BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Financial Statements

December 31, 2006 and 2005

(With Independent Auditors' Report Thereon)

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

To the Board of Governors of the Federal Reserve System:

We have audited the accompanying balance sheets of the Board of Governors of the Federal Reserve System (the Board) as of December 31, 2006 and 2005, and the related statements of revenues and expenses and changes in cumulative results of operations, and cash flows (hereinafter referred to as "financial statements") for the years then ended. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Board of Governors of the Federal Reserve System, as of December 31, 2006 and 2005, and the results of its operations, and its cash flows, for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 3 to the financial statements, in 2006, the Board adopted the provisions of the Financial Accounting Standard Board Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans.*

In accordance with *Government Auditing Standards*, we have also issued our reports dated April 17, 2007, on our consideration of the Board's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

KPMG LLP

April 17, 2007

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BALANCE SHEETS

ASSETS	As of December 31, 2006	2005
CURRENT ASSETS		
Cash	$ 60,030,706	$ 45,970,435
Accounts receivable	2,625,907	3,081,520
Prepaid expenses and other assets	4,260,507	2,992,412
Total current assets	66,917,120	52,044,367
NONCURRENT ASSETS		
Property and equipment, net (Note 4)	151,205,386	155,441,553
Total noncurrent assets	151,205,386	155,441,553
Total assets	$ 218,122,506	$ 207,485,920

LIABILITIES AND CUMULATIVE RESULTS OF OPERATIONS	2006	2005
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$ 10,950,470	$ 16,906,350
Accrued payroll and related taxes	5,421,666	4,860,572
Accrued annual leave	16,334,512	15,456,484
Capital lease payable (current portion)	327,663	270,167
Unearned revenues and other liabilities	366,304	783,711
Total current liabilities	33,400,615	38,277,284
LONG-TERM LIABILITIES		
Capital lease payable (non-current portion)	108,755	406,188
Accumulated retirement benefit obligation (Note 5)	1,354,662	813,497
Accumulated postretirement benefit obligation (Note 6)	8,111,829	6,237,290
Accumulated postemployment benefit obligation (Note 7)	6,515,301	5,111,365
Total long-term liabilities	16,090,547	12,568,340
Total liabilities	49,491,162	50,845,624
CUMULATIVE RESULTS OF OPERATIONS		
Working capital	33,844,168	14,037,250
Unfunded long-term liabilities	(14,325,986)	(12,162,152)
Net investment in property and equipment	150,768,968	154,765,198
Accumulated other comprehensive income (loss) (Note 8)	(1,655,806)	-
Total cumulative results of operations	168,631,344	156,640,296
Total liabilities and cumulative results of operations	$ 218,122,506	$ 207,485,920

See accompanying notes to financial statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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

	For the years ended December 31, 2006	2005
BOARD OPERATING REVENUES		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures	$ 301,013,500	$ 265,742,100
Other revenues (Note 9)	8,508,949	8,520,342
Total operating revenues	309,522,449	274,262,442
BOARD OPERATING EXPENSES		
Salaries	182,239,595	174,523,825
Retirement and insurance	35,853,297	31,847,951
Contractual services and professional fees	23,944,564	24,695,564
Depreciation, amortization, and net losses on disposals	13,058,667	12,954,506
Utilities	9,185,840	9,065,329
Travel	8,820,503	7,613,280
Software	6,637,765	6,052,617
Postage and supplies	4,560,368	7,169,829
Repairs and maintenance	2,634,459	3,361,179
Printing and binding	1,505,470	1,973,594
Other expenses (Note 9)	7,435,067	7,486,158
Total operating expenses	295,875,595	286,743,832
RESULTS OF OPERATIONS	13,646,854	(12,481,390)
ISSUANCE AND REDEMPTION OF FEDERAL RESERVE NOTES		
Assessments levied on Federal Reserve Banks for currency costs	491,962,202	477,087,471
Expenses for currency printing, issuance, retirement and shipping	491,962,202	477,087,471
CURRENCY ASSESSMENTS OVER (UNDER) EXPENSES	-	-
TOTAL RESULTS OF OPERATIONS	13,646,854	(12,481,390)
CUMULATIVE RESULTS OF OPERATIONS, Beginning of year	156,640,296	169,121,686
OTHER COMPREHENSIVE INCOME		
Adjustment to initially apply FASB Statement No.158 (Note 8)	(1,655,806)	-
Total Other Comprehensive Income	(1,655,806)	-
CUMULATIVE RESULTS OF OPERATIONS, End of year	$ 168,631,344	$ 156,640,296

See accompanying notes to financial statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF CASH FLOWS

	For the years ended December 31, 2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
RESULTS OF OPERATIONS	$ 13,646,854	$ (12,481,390)
Adjustments to reconcile results of operations to net cash provided by (used in) operating activities:		
Depreciation and net losses on disposals	13,058,667	12,954,506
Increase in assets:		
Accounts receivable, prepaid expenses and other assets	(812,482)	(362,385)
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	(5,955,880)	3,014,489
Accrued payroll and related taxes	561,094	308,533
Accrued annual leave	878,028	1,260,574
Unearned revenues and other liabilities	(417,407)	316,047
Accumulated retirement benefit obligation	541,165	219,328
Accumulated postretirement benefit obligation	1,874,539	447,724
Accumulated postemployment benefit obligation	1,403,936	(197,200)
Accumulated other comprehensive income	(1,655,806)	-
Net cash provided by operating activities	23,122,708	5,480,226
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from disposals	7,212	2,850
Capital expenditures	(8,829,712)	(19,370,223)
Net cash used in investing activities	(8,822,500)	(19,367,373)
CASH FLOWS FROM FINANCING ACTIVITIES		
Capital lease payments	(239,937)	(249,710)
Net cash used in financing activities	(239,937)	(249,710)
NET INCREASE (DECREASE) IN CASH	14,060,271	(14,136,857)
CASH BALANCE, Beginning of year	45,970,435	60,107,292
CASH BALANCE, End of year	$ 60,030,706	$ 45,970,435

See accompanying notes to financial statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
NOTES TO FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

(1) STRUCTURE

The Federal Reserve System was established by Congress in 1913 and consists of the Board of Governors (Board), the Federal Open Market Committee, the twelve regional Federal Reserve Banks, the Federal Advisory Council, and the private commercial banks that are members of the System. The Board, unlike the Reserve Banks, was established as a federal government agency and is supported by Washington DC based staff numbering approximately 1,800, as it carries out its responsibilities in conjunction with other components of the Federal Reserve System.

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

(2) OPERATIONS AND SERVICES

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

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

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
NOTES TO FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

(3) SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting - The financial statements have been prepared on the accrual basis of accounting.

Revenues - Assessments for operating expenses and additions to property are based on expected cash needs.

Issuance and Redemption of Federal Reserve Notes - The Board incurs expenses and assesses the Federal Reserve Banks for currency printing, issuance, retirement, and shipping of Federal Reserve Notes. These assessments and expenses are separately reported in the statements of revenues and expenses because they are passed through the Board account and are not Board operating transactions.

Property, Equipment, and Software - The Board's property, buildings, equipment, and software are stated at cost less accumulated depreciation and amortization. Depreciation and amortization is calculated on a straight-line basis over the estimated useful lives of the assets, which range from 3 to 10 years for furniture and equipment, 10 to 50 years for building equipment and structures, and 2 to 10 years for software. Upon the sale or other disposition of a depreciable asset, the cost and related accumulated depreciation or amortization are removed from the accounts and any gain or loss is recognized.

Art Collections - The Board has collections of works of art, historical treasures, and similar assets. These collections are maintained and held for public exhibition in furtherance of public service. Proceeds from any sales of collections are used to acquire other items for collections. As permitted by Statement of Financial Accounting Standards Number 116, *Accounting for Contributions Received and Contributions Made*, the cost of collections purchased by the Board is charged to expense in the year purchased and donated collection items are not recorded. The value of the Board's collections has not been determined.

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

Reclassifications - Certain 2005 amounts have been reclassified to conform with the 2006 presentation.

Implementation of FASB Statement No. 158, Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans - The Board initially applied the provisions of FASB Statement No. 158, Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, at December 31, 2006. This accounting standard requires recognition of the overfunded or underfunded status of a defined benefit postretirement plan in the Balance Sheets, and recognition of changes in the funded status in the years in which the changes occur through comprehensive income. The transition rules for implementing the standard require applying the provisions as of the end of the year of initial implementation with no retrospective application.

(4) PROPERTY AND EQUIPMENT

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

	As of December 31,	
	2006	2005
Land	$ 18,640,314	$ 18,640,314
Buildings and improvements	147,504,169	135,152,735
Furniture and equipment	47,271,434	39,926,270
Software in use	13,681,508	12,415,000
Software in process	941,912	575,050
Construction in process	360,966	13,928,149
	228,400,304	220,637,518
Less accumulated depreciation and amortization	(77,194,918)	(65,195,965)
Property and equipment, net	$ 151,205,386	$ 155,441,553

Furniture and equipment includes $1,230,000 each year for capitalized leases as of December 31, 2006 and 2005. Accumulated depreciation includes $867,000 and $612,000 for capitalized leases as of December 31, 2006 and 2005, respectively. The Board paid interest related to these capital leases in the amount of $54,000 and $83,000 for 2006 and 2005, respectively.

Construction in process includes costs incurred in 2006 and 2005 for long-term security projects and building enhancements.

The future minimum lease payments required under the capital leases and the present value of the net minimum lease payments as of December 31, 2006, are as follows:

	Year Ending December 31	Amount
	2007	$ 463,491
	2008	138,279
	2009	-
Total minimum lease payments		601,770
Less: Amount representing maintenance included in total amounts above		(130,540)
Net minimum lease payments		471,230
Less: Amount representing interest		(34,812)
Present value of net minimum lease payments		436,418
Less: Current maturities of capital lease obligations		(327,663)
Long-term capital lease obligations		$ 108,755

(5) ACCUMULATED RETIREMENT BENEFITS

The following information provides disclosure requirements contained in Statement of Financial Accounting Standards No.132, *Employers' Disclosures about Pensions and Other Postretirement Benefits* .

Substantially all of the Board's employees participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan). The System Plan is a multi-employer plan which covers employees of the Federal Reserve Banks, the Board, and the Office of Employee Benefits. No separate accounting is maintained of assets contributed by the participating employers. The Federal Reserve Bank of New York acts as a sponsor of the System Plan, and the costs associated with the Plan are not redistributed to other participating employers.

Employees of the Board who became employed prior to 1984 are covered by a contributory defined benefits program under the System Plan. Employees of the Board who became employed after 1983 are covered by a non-contributory defined benefits program under the System Plan. Contributions to the System Plan are actuarially determined and funded by participating employers. Based on actuarial calculations, it was determined that employer funding contributions were not required for the years 2006 and 2005, and the Board was not assessed a contribution for these years. Because the plan is part of a multi-employer plan, information as to vested and nonvested benefits, as well as plan assets, as it relates solely to the Board, is not readily available.

Effective January 1, 1996, Board employees covered under the System Plan are also covered under a Benefits Equalization Plan (BEP). Benefits paid under the BEP are limited to those benefits that cannot be paid from the System Plan due to limitations imposed by Sections 401(a)(17), 415(b) and 415(e) of the Internal Revenue Code of 1986. Activity for the BEP for 2006 and 2005 is summarized in the following table:

	2006	2005
Change in Projected Benefit Obligation		
Benefit obligation at beginning of year	$ 536,339	$ 140,953
Service cost	185,483	193,209
Interest cost	45,004	35,964
Plan participants' contributions	-	-
Plan amendments	-	-
Actuarial (gain)/loss	596,114	168,027
Benefits paid	(8,278)	(1,814)
Benefit obligation at end of year	$ 1,354,662	$ 536,339

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
NOTES TO FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
Change in Plan Assets		
Fair value of plan assets at beginning of year	$ -	$ -
Actual return on plan assets	-	-
Employer contributions	8,278	1,814
Plan participants' contributions	-	-
Benefits paid	(8,278)	(1,814)
Fair value of plan assets at end of year	$ -	$ -
Reconciliation of Funded Status at End of Year		
Funded status	$ (1,354,662)	$ (536,339)
Unrecognized net actuarial (gain)/loss	580,386	(15,728)
Unrecognized prior service cost	(247,417)	(261,430)
Unrecognized net transition obligation	-	-
Prepaid/(Accrued) pension cost	$ (1,021,693)	$ (813,497)
Amounts recognized in the financial statements consist of		
Prepaid benefit cost	$ -	$ -
Accrued benefit liability	(1,021,693)	(813,497)
Intangible asset	-	-
Accumulated other comprehensive income	(332,969)	-
Net amount recognized	$ (1,354,662)	$ (813,497)
Information for pension plans with an accumulated benefit obligation in excess of plan asset:		
Projected benefit obligation	$ 1,354,662	$ 536,339
Accumulated benefit obligation	$ 546,854	$ 278,252
Weighted-average assumptions used to determine benefit obligation as of December 31		
Discount rate	5.75%	5.75%
Rate of compensation increase	4.50%	4.50%
Components of Net Periodic Benefit Cost		
Service cost - benefits earned during the period	$ 185,483	$ 193,209
Interest cost on projected benefit obligation	45,004	35,964
Expected return on plan assets	-	-
Amortization of prior service cost	(14,013)	(14,013)
Amortization of (gains)/losses	-	5,982
Amortization of initial (asset)/obligation	-	-
Net periodic benefit cost (credit)	$ 216,474	$ 221,142

Additional information:	2006	2005
Increase in minimum liability included in other comprehensive income	$ -	$ -
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31		
Discount rate	5.75%	5.75%
Rate of compensation increase	4.50%	4.25%

A relatively small number of Board employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). These defined benefit plans are administered by the U.S. Office of Personnel Management, which determines the required employer contribution levels. The Board's contributions to these plans totaled $334,000 and $324,000 in 2006 and 2005, respectively. The Board has no liability for future payments to retirees under these programs and is not accountable for the assets of the plans.

Employees of the Board may also participate in the Federal Reserve System's Thrift Plan. Board contributions to members' accounts are based upon a fixed percentage of each member's basic contribution and were $8,964,000 and $8,617,000 in 2006 and 2005, respectively.

(6) ACCUMULATED POSTRETIREMENT BENEFITS

The following information provides disclosure requirements contained in Statement of Financial Accounting Standards No.106, *Employers' Accounting for Postretirement Benefits Other Than Pensions.*

The Board provides certain life insurance programs for its active employees and retirees. Activity for 2006 and 2005 is summarized in the following table:

	2006	2005
Change in Benefit Obligation		
Benefit obligation at beginning of year	$ 8,273,831	$ 8,404,551
Service cost	230,567	217,421
Interest cost	470,256	437,320
Plan participants' contributions	-	-
Plan amendments	-	(196,970)
Actuarial (gain)/loss	(603,500)	(304,006)
Benefits paid	(259,325)	(284,485)
Benefit obligation at end of year	$ 8,111,829	$ 8,273,831

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
NOTES TO FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
Change in Plan Assets		
Fair value of plan assets at beginning of year	$ -	$ -
Actual return on plan assets	-	-
Employer contribution	259,325	284,485
Plan participants' contributions	-	-
Benefits paid	(259,325)	(284,485)
Fair value of plan assets at end of year	$ -	$ -
Reconciliation of Funded Status at End of Year		
Benefit obligations	$ (8,111,829)	$ (8,273,832)
Unrecognized net actuarial (gain)/loss	-	2,145,920
Unrecognized prior service cost	-	(109,378)
Amount recognized at end of year	$ (8,111,829)	$ (6,237,290)
Amounts recognized in the financial statements consist of		
Liability	$ (8,111,829)	$ -
Accrued benefit cost	-	(6,237,290)
Accumulated other comprehensive income	-	-
Net amount recognized	$ (8,111,829)	$ (6,237,290)
Amounts recognized in accumulated other comprehensive income consist of:		
Net actuarial loss/(gain)	$ 1,422,398	-
Prior service cost/(credit)	(99,560)	-
Transition obligation/(asset)	-	-
Deferred curtailment (gain)/loss	-	-
	$ 1,322,838	$ -
Expected Cash Flows		
Expected employer contributions:		
2007	$ 274,901	
Expected benefit payments:		
2007	$ 274,901	
2008	296,030	
2009	325,793	
2010	350,050	
2011	364,265	
2012-2016	2,132,108	

The liability and costs for the postretirement benefit plan were determined using discount rates of 5.75 percent as of December 31, 2006 and 2005. Unrecognized losses of $2,145,920 as of December 31, 2005 result from changes in the discount rate used to measure the liabilities. The assumed salary trend rate for measuring the increase in postretirement benefits related to life insurance was an average of 4.50 percent.

The above accumulated postretirement benefit obligation is related to the Board-sponsored life insurance programs. The Board has no liability for future payments to employees who continue coverage under the federally sponsored life and health programs upon retiring. Contributions for active employees participating in federally sponsored health programs totaled $9,607,000 and $8,933,000 in 2006 and 2005, respectively.

(7) ACCUMULATED POSTEMPLOYMENT BENEFIT PLAN

The following information provides disclosure requirements contained in Statement of Financial Accounting Standards No.112, *Employers' Accounting for Postemployment Benefits* .

The Board provides certain postemployment benefits to eligible former or inactive employees and their dependents during the period subsequent to employment but prior to retirement. Costs were projected using the same discount rates as were used for projecting postretirement costs. The accrued postemployment benefit costs recognized by the Board for the years ended December 31, 2006 and 2005, were $1,963,000 and $155,800, respectively.

(8) ACCUMULATED OTHER COMPREHENSIVE INCOME

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

	Amount Related To Defined Benefit Retirement Plans	Amount Related To Postretirement Benefits Other than Pensions	Total Accumulated Other Comprehensive Income (Loss)
Balance January 1, 2006	$ (1,021,693)	$ (6,788,992)	$ (7,810,685)
Adjustment to initially apply Statement No. 158	(332,969)	(1,322,837)	(1,655,806)
Balance December 31, 2006	$ (1,354,662)	$ (8,111,829)	$ (9,466,491)

Additional detail regarding the classification of accumulated other comprehensive income is included in note 6.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
NOTES TO FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

(9) OTHER REVENUES AND OTHER EXPENSES

The following are summaries of the components of Other Revenues and Other Expenses.

	For the years ended December 31,	
	2006	2005
Other Revenues		
Data processing revenue	$ 4,180,692	$ 3,788,217
Rent	2,450,576	2,433,833
Subscription revenue	716,294	782,743
Reimbursable services to other agencies	599,827	664,755
Board sponsored conferences	-	250,650
Miscellaneous	561,560	600,144
Total other revenues	$ 8,508,949	$ 8,520,342
Other Expenses		
Tuition, registration and membership fees	$ 2,676,871	$ 2,573,028
Contingency operations	1,087,429	956,476
Public transportation subsidy	988,950	872,467
Subsidies and contributions	706,497	656,150
Meals and representation	529,557	518,640
Equipment and facilities rental	393,122	336,342
Administrative law judges	105,587	268,228
Security investigations	236,448	184,880
Former employee related payments	19,296	319,461
Miscellaneous	691,310	800,486
Total other expenses	$ 7,435,067	$ 7,486,158

(10) COMMITMENTS AND CONTINGENCIES

Leases

The Board has entered into several operating leases to secure office, training and warehouse space for remaining periods ranging from one to four years. Minimum annual payments under the operating leases having an initial or remaining noncancelable lease term in excess of one year at December 31, 2006, are as follows:

2007	$	176,807
2008		183,880
2009		191,235
2010		198,884
2011		84,218
	$	835,024

Rental expenses under the operating leases were $193,000 in 2006 and $157,000 in 2005.

Commitments

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

Litigation

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

One action currently pending in U.S. District Court for the District of Columbia alleges discrimination on behalf of a class of African American secretaries at the Board under Title VII of the Civil Rights Act of 1964, as amended. On January 31, 2007, the action was dismissed for failure to exhaust administrative remedies. The plaintiffs have moved to alter or amend judgment on this ruling; that motion is pending. Should the case be reinstated either as a result of the pending motion or following any appeal, the Board believes it has substantial defenses and intends to defend the case vigorously.

Four additional actions are pending in the United States District Court for the District of Columbia under Title VII of the Civil Rights Act of 1964, as amended and/or the Age Discrimination in Employment Act. All four are believed to be without merit and are being vigorously contested.

Five additional matters alleging employment discrimination are currently pending administrative resolution. One case is related to, and likely will be joined with, a case currently pending in district court. In that and another case there has not yet been an investigative report. Therefore, management is unable at this time to determine the potential for a materially adverse effect on the financial statements. Management believes that the likelihood of an unfavorable outcome in the remaining three cases is remote.

(11) FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

The Board is one of the five member agencies of the Council, and currently performs certain management functions for the Council. The five agencies which are represented on the Council are the Board, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision. The Board's financial statements do not include financial data for the Council. Activity related to the Board and Council for 2006 and 2005 is summarized in the following table:

	2006	2005
Board paid to the Council:		
Assessments for operating expenses of the Council	$ 109,760	$ 83,811
Central Data Repository	740,003	1,096,062
Uniform Bank Performance Report	204,617	202,666
Total Board paid to the Council	$ 1,054,380	$ 1,382,539
Council paid to the Board:		
Data processing related services	$ 3,429,499	$ 3,572,816
Administrative services	183,000	175,000
Total Council paid to the Board	$ 3,612,499	$ 3,747,816
Accounts receivable due from the Council	$ 395,551	$ 277,589
Accounts payable due to the Council	$ 54,870	$ 104,864

(12) FEDERAL RESERVE BANKS

The Board performs certain functions for the Reserve Banks in conjunction with its responsibilities for the Federal Reserve System, and the Federal Reserve Banks provide certain administrative functions to the Board. Activity related to the Board and Reserve Banks for 2006 and 2005 is summarized in the following table:

	2006	2005
Board paid to the Reserve Banks:		
Assessments for employee benefits	$ 2,380,474	$ 2,072,595
Data processing and communication	2,161,298	2,106,850
Contingency site	1,087,429	956,476
Total Board paid to the Reserve Banks	$ 5,629,201	$ 5,135,921
Reserve Banks paid to the Board:		
Assessments for currency costs	$ 491,962,202	$ 477,087,471
Assessments for operating expenses of the Board	301,013,500	265,742,100
Data processing	731,999	516,433
Total Reserve Banks paid to the Board	$ 793,707,701	$ 743,346,004
Accounts receivable due from Federal Reserve Banks	$ 854,142	$ 145,142
Accounts payable due to Federal Reserve Banks	$ 12,417	$ -

(13) NONCASH FINANCING ACTIVITIES

In 2005, the Board billed a federal government agency $1,096,557 for rent and leasehold improvements. In 2006, the federal government agency provided equipment, software, and services valued at $392,301 to the Board and paid the balance of $704,256 in 2006. In 2006, the Board billed the same agency $143,772 for rent, and the agency provided telecommunication equipment and services valued at $124,720 to the Board and paid the balance of $19,052 in 2006.

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report on Internal Control over Financial Reporting

To the Board of Governors of the Federal Reserve System:

We have audited the balance sheets of the Board of Governors of the Federal Reserve System (the Board) as of December 31, 2006 and 2005, and the related statements of revenues and expenses and changes in cumulative results of operations, and cash flows (hereinafter referred to as "financial statements") for the years then ended, and have issued our report thereon dated April 17, 2007.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standard*s, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the Board is responsible for establishing and maintaining effective internal control. In planning and performing our 2006 audit, we considered the Board's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards*. The objective of our audit was not to express an opinion on the effectiveness of the Board's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Board's internal control over financial reporting.

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

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Board's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the third paragraph above and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

In our 2006 audit, we noted a matter described in Exhibit I involving internal control over financial reporting that we consider to be a significant deficiency. We believe that this significant deficiency is not a material weakness. Exhibit II presents the status of the prior year finding.

The Board's response to the findings identified in our audit is presented in the Exhibit I. We did not audit the Board's response and, accordingly, we express no opinion on it.

We noted certain additional matters that we have reported to the management of the Board in a separate letter dated April 17, 2007.

This report is intended solely for the information and use of the Board's management, the Office of Inspector General, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

April 17, 2007

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Significant Deficiency

December 31, 2006

Improvement is needed in Internal Controls over Financial Reporting

Management is responsible for developing and maintaining effective internal controls to provide reasonable assurance that the Board has the ability to initiate, authorize, record, process, and report financial data reliably in accordance with generally accepted accounting principles. Internal controls help ensure that reliable and timely information is obtained, maintained, reported, and used for decision making.

Appropriate internal controls should be integrated into each policy and procedure established by the Board to direct and guide its operations. Monitoring the effectiveness of internal controls should occur in the normal course of business throughout the year. Periodic reviews, reconciliations, or comparisons of data should be included as part of staff's regularly assigned duties. In addition, periodic assessments should be integrated into management's continuous monitoring of internal controls to help provide assurance that weaknesses in the design or operation of internal control, which could adversely affect the Board's ability to meet its financial reporting objectives, are prevented or detected in a timely manner.

Board management is committed to improving its internal control environment as demonstrated by its ability to resolve prior year findings.

The following paragraphs discuss weaknesses noted in the Board's internal control over financial reporting that could adversely affect the Board's ability to produce accurate and timely financial statements. None of these deficiencies individually would be considered a significant deficiency. However, the combination of these deficiencies is considered to be a significant deficiency.

Recording Accounts Payable, Accrued Liabilities, and Prepaid Expenses

During 2006, the Management Division identified and processed transactions and journal entries to reclassify/and or correct several transactions that were initially coded to a different general ledger account or recorded in a different accounting period. We noted that the original transactions were initially reviewed and approved by a supervisor, and all the required changes were not identified during this initial review as follows.

- Two disbursements totaling $11,230, of the 115 disbursement transactions tested totaling $18,473,927, were initially recorded in different general ledger accounts or were 2007 transactions that were recorded as 2006 transactions. One transaction for $5,980 was identified and adjusted during management's review prior to year end, and one transaction for $5,250 was corrected as a post closing entry.
- Two accounts payable transactions totaling $45,709, of the 21 accounts payable invoices tested totaling $2,969,595, were received in 2006 for services to be provided in 2007. These were initially recorded as accounts payable in 2006. Both transactions were corrected as a post closing entry.
- One prepaid expense totaling $11,927, of the 19 prepaid expenses tested totaling $1,758,579, was a 2007 invoice that was paid in 2006 and was initially recorded as 2006 expense. This was subsequently identified and adjusted during management's review prior to year end.

(Continued)

We commend the Board for identifying most of these entries prior to year end. However, the Board should strengthen its procedures for posting and reviewing all entries to ensure initial posting to the proper accounts and accounting period.

Posting Accrued Annual Leave

We noted that the annual leave accrual was overstated by $301,600 at December 31, 2006, because the annual leave report did not reflect the proper year end information for all employees. The Board subsequently recorded a post closing entry to reflect the appropriate amounts.

Billing of Accounts Receivable

We noted that the Board did not record a year-end receivable from the Bank for International Settlement (BIS) for $157,317 representing services performed in 2006. Although the invoice for the 2006 services was not finalized, recorded, and submitted until 2007, this amount should have been recorded as a receivable at December 31, 2006. As a result of our audit, the Board recorded a post closing entry for this amount.

Monitoring Miscellaneous Receivables

During our audit, we noted that the Board does not have specific policies and procedures for monitoring miscellaneous receivables related to relocation expenses to determine if amounts are considered collectible and appropriately recorded. As a result of our audit, the Board recorded post closing entries to write off three accounts receivables amounting to $105,599 for relocation expenses that were not considered collectible.

Recording Property Transactions

During our audit of property and equipment, we noted that the Board inappropriately processed property and equipment additions and adjustments as follows.

- Two assets purchased for $113,016 in 2006 were recorded at an acquisition value of $109,259. As a result, the asset was overstated by $3,757.

- Three assets valued at $329,375 were put into service with the incorrect in-service dates. As a result, the 2006 depreciation expense was overstated by $25,700.

- One asset was placed in service on March 1, 2006 for $811,756, but did not have any depreciation recorded in 2006. As a result, the Board's depreciation expense was understated by $20,294.

- Three adjustments related to 22 assets acquired via trade-in were overstated on the depreciation schedule in 2005. As a result, depreciation for 2005 was overstated by $27,294 and correspondingly understated by the same amount in 2006.

During our physical inspection test work of property and equipment, we noted that one of the 22 items inspected, valued at $76,744, was included on the asset listing for the Board's contingency site, although it was physically

(Continued)

located in the Board's Washington, DC, facility. Our inspection also found that the asset tag number for one item valued at $7,042 was not identified in the Board's financial system.

Recording Financial Statement Disclosures

During our audit, we noted instances where the Board needs to improve its preparation and review process for the financial statements as follows.

- Assets traded in for other assets were incorrectly recorded as *Proceeds from Disposals* and *Capital Expenditures* in the Statement of Cash Flows. The entries, totaling $159,519, represent non-cash transactions and should not have been included in the *Proceeds from Disposals* or the *Capital Expenditures* sections of the Statement of Cash Flows.

- In Footnote 4, *Property and Equipment,* Construction in Process was initially reported as zero, and in the corresponding roll-forward schedule, the balance was $360,966.

- In Footnote 7, *Accumulated Postemployment Benefit Plan*, the Board initially understated the accrued postemployment benefits costs for FY2006. The Board originally reported $1,828,000. However, this amount did not reflect the external actuary's revised calculation, which resulted in an upward adjustment of $134,000.

The Board subsequently made all necessary adjustments in the financial statements.

Recommendations

To strengthen internal controls over financial reporting, we recommend that the Board:

- Strengthen the control process over the initial input and review of disbursement transactions to ensure that they are properly coded and recorded in the general ledger. We also recommend that management conduct periodic training for all relevant personnel, including end users, to help ensure the proper use of general ledger accounts.

- Enhance the process for determining the accrued annual leave to ensure that the reports generated include the appropriate amounts as of the end of the reporting period. The process should include matching a selection of employees' leave balances and other information included in the report to data in the Board's Human Resources system.

- Implement policies and procedures that require the calculation and reconciliation of amounts due from BIS on a regular basis. Once amounts due are determined, the applicable adjustments should be promptly recorded in the general ledger.

- Enhance its policies and procedures to include a documented periodic review and analysis of all accounts receivables, to determine if an allowance is required or if the amounts should be written off. Further, management should also review the accounting treatment required for all transactions.

(Continued)

- Strengthen its policies and procedures to improve communication between the divisions and the accounting staff to ensure the appropriate accounting entries for property transactions are recorded timely in the general ledger. The communications should include, but not be limited to: when the asset was placed in service, the cost of the asset, the asset's location and tag number, and any additional information necessary for the accounting division to make the appropriate entries. The Board should also enhance its review and approval procedures over property transactions to ensure that the appropriate entries have been recorded.

- Strengthen its process over the preparation and review of the financial statements to ensure information is accurately reported.

Management's Response

KPMG offers six recommendations aimed at strengthening the Board's internal controls over financial reporting. In its discussion of these recommendations and the supporting audit findings, KPMG does not consider any individual finding to be a significant deficiency. In combination, however, KPMG concludes that the audit findings represent a significant deficiency. While management does not concur with this conclusion, we do agree that KPMG's recommendations will strengthen the Board's system of internal controls, and we will implement the recommended actions.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATUS OF PRIOR YEAR REPORTABLE CONDITION

December 31, 2006

Reported Issue		Prior Year Recommendation	2006 Status
Improvement is needed in Internal Control over Financial Reporting			
Control over accounts payable and accrued liabilities	1.	Establish policies and procedures for processing year-end accounts payables and accruals to include the requirements for management to review and approve all entries and supporting documents before they are recorded. Management should also perform a review of the year-end accounts payable listings and subsequent disbursements to ensure that the transactions reported at year end are appropriately stated. Further, a reconciliation of the GSA account should be performed timely, to identify any discrepancies on the invoices received.	Significant Deficiency (see revised comment in Exhibit I).
Control of Census Data	2.	Confirm the data used by the actuary in the pension liability calculation prior to recording the entries in the general ledger.	Completed.
	3.	Implement recommendations made by the OIG in their report titled "*Evaluation of Service Credit Computations*." This would include performing periodic reconciliations of the census data between the Board's system and the data used by the actuary; reducing or eliminating the number of data transcriptions; requiring automated verifications for all census data transmissions; and updating the existing service credit form to clearly document all prior government service.	Substantially resolved. See revised comment in the 2006 management letter.

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Independent Auditors' Report on Compliance and Other Matters

To the Board of Governors of the Federal Reserve System:

We have audited the balance sheets of the Board of Governors of the Federal Reserve System (the Board) as of December 31, 2006 and 2005, and the related statements of revenues and expenses and changes in cumulative results of operations, and cash flows (hereinafter referred to as "financial statements") for the years then ended, and have issued our report thereon dated April 17, 2007.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the Board is responsible for complying with laws, regulations, and contracts applicable to the Board. As part of obtaining reasonable assurance about whether the Board's financial statements are free of material misstatement, we performed tests of the Board's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to the Board. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests of compliance described in the preceding paragraph, disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board's management, the Office of Inspector General, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

April 17, 2007