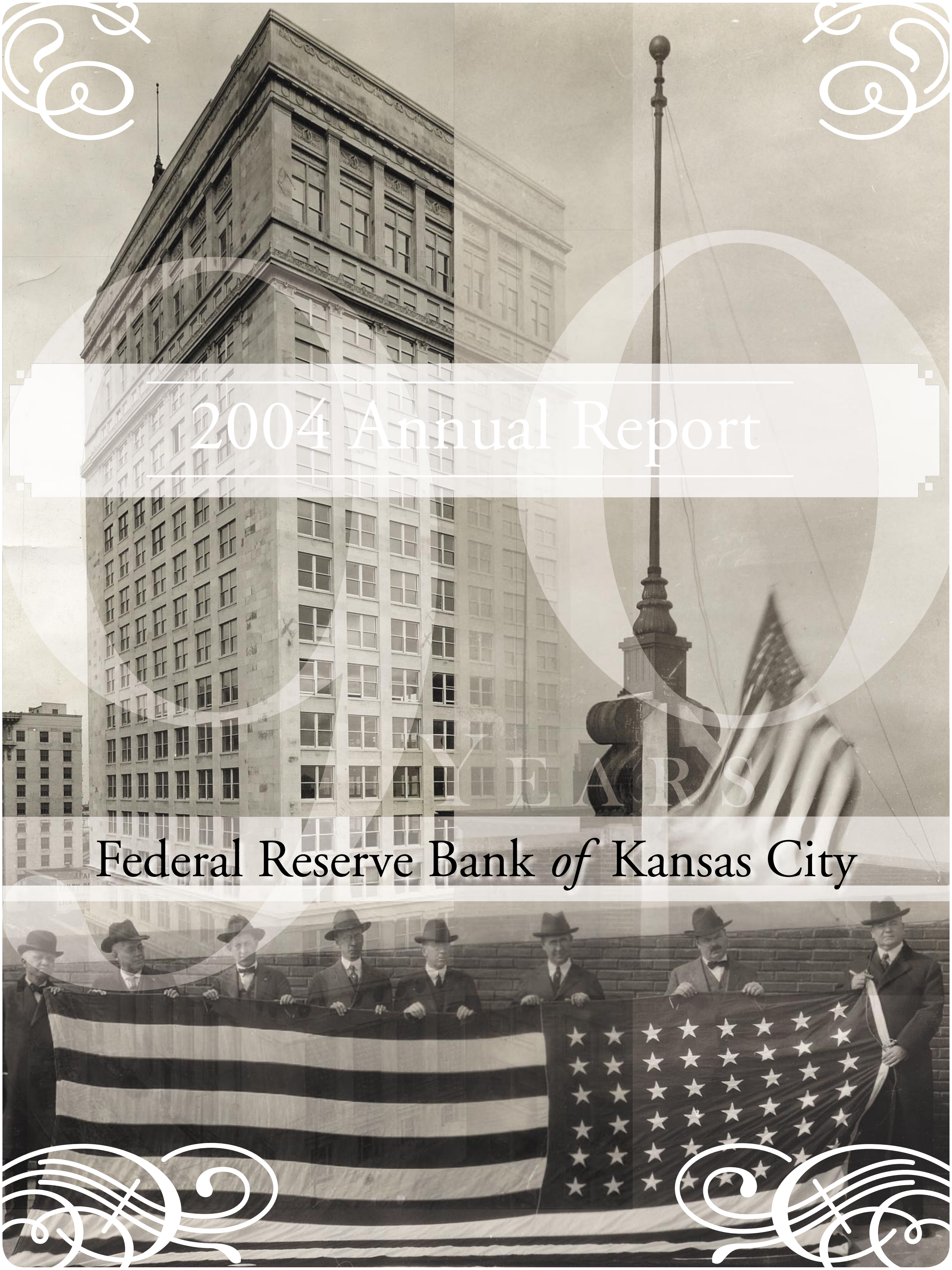
2004 Annual Report

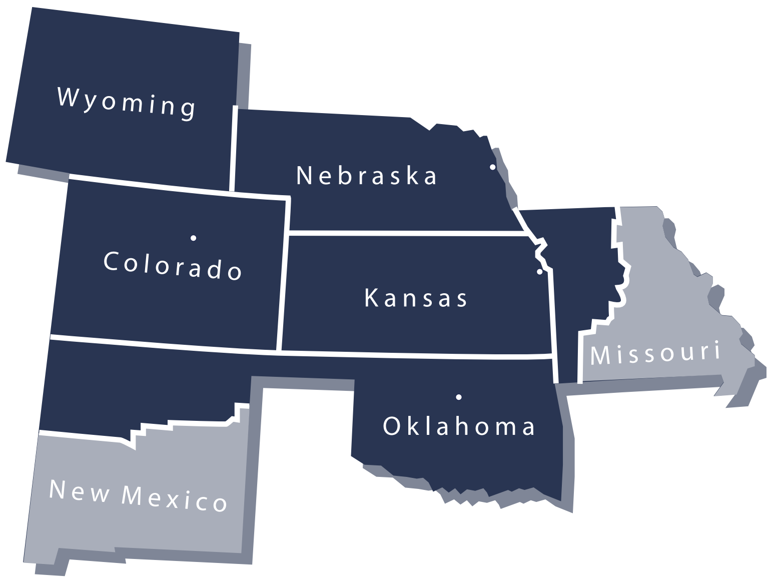
90 YEARS



Federal Reserve Bank *of* Kansas City

Tenth District

Federal Reserve



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 73102

Omaha Branch
2201 Farnam Street
Omaha, Nebraska 68102

Table of Contents

THOMAS M. HOENIG

Jo Zach Miller, Jr. served as the first chairman and Federal Reserve agent of the Bank.

President's Message

In 2004, the Federal Reserve Bank of Kansas City celebrated its 90th anniversary, a milestone that prompted us to reflect on the past as well as look forward to the opportunities and challenges that lie ahead. Our missions have not changed since we opened our doors in 1914, but there has been much change in the way we operate in each area: providing financial services to depository institutions, supervising and regulating financial firms, and participating in monetary policy deliberations.

The change is perhaps best illustrated with a story often told by one of the Bank's retired senior vice presidents. In 1970, a surprise examination at a large financial institution would involve a team of 30 examiners who would arrive at the bank on a Friday afternoon, ready to spend the weekend counting money, analyzing balance sheets and poring over loan records. Today, our examiners don't spend their time counting cash. Instead, they work with bankers on an ongoing basis, relying on electronic information gathering to focus on high-risk areas and reduce time spent in the banks.

Dramatic change also is reflected in the payments system. The consumer preference for electronic payments has resulted in declining check volumes nationwide, requiring the Federal Reserve to restructure its check processing operations. We announced plans in 2004 to reduce the number of check processing locations from 32 to 23 by early 2006. As a result, we have discontinued check operations in Omaha and plan to discontinue check operations in Oklahoma City in 2005. Our Denver operation, however, will see an increase in check volume in 2005 as it assumes responsibility for the territory currently handled by the Salt Lake City office.

Recognizing this shift in consumer preference, Congress passed the Check Clearing for the 21st Century Act, or Check 21. Under its provision, the processing of checks is being made more efficient as financial institutions streamline procedures and transmit electronic versions of checks rather than ship the actual paper documents. The Federal Reserve is part of this transition and is designing products for depository institutions to take advantage of the opportunities brought by this legislation.

As consumers turn increasingly to electronic payments, favoring debit and credit cards over checks when making purchases, the Bank's Payments System Research staff continues to explore the numerous issues related to this rapidly evolving system. In 2005 we will host an important payments conference, exploring interchange fees related to credit and debit transactions.

As part of the operational changes affecting the Federal Reserve System, this Bank is taking on important responsibilities that enhance its national presence and provide more effective delivery of services. Our Kansas City headquarters is one of only two off-line Wholesale Operations sites for the provision of Fedwire Funds and Securities Services. Importantly, we are also home

Photo of the Bank lobby in 1921, shortly before its opening.

to the Central Check User Support function, which provides technical and user support for the Federal Reserve's national check processing platform. And, as part of our national customer support responsibilities, we are coordinating the multiyear transition of more than 8,700 financial institutions to FedLine Advantage, the Fed's new Web-based channel for secure access to our payments services, including FedACH and FedWire.

Although 2005 will see our savings bond operations transfer to Federal Reserve offices in Minneapolis and Pittsburgh, our Bank has been selected to provide project management to the Treasury's Payment Application Modernization initiative that will standardize and modernize approximately 30 applications used to distribute about 1 billion federal payments annually.

Changes in the financial world also are affecting our research and policy agenda. Our economists engaged in a variety of studies that included work related to the general economy, monetary policy, banking, and community affairs. Our focus remains on understanding the macro economy, and especially on monetary policy and how we might best achieve price stability with strong economic growth. Through our annual Jackson Hole symposium, attended by the world's central bankers, we influence the debate on important economic issues through research presented by leading economists and policymakers from around the world.

But over the past decades our mandate for research has broadened. We are a regional institution and recognize our responsibility to further local as well as national economic and community efforts. For this reason, we have increased our work on the payments system, and community and rural economic development. In preparation for the next 90 years, we recently completed much of the preliminary design work for a new headquarters building. We plan to break ground on the new 600,000-square-foot facility in 2005 and move into the building in 2008. You can learn more about the headquarters project, as well as the Bank's other activities, by visiting our Website: *www.kansascityfed.org.*

The employees who opened our Bank for business on Nov. 16, 1914, would today find an institution doing business in ways they could not have imagined. However, they also would find a Bank fulfilling the same missions that guided their work nine decades ago. The staff and officers of today have demonstrated ingenuity and a pioneering spirit in meeting the changes of the banking industry. We're very proud of the way our Bank has continued to adapt over these 90 years and look forward to the challenges of the next 90 and beyond.

Thomas M. Hoenig
President and
Chief Executive Officer

Picture from the Kansas City Journal November 13, 1921.
The picture was taken from atop the Bank looking south down Grand Avenue.

Finishing touches to the Kansas City Fed Building were completed on Nov. 13, 1921.

At the time, the Bank was the tallest building in Kansas City.

The flag is raised atop the Bank on November 16, 1921.

Board of Directors, Kansas City

(From left) Mr. Schifferdecker, Mr. Moore, Mr. Nunnink, Mr. Gerhart, Mr. Funk, Mr. Dillingham, Mr. Smalley, Mr. Bard. (Not Pictured: 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

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

Frank Moore
President
Spearhead Ranch Company
Douglas, Wyoming

Kevin K. Nunnink
Chairman
Integra Realty Resources
Westwood, Kansas

Mark W. Schifferdecker
President and Chief Executive Officer
Girard National Bank
Girard, 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

First Board of Directors of the Federal Reserve Bank of Kansas City: J.Z. Miller, Jr., T.C. Bryne, W.J. Bailey, M.L. McClure, R.H. Malone, Charles M. Sawyer, A.E. Ramsay, L.A. Wilson, C.E. Burnham, and Gordon Jones.

BOARD OF DIRECTORS, DENVER

(From top left-standing): Ms. Avila, Ms. Berkeley, Mr. Stanford, Mr. Helzer, Ms. Schloss.
(From front left-seated): Mr. Williams, Mr. King.

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

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

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

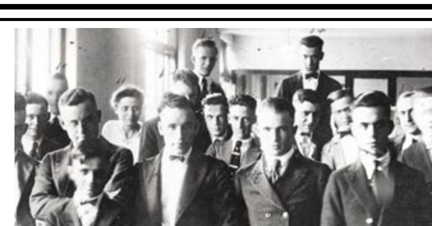
James A. Helzer
President and Chief Executive Officer
Unicover Corporation
Cheyenne, Wyoming

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

Kristy A. Schloss
President and Chief Executive Officer
Schloss Engineered Equipment, Inc.
Aurora, Colorado

Michael R. Stanford
President and Chief Executive Officer
First State Bancorporation
Albuquerque, New Mexico

District Transit Department employees, August 1920.



Board of Directors, Oklahoma City

(From left) Mr. Mabrey, Mr. Ramos, Mr. Gilbert, Mr. Ratcliffe, Mr. Minner, Mr. Nichols, Mr. Packnett.

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

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

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

J. Larry Nichols
Chairman and Chief Executive Officer
Devon Energy Corporation
Oklahoma City, Oklahoma

Michael J. Packnett
President and Chief Executive Officer
Mercy Health Center
Oklahoma City, Oklahoma

Fred M. Ramos
President
Tulsa Hispanic Chamber of Commerce
Tulsa, Oklahoma

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

Oklahoma City Branch, August 2, 1920.

Board of Directors, Omaha

(From top left-standing) Ms. Owen, Mr. Nelson, Mr. Timmerman.
(From front left-seated) Mr. Lopez, Mr. Raimondo, Ms. Milligan. (Not pictured: Mr. Moore)

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

Rodrigo Lopez
President and Chief Executive Officer
AmeriSphere Multifamily Finance, L.L.C.
Omaha, Nebraska

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

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

Michael J. Nelson
Chairman
FirsTier Bank
Kimball, Nebraska

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

James A. Timmerman
Chief Financial Officer
Timmerman & Sons Feeding Company
Springfield, Nebraska

Kansas City Federal Reserve Board Members, 1914.

Management Committee

(Clockwise from bottom left) Mr. Hoenig, Mr. Yorke, Mr. Scott, Ms. George, Mr. Dubbert, Mr.Gambs, Mr. Hakkio, Ms. Hearn, Ms. Pacheco, Mr. Bacon, Mr. Rasdall.

Thomas M. Hoenig
President and Chief Executive Officer

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

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

Barbara S. Pacheco
Senior Vice President

Kent M. Scott
Senior Vice President

John E. Yorke
Senior Vice President

Charles L. Bacon, Jr.
Senior Vice President,
General Counsel, and Secretary
Advisor to Management Committee

Posing on the roof of the Bank, staff members prepare to raise the flag on November 16, 1921.

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 and
Community Affairs Officer

Todd E. Clark
Vice President and Economist

Denise I. Connor
Vice President

Anita F. Costanza
Vice President

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

Steven D. Evans
Vice President

Janel K. Frisch
Vice President and
Chief Financial Officer

George A. Kahn
Vice President and
Associate Director of Research

Sharon Kozicki
Vice President and Economist

Kevin L. Moore
Vice President

Dawn B. Morhaus
Vice President

Charles S. Morris
Vice President

Karen A. Pennell
Vice President

Diane M. Raley
Vice President and
Public Information Officer

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 Director,
Payments System Research

Dick H. Woods, Jr.
Vice President

Susan E. Zubradt
Vice President

Josias A. Aleman
Assistant Vice President and
Assistant General Auditor

Larry Bailey
Assistant Vice President

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

Kelley D. Courtright
Assistant Vice President

Kristi A. Coy
Assistant Vice President

Tanya Cvetan
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

Annette K. Owens
Assistant Vice President

Wayne M. Powell
Assistant Vice President
and Assistant Secretary

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

Stephan Weiler
Assistant Vice President
and Economist

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

Tara B. Koenigs
Assistant Vice President

Robert W. Toler
Assistant Vice President

Omaha

Kevin A. Drusch
Vice President and
Branch Manager

Ronald M. Ryan
Assistant Vice President and
Assistant Branch Manager

D. Rick Lay
Assistant Vice President

Economic Advisory Council

(From left) Mr. Liston, Mr. Tamba, Mr. Perry, Mr. Price, Mr. Prinster, Mr. Shaw.
(Not pictured: Ms. Cordova, Ms. Johnson, Mr. King, Mr. Stout.)

Lu Cordova
President
CTEK
Boulder, Colorado

Deborah Johnson
Chief Executive Officer
Rick Johnson and Company, Inc.
Albuquerque, New Mexico

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

Dennis Liston
Financial Secretary
International Brotherhood of Electrical Workers
Kansas City, Missouri

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

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

John Stout
Chief Executive Officer
Plaza Belmont Management Group, LLC.
Shawnee Mission, Kansas

Shin-ichi Tamba
President
Kawasaki Motors Manufacturing Corp., U.S.A.
Lincoln, Nebraska

Community Development Advisory Council

(From left) Ms. Grimaldi, Mr. Merrill, Ms. Randolph, Mr. Kenny, Ms. Wells, Mr. Johnson, Mr. Martinez, Mr. Clark, Mr. Loy, Mr. Honesty, Ms. Fennell.

Dan V. Clark
Clark Consulting Group
Arvada, Colorado

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

Carol A. Grimaldi
Executive Director
Brush Creek Community Partners
Kansas City, Missouri

Edward F. Honesty, Jr.
President, Chief Operating Officer
Best Harvest Bakeries
Kansas City, Kansas

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

Tim Kenny
Executive Director
Nebraska Investment Finance Authority
200 Commerce Court
Lincoln, Nebraska

A. Thomas Loy
Chairman and President
MetaFund
Oklahoma City, Oklahoma

Michael H. Martinez
CRA Director
Vectra Bank Colorado
Denver, Colorado

Peter G. Merrill
Construction Dispute Resolution Services
Santa Fe, New Mexico

Mary E. Randolph
Executive Director
Wyoming Rural Development Council
Cheyenne, Wyoming

Robin Wells
Senior Vice President
Country Club Bank
Kansas City, Missouri

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

Denver

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

Mark Frank
Senior Operations Executive
CoBiz Bank, N.A.
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

Steve Rahill
President
First Bank & Trust
Duncan, Oklahoma

C.H. Wyatt, Jr.
Vice Chair and President
Interbank
Elk City, Oklahoma

Omaha

Craig E. Champion
Senior Vice President
Tierone Bank
Lincoln, Nebraska

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

Timothy D. Hart
Chief Financial Officer, Secretary,
and Treasurer
First National Bank of Omaha
Omaha, Nebraska

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

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

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

Credit Union Customer Advisory Council

Oklahoma City Branch

Kevin Bilbrey
President
Halliburton Employees
Federal Credit Union
Duncan, Oklahoma

Janice Caster
Managing Officer
El Reno RIL Credit Union
El Reno, Oklahoma

William (Bill) Counts
President and Chief Executive Officer
Communication Federal
Credit Union
Oklahoma City, 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

Marsha Schmidt
President
Red Crown Federal Credit Union
Tulsa, Oklahoma

Financial Report

Ninety years ago, on Nov. 16, 1914, the Federal Reserve Bank of Kansas City and 11 other Reserve Banks opened to create the Federal Reserve System. The Tenth District has seen its small staff of 30 employees grow to nearly 1,500 employees.

Letters
Statements
Notes

Federal Reserve Bank of Kansas City

925 Grand Boulevard
Kansas City, Missouri, 64198-0001
(816) 881-2000

March 10, 2005

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, 2004 (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 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

Thomas M. Hoenig
President

Richard K. Rasdall, Jr.
First Vice President

Janel K. Frisch
Chief Financial Officer

PRICEWATERHOUSECOOPERS

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

Report of Independent Accountants

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, 2004, 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, 2004 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 16, 2005
Kansas City, Missouri

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

Report of Independent Auditors

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, 2004 and 2003, 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, 2004 and 2003, and results of its operations for the years then ended, on the basis of accounting described in Note 3.

PricewaterhouseCoopers LLP

March 16, 2005
Kansas City, Missouri

Statements of Condition (in millions)
As of December 31, 2004 and 2003

Assets	2004	2003
Gold certificates	$ 302	$ 303
Special drawing rights certificates	66	66
Coin	48	42
Items in process of collection	653	595
Loans to depository institutions	1	2
U.S. government securities, net	19,067	18,156
Investments denominated in foreign currencies	392	476
Accrued interest receivable	134	136
Interdistrict settlement account	1,584	25
Bank premises and equipment, net	102	80
Other assets	15	16
Total assets	$ 22,364	$ 19,897
Liabilities and Capital		
Liabilities:		
Federal Reserve notes outstanding, net	$ 20,038	$ 17,516
Securities sold under agreements to repurchase	809	689
Deposits:		
Depository institutions	721	813
Other deposits	2	2
Deferred credit items	409	450
Interest on Federal Reserve notes due U.S. Treasury	30	46
Accrued benefit costs	41	52
Other liabilities	8	5
Total liabilities	22,058	19,573
Capital:		
Capital paid-in	153	162
Surplus	153	162
Total capital	306	324
Total liabilities and capital	$ 22,364	$ 19,897

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

Statements of Income (in millions)
For the years ended December 31, 2004 and 2003

	2004	2003
Interest income:		
Interest on U.S. government securities	$ 581	$ 617
Interest on investments denominated in foreign currencies	5	6
Total interest income	586	623
Interest expense:		
Interest expense on securities sold under agreements to repurchase	8	6
Net interest income	578	617
Other operating income:		
Income from services	53	58
Reimbursable services to government agencies	14	14
Foreign currency gains, net	23	65
Other income	1	1
Total other operating income	91	138
Operating expenses:		
Salaries and other benefits	104	112
Occupancy expense	9	9
Equipment expense	10	11
Assessments by Board of Governors	22	25
Other expenses	37	45
Total operating expenses	182	202
Net income prior to distribution	$ 487	$ 553
Distribution of net income:		
Dividends paid to member banks	$ 9	$ 12
Transferred from surplus	(9)	(39)
Payments to U.S. Treasury as interest on Federal Reserve notes	487	580
Total distribution	$ 487	$ 553

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

Statements of Changes in Capital (in millions)
For the years ended December 31, 2004 and 2003

	Capital Paid-in	Surplus	Total Capital
Balance at January 1, 2003 (4.0 million shares)	$ 201	$ 201	$ 402
Transferred from surplus	–	(39)	(39)
Net change in capital stock redeemed (0.8 million shares)	(39)	–	(39)
Balance at December 31, 2003 (3.2 million shares)	$ 162	$ 162	$ 324
Transferred from surplus	–	(9)	(9)
Net change in capital stock redeemed (0.1 million shares)	(9)	–	(9)
Balance at December 31, 2004 (3.1 million shares)	$ 153	$ 153	$ 306

The accompanying notes are an integral part of these 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 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, 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 and to invest such foreign currency holdings ensuring adequate liquidity is maintained. In addition, FRBNY is authorized to 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. 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: Check Automation Services, Customer Relations and Support Office/Customer Contact Center, Savings Bonds, Wholesale Operations Site, People*Soft* Support Center, and Billing Operations 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 2004 or 2003.

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 Bank. 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 Board of Directors of the Reserve Bank, 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.

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 lent are 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 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. Securities sold under agreements to repurchase are accounted for as secured borrowing transactions with the associated interest expense recognized over the life of the transaction. Such transactions are settled by FRBNY. Interest income is accrued on a straight-line basis. 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. 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."

Activity related to U.S. government securities bought outright, securities sold under agreements to repurchase, securities loaned, investments denominated in foreign currency, excluding those held under an F/X swap arrangement, and deposit accounts of foreign central banks and governments above core balances are allocated to each Reserve Bank. U.S. government 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 calculations, of which $2 million was allocated to the Bank. 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 and are amortized over the remaining useful life of the asset. 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.

Assets eligible to be pledged as collateral security include all Federal Reserve Bank assets. 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. To satisfy the obligation to provide sufficient collateral for outstanding 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 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 $4,497 million and $4,083 million at December 31, 2004 and 2003, 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 Reserve Bank stock must be adjusted. Member banks are 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.

The Financial Accounting Standards Board (FASB) has deferred the implementation date for SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity," for the Bank. When applicable, the Bank will determine the impact and provide the appropriate disclosures.

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 an increase in capital paid-in, payments to the U.S. Treasury are suspended and earnings are retained until the surplus is equal to the capital paid-in. Weekly payments to the U.S. Treasury may vary significantly.

In the event of a decrease in capital paid-in, the excess surplus, after equating capital paid-in and surplus at December 31, is distributed to the U.S. Treasury in the following year. This amount is reported as a component of "Payments to U.S. Treasury as interest on Federal Reserve notes."

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, 2004 and 2003, and are reported as a component of "Occupancy expense."

l. Restructuring Charges

In 2003, the System started the restructuring of several operations, primarily check, cash, and Treasury 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. These restructuring activities continued in 2004.

Footnote 10 describes the restructuring and provides information about the Bank's costs and liabilities associated with employee separations and contract terminations. The costs associated with the write-down of certain Bank assets are discussed in footnote 6. Costs and liabilities associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY.

4. U.S. GOVERNMENT 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 that occurs in April of each year. The settlement equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding. The Bank's allocated share of SOMA balances was approximately 2.628 percent and 2.687 percent at December 31, 2004 and 2003, respectively.

The Bank's allocated share of U.S. government securities, net held in the SOMA at December 31, was as follows (in millions):

Par value:	**2004**	**2003**
U.S. government:		
Bills	$ 6,910	$ 6,580
Notes	9,482	8,690
Bonds	2,471	2,646
Total par value	18,863	17,916
Unamortized premiums	247	264
Unaccreted discounts	(43)	(24)
Total allocated to Bank	$ 19,067	$ 18,156

The total of the U.S. government securities, net held in the SOMA was $725,584 million and $675,569 million at December 31, 2004 and 2003, respectively.

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, 2004, 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	$ 805	$ 809
16 days to 90 days	4,687	–
91 days to 1 year	4,478	–
Over 1 year to 5 years	5,473	–
Over 5 years to 10 years	1,429	–
Over 10 years	1,991	–
Total	$ 18,863	$ 809

At December 31, 2004 and 2003, U.S. government securities with par values of $6,609 million and $4,426 million, respectively, were loaned from the SOMA, of which $174 million and $119 million were allocated to the Bank.

At December 31, 2004 and 2003, securities sold under agreements to repurchase with contract amounts of $30,783 million and $25,652 million, respectively, and par values of $30,808 million and $25,658 million, respectively, were outstanding. The Bank's allocated share at December 31, 2004 and 2003 was $809 million and $689 million, respectively, of the contract amount and $810 million and $690 million, respectively, of the par value.

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 1.835 percent and 2.394 percent at December 31, 2004 and 2003, 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):

	2004	**2003**
European Union Euro:		
Foreign currency deposits	$ 111	$ 165
Securities purchased under agreements to resell	39	49
Government debt instruments	71	49
Japanese Yen:		
Foreign currency deposits	28	35
Government debt instruments	141	176
Accrued interest	2	2
Total	$ 392	$ 476

Total System investments denominated in foreign currencies were $21,368 million and $19,868 million at December 31, 2004 and 2003, respectively.

The maturity distribution of investments denominated in foreign currencies which were allocated to the Bank at December 31, 2004, was as follows (in millions):

Maturities of Investments Denominated in Foreign Currencies	European Euro	Japanese Yen	Total
Within 1 year	$ 165	$ 169	$ 334
Over 1 year to 5 years	55	–	55
Over 5 years to 10 years	3	–	3
Over 10 years	–	–	–
Total	$ 223	$ 169	$ 392

At December 31, 2004 and 2003, there were no material open foreign exchange contracts.

At December 31, 2004 and 2003, the warehousing facility was $5,000 million, with no balance outstanding.

6. BANK PREMISES, EQUIPMENT, AND SOFTWARE

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

	Maximum Useful Life (in years)	2004	2003
Bank premises and equipment:			
Land	N/A	$ 41	$ 19
Buildings	50	53	52
Building machinery and equipment	20	19	19
Construction in progress	N/A	9	2
Furniture and equipment	10	65	70
Subtotal		187	162
Accumulated depreciation		(85)	(82)
Bank premises and equipment, net		$ 102	$ 80
Depreciation expense, for the years ended		$ 9	$ 9

The Bank is constructing a new building to replace the head office in Kansas City. Approximately $27 million of costs associated with the acquisition of land and site preparation for the new building are included in Land, and approximately $9 million of costs associated with the construction of the new building are included in Construction in progress.

In March 2005, the Bank entered into an agreement to sell and leaseback its head office in Kansas City, pending a 75 day due diligence period in which certain conditions must be met. If the sale is consummated, it is expected to result in a loss of approximately $700 thousand.

The Bank leases unused space to outside tenants. Those leases have terms ranging from one to four years. Rental income from such leases was not material for the years ended December 31, 2004 and 2003. Future minimum lease payments under noncancelable agreements in existence at December 31, 2004, were not material.

The Bank has capitalized software assets, net of amortization, of $3 million for each of the years ended December 31, 2004 and 2003. Amortization expense was $1 million for each of the years ended December 31, 2004 and 2003.

Assets impaired either as a result of the Bank's restructuring plan, as discussed in footnote 10, or the Bank's decision to standardize check processing, include software, building, leasehold improvements, furniture, and equipment. Asset impairment losses of $1 million for each of the periods ending December 31, 2004 and 2003, were determined using fair values based on quoted market values or other valuation techniques and are reported as a component of "Other expenses."

7. COMMITMENTS AND CONTINGENCIES

At December 31, 2004, the Bank was obligated under noncancelable leases for premises and equipment with terms ranging from one to approximately four years. 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, 2004 and 2003. 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, 2004, were (in thousands):

2005	$ 1,440
2006	1,250
2007	1,212
2008	492
2009	–
Thereafter	–
	$ 4,394

The Bank entered into several long-term contracts for services related to constructing a new building to replace the head office in Kansas City. At December 31, 2004, the outstanding contractual obligations for this construction totaled $14 million, none of which has been recognized as a liability in the 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 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, 2004 or 2003.

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, 2004 and 2003, 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, 2004 and 2003, 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):

	2004	2003
Accumulated postretirement benefit obligation at January 1	$ 28.7	$ 23.6
Service cost-benefits earned during the period	0.7	0.7
Interest cost of accumulated benefit obligation	1.6	1.6
Actuarial loss	1.7	4.2
Curtailment gain	(0.1)	–
Special termination loss	–	0.1
Contributions by plan participants	0.9	0.4
Benefits paid	(3.0)	(1.9)
Plan amendments	(5.6)	–
Accumulated postretirement benefit obligation at December 31	$ 24.9	$ 28.7

At December 31, 2004 and 2003, the weighted average discount rate assumptions used in developing the postretirement benefit obligation were 5.75 percent and 6.25 percent, respectively.

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):

	2004	2003
Fair value of plan assets at January 1	$ –	$ –
Actual return on plan assets	–	–
Contributions by the employer	2.1	1.5
Contributions by plan participants	0.9	0.4
Benefits paid	(3.0)	(1.9)
Fair value of plan assets at December 31	$ –	$ –
Unfunded postretirement benefit obligation	$ 24.9	$ 28.7
Unrecognized net curtailment gain	1.0	–
Unrecognized prior service cost	9.1	15.4
Unrecognized net actuarial gain (loss)	(0.9)	0.8
Accrued postretirement benefit costs	$ 34.1	$ 44.9

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

For measurement purposes, the assumed health care cost trend rates at December 31 are as follows:

	2004	2003
Health care cost trend rate assumed for next year	9.00%	10.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	4.75%	5.00%
Year that the rate reaches the ultimate trend rate	2011	2011

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, 2004 (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	$ 0.2	$ (0.1)
Effect on accumulated postretirement benefit obligation	$ 1.2	$ (1.0)

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

	2004	2003
Service cost-benefits earned during the period	$ 0.7	$ 0.7
Interest cost of accumulated benefit obligation	1.6	1.6
Amortization of prior service cost	(2.0)	(2.1)
Recognized net actuarial gain	–	(0.1)
Total periodic expense	$ 0.3	$ 0.1
Curtailment gain	(9.0)	–
Special termination loss	–	0.1
Net periodic postretirement benefit costs (credit)	$ (8.7)	$ 0.2

At December 31, 2004 and 2003, the weighted average discount rate assumptions used to determine net periodic postretirement benefit costs were 6.25 percent and 6.75 percent, respectively.

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

A plan amendment that modified the credited service period eligibility requirements created curtailment gains. The recognition of special termination losses is primarily the result of enhanced retirement benefits provided to employees during the restructuring described in footnote 10. Because the special termination loss is less than $50,000, the amount is not displayed in the tables above. The curtailment gain associated with restructuring programs announced in 2004 that are described in footnote 10 will be offset by unrecognized actuarial losses and prior service gains. As a result, an unrecognized net curtailment gain will be recorded in 2005 when the affected employees terminate employment.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") was enacted in December 2003. The Act established a prescription drug benefit under Medicare ("Medicare Part D") and a federal subsidy to sponsors of retiree health care benefit plans that provide benefits that are at least actuarially equivalent to Medicare Part D. Following the guidance of the Financial Accounting Standards Board, the Bank elected to defer recognition of the financial effects of the Act until further guidance was issued in May 2004.

Benefits provided to certain participants are at least actuarially equivalent to Medicare Part D. The estimated effects of the subsidy, retroactive to January 1, 2004, are reflected in actuarial loss in the accumulated postretirement benefit obligation and net periodic postretirement benefit costs.

Following is a summary of the effects of the expected subsidy (in millions):

	2004
Decrease in the accumulated postretirement benefit obligation	$6.8
Decrease in the net periodic postretirement benefit costs	$0.8

Expected benefit payments:

	Without Subsidy	**With Subsidy**
2005	$ 1.6	$ 1.6
2006	1.6	1.4
2007	1.6	1.4
2008	1.7	1.5
2009	1.8	1.5
2010–2014	10.4	8.7
Total	$ 18.7	$ 16.1

Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31, 2004 measurement date and include the cost of medical and dental insurance, survivor income, and disability benefits. For 2004, the Bank changed its practices for estimating postemployment costs and used a 5.25 percent discount rate and the same health care trend rates as were used for projecting postretirement costs. Costs for 2003, however, 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, 2004 and 2003, were $6 million and $7 million, respectively. This cost is included as a component of "Accrued benefit costs." Net periodic postemployment benefit costs included in 2004 and 2003 operating expenses were $1 million for both years.

10. BUSINESS 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. In 2004, additional consolidation and restructuring initiatives were announced in the check and savings bonds operations and 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 12/31/2003	Total Charges	Total Paid	Accrued Liability 12/31/2004
Employee separation	$ 5	$ 2	$ 3	$ 2	$ 3
Contract termination	–	–	–	–	–
Other	–	–	–	–	–
Total	$ 5	$ 2	$ 3	$ 2	$ 3

Employee separation costs are primarily severance costs related to identified staff reductions of approximately 210 staff, including 73 staff reductions related to restructuring announced in 2003. These costs 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."

Restructuring 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 2005.

The Bank anticipates substantially completing its announced plans by October 2005.

Volume of Principal Operations (unaudited)

		2004		2003
Loans and Discounts, Daily Average	$	15,611,000	$	8,637,000
Number of Institutions Borrowing		75		69
Commercial Checks	$	1,066,725,000,000	$	1,204,436,000,000
Commercial Checks Collected		1,249,263,000		1,517,260,000
Currency Receipts and Payments	$	57,217,763,000	$	55,021,071,000
Pieces		3,692,199,000		3,588,032,000
Coin Receipts and Payments	$	112,831,000	$	157,915,000
Bags		223,000		252,000
Issues and Redemption of U.S. Government Securities	$	266,797,294,000	$	266,254,686,000
Funds Transfer	$	87,841,830,000,000	$	91,728,584,000,000
Numbers		48,873,000		51,104,000

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 2004 was PricewaterhouseCoopers LLP (PwC). Fees for these services totaled $2.0 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 the 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 2004, the Bank did not engage PwC for any material advisory services.

Acknowledgements

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