

Board of Governors Financial Statements

The financial statements of the Board for 1997 and 1996 were audited by Price Waterhouse, independent public accountants.

Price Waterhouse



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, 1997 and 1996, 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 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, 1997 and 1996, 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 16, 1998 on our consideration of the Board's internal controls and a report dated March 16, 1998 on its compliance with laws and regulations.

Price Waterhouse LLP

March 16, 1998
Arlington, Virginia

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
BALANCE SHEET

ASSETS	As of December 31,	
	1997	1996
CURRENT ASSETS		
Cash	\$ 23,364,834	\$ 15,712,258
Accounts receivable	1,071,278	2,561,975
Transfers receivable—surplus Federal Reserve Bank earnings (Note 1)	652,913,560	659,862,602
Prepaid expenses and other assets	992,096	2,247,391
Total current assets	678,341,768	680,384,226
PROPERTY, BUILDINGS, AND EQUIPMENT, NET (Note 4)	64,220,105	61,110,184
Total assets	\$742,561,873	\$741,494,410
LIABILITIES AND FUND BALANCE		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	\$ 9,797,829	\$ 10,435,545
Accrued payroll and related taxes	7,609,781	6,804,678
Transfers payable—surplus Federal Reserve Bank earnings (Note 1)	652,913,560	659,862,602
Accrued annual leave	7,477,187	6,966,327
Capital lease payable (current portion)	98,772	0
Unearned revenues and other liabilities	2,016,190	2,263,338
Total current liabilities	679,913,319	686,332,490
CAPITAL LEASE PAYABLE (non-current portion)	516,228	0
ACCUMULATED RETIREMENT BENEFIT OBLIGATION (Note 2)	740,497	466,056
ACCUMULATED POSTRETIREMENT BENEFIT OBLIGATION (Note 3)	20,193,034	18,171,722
ACCUMULATED POSTEMPLOYMENT BENEFIT OBLIGATION (Note 3)	1,769,646	1,409,343
FUND BALANCE	39,429,149	35,114,799
Total liabilities and fund balance	\$742,561,873	\$741,494,410

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,	
	1997	1996
BOARD OPERATING REVENUES		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures.....	\$ 174,406,600	\$ 162,642,400
Other revenues (Note 5).....	9,460,475	9,789,141
Total operating revenues	183,867,075	172,431,541
BOARD OPERATING EXPENSES		
Salaries	108,870,919	106,353,644
Retirement and insurance contributions.....	19,835,377	18,417,943
Contractual services and professional fees	10,735,745	11,159,490
Depreciation and net losses on disposals.....	9,306,428	8,626,785
Travel	4,680,031	4,942,020
Equipment and facilities rental.....	4,291,093	4,356,715
Postage and supplies	4,261,161	4,263,382
Utilities	4,172,795	4,189,203
Software	4,130,603	3,907,874
Repairs and maintenance	2,895,097	3,417,539
Printing and binding	2,707,738	2,665,188
Other expenses (Note 5).....	3,665,738	4,354,734
Total operating expenses	179,552,725	176,654,517
BOARD OPERATING REVENUES OVER (UNDER) EXPENSES	4,314,350	(4,222,976)
ISSUANCE AND REDEMPTION OF FEDERAL RESERVE NOTES		
Assessments levied on Federal Reserve Banks for currency costs	363,738,623	403,232,215
Expenses for currency printing, issuance, retirement, and shipping	363,738,623	403,232,215
CURRENCY ASSESSMENTS OVER (UNDER) EXPENSES	0	0
TOTAL REVENUE OVER (UNDER) EXPENSES	4,314,350	(4,222,976)
FUND BALANCE, Beginning of year.....	35,114,799	39,337,775
TRANSFERS TO THE U.S. TREASURY		
Transfers and accrued transfers from surplus Federal Reserve Bank earnings (Note 1)	20,765,972,296	5,623,716,034
Transfers and accrued transfers to the U.S. Treasury (Note 1)	(20,765,972,296)	(5,623,716,034)
FUND BALANCE, End of year.....	\$ 39,429,149	\$ 35,114,799

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

	For the years ended December 31,	
	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES		
Board operating revenues over (under) expenses	\$ 4,314,350	\$ (4,222,976)
Adjustments to reconcile operating revenue over (under) expenses to net cash provided by operating activities:		
Depreciation and net losses on disposals	9,306,428	8,626,785
Decrease (increase) in transfers receivable—surplus Federal Reserve Bank earnings	6,949,042	(659,862,602)
Increase in accumulated postretirement benefits	2,021,312	1,097,134
Increase in accumulated retirement benefits	274,441	466,056
Increase in accumulated postemployment benefits	360,303	315,943
Decrease (increase) in accounts receivable, prepaid expenses, and other assets	2,745,993	(1,684,189)
Increase in accrued annual leave	510,860	365,323
(Decrease) increase in accounts payable and accrued liabilities	(637,716)	2,855,174
(Decrease) increase in transfers payable—surplus Federal Reserve Bank earnings	(6,949,042)	659,862,602
Increase in payroll payable and related taxes	805,103	1,936,181
(Decrease) increase in unearned revenues and other liabilities	(247,148)	78,456
Net cash provided by operating activities	19,453,926	9,833,887
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from disposals of furniture and equipment	18,301	70,500
Capital expenditures	(11,819,651)	(10,334,324)
Net cash used in investing activities	(11,801,350)	(10,263,824)
NET INCREASE (DECREASE) IN CASH	7,652,576	(429,937)
CASH BALANCE, Beginning of year	15,712,258	16,142,195
CASH BALANCE, End of year	\$23,364,834	\$ 15,712,258
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Capital lease obligations incurred	\$ 615,000	\$ 0

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 1996 disclosures have been reclassified to conform with the 1997 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 Plan is a multiemployer plan that 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 1997 and 1996, 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 \$98,000 and \$201,500 in 1997 and 1996 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 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. The net periodic pension cost for the BEP for 1997 and 1996 included the following components:

	1997	1996
Service cost (benefits attributed to employee services during the year)	\$133,331	\$260,868
Interest cost on projected benefit obligation	81,060	102,594
Amortization of unrecognized net liability	102,594	102,594
Amortization of unrecognized prior service cost	(13,490)	0
Amortization of unrecognized net (gain)/loss	(29,054)	0
Net periodic pension cost	<u>\$274,441</u>	<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 7.25 percent discount rate and average compensation growth of 5 percent.

The FAS 87 accumulated benefit obligation at December 31, 1997, comprises:

	<u>1997</u>	<u>1996</u>
Accumulated benefit obligation		
Vested	\$ 329,000	\$ 218,000
Nonvested	20,000	21,000
Total	<u>\$ 349,000</u>	<u>\$ 239,000</u>
Plan assets at fair value	\$ 0	0
Less: Actuarial present value of projected benefit obligation	<u>(527,980)</u>	<u>(1,589,924)</u>
Projected benefit obligation in excess of plan assets	(527,980)	(1,589,924)
Less: Unrecognized net transition obligation ...	1,260,447	1,363,041
Unrecognized prior service cost ..	(996,371)	(190,000)
Unrecognized net (gain)/loss ...	<u>(476,593)</u>	<u>(49,173)</u>
Unfunded pension cost ..	<u>\$ (740,497)</u>	<u>\$ (466,056)</u>

The liability as of December 31, 1997, was determined using a 7.25 percent discount rate and average compensation growth of 5 percent. 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 \$4,771,700 in 1997 and \$4,644,100 in 1996.

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 1997 and 1996 included the following components:

	<u>1997</u>	<u>1996</u>
Service cost (benefits attributed to employee services during the year)	\$ 154,474	\$ 195,016
Interest cost on accumulated postretirement benefit obligation	1,474,782	1,461,103
Amortization of gains and losses	112,493	372,253
Curtailement effect	<u>1,174,489</u>	<u>0</u>
Net periodic postretirement benefit cost	<u>\$2,916,238</u>	<u>\$2,028,372</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, 1997 and 1996, comprises:

	<u>1997</u>	<u>1996</u>
Retirees	\$16,959,528	\$14,393,309
Fully eligible active plan participants	3,574,930	3,512,825
Other active plan participants	<u>2,439,440</u>	<u>3,422,992</u>
	22,973,898	21,329,126
Unrecognized net loss	<u>(2,780,864)</u>	<u>(3,157,404)</u>
Liability for accumulated postretirement benefit obligation	<u>\$20,193,034</u>	<u>\$18,171,722</u>

The liability for the accumulated postretirement benefit obligation and the net periodic benefit cost were determined using a 7.25 percent discount rate. Unrecognized losses of \$2,780,864 result from changes in the discount rate used to measure the 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 1997 to 1998 was 9.5 percent. These rates were assumed to gradually decline to an ultimate rate of 5.0 percent in the year 2005 for the purpose of calculating the December 31, 1997, 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 \$1,777,007 at December 31, 1997, and the net periodic benefit cost by \$172,488 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. 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 during the year, comprising \$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 \$3,667,300 and \$3,553,400 in 1997 and 1996 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,	
	1997	1996
Land and improvements ...	\$ 1,301,314	\$ 1,301,314
Buildings	65,611,228	65,343,600
Furniture and equipment	63,486,071	55,102,012
	<u>130,398,613</u>	<u>121,746,926</u>
Less accumulated depreciation	(66,178,508)	(60,636,742)
Total property, buildings and equipment	<u>\$ 64,220,105</u>	<u>\$ 61,110,184</u>

Furniture and equipment and accumulated depreciation as of December 31, 1997, includes \$615,000, and \$0, respectively for capitalized leases, which were acquired during 1997.

(5) OTHER REVENUES AND OTHER EXPENSES

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

	For the years ended December 31,	
	1997	1996
Other Revenues		
Data processing revenue	\$5,184,075	\$4,612,476
National Information Center	2,156,191	1,974,295
Subscription revenue	1,394,394	1,583,193
Reimbursable services to other agencies .	399,426	424,940
Miscellaneous	<u>326,389</u>	<u>1,194,237</u>
Total Other Revenues	<u>\$9,460,475</u>	<u>\$9,789,141</u>
Other Expenses		
Tuition, registration, and membership fees	\$1,118,683	\$1,290,090
Cafeteria operations, net	794,019	870,429
Subsidies and contributions ...	653,207	646,194
Miscellaneous	<u>1,099,833</u>	<u>1,548,021</u>
Total Other Expenses	<u>\$3,665,742</u>	<u>\$4,354,734</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, 1997, are as follows:

1998	\$ 3,689,825
1999	3,707,625
2000	3,965,158
2001	3,948,759
after 2001	<u>13,215,854</u>
	<u>\$28,527,221</u>

Rental expenses under the operating leases were \$3,960,400 and \$3,930,700 in 1997 and 1996 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 1997 and 1996, the Board paid \$228,200 and \$224,600 respectively in assessments for operating expenses of the Council. These amounts are included in subsidies and contributions for 1997 and 1996. During 1997 and 1996, the Board paid \$157,800 and \$127,100 respectively for office space subleased from the Council. ■