Federal Reserve Bank of Kansas City

missions

monetary policy

supervision

financial services

VISION

trust & confidence

2001 Annual Report

inside

" ...our three complementary mission areas, and the structure of the System itself, serve to foster the stability, integrity, and efficiency of local, national, and world financial and payments systems..."

Trust & Confidence

Our vision guides our missions

The Federal Reserve Bank of Kansas City's vision statement focuses on the principles of "Trust and Confidence." It is a simple but important statement that took on special meaning as the Federal Reserve worked with the financial and business communities, and the American people, during the tragic events of September 2001. Our Annual Report this year attempts to better explain this statement – first, in the context of the events around September 11 and, second, in the context of this Reserve Bank's changing role as one of twelve Banks and the Board of Governors making up the Federal Reserve System.

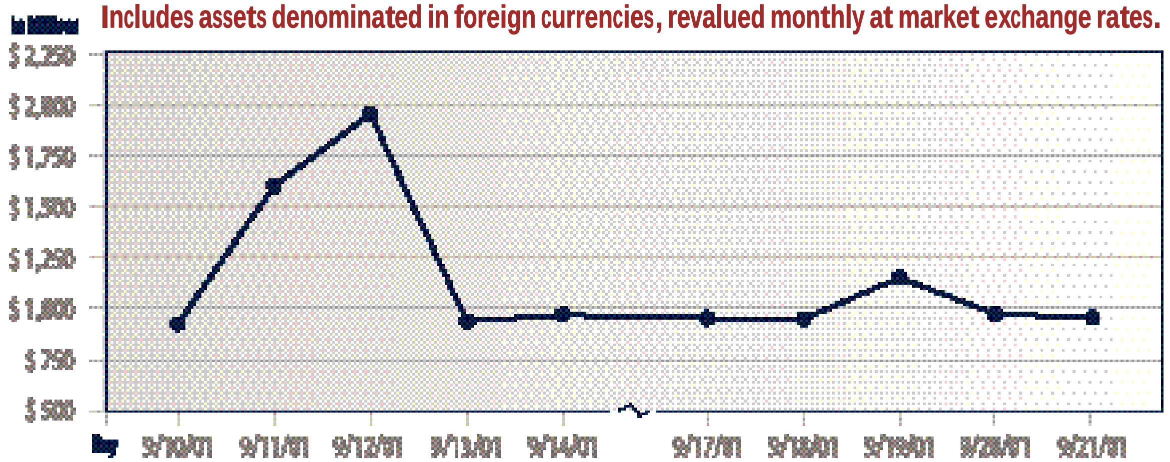
The Federal Reserve System's mission centers on the fulfillment of three central bank responsibilities: monetary policy, supervision, and financial and Treasury services. The provision of these services is what Jerry Corrigan, the former president of the Federal Reserve Banks of Minneapolis and New York, likes to call "the trilogy of central bank responsibilities." While often viewed as separate and unique, these mission areas are, in fact, complementary and assist the Federal Reserve to achieve the highest level of performance in fulfilling its public policy role. This becomes particularly evident during times of crisis, when individuals across business lines share and manage information.

Thomas M. Hoenig
President and Chief Executive Officer

The Federal Reserve's Response to the Events of September 11

The events of September 11 produced outcomes that are unspeakable in their effects on human life. They also illustrate how our three complementary mission areas, and the structure of the System itself, serve to foster the stability, integrity, and efficiency of local, national, and world financial and payments systems, and promote confidence in these systems throughout the world.

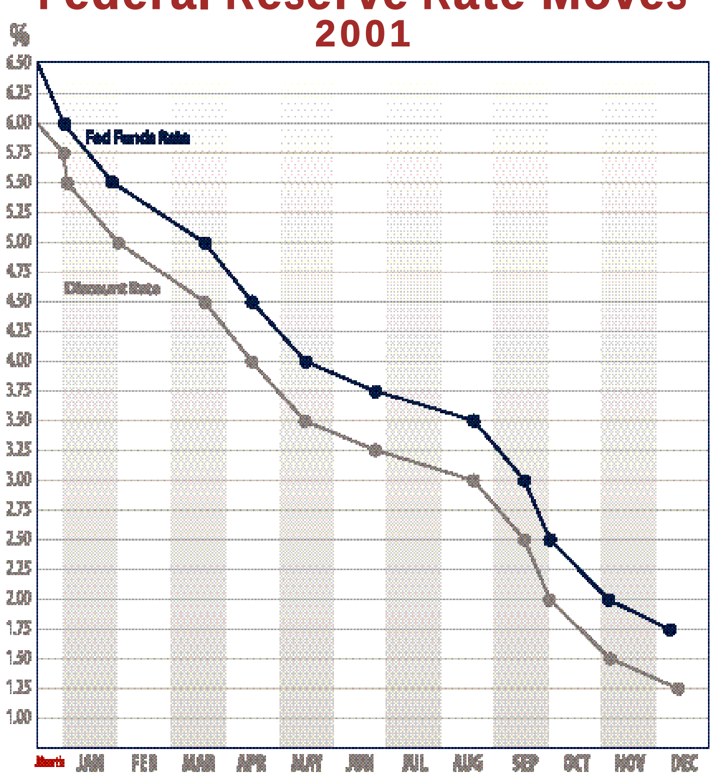
10th District Loans and Other Assets



Monetary Policy and the Provision of Liquidity

Following September 11, the Federal Reserve acted quickly to supply funds necessary to meet the extraordinary demand for liquidity and to assist banks whose ability, or whose customers' ability, to receive and send payments had been disrupted. Discount window borrowing on September 12 was $45.6 billion; a week earlier it had been $195 million. In addition, the day after the attacks the Open Market Desk at the New York Fed injected $38 billion of liquidity into the market through overnight repurchase agreements, and by Friday, September 14, the desk had injected a record $81.25 billion. Since the demand for dollar liquidity is global, the Federal Reserve established or expanded currency exchange lines of credit with other central banks around the world to ensure that foreign banks operating in the United States had sufficient access to U.S. dollars to enable them to operate without undue disruption.

Federal Reserve Rate Moves 2001



Before the reopening of the stock markets on September 17, the Federal Open Market Committee (FOMC) lowered the federal funds rate target, and the Board of Governors, with recommendations from the Reserve Banks, lowered the discount rate by 50 basis points. Additionally, the FOMC reaffirmed its commitment to supply unusually large volumes of liquidity to the financial markets, as needed, until more normal market functioning could be restored.

Mission

mission 1

Monetary Policy

Our mission is to formulate and implement monetary policy that promotes financial stability and sustainable economic growth for the nation; price stability fosters these goals. Price stability leads to an environment that allows businesses and consumers to plan with confidence, encourages growth and business investment, and leads to an increased capacity to produce goods and services.

one 1

President's Message • President's Message • President's Message

To counter the negative economic effects of the terrorist attacks – and the continuing economic weakness that had begun before the attacks – the FOMC lowered rates 50 basis points on October 2 and November 6, and 25 basis points on December 11. The result was a $1^{3}/_{4}$ percent federal funds rate target – the lowest in forty years, and a $1^{1}/_{4}$ percent discount rate – the lowest since the 1940s. At the beginning of the year, the funds rate target stood at $6^{1}/_{2}$ percent. At year-end it was $1^{3}/_{4}$ percent.

Promoting a Safe and Efficient Payments Mechanism

These actions, while substantial, were but one dimension of the Federal Reserve's reaction to September 11. Complementing its monetary and liquidity actions, the Federal Reserve managed its payments activities with a view to keeping the U.S. financial system open and working. Early in the day of September 11, the twelve Reserve Bank presidents and the Board of Governors committed themselves to remaining open and operating to ensure the continuation of vital payment services, such as electronic transactions, currency distribution, and check processing.

10th District Financial Services Statistics 2001

Approximately 2,200 institutions served

1,400 customers with electronic connections

980 forward check depositors

1,340 Automated Clearinghouse originators

$20 billion received and $22 billion paid out in currency

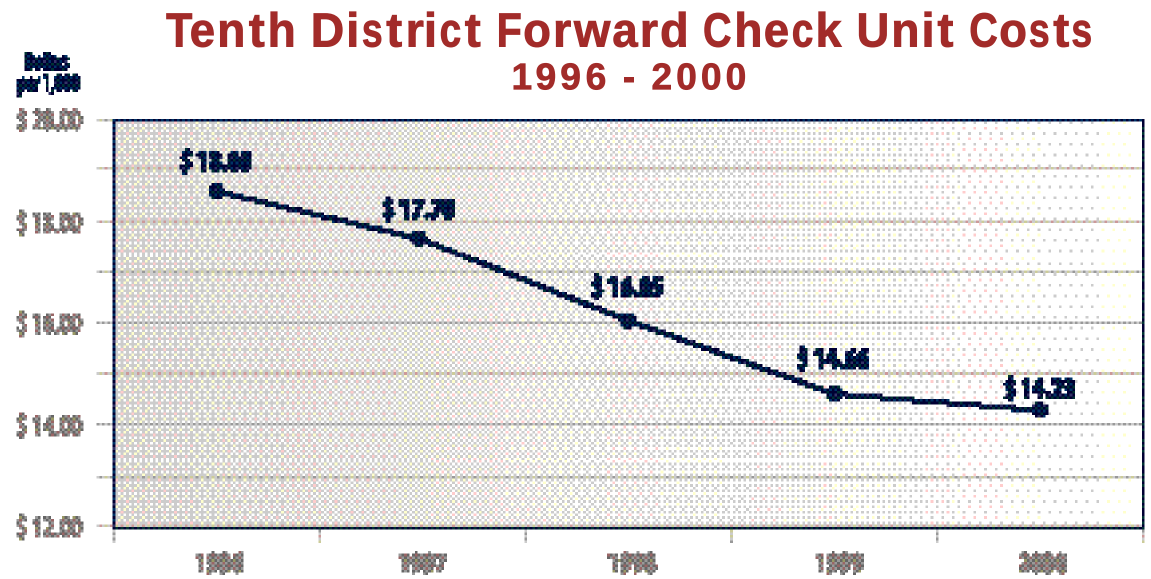
1.4 billion checks processed

13.5 million savings bonds printed and mailed

187,000 calls to automated voice response service

63,500 customer and public phone calls handled every month

The Federal Reserve's electronic payments systems – the Fedwire funds and securities transfer system, and the automated clearinghouse system – remained open and functioning. For several days following the attacks, the Fed extended the normal Fedwire closing time until late into the evening to accommodate banks that experienced operating problems. Right after the attacks there was a moderate increase in demand for currency, not unlike the increased demand that is experienced after natural disasters. Accordingly, throughout the post-attack period, Reserve Banks and depository institutions maintained ample supplies of currency, and demand quickly returned to normal levels.



Finally, during the week of September 11, each Reserve Bank continued to provide credit for check deposits based on its published schedules. Credit was given even though the Fed could not present many of these checks on normal schedules because of the absence of air transportation.

Providing Supervisory and Regulatory Oversight

Consistent with our third area of responsibility, on September 11 and in the days that followed, the Federal Reserve relied on its supervisory staff to serve as key central points of contact with the nation's largest banking organizations. This ongoing support assisted the System's effort to ensure that the payment systems continued to function. Also, the Federal Reserve encouraged its state-chartered banks and bank holding companies to work flexibly with borrowers and other customers who were directly or indirectly affected by the attacks. The Fed issued a press release on September 14 encouraging banking organizations to "take prudent steps to make credit available to sound borrowers" and assuring lenders that such actions are consistent with safe and sound banking practices and promote the public interest. Finally, the Federal Reserve worked closely with law enforcement to disseminate a list of suspected terrorists to all of its banking organizations, asking them to check their account and transaction records against this list and report any positive responses to law enforcement as quickly as possible.

We take a risk-focused approach to supervision that allows us to tailor our process to fit the risk-profile of individual institutions. We are proactive in offering outreach and education to community bank officers and directors to help ensure stronger oversight and identify issues before problems arise.

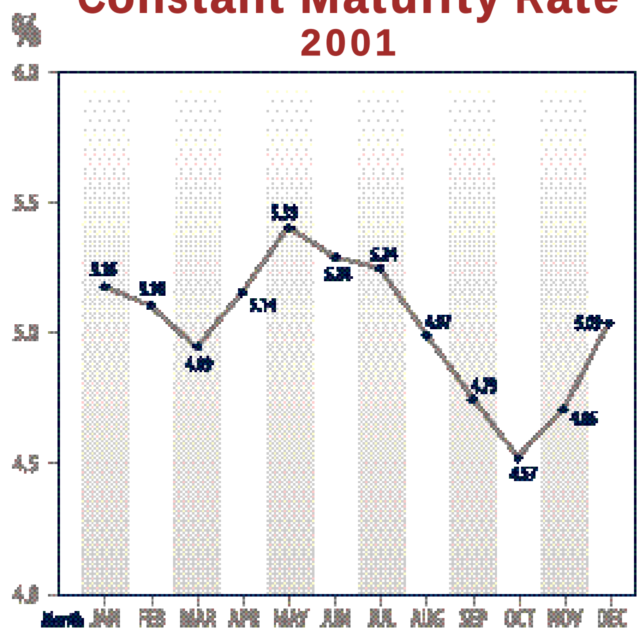
Our Regional Structure Contributed to an Effective Response

Among the Reserve Banks, there can be no doubt that the Federal Reserve Bank of New York did the heavy lifting following the attacks. It is located in the financial center of New York, only three blocks from the World Trade Center site, and the financial institutions affected most directly by the attack were institutions it serves. During the hours and days following the tragedy, the Federal Reserve Bank of New York remained in operation, and its leadership and staff were responsive, responsible, and demonstrated enormous courage.

> ***"… a connection that allows the Federal Reserve System to act in an informed manner and to lead both in times of calm and in times of crisis."***

The other eleven Banks were affected to varying degrees. Each of them, including the Federal Reserve Bank of Kansas City, provided credit and liquidity to financial institutions in its region whose payments might have been disrupted. Each Reserve Bank worked with hundreds of financial institutions and individuals in its region to meet their needs and to reassure them that the Federal Reserve was open and that the financial system was working and safe. The twelve Banks acting separately, but in a coordinated fashion, were able to communicate at local and national levels and dealt as well as one might hope with this horrific tragedy. Partly as a result of these efforts, financial markets remained relatively stable, a key ingredient in a market-based economic system.

10-Year Treasury Note Constant Maturity Rate
2001



In recapping these events, I hope you have a sense of why I am proud of the Federal Reserve System and why I believe our vision has special meaning. However, the Federal Reserve's ability to engender trust and confidence over time depends on far more than managing a single crisis. It also hinges on each Reserve Bank's continuing involvement with people and activities in its region – a connection that allows the Federal Reserve System to act in an informed manner and to lead both in times of calm and in times of crisis.

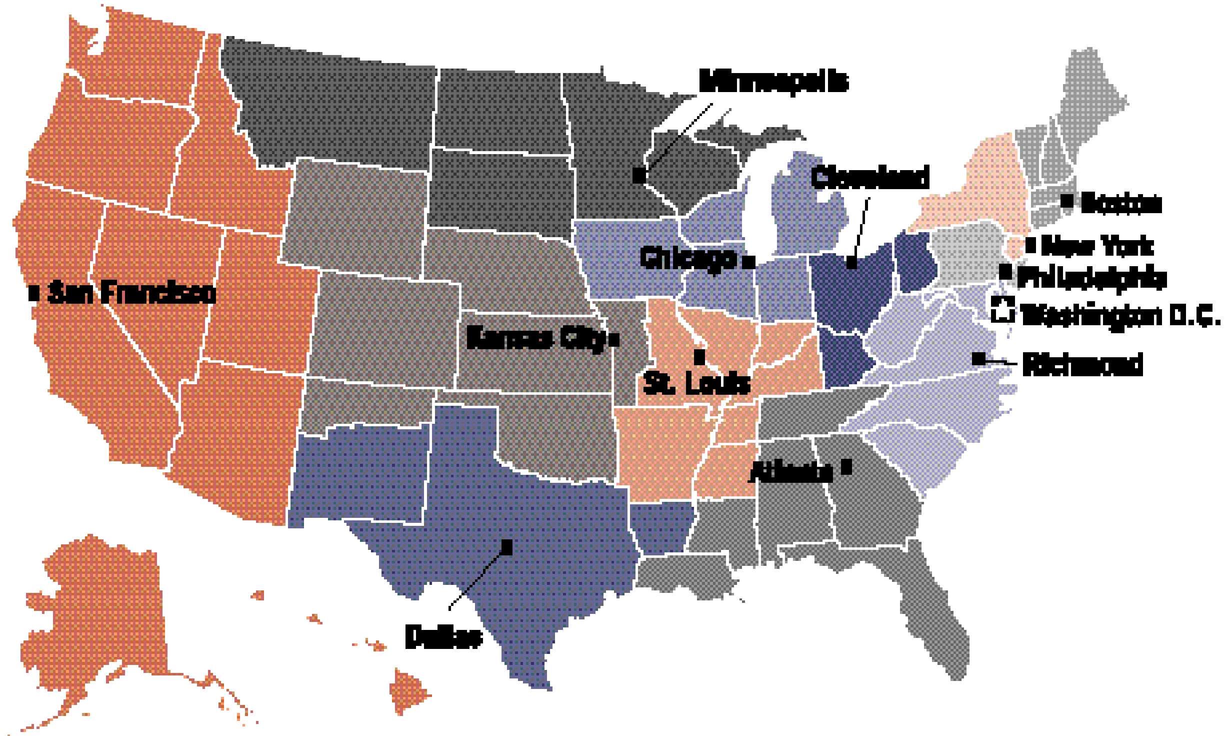
Mission

mission 2

Financial Services

Our mission is to foster the integrity, efficiency, and accessibility of U.S. dollar payments and settlement systems in support of U.S. financial stability and economic growth in a global context. As both leaders and participants in the payments system, we strive to promote the public interest by reducing system risks while providing high-quality, innovative financial services to our customers.

two 2



The Structure of the Federal Reserve System

It is important to note that the very structure of the Federal Reserve System is engineered to instill trust among U.S. citizens, by dispersing power and assuring a local dimension to central bank activities. This structure also supports our three mission areas and allows us to operate effectively even under adverse conditions.

During the past several years, the Federal Reserve has been viewed favorably by a majority of the American people. But as the Fed has pursued its long-term mandate of stable prices and sustainable growth, this positive view has not always been the case in the past, and it will not always be the case in the future. In addition, there are people who simply are suspicious of and object to having a single, independent central bank of the United States.

Such uneasiness about central banks certainly also existed in 1913 when Congress chartered the Federal Reserve, and it was a principal factor in the decision to organize the Federal Reserve as a System of twelve separately chartered Banks. Indeed, the Fed's founders thought it was especially important to build a network of regional Reserve Banks in order to diffuse power and provide a mechanism for obtaining independent views on economic and financial events. By being attentive to local as well as national issues, these Banks would serve to instill confidence about the Federal Reserve in communities across the country.

Paul Warburg, one of the original architects of the Federal Reserve System, said it best in his book, titled *The Federal Reserve System: Reflections and Recollections*:

> One of the striking points of strength of the Reserve System lies in its weakness. This paradox means that the strength of a system of regional banks consists in engendering in the minds of people a comfortable feeling of protection against the dangers of an autocratic central administration.

The Federal Reserve System, in other words, is a product of this country's populist roots, with its inherent suspicion of "big" institutions. This uneasiness, while currently somewhat dormant, is as real today as it was nearly ninety years ago. If, for whatever reason, the System's structure were dismantled or seriously altered, the resulting weakening of the System's connections to the community, loss of regional directors with local oversight, and reduction in the System's effectiveness in communicating with the broad populace of the United States would provide substance to such uneasiness. And, in my opinion, we would likely see a significant decline in the Federal Reserve System's ability to successfully meet its three core mission areas – monetary policy, supervision, and financial services.

Fragmented but Whole

There is a final reason for this unique structure that goes beyond politics and public opinion – operational effectiveness. Jared Diamond, the Pulitzer Prize-winning author of *Guns, Germs, and Steel*, said it best when he noted, "History tells us that authority should be neither too centralized nor too diffuse. Organizations, from business to states, function best when they are optimally fragmented." So it is with the Federal Reserve System. It is fragmented across the United States and yet, when necessary, its components can function as one organization with a single purpose and a loyal, effective cadre of people who know their jobs and communities.

10th District Boards of Directors and Advisory Councils

Boards of Directors
Confer on economic and banking developments and advise the Bank on its operations and policies.

Economic Advisory Council
Provides the Bank with perspectives on economic conditions and business issues.

Community Development Advisory Council
Supplies information about community economic development issues and needs.

Financial Services Customer Advisory Council
Identifies current and emerging issues in payments services and provides information on payments system trends.

Credit Union Customer Advisory Council
Encourages discussion of issues specific to credit unions.

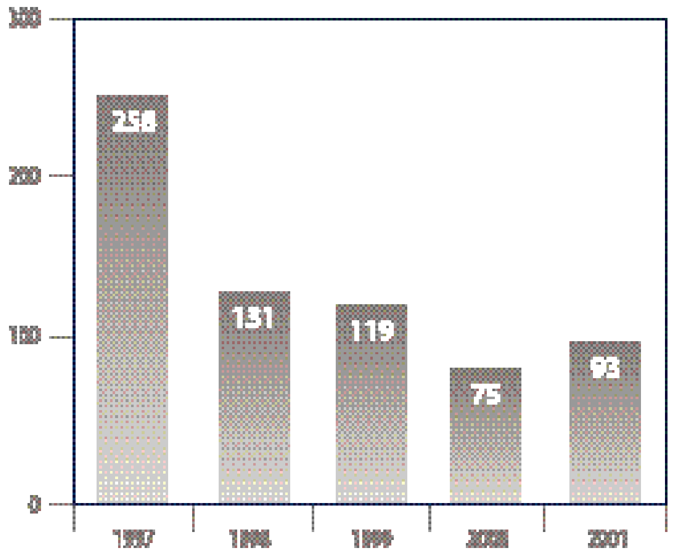
We must continue to examine how the information economy will alter the structure of financial, product, and labor markets. We must also address the key policy challenges that arise in the information economy.

Changing Times Require the Federal Reserve to Change

In saying all this, of course, I acknowledge that times and situations change and that if the Federal Reserve is to maintain the public trust, it must change as well. Indeed, how the Federal Reserve prepares for the future will be one of its greatest challenges in the coming years and will determine its level of success.

Automated Clearinghouse Originators

New 10th District Customers



As the Federal Reserve goes about the process of change, it must do so in a manner that carefully balances goals that are enormously complex and sometimes competing. It must hold its vision dear, appreciate its trio of central bank responsibilities, and respect its decentralized structure and role as the central bank of the United States. But it also must balance these priorities with the need to adopt new ways of operating, embrace new technology, and be sensitive to cost pressures affecting all modern institutions.

Today, the rapid changes and operational advantages facilitated by technology have led the Federal Reserve to focus on harvesting these advantages for itself. This has resulted in an enormous Systemwide focus on the issues of operational scale and cost containment. Because technology, especially communication technology, requires significant capital investments in equipment and software, the need to capture economies of scale is real and appropriate. From nearly every perspective, the drive toward efficiency is unrelenting and understood as necessary within the Federal Reserve System.

Mission

mission 3

Supervision & Regulation

Our mission is to promote the safety and soundness of the nation's banking and financial systems by ensuring compliance with applicable laws and regulations, while encouraging institutions to meet the credit needs of all segments of their communities. Consistently carrying out this mission inspires public trust and confidence in our ability to ensure the availability of credit in any situation.

3

three

President's Message • President's Message • President's Message

Our System project leadership allows us to coordinate efficiencies while retaining our District's individuality.

Check Standardization Project - Central Check User Support, Central Implementation Team, and Payor Bank Services Software Development

People*Soft* Nationally Provided Support Service

Customer Relations Support Office

Consolidated On-Line Customer Support for Funds Transfer and Book-Entry Securities Services

FederalReserveEducation.org Development

Large Complex Banking Organization (LCBO) Coordination

If the Federal Reserve fails to seek out better and more efficient ways to operate, it will soon find itself unable to deliver services effectively and will be legitimately subject to criticism. However, as I have said elsewhere, we must be thoughtful as we pursue lower costs. There are other long-term implications that follow if the Federal Reserve allows itself to be driven only by cost factors.

While the Federal Reserve is committed to providing services in an efficient manner, it must also remain aware that, foremost, it is a "central bank" – not a commercial bank. As such, its principal obligation is to deliver value in the form of financial stability and reliability, and, at times, it must look beyond factors such as cost or market share. For example, if consolidating operations to achieve economies of scale involves a loss of local flexibility, the result may be a significant trade-off in performance levels or the ability to react to local events such as the September 11 crisis. Would the response and outcome have been as exceptional if the Federal Reserve were a monolithic organization? I don't believe so.

Organizational Models for Managing Processes

So, what should we do in these circumstances? How do we, as a central bank, act responsibly in bringing value to the public domain? We must constantly remind ourselves of our vision and carefully balance the need to be efficient and the political realities within which we operate against the demands that our vision and mission areas require over the long run.

Organizational models are emerging that may help us to better understand and balance such trade-offs. These models are geared toward managing processes, such as the Federal Reserve's wholesale and retail payments operations, across business lines and regions.

In these models, the operation is assigned an "owner"– for example, one Reserve Bank. The owner has significant authority over how the Systemwide operation is conducted, and leads design and budget development for that activity. The other regional banks are expected to help develop and then follow the agreed design for the process or product. Because the local Reserve Banks are familiar with their constituencies, they each have a clear responsibility to identify unique regional issues during the design process. In the end, the regional Reserve Banks and the operation owner must work as partners to ensure success.

This is the model that the Federal Reserve System is adopting as it carries out certain aspects of its core missions. The goal is to remain responsive to our regional responsibilities while delivering services on a national scale, at reasonable costs, under normal and sometimes stressful circumstances. In other words, the goal is to preserve the best of the old, adapt to the new, and ultimately fulfill our three responsibilities in a way that adds value to the national financial and market economy.

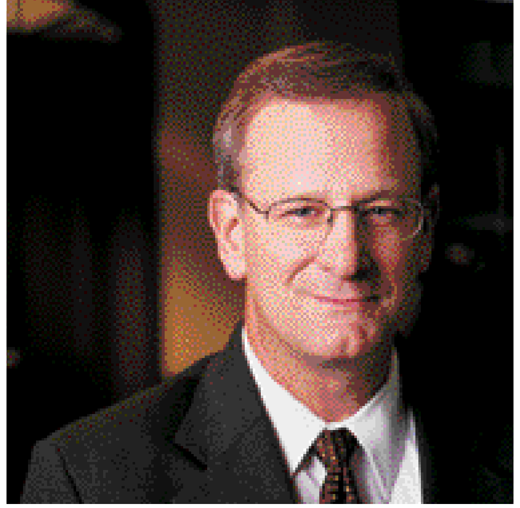
Conclusion

Well-advised monetary policy, innovative financial services, and consistent supervision are all essential to our vision of a central bank that inspires trust and confidence in our customers and the public. These parties trust that our core services are available and that our money and financial system runs well, under the most normal or the most difficult of circumstances. We must inspire confidence that all parties have a voice and are served by a regional organization that works effectively on a national scale.

Finally, the Federal Reserve Bank of Kansas City's Annual Report this year reflects our strong sense of our importance as a regional institution – though, I would like to think, with the right degree of objectivity. In the final analysis, we are proud of our unique structure, of our Federal Reserve System heritage, and of the way we serve the financial industry, our community, and the nation.

Thomas M. Hoenig

Thomas M. Hoenig



Management *management* *committee* COMMITTEE

Thomas M. Hoenig
President and
Chief Executive Officer

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

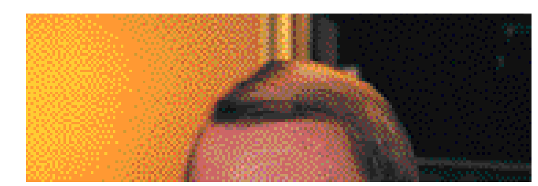
Enis Alldredge, Jr.
Senior Vice President
Operations Division

Carl M. Gambs
Senior Vice President
Automation Division

Esther L. George
Senior Vice President
Supervision and
Risk Management Division

Craig S. Hakkio
Senior Vice President and
Director of Research

Maryann F. Hunter
Senior Vice President and
Denver Branch Manager



Kent M. Scott
Senior Vice President
Administrative Services Division

John E. Yorke
Senior Vice President and
Coordinator for Large Complex
Banking Organizations (LCBO)

Management Committee • Management Committee • Management Committee

BOARD of Directors

board of directors

Kansas City

pictured from left, front row

Paula Marshall-Chapman
CEO
The Bama Companies, Inc.
Tulsa, Oklahoma

Jo Marie Dancik, Deputy Chairman
Regional Managing Partner
Ernst & Young LLP
Denver, Colorado

Terrence P. Dunn, Chairman
President and CEO
J.E. Dunn Construction Co.
Kansas City, Missouri

Hans C. Helmerich
President and CEO
Helmerich & Payne, Inc.
Tulsa, Oklahoma

pictured from left,back row

Dennis E. Barrett
Vice Chairman
First Bank Holding Co. of Colorado
Lakewood, Colorado

Bruce A. Schriefer
President and CEO
Bankers' Bank of Kansas
Wichita, Kansas

Jeffery L. Gerhart
President and CEO
First National Bank
Newman Grove, Nebraska

Frank A. Potenziani
Investor, Trustee
M&T Trust
Albuquerque, New Mexico

Rhonda Holman
Vice President
Kauffman Center for
Entrepreneurial Leadership
Ewing Marion Kauffman Foundation
Kansas City, Missouri

Denver

pictured from left, front row

James A. King
CEO
BT Incorporated
Riverton, Wyoming

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

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

Kathleen Avila
Partner and CEO
Avila Retail
Albuquerque, New Mexico

pictured from left, back row

Albert C. Yates
President
Colorado State University
Fort Collins, Colorado

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

Virginia K. Berkeley
President
Colorado Business Bank, NA
Denver, Colorado

BOARD of Directors

board of directors

Oklahoma City

pictured from left

J. Clifford Hudson
Chairman and CEO
Sonic Corp.
Oklahoma City, Oklahoma

Betty Bryant Shaull
President-Elect and Director
Bank of Cushing and Trust Company
Cushing, Oklahoma

Robert A. Funk
Chairman and CEO
Express Personnel Services International
Oklahoma City, Oklahoma

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

W. Carlisle Mabrey, III
President and CEO
Citizens Bank and Trust Company
Okmulgee, Oklahoma

not pictured

Russell W. Teubner
Founder and Director
Esker, Inc.
Stillwater, Oklahoma

Cuba Wadlington, Jr.
(Deceased)
President and CEO
Williams Gas Pipeline
Tulsa, Oklahoma

Omaha

pictured from left, front row

Bob L. Gottsch
Vice President
Gottsch Feeding Corporation
Hastings, Nebraska

Gladys Styles Johnston, Chairman
Chancellor
University of Nebraska at Kearney
Kearney, Nebraska

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

pictured from left, back row

A. F. "Tony" Raimondo
Chairman and CEO
Behlen Mfg. Co.
Columbus, Nebraska

H. H. Kosman
Chairman, President, and CEO
Platte Valley National Bank
Scottsbluff, Nebraska

Judith A. Owen
President and CEO
Wells Fargo Bank Nebraska, NA
Omaha, Nebraska

ADVISORY COUNCILS

Financial Services Customer Advisory Council

Kansas City

William Esry
President and COO
Blue Ridge Bank & Trust Co.
Kansas City, Missouri

Camden Fine
President and CEO
Midwest Independent Bank
Jefferson City, Missouri

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

Danny Little
Executive Vice President
Lamar Bank and Trust Co.
Lamar, Missouri

Bruce B. Morgan
President and CEO
The Valley State Bank
Roeland Park, Kansas

Bruce Schriefer
President and CEO
Bankers' Bank of Kansas
Wichita, Kansas

Rick Smalley
President and CEO
Dickinson Financial Corp.
Kansas City, Missouri

Larry Snyder
President and CEO
The Hamilton Bank
Hamilton, Missouri

Denver

Jean L. Burr
Senior Vice President
Community Bankshares, Inc.
Greenwood Village, Colorado

Jack W. Calabrese
President
Integrated Payment Systems Inc.
Englewood, Colorado

Don A. Childears
President and CEO
The Colorado Bankers Association
Denver, Colorado

Dan M. Fisher
President and CEO
Community First Service Corporation
Fargo, North Dakota

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

James A. Reuter
President
FristBank Data Corporation
Lakewood, Colorado

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

Oklahoma City

Don Abernathy
President and CEO
The Bankers Bank
Oklahoma City, Oklahoma

Steve Carmack
Chairman and CEO
Legacy Bank
Hinton, Oklahoma

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

Mike Elvir
Executive Vice President and CIO
Bank of Oklahoma
Tulsa, Oklahoma

Robert R. Gilbert
President and COO
F & M Bank & Trust Co.
Tulsa, Oklahoma

Bob Horn
Vice President
MidFirst Bank
Oklahoma City, Oklahoma

J.L. Miller
President, CEO, and COO
Bank of Chelsea
Chelsea, Oklahoma

Omaha

J. Sid Dinsdale
President
Pinnacle Bank
Omaha, Nebraska

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

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

Lloyd R. Kitrell
President
Hastings State Bank
Hastings, Nebraska

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

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

Gerald E. Wortman
President and CEO
Sherman County Bank
Loup City, Nebraska

Credit Union Customer Advisory Council Oklahoma City Branch

Steven Cole
President and CEO
Red Crown Federal Credit Union
Tulsa, Oklahoma

Terri Davis
Vice President
66 Federal Credit Union
Bartlesville, Oklahoma

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

Larry Hackler
President and CEO
OU Federal Credit Union
Norman, Oklahoma

Duane Hall
President and CEO
University & Community FCU
Stillwater, Oklahoma

Mark W. Kelly
President and CEO
Oklahoma Employees Credit Union
Oklahoma City, Oklahoma

Mike Kloiber
President and CEO
Tinker Federal Credit Union
Oklahoma City, Oklahoma

Shirley R. McConnell
President and CEO
Oklahoma Federal Credit Union
Oklahoma City, Oklahoma

Donald D. Stivers
President and CEO
Oil Capital Federal Credit Union
Tulsa, Oklahoma

Jim M. Williams
President and CEO
Oklahoma Health Services Federal Credit Union
Oklahoma City, Oklahoma

Community Development Advisory Council

Grace Buckley
Director of Housing Resources
Mercy Housing
Denver, Colorado

Dan Clark
Clark Consulting Group
Arvada, Colorado

Kevin Danler
Executive Director
Family Housing Advisory Services
Omaha, Nebraska

Diana Dorn-Jones
Executive Director
United South Broadway Corp.
Albuquerque, New Mexico

Carol Grimaldi
Executive Director
Brush Creek Partners
Kansas City, Missouri

Jay Hannah
Executive Vice President
BancFirst
Oklahoma City, Oklahoma

Thomas G. Johnson
Director
Community Policy Analysis Center
Columbia, Missouri

Thomas Loy
Chairman & President
Meta-Fund
Oklahoma City, Oklahoma

Michael Martinez
CRA Director
Vectra Banks
Denver, Colorado

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

Peter Merrill
Design Services
Santa Fe, New Mexico

Florine Raitano
Executive Director
Colorado Rural Development Council
Dillon, Colorado

Mary Randolph
Executive Director
Wyoming Rural Development Council
Cheyenne, Wyoming

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

Steve Roling, Sr.
Vice President
Kauffman Foundation
Kansas City, Missouri

Economic Advisory Council

Hugh Aiken
CEO
Atchison Casting Corporation
Atchinson, Kansas

Leonard G. Beauchamp
Director of Research and Collective Bargaining Services
International Brotherhood of Boilermakers
Kansas City, Kansas

David W. Burkholder
President
Will Feed, Inc. and Island Dehy, Inc.
Cozad, Nebraska

I. B. Hoover
President
Business Environments
Albuquerque, New Mexico

Terry L. Moore
President
Omaha Federation of Labor, AFL-CIO
Omaha, Nebraska

John D. Novak
President
Ash Grove Materials Corporation
Shawnee Mission, Kansas

Kevin K. Nunnink
Managing Director
Integra Realty Resources
Westwood, Kansas

Derek L. Park
President
PMS Foods, Inc.
Hutchinson, Kansas

Anthony F. Prinster
President
City Market, Inc.
Grand Junction, Colorado

Richard L. Robinson
Chairman and CEO
Robinson Dairy, Inc.
Denver, Colorado

Clint Roush
Clint Roush Farms, Inc.
Arapaho, Oklahoma

Richard E. Wheeler
Chief Executive Officer
Wyoming Machinery Company
Casper, Wyoming

TENTH DISTRICT Officers

Kansas City

Thomas M. Hoenig
President and Chief Executive Officer

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

Enis Alldredge, Jr.
Senior Vice President

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

Carl M. Gambs
Senior Vice President

Esther L. George
Senior Vice President

Craig S. Hakkio
Senior Vice President and Director of Research

Kent M. Scott
Senior Vice President

John E. Yorke
Senior Vice President

Alan D. Barkema
Vice President

Denise I. Connor
Vice President

G. Will Cook
General Auditor

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

Kelly J. Dubbert
Vice President

Roberta E. Hearn
Vice President

Carol A. Hefley
Vice President

George A. Kahn
Vice President and Economist

Stephen E. McBride
Vice President

Larry G. Meeker
Vice President

Dawn B. Morhaus
Vice President

Charles S. Morris
Vice President

Barbara S. Pacheco
Vice President

Karen A. Pennell
Vice President

Linda S. Schroeder
Vice President

Gordon H. Sellon, Jr.
Vice President and Economist

John C. Vandermade, Jr.
Vice President

Stuart E. Weiner
Vice President and Economist

Stanley R. Beatty
Assistant Vice President

Debra L. Bronston
Assistant Vice President

Harriet I. Chern
Assistant Vice President

Michael R. Childs
Assistant Vice President

Todd E. Clark
Assistant Vice President and Economist

Paul S.J. Coquillette
Assistant Vice President

Anita F. Constanza
Assistant Vice President

Kelley D. Courtright
Assistant Vice President

Nigel S. Davis
Assistant Vice President

James R. Deis
Assistant Vice President

Andrew J. Filardo
Assistant Vice President and Economist

Janel K. Frisch
Assistant Vice President

C. Alan Garner
Assistant Vice President and Economist

Leesa M. Guyton
Assistant Vice President

Lori D. Haley
Assistant Vice President

Ann L. Hoelting
Assistant Vice President

Sharon Kozicki
Assistant Vice President and Economist

D. Michael Manies
Assistant Vice President

Kevin L. Moore
Assistant Vice President

Randall L. Mueller
Assistant Vice President

Diane M. Raley
Assistant Vice President

Stacey L. Schreft
Assistant Vice President and Economist

Veronica M. Sellers
Assistant General Counsel

Lawrence D. Taft
Assistant Vice President

Wilmer R. Ullman
Associate General Counsel

Kathryn A. Webster
Assistant Vice President

John A. Wood
Assistant Vice President and Community Affairs Officer

Margaret L. Yarrington
Assistant Vice President

Catherine A. Zeigler
Assistant Vice President

Susan E. Zubradt
Assistant Vice President and Assistant Secretary

Denver

Maryann F. Hunter
Senior Vice President and Branch Manager

Randy M. Schartz
Vice President and Assistant Branch Manager

Pamela L. Weinstein
Vice President

Thomas P. Bennett
Assistant Vice President

Gary E. Darby
Assistant Vice President

Debbie L. Meyers
Assistant Vice President

S. Andrew Thompson, Jr.
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

financial
financial
report
REPORT

letters

statements

notes

Federal Reserve Bank of Kansas City
925 Grand Boulevard
Kansas City, Missouri 64198-0001
(816) 881-2000

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, 2001 ("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, and as such, include amounts, some of which are based on judgments and estimates of management.

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, management of the FRBKC believes 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.

Thomas M. Hoenig
President

Richard K. Rasdall, Jr.
First Vice President

Federal Reserve Bank of Kansas City
March 4, 2002

PRICEWATERHOUSECOOPERS

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 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, 2001 included in the accompanying Management's Assertion. The assertion is the responsibility of FRBKC management. Our responsibility is to express an opinion on the assertions based on our examinations.

Our examination was made in accordance with standards established by the American Institute of Certified Public Accountants, and accordingly, included obtaining an understanding of the internal control over financial reporting, testing, and evaluating the design and operating effectiveness of the internal control, and 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 the 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 the 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, 2001, is fairly stated, in all material respects, based upon criteria described in "Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

PricewaterhouseCoopers LLP

March 4, 2002
Kansas City, Missouri

PRICEWATERHOUSECOOPERS

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 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, 2001 and 2000, and the related statements of income and changes in capital for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the 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 discussed in Note 3, the 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, 2001 and 2000, and results of its operations for the years then ended, on the basis of accounting described in Note 3.

PricewaterhouseCoopers LLP

March 4, 2002
Kansas City, Missouri

FINANCIAL *financial* *statements* Statements

Federal Reserve Bank of Kansas City

STATEMENTS OF CONDITIONS (in millions)

As of December 31, 2001 and 2000

	2001	2000
ASSETS		
Gold certificates	$ 317	$ 340
Special drawing rights certificates	66	66
Coin	69	67
Items in process of collection	236	579
Loans to depository institutions	3	31
U.S. government and federal agency securities, net	17,337	17,279
Investments denominated in foreign currencies	378	436
Accrued interest receivable	176	201
Bank premises and equipment, net	79	79
Other assets	20	15
Total assets	$ 18,681	$ 19,093
LIABILITIES AND CAPITAL		
LIABILITIES:		
Federal Reserve notes outstanding, net	$ 16,960	$ 16,646
Deposits:		
Depository institutions	758	722
Other deposits	7	21
Deferred credit items	135	433
Interest on Federal Reserve notes due U.S. Treasury	18	33
Interdistrict settlement account	358	818
Accrued benefit costs	53	54
Other liabilities	10	8
Total liabilities	18,299	18,735
CAPITAL:		
Capital paid-in	191	179
Surplus	191	179
Total capital	382	358
Total liabilities and capital	$ 18,681	$ 19,093

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

Federal Reserve Bank of Kansas City

STATEMENTS OF INCOME (in millions)

For the years ended December 31, 2001 and 2000

	2001	2000
INTEREST INCOME:		
Interest on U.S. government and federal agency securities	$ 934	$ 1,019
Interest on investments denominated in foreign currencies	8	8
Interest on loans to depository institutions	1	3
Total interest income	943	1,030
OTHER OPERATING INCOME:		
Income from services	72	68
Reimbursable services to government agencies	17	20
Foreign currency losses, net	(38)	(39)
U.S. government securities gains (losses), net	10	(2)
Other income	2	2
Total other operating income	63	49
OPERATING EXPENSES:		
Salaries and other benefits	104	89
Occupancy expense	8	8
Equipment expense	12	11
Assessments by Board of Governors	18	19
Other expenses	49	52
Total operating expenses	191	179
Net income prior to distribution	$ 815	$ 900
DISTRIBUTION OF NET INCOME:		
Dividends paid to member banks	$ 11	$ 11
Transferred to surplus	12	104
Payments to U.S. Treasury as interest on Federal Reserve notes	792	785
Total distribution	$ 815	$ 900

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

Federal Reserve Bank of Kansas City

STATEMENTS OF CHANGES IN CAPITAL (in millions)

For the years ended December 31, 2001 and December 31, 2000

	Capital Paid-in		Surplus		Total Capital	
BALANCE AT JANUARY 1, 2000						
(3.6 million shares)	$	179	$	179	$	358
Net income transferred to surplus		—		104		104
Surplus transfer to the U.S. Treasury		—		(104)		(104)
BALANCE AT DECEMBER 31, 2000						
(3.6 million shares)	$	179	$	179	$	358
Net income transferred to surplus		—		12		12
Net change in capital stock issued						
(0.2 million shares)		12		—		12
BALANCE AT DECEMBER 31, 2001						
(3.8 million shares)	$	191	$	191	$	382

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

Federal Reserve Bank of Kansas City

Notes to Financial Statements

1. ORGANIZATION

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. 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.

Structure

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 a portion of Missouri and New Mexico. In accordance with the Federal Reserve Act, supervision and control of the Bank are exercised by a Board of Directors. 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

The Federal Reserve Act specifies the composition of the Board of Directors for each of the Reserve Banks. Each board is composed of nine 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.

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, 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 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 to 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 differences are 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 borrowings 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 as 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 Conditions, Income, and Changes in Capital. Therefore, a Statement of Cash Flows would not provide any additional useful information. There are no other significant differences between the policies outlined in the Financial Accounting Manual and GAAP.

Effective January 2001, the System implemented procedures to eliminate the sharing of costs by Reserve Banks for certain services a Reserve Bank may provide on behalf of the System. Data for 2001 reflects the adoption of this policy. Major services provided for the System by the Bank, for which the costs will not be redistributed to the other Reserve Banks, include: Central Check User Support, Standard Check Software Management, Customer Support Tools, and Human Resource Information System Shared Services Center.

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 and 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. Certain amounts relating to the prior year have been reclassified to conform to the current-year presentation. 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 upon 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 SDRs, at the direction of the U.S. Treasury, for the purpose of financing SDR certificate acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates amounts 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 2001.

Financial Statements • Financial Statements • Financial Statements

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 any loans were 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 Board of Directors of the Reserve Banks, subject to review by the Board of Governors. Reserve Banks retain the option to impose a surcharge above the basic rate in certain circumstances.

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.

Matched sale-purchase transactions are accounted for as separate sale and purchase transactions. Matched sale-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.

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 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 FRBNY on a daily basis, with additional collateral obtained as necessary. The securities loaned continue to be accounted for in the SOMA.

Foreign exchange ("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 prearranged 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 that 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 which 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 can result in gains or losses when holdings are sold prior to maturity. However, decisions regarding the securities and foreign currencies transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, 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 (losses), net." Foreign-currency-denominated assets are revalued daily at current 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 losses, 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 loaned, investments denominated in foreign currency, interest income, 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. Income from securities lending transactions undertaken by FRBNY are also 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. Statement of Financial Accounting Standards No. 133, as amended and interpreted, became effective January 1, 2001. For the periods presented, the Reserve Banks had no derivative instruments required to be accounted for under the standard.

e. Bank Premises and Equipment

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 2 to 50 years. New assets, 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. Internally developed software is capitalized based on the cost of direct materials and services and those indirect costs associated with developing, implementing, or testing software.

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 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 accordance with the Federal Reserve Act, gold certificates, special drawing rights certificates, U.S. government and

federal agency securities, triparty agreements, loans to depository institutions, and investments denominated in foreign currencies are pledged as collateral for net Federal Reserve notes outstanding. 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 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 which 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 Federal Reserve notes reduced by currency held in the vaults of the Bank of $4,117 million, and $4,932 million at December 31, 2001 and 2000, 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. Reserve Banks are required by the Board of Governors to transfer to the U.S. Treasury 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.

The Consolidated Appropriations Act of 2000 (Public Law 106-113, Section 302) directed the Reserve Banks to transfer to the U.S. Treasury additional surplus funds of $3,752 million during the Federal Government's 2000 fiscal year. The Bank transferred $104 million to the U.S. Treasury. Reserve Banks were not permitted to replenish the surplus for these amounts during fiscal year 2000, which ended September 30, 2000; however, the surplus was replenished by December 31, 2000.

Financial Statements • Financial Statements • Financial Statements

In the event of losses or a substantial increase in capital, payments to the U.S. Treasury are suspended until such losses or increases in capital 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. The costs of providing fiscal agency and depository services to the Treasury Department that have been billed but not paid are immaterial and included in "Other expenses."

k. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property, which are reported as a component of "Occupancy expense."

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, with the exception of securities held under agreements to resell and the related premiums, discounts and income, 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 Bank gold certificate holdings to Federal Reserve notes outstanding. The Bank's allocated share of SOMA balances was approximately 3.087 percent and 3.332 percent at December 31, 2001 and 2000, respectively.

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

	2001	2000
Par value:		
Federal agency	$ –	$ 4
U.S. government:		
Bills	5,620	5,956
Notes	8,208	8,004
Bonds	3,200	3,092
Total par value	17,028	17,056
Unamortized premiums	349	325
Unaccreted discounts	(40)	(102)
Total allocated to Bank	$ 17,337	$ 17,279

Total SOMA securities bought outright were $561,701 million and $518,501 million at December 31, 2001 and 2000, respectively.

The maturity distribution of U.S. government securities bought outright, which were allocated to the Bank at December 31, 2001, were as follows (in millions):

	Par Value
Maturities of Securities Held	U.S. Government Securities
Within 15 days	$ 330
16 days to 90 days	3,844
91 days to 1 year	4,032
Over 1 year to 5 years	4,727
Over 5 years to 10 years	1,646
Over 10 years	2,449
Total	$ 17,028

At December 31, 2001 and 2000, matched sale-purchase transactions involving U.S. government securities with par values of $23,188 million and $21,112 million, respectively, were outstanding, of which $716 million and $704 million were allocated to the Bank. Matched sale-purchase transactions are generally overnight arrangements.

At December 31, 2001 and 2000, U.S. government securities with par values of $7,345 million and $2,086 million, respectively, were loaned from the SOMA, of which $227 million and $70 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 held 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 2.593 percent and 2.782 percent at December 31, 2001 and 2000, respectively.

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

	2001	2000
European Union Euro:		
Foreign currency deposits	$ 119	$ 129
Government debt instruments including agreements to resell	70	75
Japanese Yen:		
Foreign currency deposits	49	77
Government debt instruments including agreements to resell	138	153
Accrued interest	2	2
Total	$ 378	$ 436

Total investments denominated in foreign currencies were $14,559 million and $15,670 million at December 31, 2001 and 2000, respectively.

The maturity distribution of investments denominated in foreign currencies which were allocated to the Bank at December 31, 2001, was as follows (in millions):

Maturities of Investments Denominated in Foreign Currencies	
Within 1 year	$ 356
Over 1 year to 5 years	10
Over 5 years to 10 years	12
Over 10 years	–
Total	$ 378

At December 31, 2001 and 2000, there were no open foreign exchange contracts or outstanding F/X swaps.

At December 31, 2001 and 2000, the warehousing facility was $5 billion, with zero outstanding.

6. BANK PREMISES AND EQUIPMENT

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

	2001	2000
Bank premises and equipment:		
Land	$ 12	$ 12
Buildings	49	48
Building machinery and equipment	18	17
Construction in progress	3	2
Furniture and equipment	76	72
	158	151
Accumulated depreciation	(79)	(72)
Bank premises and equipment, net	$ 79	$ 79

Depreciation expense was $10 million and $11 million for the years ended December 31, 2001 and 2000, respectively.

7. COMMITMENTS AND CONTINGENCIES

At December 31, 2001, the Bank was obligated under noncancelable leases for premises and equipment with terms ranging from 1 to approximately 3 years. These leases provide for increased rentals 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 $1,475 thousand and $638 thousand for the years ended December 31, 2001 and 2000, respectively. 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 one year or more, at December 31, 2001, were (in thousands):

	Operating
2002	$ 1,108
2003	1,118
2004	760
2005	–
2006	–
Thereafter	–
Total	$ 2,986

Financial Statements • Financial Statements • Financial Statements

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 1 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, 2001 or 2000.

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"). The System Plan is a multi-employer plan with contributions fully funded by participating employers. No separate accounting is maintained of assets contributed by the participating employers. The Bank's projected benefit obligation and net pension costs for the BEP at December 31, 2001 and 2000, 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 $3 million for each of the years ended December 31, 2001 and 2000, 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.

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):

	2001	2000
Accumulated postretirement benefit obligation at January 1	$ 26.6	$ 23.8
Service cost-benefits earned during the period	0.6	0.7
Interest cost of accumulated benefit obligation	1.7	1.8
Actuarial (gain)/loss	(1.5)	1.8
Contributions by plan participants	0.5	0.3
Benefits paid	(1.5)	(1.8)
Plan amendment/settlement	(1.0)	—
Accumulated postretirement benefit obligation at December 31	$ 25.4	$ 26.6

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):

	2001	2000
Fair value of plan assets at January 1	$ —	$ —
Actual return on plan assets	—	—
Contributions by the employer	1.0	1.5
Contributions by plan participants	0.5	0.3
Benefits paid	(1.5)	(1.8)
Fair value of plan assets at December 31	$ —	$ —
Unfunded postretirement benefit obligation	$ 25.4	$ 26.6
Unrecognized prior service cost	19.1	20.2
Unrecognized net actuarial gain	2.9	1.5
Accrued postretirement benefit costs	$ 47.4	$ 48.3

Accrued postretirement benefit costs are reported as a component of "Accrued benefit costs."

At December 31, 2001 and 2000, the weighted average discount rate assumptions used in developing the benefit obligation were 7.0 percent and 7.5 percent, respectively.

For measurement purposes, a 10.00 percent annual rate of increase in the cost of covered health care benefits was assumed for 2002. Ultimately, the health care cost trend rate is expected to decrease gradually to 5.00 percent by 2008, 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, 2001 (in millions):

	1 Percentage Point Increase	1 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	(1.1)

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

	2001	2000
Service cost-benefits earned during the period	$ 0.6	$ 0.7
Interest cost of accumulated benefit obligation	1.7	1.8
Amortization of prior service cost	(2.0)	(2.0)
Recognized net actuarial gain	(0.1)	-
Net periodic postretirement benefit costs	$ 0.2	$ 0.5

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

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, 2001 and 2000, were $6 million and $5 million, respectively. This cost is included as a component of "Accrued benefit costs." Net periodic postemployment benefit costs included in 2001 and 2000 operating expenses were $1 million for both years.

Volume of Principal Operations (Unaudited)

	2001	2000
Loans and Discounts, Daily Average	$ 14,469,000	$ 49,702,000
Number of Institutions Borrowing	106	167
Commercial Checks	$ 1,172,497,000,000	$ 1,094,593,000,000
Commercial Checks Collected	1,553,022,000	1,552,869,000
Currency Receipts and Payments	$ 47,051,531,000	$ 40,443,309,000
Pieces	3,049,755,000	2,748,537,000
Coin Receipts and Payments	$ 355,224,000	$ 433,933,000
Bags	631,000	673,000
Issues and Redemption of U. S. Government Securities	$ 162,924,620,000	$ 96,860,134,000
Funds Transfers	$ 6,364,295,000,000	$ 5,566,421,000,000
Numbers	4,056,000	4,074,000

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

TENTH
Federal Reserve
District

Federal Reserve Bank of Kansas City
925 Grand Boulevard
Kansas City, Missouri 64198

Denver Branch
1020 16th Street
Denver, Colorado 80202

Oklahoma City Branch
226 Dean A. McGee
Oklahoma City, Oklahoma 73125

Omaha Branch
2201 Farnam Street
Omaha, Nebraska 68102

Federal Reserve
Bank of
Kansas City
www.kc.frb.org