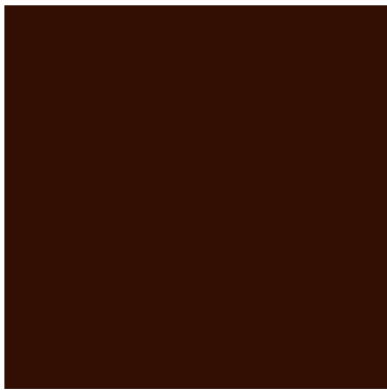
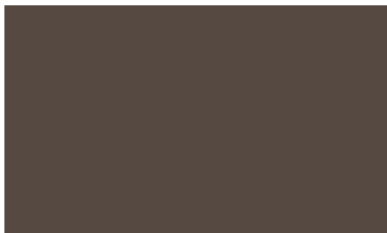
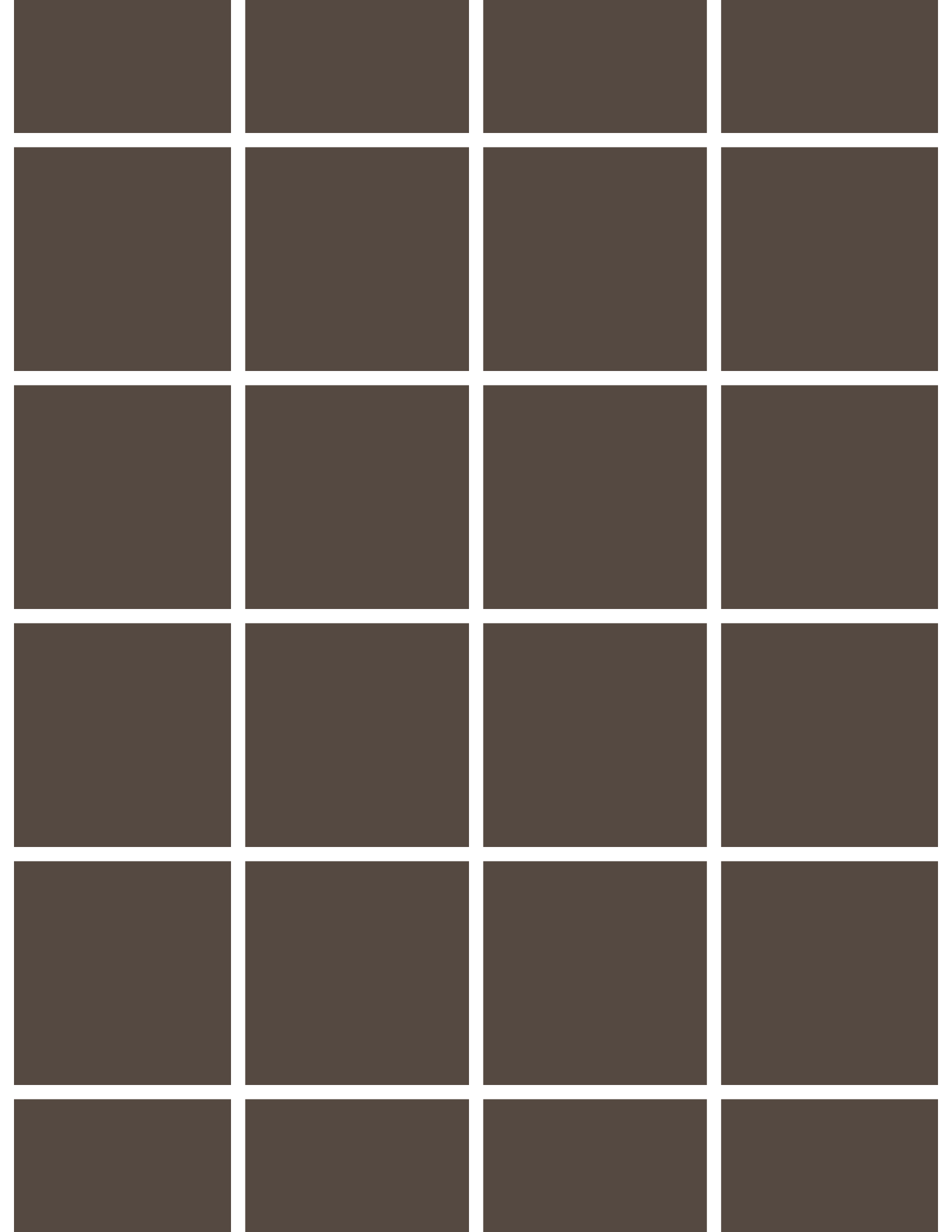


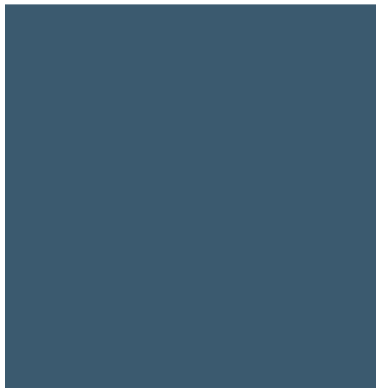
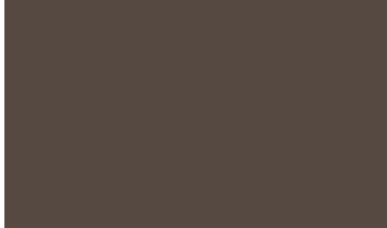
LEADING  
 through  
*change*  
 Federal Reserve Bank of Kansas City



*2003*  
 Annual  
 Report







3 Leading Through Change

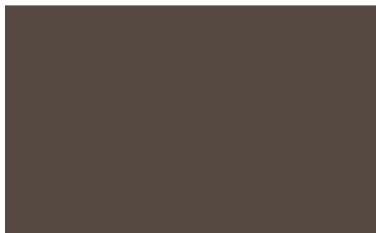
12 Board of Directors

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*progress*



*change*



*Thomas M. Hoenig  
President and  
Chief Executive Officer*



# Leading Through Change

Change is ever-present in the world and our nation today – from uncertainty in the Middle East and Korean peninsula, to a U.S. economy on the mend, to corporate scandals, to shortfalls in local and national government budgets, which limit needed services and programs.



A famous historian once summed it up best when he wrote, “Change is certain; progress is not.” Change is a part of our history and will be a part of our future. The true mark of leadership is to achieve progress in the face of change.

“The true mark of leadership is to achieve progress in the face of change.”

As president of the Federal Reserve Bank of Kansas City, this quote has influenced my thinking concerning what a leader needs to do to achieve progress in times of change. In a speech given in early 2003, I observed four imperatives possessed by leaders who have achieved progress during great change. They are an acute sense of ethics, knowledge, wisdom, and endurance.

As the nation’s central bank, the Federal Reserve System and each Federal Reserve Bank are thrust into a leadership role in our three mission areas – monetary policy, supervision and risk management, and financial and Treasury services. Our goal in the Tenth District has been to translate the personal imperatives of leadership to the organizational level so we can achieve progress. This sometimes can be challenging given the large geographic area that we cover coupled with the unique makeup of the District’s economy, including such diverse industries as agriculture, community banks, energy, aerospace, tourism, telecommunications, and manufacturing.



During 2003, the staff and management of the Federal Reserve Bank of Kansas City faced challenges nationally and regionally. In the area of monetary policy, 2003 can best be described as an economy in transition. The economy was sluggish and restrained in the first half of the year because of continued corporate governance issues and the war in Iraq. However, the second half of the year saw the economy growing stronger as the situation in the Middle East calmed and the Federal Reserve kept monetary policy highly accommodative. Gross domestic product growth was approximately 2.5 percent in the first half of 2003, but it increased to approximately 6.2 percent by year-end.



$$\frac{\Delta U_{\text{value}} + \Delta U_{\text{price}} + \Delta U_{\text{policy}}}{k_c}$$

$$L_s = \left( \frac{L}{(1-d)A_s} \right)^{\frac{1}{1-\alpha}} \left( \frac{2\alpha}{b_{k,s}} \right)^{\frac{\alpha}{1-\alpha}} + p \cdot \dots$$
$$k_s^* = A_s \left( \frac{2\alpha}{b_{k,s}} \right)^{\frac{\alpha}{1-\alpha}} \dots$$

$$\frac{1}{L_s} \left( \frac{2\alpha}{b_{k,s}} \right)^{\frac{\alpha}{1-\alpha}} A_s \left( \frac{2\alpha}{b_{k,s}} \right)^{\frac{\alpha}{1-\alpha}}$$

$$\Delta U_{\text{value}} = e^{\rho \Delta U_{\text{value}}} - \frac{(1-d)A_s k_s^*}{k_c}$$
$$q_s = (s+p) - d A_s k_s^*$$
$$\Delta U_{\text{price}} =$$



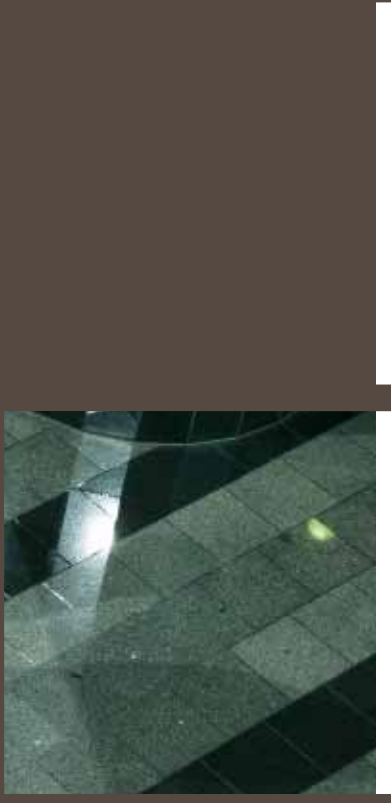
$$k_s^* = A_s \left( \frac{2\alpha}{b_{k,s}} \right)^{\frac{\alpha}{1-\alpha}} \dots$$



$$\Delta U_{\text{value}} =$$
$$k_s^* =$$



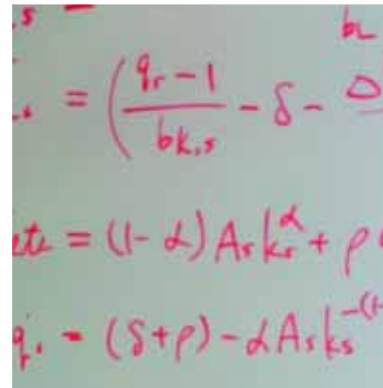
*insight*



trust



Conducting monetary policy in an uncertain economic environment is one of the most difficult challenges facing central banks, especially when the changing structure of the economy makes economic models and forecasts less reliable. In these times, questions arise about how cautiously or aggressively policymakers should act or whether they should depend on formal rules or their judgment in designing monetary policy. The Federal Reserve Bank of Kansas City addressed these questions and others at its 2003 Economic Symposium titled “Monetary Policy and Uncertainty: Adapting to a Changing Economy.” A distinguished group of central bank officials, academic economists, and business economists met in Jackson Hole, Wyoming, on August 28-30 to discuss and debate these issues.



With so many challenges facing the national and regional economy in 2003, the economists in our Economic Research Department and the Center for the Study of Rural America had many issues to address in the Bank’s two publications, the *Economic Review* and the *Main Street Economist*, as well as in various professional and academic publications. In the *Economic Review*, articles were published throughout the year on topics including deposit insurance reform, inflation, jobless recoveries, community banks, rural policy, tourism, globalization, and monetary policy and the zero bound. These articles provide insight and are a valuable tool for the public, media, businesses, and policymakers.

“...we hold our organization, its employees, and the business we perform to the utmost standards while fulfilling our missions, as well as our day-to-day responsibilities.”

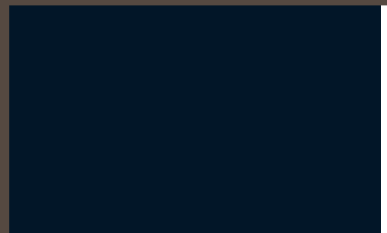
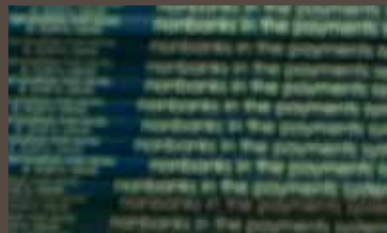
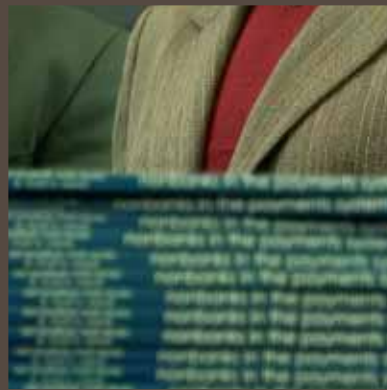


Our economy and market system are built on trust. This trust must be earned. At the Federal Reserve Bank of Kansas City, we hold our organization, its employees, and the business we perform to the utmost standards while fulfilling our missions, as well as our day-to-day responsibilities.



In 2003, all of our employees supported efforts to manage our resources responsibly and well through the local and national streamlining of functions. An example of this at the local level is our program to enhance efficiency and effectiveness in our Supervision and Risk Management Division. The division looked at its processes for performing examinations of financial institutions and other duties and identified possible improvements. It then introduced changes that recast the roles of examiners, presented a more coordinated

*knowledge*





approach in outreach to both state member banks and large bank holding companies in the District, and focused on operational risks in financial institutions to help ensure that a bank doesn't unintentionally create opportunities for its employees or the public to defraud or financially damage it. During the year, our staff conducted 215 safety and soundness, consumer compliance, and other specialty examinations and 692 bank holding company inspections and risk assessments.



No leader can effectively approach a challenge without understanding it and its effects. Each year, the Federal Reserve System and the Tenth Federal Reserve District identify future challenges and opportunities, analyze the many different scenarios and implications of each, and consider strategies to manage the situation in the most proactive and progressive way.

“This same imperative of knowledge prompted the Federal Reserve Bank of Kansas City to continue its studies of the ever-evolving payments system.”

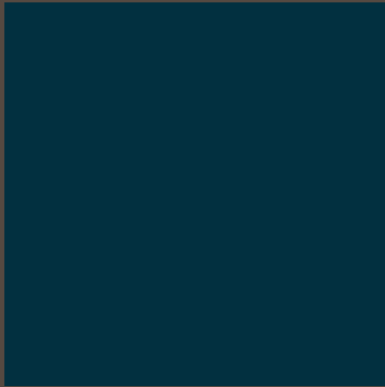
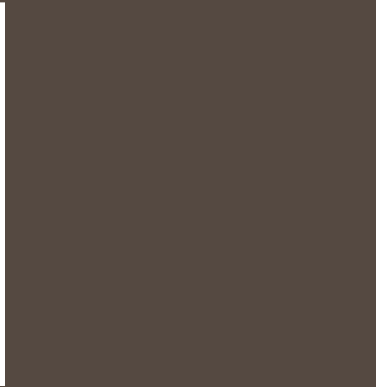
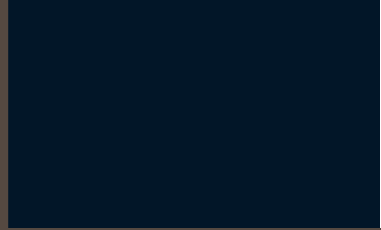
The Federal Reserve System identified that check business would decrease as electronic payments become more commonplace. During 2003, the Reserve Banks better positioned themselves for this shift by making the difficult decision to reduce the number of locations for check processing from 45 to 32 and check adjustment locations from 43 to 12. As a result, our Omaha Branch relinquished its check operations to the Des Moines Office in the Seventh Federal Reserve District in April 2004.



This same imperative of knowledge prompted the Federal Reserve Bank of Kansas City to continue its studies of the ever-evolving payments system. In 2003, the District's Payments System Research staff published two books, *A Guide to the ATM and Debit Card Industry* and *Nonbanks in the Payments System*, and continued researching the various payments instruments. Because there is little documented research in this area, the staff's work will be a valuable tool for individuals in the Federal Reserve System, academia, and the financial industry.



*experience*



leadership



A superior organization builds upon ethics and knowledge and adds experience to the mix. To be successful, an organization must not only operate ethically and research and understand the potential effects of change, but it also must apply what it has learned from past experiences, both good and bad, to the evolving environment. For 90 years, the Federal Reserve Banks have operated independently in many ways but have benefited from the experience and cooperation of their 11 counterparts.



There are many programs and services that are used by each Reserve Bank. Often, one or more offices are selected, based on their experience in the area, to provide these services for the entire Federal Reserve System. The Tenth District's Central Check User Support staff has been fortunate to have had the opportunity to coordinate and implement a common check operating platform for the System. For several years, staff has worked in conjunction with the Federal Reserve Bank of Minneapolis and colleagues throughout the System to create a common check operating platform and to convert all Reserve Banks to it. In 2003, these conversions were completed. Additionally, Tenth District Customer Contact Center staff provides support to half of the financial institutions in the country that access Federal Reserve payments services electronically. Customer Relations and Support Office staff successfully coordinated the nationwide transition of customer support for these services to the two Customer Contact Centers in Kansas City and Minneapolis in March 2004.

“A superior organization builds upon ethics and knowledge and adds experience to the mix.”

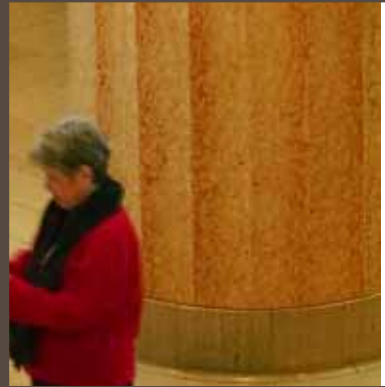


Leadership requires more than just reacting to a situation. It demands that the long-term ramifications of every decision are considered to ensure the future stability of the organization, and, when necessary, that the original plan or idea be restructured to achieve the ultimate goal.

In 2003, the Bank proposed and began piloting a new internal Enterprise Risk Management program. Through Enterprise Risk Management, a department analyzes risk from an integrated, organization-wide perspective. As each risk is identified, the department considers its impact and how best to reduce the risk or address it. The department will continue to assess its risks and resolutions going forward, serving as a continuing audit of the work it does and identifying any risk of impropriety.



challenge

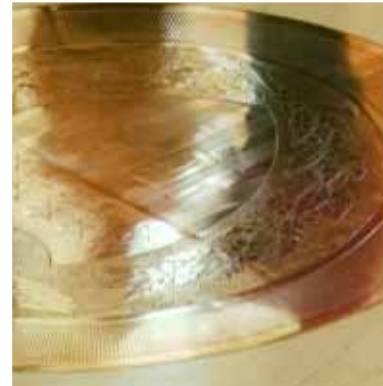


*opportunity*



## Conclusion

The employees of the Federal Reserve Bank of Kansas City worked hard in 2003 to successfully address our challenges and achieve progress as an organization within the Federal Reserve System. The successes that we celebrate are due to the teamwork and dedication displayed by our staff and officers in our four offices – Kansas City, Denver, Oklahoma City, and Omaha. I want to recognize all that they do to meet the needs of our District and the Federal Reserve System.



In the years to come, we will face further change in the way we do business – from shifting economic conditions, to evolving banking supervision issues, to a developing payments system, and even to the building in which we conduct our business in the Tenth Federal Reserve District. Last year, we secured approval from our local Board of Directors and the Federal Reserve Board of Governors to build a new District headquarters building in Kansas City. The construction of the state-of-the-art building will provide needed, secure space and flexibility to meet the future needs of our District.

“The successes that we celebrate are due to the teamwork and dedication displayed by our staff and officers in our four offices...”

The future challenges of the new building coupled with the many other changes ahead of us in the areas of monetary policy, supervision and risk management, and financial services, necessitate strong organizational leadership. We look forward to these challenges and the opportunity to serve.



Thomas M. Hoenig

President and Chief Executive Officer

*A complete transcript of the speech, “Leadership, Change and Progress,” is available at [www.kansascityfed.org](http://www.kansascityfed.org).*

# Board of Directors

## *Kansas City*



*(From top left)*  
*Back Row: Mr. Dillingham,*  
*Mr. Helmerich, Mr. Gerhart;*  
*Center Row: Mr. Moore,*  
*Mr. Schriefer, Mr. Smalley;*  
*Front Row: Mr. Funk, Mr. Bard,*  
*Ms. Holman.*



**Richard H. Bard – Chairman**  
Chairman  
and Chief Executive Officer  
International Surface  
Preparation Corporation  
Golden, Colorado

**Robert A. Funk –**  
Deputy Chairman  
Chairman of the Board  
and Chief Executive Officer  
Express Personnel Services  
International  
Oklahoma City, Oklahoma

**Dan L. Dillingham**  
Chief Executive Officer  
Dillingham Insurance  
Enid, Oklahoma

**Jeffrey L. Gerhart**  
President  
and Chief Executive Officer  
First National Bank  
of Newman Grove  
Newman Grove, Nebraska

**Hans C. Helmerich**  
President  
and Chief Executive Officer  
Helmerich & Payne, Inc.  
Tulsa, Oklahoma

**Rhonda Holman**  
Interim Director  
Entrepreneurial Growth  
Resource Center  
University of Missouri –  
Kansas City  
Kansas City, Missouri

**Frank Moore**  
President  
Spearhead Ranch Company  
Douglas, Wyoming

**Bruce A. Schriefer**  
President  
Bankers' Bank  
of Kansas, N.A.  
Wichita, Kansas

**Rick L. Smalley**  
Chief Executive Officer  
Dickinson Financial  
Corporation  
Kansas City, Missouri

*Federal Advisory Council Member*

**Byron G. Thompson**  
Chairman  
Country Club Bank, N.A.  
Kansas City, Missouri

# Board of Directors

*Denver*



*(From top left)*

*Back Row: Ms. Berkeley,*

*Mr. King, Mr. Hay;*

*Front Row: Ms. Avila,*

*Mr. Murphy, Ms. Paul,*

*Mr. Williams.*

Robert M. Murphy – Chairman  
President  
Sandia Properties Ltd., Co.  
Albuquerque, New Mexico

Kathleen Avila  
Managing Member  
Avila Retail Development &  
Management  
Albuquerque, New Mexico

Virginia K. Berkeley  
President  
Colorado Business Bank, N.A.  
Denver, Colorado

John W. Hay, III  
President  
Rock Springs National Bank  
Rock Springs, Wyoming

James A. King  
Chief Executive Officer  
BT Incorporated  
Riverton, Wyoming

Kathryn A. Paul  
President  
Delta Dental Plan of Colorado  
Denver, Colorado

Thomas Williams  
President  
and Chief Executive Officer  
Williams Group LLC  
Golden, Colorado

# Board of Directors *Oklahoma City*



*(From left)*

*Mr. Mabrey, Ms. Fennell,  
Mr. Minner, Mr. Funk,  
Mr. Gilbert, Mr. Hudson.*

*(Not pictured: Mr. Ratcliffe)*

Patricia B. Fennell – Chairman  
Executive Director  
Latino Community Development  
Agency  
Oklahoma City, Oklahoma

Robert A. Funk\*  
Chairman of the Board  
and Chief Executive Officer  
Express Personnel Services  
International  
Oklahoma City, Oklahoma

*\*Appointed by the Board of Governors  
in August 2003 to the Kansas City  
Board of Directors.*

Robert R. Gilbert, III  
President  
and Chief Operating Officer  
The F&M Bank & Trust  
Company  
Tulsa, Oklahoma

J. Clifford Hudson  
Chairman of the Board  
and Chief Executive Officer  
Sonic Corp.  
Oklahoma City, Oklahoma

W. Carlisle Mabrey, III  
President  
and Chief Executive Officer  
Citizens Bank & Trust Co.  
Okmulgee, Oklahoma

Tyree O. Minner  
Plant Manager  
General Motors,  
Oklahoma City  
Assembly Plant  
Oklahoma City, Oklahoma

Richard K. Ratcliffe  
Chairman  
Ratcliffe's Inc.  
Weatherford, Oklahoma





# Board of Directors

*O m a h a*



*(From top left)*  
*Back Row: Mr. Raimondo,*  
*Mr. Timmerman,*  
*Ms. Milligan;*  
*Front Row: Mr. Hayes,*  
*Ms. Owen, Mr. Kosman.*

A. F. "Tony" Raimondo –  
Chairman  
Chairman  
and Chief Executive Officer  
Behlen Mfg. Co.  
Columbus, Nebraska

Frank L. Hayes  
President  
Hayes & Associates, L.L.C.,  
CPAs  
Omaha, Nebraska

H. H. "Hod" Kosman  
Chairman, President,  
and Chief Executive Officer  
Platte Valley National Bank  
Scottsbluff, Nebraska

Cynthia Hardin Milligan  
Dean, College of Business  
Administration  
University of Nebraska-Lincoln  
Lincoln, Nebraska

Judith A. Owen  
President  
and Chief Executive Officer  
Wells Fargo Bank, N.A.  
Omaha, Nebraska

James A. Timmerman  
Chief Financial Officer  
and Secretary/Treasurer  
Timmerman & Sons Feeding Co.  
Springfield, Nebraska

# Advisory Councils

## *Economic Advisory Council*

### **David W. Burkholder**

President  
Will Feed, Inc. and Island Dehy, Inc.  
Cozad, Nebraska

### **Lu Cordova**

President  
CTEK  
Boulder, Colorado

### **Ralph King**

Owner and Operator  
King's Management Company, Inc.  
Kansas City, Kansas

### **Terry L. Moore**

President  
Omaha Federation of Labor, AFL-CIO  
Omaha, Nebraska

### **John D. Novak**

President  
Ash Grove Materials Corporation  
Shawnee Mission, Kansas

### **Kevin Nunnink**

Managing Director  
Integra Realty Resources Kansas City  
Westwood, Kansas

### **Russell M. Perry**

President  
Perry Publishing  
and Broadcasting Company  
Oklahoma City, Oklahoma

### **Tom B. Price**

President  
UFCW District Union Local Two,  
AFL-CIO  
Kansas City, Missouri

### **Anthony F. Prinster**

Hoskin, Farina, Aldrich & Kampf  
Grand Junction, Colorado

### **Clint Roush**

Clint Roush Farms, Inc.  
Arapaho, Oklahoma

### **Michael Shaw**

President and Owner  
Mike Shaw Chevrolet, Buick, Saab  
Denver, Colorado

## *Community Development Advisory Council*

### **Grace M. Buckley**

Director of Housing Resources  
Mercy Housing  
Denver, Colorado

### **Dan V. Clark**

Clark Consulting Group  
Arvada, Colorado

### **Kevin S. Biltz-Ruegg**

Executive Director  
Family Housing Advisory Services  
Omaha, Nebraska

### **Carol A. Grimaldi**

Executive Director  
Brush Creek Community Partners  
Kansas City, Missouri

### **Thomas G. Johnson**

Director  
Community Policy Analysis Center  
University of Missouri  
Columbia, Missouri

### **A. Thomas Loy**

Chairman and President  
MetaFund  
Oklahoma City, Oklahoma

### **Michael H. Martinez**

CRA Director  
Vectra Bank Colorado  
Denver, Colorado

### **Evalin E. McClain**

Assistant to the City Manager  
City of Overland Park  
Overland Park, Kansas

### **Peter G. Merrill**

Design Services  
Santa Fe, New Mexico

### **Mary E. Randolph**

Executive Director  
Wyoming Rural Development Council  
Cheyenne, Wyoming

### **John L. Rolfe**

President and Chief Executive Officer  
Greater Wichita Convention and  
Visitors Bureau  
Wichita, Kansas

### **Lou E. Trost**

Vice Chairman  
and Chief Executive Officer  
Lincoln National Bank  
Oklahoma City, Oklahoma

## *Credit Union Customer Advisory Council – Oklahoma City Branch*

### **Janice Caster**

Managing Officer  
El Reno RIL Credit Union  
El Reno, Oklahoma

### **Terri Davis**

Vice President  
66 Federal Credit Union  
Bartlesville, Oklahoma

### **Tom Eaton**

Managing Officer  
St. Francis Employees  
Federal Credit Union  
Tulsa, Oklahoma

### **Denise Floyd**

President and Chief Executive Officer  
Fort Sill Federal Credit Union  
Fort Sill, Oklahoma

### **Mark W. Kelly**

President and Chief Executive Officer  
Oklahoma Employees Credit Union  
Oklahoma City, Oklahoma

### **Mike Kloiber**

President and Chief Executive Officer  
Tinker Federal Credit Union  
Oklahoma City, Oklahoma

### **Lynette Leonard**

President  
Allegiance Credit Union  
Oklahoma City, Oklahoma

### **Steve Rasmussen**

President and Chief Executive Officer  
FAA Employees Credit Union  
Oklahoma City, Oklahoma

### **Donald D. Stivers**

President and Chief Executive Officer  
Oil Capital Community Credit Union  
Tulsa, Oklahoma



# *Customer Advisory Council on Financial Services*



## *Kansas City*

**Tim Connealy**  
Executive Vice President  
and Chief Operating Officer  
Bank Midwest  
Kansas City, Missouri

**Lloyd Davidson**  
President  
First Bank Kansas  
Salina, Kansas

**William Esry**  
President  
and Chief Operating Officer  
Blue Ridge Bank & Trust Company  
Kansas City, Missouri

**Steve Hipp**  
Executive Vice President  
Intrust Bank, N.A.  
Wichita, Kansas

**Danny Little**  
President  
and Chief Executive Officer  
Lamar Bank and Trust Company  
Lamar, Missouri

**L.D. McDonald**  
President and Chief Executive Officer  
Midwest Independent Bank  
Jefferson City, Missouri

**Bruce B. Morgan**  
President and Chief Executive Officer  
The Valley State Bank  
Roeland Park, Kansas

**Bruce Schriefer**  
President and Chief Executive Officer  
Bankers' Bank of Kansas  
Wichita, Kansas

**Larry Snyder**  
President and Chief Executive Officer  
The Hamilton Bank  
Hamilton, Missouri



## *Denver*

**Adam P. Coyle**  
President  
Integrated Payment Systems Inc.  
Englewood, Colorado

**Don A. Childears**  
President and Chief Executive Officer  
Colorado Bankers Association  
Denver, Colorado

**Mark Frank**  
Senior Operations Executive  
American Business Bank  
Denver, Colorado

**Roger R. Reiling**  
President  
Bankers' Bank of the West  
Denver, Colorado

**James A. Reuter**  
President  
FirstBankData Corporation  
Lakewood, Colorado

**Polly Thorsness**  
Senior Vice President  
Community First Service Corporation  
Fargo, North Dakota

**Barbara M.A. Walker**  
Executive Manager  
Independent Bankers of Colorado  
Denver, Colorado

## *Oklahoma City*

**Don Abernathy**  
President and Chief Executive Officer  
The Bankers Bank  
Oklahoma City, Oklahoma

**Scott Copeland**  
Executive Vice President  
BancFirst  
Oklahoma City, Oklahoma

**Kerby E. Crowell**  
Executive Vice President  
Stillwater National Bank & Trust Co.  
Stillwater, Oklahoma

**Mike Elvir**  
Executive Vice President  
and Chief Information Officer  
Bank of Oklahoma  
Tulsa, Oklahoma

**Bob Horn**  
Vice President  
MidFirst Bank  
Oklahoma City, Oklahoma

**Jan Miller**  
President, Chief Executive Officer,  
and Chief Financial Officer  
Bank of Commerce  
Chelsea, Oklahoma

**Steve Rahill**  
President  
First Bank & Trust  
Duncan, Oklahoma

## *Omaha*

**Sid Dinsdale**  
President  
Pinnacle Bank  
Omaha, Nebraska

**Alan L. Fosler**  
Senior Vice President and Cashier  
Union Bank and Trust Company  
Lincoln, Nebraska

**Don G. Johnson**  
Chairman of the Board  
Midwest Bank  
Pierce, Nebraska

**Jim E. Kozal**  
Vice President  
Platte Valley National Bank  
Scottsbluff, Nebraska

**William W. Marshall, III**  
Chairman and President  
Five Points Bank  
Grand Island, Nebraska

**Gerald E. Wortman**  
President  
and Chief Executive Officer  
Sherman County Bank  
Loup City, Nebraska

# Tenth District *Officers*

## *Kansas City*

**Thomas M. Hoenig**  
President  
and Chief Executive Officer

**Richard K. Rasdall, Jr.**  
First Vice President  
and Chief Operating Officer

**Charles L. Bacon, Jr.**  
General Counsel,  
Senior Vice President,  
and Secretary

**Kelly J. Dubbert**  
Senior Vice President

**Carl M. Gambs**  
Senior Vice President

**Esther L. George**  
Senior Vice President

**Craig S. Hakkio**  
Senior Vice President  
and Director of Research

**Roberta E. Hearn**  
Senior Vice President

**Stephen E. McBride**  
Senior Vice President  
and General Auditor

**Barbara S. Pacheco**  
Senior Vice President

**Kent M. Scott**  
Senior Vice President

**John E. Yorke**  
Senior Vice President

**Alan D. Barkema**  
Vice President

**Todd E. Clark**  
Vice President  
and Economist

**Denise I. Connor**  
Vice President

**Mark R. Drabenstott**  
Vice President and Director,  
Center for the Study  
of Rural America

**Janel K. Frisch**  
Vice President  
and Chief Financial Officer

**Carol A. Hefley**  
Vice President

**George A. Kahn**  
Vice President  
and Associate Director  
of Research

**Sharon Koziicki**  
Vice President  
and Economist

**Kevin L. Moore**  
Vice President

**Dawn B. Morhaus**  
Vice President  
and Assistant Secretary

**Charles S. Morris**  
Vice President

**Karen A. Pennell**  
Vice President

**Randy M. Schartz**  
Vice President

**Stacey L. Schreft**  
Vice President  
and Economist

**Linda S. Schroeder**  
Vice President

**Veronica M. Sellers**  
Associate General Counsel  
and Vice President

**Gordon H. Sellon, Jr.**  
Vice President  
and Economist

**Stuart E. Weiner**  
Vice President  
and Economist

**Dick H. Woods, Jr.**  
Vice President

**Susan E. Zubradt**  
Vice President

**Josias A. Aleman**  
Assistant Vice President  
and Assistant General  
Auditor

**Stanley R. Beatty**  
Assistant Vice President

**Debra L. Bronston**  
Assistant Vice President

**Harriet I. Chern**  
Assistant Vice President

**Michael R. Childs**  
Assistant Vice President

**Paul S.J. Coquillette**  
Assistant Vice President

**Anita F. Costanza**  
Assistant Vice President

**Kelley D. Courtright**  
Assistant Vice President

**Kristi A. Coy**  
Assistant Vice President

**Nigel S. Davis**  
Assistant Vice President

**James R. Deis**  
Assistant Vice President

**Linda K. Edwards**  
Assistant Vice President

**C. Alan Garner**  
Assistant Vice President  
and Economist



**Lori D. Haley**  
Assistant Vice President

**Ann L. Hoelting**  
Assistant Vice President

**James H. Hunter**  
Assistant Vice President

**William Keeton**  
Assistant Vice President  
and Economist

**W. Todd Mackey**  
Assistant Vice President

**D. Michael Manies**  
Assistant Vice President

**Renu A. Mehra**  
Assistant Vice President

**Korie Miller**  
Assistant Vice President

**Randall L. Mueller**  
Assistant Vice President

**Wayne M. Powell**  
Assistant Vice President

**Diane M. Raley**  
Assistant Vice President  
and Public Information  
Officer

**Lawrence D. Taft**  
Assistant Vice President

**Leesa M. Thompson**  
Assistant Vice President

**Wilmer R. Ullmann**  
Associate General Counsel  
and Ethics Officer

**Donna J. Ward**  
Assistant Vice President

**Kathryn A. Webster**  
Assistant Vice President

**Margaret L. Yarrington**  
Assistant Vice President

**Catherine A. Zeigler**  
Assistant Vice President

*Denver*

**Pamela L. Weinstein**  
Vice President  
and Branch Manager

**Thomas P. Bennett**  
Assistant Vice President

**Gary E. Darby**  
Assistant Vice President

**Debbie L. Meyers**  
Assistant Vice President

*Oklahoma City*

**Dwayne E. Boggs**  
Vice President  
and Branch Manager

**Mark E. Clem**  
Assistant Vice President

**Tara B. Koenigs**  
Assistant Vice President

**Robert W. Toler**  
Assistant Vice President



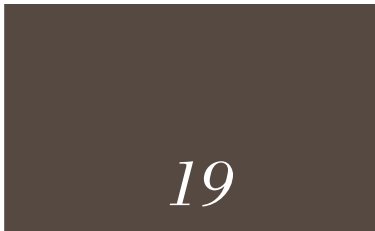
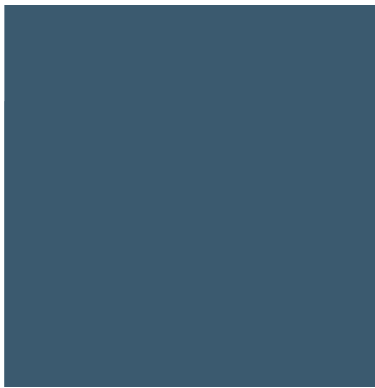
*Omaha*

**Steven D. Evans**  
Vice President  
and Branch Manager

**Ronald M. Ryan**  
Assistant Vice President  
and Assistant Branch  
Manager

**Kevin A. Drusch**  
Assistant Vice President

**D. Rick Lay**  
Assistant Vice President



*statements*

*notes*

# Financial Report

*letters*





# *Federal Reserve Bank of Kansas City*

925 Grand Boulevard  
Kansas City, Missouri 64198-0001  
(816) 881-2000  
[www.kansascityfed.org](http://www.kansascityfed.org)

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March 1, 2004

To the Board of Directors:

The management of the Federal Reserve Bank of Kansas City (“FRBKC”) is responsible for the preparation and fair presentation of the Statement of Financial Condition, Statement of Income, and Statement of Changes in Capital as of December 31, 2003 (the “Financial Statements”). The Financial Statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System and as set forth in the Financial Accounting Manual for the Federal Reserve Banks (“Manual”), and as such, include amounts, some of which are based on judgments and estimates of management. To our knowledge, the Financial Statements are, in all material respects, fairly presented in conformity with the accounting principles, policies and practices documented in the Manual and include all disclosures necessary for such fair presentation.

The management of the FRBKC is responsible for maintaining an effective process of internal controls over financial reporting including the safeguarding of assets as they relate to the Financial Statements. Such internal controls are designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation of reliable Financial Statements. This process of internal controls contains self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in the process of internal controls are reported to management, and appropriate corrective measures are implemented.

Even an effective process of internal controls, no matter how well designed, has inherent limitations, including the possibility of human error, and therefore can provide only reasonable assurance with respect to the preparation of reliable financial statements.

The management of the FRBKC assessed its process of internal controls over financial reporting including the safeguarding of assets reflected in the Financial Statements, based upon the criteria established in the “Internal Control – Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, we believe that the FRBKC maintained an effective process of internal controls over financial reporting including the safeguarding of assets as they relate to the Financial Statements.

Federal Reserve Bank of Kansas City

by 

Thomas M. Hoenig, President

by 

Richard K. Rasdall, Jr., First Vice President

by 

Janel K. Frisch, Chief Financial Officer

*Report of Independent Accountants*

**PricewaterhouseCoopers LLP**  
1055 Broadway  
10th Floor  
Kansas City MO 64105-1595  
Telephone (816) 472 7921  
Facsimile (816) 218 1890

To the Board of Directors of the  
Federal Reserve Bank of Kansas City

We have examined management's assertion, included in the accompanying Management Assertion, that the Federal Reserve Bank of Kansas City ("FRBKC") maintained effective internal control over financial reporting and the safeguarding of assets as they relate to the financial statements as of December 31, 2003, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. FRBKC's management is responsible for maintaining effective internal control over financial reporting and safeguarding of assets as they relate to the financial statements. Our responsibility is to express an opinion on management's assertion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of internal control over financial reporting, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that FRBKC maintained effective internal control over financial reporting and over the safeguarding of assets as they relate to the financial statements as of December 31, 2003 is fairly stated, in all material respects, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

This report is intended solely for the information and use of management and the Board of Directors and Audit Committee of FRBKC, and any organization with legally defined oversight responsibilities and is not intended to be and should not be used by anyone other than these specified parties.

*PricewaterhouseCoopers LLP*

March 1, 2004



*Report of Independent Auditors*

**PricewaterhouseCoopers LLP**  
1055 Broadway  
10th Floor  
Kansas City MO 64105-1595  
Telephone (816) 472 7921  
Facsimile (816) 218 1890

To the Board of Governors of The Federal Reserve System  
and the Board of Directors of The Federal Reserve Bank of Kansas City

We have audited the accompanying statements of condition of The Federal Reserve Bank of Kansas City (the "Bank") as of December 31, 2003 and 2002, and the related statements of income and changes in capital for the years then ended, which have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of The Federal Reserve System. These financial statements are the responsibility of the Bank'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. 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.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 2003 and 2002, and results of its operations for the years then ended, on the basis of accounting described in Note 3.

*PricewaterhouseCoopers LLP*

March 1, 2004  
Kansas City, Missouri

Financial Statements

*Statements of Condition*

Federal Reserve Bank of Kansas City

Statements of Condition (in millions)

As of December 31, 2003 and 2002

	2003	2002
<b>Assets</b>		
Gold certificates	\$ 303	\$ 309
Special drawing rights certificates	66	66
Coin	42	66
Items in process of collection	595	870
Loans to depository institutions	2	2
U.S. government and federal agency securities, net	18,156	18,893
Investments denominated in foreign currencies	476	440
Accrued interest receivable	136	161
Interdistrict settlement account	25	—
Bank premises and equipment, net	80	77
Other assets	16	20
	<hr/>	<hr/>
Total assets	\$ 19,897	\$ 20,904
	<hr/> <hr/>	<hr/> <hr/>
<b>Liabilities and Capital</b>		
<b>Liabilities:</b>		
Federal Reserve notes outstanding, net	\$ 17,516	\$ 16,125
Securities sold under agreements to repurchase	689	623
<b>Deposits:</b>		
Depository institutions	813	822
Other deposits	2	2
Deferred credit items	450	598
Interest on Federal Reserve notes due U.S. Treasury	46	31
Interdistrict settlement account	—	2,244
Accrued benefit costs	52	53
Other liabilities	5	4
	<hr/>	<hr/>
Total liabilities	19,573	20,502
	<hr/>	<hr/>
<b>Capital:</b>		
Capital paid-in	162	201
Surplus	162	201
	<hr/>	<hr/>
Total capital	324	402
	<hr/>	<hr/>
Total liabilities and capital	\$ 19,897	\$ 20,904
	<hr/> <hr/>	<hr/> <hr/>

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

# Financial Statements

## *Statements of Income*

Federal Reserve Bank of Kansas City

### Statements of Income (in millions)

For the years ended December 31, 2003 and 2002

	2003	2002
Interest income:		
Interest on U.S. government and federal agency securities	\$ 617	\$ 752
Interest on investments denominated in foreign currencies	6	7
Total interest income	<u>623</u>	<u>759</u>
Interest expense:		
Interest expense on securities sold under agreements to repurchase	\$ 6	\$ —
Net interest income	<u>617</u>	<u>759</u>
Other operating income:		
Income from services	58	71
Reimbursable services to government agencies	14	16
Foreign currency gains, net	65	54
U.S. government securities gains, net	—	2
Other income	1	1
Total other operating income	<u>138</u>	<u>144</u>
Operating expenses:		
Salaries and other benefits	112	108
Occupancy expense	9	8
Equipment expense	11	11
Assessments by Board of Governors	25	17
Other expenses	45	47
Total operating expenses	<u>202</u>	<u>191</u>
Net income prior to distribution	<u>\$ 553</u>	<u>\$ 712</u>
Distribution of net income:		
Dividends paid to member banks	\$ 12	\$ 12
Transferred to (from) surplus	(39)	10
Payments to U.S. Treasury as interest on Federal Reserve notes	580	690
Total distribution	<u>\$ 553</u>	<u>\$ 712</u>

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

Financial Statements

*Statements of Changes in Capital*

Federal Reserve Bank of Kansas City  
 Statements of Changes in Capital (in millions)  
 For the years ended December 31, 2003 and December 31, 2002

	Capital Paid-in	Surplus	Total Capital
Balance at January 1, 2002 (3.8 million shares)	\$ 191	\$ 191	\$ 382
Net income transferred to surplus	—	10	10
Net change in capital stock issued (0.2 million shares)	10	—	10
	<hr/>	<hr/>	<hr/>
Balance at December 31, 2002 (4.0 million shares)	\$ 201	\$ 201	\$ 402
Net income transferred from surplus	—	(39)	(39)
Net change in capital stock redeemed (0.8 million shares)	(39)	—	(39)
	<hr/>	<hr/>	<hr/>
Balance at December 31, 2003 (3.2 million shares)	\$ 162	\$ 162	\$ 324
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

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

# Federal Reserve Bank of Kansas City

## *Notes to Financial Statements*

### 1. STRUCTURE

The Federal Reserve Bank of Kansas City (“Bank”) is part of the Federal Reserve System (“System”) created by Congress under the Federal Reserve Act of 1913 (“Federal Reserve Act”) which established the central bank of the United States. The System consists of the Board of Governors of the Federal Reserve System (“Board of Governors”) and twelve Federal Reserve Banks (“Reserve Banks”). The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. The Bank and its branches in Denver, Colorado, Oklahoma City, Oklahoma, and Omaha, Nebraska, serve the Tenth Federal Reserve District, which includes Colorado, Kansas, Nebraska, Oklahoma, Wyoming, and portions of Missouri and New Mexico. Other major elements of the System are the Federal Open Market Committee (“FOMC”) and the Federal Advisory Council. The FOMC is composed of members of the Board of Governors, the president of the Federal Reserve Bank of New York (“FRBNY”) and, on a rotating basis, four other Reserve Bank presidents. Banks that are members of the System include all national banks and any state-chartered bank that applies and is approved for membership in the System.

#### *Board of Directors*

In accordance with the Federal Reserve Act, supervision and control of the Bank are exercised by a Board of Directors. The Federal Reserve Act specifies the composition of the Board of Directors for each of the Reserve Banks. Each board is composed of nine external members serving three-year terms: three directors, including those designated as Chairman and Deputy Chairman, are appointed by the Board of Governors, and six directors are elected by member banks. Of the six elected by member banks, three represent the public and three represent member banks. Member banks are divided into three classes according to size. Member banks in each class elect one director representing member banks and one representing the public. In any election of directors, each member bank receives one vote, regardless of the number of shares of Reserve Bank stock it holds.

### 2. OPERATIONS AND SERVICES

The System performs a variety of services and operations. Functions include: formulating and conducting monetary policy; participating actively in the payments mechanism, including large-dollar transfers of funds, automated clearinghouse (“ACH”) operations and check processing; distributing coin and currency; performing fiscal agency functions for the U.S. Treasury and certain federal agencies; serving as the federal government’s bank; providing short-term loans to depository institutions; serving the consumer and the community by providing educational materials and information regarding consumer laws; supervising bank holding companies and state member banks; and administering other regulations of the Board of Governors. The Board of Governors’ operating costs are funded through assessments on the Reserve Banks.

In performing fiscal agency functions for the U.S. Treasury, the Bank provides U.S. securities direct purchase and savings bond processing services. In December 2003, the U.S. Treasury announced plans to consolidate the provision of these services at FRB Cleveland and Minneapolis. An implementation plan is expected to be announced in March 2004. At this time, the Bank has not developed a detailed estimate of the financial effect of the consolidation.

# Federal Reserve Bank of Kansas City

## 2003 Annual Report

The FOMC establishes policy regarding open market operations, oversees these operations, and issues authorizations and directives to the FRBNY for its execution of transactions. Authorized transaction types include direct purchase and sale of securities, matched sale-purchase transactions, the purchase of securities under agreements to resell, the sale of securities under agreements to repurchase, and the lending of U.S. government securities. The FRBNY is also authorized by the FOMC to hold balances of, and to execute spot and forward foreign exchange (“F/X”) and securities contracts in, nine foreign currencies, maintain reciprocal currency arrangements (“F/X swaps”) with various central banks, and “warehouse” foreign currencies for the U.S. Treasury and Exchange Stabilization Fund (“ESF”) through the Reserve Banks.

### 3. SIGNIFICANT ACCOUNTING POLICIES

Accounting principles for entities with the unique powers and responsibilities of the nation’s central bank have not been formulated by the Financial Accounting Standards Board. The Board of Governors has developed specialized accounting principles and practices that it believes are appropriate for the significantly different nature and function of a central bank as compared with the private sector. These accounting principles and practices are documented in the *Financial Accounting Manual for Federal Reserve Banks* (“Financial Accounting Manual”), which is issued by the Board of Governors. All Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the Financial Accounting Manual.

The financial statements have been prepared in accordance with the Financial Accounting Manual. Differences exist between the accounting principles and practices of the System and accounting principles generally accepted in the United States of America (“GAAP”). The primary difference is the presentation of all security holdings at amortized cost, rather than at the fair value presentation requirements of GAAP, and the accounting for matched sale-purchase transactions as separate sales and purchases, rather than secured borrowing with pledged collateral, as is generally required by GAAP. In addition, the Bank has elected not to present a Statement of Cash Flows. The Statement of Cash Flows has not been included because the liquidity and cash position of the Bank are not of primary concern to the users of these financial statements. Other information regarding the Bank’s activities is provided in, or may be derived from, the Statements of Condition, Income, and Changes in Capital. A Statement of Cash Flows, therefore, would not provide any additional useful information. There are no other significant differences between the policies outlined in the Financial Accounting Manual and GAAP.

Each Reserve Bank provides services on behalf of the System for which costs are not shared. Major services provided on behalf of the System by the Bank, for which the costs were not redistributed to the other Reserve Banks, include: Savings Bonds, Wholesale Operations Site, Central Check User Support, Customer Relations and Support Office, Electronic Access Customer Contact Center, PeopleSoft Support Center, and Billing Operations Consolidation Site.

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

## a. Gold Certificates

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

## b. Special Drawing Rights Certificates

Special drawing rights ("SDRs") are issued by the International Monetary Fund ("Fund") to its members in proportion to each member's quota in the Fund at the time of issuance. SDRs serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for United States participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates, somewhat like gold certificates, to the Reserve Banks. At such time, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the U.S. Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among Reserve Banks based upon Federal Reserve notes outstanding in each District at the end of the preceding year. There were no SDR transactions in 2003 or 2002.

## c. Loans to Depository Institutions

The Depository Institutions Deregulation and Monetary Control Act of 1980 provides that all depository institutions that maintain reservable transaction accounts or nonpersonal time deposits, as defined in Regulation D issued by the Board of Governors, have borrowing privileges at the discretion of the Reserve Banks. Borrowers execute certain lending agreements and deposit sufficient collateral before credit is extended. Loans are evaluated for collectibility, and currently all are considered collectible and fully collateralized. If loans were ever deemed to be uncollectible, an appropriate reserve would be established. Interest is accrued using the applicable discount rate established at least every fourteen days by the Boards of Directors of the Reserve Banks, subject to review by the Board of Governors.

## d. U.S. Government and Federal Agency Securities and Investments Denominated in Foreign Currencies

The FOMC has designated the FRBNY to execute open market transactions on its behalf and to hold the resulting securities in the portfolio known as the System Open Market Account ("SOMA"). In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes and directs the FRBNY to execute operations in foreign markets for major currencies in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC in carrying out the System's central bank responsibilities. Such authorizations are reviewed and approved annually by the FOMC.

# Federal Reserve Bank of Kansas City

## *2003 Annual Report*

In December 2002, the FRBNY replaced matched sale-purchase (“MSP”) transactions with securities sold under agreements to repurchase. MSP transactions, accounted for as separate sale and purchase transactions, are transactions in which the FRBNY sells a security and buys it back at the rate specified at the commencement of the transaction. Securities sold under agreements to repurchase are treated as secured borrowing transactions with the associated interest expense recognized over the life of the transaction.

The FRBNY has sole authorization by the FOMC to lend U.S. government securities held in the SOMA to U.S. government securities dealers and to banks participating in U.S. government securities clearing arrangements on behalf of the System, in order to facilitate the effective functioning of the domestic securities market. These securities-lending transactions are fully collateralized by other U.S. government securities. FOMC policy requires the FRBNY to take possession of collateral in excess of the market values of the securities loaned. The market values of the collateral and the securities loaned are monitored by the FRBNY on a daily basis, with additional collateral obtained as necessary. The securities loaned continue to be accounted for in the SOMA.

F/X contracts are contractual agreements between two parties to exchange specified currencies, at a specified price, on a specified date. Spot foreign contracts normally settle two days after the trade date, whereas the settlement date on forward contracts is negotiated between the contracting parties, but will extend beyond two days from the trade date. The FRBNY generally enters into spot contracts, with any forward contracts generally limited to the second leg of a swap/warehousing transaction.

The FRBNY, on behalf of the Reserve Banks, maintains renewable, short-term F/X swap arrangements with two authorized foreign central banks. The parties agree to exchange their currencies up to a pre-arranged maximum amount and for an agreed-upon period of time (up to twelve months), at an agreed-upon interest rate. These arrangements give the FOMC temporary access to foreign currencies it may need for intervention operations to support the dollar and give the partner foreign central bank temporary access to dollars it may need to support its own currency. Drawings under the F/X swap arrangements can be initiated by either the FRBNY or the partner foreign central bank and must be agreed to by the drawee. The F/X swaps are structured so that the party initiating the transaction (the drawer) bears the exchange rate risk upon maturity. The FRBNY will generally invest the foreign currency received under an F/X swap in interest-bearing instruments.

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

In connection with its foreign currency activities, the FRBNY, on behalf of the Reserve Banks, may enter into contracts that contain varying degrees of off-balance sheet market risk, because they represent contractual commitments involving future settlement and counter-party credit risk. The FRBNY controls credit risk by obtaining credit approvals, establishing transaction limits, and performing daily monitoring procedures.

While the application of current market prices to the securities currently held in the SOMA portfolio and investments denominated in foreign currencies may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Reserve Bank earnings or capital. Both the



domestic and foreign components of the SOMA portfolio from time to time involve transactions that may result in gains or losses when holdings are sold prior to maturity. Decisions regarding the securities and foreign currencies transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, market values, earnings, and any gains or losses resulting from the sale of such currencies and securities are incidental to the open market operations and do not motivate its activities or policy decisions.

U.S. government and federal agency securities and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Interest income is accrued on a straight-line basis and is reported as “Interest on U.S. government and federal agency securities” or “Interest on investments denominated in foreign currencies,” as appropriate. Income earned on securities lending transactions is reported as a component of “Other income.” Gains and losses resulting from sales of securities are determined by specific issues based on average cost. Gains and losses on the sales of U.S. government and federal agency securities are reported as “U.S. government securities gains, net.” Foreign-currency-denominated assets are revalued daily at current foreign currency market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on investments denominated in foreign currencies are reported as “Foreign currency gains, net.” Foreign currencies held through F/X swaps, when initiated by the counter-party, and warehousing arrangements are revalued daily with the unrealized gain or loss reported by the FRBNY as a component of “Other assets” or “Other liabilities,” as appropriate.

Balances of U.S. government and federal agency securities bought outright, securities sold under agreements to repurchase, securities loaned, investments denominated in foreign currency, interest income and expense, securities lending fee income, amortization of premiums and discounts on securities bought outright, gains and losses on sales of securities, and realized and unrealized gains and losses on investments denominated in foreign currencies, excluding those held under an F/X swap arrangement, are allocated to each Reserve Bank. Securities purchased under agreements to resell and unrealized gains and losses on the revaluation of foreign currency holdings under F/X swaps and warehousing arrangements are allocated to the FRBNY and not to other Reserve Banks.

In 2003, additional interest income of \$61 million representing one day’s interest on the SOMA portfolio was accrued to reflect a change in interest accrual methods, of which \$2 million was allocated to the Bank. Interest accruals and the amortization of premiums and discounts are now recognized beginning the day that a security is purchased and ending the day before the security matures or is sold. Previously, accruals and amortization began the day after the security was purchased and ended on the day that the security matured or was sold. The effect of this change was not material; therefore, it was included in the 2003 interest income.

## e. Bank Premises, Equipment, and Software

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over estimated useful lives of assets ranging from two to fifty years. Major alterations, renovations and improvements are capitalized at cost as additions to the asset accounts. Maintenance, repairs and minor replacements are charged to operations in the year incurred. Costs incurred for software, either developed internally or acquired for internal use, during the application development stage are capitalized based on the cost of direct services and materials associated with designing, coding, installing, or testing software. Capitalized software costs are amortized on a straight-line basis over the estimated useful lives of the software applications, which range from two to five years.

### f. Interdistrict Settlement Account

At the close of business each day, all Reserve Banks and branches assemble the payments due to or from other Reserve Banks and branches as a result of transactions involving accounts residing in other Districts that occurred during the day's operations. Such transactions may include funds settlement, check clearing and ACH operations, and allocations of shared expenses. The cumulative net amount due to or from other Reserve Banks is reported as the "Interdistrict settlement account."

### g. Federal Reserve Notes

Federal Reserve notes are the circulating currency of the United States. These notes are issued through the various Federal Reserve agents (the Chairman of the Board of Directors of each Reserve Bank) to the Reserve Banks upon deposit with such agents of certain classes of collateral security, typically U.S. government securities. These notes are identified as issued to a specific Reserve Bank. The Federal Reserve Act provides that the collateral security tendered by the Reserve Bank to the Federal Reserve agent must be equal to the sum of the notes applied for by such Reserve Bank. In 2003, the Federal Reserve Act was amended to expand the assets eligible to be pledged as collateral security to include all Federal Reserve Bank assets. Prior to the amendment, only gold certificates, special drawing rights certificates, U.S. government and federal agency securities, securities purchased under agreements to resell, loans to depository institutions, and investments denominated in foreign currencies could be pledged as collateral. The collateral value is equal to the book value of the collateral tendered, with the exception of securities, whose collateral value is equal to the par value of the securities tendered. The par value of securities pledged for securities sold under agreements to repurchase is similarly deducted. The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the Federal Reserve notes. The Reserve Banks have entered into an agreement that provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes of all Reserve Banks in order to satisfy their obligation of providing sufficient collateral for outstanding Federal Reserve notes. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, as obligations of the United States, Federal Reserve notes are backed by the full faith and credit of the United States government.

The "Federal Reserve notes outstanding, net" account represents the Bank's Federal Reserve notes outstanding, reduced by its currency holdings of \$4,083 million and \$3,854 million at December 31, 2003 and 2002, respectively.

### h. Capital Paid-in

The Federal Reserve Act requires that each member bank subscribe to the capital stock of the Reserve Bank in an amount equal to 6 percent of the capital and surplus of the member bank. As a member bank's capital and surplus changes, its holdings of the Reserve Bank's stock must be adjusted. Member banks are those state-chartered banks that apply and are approved for membership in the System and all national banks. Currently, only one-half of the subscription is paid-in and the remainder is subject to call. These shares are nonvoting with a par value of \$100. They may not be transferred or hypothecated. By law, each member bank is entitled to receive an annual dividend of 6 percent on the paid-in capital stock. This cumulative dividend is paid semiannually. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

### i. Surplus

The Board of Governors requires Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks would be required to call on member banks for additional capital. Pursuant to Section 16 of the Federal Reserve Act, Reserve Banks are required by the Board of Governors to transfer to the U.S. Treasury as interest on Federal Reserve notes excess earnings, after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in.

In the event of losses or a substantial increase in capital, payments to the U.S. Treasury are suspended until such losses are recovered through subsequent earnings. Weekly payments to the U.S. Treasury may vary significantly.

### j. Income and Costs related to Treasury Services

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States. By statute, the Department of the Treasury is permitted, but not required, to pay for these services.

### k. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property. The Bank's real property taxes were \$1 million for each of the years ended December 31, 2003 and 2002, and are reported as a component of "Occupancy expense."

### l. Recent Accounting Developments

In May 2003, the Financial Accounting Standards Board issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150, which will become applicable for the Bank in 2004, establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity and imposes certain additional disclosure requirements. When adopted, there may be situations in which the Bank has not yet processed a member bank's application to redeem its Reserve Bank stock. In those situations, this standard requires that the portion of the capital paid-in that is mandatorily redeemable be reclassified as debt.

### m. 2003 Restructuring Charges

In 2003, the System restructured several operations, primarily in the check and cash services. The restructuring included streamlining the management and support structures, reducing staff, decreasing the number of processing locations, and increasing processing capacity in the remaining locations.

Footnote 10 describes the restructuring and provides information about the Bank's costs and liabilities associated with employee separations and contract terminations. Costs and liabilities associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY as discussed in footnote 8 and those associated with the Bank's enhanced postretirement benefits are disclosed in footnote 9.

## 4. U.S. GOVERNMENT AND FEDERAL AGENCY SECURITIES

Securities bought outright are held in the SOMA at the FRBNY. An undivided interest in SOMA activity and the related premiums, discounts and income, with the exception of securities purchased under agreements to resell, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of interdistrict clearings. The settlement, performed in April of each year, equalizes Reserve

# Federal Reserve Bank of Kansas City

## 2003 Annual Report

Bank gold certificate holdings to Federal Reserve notes outstanding. The Bank's allocated share of SOMA balances was approximately 2.687 percent and 2.956 percent at December 31, 2003 and 2002, respectively.

The Bank's allocated share of securities held in the SOMA at December 31, that were bought outright, was as follows (in millions):

	2003	2002
Par value:		
U.S. government:		
Bills	\$ 6,580	\$ 6,701
Notes	8,690	8,806
Bonds	2,646	3,099
Total par value	17,916	18,606
Unamortized premiums	264	318
Unaccreted discounts	(24)	(31)
Total allocated to Bank	\$ 18,156	\$ 18,893

The total of SOMA securities bought outright was \$675,569 million and \$639,125 million at December 31, 2003 and 2002, respectively.

As noted in footnote 3, the FRBNY replaced MSP transactions with securities sold under agreements to repurchase in December 2002. At December 31, 2003 and 2002, securities sold under agreements to repurchase with a contract amount of \$25,652 million and \$21,091 million, respectively, were outstanding, of which \$689 million and \$623 million were allocated to the Bank. At December 31, 2003 and 2002, securities sold under agreements to repurchase with a par value of \$25,658 million and \$21,098 million, respectively, were outstanding, of which \$690 million and \$624 million were allocated to the Bank.

The maturity distribution of U.S. government securities bought outright and securities sold under agreements to repurchase, that were allocated to the Bank at December 31, 2003, was as follows (in millions):

Maturities of Securities Held	U.S. Government Securities (Par Value)	Securities Sold Under Agreements to Repurchase (Contract Amount)
Within 15 days	\$ 1,283	\$ 689
16 days to 90 days	3,745	—
91 days to 1 year	4,409	—
Over 1 year to 5 years	5,027	—
Over 5 years to 10 years	1,379	—
Over 10 years	2,073	—
Total	\$ 17,916	\$ 689

At December 31, 2003 and 2002, U.S. government securities with par values of \$4,426 million and \$1,841 million, respectively, were loaned from the SOMA, of which \$119 million and \$54 million were allocated to the Bank.

## 5. INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES

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

Each Reserve Bank is allocated a share of foreign-currency-denominated assets, the related interest income, and realized and unrealized foreign currency gains and losses, with the exception of unrealized gains and losses on F/X swaps and warehousing transactions. This allocation is based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. The Bank's allocated share of investments denominated in foreign currencies was approximately 2.394 percent and 2.601 percent at December 31, 2003 and 2002, respectively.

The Bank's allocated share of investments denominated in foreign currencies, valued at current foreign currency market exchange rates at December 31, was as follows (in millions):

	2003	2002
European Union Euro:		
Foreign currency deposits	\$ 165	\$ 145
Government debt instruments including agreements to resell	98	86
Japanese Yen:		
Foreign currency deposits	35	47
Government debt instruments including agreements to resell	176	160
Accrued interest	2	2
Total	<u>\$ 476</u>	<u>\$ 440</u>

Total investments denominated in foreign currencies were \$19,868 million and \$16,913 million at December 31, 2003 and 2002, respectively.

The maturity distribution of investments denominated in foreign currencies which were allocated to the Bank at December 31, 2003, was as follows (in millions):

Maturities of Investments Denominated in Foreign Currencies	
Within 1 year	\$ 437
Over 1 year to 5 years	31
Over 5 years to 10 years	8
Over 10 years	—
Total	<u>\$ 476</u>

At December 31, 2003 and 2002, there were no outstanding F/X swaps or material open foreign exchange contracts.

At December 31, 2003 and 2002, the warehousing facility was \$5,000 million, with no balance outstanding.

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### 6. BANK PREMISES, EQUIPMENT, AND SOFTWARE

A summary of bank premises and equipment at December 31 is as follows (in millions):

	2003	2002
Bank premises and equipment:		
Land	\$ 19	\$ 13
Buildings	52	51
Building machinery and equipment	19	20
Construction in progress	2	2
Furniture and equipment	70	77
Subtotal	\$ 162	\$ 163
Accumulated depreciation	(82)	(86)
Bank premises and equipment, net	\$ 80	\$ 77
Depreciation expense, for the years ended	\$ 9	\$ 10

The Bank is constructing a new building to replace the head office in Kansas City. At December 31, 2003, the contractual obligation for property for the new building site totaled \$18 million, none of which has been recognized.

The Bank leases unused space to outside tenants. Those leases have terms of less than one year. Future minimum lease payments under noncancelable agreements in existence at December 31, 2003 were not material.

The Bank has capitalized software assets, net of amortization, of \$3 million and \$5 million at December 31, 2003 and 2002, respectively. Amortization expense was \$1 million for each of the years ended December 31, 2003 and 2002. A software asset was impaired as a result of the decision to standardize check processing in the System. Asset impairment losses of \$1 million were reported as a component of "Other expenses" for the period ending December 31, 2003.

### 7. COMMITMENTS AND CONTINGENCIES

At December 31, 2003, the Bank was obligated under noncancelable leases for premises and equipment with terms of less than one year. These leases provide for increased rental payments based upon increases in real estate taxes, operating costs or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance and maintenance when included in rent), net of sublease rentals, was \$2 million for each of the years ended December 31, 2003 and 2002. Certain of the Bank's leases have options to renew.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with terms of less than one year, at December 31, 2003, were not material.

Under the Insurance Agreement of the Federal Reserve Banks dated as of March 2, 1999, each of the Reserve Banks has agreed to bear, on a per incident basis, a pro rata share of losses in excess of one percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio that a Reserve Bank's capital paid-in bears to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under such agreement at December 31, 2003 or 2002.

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

## 8. RETIREMENT AND THRIFT PLANS

### *Retirement Plans*

The Bank currently offers two defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the Bank's employees participate in the Retirement Plan for Employees of the Federal Reserve System ("System Plan") and the Benefit Equalization Retirement Plan ("BEP"). In addition, certain Bank officers participate in the Supplemental Employment Retirement Plan ("SERP").

The System Plan is a multi-employer plan with contributions fully funded by participating employers. Participating employers are the Federal Reserve Banks, the Board of Governors of the Federal Reserve System, and the Office of Employee Benefits of the Federal Reserve Employee Benefits System. No separate accounting is maintained of assets contributed by the participating employers. The FRBNY acts as a sponsor of the Plan for the System and the costs associated with the Plan are not redistributed to the Bank. The Bank's projected benefit obligation and net pension costs for the BEP and the SERP at December 31, 2003 and 2002, and for the years then ended, are not material.

### *Thrift Plan*

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank's Thrift Plan contributions totaled \$4 million for each of the years ended December 31, 2003 and 2002, and are reported as a component of "Salaries and other benefits."

## 9. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS AND POSTEMPLOYMENT BENEFITS

### *Postretirement Benefits other than Pensions*

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

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The Bank funds benefits payable under the medical and life insurance plans as due and, accordingly, has no plan assets. Net postretirement benefit costs are actuarially determined using a January 1 measurement date.

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

	2003	2002
Accumulated postretirement benefit obligation at January 1	\$ 23.6	\$ 25.4
Service cost-benefits earned during the period	0.7	0.6
Interest cost of accumulated benefit obligation	1.6	1.5
Actuarial loss (gain)	4.2	(2.5)
Special termination loss	0.1	—
Contributions by plan participants	0.4	0.5
Benefits paid	(1.9)	(1.4)
Plan amendment/settlement	—	(0.5)
Accumulated postretirement benefit obligation at December 31	<u>\$ 28.7</u>	<u>\$ 23.6</u>

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

	2003	2002
Fair value of plan assets at January 1	\$ —	\$ —
Actual return on plan assets	—	—
Contributions by the employer	1.5	0.9
Contributions by plan participants	0.4	0.5
Benefits paid	(1.9)	(1.4)
Fair value of plan assets at December 31	<u>\$ —</u>	<u>\$ —</u>
Unfunded postretirement benefit obligation	\$ 28.7	\$ 23.6
Unrecognized prior service cost	15.4	17.6
Unrecognized net actuarial gain	0.8	5.1
Accrued postretirement benefit costs	<u>\$ 44.9</u>	<u>\$ 46.3</u>

Accrued postretirement benefit costs are reported as a component of “Accrued benefit costs.”

At December 31, 2003 and 2002, the weighted average discount rate assumptions used in developing the benefit obligation were 6.25 percent and 6.75 percent, respectively.

For measurement purposes, a 10.00 percent annual rate of increase in the cost of covered health care benefits was assumed for 2004. Ultimately, the health care cost trend rate is expected to decrease gradually to 5.00 percent by 2011 and remain at that level thereafter.



Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2003 (in millions):

	One Percentage Point Increase	One Percentage Point Decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	\$ 0.1	\$ (0.1)
Effect on accumulated postretirement benefit obligation	\$ 1.1	\$ (0.9)

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

	2003	2002
Service cost-benefits earned during the period	\$ 0.7	\$ 0.6
Interest cost of accumulated benefit obligation	1.6	1.5
Amortization of prior service cost	(2.1)	(2.1)
Recognized net actuarial gain	(0.1)	(0.2)
Total periodic expense (credit)	\$ 0.1	\$ (0.2)
Special termination loss	0.1	—
Net periodic postretirement benefit cost (credit)	\$ 0.2	\$ (0.2)

Net periodic postretirement benefit costs are reported as a component of “Salaries and other benefits.”

The recognition of a special termination loss is the result of enhanced retirement benefits provided to employees during the restructuring described in footnote 10.

Following the guidance of the Financial Accounting Standards Board, the Bank elected to defer recognition of the financial effects of the Medicare Prescription Drug Improvement and Modernization Act of 2003 until further guidance is issued. Neither the accumulated postretirement benefit obligation at December 31, 2003 nor the net periodic postretirement benefit cost for the year then ended reflect the effect of the Act on the plan.

### *Postemployment Benefits*

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined and include the cost of medical and dental insurance, survivor income, and disability benefits. Costs were projected using the same discount rate and health care trend rates as were used for projecting postretirement costs. The accrued postemployment benefit costs recognized by the Bank at December 31, 2003 and 2002, were \$7 million and \$6 million, respectively. This cost is included as a component of “Accrued benefit costs.” Net periodic postemployment benefit costs included in 2003 and 2002 operating expenses were \$1 million for both years.

# Federal Reserve Bank of Kansas City

## 2003 Annual Report

### 10. RESTRUCTURING CHARGES

In 2003, the Bank announced plans for restructuring to streamline operations and reduce costs, including consolidation of check operations and staff reductions in various functions of the Bank. These actions resulted in the following business restructuring charges:

Major categories of expense (in millions):

	Total Estimated Costs	Accrued Liability 12/31/02	Total Charges	Total Paid	Accrued Liability 12/31/03
Employee separation	\$ 1.9	\$ —	\$ 1.9	\$ (.2)	\$ 1.7
Contract termination	—	—	—	—	—
Other	—	—	—	—	—
	<u>\$ 1.9</u>	<u>\$ —</u>	<u>\$ 1.9</u>	<u>\$ (.2)</u>	<u>\$ 1.7</u>

Employee separation costs are primarily severance costs related to reductions of approximately 76 staff and are reported as a component of “Salaries and other benefits.” Contract termination costs include the charges resulting from terminating existing lease and other contracts and are shown as a component of “Other expenses.”

Costs associated with the write-downs of certain Bank assets, including software, buildings, leasehold improvements, furniture, and equipment are discussed in footnote 6. Costs associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY as discussed in footnote 8. Costs associated with enhanced postretirement benefits are disclosed in footnote 9.

Future costs associated with the restructuring that are not estimable and are not recognized as liabilities will be incurred in 2004.

The Bank anticipates substantially completing its announced plans by June 2004.

### 11. SUBSEQUENT EVENT

In January and February 2004, the Bank satisfied its contractual obligation to purchase property on which a new building will be constructed, as described in footnote 6, at a cost of \$18 million.

## Federal Reserve Bank of Kansas City

### *Volume of Principal Operations (unaudited)*

	2003	2002
Loans and Discounts, Daily Average	\$ 8,637,000	\$ 11,916,000
Number of Institutions Borrowing	69	77
Commercial Checks	\$ 1,204,436,000,000	\$ 1,092,901,000,000
Commercial Checks Collected	1,517,260,000	1,590,318,000
Currency Receipts and Payments	\$ 55,021,071,000	\$ 50,659,551,000
Pieces	3,588,032,000	3,292,431,000
Coin Receipts and Payments	\$ 157,915,000	\$ 231,245,000
Bags	252,000	393,000
Issues and Redemption of U.S. Government Securities*	\$ 266,254,686,000	\$ 1,641,229,756,000
Funds Transfers	\$ 91,728,584,000,000	\$ 71,472,538,000,000
Numbers	51,104,000	41,911,000

\*The processing of book-entry agency redemptions was consolidated at the East Rutherford Operating Center beginning in 2003.

Volume of Principal Operations numbers were not included in PricewaterhouseCoopers audit.

### *Statement of Auditor Independence*

The firm engaged by the Board of Governors for the audits of the individual and combined financial statements of the Reserve Banks for 2003 was PricewaterhouseCoopers LLP (PwC). Fees for these services totaled \$1.4 million. To ensure auditor independence, the Board of Governors requires that PwC be independent in all matters relating to the audit. Specifically, PwC may not perform services for the Reserve Banks or others that would place it in a position of auditing its own work, making management decisions on behalf of the Reserve Banks, or in any other way impairing its audit independence. In 2003, the Bank did not engage PwC for advisory services.

# Tenth *Federal Reserve* District



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