	1,076,914	326,334	1,711,486
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 estimate	138,143	217,200	1,177,565	426,385	1,959,294
1997 budget	145,693	213,090	1,194,002	444,431	1,997,216
MEMO					
Average annual change (percent)	5.8	3.2	3.2	10.0	4.7

1. Excludes special projects.

*Table D.10***Employment at the Federal Reserve Banks, by Operational Area, 1992–97**Average number of personnel, except as noted¹

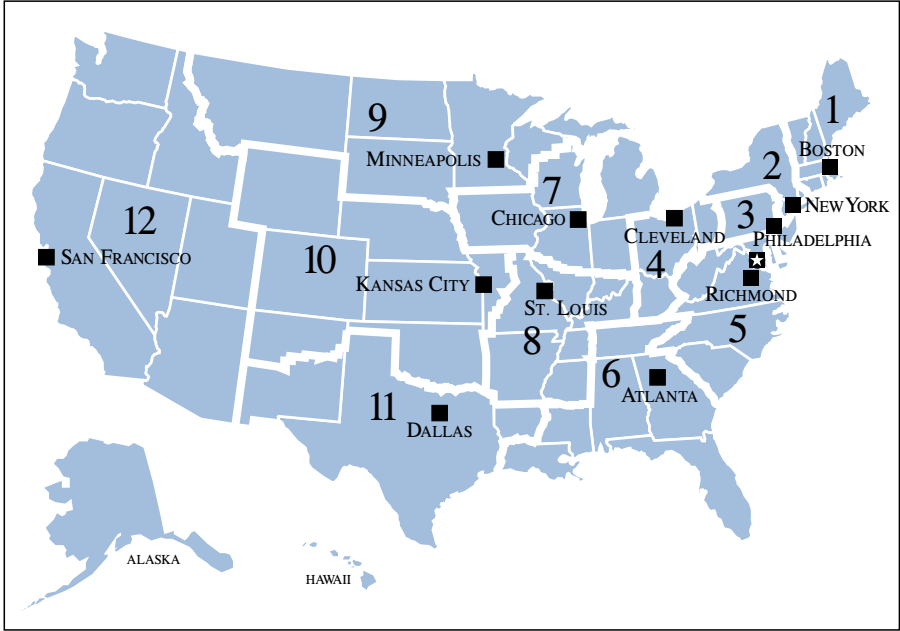
Year	Monetary and economic policy	Services to the U.S. Treasury and other government agencies	Services to financial institutions and the public	Supervision and regulation	Support ²	Overhead ²	Total
1992	776	1,832	8,878	2,587	4,711	4,998	23,782
1993	751	1,780	8,609	2,910	4,762	5,182	23,995
1994	729	1,754	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 estimate	728	1,566	8,099	3,126	4,531	4,952	23,001
1997 budget	731	1,524	7,851	3,100	4,540	4,963	22,709
MEMO							
Average annual change (percent)	-1.2	-3.6	-2.4	3.7	-7	-.1	-.9

1. Excludes special projects and FRAS. See chapter 3, note 2, for definition of average number of personnel.

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

*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 February 1997.

