

Annual Report: Budget Review

Board of Governors of the Federal Reserve System

2005

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Introduction

The Federal Reserve System consists of the Board of Governors in Washington, D.C., the twelve Federal Reserve Banks with their twenty-five Branches distributed throughout the nation, the Federal Open Market Committee (FOMC), and three advisory groups—the Federal Advisory Council, the Consumer Advisory Council, and the Thrift Institutions Advisory Council. The System was created in 1913 by Congress to establish a safe and flexible monetary and banking system. Over the years, Congress has given the Federal Reserve more authority and responsibility for achieving broad national economic and financial objectives.

As the nation's central bank, the Federal Reserve has many, varied responsibilities. It acts to ensure that the nation's economy grows at a pace consistent with price stability; it serves as the nation's lender of last resort, with responsibility for forestalling national liquidity crises; and it is involved in bank supervision and regulation, with responsibilities for bank holding companies, financial holding companies (created under the Gramm-Leach-Bliley Act, enacted in November 1999), state-chartered banks that are members of the Federal Reserve System, the foreign activities of U.S. banks, and the U.S. activities of foreign banks. The Federal Reserve also administers the nation's financial consumer protection laws.

The Federal Reserve System plays a major role in the nation's payment mechanism. The Reserve Banks distribute currency and coin; process Fedwire, automated clearinghouse, and securities transfers; and process checks. In addition, the Federal Reserve Banks serve as the

fiscal agents of the United States and provide a variety of financial services for the Treasury, other government agencies, and other fiscal principals. For a fuller discussion of the Federal Reserve's responsibilities, see the Board publication *The Federal Reserve System: Purposes and Functions*.

Summary of 2004 Income and Expenditures

In carrying out its responsibilities in 2004, the Federal Reserve System incurred an estimated \$1.6 billion in net operating expenses. Total spending of an estimated \$2.9 billion was offset by an estimated \$1.3 billion in revenue from priced services, claims for reimbursements, and other income.

The major source of Federal Reserve income is earnings from the portfolio of U.S. government securities in the System Open Market Account, estimated at \$22.3 billion in 2004. Earnings in excess of expenses, dividends, and surplus are transferred to the U.S. Treasury—in 2004 an estimated \$18.1 billion. (These earnings are treated as receipts in the U.S. budget accounting system and as anticipated earnings projected by the Office of Management and Budget in the U.S. budget.)

Beginning with the 1998–99 budget, the Board of Governors has operated on a two-year budget cycle and a four-year planning cycle. Given their current business needs, the Federal Reserve Banks maintain an annual budget cycle. For more information on the budget processes, see appendix A.

Operational Areas

In 2004 the Federal Reserve System accounted for costs using the following categories—monetary and economic policy, supervision and regulation of financial institutions, services to financial institutions and the public, services to the U.S. Treasury and other government agencies, and System policy direction and oversight.

Monetary and Economic Policy

The monetary and economic policy operational area encompasses Federal Reserve actions to influence the availability and cost of money and credit in the nation's economy. In 2004, the FOMC held eight regularly scheduled meetings and adjusted the federal funds rate five times.

A vast amount of banking and financial data flows through the Reserve Banks to the Board, where it is compiled and made available to the public. The research staffs at the Board and the Reserve Banks use these data, along with information collected by other public and private institutions, to assess the state of the economy and the relationships between the financial markets and economic activity. Staff members provide background information for the Board of Governors and for each meeting of the FOMC by preparing detailed economic and financial analyses and projections for the domestic economy and international markets. The Board and the FOMC use these analyses and projections in setting reserve requirements, setting the discount rate (which affects the cost of borrowing), and conducting open market operations. Staff members also conduct longer-run economic studies on regional, national, and international issues.

Supervision and Regulation

The Federal Reserve System plays a major role in the supervision and regulation of banks and bank holding companies. The Board of Governors adopts regulations to carry out statutory directives and establishes System supervisory and regulatory policies; the Reserve Banks conduct on-site examinations and inspections of state member banks and bank holding companies, review applications for mergers, acquisitions, and changes in control from banks and bank holding companies, and take formal supervisory actions. In 2004, the Federal Reserve conducted 581 examinations of state member banks (some of them jointly with state agencies) and 491 inspections and 3,340 risk assessments of bank holding companies; it acted on 2,548 international and domestic applications.

The Board also enforces state member banks' and certain foreign banking organizations' compliance with the federal laws protecting consumers in their use of credit and deposit products. Between July 1, 2003, and June 30, 2004, the System conducted 329 consumer compliance examinations, including 305 covering state member banks and 24 covering foreign banking organizations. Additionally, during the 2004 reporting period, the System performed 242 Community Reinvestment Act examinations.

The Board's supervisory responsibilities also extend to the foreign operations of U.S. banks and, under the International Banking Act, to the U.S. operations of foreign banks. Beyond these activities, the Federal Reserve maintains continuous oversight of the banking industry to ensure the overall safety and soundness of the financial system. This broader responsibility is reflected in the System's presence in financial markets, through open market operations, and in the Fed-

eral Reserve's role as lender of last resort.

Services to Financial Institutions and the Public

The Federal Reserve System plays a central role in the nation's payment systems by ensuring that enough currency and coin are in circulation to meet the public's demand. The Bureau of Engraving and Printing prints currency and the U.S. Mint mints coin that the Reserve Banks distribute to the public through depository institutions. Reserve Banks also receive deposits of currency and coin from depository institutions, identify suspect currency that they forward to the U.S. Secret Service, and destroy currency that is unfit for circulation. In 2004, the Reserve Banks received approximately \$656.2 billion in currency and \$5.4 billion in coin from depository institutions, distributed approximately \$686.4 billion in currency and \$6.4 billion in coin, and destroyed \$90.9 billion in unfit currency.

The Reserve Banks also play a central role in the nation's payment systems by processing paper checks and providing a variety of electronic services for depository institutions. In 2004, the Reserve Banks collected approximately 13.8 billion commercial checks, with a total value of about \$15.1 trillion. The Reserve Banks' automated clearinghouse (ACH) service allows depository institutions to send or receive credit and debit payment transactions. ACH payments are typically used for check payments, such as payroll, dividend, mortgage, and bill payments. In 2004, the Reserve Banks processed approximately 7.4 billion ACH transactions, valued at about \$15.5 trillion. Approximately 12.5 percent of the transactions were for the federal government; the rest were for commercial establishments.

The Reserve Banks' Fedwire Funds

Service allows depository institutions to draw on their reserve or clearing balances at the Reserve Banks and to transfer funds to other institutions that maintain accounts at the Reserve Banks. In 2004, the Reserve Banks processed approximately 125 million Fedwire funds transfers, valued at about \$470 trillion.

The Reserve Banks' National Settlement Service allows participants in private clearing arrangements to settle transactions through reserve or clearing account balances. Approximately 60 local and national private arrangements, primarily check clearinghouse associations but also other types of arrangements, use the National Settlement Service. In 2004, the Reserve Banks processed over 434,000 settlement entries for these arrangements.

The Reserve Banks' Fedwire Securities Service provides securities services for the handling of book-entry (computer-based) securities and the collection of physical interest coupons and miscellaneous items. The service allows participants to electronically transfer to other participants securities issued by the Treasury, federal government agencies, and other approved entities. In 2004, participants originated approximately 21 million transfers valued at about \$322 trillion. The noncash collection service, through which maturing or called municipal coupons and bonds are presented for collection, processed about 211,000 transactions in 2004. In February 2005, the Board approved a plan to withdraw from the noncash service by the end of 2005. The Reserve Banks will stop accepting deposits September 30, 2005, and withdrawal from this service will be complete on December 30, 2005.

Services to the U.S. Treasury and Other Government Agencies

The Reserve Banks provide fiscal agency

and depository services to the U.S. government. Through deposit accounts at Reserve Banks, the government issues checks, makes payments, and collects receipts. The Reserve Banks also process Fedwire funds transfers and automated clearinghouse payments and provide the Treasury with daily statements of account activity. In 2004, Reserve Banks provided claims for reimbursement of approximately \$368 million to the Treasury, other government agencies, and other fiscal principals that are billed to these agencies for the full cost of providing these services; reimbursement was received or is expected for all of the expenses incurred.

Reserve Banks provide the Department of the Treasury with services related to the federal debt. For example, Reserve Banks issue, service, and redeem marketable Treasury securities and savings bonds; they also process secondary-market Fedwire securities transfers initiated by depository institutions. In 2004, the Reserve Banks processed nearly 48,000 competitive and noncompetitive bids for Treasury securities and printed and mailed more than 36 million savings bonds. The Reserve Banks operate two book-entry (computer-based) securities systems for the custody of Treasury securities—the Fedwire book-entry securities system and TreasuryDirect. Almost all book-entry Treasury securities are maintained on Fedwire, which is also the nation’s principal securities transfer mechanism; the remainder are maintained on TreasuryDirect, which is used primarily by individuals.

Reserve Banks collect and disburse funds on behalf of the federal government. The Reserve Banks maintain the Treasury’s funds account, accept deposits, pay checks drawn on the Treasury’s account, and make Fedwire and automated clearinghouse payments on behalf of the Treasury. In 2004, the Reserve

Banks continued to assist Treasury in its efforts to increase the use of electronic payment vehicles. For example, the Reserve Banks operate the Pay.gov Internet portal, which permits the public to pay Treasury and agencies through the Internet.

The Reserve Banks also invest excess Treasury balances with more than 1,100 depository institutions, which pay interest to Treasury for the use of the funds. In 2004, the Reserve Banks invested \$1.4 trillion of Treasury balances through the program. Some of these funds are callable on demand and pay interest equal to the federal funds rate less 25 basis points. The Reserve Banks also place Treasury funds with depository institutions for a set term, with the interest rate set at auction.

The Reserve Banks also provide fiscal agency and depository services to other domestic and international entities. Depending on the authority under which the services are provided, the Reserve Banks may maintain book-entry accounts of securities, provide custody for the stock of unissued, definitive (physical) securities, maintain and update balances of outstanding book-entry and definitive securities for issuers, and maintain related funds accounts.

System Policy Direction and Oversight

This operational area encompasses activities by the Board of Governors in supervising Board and Reserve Bank programs. At the System level, the expenses for these activities are considered overhead and are therefore allocated across the other operational areas. At the Board level, these expenses are not treated as overhead nor allocated to other operational areas. ■

The Budgets

Chapter 1

Federal Reserve System

For 2005, total operating expenses are budgeted at \$2,933.8 million, an increase of 2.7 percent from estimated 2004 expenses. Of this total, \$2,663.1 million is for the Reserve Banks, and \$270.7 million is for the Board of Governors (tables 1.1 and 1.2).¹ Revenue from priced services provided to depository institutions is expected to total \$901.7 million, or 30.7 percent of total budgeted operating expenses. This revenue, combined with claims for reimbursement and other income, results in projected net operating expenses of \$1,606.2 million.²

1. The Board of Governors budgets on a two-year cycle; in this chapter, 2005 values shown for the System and the Board reflect the estimated second-year effect of the Board's 2004–05 budget.

2. *Claims for reimbursement* refers to costs of fiscal agency and depository services provided to the U.S. Treasury, other government agencies, and other fiscal principals that are billed to these agencies. *Other income* comes from services provided on behalf of the U.S. Treasury that are paid

The System expects to recover 45.2 percent of its budgeted 2005 operating expenses through revenue from priced services, other income, and claims for reimbursement. When these items are deducted from budgeted 2005 operating expenses, the net expenses of the System show an increase of 3.1 percent from estimated 2004 net operating expenses (table 1.1).

Not included in the budget for operations is the cost of currency, budgeted at \$532.9 million for 2005, an increase of 4.1 percent from the 2004 estimated cost of \$512.1 million.³ The distribution of expenses is similar to that in previous

for by the depository institutions using the services, which include the transfer of funds between depository institutions and the Treasury.

3. The Federal Reserve pays for the printing of new currency at the Bureau of Engraving and Printing. This cost is not included in the Federal Reserve operating expenses. For more information, see appendix C, "Currency Budget."

Table 1.1

Operating Expenses of the Federal Reserve System, Net of Receipts and Claims for Reimbursement, 2002–04

Millions of dollars, except as noted

Item	2003 (actual)	2004 (estimated)	2005 (budgeted)	Percent change	
				2003–04	2004–05
Total System operating expenses	2,865.3	2,856.8	2,933.8	-0.3	2.7
LESS					
Revenue from priced services	881.7	913.6	901.7	3.6	-1.3
Other income	0.8	1.0	1.0	25.0	0.0
Claims for reimbursements ¹	327.5	384.9	424.9	17.5	10.4
EQUALS					
Net System operating expenses	1,655.3	1,557.3	1,606.2	-5.9	3.1

NOTE. Components may not sum to totals and may not yield percentages shown because of rounding.

Operating expenses reflect all redistributions for support and overhead, and they exclude capital outlays.

1. Costs of fiscal agency and depository services provided to the U.S. Treasury, other government agencies, and other fiscal principals that are billed to these agencies.

Table 1.2

Expenses of the Federal Reserve System for Operations and Currency, 2003–05

Millions of dollars, except as noted

Item	2003 (actual)	2004 (estimated)	2005 (budgeted)	Percent change	
				2003–04	2004–05
Reserve Banks ¹	2,602.5	2,581.1	2,663.1	-1.5	3.2
Personnel	1,679.1	1,611.2	1,719.8	-0.8	3.2
Nonpersonnel	941.4	914.9	943.3	-2.8	3.1
Board of Governors ²	244.8	275.7	270.7	12.6	-1.8
Personnel	182.9	197.5	199.1	8.0	0.8
Nonpersonnel	61.9	78.2	71.6	26.4	-8.5
Total System operating expenses	2,865.3	2,856.8	2,933.8	-0.3	2.7
Personnel	1,862.0	1,863.7	1,918.9	0.1	3.0
Nonpersonnel	1,003.3	993.1	1,014.9	-1.0	2.2
Currency ³	514.0	512.0	533.0	-0.4	4.1

NOTE. Components may not sum to totals and may not yield percentages shown because of rounding.

Operating expenses include costs for special projects and exclude capital outlays.

1. For detailed information on Reserve Bank expenses, see chapter 3.

2. Includes extraordinary items and expenses of the Office of Inspector General. See also chapter 2.

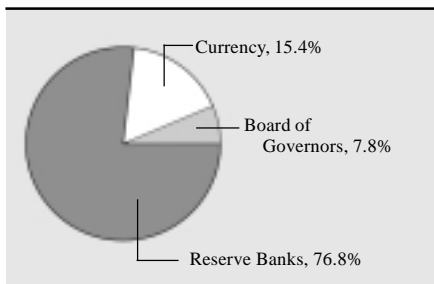
3. See appendix C.

years, with the Reserve Banks' expenses accounting for 77 percent of the total, currency expenses accounting for 15 percent, and Board expenses accounting for the remainder (chart 1.1).

System employment is budgeted at 21,822 for 2005, a decrease of 1,160 from the estimated 2004 level, largely because of planned staff reductions by the Reserve Banks, primarily in the check and support areas.

Chart 1.1

Distribution of Expenses of the Federal Reserve System, 2005



2005 System Budget Initiatives

In response to the continuing decline in check volume, the Reserve Banks have again established aggressive spending targets for their 2005 budgets. This spending restraint reflects the Banks' efforts to reduce direct operating costs of the check service, as well as Bank support and overhead costs, in keeping with a business and operational strategy to meet the System's long-term financial and payment system objectives. The strategy focuses on reducing check-service operating costs by streamlining management and administrative structures, decreasing the number of check-processing locations, and increasing processing capacity at some locations. The Banks' 2005 budget plans also fund other high-priority payment system objectives, such as consolidations in Reserve Bank marketing and customer support and in Treasury's retail securities operations. The major factors affecting the 2005 Reserve Bank budgets are outlined in more detail in chapter 3.

Trends in Expenses and Employment

From actual 1996 levels to budgeted 2005 amounts, the operating expenses of the Federal Reserve System have increased an average of 3.5 percent per year (1.8 percent per year when adjusted for inflation) (chart 1.2). Over the same period, nondefense discretionary spending by the federal government has increased an annual average of 6.4 percent (chart 1.3). Over the 1996–2005 period, Federal Reserve System employment has decreased 3,399 (chart 1.4).

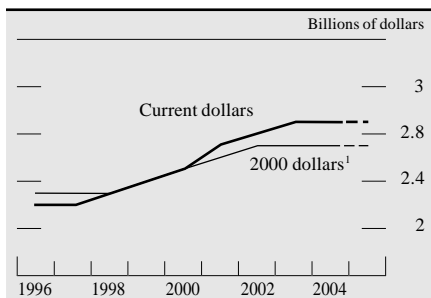
As mentioned above and detailed in chapter 3, the primary factors in Reserve Bank spending restraint and in the substantial staffing decreases are restructuring efforts in the check-processing function and efficiency measures in support and overhead functions. Over the same ten-year period, check costs increased by 2.6 percent and staffing levels declined by 1.6 percent. Support and overhead costs decreased by 0.9 percent and staffing levels declined by 4.4 percent.

2005 Capital Budgets

The capital budget for the Reserve Banks and the Board totals \$463.9 million; \$430.5 million budgeted for Reserve

Chart 1.2

Operating Expenses of the Federal Reserve System, 1996–2005

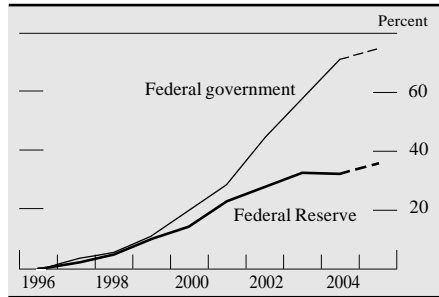


NOTE. For 2004, estimated; for 2005, budgeted.
1. Calculated with the GDP price deflator.

Chart 1.3

Cumulative Change in Federal Reserve System Expenses and Federal Government Expenses, 1996–2005

Includes special projects



NOTE. Federal government expenses are discretionary spending less expenditures on defense.

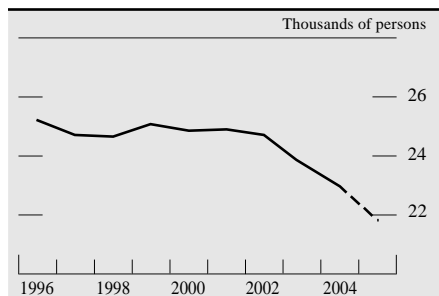
For 2004, estimated; for 2005, budgeted.

Banks and Federal Reserve Information Technology (FRIT) and \$33.4 million budgeted for the Board. As in previous years, the 2005 capital budgets include funding for projects that support the strategic direction outlined by the individual Reserve Banks, System business leaders, and the Board. These strategic goals focus on investments that improve operational efficiencies and services to Bank customers and on providing a safe, quality work environment. More detailed discussions of the Board and Reserve Bank capital budgets are included in chapters 2 and 3, respectively. ■

Chart 1.4

Employment in the Federal Reserve System, 1996–2005

Includes special projects



NOTE. For 2004, estimated; for 2005, budgeted.

Chapter 2

Board of Governors

Every two years, the Board and its senior staff undertake a process that produces a four-year strategic plan and a biennial budget. For the 2004–07 planning period and the 2004–05 budget period, the Committee on Board Affairs, assisted by a senior-level Staff Planning Group (SPG) and staff in the Planning and Budget Section of the Management Division, guided the process. During 2004, the first year of the current budget period, a number of minor reallocations were made within the 2004–05 approved operations budget. The operations budget was also decreased \$0.8 million in accordance with the Board’s policy on software capitalization. An additional \$4.28 million was added to the capital budget for enhanced Board perimeter security and for the software capitalization.

The revised 2004–05 budget for the Board consists of \$527.8 million for operations, \$10.0 million for extraordinary items (projects of a unique nature), and \$8.5 million for the Office of Inspector General (OIG). The Board has authorized 1,948 staff positions and 31 positions for the OIG; no positions are required for the extraordinary items.

Planning Issues

The Staff Planning Group reviewed the planning materials submitted by the Board’s divisions and offices and identified the following major issues that will have Boardwide impact over the planning period:

- strategic human resource issues, including support for efforts to attract and retain highly qualified staff
- information technology initiatives that provide the public with improved

- access to Board data and information
- legislation and support for initiatives, such as Basel II
- physical and information security and continuity of operations
- investments in facilities

These issues are reflected in the resource-allocation decisions of the Committee on Board Affairs that are the basis of the approved budget. They will also serve as the basis for the 2004–05 performance plan prepared as part of the Board’s voluntary compliance with the Government Performance and Results Act.

Major Initiatives

To address these major planning issues, the approved budget includes the following initiatives and projects for the 2004–05 period.

- *Attract and retain staff.* Initiatives to improve the Board’s ability to attract and retain staff include the variable-pay program for economists, attorneys, and officers; a 4.1 percent merit increase for 2004 and a 3.8 percent merit increase for 2005; and actions to enhance productivity and meet new requirements, such as acquiring improved information technology equipment, providing access to enhanced data sets, and slightly increasing staff to assist with current analysis.
- *Information technology (IT).* Funding is provided for the Board to comply with e-government initiatives such as improved public access to data, enhanced information security, and section 508 compliance.

- *Workload.* A small increase in the number of positions, a reallocation of positions to meet higher-priority requirements, and the filling of a number of vacant positions are necessary to comply with new laws that affect Board operations, such as the Federal Information Security Management Act; to fulfill expanded supervisory responsibilities under the Sarbanes-Oxley Act; and to prepare for Basel II and other key initiatives.
- *Security and continuity of operations.* Funding to hire and train armed security staff authorized during the 2002–03 biennium, and other actions to enhance employee safety and the Board’s ability to operate in a contingency environment, added significantly to the budget.
- *Facilities.* In line with the Board’s strategic plan, capital investments are planned for the three Board facilities, as discussed below in the section on the capital budget. Additional non-capital improvements are also planned at all three facilities.

Areas of Risk

Despite a careful and coordinated planning effort, future developments such as the following could require resources beyond what is currently approved:

- significant changes in or shocks to the economy or the financial system that create a material increase in workload
- terrorist activity requiring additional security and contingency enhancements
- a decision to fund a major Systemwide supervisory technology initiative such as the Shared National Credit Program
- increased workload created by laws or decisions to expand or modify central bank operations

- changes to the position-vacancy-rate assumptions used in developing the salary budget and a need for more office space if the staff increases

Operations Budget by Operational Area

The Board’s operations budget supports four broadly defined operational areas: monetary and economic policy, supervision and regulation, services to financial institutions and the public, and Federal Reserve System policy direction and oversight (tables 2.1 and 2.2). The following is a summary discussion of the resources, including support and overhead, budgeted for each area for 2004–05.

Monetary and Economic Policy

The revised 2004–05 budget for the monetary and economic policy function is \$211.1 million, an increase of \$21.0 million, or an average of 5.4 percent per year. Activities in this operational area include the Board’s monitoring and analysis of developments in the money and credit markets, the setting of reserve requirements, the approval of changes in the discount rate, and other activities related to managing the nation’s monetary policy.

Besides the additional funding for compensation initiatives, increases in this area will cover the acquisition of additional data to assist staff. These data relate to credit risk, retail banking fees and services, global financial markets, and consumer credit.

Supervision and Regulation

The revised 2004–05 budget for the supervision and regulation function is \$220.4 million, an increase of \$25.1 million, or an average of 6.2 percent per year.

Table 2.1

Expenses of the Board of Governors for Operational Areas, Extraordinary Items, and Office of Inspector General, 2002–05

Thousands of dollars, except as noted

Operational area, extraordinary items, or Office of Inspector General	2002–03 (budgeted)	2002–03 (actuals)	2004–05 (revised budget)	Average annual percent change	
				2002–03 actuals compared with 2002–03 budgeted	2004–05 revised budget compared with 2002–03 actuals
Monetary and economic policy ..	190,057	189,683	211,072	–0.1	5.4
Supervision and regulation	195,354	189,789	220,415	–1.4	6.2
Services to financial institutions and the public	9,045	8,929	10,397	–0.6	7.2
System policy direction and oversight	77,696	76,784	85,925	–0.6	5.2
Total, Board operations	472,152	465,185	527,809	–0.7	5.7
Extraordinary items	1,500	1,907	10,000	12.8	158.2
Office of Inspector General	7,757	7,286	8,533	–3.1	4.9

NOTE: Operating expenses reflect all redistributions for support and allocations for overhead, and they exclude capital outlays. Components may not sum to totals and may not yield percentages shown because of rounding.

Table 2.2

Positions Authorized at the Board of Governors, for Operational Areas, Support and Overhead, and Office of Inspector General, 2002–05

Operational area, extraordinary items, or Office of Inspector General	2002–03 (budgeted)	2002–03 (actuals)	2004–05 (revised budget)	Average annual percent change	
				2002–03 actuals compared with 2002–03 budgeted	2004–05 revised budget compared with 2002–03 actuals
Monetary and economic policy ..	433	460	433	3.1	–3.0
Supervision and regulation	381	432	399	6.5	–3.9
Services to financial institutions and the public	22	41	25	36.5	–21.9
System policy direction and oversight	163	161	170	–0.6	2.8
Support and overhead ¹	691	678	894	–0.9	14.8
Subtotal	1,690	1,772	1,921	2.4	4.1
Reimbursable IRM support ²	25	27	27	3.9	0.0
Total, Board operations	1,715	1,799	1,948	2.4	4.1
Extraordinary items
Office of Inspector General	29	31	31	3.4	0.0

1. Includes seventeen youth positions, ten worker trainee positions, and four summer intern positions.

2. Positions in the Division of Information Technology that provide support to the Federal Financial Institu-

tions Examination Council for processing data collected under the Home Mortgage Disclosure Act and the Community Reinvestment Act.

Activities in this area include working with other federal and state financial authorities to ensure safety and soundness in the operation of financial institutions, stability in the financial markets, development of guidance related to regulatory capital and risk management, and fair and equitable treatment of consumers in their financial transactions. The 2004–05 budgetary increases will enhance supervisory activities such as monitoring, inspecting, and examining banking organizations to assess their condition and their compliance with relevant laws and regulations as well as the development of supervisory guidance that addresses an increasingly complex financial environment and risk-management techniques. Programmatic increases include funding for positions added in late 2003, greater focus on money-laundering activities, the development of a revised international capital accord, international training and assistance to foreign governments, and a review of regulations and policies related to consumer protection. As risk-management processes and financial transactions become increasingly complex, staff will need to spend more time on complex bank examinations, monitoring new risk-management practices and ensuring that proper controls are in place at all financial institutions that are supervised by the Federal Reserve.

Services to Financial Institutions and the Public

The revised 2004–05 budget for oversight of Reserve Bank services to financial institutions and the public is \$10.4 million, an increase of \$1.3 million, or an average of 7.2 percent per year. This increase, aside from compensation and security initiatives, is primarily due to the development of the Cash Statistical Data System.

System Policy Direction and Oversight

The revised 2004–05 budget for System policy direction and oversight is \$85.9 million, an increase of \$8.2 million, or an average increase of 5.2 percent per year. Aside from compensation initiatives, this increase is due to the continued focus on security and contingency planning.

Capital Budget

The Board's revised 2004–05 capital budget is \$33.4 million. Of this total, \$20.0 million is for continued security enhancements and major building projects. Major facility projects include perimeter security enhancements, a fire sprinkler system, design for a Martin Building renovation, building security and office reconfigurations, and a new access control system to improve monitoring of individuals as they enter Board facilities.

Information technology projects, including server replacements, network infrastructure, and data security enhancements, will cost \$4.6 million. Another \$6.8 million is for nonautomation projects such as enhancements to the Board's web site and a new telephone system. The remaining \$2.0 million is for a new mainframe, software, furniture, and other miscellaneous items.

Positions

For the revised 2004–05 budget period, staffing requests resulted in a net increase of 58 positions in the Board's position authorization, bringing the total to 1,948 positions (see appendix D, table D.2).

Fifteen positions were added for more advanced and quantitative approaches to risk management and measurement; Basel II Accord development and implementation; corporate governance, internal con-

trol, accounting, and disclosure enhancements; the anti-money-laundering program; policy issues; and continuity of bank operations. A net of seven positions were created to monitor systemically important nondepository institutions, oversee operation of the discount window across the System, and conduct research on financial stability and the role of a central bank at times of market stress.

Fifteen positions were added to eliminate the need for a like number of long-term dual-occupied positions. Eleven positions were added as a result of reorganizations to improve effectiveness and efficiency of operations.

Trends in Expenses and Employment

The rate of increase within the 2004–05 budget is 6.5 percent per year, which is more than the 6.3 percent projected average annual rate of increase since the 1994–95 biennium (chart 2.1). The increase since the 1994–95 biennium is mainly attributable to strategic human-capital initiatives and the increasing complexity of Board work over this period. This increased complexity required a net increase in positions and higher average grades, higher salaries, and increasingly

Chart 2.1
Operating Expenses of the Board of Governors, 1994–2005

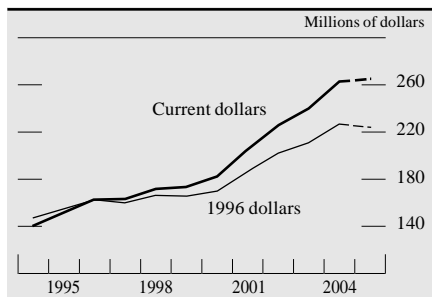
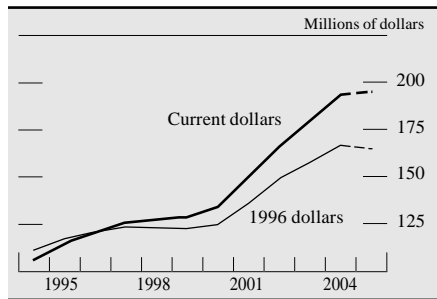


Chart 2.2

Expenses for Personnel Services at the Board of Governors, 1994–2005

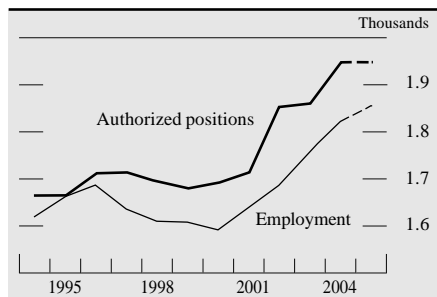


sophisticated automation systems to manage ever-increasing volumes of data. More recently, the Board has experienced sharply higher security and contingency costs.

Approximately three-fourths of the Board's operating expenses are for personnel (chart 2.2); consequently, analysis of trends is heavily tied to staffing levels. From 1994 to 2005, the number of authorized positions for Board operations rose from 1,644 to 1,948, a net increase of 304, or 18.5 percent (chart 2.3).

Chart 2.3

Employment and Authorized Positions at the Board of Governors, 1994–2005



NOTE: Year-end data. Excludes summer intern and youth positions as well as positions for the Office of Inspector General. These positions number 62 for 2004 and 2005. Includes positions that provide support to the Federal Financial Institutions Examination Council for processing data collected under the Home Mortgage Disclosure Act and the Community Reinvestment Act.

Reflecting the growing complexity of the Board's work, the average grade for professional staff rose from 25 to 26.

During the ten-year period, changes in banking, many associated with operations risk, increased the complexity of supervisory safety-and-soundness activities. To adequately perform these activities, and to increase attention to consumer issues, including collection and analysis of data for the Home Mortgage Disclosure Act and Community Reinvestment Act, a net of thirty-four positions were added. (Many positions associated with lower-priority work were eliminated to offset part of the cost of the new work.) The increasing complexity of monetary policy issues resulted in an increase of thirty-three positions.

There has been substantial change in the overall Reserve Bank environment, including numerous operational consolidations and related changes to the governance process. As a result of these changes, as well as the need to track private-sector clearing and settlement organizations, twenty-seven positions were added.

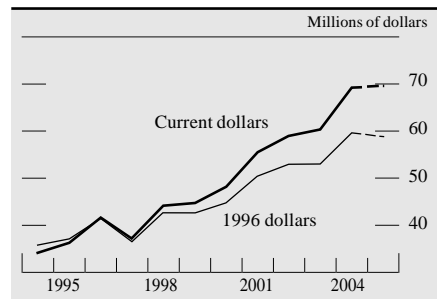
As have other government entities, the Board has significantly increased security in the past several years. Over half of the net increase in positions was attributable to safeguarding the premises and ensuring the safety of personnel.

Finally, a net decrease of five administrative and support positions resulted from the Board's efforts to outsource where feasible. Without these efforts, the number of administrative and support positions would have increased because of enhanced security and the purchase of an office building to replace leased space.

While the number of positions at the Board has fluctuated during the 1994–05 period, the salary budget (not including retirement and insurance benefits) has remained relatively constant at roughly 63 percent of operating expenses. The portion of operating expenses devoted to retirement and insurance has increased

Chart 2.4

Operating Expenses of the Board of Governors, 1994–2005



approximately 1 percentage point over the period as a result of administrative actions to enhance benefits such as the Thrift Plan and because of significant rate increases for health insurance.

Over the 1994–05 period, the average annual increase in expenses for goods and services has been 6.4 percent (chart 2.4). The largest increase was in contractual professional services. This growth resulted primarily from four factors: (1) increased use of contracting services in the divisions of Information Technology, Management, and Banking Supervision and Regulation; (2) significant increases in the amount and cost of data acquired from third parties; (3) procurement of outside legal services, and (4) design work for major construction tied to security. Partially offsetting the overall increase is a significant decrease in rental costs due to the purchase of the New York Avenue building.

Survey Expenses

The Board's extraordinary items budget for 2004–05 provides funds of \$10.0 million for the Survey of Small Business Finances (\$3.3 million) and the Survey of Consumer Finances (\$6.7 million). These surveys, which gather information on the economic behavior of U.S. households and the financial health of U.S. firms, will improve the quality of eco-

conomic analysis produced by the Board. A summary article on the Survey of Consumer Finances is expected to be published in the January 2006 *Federal Reserve Bulletin*, and a version of the survey data will be released to the public shortly thereafter.

OIG's budget is prepared in a manner that is consistent with the preparation of the Board's operating budget. In conformance with the statutory independence of the office, the OIG presents its budget directly to the Chairman of the Board of Governors for consideration by the Board. ■

Office of Inspector General

The 2004–05 budget of \$8.5 million for the Office of Inspector General (OIG) is separate from the Board's budget. The

Chapter 3

Federal Reserve Banks

The 2005 operating budgets of the twelve Reserve Banks total \$2,663.1 million.¹ The 2005 total is \$82.0 million, or 3.2 percent, above estimated 2004 expenses, largely because of a one-time curtailment gain in 2004 (table 3.1). In 2004, the Reserve Banks adopted a change in eligibility criteria for post-retirement medical benefits. In accordance with generally accepted accounting principles (FAS 106), a one-time curtailment gain associated with this change will be realized in 2004, totaling approximately \$85 million. When the one-time gain is excluded from the 2004 estimate, 2005 budgeted expenses are \$3.2 million lower than the 2004 estimate. To reflect the 2005 change

in ongoing operating expenses more accurately, data presented in this chapter approximate the expense effect of various initiatives, excluding the effect of this significant one-time event.

The 2005 budget reflects the effect of initiatives to manage cost growth aggressively through operational efficiencies, including additional restructuring and consolidation efforts. These efforts are driven, in large part, by the need to reduce check costs commensurate with declining revenue. Banks have significantly reduced costs in the support functions in an effort to align these functions with a shrinking demand for their services. In 2005, further check restructuring is planned, along with consolidations in Reserve Bank customer support and marketing functions and in Treasury's retail securities operations (TreasuryDirect and savings bonds).

1. These expenses, which are chargeable to the Reserve Banks, include those budgeted by Federal Reserve Information Technology (FRIT) and the System's Office of Employee Benefits (OEB).

Table 3.1

Expenses of the Federal Reserve Banks, Net of Receipts and Claims for Reimbursement, 2004 and 2005

Millions of dollars except as noted

Item	2004 (estimated)	2005 (budgeted)	Change	
			Amount	Percent
Operations	2,581.1	2,663.1	82.0	3.2
LESS				
Revenue from priced services	913.6	901.7	-11.9	-1.3
Other income	1.0	1.0	0.0	0.0
Claims for reimbursement ¹	384.9	424.9	40.0	10.4
EQUALS				
Net expenses	1,281.6	1,335.5	53.9	4.2

NOTE. Excludes capital outlays. Includes expenses budgeted by FRIT and OEB. Expenses from these entities have been charged to the Reserve Banks, as appropriate, and included in their budgets. Components may not sum to totals and may not yield percentages shown because of rounding.

Operating expenses reflect all redistributions for support and allocations for overhead.

1. Costs of fiscal agency and depository services provided to the U.S. Treasury, other government agencies, and other fiscal principals that are billed to these agencies.

Approximately 50 percent of Reserve Bank expenses in the 2005 budget are offset by priced-service revenues (34 percent) and claims for services provided to the Treasury, other government agencies, and other fiscal principals that are billed to these agencies (16 percent). Budgeted 2005 revenue is lower than the 2004 estimated level, primarily as a result of declining check volume, offset slightly by higher imputed net income on clearing balances and electronic-connection revenue. Reimbursable claims will increase 10.4 percent in 2005, reflecting additional efforts by the Reserve Banks on behalf of the Treasury.

Total 2005 projected average number of personnel (ANP) for the Reserve Banks, FRIT, and OEB is 19,967, a decrease of 1,193, or 5.6 percent, from 2004 estimated staff levels (table 3.2).² The 2005 staffing decrease continues the trend of workforce reductions that began in 1999 and is the lowest staffing level since the early 1970s. The 2005 budget reduction reflects Treasury and check-

restructuring efforts, initiatives to increase productivity and efficiency in support and overhead areas, and the full-year effect of early retirement programs offered by most Banks in 2004.

2004 Budget Performance

Total 2004 expenses are estimated to be \$2,581.1 million, which represents a decrease of \$85.3 million, or 3.2 percent, from the approved 2004 budget. The Banks, FRIT, and OEB estimate 2004 ANP at 21,160, a decrease of 140 from budgeted 2004 levels. The expense underrun is due mainly to the \$85.2 million curtailment gain associated with accounting for post-retirement medical benefits discussed above. Reductions in check and cash operations and many support areas also contribute to the decrease. Partially offsetting these savings are increased costs related to additional requests for services by the Treasury.

Estimated 2004 check costs decreased by approximately 3 percent and staffing levels decreased by 78 ANP compared with the 2004 budget as Reserve Banks trimmed staff in response to further volume declines and increased efficiencies. Partially offsetting the decrease

2. ANP is the average number of employees in terms of full-time positions for the period. For instance, a full-time employee who works one-half of the year counts as 0.5 ANP for that calendar year; two half-time employees who work the full year count as 1 ANP.

Table 3.2

Employment at the Federal Reserve Banks, FRIT, and OEB, 2004 and 2005

Average number of personnel except as noted

Item	2004 (estimated)	2005 (budgeted)	Change	
			Amount	Percent
Reserve Banks	20,365	19,168	-1,197	-5.9
Federal Reserve Information Technology	758	759	1	0.1
Office of Employee Benefits	38	40	2	5.3
Total	21,160	19,967	-1,193	-5.6

NOTE. Components may not sum to totals and may not yield percentages shown because of rounding. See text note 2 for definition of *average number of personnel*.

are severance costs included in the estimate related to a midyear decision to undertake a second phase of check restructuring.

Expenses in cash remained flat compared with the original budget. Spending restraint in the cash area has been facilitated by productivity improvements, resulting in a decrease of 52 ANP. In addition, depreciation costs are lower because of a decision to extend the useful life of currency-processing machines. Offsetting these reductions somewhat is an increase in the Standard Cash Automation (SCA) project, a standard software platform that Reserve Banks use to manage their cash operations.

Estimated 2004 support costs were approximately 1 percent lower than budget as Banks continue to reduce support levels. Staffing levels declined by 112 ANP from budgeted levels, largely as a result of efforts to streamline the business development (36 ANP), information technology (12 ANP), and facilities (37 ANP) functions.

Expenses associated with the Treasury Web Applications Infrastructure (TWA) project were \$16.0 million higher than the approved 2004 budget. TWA provides a multi-tiered web environment that balances the business need for a secure access system with the need to provide public access to Treasury applications. The increase was due primarily to the expansion of the TWA project, which had not been budgeted, and revisions to the contract with the vendor supporting TWA. These changes were all made at Treasury's request and are fully reimbursable.

After the 2004 budgets were submitted to the Board for approval, the Bureau of Public Debt announced that Treasury retail securities, which include TreasuryDirect and savings bonds operations, will be further consolidated, from seven offices into two. This consolidation is expected to be completed by late 2005. The 2004 estimate includes \$5.6 million

for an additional 82 ANP hired at the consolidated sites in preparation for the additional volume. The estimate also includes \$5.2 million in severance costs for staff at the nonconsolidated sites who will be displaced in 2005.

Estimated costs in the monetary and economic policy and the supervision and regulation areas were near 2004 budgeted levels. Monetary and economic policy costs increased slightly from the budget (about 1 percent), and supervision and regulation costs are estimated to be about 1 percent lower than the budget (because of positions budgeted but not filled).

Factors Affecting the 2005 Budget

For 2005, the Reserve Banks' budgets reflect continued focus on several cost-reduction efforts currently under way. As previously mentioned, these efforts are largely a response to shortfalls in check-cost recovery over the last several years. The Bank budgets reflect efforts to streamline operations through increased efficiencies, including downsizing support operations in response to staff reductions. Decisions by the Treasury will result in further consolidation of its retail securities operations and continued expansion of TWA. The 2005 budget also reflects funding and staffing to support an increased focus on community outreach and economic and financial literacy programs in many Banks.

Check Service

Over the past five years, the Federal Reserve's check-processing operations have undergone considerable change to improve efficiency. In 2000, the Banks launched their check-modernization effort (composed of the Check Standardization, Enterprise Wide Adjustments, FedImage, and Check Electronic Access and Delivery projects) to install uniform

software and hardware for check processing, imaging, and adjustments at all Federal Reserve check-processing sites and to provide web access to check services. This initiative was completed in 2004. In 2003, the Banks began efforts to reduce the number of check processing-sites to better align the Federal Reserve check-processing infrastructure with the evolving market environment. By year-end 2004, the Banks had closed 13 check-processing sites. A second phase of restructuring, announced in 2004, will result in the closure of an additional nine check operations by early 2006. Checks from sites eliminating check operations will be processed at other Reserve Bank offices. Also in 2004, the Banks made operational preparations to implement the authority provided by the Check Clearing for the 21st Century Act (Check 21).

Overall, the results of these initiatives and continued efforts to increase productivity in the check service have resulted in approximately a 13 percent reduction in costs and a 712 ANP decline in staffing from estimated 2004 levels. The 2005 budget includes the full-year effect of savings from the completion of the check-modernization projects and the 2004 check-processing site closures. The amount of the reduction also reflects the nonrecurrence of severance costs, accounted for in the 2004 estimate, associated with the second phase of restructuring. Support costs to the check area are budgeted to decrease by 38 percent from the 2004 estimate. This reduction is the combination of two factors—an overall reduction in support costs and a lower percentage of support costs flowing to the check service commensurate with the reductions in check operations.

Treasury-Related Functions

Costs for Treasury services continue to increase, largely as a result of additional work for TWAI. The \$20.0 million

increase in the TWAI project costs budgeted in 2005 is primarily the full-year effect of changes made to the vendor contract in 2004 and additional staff and equipment at FRIT dedicated to this project. Costs related to the Pay.gov and Paper Check Conversion (PCC) e-government projects are budgeted to increase, largely as a result of an additional 14 ANP to support project technical and operational workloads, as well as increased software amortization related to new application enhancements and consultant fees. Pay.gov allows individuals and organizations to make payments to the government for services and fees using the Internet to initiate ACH transactions. The PCC project involves imaging check payments and converting them to ACH payments.

Consolidation of the Treasury's retail securities operations are expected to yield net savings of \$15.8 million and 83 ANP in 2005 as savings bonds and TreasuryDirect operations are consolidated into two offices. The reduction reflects the full-year effect of the restructuring, which began in 2004.

Support Services

Support function costs are budgeted to decrease by approximately 2.5 percent and staffing levels by 478 ANP from the 2004 estimate. The decrease is driven mainly by efforts to reorganize the business development function, resulting in reductions of \$14 million and 66 ANP. The initiative, approved early in 2004, involves national management of the marketing function, with all marketing performed by staff reporting to the Customer Relations and Support Office (CRSO). Some additional customer support functions will also be managed nationally, and national product offices will exercise greater control over the costs of the remaining customer support functions. Reserve Bank sales functions also

have been downsized to reflect more targeted efforts.

Other support function cost-containment efforts are reflected in the information technology and human resources budgets. The 2005 budget includes a substantial decrease in local IT costs, primarily as a result of efficiencies gained from the implementation of standard desktop hardware and software and reduced demand as a result of lower overall Bank staffing levels. These savings are offset by investments at the System level to enhance payment systems. In aggregate, IT costs are increasing about 1 percent over estimated 2004 spending levels. In 2005, total human resources administration costs are budgeted to decrease about 1.5 percent and human resources staffing is projected to decrease by 45 ANP from the 2004 estimate, largely as a result of efficiencies gained through the consolidations of functions, such as PeopleSoft and payroll, and adjustments to staffing levels commensurate with overall reductions in Reserve Bank workforces.

Public Programs

Costs for the public programs function, including community outreach and financial and economic education efforts, are budgeted to increase by \$14.2 million, or 12.0 percent, in the 2005 budget and staffing is budgeted to increase by 34 ANP. Many Banks have noted an increased need to enhance financial literacy and economic education and to improve community outreach efforts within their regions.

2005 Personnel Expenses

Budgeted officer and employee salaries and other personnel expenses (which includes variable pay and severance costs) total \$1,338.6 million, which is 2.0

percent below the 2004 estimate. The budget includes \$24.0 million for officer salary administration and \$74.6 million for employees, reflecting an average merit increase of 3.6 percent for officers and 3.5 percent for employees, somewhat higher than the 2004 average merits of 3.4 percent for officers and 3.2 percent for employees.³

In the 2005 budget, officer variable-pay programs total \$15.2 million, and employee variable-pay programs total \$29.8 million. The Reserve Banks have devoted an increasingly higher percent of their salary expense to variable pay. This increase reflects the Reserve Banks' increased emphasis on pay for performance over the past several years.

Of the projected 2,381 fewer ANP at the Reserve Banks, FRIT, and OEB in 2005, an estimated 45 percent will not be replaced, primarily because of planned staff reductions associated with check restructuring, business development, and Treasury retail securities consolidation. Turnover is projected to be lower in 2005 than in 2004 in large part because of the completion of voluntary retirement programs approved in 2003 by the Committee on Employee Benefits for nine Reserve Banks and FRIT.

Retirement and other benefit expenses account for 20 percent of personnel expenses and 14 percent of 2005 Reserve Bank budgets. Excluding the effect of the change in the eligibility criteria for post-retirement medical expenses, retirement and other benefits are anticipated to increase by approximately \$18 million, or 5 percent, in 2005. Factors driving the increase include higher health care costs and group life insurance costs.

3. Salary administration represents the budgeted funds that are available to increase compensation to officers and employees in the upcoming year. It does not include adjustments for changes in staffing levels, turnover and lag in hiring, and overtime.

Risks in the 2005 Budget

The continued effect of check-restructuring initiatives, the implementation of Check 21, and projected volume declines pose continued risk to the check area in 2005. In addition, changes in the scope or direction of the various Treasury projects and continued unbudgeted Treasury requests also present risks for this budget year.

The check service continues to be an area where Banks have identified a considerable amount of budget risk. All planned restructuring efforts in thirteen offices were completed in 2004. In August, the Reserve Banks announced that another nine sites would discontinue check processing during 2005 and early 2006. At the same time, the Retail Payments Office (RPO) is moving toward national management of check adjustments, float management, and product pricing. Delays in the check-restructuring schedule could result in the need for higher-than-budgeted staffing, overtime, and facility costs. In addition, the budget would be affected by any large reconciliation issues resulting in unbudgeted write-offs. Projected check volume declines of 15 percent are anticipated because of the continued decline in the use of paper checks in the United States, price increases, and the reduction in the number of check-processing sites. While the Banks are positioned to react to shifts in volumes, a significant change from plan would affect operations. The RPO also cites as a 2005 risk increased costs for check transportation, which would result from higher-than-planned-for fuel costs and additional changes in carrier routes related to further check-restructuring efforts.

As in the past, unforeseen requests from the Treasury or changes in scope and direction would add costs and could require additional resources in 2005; however, the Reserve Banks are fully reimbursed for those costs by the Treas-

ury. For 2004, Reserve Banks have estimated Treasury costs to be about 8.0 percent higher than the original budget, largely as a result of increased requests for services.

2005 Capital Plan

The 2005 capital budget submitted by the Reserve Banks, FRIT, and OEB totals \$430.5 million, a \$39.2 million decrease from 2004 estimated levels. The decrease from the 2004 estimate is largely due to the completion of the Houston building, planned for mid-2005.

As in previous years, the 2005 capital budget includes funding for projects that support the strategic direction outlined by the individual Reserve Bank and System plans. These strategies focus on investments that improve operational efficiencies and services to Bank customers and on providing a safe and quality work environment. In support of these strategies, the 2005 budget identifies five major categories of capital outlays: building projects and facility improvements, payment system improvements, automation and communication initiatives, security enhancements, and miscellaneous acquisitions.

Building Projects

The proposed capital budget includes \$245.2 million for building-related projects and facility improvements. Almost half of this total, \$112.5 million, is related to new building projects in Detroit, Houston, Kansas City, and Seattle. The remaining outlays in this category will fund various building renovation and refurbishment projects, as well as miscellaneous facility improvement and energy efficiency projects.

Payment System Projects

The budget includes \$83.5 million for

initiatives related to payment system improvements. Almost two-thirds of these funds (\$50.5 million) support reimbursable initiatives for the Treasury, mainly software for several Treasury projects across the System.

Information Technology Projects

Banks have included \$61.7 million in funding for major automation and communication initiatives. These initiatives do not include the automation components of building or payment systems initiatives discussed separately. Of the total automation-related outlays, FRIT projects and acquisitions account for over one-

third, or \$24.1 million. Aside from FRIT, the District budgets include \$23.6 million for equipment, mainly for servers and telecommunications upgrades, and \$14.0 million for various software projects to support local and System initiatives.

Security Enhancements and Miscellaneous Items

The proposed capital budget includes \$35.4 million for security enhancements and \$4.6 million for miscellaneous capital items. Miscellaneous capital includes funding for other equipment and software not falling into the other defined categories. ■

Appendixes

Appendix A

Federal Reserve Budget Processes

This appendix is an overview of the separate budgets and budgeting processes followed by the Board of Governors and the Reserve Banks. The purpose of this overview is to inform the reader of the data, assumptions, and initiatives considered when the Federal Reserve System budgets were developed and approved by the Board of Governors.

Board of Governors

The Board's budget covers a two-year period. Toward the end of the first year of the budget cycle—the even-numbered year—the strategic plan for the next four years is updated, and the second year is used to develop the budget for the next two years. The two-year cycle begins in the fall (thus, for the 2006–07 budget, in the fall of 2004). At that time, the Board's divisions examine their operating environments and consider whether any adjustments to their mission, priorities, activities, and associated resources might improve the efficiency and effectiveness of the Board's operations.

The management of each division discusses with the appropriate Board oversight committee the issues that arise in its review. After any adjustments, the division gives the results to the Staff Planning Group, a small group of senior managers with a Boardwide perspective, for use in their analysis of the Board's budget options.

After consulting with the Board-level Committee on Board Affairs for final guidance, the Planning and Budget staff updates the strategic plan, one of several factors used to prepare a preliminary budget objective that identifies the resources needed to support the plan. Individual

division budget objectives are prepared on the basis of Boardwide priorities and planning assumptions. The Committee on Board Affairs reviews the plan and preliminary budget objective, clarifies outstanding planning issues with the Staff Planning Group and division directors, and at the end of summer in odd-numbered years submits the budget objective to the Board for its consideration.

The divisions use the budget objective approved by the Board to complete their budgeting under the approved plan. The Board's Committee on Board Affairs, under authority delegated by the Chairman, oversees the process until the budget is submitted to the Board for action in the fall of the odd-numbered year. The budget memorandum is published on the Board's public web site and becomes the primary source for this report and other similar documents.

The Board of Governors budgets its resources by division and accounts for its activities by division and across operational areas. Direct costs, such as those for salary, retirement, insurance, and travel, are billed to the operational areas. Costs for data processing are also charged as a direct expense to each of the areas according to service-level agreements (at prices derived from the cost of resources needed to provide the services and agreed upon before the budget year starts). Expenses for other elements of support and overhead are distributed among the operational areas in proportion to the share of direct costs attributable to each area.

The Board, in accordance with generally accepted accounting principles, capitalizes certain assets and depreciates their value over appropriate periods instead of

expensing them in their year of purchase. Hence, the Board has both an operations budget and a capital budget.

After the budget is approved by the Board, it is converted to an operating plan that allocates funding by month; the operating plan is also the vehicle for subsequent performance reports and adjustments within the budget. In January of each year, the cash requirement for the first half of the calendar year is estimated, and the cash is raised by an assessment on each of the Reserve Banks in proportion to its capital stock and surplus. The cash requirement for the second half of each year is estimated in June, and the second assessment is made in July.

The Board accounts for extraordinary items separately from the operations budget so that unique, one-time requirements do not compete with regular operations and so that expenses in those operations can be readily compared across years without distortion. As discussed more fully in chapter 2, the extraordinary items budget for 2004–05 consists of funds to support planning for two periodic surveys, one on consumer finances and the other on small business finances.

The Board's Office of Inspector General (OIG), in keeping with its statutory independence, prepares its proposed budget apart from the Board's budget. The OIG presents its two-year budget directly to the Chairman for action by the Board, also in the fall.

Reserve Banks

Each year, the Federal Reserve Banks establish major operating goals for the coming year, devise strategies to attain those goals, estimate required resources, and monitor results. The process begins with development of budget guidance by

the business leaders in each functional area. This information is used to develop a preliminary budget projection, the Reserve Bank budget outlook (RBBO). Each Bank then develops its own budget using the business-leader guidance. The budgets are reviewed at the Board by a committee of governors—the Committee on Federal Reserve Bank Affairs—both individually and in the context of Systemwide issues and the plans of the other Banks. The budgets are then presented to the full Board of Governors for final action in December.

The Banks' budgets are structured in operational areas, with support and overhead charged to these areas.

As does the Board, the Banks, in accordance with generally accepted accounting principles, capitalize certain assets and depreciate their value over appropriate periods instead of expensing them in the year of purchase. Hence, the Banks have a capital budget in addition to an operating budget.

The Banks budget annually for capital outlays by capital class to estimate the effect of total operating and capital spending. During the budget year, the Banks must submit proposals for major purchases of assets to the Board for further review and approval.

The operations and financial performance of the Reserve Banks are monitored throughout the year via a cost-accounting system, the Planning and Control System (PACS). Under PACS, the costs of all Reserve Bank services, both priced and nonpriced, are grouped by operational area, and the costs of support and overhead are charged to these areas. PACS makes it possible to compare budgets with actual expenses and facilitates comparison of the financial and operating performances of the Reserve Banks. ■

Appendix B

Priced Services

The Monetary Control Act of 1980 requires the Federal Reserve to charge depository institutions for certain services that the Federal Reserve had previously provided without explicit charge and only to member banks. As the act requires, the fees charged for providing these priced services are set to recover, over the long run, all direct and indirect costs of providing the services plus imputed costs, including the interest on items credited before actual collection (float), and the private-sector adjustment factor (PSAF). The intent of the PSAF calculation is to impute the costs that would have been incurred, such as taxes that would have been paid, and the profits that would have been earned had the Federal Reserve Banks' priced services been provided by a private firm. Table B.1 provides details on projected revenue from priced services.

Annual Pricing Process

To meet the requirement for the full recovery of costs over the long term, the

Table B.1

Revenue from Priced Services, 2003–2005

Millions of dollars

Service	2003	2004 (estimated)	2005 (budgeted)
Funds transfers and net settlement	51.1	57.9	64.2
Automated clearinghouse ...	68.2	75.2	82.1
Commercial checks	737.9	758.0	732.7
Book-entry securities transfers	21.8	20.8	21.4
Noncash collection	2.3	1.7	1.3
Special cash services	0.4	0.0	0.0
Total	881.7	913.6	901.7

Federal Reserve has developed an annual pricing process involving projections of Reserve Bank expenses, volumes, and revenues, as well as the PSAF and net income on clearing balances, for each major service category.

Fees for Federal Reserve services must be approved by the product director for the respective service, by the Financial Services Policy Committee, and ultimately by the Board of Governors.¹

The cost of float is estimated by applying the federal funds rate to the level of float expected to be generated in the coming year. Estimates of income taxes and the return on capital are based on tax and financing rates derived using a model of the fifty largest U.S. bank holding companies. These rates are applied to the assets the Federal Reserve expects to use in providing priced services in the coming year.

The other components of the PSAF are derived from the budgets of the Reserve Banks and the Board: the imputed sales tax (based on budgeted outlays for materials, supplies, and capital); the imputed assessment for insurance by the Federal Deposit Insurance Corporation (based on expected clearing balances and amounts deferred to depository institutions for items deposited for collection with the Reserve Banks); and the portion of the expenses of the Board of Governors directly related to providing priced services. ■

1. The product directors are the first vice presidents at selected Reserve Banks with responsibility for day-to-day policy guidance over specific services. The Financial Services Policy Committee (FSPC) is responsible for the overall direction of financial services for the Federal Reserve Banks.

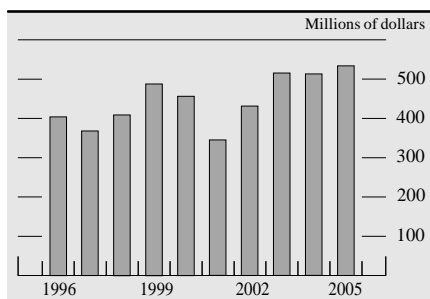
Appendix C

Currency Budget

Federal Reserve Banks issue new and fit currency to the public through depository institutions and destroy currency already in circulation as it becomes unfit or when a new design is issued. Each year, under authority delegated by the Board, the director of the Division of Reserve Bank Operations and Payment Systems orders new currency from the U.S. Department of Treasury's Bureau of Engraving and Printing (BEP). Upon reviewing the order, the BEP establishes billing rates for new currency, which Board staff uses to prepare the annual budget for new currency. Once the Board approves the new currency budget, it assesses each Federal Reserve Bank through an accounting procedure similar to that used in assessing the Banks for the Board's operating expenses.

Estimated currency expenditures for 2004 total \$512.1 million, which is \$6.3 million, or 1.2 percent, less than budgeted (table C.1). The underrun is primarily due to the BEP's producing fewer notes in the first quarter of fiscal year 2005 (the last quarter of calendar year 2004), based on a print order for fiscal year 2005 that was lower than staff estimated at the time of the 2004 budget submission. Budgeted currency expenditures for 2005 total

Chart C.1
Federal Reserve Budget for New Currency, 1996–2005



NOTE: For 2004, estimated; for 2005, budgeted.

\$532.9 million, which is \$20.8 million, or 4.1 percent, more than estimated 2004 expenses (chart C.1). The increase is primarily due to an increase in the BEP's billing rates, which resulted in higher costs for printing new currency in 2005.

Printing of Federal Reserve Notes

The Board ordered 8.6 billion new notes for the calendar year 2005 budget. The budget for printing the Board's order is \$510.0 million, or 95.7 percent of the total 2005 new currency budget. For Janu-

Table C.1

Federal Reserve Budget for New Currency, 2004 and 2005

Thousands of dollars, except as noted

Item	2004 (estimated)	2005 (budgeted)	Percentage change
Printing of new Federal Reserve notes	492,814	509,974	3.5
Currency transportation	13,146	16,050	22.1
Counterfeit-deterrence research	2,796	3,521	25.9
Reimbursement to the U.S. Treasury's Office of Currency Standards	3,340	3,400	1.8
Total cost of currency	512,096	532,945	4.1

Table C.2

Projected Federal Reserve Costs of Printing New Notes, by Type of Note, 2005

Type of currency	Number of notes (millions)	Percentage of total notes	Cost per thousand notes (dollars)	Total cost (thousands of dollars)
Unthreaded (\$1s)	3,368.2	39.0	40.10	135,065
New Currency Design (\$5s)	710.2	8.2	52.90	37,569
(\$10s, \$100s)	908.8	10.6	65.10	59,163
Series-2004 (\$10s, \$20s, \$50s)	3,644.4	42.2	76.33	278,177
Average cost			59.04	
Total	8,631.6	100.0		509,974

ary through September 2005 (the portion of the federal government's 2005 fiscal year that falls within the 2005 calendar year), the BEP will produce 6.7 billion notes; for October through December 2005 (the remainder of the 2005 calendar year), it will produce another 1.9 billion notes.

The 2005 billing rates reflect four types of currency produced: unthreaded (\$1s); New Currency Design (NCD) without color-shifting ink (\$5s); NCD with color-shifting ink (\$10s and \$100s); and Series-2004 with new and enhanced security features, including color-shifting ink (\$10s, \$20s, and \$50s) (table C.2).¹ During 2005, 18.8 percent of the notes produced will be NCD notes, 42.2 percent will be Series-2004, and the remaining 39.0 percent will be unthreaded. The weighted average price that the Board will pay the BEP for producing notes in 2005 is \$59.04 per thousand.

Currency Transportation

The currency transportation budget consists of funds for shipping new currency

from the BEP to the Reserve Banks and new and fit currency among the Reserve Banks. The 2005 currency transportation budget is \$16.1 million, which is \$2.9 million, or 22.1 percent, more than the Board estimated for 2004. The 2005 budget for shipments of new currency from the BEP is \$12.5 million, which is 25.0 percent more than estimated 2004 expenses because of a return to historical pricing levels for ground shipments and an increase in the cost of fuel for air and ground shipments. The 2005 budget for currency shipments among Reserve Banks is \$3.5 million, which is 12.9 percent more than estimated 2004 expenses. These shipments include moving currency from Reserve Bank offices with excess fit currency to offices that would otherwise require new currency from the BEP.

Counterfeit-Deterrence Research

The 2005 budget for the counterfeit-deterrence program is \$3.5 million. The funds will support the Federal Reserve Board's participation in the Central Bank Counterfeit Deterrence Group (formerly known as the SSG-2), which operates under the auspices of the G-10 central bank governors to combat digital counterfeiting, and membership to the Reprographic Research Center, a state-of-the-

1. For NCD notes greater than the \$5 denomination, the color of the ink shifts from green to black as the viewing angle of the note changes. For Series-2004 notes, the color shifts from copper to green.

art adversarial testing facility for testing bank note designs and counterfeit-deterrence features.

**Treasury's
Office of Currency Standards**

The 2005 budget to reimburse the Treasury Department for expenses of its

Office of Currency Standards (OCS) is \$3.4 million. Because destroying unfit currency is a function delegated from the Treasury Department to the Reserve Banks, the OCS develops Reserve Bank standards for the cancellation, destruction, and accountability of unfit currency and processes claims for the redemption of damaged or mutilated currency. ■

Appendix D

Expenses and Employment at the Board of Governors

Table D.1

Operating Expenses of the Board of Governors, by Division, Office, or Special Account, 2002–2005

Thousands of dollars, except as noted

Division, office, or special account	2002–03 (budgeted)	2002–03 (actuals)	2004–05 (revised budget)	Average annual percent change	
				2002–03 actuals compared with 2002–03 budgeted	2004–05 revised budget compared with 2002–03 actuals
Board Members	20,606	20,091	25,188	-1.3	12.0
Secretary	11,513	11,149	11,602	-1.6	2.0
Research and Statistics	69,599	69,966	75,830	0.3	4.1
International Finance	26,067	26,579	28,548	1.0	3.6
Monetary Affairs	21,730	21,367	24,070	-0.8	6.1
Banking Supervision and Regulation	76,198	73,767	84,074	-1.6	6.8
Consumer and Community Affairs	22,082	21,960	24,478	-0.3	5.6
Legal	21,725	21,428	23,846	-0.7	5.5
Reserve Bank Operations and Payment Systems	35,663	35,517	38,292	-0.2	3.8
Staff Director for Management	11,468	11,605	16,256	0.6	18.4
Information Technology	83,144	78,869	87,817	-2.6	5.5
Management	91,790	97,878	115,930	3.3	8.8
Special projects	18,367	11,584	10,480	-20.6	-4.9
IRM income account ¹	(37,799)	(36,575)	(38,602)	-1.6	2.7
Total, Board operations	472,153	465,185	527,809	-0.7	6.5
Extraordinary items	1,500	1,907	10,000	12.8	0.0
Office of the Inspector General	7,757	7,286	8,533	-3.1	8.2

1. Income from various Board divisions for use of central information resources management (IRM) resources.

Table D.2

Positions Authorized at the Board of Governors, by Division, Office, or Special Account, 2002–2005

Division, office, or special account	2002–03 (authorized)	2004–05 (revised budget)	Change
Board Members	77	77	...
Secretary	53	50	–3
Research and Statistics	275	277	2
International Finance	118	114	–4
Monetary Affairs	68	75	7
Banking Supervision and Regulation	235	251	16
Consumer and Community Affairs	80	84	4
Legal	80	80	...
Reserve Bank Operations and Payment Systems	138	138	...
Staff Director for Management	47	45	–2
Information Technology ¹	261	276	15
Management	397	422	25
Concern ²	31	31	...
Special Projects	3	1	–2
Subtotal	1,863	1,921	58
Reimbursable IT support ¹	27	27	...
Total, Board operations	1,890	1,948	58
Office of Inspector General	31	31	...

1. Positions in the Division of Information Technology that provide support to the Federal Financial Institutions Examination Council for processing data collected under the Home Mortgage Disclosure Act and the Community Reinvestment Act.

2. Summer intern and youth positions handled by the Management Division.
... Not applicable.

Table D.3

Operating Expenses of the Board of Governors, by Account Classification, 2002–2005

Thousands of dollars, except as noted

Account classification	2002–03 (budgeted)	2002–03 (actuals)	2004–05 (revised budget)	Average annual percent change	
				2002–03 actuals compared with 2002–03 budgeted	2004–05 revised budget compared with 2002–03 actuals
<i>Personnel services</i>					
Salaries	294,075	293,082	329,353	-0.2	6.0
Retirement	28,822	29,225	30,633	0.7	2.4
Insurance	23,868	23,590	29,004	-0.6	10.9
Subtotal	346,765	345,897	388,989	-0.1	6.0
<i>Goods and services</i>					
Travel	14,039	11,724	13,599	-8.6	7.7
Postage and expressage	1,571	1,300	1,176	-9.0	-4.9
Telecommunications	9,731	9,284	10,576	-2.3	6.7
Printing and binding	2,518	2,209	2,963	-6.3	15.8
Publications	2,044	1,681	1,381	-9.3	-9.4
Stationery and supplies	2,756	2,765	2,292	0.2	-9.0
Software	12,994	12,600	14,651	-1.5	7.8
Furniture and equipment	7,636	8,144	8,838	3.3	4.2
Rentals	816	758	748	-3.6	-0.7
Books and subscriptions	2,123	1,783	2,005	-8.4	6.0
Utilities	5,587	5,599	5,916	0.1	2.8
Building repairs and alterations	4,896	5,479	5,991	5.8	4.6
Furniture repairs and maintenance	5,255	3,216	2,578	-21.8	-10.5
Contingency Processing Center expenses	400	969	896	...	-3.9
Contractual professional services	39,557	33,569	40,331	-7.9	9.6
Tuition/registration, and membership fees	3,810	3,156	4,405	-9.0	18.1
Subsidies and contributions	1,739	1,528	1,285	-6.3	-8.3
Depreciation	24,564	23,885	26,544	-1.4	5.4
All other	(16,648)	(10,362)	(7,354)	-21.1	-15.8
Subtotal	125,388	119,288	138,820	-2.5	7.9
Total, Board operations	472,153	465,185	527,809	-0.7	6.5
Extraordinary items	1,500	1,907	10,000	12.8	129.0
Office of the Inspector General	7,757	7,286	8,533	-3.1	8.2

NOTE. Components may not sum to totals and may not yield percentages shown because of rounding. . . . Not applicable.

Appendix E
Expenses and Employment
at the Federal Reserve Banks

Table E.1

Operating Expenses of the Federal Reserve Banks, by District, 2004 and 2005

Thousands of dollars except as noted

District	2004 (budgeted)	2004 (estimated)	2005 (budgeted)	Percent change	
				2004 estimated compared with 2004 budgeted	2005 budgeted compared with 2004 estimated
Boston	161,412	154,914	155,553	-4.0	0.4
New York	494,436	486,960	500,686	-1.5	2.8
Philadelphia	129,646	118,547	128,516	-8.6	8.4
Cleveland	163,398	167,175	184,225	2.3	10.2
Richmond	201,216	201,111	192,960	-0.1	-4.1
Atlanta	323,960	298,810	296,587	-7.8	-0.7
Chicago	263,081	249,565	254,035	-5.1	1.8
St. Louis	186,643	193,192	215,553	3.5	11.6
Minneapolis	135,191	132,190	144,866	-2.2	9.6
Kansas City	166,730	156,871	159,878	-5.9	1.9
Dallas	166,539	163,295	170,815	-1.9	4.6
San Francisco	274,112	258,456	259,450	-5.7	0.4
Total	2,666,364	2,581,085	2,663,125	-3.2	3.2

NOTE. Excludes capital outlays. Includes expenses budgeted by Federal Reserve Information Technology (FRIT) and the System's Office of Employee Benefits (OEB).

Components may not sum to totals and may not yield percentages shown because of rounding.

Operating expenses reflect all redistributions for support and allocations for overhead.

Table E.2

Employment at the Federal Reserve Banks, by District, and of FRIT and OEB, 2004 and 2005

Average number of personnel except as noted

District	2004 (budgeted)	2004 (estimated)	2005 (budgeted)	Amount change	
				2004 estimated compared with 2004 budgeted	2005 budgeted compared with 2004 estimated
Boston	1,152	1,136	1,099	-16	-37
New York	3,066	3,040	2,947	-26	-94
Philadelphia	1,205	1,177	1,110	-28	-67
Cleveland	1,409	1,433	1,543	24	111
Richmond	1,995	2,009	1,832	13	-176
Atlanta	2,178	2,194	2,042	16	-152
Chicago	1,857	1,883	1,577	26	-306
St. Louis	1,284	1,283	1,123	-1	-159
Minneapolis	1,248	1,270	1,298	22	28
Kansas City	1,609	1,536	1,429	-73	-107
Dallas	1,365	1,347	1,243	-18	-103
San Francisco	2,182	2,058	1,924	-124	-134
Total, all Districts	20,550	20,365	19,168	-185	-1,197
Federal Reserve Information					
Technology	713	758	759	45	2
Office of Employee Benefits	37	38	40	1	2
Total	21,300	21,160	19,967	-140	-1,193

NOTE. See note to table E.1.

The term *average number of personnel* (ANP) describes levels and changes in employment at the Reserve Banks. ANP is the average number of employees

in terms of full-time positions for the period. For instance, a full-time employee who starts work on July 1 counts as 0.5 ANP for that calendar year; two half-time employees who start on January 1 count as 1 ANP.

Table E.3

Operating Expenses of the Federal Reserve Banks, and of FRIT and OEB, by Operational Area, 2004 and 2005

Thousands of dollars except as noted

Operational area	2004 (budgeted)	2004 (estimated)	2005 (budgeted)	Percent change	
				2004 estimated compared with 2004 budgeted	2005 budgeted compared with 2004 estimated
Monetary and economic policy	270,789	263,731	291,841	-2.6	10.7
Services to U.S. Treasury and other government agencies	347,982	364,681	403,619	4.8	10.7
Services to financial institutions and the public	645,711	623,301	672,802	-3.5	7.9
Supervision and regulation	520,137	494,132	519,391	-5.0	5.1
Fee-based services to financial institutions	881,747	835,239	775,471	-5.3	-7.2
Total	2,666,366	2,581,085	2,663,125	-3.2	3.2

Table E.4

Employment at the Federal Reserve Banks, and of FRIT and OEB,
by Operational Area, 2004 and 2005

Average number of personnel except as noted

Operational area	2004 (budgeted)	2004 (estimated)	2005 (budgeted)	Amount change	
				2004 estimated compared with 2004 budgeted	2005 budgeted compared with 2004 estimated
Monetary and economic policy	858	863	878	5	15
Services to U.S. Treasury and other government agencies	1,293	1,331	1,303	38	-28
Services to financial institutions and the public	2,795	2,748	2,799	-46	51
Supervision and regulation	2,607	2,587	2,592	-20	5
Fee-based services to financial institutions	4,464	4,381	3,114	-84	-1,267
Support and overhead	9,283	9,251	9,281	-32	31
Total	21,300	21,160	19,968	-140	-1,193

Table E.5

Expenses of the Federal Reserve Banks for Salaries of Officers and Employees,
by District, 2004 and 2005

Thousands of dollars except as noted

District	2004 (budgeted)	2004 (estimated)	2005 (budgeted)	Percent change	
				2004 estimated compared with 2004 budgeted	2005 budgeted compared with 2004 estimated
Boston	74,820	71,974	73,556	-3.8	2.2
New York	247,705	243,994	253,289	-1.5	3.8
Philadelphia	63,501	61,977	61,471	-2.4	-0.8
Cleveland	70,683	71,293	76,787	0.9	7.7
Richmond	107,008	106,670	103,836	-0.3	-2.7
Atlanta	116,556	117,912	113,637	1.2	-3.6
Chicago	112,296	111,916	102,867	-0.3	-8.1
St. Louis	67,407	67,108	63,743	-0.4	-5.0
Minneapolis	64,417	64,295	67,802	-0.2	5.5
Kansas City	87,547	83,969	82,993	-4.1	-1.2
Dallas	71,412	70,432	66,624	-1.4	-5.4
San Francisco	135,235	130,670	129,304	-3.4	-1.0
Total, all Districts	1,218,585	1,202,210	1,195,911	-1.3	-0.5
Federal Reserve Information					
Technology	55,483	58,292	60,438	5.1	3.7
Office of Employee Benefits	3,556	3,560	3,970	0.1	11.5
Total	1,277,624	1,264,063	1,260,318	-1.1	-0.3

Table E.6

Capital Outlays of the Federal Reserve Banks, by District, and of FRIT and OEB, 2004 and 2005

Thousands of dollars except as noted

District	2004 (budgeted)	2004 (estimated)	2005 (budgeted)	Percent change	
				2004 estimated compared with 2004 budgeted	2005 budgeted compared with 2004 estimated
Boston	20,140	24,608	22,130	22.2	-10.1
New York	56,379	54,687	59,454	-3.0	8.7
Philadelphia	10,178	9,722	10,225	-4.5	5.2
Cleveland	29,086	40,373	34,592	38.8	-14.3
Richmond	22,005	15,094	41,249	-31.4	173.3
Atlanta	12,633	16,621	9,521	31.6	-42.7
Chicago	77,219	64,502	71,651	-16.5	11.1
St. Louis	29,375	35,126	25,472	19.6	-27.5
Minneapolis	3,766	4,628	5,192	22.9	12.2
Kansas City	22,204	34,208	28,339	54.1	-17.2
Dallas	86,151	90,201	33,113	4.7	-63.3
San Francisco	29,709	16,233	38,547	-45.4	137.5
Total, all Districts	398,845	406,003	379,484	1.8	-6.5
Federal Reserve Information					
Technology	67,408	63,326	51,010	-6.1	-19.4
Office of Employee Benefits	1,150	350	0
Total	467,402	469,679	430,494	0.5	-8.3

... Not applicable.

Table E.7

Capital Outlays of the Federal Reserve Banks, by Category, 2004 and 2005

Thousands of dollars except as noted

Category	2004 (budgeted)	2004 (estimated)	2005 (budgeted)	Percent change	
				2004 estimated compared with 2004 budgeted	2005 budgeted compared with 2004 estimated
Building-related projects and facility improvements	249,884	248,035	245,245	-0.7	0.7
Security enhancements	53,950	41,387	35,431	-23.3	30.4
Information technology	61,566	72,573	61,704	17.9	-15.2
Payment system improvement initiatives	97,072	100,577	83,516	3.6	-3.5
Miscellaneous ¹	4,930	7,107	4,599	44.2	-30.6
Total	467,402	469,679	430,494	0.5	-8.3

NOTE. Includes outlays for FRIT and OEB.

1. Includes other equipment purchases.

*Maps of the
Federal Reserve System*

The Federal Reserve System



LEGEND

Both pages

- Federal Reserve Bank city
- ▣ Board of Governors of the Federal Reserve System, Washington, DC

Facing page

- Federal Reserve Branch city
- Branch boundary

NOTE

The Federal Reserve officially identifies Districts by number and Reserve Bank city (shown on both pages) and by letter (shown on the facing page).

In the 12th District, the Seattle Branch serves Alaska and the San Francisco Bank serves Hawaii.

The System serves commonwealths and territories as follows: the New York

Bank serves the Commonwealth of Puerto Rico and the U.S. Virgin Islands; the San Francisco Bank serves American Samoa, Guam, and the Commonwealth of the Northern Mariana Islands. The maps show the boundaries within the System as of year-end 2004.

