Financial Statements and Statistical Tables

Board of Governors Financial Statements

The financial statements of the Board for 1999 and 1998 were audited by Deloitte & Touche LLP, independent auditors.

Deloitte & Touche

Independent Auditors' Report

To the Board of Governors of the
Federal Reserve System

We have audited the accompanying balance sheets of the Board of Governors of the Federal Reserve System (the Board) as of December 31, 1999 and 1998, and the related statements of revenues and expenses and fund balance, and of cash flows for the years then ended. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Board as of December 31, 1999 and 1998, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

As discussed in Note 5 to the financial statements, in 1999 the Board changed its method of accounting for the costs of software obtained for internal use.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 18, 2000, on our consideration of the Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche LLP

February 18, 2000

Deloitte Touche Tohmatsu

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BALANCE SHEETS

	As of December 31, 1999	As of December 31, 1998
ASSETS		
CURRENT ASSETS		
Cash	$31,072,908	$20,111,430
Accounts receivable	873,148	910,282
Prepaid expenses and other assets	794,000	1,215,277
Total current assets	32,740,056	22,236,989
PROPERTY, BUILDINGS, AND EQUIPMENT, NET (Note 5)	63,928,406	58,438,555
Total assets	$96,668,462	$80,675,544
LIABILITIES AND FUND BALANCE		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$12,360,089	$ 8,231,187
Accrued payroll and related taxes	7,090,754	7,745,624
Accrued annual leave	8,063,655	7,493,533
Capital lease payable (current portion)	172,058	135,205
Unearned revenues and other liabilities	2,347,303	2,034,129
Total current liabilities	30,033,859	25,639,678
CAPITAL LEASE PAYABLE (non-current portion)	366,464	406,773
ACCUMULATED RETIREMENT BENEFIT OBLIGATION (Note 2)	747,717	773,177
ACCUMULATED POSTRETIREMENT BENEFIT OBLIGATION (Note 3)	3,614,828	20,721,869
ACCUMULATED POSTEMPLOYMENT BENEFIT OBLIGATION (Note 4)	2,581,079	2,183,602
Total liabilities	37,343,947	49,725,099
FUND BALANCE	59,324,515	30,950,445
Total liabilities and fund balance	$96,668,462	$80,675,544

See notes to financial statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF REVENUES AND EXPENSES AND FUND BALANCE

	For the years ended December 31, 1999	1998
BOARD OPERATING REVENUES		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures	$213,789,510	$ 178,008,900
Other revenues (Note 6)	8,661,435	8,345,087
Total operating revenues	222,450,945	186,353,987
BOARD OPERATING EXPENSES		
Salaries	115,618,738	110,455,527
Retirement and insurance contributions	16,012,513	18,684,301
Contractual services and professional fees	15,642,464	17,913,599
Depreciation and net losses on disposals	8,124,505	13,013,690
Postage and supplies	6,879,584	6,843,836
Utilities	6,109,935	4,798,940
Travel	5,970,437	5,170,630
Equipment and facilities rental	4,761,618	4,257,297
Software	4,189,644	4,344,064
Repairs and maintenance	3,662,547	3,280,615
Printing and binding	2,387,568	2,138,315
Other expenses (Note 6)	4,717,322	3,931,877
Total operating expenses	194,076,875	194,832,691
BOARD OPERATING REVENUES OVER (UNDER) EXPENSES	28,374,070	(8,478,704)
ISSUANCE AND REDEMPTION OF FEDERAL RESERVE NOTES		
Assessments levied on Federal Reserve Banks for currency costs	484,959,221	408,544,472
Expenses for currency printing, issuance, retirement, and shipping	484,959,221	408,544,472
CURRENCY ASSESSMENTS OVER (UNDER) EXPENSES	0	0
TOTAL REVENUE OVER (UNDER) EXPENSES	28,374,070	(8,478,704)
FUND BALANCE, Beginning of year	30,950,445	39,429,149
TRANSFERS TO THE U.S. TREASURY		
Transfers and accrued transfers from surplus Federal Reserve Bank earnings (Note 1)	0	18,438,855,572
Transfers and accrued transfers to the U.S. Treasury (Note 1)	0	(18,438,855,572)
FUND BALANCE, End of year	$ 59,324,515	$ 30,950,445

See notes to financial statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF CASH FLOWS

	For the years ended December 31, 1999	1998
Cash Flows from Operating Activities		
Board operating revenues over (under) expenses	$28,374,070	$ (8,478,704)
Adjustments to reconcile operating revenue over (under) expenses to net cash provided by operating activities:		
Depreciation and net losses on disposals	8,124,505	13,013,690
(Increase) decrease in accounts receivable, prepaid expenses and other assets	458,411	(62,185)
(Increase) decrease in transfers receivable—surplus Federal Reserve Bank earnings	0	652,913,560
Increase (decrease) in accounts payable and accrued liabilities	4,128,902	(1,566,642)
Increase (decrease) in accrued payroll and related taxes	(654,870)	135,843
Increase (decrease) in transfers payable—surplus Federal Reserve Bank earnings	0	(652,913,560)
Increase (decrease) in accrued annual leave	570,122	16,346
Increase (decrease) in capital lease payable	(3,456)	(73,022)
Increase (decrease) in unearned revenues and other liabilities	313,174	17,939
Increase (decrease) in accumulated retirement benefit obligation	(25,460)	32,680
Increase (decrease) in accumulated postretirement benefit obligation	(17,107,041)	528,835
Increase (decrease) in accumulated postemployment benefit obligation	397,477	413,956
Net cash provided by operating activities	24,575,834	3,978,736
Cash Flows from Investing Activities		
Proceeds from disposals	88,292	16,400
Capital expenditures	(13,702,648)	(7,248,540)
Net cash used in investing activities	(13,614,356)	(7,232,140)
Net Increase (Decrease) in Cash	10,961,478	(3,253,404)
Cash Balance, Beginning of year	20,111,430	23,364,834
Cash Balance, End of year	$31,072,908	$ 20,111,430
Supplemental Disclosure of Cash Flow Information		
Capital lease obligations incurred	$ 123,020	$ 0

See notes to financial statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOTES TO FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 1999 AND 1998

(1) Significant Accounting Policies

Organization—The Federal Reserve System was founded by Congress in 1913 and consists of the Board of Governors (Board) and twelve regional Reserve Banks. The Board was established as a federal government agency and is supported by Washington staff numbering about 1,700, as it carries out its responsibilities in conjunction with other components of the Federal Reserve System. The accompany financial statements include only the operations and activities for the Board and are prepared in accordance with generally accepted accounting principles.

Board Operating Revenues and Expenses—Assessments made on the Federal Reserve Banks for Board operating expenses and capital expenditures are calculated based on expected cash needs. These assessments, other operating revenues, and operating expenses are recorded on the accrual basis of accounting.

Issuance and Redemption of Federal Reserve Notes—The Board incurs expenses and assesses the Federal Reserve Banks for the costs of printing, issuing, shipping, and retiring Federal Reserve Notes. These assessments and expenses are separately reported in the statements of revenues and expenses because they are not Board operating transactions.

Property, Buildings and Equipment—The Board's property, buildings and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, which range from 4 to 10 years for furniture and equipment and from 10 to 50 years for building equipment and structures. Upon the sale or other disposition of a depreciable asset, the cost and related accumulated depreciation are removed from the accounts and any gain or loss is recognized.

Federal Reserve Bank Surplus Earnings—The Omnibus Budget Reconciliation Act of 1993 required that surplus Federal Reserve Bank earnings be transferred from the Banks to the Board and then to the U.S. Treasury for the period October 1, 1996, to September 30, 1998. Prior to October 1, 1996, and after September 30, 1998, the Federal Reserve Banks made their transfers directly to the Treasury. The Board accounted for these transfers when earned and due, which may have resulted in transfers receivable and payable as of the balance sheet date.

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

Reclassifications—Certain 1998 amounts have been reclassified to conform with the 1999 presentation.

(2) Retirement Benefits

Substantially all of the Board's employees participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan). The System Plan is a multiemployer plan which covers employees of the Federal Reserve Banks, the Board, and the Plan Administrative Office. Employees of the Board who entered on duty prior to 1984 are covered by a contributory defined benefits program under the System Plan. Employees of the Board who entered on duty after 1983 are covered by a non-contributory defined benefits program under the System Plan. Contributions to the System Plan are actuarially determined and funded by participating employers at amounts prescribed by the System Plan's administrator. Based on actuarial calculations, it was determined that employer funding contributions were not required for the years 1999 and 1998, and the Board was not assessed a contribution for these years. Excess Plan assets will continue to fund future years' contributions. The Board is not accountable for the assets of this plan.

A relatively small number of Board employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). The Board matches employee contributions to these plans. These defined benefits plans are administered by the Office of Personnel Management. The Board's contributions to these plans totaled $244,000 and $233,000 in 1999 and 1998, respectively. The Board has no liability for future payments to retirees under these programs, and it is not accountable for the assets of the plans.

Employees of the Board may also participate in the Federal Reserve System's Thrift Plan. Under the Thrift Plan, members may contribute up to a fixed percentage of their salary. Board contributions are based upon a fixed percentage of each member's basic contribution and were $4,966,000 and $4,794,000 in 1999 and 1998, respectively.

Effective January 1, 1996, Board employees covered under the System Plan are also covered under a Benefits Equalization Plan (BEP). Benefits paid under the BEP are limited to those benefits that cannot be paid from the System Plan because of limitations imposed by Sections 401(a)(17), 415(b), and 415(e) of the Internal Revenue Code of 1986. Pension costs attributed to the BEP reduce the pension costs of the System Plan. Activity for 1999 and 1998 is summarized in the following table:

	1999	1998
Change in benefit obligation		
Benefit obligation at beginning of year	$897,822	$527,980
Service cost	12,206	65,357
Interest cost	37,840	21,296
Plan participants' contributions	0	0
Plan amendments	0	0
Actuarial (gain)/loss	(234,999)	319,002
Benefits paid	(81,605)	(35,813)
Benefit obligation at end of year	$631,264	$897,822

	1999	1998
Change in plan assets		
Fair value of plan assets at beginning of year	$ 0	$ 0
Actual return on plan assets	0	0
Employer contributions	81,605	35,813
Plan participants' contributions	0	0
Benefits paid	(81,605)	(35,813)
Fair value of plan assets at end of year	$ 0	$ 0
Reconciliation of funded status at end of year		
Funded status	$ (631,264)	$ (897,822)
Unrecognized net actuarial (gain)/loss	(320,381)	(109,357)
Unrecognized prior service cost	(851,331)	(923,851)
Unrecognized net transition obligation	1,055,259	1,157,853
Prepaid/(accrued) postretirement benefit cost	$ (747,717)	$ (773,177)
Amounts recognized in the Statement of Financial Position consist of:		
Prepaid benefit cost	$ 0	$ 0
Accrued benefit liability	(747,717)	(844,000)
Intangible asset	0	70,823
Accumulated other comprehensive income	0	0
Net amount recognized	$ (747,717)	$ (773,177)
Weighted-average assumptions as of December 31		
Discount rate	7.50%	6.25%
Expected asset return	N/A	N/A
Salary scale	5.00%	4.25%
Corridor	10.00%	10.00%
Components of net periodic expense for year		
Service cost	$ 12,206	$ 65,357
Interest cost	37,840	21,296
Expected return on plan assets	0	0
Amortization of prior service cost	(72,520)	(72,520)
Recognized net actuarial gain	(23,975)	(48,234)
Amortization of net liability	102,594	102,594
Net periodic benefit expense	$ 56,145	$ 68,493

(3) Postretirement Benefits

The Board provides certain defined benefit health benefits (through 1998) and life insurance programs for its active employees and retirees. Activity for 1999 and 1998 is summarized in the following table:

	1999	1998
Change in benefit obligation		
Benefit obligation at beginning of year	$22,946,312	$22,973,898
Service cost	162,487	133,733
Interest cost	265,565	1,397,922
Plan participants' contributions	0	195,272
Plan amendments	(1,384,322)	0
Actuarial (gain)/loss	(1,703,601)	(549,800)
Benefits paid	(16,190,030)	(1,204,713)
Benefit obligation at end of year	$ 4,096,411	$22,946,312
Change in plan assets		
Fair value of plan assets at beginning of year	$ 0	$ 0
Actual return on plan assets	0	0
Employer contributions	16,190,030	1,009,441
Plan participants' contributions	0	195,272
Benefits paid	(16,190,030)	(1,204,713)
Fair value of plan assets at end of year	$ 0	$ 0
Reconciliation of funded status at end of year		
Funded status	$(4,096,411)	$(22,946,312)
Unrecognized net actuarial (gain)/loss	481,583	2,224,443
Unrecognized prior service cost	0	0
Unrecognized net transition obligation	0	0
Prepaid/(accrued) postretirement benefit cost	$(3,614,828)	$(20,721,869)
Components of net periodic expense for year		
Service cost	$ 162,487	$ 133,733
Interest cost	265,565	1,397,922
Amortization of prior service cost	0	0
Amortization of (gains)/losses	39,259	6,621
Total net periodic expense	467,311	1,538,276
Other credit	(1,384,322)	0
Total expense	$ (917,011)	$ 1,538,276

	1999	1998
Effect of a one-percentage point increase in health care cost trend rate on:		
Year-end benefit obligation	N/A	$2,382,383
Total of service and interest cost components	N/A	97,751
Effect of a one-percentage point decrease in health care cost trend rate on:		
Year-end benefit obligation	N/A	$(1,885,077)
Total of service and interest cost components	N/A	(156,553)

The liability and costs for the postretirement benefit plan were determined using discount rates of 7.50 percent as of December 31, 1999, and 6.25 percent as of December 31, 1998. Unrecognized losses of $481,583 and $2,224,443 as of December 31, 1999 and 1998, respectively, result from changes in the discount rate used to measure the liabilities. Under Statement of Financial Accounting Standards No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* the Board may have to record some of these unrecognized losses in operations in future years. The assumed salary trend rate for measuring the increase in postretirement benefits related to life insurance was an average of 6 percent.

The above accumulated postretirement benefit obligation is related to the Board sponsored health benefits (through 1998) and life insurance programs. During 1997, a special retirement program was offered to employees who were eligible to retire by May 31, 1998. This resulted in a curtailment loss of $1,174,489 for 1997, comprised of $1,044,096 for 62 employees covered by the Board sponsored health benefits plan, and $130,393 for 78 employees covered by the Board sponsored life insurance plan. The Board has no liability for future payments to employees who continue coverage under the federally sponsored programs upon retiring. Contributions for active employees participating in federally sponsored programs totaled $4,482,000 and $3,839,000 in 1999 and 1998, respectively.

The medical component of the benefit obligation at end of year 1998 was $18,538,000. Pursuant to the Federal Employees Health Care Act of 1998, on January 11, 1999, the Board paid the Office of Personnel Management $16,100,000 to compensate the Employee Health Benefits Fund for the costs of providing future health care benefits. Coverage for Board employees and retirees enrolled in the Federal Reserve System Health Plan terminated involuntarily on December 31, 1998. Therefore, data for the effect of a one-percentage point increase or decrease in health care cost trend rate is not applicable to 1999.

(4) Postemployment Benefit Plan

The Board provides certain postemployment benefits to eligible employees after employment but before retirement. Effective January 1, 1994, the Board adopted Statement of Financial Accounting Standards No. 112, *Employers' Accounting for Postemployment Benefits,* which requires that employers providing postemployment benefits to their employees accrue the cost of such benefits. Prior to January 1994, postemployment benefit expenses were recognized on a pay-as-you-go basis. The postemployment benefit expense was $628,000 and $614,000 for 1999 and 1998, respectively.

(5) Property, Buildings and Equipment

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

	As of December 31,	
	1999	1998
Land and improvements	$ 1,301,314	$ 1,301,314
Buildings	43,661,936	41,147,334
Furniture and equipment	49,187,837	42,723,644
Software	5,047,293	3,409,767
Construction in process	4,699,571	2,014,706
	103,897,951	90,596,765
Less accumulated depreciation	(39,969,545)	(32,158,210)
Property, buildings, and equipment, net	$ 63,928,406	$ 58,438,555

Furniture and equipment and accumulated depreciation include $738,000 and $225,000, and $615,000 and $102,500 as of December 31, 1999 and 1998, respectively, for capitalized leases.

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

During 1998 the Board increased the threshold for capitalization of furniture and equipment from $1,000 to $5,000 per item. The Board expensed the undepreciated value of previously capitalized furniture and equipment not meeting the new capitalization threshold. The Board also simplified the method of capitalizing major building modifications, eliminating the previously used depreciation recovery method of reporting. For 1998, these changes increased depreciation expense $4,033,000, decreased cost by $44,112,000, and decreased accumulated depreciation by $40,079,000.

Effective January 1, 1999, in accordance with AICPA Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, the Board began to capitalize the costs of computer software developed or obtained for internal use. Prior to 1999, the Board capitalized purchased software only. For 1999, these changes increased software assets and decreased expenses by $1,691,000. For 1999, these changes did not affect accumulated depreciation.

(6) Other Revenues and Other Expenses

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

	As of December 31, 1999	1998
Other revenues		
Data processing revenue	$4,073,910	$4,332,513
National Information Center	1,937,206	2,052,273
Subscription revenue	1,240,032	1,248,121
Reimbursable services to other agencies	609,442	147,491
Miscellaneous	800,845	564,689
Total Other Revenues	$8,661,435	$8,345,087
Other expenses		
Tuition, registration, and membership fees	$1,352,849	$1,428,717
Cafeteria operations, net	857,435	756,548
Subsidies and contributions	856,893	666,843
Miscellaneous	1,650,145	1,079,769
Total Other Expenses	$4,717,322	$3,931,877

(7) Commitments

The Board has entered into several operating leases to secure office, training, and warehouse space for periods ranging from one to ten years. Minimum future commitments under those leases having an initial or remaining noncancelable lease term in excess of one year at December 31, 1999, are as follows:

2000	$ 4,851,000
2001	4,846,000
2002	4,820,000
2003	4,578,000
2004	4,932,000
After 2004	6,247,000
	$30,274,000

Rental expenses under the operating leases were $4,334,000 and $3,873,000 in 1999 and 1998, respectively.

(8) Federal Financial Institutions Examination Council

The Board is one of the five member agencies of the Federal Financial Institutions Examination Council (the ''Council''). During 1999 and 1998, the Board paid $327,000 and $249,000, respectively, in assessments for operating expenses of the Council. These amounts are included in other expenses for 1999 and 1998. During 1998, the Board paid $159,000 for office space sub-leased from the Council, and the Board did not sub-lease office space from the Council in 1999. ■

Deloitte & Touche

Independent Auditors' Report on Internal Control over Financial Reporting and Compliance Based upon the Audit Performed in Accordance with *Government Auditing Standards*

To the Board of Governors of the
Federal Reserve System

We have audited the financial statements of the Board of Governors of the Federal Reserve System (the Board) as of and for the year ended December 31, 1999, and have issued our report thereon dated February 18, 2000. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Board's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether the Board's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Members and management of the Board and the Inspector General of the Board of Governors of the Federal Reserve System, and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

February 18, 2000

Deloitte Touche
Tohmatsu

Federal Reserve Banks Combined Financial Statements

The combined financial statements of the Federal Reserve Banks were audited by PricewaterhouseCoopers LLP, independent accountants, for the years ended December 31, 1999 and 1998.

PRICEWATERHOUSECOOPERS

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Governors of The Federal Reserve System
and the Board of Directors of each of The Federal Reserve Banks:

We have audited the accompanying combined statements of condition of The Federal Reserve Banks (the "Reserve Banks") as of December 31, 1999 and 1998, and the related combined statements of income and changes in capital for the years then ended. These financial statements are the responsibility of the Reserve Banks' 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. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 combined 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined financial position of the Reserve Banks as of December 31, 1999 and 1998, and combined results of their operations for the years then ended, on the basis of accounting described in Note 3.

PricewaterhouseCoopers LLP

Washington, D.C.
March 15, 2000

THE FEDERAL RESERVE BANKS
COMBINED STATEMENTS OF CONDITION
December 31, 1999 and 1998

(in millions)

Assets	1999	1998
Gold certificates	$ 11,048	$ 11,046
Special drawing rights certificates	6,200	9,200
Coin	207	358
Items in process of collection	6,524	6,933
Loans to depository institutions	233	17
Securities purchased under agreements to resell (tri-party)	140,640	. . .
U.S. government and federal agency securities, net	483,902	488,911
Investments denominated in foreign currencies	16,140	19,768
Accrued interest receivable	5,314	4,680
Bank premises and equipment, net	1,861	1,787
Other assets	2,391	1,942
Total assets	$674,460	$544,642

Liabilities and Capital		
Liabilities		
Federal Reserve notes outstanding, net	$600,662	$491,657
Deposits		
Depository institutions	24,027	26,306
U.S. Treasury, general account	28,402	6,086
Other deposits	274	413
Deferred credit items	6,117	5,924
Surplus transfer due U.S. Treasury	1,066	1,373
Accrued benefit cost	816	780
Other liabilities	234	199
Total liabilities	661,598	532,738
Capital		
Capital paid-in	6,431	5,952
Surplus	6,431	5,952
Total capital	12,862	11,904
Total liabilities and capital	$674,460	$544,642

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

THE FEDERAL RESERVE BANKS
COMBINED STATEMENTS OF INCOME
for the years ended December 31, 1999 and 1998

(in millions)

	1999	1998
Interest income		
Interest on U.S. government and federal agency securities	$28,216	$26,842
Interest on foreign currencies	225	435
Interest on loans to depository institutions	11	9
Total interest income	28,452	27,286
Other operating income (loss)		
Income from services	836	816
Reimbursable services to government agencies	295	299
Foreign currency (losses) gains, net	(504)	1,870
Government securities (losses) gains, net	(22)	44
Other income	83	72
Total other operating income	688	3,101
Operating expenses		
Salaries and other benefits	1,446	1,358
Occupancy expense	189	181
Equipment expense	242	244
Cost of unreimbursed Treasury services	8	8
Assessments by Board of Governors	699	587
Other expenses	294	374
Total operating expenses	2,878	2,752
Net income prior to distribution	$26,262	$27,635
Distribution of net income		
Dividends paid to member banks	$ 374	$ 343
Transferred to surplus	479	732
Payments to U.S. Treasury as interest on Federal Reserve notes	25,409	8,774
Payments to U.S. Treasury as required by statute	. . .	17,786
Total distribution	$26,262	$27,635

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

THE FEDERAL RESERVE BANKS
COMBINED STATEMENTS OF CHANGES IN CAPITAL
for the years ended December 31, 1999 and 1998

(in millions)

	Capital paid-in	Surplus	Total capital
Balance at January 1, 1998 (109 million shares)	$5,433	$5,220	$10,653
Net income transferred to surplus	. . .	732	732
Net change in capital stock issued (10 million shares)	519	. . .	519
Balance at December 31, 1998 (119 million shares)	$5,952	$5,952	$11,904
Net income transferred to surplus	. . .	479	479
Net change in capital stock issued (9 million shares)	479	. . .	479
Balance at December 31, 1999 (128 million shares)	$6,431	$6,431	$12,862

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

Notes to the Combined Financial Statements of the Federal Reserve Banks

(1) Organization and Basis of Presentation

The twelve Federal Reserve Banks (Reserve Banks) are 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 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 Board of Governors of the Federal Reserve System (Board of Governors), 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.

Although the Reserve Banks are chartered as independent organizations overseen by the Board of Governors, the Reserve Banks work jointly to carry out their statutory responsibilities. The majority of the assets, liabilities, and income of the Reserve Banks is derived from central bank activities and responsibilities with regard to monetary policy and currency. For this reason, the accompanying combined set of financial statements for the twelve independent Reserve Banks is prepared, adjusted to eliminate interdistrict accounts and transactions.

Structure

The Reserve Banks serve twelve Federal Reserve Districts nationwide. In accordance with the Federal Reserve Act, supervision and control of each Reserve Bank is 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 operations, and check processing; distribution of coin and currency; 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, state member banks, and U.S. offices of foreign banking organizations; and administering other regulations of the Board of Governors. The Board of Governors' operating costs are funded through assessments on the Reserve Banks.

NOTES TO THE COMBINED FINANCIAL STATEMENTS OF THE FEDERAL RESERVE BANKS—CONTINUED

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 U.S. government and federal agency securities, matched sale–purchase transactions, the purchase of securities under agreements to resell, and the lending of U.S. government securities. Additionally, the FRBNY is authorized by the FOMC to hold balances of and to execute spot and forward foreign exchange and securities contracts in fourteen 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 generally accepted accounting principles (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 required by GAAP. In addition, the Board of Governors and the Reserve Banks have elected not to include a Statement of Cash Flows or a Statement of Comprehensive Income. The Statement of Cash Flows has not been included as the liquidity and cash position of the Reserve Banks are not of primary concern to users of these financial statements. The Statement of Comprehensive Income, which comprises net income plus or minus certain adjustments, such as the fair value adjustments for securities, has not been included because as stated above the securities are reported at amortized cost and there are no other adjustments in the determination of Comprehensive Income applicable to the Reserve Banks. Other information regarding the Reserve Banks' activities is provided in, or may be derived from, the Statements of Condition, Income, and Changes in Capital. Therefore, a Statement of Cash Flows or a Statement of Comprehensive Income would not provide any additional useful information. There are no other significant differences between the policies outlined in the *Financial Accounting Manual* and GAAP.

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. 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 account is lowered. The value of gold for purposes of backing the gold certificates is set by law at \$42⅖ a fine troy ounce.

(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 U.S. 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 account is 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.

(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 recorded on the accrual basis and is charged at the applicable discount rate established at least every fourteen days by the boards of directors of the Reserve Banks, subject to review by the Board of

Governors. However, Reserve Banks retain the option to impose a surcharge above the basic rate in certain circumstances.

The Board of Governors established a Special Liquidity Facility (SLF) to make discount window credit readily available to depository institutions in sound financial condition around the century date change (October 1, 1999, to April 7, 2000) in order to meet unusual liquidity demands and to allow institutions to confidently commit to supplying loans to other institutions and businesses during this period. Under the SLF, collateral requirements are unchanged from normal discount window activity and loans are made at a rate of 150 basis points above the FOMC's target federal funds rate.

(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 other needs specified by the FOMC in carrying out the System's central bank responsibilities.

Purchases of securities under agreements to resell and matched sale–purchase transactions are accounted for as separate sale and purchase transactions. Purchases under agreements to resell are transactions in which the FRBNY purchases a security and sells it back at the rate specified at the commencement of the transaction. 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.

In addition to the aforementioned purchases of securities under agreements to resell and matched sale–purchase transactions, the FRBNY also through FOMC's temporary authorization engages in tri-party repurchase and reverse repurchase agreements (''tri-party agreements''). Tri-party agreements are conducted with two custodial banks that manage the clearing and settlement of collateral. Acceptable collateral under tri-party repurchase agreements primarily includes U.S. Government and agency securities, pass-through mortgage securities of GNMA, FHLMC, and FNMA, STRIP securities of the U.S. Government and ''stripped'' securities of other government agencies. The tri-party repurchase and reverse repurchase transactions are accounted for as financing transactions with the associated interest income and interest expense recorded over the period of the agreement. Tri-party operations commenced in October 1999 and have been approved by the FOMC through April 2000.

Another tool employed by the FRBNY to address potential reserve shortages was the ability to sell options on overnight repurchase agreements. The FRBNY has the temporary authority to sell European options to primary dealers that give the dealers the right to enter into repurchase agreements with the FRBNY on the exercise date. The options were auctioned in three week long ''strips'' with each strip consisting of the right to exercise overnight repurchase agreements for up to five consecutive business days. In general, the options could only be exercised at strike price of 150 to 250 basis points above the most recently announced FOMC Federal funds target rate.

Effective April 26, 1999 the FRBNY was given the 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, 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. The FOMC policy requires FRBNY to take possession of collateral in amounts 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. Prior to April 26, 1999, all Reserve Banks were authorized to engage in such lending activity.

Foreign exchange 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 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 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 Bank 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

NOTES TO THE COMBINED FINANCIAL STATEMENTS OF THE FEDERAL RESERVE BANKS—CONTINUED

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 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 ‘‘Government securities gains, net.’’ Foreign currency denominated assets are revalued monthly 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 gains (losses), net.’’ Foreign currencies held through F/X swaps, when initiated by the counter party, and warehousing arrangements are revalued monthly, with the unrealized gain or loss reported as a component of ‘‘Other assets’’ or ‘‘Other liabilities,’’ as appropriate.

(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.

(F) *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 agency securities, loans allowed under section 13, 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. Tri-party agreements, which received temporary authorization through April 2000, however, are valued at the contract amount. 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 that certain assets of the Reserve Banks are 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 U.S. government.

The ‘‘Federal Reserve notes outstanding, net’’ account represents Federal Reserve notes reduced by cash held in the vaults of the Reserve Banks of $221,297 million and $120,030 million at December 31, 1999 and 1998, respectively.

At December 31, 1999 and 1998, all gold certificates, all special drawing rights certificates, and domestic securities with par values of $583,414 million and $471,411 million, respectively, were pledged as collateral. At December 31, 1999 and 1998, no loans or investments denominated in foreign currencies were pledged as collateral.

(G) *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% 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% 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.

NOTES TO THE COMBINED FINANCIAL STATEMENTS OF THE FEDERAL RESERVE BANKS—CONTINUED

(H) *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. Payments made after September 30, 1998, represent payment of interest on Federal Reserve notes outstanding.

The Omnibus Budget Reconciliation Act of 1993 (Public Law 103-66, Section 3002) codified the existing Board surplus policies as statutory surplus transfers, rather than as payments of interest on Federal Reserve notes, for federal government fiscal years 1998 and 1997 (which ended on September 30, 1998 and 1997, respectively). In addition, the legislation directed the Reserve Banks to transfer to the U.S. Treasury additional surplus funds of $107 million and $106 million during fiscal years 1998 and 1997 respectively. Reserve Banks were not permitted to replenish surplus for these amounts during this time. Payments to the U.S. Treasury made after September 30, 1998, represent payment of interest on Federal Reserve notes outstanding.

The Consolidated Appropriations Act of 1999 (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 Reserve Banks will make this payment prior to September 30, 2000.

In the event of losses, payments to the U.S. Treasury are suspended until such losses are recovered through subsequent earnings. Weekly payments to the U.S. Treasury vary significantly.

(I) *Income and Cost Related to Treasury Services*

Reserve Banks are required by the Federal Reserve Act to serve as fiscal agents and depositories 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 will not be paid are reported as the "Cost of unreimbursed Treasury services."

(J) *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 and held under agreements to resell are held in the SOMA at the FRBNY.

Total securities held in the SOMA at December 31, 1999 and 1998, that were bought outright were as follows (in millions):

	1999	1998
Par value		
Federal agency	$ 181	$ 337
U.S. government		
Bills	176,518	194,772
Notes	218,467	187,895
Bonds	82,978	69,474
Total par value	478,144	452,478
Unamortized premiums	9,098	7,387
Unaccreted discounts	(3,340)	(3,198)
Total	$483,902	$456,667

The maturities of U.S. government and federal agency securities bought outright, which were held in the SOMA at December 31, 1999, were as follows (in millions):

	Par value		
Maturities of securities held	U.S. government securities	Federal agency obligations	Total
Within 15 days	$ 4,632	$ . . .	$ 4,632
16 days to 90 days	91,919	31	91,950
91 days to 1 year	139,866	20	139,886
Over 1 year to 5 years	124,169	10	124,179
Over 5 years to 10 years	51,107	120	51,227
Over 10 years	66,270	. . .	66,270
Total	$477,963	$181	$478,144

Total securities held under agreements to resell at December 31 1999 were $140,640 million that consisted entirely of agreements through third party custodial arrangements and are reported as "Securities purchased under agreements to resell (tri-party)." Securities held under agreements to resell at December 31, 1998 totaled $32,244 million and are included in "U.S. government and federal agency securities, net." In August 1999, the FOMC extended the maximum pemissible maturity for securities purchased under agreements to resell from 60 days to 90 days.

NOTES TO THE COMBINED FINANCIAL STATEMENTS OF THE FEDERAL RESERVE BANKS—CONTINUED

At December 31, 1999 and 1998, matched sale–purchase transactions involving U.S. government securities with par values of $39,182 million and $20,297 million, respectively, were outstanding. Matched sale–purchase transactions are generally overnight arrangements.

At December 31, 1999 and 1998, U.S. government securities with par values of $2,061 million and $325 million, respectively, were loaned.

Option contracts that were held on overnight repurchase agreements at December 31, 1999 were as follows (in millions):

	12/30/1999–01/05/2000	01/06/1999–01/12/2000
Outstanding options	$222,950	$144,000

(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.

Total investments denominated in foreign currencies, valued at current exchange rates at December 31, were as follows (in millions):

	1999	1998
German marks		
Foreign currency deposits	$ . . .	$10,451
Government debt instruments including agreements to resell	. . .	2,373
European Union euros		
Foreign currency deposits	4,333	. . .
Government debt instruments including agreements to resell	2,538	. . .
Japanese yen		
Foreign currency deposits	323	666
Government debt instruments including agreements to resell	8,898	6,196
Accrued interest	48	97
Total	$16,140	$19,783

In addition to the balances reported above, $15 million in unearned interest collected on certain foreign currency holdings were also reported as "Investments denominated in foreign currencies" at December 31, 1998.

The maturities of investments denominated in foreign currencies at December 31, 1999, were as follows (in millions):

Maturities of Investments Denominated in Foreign Currencies	
Within 1 year	$15,071
Over 1 year to 5 years	496
Over 5 years to 10 years	573
Total	$16,140

At December 31, 1999 and 1998, there were no open foreign exchange contracts or outstanding F/X swaps.

At December 31, 1999 and 1998 the warehousing facility was $5,000 million, with nothing outstanding.

(6) BANK PREMISES AND EQUIPMENT

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

	1999	1998
Bank premises and equipment		
Land	$ 191	$ 191
Buildings	1,222	1,177
Building machinery and equipment	287	271
Construction in progress	98	41
Furniture and equipment	1,238	1,244
	3,036	2,924
Accumulated depreciation	(1,175)	(1,137)
Bank premises and equipment, net	$1,861	$1,787

Depreciation expense was $183 million and $184 million for the years ended December 31, 1999 and 1998, respectively.

Bank premises and equipment at December 31 include the following amounts for leases that have been capitalized (in millions):

	1999	1998
Bank premises and equipment	$33	$89
Accumulated depreciation	(19)	(78)
Capitalized leases, net	$14	$11

Certain of the Reserve Banks lease unused space to outside tenants. Those leases have terms ranging from 1 to 16 years. Rental income from such leases totaled $17 million for each of the years ended December 31, 1999 and 1998. Future minimum lease payments under agreements in existence at December 31, 1999, were (in millions):

2000	$15
2001	14
2002	13
2003	9
2004	8
Thereafter	21
Total	$80

Notes to the Combined Financial Statements of the Federal Reserve Banks—Continued

(7) Commitments and Contingencies

At December 31, 1999, the Reserve Banks were obligated under noncancelable leases for premises and equipment with terms ranging from 1 year to approximately 24 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 $66 million and $64 million for the years ended December 31, 1999 and 1998, respectively. Certain of the Reserve Banks' leases have options to renew.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with terms of 1 year or more, at December 31, 1999, were (in millions):

	Operating
2000	$ 13
2001	11
2002	7
2003	6
2004	6
Thereafter	$114
Total	$157

At December 31, 1999, the Reserve Banks had contractual commitments through the year 2007 totaling $391 million for the maintenance of currency and check processing machines, none of which has been recognized. One Reserve Bank contracts for maintenance for these machines on behalf of the System and allocates the costs, annually, to each other Reserve Bank.

The Reserve Banks are 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 Reserve Banks.

(8) Retirement and Thrift Plans

Retirement Plans

The Reserve Banks currently offer two defined benefit retirement plans to their employees, based on length of service and level of compensation. Substantially all of the Reserve Banks' employees participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan) and the Benefit Equalization Retirement Plans offered by each individual Reserve Bank (BEPs).

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. FRBNY acts as the sponsor of this plan. The prepaid pension cost includes amounts related to the participation of employees of the 12 Reserve Banks, the Board of Governors, and the Plan Administrative Office in the plan.

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

	1999	1998
Estimated actuarial present value of projected benefit obligation at January 1	$2,774	$2,476
Service cost—benefits earned during the period	89	79
Interest cost of projected benefit obligation	169	169
Actuarial (gain) loss	(330)	140
Contributions by plan participants	3	4
Benefits paid	(129)	(125)
Plan amendments	. . .	31
Estimated actuarial present value of projected benefit obligation at December 31	$2,576	$2,774

Following is a reconciliation showing the beginning and ending balance of the System Plan assets, the funded status, and the prepaid pension benefit cost (in millions):

	1999	1998
Estimated fair value of plan assets at January 1	$5,798	$5,031
Actual return on plan assets	484	888
Contributions by employer	. . .	. . .
Contributions by plan participants	3	4
Benefits paid	(129)	(125)
Estimated fair value of plan assets at December 31	$6,156	$5,798
Funded status	$3,580	$3,024
Unrecognized initial net transition (obligation)	(91)	(136)
Unrecognized prior service cost	136	152
Unrecognized net actuarial (gain)	(1,767)	(1,549)
Prepaid pension benefit cost	1,858	1,491

Prepaid pension benefit cost is reported as a component of "Other assets."

The weighted-average assumptions used in developing the pension benefit obligation for the System Plan are as follows:

	1999	1998
Discount rate	7.50%	6.25%
Expected long-term rate of return on plan assets	9.00%	9.00%
Rate of compensation increase	5.00%	4.25%

NOTES TO THE COMBINED FINANCIAL STATEMENTS OF THE FEDERAL RESERVE BANKS—CONTINUED

The components of net periodic pension benefit credit for the System Plan as of December 31 are shown below (in millions):

	1999	1998
Service cost—benefits earned during the period	$ 89	$ 79
Interest cost on projected benefit obligation	169	169
Amortization of initial net transition obligation	(45)	(45)
Amortization of prior service cost	16	15
Recognized net (gain)	(76)	(59)
Expected return on plan assets	(520)	(448)
Net periodic pension benefit (credit)	$(367)	$(289)

Net periodic pension benefit (credit) is reported as a component of ''Other expense.''

The Reserve Banks' projected benefit obligation and net pension costs for the BEP at December 31, 1999 and 1998, and for the years then ended, are not material.

Thrift Plan

Employees of the Reserve Banks may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The Reserve Banks' Thrift Plan contributions totaled $45 million and $43 million for the years ended December 31, 1999 and 1998, respectively, 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 Reserve Banks' 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 Reserve Banks fund benefits payable under the medical and life insurance plans as due and, accordingly, have no plan assets. Net postretirement benefit cost is actuarially determined, using a January 1 measurement date.

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

	1999	1998
Accumulated postretirement benefit obligation at January 1	$645	$588
Service cost—benefits earned during the period	18	15
Interest cost of accumulated benefit obligation	39	39
Actuarial loss (gain)	(73)	41
Contributions by plan participants	3	3
Benefits paid	(25)	(24)
Plan amendments	(7)	(17)
Accumulated postretirement benefit obligation at December 31	$600	$645

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

	1999	1998
Fair value of plan assets at January 1	$ . . .	$ . . .
Actual return on plan assets	. . .	. . .
Contributions by the employer	22	21
Contributions by plan participants	3	3
Benefits paid	(25)	(24)
Fair value of plan assets at December 31	$ . . .	$ . . .
Unfunded postretirement benefit obligation	$600	$645
Unrecognized prior service cost	99	100
Unrecognized net actuarial gain/(loss)	(23)	(50)
Accrued postretirement benefit cost	$722	$695

Accrued postretirement benefit cost is reported as a component of "Accrued benefit cost."

The weighted-average assumption used in developing the postretirement benefit obligation as of December 31, 1999 and 1998, was 7.50% and 6.25%, respectively.

For measurement purposes, an 8.75% annual rate of increase in the cost of covered health care benefits was assumed for 2000. Ultimately, the health care cost trend rate is expected to decrease gradually to 5.50% by 2006, and remain at that level thereafter.

NOTES TO THE COMBINED FINANCIAL STATEMENTS OF THE FEDERAL RESERVE BANKS—CONTINUED

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A 1 percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 1999 (in millions):

	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit cost	$ 12	$ (9)
Effect on accumulated postretirement benefit obligation	94	(77)

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

	1999	1998
Service cost—benefits earned during the period	$18	$15
Interest cost of accumulated benefit obligation	39	39
Amortization of prior service cost	(9)	(8)
Recognized net actuarial loss	. . .	. . .
Net periodic postretirement benefit cost	$48	$46

Net periodic postretirement benefit cost is reported as a component of "Salaries and other benefits."

Postemployment Benefits

The Reserve Banks offer benefits to former or inactive employees. Postemployment benefit costs are actuarially determined and include the cost of medical and dental insurance, survivor income, disability benefits, and those workers' compensation expenses self-insured by individual Reserve Banks. 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 Reserve Banks at December 31, 1999 and 1998, were $93 million and $84 million, respectively. This cost is included as a component of "Accrued benefit cost." Net periodic postemployment benefit costs included in 1999 and 1998 operating expenses were $20 million and $19 million, respectively.