



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Financial Statements

December 31, 2002

(With Independent Auditors' Report Thereon)



2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report on Financial Statements

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, 2002 and 2001, and the related statements of revenues and expenses and changes in cumulative results of operations and cash flows 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 *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our 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 at December 31, 2002 and 2001, and its results of operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our reports dated March 28, 2003 on our consideration of the Board's internal control over financial reporting and its compliance with laws and regulations. Those reports are an integral part of an audit conducted in accordance with *Government Auditing Standards*, and should be read in conjunction with this report in considering the results of our audit.

KPMG LLP

March 28, 2003



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BALANCE SHEETS

| | <u>As of December 31,</u> | |
|---|---------------------------|-----------------------|
| | <u>2002</u> | <u>2001</u> |
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash | \$ 8,635,164 | \$ 40,788,564 |
| Accounts receivable | 871,626 | 1,325,065 |
| Prepaid expenses and other assets | 801,031 | 866,407 |
| Total current assets | <u>10,307,821</u> | <u>42,980,036</u> |
| PROPERTY AND EQUIPMENT, NET (Note 5) | <u>143,971,006</u> | <u>138,895,601</u> |
| Total assets | <u>\$ 154,278,827</u> | <u>\$ 181,875,637</u> |
| LIABILITIES AND CUMULATIVE RESULTS OF OPERATIONS | | |
| CURRENT LIABILITIES | | |
| Accounts payable and accrued liabilities | \$ 11,450,099 | \$ 16,125,797 |
| Accrued payroll and related taxes | 8,102,710 | 7,307,754 |
| Accrued annual leave | 11,873,527 | 10,732,356 |
| Capital lease payable (current portion) | 50,546 | 247,242 |
| Unearned revenues and other liabilities | 442,066 | 391,572 |
| Total current liabilities | <u>31,918,948</u> | <u>34,804,721</u> |
| LONG-TERM LIABILITIES | | |
| Capital lease payable (non-current portion) | 32,153 | 80,276 |
| Accumulated retirement benefit obligation (Note 2) | 614,108 | 651,628 |
| Accumulated postretirement benefit obligation (Note 3) | 4,917,787 | 4,555,487 |
| Accumulated postemployment benefit obligation (Note 4) | 4,299,252 | 3,591,571 |
| Total long-term liabilities | <u>9,863,300</u> | <u>8,878,962</u> |
| Total liabilities | <u>41,782,248</u> | <u>43,683,683</u> |
| CUMULATIVE RESULTS OF OPERATIONS | | |
| Working capital | (21,560,581) | 8,422,557 |
| Unfunded long-term liabilities | (9,831,147) | (8,798,686) |
| Net investment in property and equipment | 143,888,307 | 138,568,083 |
| Total cumulative results of operations | <u>112,496,579</u> | <u>138,191,954</u> |
| Total liabilities and cumulative results of operations | <u>\$ 154,278,827</u> | <u>\$ 181,875,637</u> |

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, | |
|---|----------------------------------|-----------------------|
| | 2002 | 2001 |
| BOARD OPERATING REVENUES | | |
| Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures | \$ 205,110,800 | \$ 295,055,600 |
| Other revenues (Note 6) | 9,039,417 | 8,747,799 |
| Total operating revenues | <u>214,150,217</u> | <u>303,803,399</u> |
| BOARD OPERATING EXPENSES | | |
| Salaries | 146,022,212 | 132,647,612 |
| Retirement and insurance contributions | 25,560,734 | 22,277,244 |
| Contractual services and professional fees | 18,073,228 | 19,339,948 |
| Depreciation and net losses on disposals | 12,426,581 | 10,394,156 |
| Utilities | 7,218,999 | 5,880,777 |
| Software | 6,822,066 | 5,415,856 |
| Postage and supplies | 5,961,699 | 8,252,490 |
| Travel | 5,925,674 | 5,037,577 |
| Repairs and maintenance | 4,666,439 | 4,201,386 |
| Printing and binding | 2,026,370 | 2,095,676 |
| Equipment and facilities rental | 318,132 | 3,830,557 |
| Other expenses (Note 6) | 4,823,458 | 4,157,305 |
| Total operating expenses | <u>239,845,592</u> | <u>223,530,584</u> |
| RESULTS OF OPERATIONS | <u>(25,695,375)</u> | <u>80,272,815</u> |
| ISSUANCE AND REDEMPTION OF FEDERAL RESERVE NOTES | | |
| Assessments levied on Federal Reserve Banks for currency costs | 429,568,393 | 338,537,426 |
| Expenses for currency printing, issuance, retirement and shipping | 429,568,393 | 338,537,426 |
| CURRENCY ASSESSMENTS OVER (UNDER) EXPENSES | <u>0</u> | <u>0</u> |
| TOTAL RESULTS OF OPERATIONS | (25,695,375) | 80,272,815 |
| CUMULATIVE RESULTS OF OPERATIONS, Beginning of year | <u>138,191,954</u> | <u>57,919,139</u> |
| CUMULATIVE RESULTS OF OPERATIONS, End of year | <u>\$ 112,496,579</u> | <u>\$ 138,191,954</u> |

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF CASH FLOWS

| | <u>For the years ended December 31,</u> | |
|--|---|-----------------------------|
| | <u>2002</u> | <u>2001</u> |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| RESULTS OF OPERATIONS | \$ (25,695,375) | \$ 80,272,815 |
| Adjustments to reconcile results of operations to net cash provided by (used in) operating activities: | | |
| Depreciation and net losses on disposals | 12,426,581 | 10,394,156 |
| (Increase) decrease in assets: | | |
| Accounts receivable, prepaid expenses and other assets | 518,815 | (24,805) |
| Increase (decrease) in liabilities: | | |
| Accounts payable and accrued liabilities | (4,675,698) | 5,423,057 |
| Accrued payroll and related taxes | 794,956 | 1,266,793 |
| Accrued annual leave | 1,141,171 | 2,239,628 |
| Unearned revenues and other liabilities | 50,494 | (1,652,588) |
| Accumulated retirement benefit obligation | (37,520) | (43,154) |
| Accumulated postretirement benefit obligation | 362,300 | 489,783 |
| Accumulated postemployment benefit obligation | 707,681 | 482,115 |
| Net cash provided by (used in) operating activities | <u>(14,406,595)</u> | <u>98,847,800</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from disposals | 5,200 | 119,013 |
| Capital expenditures | <u>(17,507,186)</u> | <u>(80,886,996)</u> |
| Net cash provided by (used in) investing activities | <u>(17,501,986)</u> | <u>(80,767,983)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Capital lease payments | <u>(244,819)</u> | <u>(133,505)</u> |
| Net cash provided by (used in) financing activities | <u>(244,819)</u> | <u>(133,505)</u> |
| NET INCREASE (DECREASE) IN CASH | (32,153,400) | 17,946,312 |
| CASH BALANCE, Beginning of year | 40,788,564 | 22,842,252 |
| CASH BALANCE, End of year | <u>\$ 8,635,164</u> | <u>\$ 40,788,564</u> |

See accompanying notes to financial statements

**BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001**

(1) SIGNIFICANT ACCOUNTING POLICIES

Organization - 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 staff numbering about 1,700, 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 operations and activities of the Board. A combined financial statement for the Federal Reserve Banks are included in the Board's annual report to the Speaker of the House of Representatives.

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. Amounts over or under assessed due to differences between actual and expected cash needs flow into "Cumulative Results of Operations" during the year.

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 not Board operating transactions.

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

Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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 2001 amounts have been reclassified to conform with the 2002 presentation.

(2) RETIREMENT BENEFITS

Substantially all of the Board's employees participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan). The System Plan is a multi-employer plan which covers employees of the Federal Reserve Banks, the Board, and the Plan Administrative Office.

**BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001**

Employees of the Board who entered on duty prior to 1984 are covered by a contributory defined benefits program under the System Plan. Employees of the Board who entered on duty 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 at amounts prescribed by the System Plan's administrator. Based on actuarial calculations, it was determined that employer funding contributions were not required for the years 2002 and 2001, and the Board was not assessed a contribution for these years. Excess Plan assets are expected to continue to fund future years' contributions. 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.

A relatively small number of Board employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). The Board matches employee contributions to these plans. These defined benefit plans are administered by the Office of Personnel Management. The Board's contributions to these plans totaled \$327,000 and \$308,000 in 2002 and 2001, respectively. The Board has no liability for future payments to retirees under these programs, and it is not accountable for the assets of the plans.

Employees of the Board may also participate in the Federal Reserve System's Thrift Plan. Under the Thrift Plan, members may contribute up to a fixed percentage of their salary. Board contributions are based upon a fixed percentage of each member's basic contribution and were \$7,185,000 and \$5,540,000 in 2002 and 2001, respectively.

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. Pension costs attributed to the BEP reduce the pension costs of the System Plan. Activity for the BEP for 2002 and 2001 is summarized in the following table:

| | 2002 | 2001 |
|---|-----------|----------|
| <u>Change in Benefit Obligation</u> | | |
| Projected Benefit Obligation at Beginning of Year | \$ 2,125 | \$ 1,804 |
| Service Cost | 3,363 | 450 |
| Interest Cost | 561 | 112 |
| Plan Participants' Contributions | 0 | 0 |
| Plan Amendments | 2,852 | 0 |
| Actuarial (Gain)/Loss | 3,965 | (241) |
| Benefits Paid | 0 | 0 |
| Projected Benefit Obligation at End of Year | \$ 12,866 | \$ 2,125 |
| | 2002 | 2001 |
| <u>Change in Plan Assets</u> | | |
| Fair Value of Plan Assets at Beginning of Year | \$ 0 | \$ 0 |
| Actual Return on Plan Assets | 0 | 0 |
| Employer Contributions | 0 | 0 |
| Plan Participants' Contributions | 0 | 0 |
| Benefits Paid | 0 | 0 |
| Fair Value of Plan Assets at End of Year | \$ 0 | \$ 0 |

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001

Reconciliation of Funded Status at End of Year

| | | |
|--|---------------------|---------------------|
| Funded Status | \$ (12,866) | \$ (2,125) |
| Unrecognized Net Actuarial (Gain)/Loss | (297,773) | (329,169) |
| Unrecognized Prior Service Cost | (1,050,946) | (1,170,405) |
| Unrecognized Net Transition (Asset)/Obligation | 747,477 | 850,071 |
| Postretirement Benefit Liability | <u>\$ (614,108)</u> | <u>\$ (651,628)</u> |

Weighted-average assumptions as of December 31

| | | |
|-----------------------|--------|--------|
| Discount Rate | 6.75% | 7.00% |
| Expected Asset Return | N/A | N/A |
| Salary Scale | 4.25% | 4.50% |
| Corridor | 10.00% | 10.00% |

Components of Net Periodic Benefit Cost

| | | |
|---|--------------------|--------------------|
| Service Cost | \$ 3,363 | \$ 450 |
| Interest Cost | 561 | 112 |
| Expected Return on Plan Assets | 0 | 0 |
| Amortization of Prior Service Cost | (116,607) | (116,848) |
| Recognized Actuarial (Gain)/Loss | (27,431) | (29,462) |
| Amortization of Net Transition (Asset)/Obligation | 102,594 | 102,594 |
| Net Periodic Benefit Cost | <u>\$ (37,520)</u> | <u>\$ (43,154)</u> |

(3) POSTRETIREMENT BENEFITS

The Board provides certain life insurance programs for its active employees and retirees. Activity for 2002 and 2001 is summarized in the following table:

| | <u>2002</u> | <u>2001</u> |
|---|---------------------|---------------------|
| <u>Change in Benefit Obligation</u> | | |
| Benefit Obligation at Beginning of Year | \$ 5,868,425 | \$ 4,255,290 |
| Service Cost | 158,179 | 133,550 |
| Interest Cost | 386,215 | 345,753 |
| Plan Participants' Contributions | 0 | 0 |
| Plan Amendments | 0 | 95,993 |
| Actuarial (Gain)/Loss | (63,554) | 1,037,839 |
| Benefits Paid | (214,870) | 0 |
| Benefit Obligation at End of Year | <u>\$ 6,134,395</u> | <u>\$ 5,868,425</u> |

| | <u>2002</u> | <u>2001</u> |
|--|-------------|-------------|
| <u>Change in Plan Assets</u> | | |
| Fair Value of Plan Assets at Beginning of Year | \$ 0 | \$ 0 |
| Actual Return on Plan Assets | 0 | 0 |
| Employer Contributions | 213,958 | 0 |
| Plan Participants' Contributions | 0 | 0 |
| Benefits Paid | (213,958) | 0 |
| Fair Value of Plan Assets at End of Year | <u>\$ 0</u> | <u>\$ 0</u> |

Reconciliation of Funded Status at End of Year

| | | |
|--|-----------------------|-----------------------|
| Funded Status | \$ (6,134,395) | \$ (5,868,425) |
| Unrecognized Net Actuarial (Gain)/Loss | 1,126,688 | 1,216,945 |
| Unrecognized Prior Service Cost | 89,920 | 95,993 |
| Unrecognized Net Transition Obligation | 0 | 0 |
| Prepaid/(Accrued) Postretirement Benefit Liability | <u>\$ (4,917,787)</u> | <u>\$ (4,555,487)</u> |

**BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001**

Components of Net Periodic Cost for Year

| | | |
|------------------------------------|-------------------|-------------------|
| Service Cost | \$ 158,179 | \$ 133,550 |
| Interest Cost | 386,215 | 345,756 |
| Amortization of Prior Service Cost | 6,073 | 0 |
| Amortization of (Gains)/Losses | 26,706 | 10,477 |
| Total Net Periodic Cost | <u>\$ 577,173</u> | <u>\$ 489,783</u> |

The liability and costs for the postretirement benefit plan were determined using discount rates of 6.75 percent and 7.0 percent as of December 31, 2002 and December 31, 2001, respectively. Unrecognized losses of \$1,126,688 and \$1,216,945 as of December 31, 2002 and 2001, respectively, result from changes in the discount rate used to measure the liabilities. Under Statement of Financial Accounting Standards No.106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, the Board may have to record some of these unrecognized losses in operations in future years. The assumed salary trend rate for measuring the increase in postretirement benefits related to life insurance was an average of 4.25% 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 \$6,205,000 and \$5,364,000 in 2002 and 2001, respectively.

(4) POSTEMPLOYMENT BENEFIT PLAN

The Board provides disability and survivor income benefits to eligible employees after employment but before retirement. Effective January 1, 1994, the Board adopted Statement of Financial Accounting Standards No. 112, *Employers' Accounting for Postemployment Benefits*, which requires that employers providing postemployment benefits to their employees accrue the cost of such benefits. Prior to January 1994, postemployment benefit expenses were recognized on a pay-as-you-go basis.

| <u>Change in Benefit Obligation</u> | <u>2002</u> | <u>2001</u> |
|---|---------------------|---------------------|
| Benefit Obligation at Beginning of Year | \$ 3,591,571 | \$ 3,109,456 |
| Service Cost | 891,192 | 755,135 |
| Interest Cost | 166,520 | 115,142 |
| Plan Participants' Contributions | 0 | 0 |
| Plan Amendments | 0 | 0 |
| Actuarial (Gain)/Loss | (76,282) | (129,585) |
| Benefits Paid | (273,749) | (258,577) |
| Benefit Obligation at End of Year | <u>\$ 4,299,252</u> | <u>\$ 3,591,571</u> |

Weighted-average assumptions as of December 31

| | | |
|-----------------------|--------|--------|
| Discount Rate | 6.75% | 7.00% |
| Expected Asset Return | N/A | N/A |
| Salary Scale | 4.25% | 4.50% |
| Corridor | 10.00% | 10.00% |

**BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001**

(5) PROPERTY AND EQUIPMENT

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

| | As of December 31, | |
|-------------------------------|-----------------------|-----------------------|
| | 2002 | 2001 |
| Land and improvements | \$ 18,640,314 | \$ 18,640,314 |
| Buildings | 113,309,775 | 104,403,830 |
| Furniture and equipment | 37,044,828 | 54,301,936 |
| Software | 9,830,112 | 9,215,280 |
| Construction in process | 9,467,020 | 6,901,864 |
| | <u>188,292,049</u> | <u>193,463,224</u> |
| Less accumulated depreciation | <u>(44,321,043)</u> | <u>(54,567,623)</u> |
| Property and equipment, net | <u>\$ 143,971,006</u> | <u>\$ 138,895,601</u> |

Furniture and equipment includes \$864,000 for capitalized leases as of December 31, 2002 and 2001. Accumulated depreciation includes \$654,000 and \$510,000 for capitalized leases as of December 31, 2002 and 2001, respectively. The Board paid interest related to these capital leases in the amount of \$15,731 and \$32,201 for 2002 and 2001, respectively.

The Board began the Eccles Building Infrastructure Enhancement Project in July 1999. This \$12.5 million project, scheduled for nineteen phases over three and a half years, includes asbestos removal, lighting and plumbing improvements, cabling and other enhancements. Multiple phases will be in process at the same time.

In 2001, the Board purchased land and building located at 1709 New York Avenue, N.W., Washington, DC. This purchase increased land and improvements by \$17,339,000 and buildings by \$48,727,000.

In 2002, fully depreciated furniture and equipment totaling \$22,350,000 was retired.

(6) OTHER REVENUES AND OTHER EXPENSES

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

| | As of December 31, | |
|---|---------------------|---------------------|
| | 2002 | 2001 |
| Other Revenues | | |
| Data processing revenue | \$ 4,830,600 | \$ 4,427,360 |
| Rent | 1,996,893 | 664,537 |
| Subscription revenue | 810,032 | 869,595 |
| Reimbursable services to other agencies | 788,095 | 568,753 |
| Board sponsored conferences | 115,965 | 240,967 |
| National Information Center | 30,334 | 25,591 |
| Miscellaneous | 467,498 | 1,950,996 |
| Total other revenues | <u>\$ 9,039,417</u> | <u>\$ 8,747,799</u> |
| Other Expenses | | |
| Tuition, registration and membership fees | \$ 1,642,013 | \$ 1,472,539 |
| Subsidies and contributions | 900,049 | 851,225 |
| Public transportation subsidy | 745,973 | 484,618 |
| Meals and representation | 378,387 | 438,748 |
| Contingency operations | 264,232 | 180,871 |
| Security investigations | 229,387 | 108,981 |
| Miscellaneous | 663,417 | 620,323 |
| Total other expenses | <u>\$ 4,823,458</u> | <u>\$ 4,157,305</u> |

**BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001**

(7) COMMITMENTS

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 future commitments under those leases having an initial or remaining noncancelable lease term in excess of one year at December 31, 2002, are as follows:

| | | |
|------|-----------|----------------|
| 2003 | \$ | 151,038 |
| 2004 | | 157,079 |
| 2005 | | 163,363 |
| 2006 | | 71,991 |
| | <u>\$</u> | <u>543,471</u> |

Rental expenses under the operating leases were \$156,000 and \$171,000 in 2002 and 2001, respectively.

(8) FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

The Board is one of the five member agencies of the Federal Financial Institutions Examination Council (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 2002 and 2001 is summarized in the following table:

| | <u>2002</u> | <u>2001</u> |
|---|---------------------|---------------------|
| Board paid to the Council: | | |
| Assessments for operating expenses of the Council | \$ 300,000 | \$ 293,000 |
| Total Board paid to the Council | <u>\$ 300,000</u> | <u>\$ 293,000</u> |
| Council paid to the Board: | | |
| Data processing related services | 3,350,412 | 2,788,243 |
| Administrative services | 69,593 | 66,117 |
| Total Council paid to the Board | <u>\$ 3,420,005</u> | <u>\$ 2,854,360</u> |

(9) FEDERAL RESERVE BANKS

The Board performs certain transactions for the Reserve Banks in conjunction with its responsibilities for the Federal Reserve System, and the Federal Reserve Banks provide certain administrative functions for the Board. Activity related to the Board and Reserve Banks for 2002 and 2001 is summarized in the following table:

| | <u>2002</u> | <u>2001</u> |
|---|-----------------------|-----------------------|
| Board paid to the Reserve Banks: | | |
| Assessments for Employee Benefits | \$ 2,014,839 | \$ 1,859,752 |
| Data processing and communication | 2,154,087 | 2,469,052 |
| Contingency Site | 264,232 | 180,871 |
| Total Board paid to the Reserve Banks | <u>\$ 4,433,158</u> | <u>\$ 4,509,675</u> |
| Reserve Banks paid to the Board: | | |
| Assessments for currency costs | \$ 429,568,393 | \$ 338,537,426 |
| Assessments for operating expenses of the Board | 205,110,800 | 295,055,600 |
| Data processing | 1,281,759 | 1,499,559 |
| Total Reserve Banks paid to the Board | <u>\$ 635,960,952</u> | <u>\$ 635,092,585</u> |



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 financial statements of the Board of Governors of the Federal Reserve System (the Board) as of and for the years ended December 31, 2002 and 2001, and have issued our report thereon dated March 28, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

In planning and performing our 2002 audit, we considered the Board's internal control over financial reporting by obtaining an understanding of the Board's internal control, determining whether those internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in internal control over financial reporting that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. Material weaknesses are conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control and its operation that we consider to be material weaknesses as defined above.

This report is intended solely for the information and use of the Board and management, the U.S. Office of Management and Budget, 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

March 28, 2003





2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report on Compliance with Laws and Regulations

To the Board of Governors of the Federal Reserve System

We have audited the financial statements of the Board of Governors of the Federal Reserve System (the Board) as of and for the years ended December 31, 2002 and 2001, and have issued our report thereon dated March 28, 2003. 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.

The management of the Board is responsible for complying with laws and regulations applicable to the Board. As part of obtaining reasonable assurance about whether the Board's 2002 financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board and management, the U.S. Office of Management and Budget, 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

March 28, 2003

