

## *Board of Governors Financial Statements*

The financial statements of the Board were audited by Price Waterhouse, independent public accountants, for 1996 and 1995.

***Price Waterhouse LLP***



### REPORT OF INDEPENDENT ACCOUNTANTS

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, 1996 and 1995, 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 *Government Auditing Standards* issued by the Comptroller General of 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Board as of December 31, 1996 and 1995, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 25, 1997 on our consideration of the Board's internal controls and a report dated March 25, 1997 on its compliance with laws and regulations.

*Price Waterhouse LLP*

March 25, 1997  
Arlington, Virginia

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
BALANCE SHEET

| ASSETS  | As of December 31,   |                     |
|---|----------------------|---------------------|
|   | 1996                 | 1995                |
| <b>CURRENT ASSETS</b>   |                      |                     |
| Cash .....  | \$ 15,712,258        | \$16,142,195        |
| Accounts receivable .....   | 2,561,975            | 1,900,155           |
| Transfers receivable—surplus Federal Reserve Bank earnings (Note 1) ..... | 659,862,602          | —                   |
| Prepaid expenses and other assets .....                                   | 2,247,391            | 1,225,022           |
| Total current assets .....  | 680,384,226          | 19,267,372          |
| <b>PROPERTY, BUILDINGS, AND EQUIPMENT, NET (Note 4) .....</b>             | <b>61,110,184</b>    | <b>59,781,623</b>   |
| Total assets .....  | <b>\$741,494,410</b> | <b>\$79,048,995</b> |
| <b>LIABILITIES AND FUND BALANCE</b>                                       |                      |                     |
| <b>CURRENT LIABILITIES</b>  |                      |                     |
| Accounts payable and accrued liabilities .....                            | \$ 10,435,545        | \$ 7,580,371        |
| Accrued payroll and related taxes .....                                   | 6,804,678            | 4,868,497           |
| Transfers payable—surplus Federal Reserve Bank earnings (Note 1) .....    | 659,862,602          | —                   |
| Accrued annual leave .....  | 6,966,327            | 6,601,004           |
| Capital lease payable (current portion) .....                             | —                    | 75,840              |
| Unearned revenues and other liabilities .....                             | 2,263,338            | 2,184,882           |
| Total current liabilities .....   | 686,332,490          | 21,310,594          |
| <b>CAPITAL LEASE PAYABLE (non-current portion) .....</b>                  | <b>—</b>             | <b>232,638</b>      |
| <b>ACCUMULATED RETIREMENT BENEFIT OBLIGATION (Note 2) .....</b>           | <b>466,056</b>       | <b>—</b>            |
| <b>ACCUMULATED POSTRETIREMENT BENEFIT OBLIGATION (Note 3) .....</b>       | <b>18,171,722</b>    | <b>17,074,588</b>   |
| <b>ACCUMULATED POSTEMPLOYMENT BENEFIT OBLIGATION (Note 3) .....</b>       | <b>1,409,343</b>     | <b>1,093,400</b>    |
| <b>FUND BALANCE .....</b>   | <b>35,114,799</b>    | <b>39,337,775</b>   |
| Total liabilities and fund balance .....                                  | <b>\$741,494,410</b> | <b>\$79,048,995</b> |

The accompanying notes are an integral part of these statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
STATEMENT OF REVENUES AND EXPENSES  
AND FUND BALANCE

|   | For the years ended December 31, |                      |
|---|----------------------------------|----------------------|
|   | 1996                             | 1995                 |
| <b>BOARD OPERATING REVENUES</b>   |                                  |                      |
| Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures ..... | \$ 162,642,400                   | \$161,347,900        |
| Other revenues (Note 5) .....   | 9,789,141                        | 10,240,830           |
| Total operating revenues .....  | 172,431,541                      | 171,588,730          |
| <b>BOARD OPERATING EXPENSES</b>   |                                  |                      |
| Salaries .....  | 106,353,644                      | 100,412,576          |
| Retirement and insurance contributions .....  | 18,417,943                       | 16,394,955           |
| Contractual services and professional fees .....  | 11,159,490                       | 11,240,373           |
| Depreciation and net losses on disposals .....  | 8,626,785                        | 7,525,971            |
| Travel .....  | 4,942,020                        | 4,920,996            |
| Equipment and facilities rental .....   | 4,356,715                        | 3,853,657            |
| Postage and supplies .....  | 4,263,382                        | 4,523,272            |
| Utilities .....   | 4,189,203                        | 4,155,038            |
| Software .....  | 3,907,874                        | 3,362,342            |
| Repairs and maintenance .....   | 3,417,539                        | 3,689,603            |
| Printing and binding .....  | 2,665,188                        | 3,144,178            |
| Other expenses (Note 5) .....   | 4,354,734                        | 3,915,489            |
| Total operating expenses .....  | 176,654,517                      | 167,138,450          |
| <b>BOARD OPERATING REVENUES (UNDER) OVER EXPENSES .....</b>   | <b>(4,222,976)</b>               | <b>4,450,280</b>     |
| <b>ISSUANCE AND REDEMPTION OF FEDERAL RESERVE NOTES</b>   |                                  |                      |
| Assessments levied on Federal Reserve Banks for currency costs .....                                    | 403,232,215                      | 370,206,037          |
| Expenses for currency printing, issuance, retirement, and shipping .....                                | 403,232,215                      | 370,206,037          |
| <b>CURRENCY ASSESSMENTS OVER (UNDER) EXPENSES .....</b>   | <b>—</b>                         | <b>—</b>             |
| <b>TOTAL REVENUES (UNDER) OVER EXPENSES .....</b>   | <b>(4,222,976)</b>               | <b>4,450,280</b>     |
| <b>FUND BALANCE, Beginning of year .....</b>  | <b>39,337,775</b>                | <b>34,887,495</b>    |
| <b>TRANSFERS TO THE U.S. TREASURY</b>   |                                  |                      |
| Transfers and accrued transfers from surplus Federal Reserve Bank earnings (Note 1) .....               | 5,623,716,034                    | —                    |
| Transfers and accrued transfers to the U.S. Treasury (Note 1) .....                                     | (5,623,716,034)                  | —                    |
| <b>FUND BALANCE, End of year .....</b>  | <b>\$ 35,114,799</b>             | <b>\$ 39,337,775</b> |

The accompanying notes are an integral part of these statements.

## BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

## STATEMENT OF CASH FLOWS

## Increase (Decrease) in Cash

|  | <u>For the years ended December 31,</u> |                     |
|--|---|---------------------|
|  | <u>1996</u>                             | <u>1995</u>         |
| CASH FLOWS FROM OPERATING ACTIVITIES   |   |                     |
| Board operating revenues (under) over expenses .....   | \$ (4,222,976)                          | \$ 4,450,280        |
| Adjustments to reconcile operating revenues (under) over expenses<br>to net cash provided by operating activities: |   |                     |
| Depreciation and net losses on disposals .....   | 8,626,785                               | 7,525,971           |
| (Increase) in transfers receivable—surplus Federal Reserve Bank earnings ..  | (659,862,602)                           | —                   |
| Increase in accumulated postretirement benefits .....  | 1,097,134                               | 800,142             |
| Increase in accumulated retirement benefits .....  | 466,056                                 | —                   |
| Increase (decrease) in accumulated postemployment benefits .....   | 315,943                                 | (226,618)           |
| (Increase) decrease in accounts receivable, prepaid expenses,<br>and other assets .....                            | (1,684,189)                             | 438,229             |
| Increase in accrued annual leave .....   | 365,323                                 | 377,085             |
| Increase in accounts payable and accrued liabilities .....   | 2,855,174                               | 2,129,494           |
| Increase in transfers payable—surplus Federal Reserve Bank earnings .....  | 659,862,602                             | —                   |
| Increase in payroll payable and related taxes .....  | 1,936,181                               | 948,432             |
| Increase in unearned revenues and other liabilities .....  | <u>78,456</u>                           | <u>332,268</u>      |
| Net cash provided by operating activities .....  | <u>9,833,887</u>                        | <u>16,775,283</u>   |
| CASH FLOWS FROM INVESTING ACTIVITIES   |   |                     |
| Proceeds from disposals of furniture and equipment .....   | 70,500                                  | 12,112              |
| Capital expenditures .....   | <u>(10,334,324)</u>                     | <u>(15,594,485)</u> |
| Net cash used in investing activities .....  | <u>(10,263,824)</u>                     | <u>(15,582,373)</u> |
| NET (DECREASE) INCREASE IN CASH .....  | (429,937)                               | 1,192,910           |
| CASH BALANCE, Beginning of year .....  | <u>16,142,195</u>                       | <u>14,949,285</u>   |
| CASH BALANCE, End of year .....  | <u>\$ 15,712,258</u>                    | <u>\$16,142,195</u> |

The accompanying notes are an integral part of these statements.

## BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

## NOTES TO FINANCIAL STATEMENTS

## (1) SIGNIFICANT ACCOUNTING POLICIES

*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 requires 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 this time the Federal Reserve Banks made their transfers directly to the Treasury. The Board accounts for these transfers when earned and due, which may result in transfers receivable and payable as of the balance sheet date.

*Estimates*—The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period.

*Reclassifications*—Certain 1995 disclosures have been reclassified to conform with the 1996 presentation, the effect of which is immaterial.

## (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's 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's Plan. Employees of the Board who entered on duty after 1983 are covered by a non-contributory defined benefits program under the System's Plan. Contributions to the System's 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 1996 and 1995, 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 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 \$201,500 and \$802,200 in 1996 and 1995 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.

Effective January 1, 1996, Board employees covered under the System's 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's 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's Plan. The net periodic pension cost of the BEP for 1996 included the following components:

|   |                  |
|---|------------------|
| Service cost (benefits attributed to employee services during the year) ..... | \$260,868        |
| Interest cost on projected benefit obligation ..                              | 102,594          |
| Amortization of unrecognized net liability ..                                 | <u>102,594</u>   |
| Net periodic pension cost .....   | <u>\$466,056</u> |

Although these pension costs are recorded using the accrual basis of accounting in accordance with Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" (FAS 87), the Board's current policy is to fund the cost of these benefits on a pay-as-you-go basis.

The net periodic pension cost was determined using a 7 percent discount rate and average compensation growth of 5 percent.

The FAS 87 accumulated benefit obligation at December 31, 1996, comprises:

|   |                     |
|---|---------------------|
| Accumulated benefit obligation                                      |                     |
| Vested .....  | \$ 218,000          |
| Nonvested .....   | <u>21,000</u>       |
| Total .....   | <u>\$ 239,000</u>   |
| Plan assets at fair value .....                                     | \$ 0                |
| Less: Actuarial present value of projected benefit obligation ..... | <u>(1,589,924)</u>  |
| Projected benefit obligation in excess of plan assets .....         | (1,589,924)         |
| Less: Unrecognized net transition obligation .....                  | 1,363,041           |
| Unrecognized prior service cost .....                               | (190,000)           |
| Unrecognized net (gain)/loss .....                                  | <u>(49,173)</u>     |
| Unfunded pension cost .....   | <u>\$ (466,056)</u> |

The liability as of December 31, 1996, was determined using a 7.25 percent discount rate. The average rate of compensation increase used was 5 percent per year. The

Board has elected to amortize the unrecognized prior service cost over 14.3 years.

### (3) OTHER BENEFIT 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 \$4,644,100 in 1996 and \$4,320,400 in 1995.

The Board also provides certain defined benefit health and life insurance for its active employees and retirees under Federal and Board sponsored programs. The net periodic postretirement benefit cost for 1996 and 1995 included the following components:

|   | 1996               | 1995               |
|---|--------------------|--------------------|
| Service cost (benefits attributed to employee services during the year) ..... | \$ 195,016         | \$ 418,649         |
| Interest cost on accumulated postretirement benefit obligation .....          | 1,461,103          | 1,441,350          |
| Amortization of gains and losses .....  | <u>372,253</u>     | <u>(80)</u>        |
| Net periodic postretirement benefit cost .....                                | <u>\$2,028,372</u> | <u>\$1,859,919</u> |

Although postretirement benefits are recorded using the accrual basis of accounting in accordance with FAS 106, the Board's current policy is to fund the cost of these benefits on a pay-as-you-go basis.

The FAS 106 accumulated postretirement benefit obligation at December 31, 1996 and 1995 comprises:

|   | 1996                | 1995<br>(reclassified) |
|---|---------------------|------------------------|
| Retirees .....  | \$14,393,309        | \$14,061,087           |
| Fully eligible active plan participants .....                     | 3,512,825           | 3,528,612              |
| Other active plan participants .....                              | <u>3,422,992</u>    | <u>3,773,612</u>       |
|   | 21,329,126          | 21,363,311             |
| Unrecognized net loss .....                                       | <u>(3,157,404)</u>  | <u>(4,288,723)</u>     |
| Liability for accumulated postretirement benefit obligation ..... | <u>\$18,171,722</u> | <u>\$17,074,588</u>    |

The liability for the accumulated postretirement benefit obligation and the net periodic benefit cost was determined using a 7.25 percent discount rate. Unrecognized losses of \$3,157,404 result from changes in the discount rate used to measure liabilities. Under FAS 106, the Board may have to record some of these unrecognized losses in operations in future years. The assumed health care cost trend rate for measuring the increase in costs from 1996 to 1997 was 9.5 percent. These rates were assumed to gradually decline to an ultimate rate of 5.5 percent in the year 2005 for the purpose of calculating the December 31, 1996, accumulated postretirement benefit obligation. The effect of a 1-percent increase in

the assumed health care cost trend rate would increase the accumulated postretirement benefit obligation by \$2,543,145 at December 31, 1996, and the net periodic benefit cost by \$184,055 for the year. The assumed salary trend rate for measuring the increase in postretirement benefits related to life insurance was an average of 5 percent.

The above accumulated postretirement benefit obligation is related to the Board sponsored health benefits and life insurance programs. 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 \$3,553,400 and \$3,477,300 in 1996 and 1995 respectively.

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 (FAS 112), 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.

### (4) PROPERTY, BUILDINGS, AND EQUIPMENT

The following is a summary of the components of the Board's fixed assets, at cost, net of accumulated depreciation.

|   | As of December 31,   |                      |
|---|----------------------|----------------------|
|   | 1996                 | 1995                 |
| Land and improvements ...                     | \$ 1,301,314         | \$ 1,301,314         |
| Buildings .....                               | 65,343,600           | 65,298,136           |
| Furniture and equipment .....                 | <u>54,592,393</u>    | <u>52,215,976</u>    |
|   | 121,237,307          | 118,815,426          |
| Less accumulated depreciation .....           | <u>60,127,123</u>    | <u>59,033,803</u>    |
| Total property, buildings and equipment ..... | <u>\$ 61,110,184</u> | <u>\$ 59,781,623</u> |

### (5) OTHER REVENUES AND OTHER EXPENSES

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

|   | For the years<br>ended December 31, |                     |
|---|-------------------------------------|---------------------|
|   | 1996                                | 1995                |
| Other Revenues                            |                                     |                     |
| Data processing revenue .....             | \$4,612,476                         | \$ 4,100,517        |
| National Information Center .....         | 1,974,295                           | 2,070,267           |
| Subscription revenue .....                | 1,583,193                           | 1,648,931           |
| Reimbursable services to other agencies . | 424,940                             | 383,752             |
| Miscellaneous .....                       | <u>1,194,237</u>                    | <u>2,037,363</u>    |
| Total other revenues .....                | <u>\$9,789,141</u>                  | <u>\$10,240,830</u> |

## Other Expenses

|  |                    |                     |
|--|--------------------|---------------------|
| Tuition, registration,<br>and membership<br>fees ..... | \$1,290,090        | \$ 1,413,233        |
| Cafeteria operations,<br>net .....                     | 870,429            | 788,506             |
| Subsidies and<br>contributions ...                     | 646,194            | 755,857             |
| Miscellaneous .....                                    | <u>1,548,021</u>   | <u>957,893</u>      |
| Total other<br>expenses .....                          | <u>\$4,354,734</u> | <u>\$ 3,915,489</u> |

## (6) COMMITMENTS

The Board has entered into several operating leases to secure office, training, and warehouse space for periods ranging from one to nine years. Minimum future commitments under those leases having an initial or remaining noncancelable lease term in excess of one year at December 31, 1996, are as follows:

|                  | <u>Operating</u>    |
|------------------|---------------------|
| 1997 .....       | \$ 3,724,037        |
| 1998 .....       | 3,645,048           |
| 1999 .....       | 3,681,559           |
| 2000 .....       | 3,938,055           |
| after 2000 ..... | <u>17,121,831</u>   |
|                  | <u>\$32,110,530</u> |

Rental expenses under the operating leases were \$3,930,689 and \$3,301,186 in 1996 and 1995 respectively.

(7) FEDERAL FINANCIAL INSTITUTIONS  
EXAMINATION COUNCIL

The Board is one of the five member agencies of the Federal Financial Institutions Examination Council (the "Council"). During 1996 and 1995, the Board paid \$224,600 and \$269,040 respectively, in assessments for operating expenses of the Council. These amounts are included in subsidies and contributions for 1996 and 1995. During 1996 and 1995, the Board paid \$127,100 and \$126,900 respectively, for office space subleased from the Council. ■