

***BOARD OF GOVERNORS
OF THE FEDERAL
RESERVE SYSTEM***

*Financial Statement as of and for the
Years Ended December 31, 2007 and 2006,
and Independent Auditors' Report*

INDEPENDENT AUDITORS' REPORT

The Board of Governors of the Federal Reserve System:

We have audited the accompanying balance sheet of the Board of Governors of the Federal Reserve System (the "Board") as of December 31, 2007, and the related statements of revenues and expenses and changes in cumulative results of operations, and cash flows for the year 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 audit. The financial statements of the Board for the year ended December 31, 2006 were audited by other auditors whose report, dated April 17, 2007, expressed an unqualified opinion on those statements and included an explanatory paragraph related to adoption of the Financial Accounting Standard Board Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Board's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such 2007 financial statements present fairly, in all material respects, the financial position of the Board of Governors of the Federal Reserve System as of December 31, 2007, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 19, 2008 on our consideration of the Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be considered in assessing the results of our audit.

Deloitte + Touche LLP

March 19, 2008

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BALANCE SHEETS DECEMBER 31, 2007 AND 2006

	2007	2006
ASSETS		
CURRENT ASSETS:		
Cash	\$ 44,613,728	\$ 60,030,706
Accounts receivable	2,996,318	2,625,907
Prepaid expenses and other assets	4,653,684	3,916,608
Total current assets	52,263,730	66,573,221
NONCURRENT ASSETS:		
Property and equipment — net (Note 4)	153,350,880	151,205,386
Other assets	166,119	343,899
Total noncurrent assets	153,516,999	151,549,285
TOTAL ASSETS	<u>\$205,780,729</u>	<u>\$218,122,506</u>
LIABILITIES AND CUMULATIVE RESULTS OF OPERATIONS		
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	\$ 20,400,282	\$ 10,950,470
Accrued payroll and related taxes	5,647,053	5,421,666
Accrued annual leave	18,429,601	16,334,512
Capital lease payable (current portion)	108,755	327,663
Unearned revenues and other liabilities	702,122	366,304
Total current liabilities	45,287,813	33,400,615
LONG-TERM LIABILITIES:		
Capital lease payable (non-current portion)		108,755
Accumulated retirement benefit obligation (Note 5)	2,201,675	1,354,662
Accumulated postretirement benefit obligation (Note 6)	7,972,469	8,111,829
Accumulated postemployment benefit obligation (Note 7)	8,855,613	6,515,301
Total long-term liabilities	19,029,757	16,090,547
Total liabilities	64,317,570	49,491,162
CUMULATIVE RESULTS OF OPERATIONS:		
Working capital	7,084,672	33,500,269
Unfunded long-term liabilities	(17,542,943)	(14,325,986)
Net investment in noncurrent assets	153,408,244	151,112,867
Accumulated other comprehensive income (loss) (Note 8)	(1,486,814)	(1,655,806)
Total cumulative results of operations	141,463,159	168,631,344
TOTAL LIABILITIES AND CUMULATIVE RESULTS OF OPERATIONS	<u>\$205,780,729</u>	<u>\$218,122,506</u>

See notes to financial statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF REVENUES AND EXPENSES AND CHANGES IN CUMULATIVE RESULTS OF OPERATIONS FOR THE YEARS ENDING DECEMBER 31, 2007 AND 2006

	2007	2006
BOARD OPERATING REVENUES:		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures	\$296,124,700	\$301,013,500
Other revenues	<u>10,365,414</u>	<u>8,508,949</u>
Total operating revenues	<u>306,490,114</u>	<u>309,522,449</u>
BOARD OPERATING EXPENSES:		
Salaries	197,656,442	182,239,595
Retirement and insurance	39,451,541	35,853,297
Contractual services and professional fees	36,300,185	23,944,564
Depreciation, amortization, and net losses on disposals	13,557,498	13,058,667
Utilities	8,998,496	9,185,840
Travel	8,619,615	8,820,503
Software	6,678,514	6,637,765
Postage and supplies	8,836,143	4,560,368
Repairs and maintenance	3,890,191	2,634,459
Printing and binding	1,976,765	1,505,470
Other expenses	<u>7,861,901</u>	<u>7,435,067</u>
Total operating expenses	<u>333,827,291</u>	<u>295,875,595</u>
RESULTS OF OPERATIONS	<u>(27,337,177)</u>	<u>13,646,854</u>
CURRENCY COSTS:		
Assessments levied on Federal Reserve Banks for currency costs	576,306,073	491,962,202
Expenses for printing, transporting, and retiring Federal Reserve Notes	<u>576,306,073</u>	<u>491,962,202</u>
CURRENCY ASSESSMENTS OVER (UNDER) EXPENSES		
TOTAL RESULTS OF OPERATIONS	<u>(27,337,177)</u>	<u>13,646,854</u>
CUMULATIVE RESULTS OF OPERATIONS — Beginning of period	<u>168,631,344</u>	<u>156,640,296</u>
OTHER COMPREHENSIVE INCOME:		
Adjustment to initially apply SFAS No. 158 (Note 8)		(1,655,806)
Amortization of prior service cost	(23,831)	
Amortization of net actuarial loss	113,142	
Net actuarial loss arising during the year	<u>79,681</u>	
Total Other Comprehensive Income	168,992	(1,655,806)
CUMULATIVE RESULTS OF OPERATIONS — End of period	<u>\$141,463,159</u>	<u>\$168,631,344</u>

See notes to financial statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDING DECEMBER 31, 2007 AND 2006

	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES		
RESULTS OF OPERATIONS:		
Adjustments to reconcile results of operations to net cash provided by (used in) operating activities:		
Depreciation	\$ (27,337,177)	\$ 13,646,854
Net losses on disposals of property and equipment	13,433,306	13,047,064
Increase (decrease) in assets —		
Accounts receivable, prepaid expenses and other assets	124,192	11,603
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	(929,708)	(812,482)
Accrued payroll and related taxes	9,449,812	(5,955,880)
Accrued annual leave	225,387	561,094
Unearned revenues and other liabilities	2,095,089	878,028
Accumulated retirement benefit obligation	335,818	(417,407)
Accumulated postretirement benefit obligation	847,013	541,165
Accumulated postemployment benefit obligation	(139,360)	1,874,539
Accumulated other comprehensive income	2,340,312	1,403,936
	<u>168,992</u>	<u>(1,655,806)</u>
Net cash provided by operating activities	<u>613,676</u>	<u>23,122,708</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from disposals	65,988	7,212
Capital expenditures	<u>(15,768,979)</u>	<u>(8,829,712)</u>
Net cash used in investing activities	<u>(15,702,991)</u>	<u>(8,822,500)</u>
CASH FLOWS FROM FINANCING ACTIVITIES —		
Capital lease payments	<u>(327,663)</u>	<u>(239,937)</u>
Net cash used in financing activities	<u>(327,663)</u>	<u>(239,937)</u>
NET INCREASE (DECREASE) IN CASH	(15,416,978)	14,060,271
CASH BALANCE — Beginning of period	<u>60,030,706</u>	<u>45,970,435</u>
CASH BALANCE — End of period	<u>\$ 44,613,728</u>	<u>\$ 60,030,706</u>

See notes to financial statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDING DECEMBER 31, 2007 AND 2006

1. STRUCTURE

The Federal Reserve System (System) was established by Congress in 1913 and consists of the Board of Governors (Board), the Federal Open Market Committee, the twelve regional Federal Reserve Banks, the Federal Advisory Council, and the private commercial banks that are members of the System. The Board, unlike the Reserve Banks, was established as a federal government agency and is supported by Washington, DC based staff numbering approximately 1,900, as it carries out its responsibilities in conjunction with other components of the Federal Reserve System.

The Board is required by the Federal Reserve Act to report its operations to the Speaker of the House of Representatives. The Act also requires the Board, each year, to order a financial audit of each Federal Reserve Bank and to publish each week a statement of the financial condition of each such Reserve Bank and a consolidated statement for all of the Reserve Banks. Accordingly, the Board believes that the best financial disclosure consistent with law is achieved by issuing separate financial statements for the Board and for the Reserve Banks. Therefore, the accompanying financial statements include only the results of operations and activities of the Board. Combined financial statements for the Federal Reserve Banks are included in the Board's annual report to the Speaker of the House of Representatives.

2. OPERATIONS AND SERVICES

The Board's responsibilities require thorough analysis of domestic and international financial and economic developments. The Board carries out those responsibilities in conjunction with other components of the Federal Reserve System. The Board also supervises and regulates the operations of the Federal Reserve Banks, exercises broad responsibility in the nation's payments system, and administers most of the nation's laws regarding consumer credit protection. Policy regarding open market operations is established by the Federal Open Market Committee. However, the Board has sole authority over changes in reserve requirements, and it must approve any change in the discount rate initiated by a Federal Reserve Bank.

The Board also plays a major role in the supervision and regulation of the U.S. banking system. It has supervisory responsibilities for state-chartered banks that are members of the Federal Reserve System, bank holding companies, foreign activities of member banks, and U.S. activities of foreign banks.

3. SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting — The Board prepares its financial statements in accordance with accounting principles generally accepted in the United States of America.

Revenues — The Board assesses the Federal Reserve Banks for operating expenses and additions to property, which are based on expected cash needs.

Currency Costs — Federal Reserve Banks issue new and fit currency to the public and destroy currency already in circulation as it becomes unfit or when a new design is issued. Each year, the Board orders new currency from the U.S. Department of Treasury's Bureau of Engraving and Printing. The

Board incurs expenses and assesses the Federal Reserve Banks for printing, transporting, and retiring Federal Reserve Notes. These expenses and assessments are reported separately from the Board's operating transactions in the Board's Statement of Revenues and Expenses and Cumulative Results of Operations.

Allowance for Doubtful Accounts — Accounts receivable considered uncollectible are charged against the allowance account in the year they are deemed uncollectible. The allowance for doubtful accounts is adjusted monthly, based upon a review of outstanding receivables.

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

The Board complies with Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, which requires that certain costs incurred in the development of internal use software be capitalized and amortized over its useful life.

Art Collections — The Board has collections of works of art, historical treasures, and similar assets. These collections are maintained and held for public exhibition in furtherance of public service. Proceeds from any sales of collections are used to acquire other items for collections. As permitted by Statement of Financial Accounting Standards (SFAS) No. 116, Accounting for Contributions Received and Contributions Made, the cost of collections purchased by the Board is charged to expense in the year purchased and donated collection items are not recorded. The value of the Board's collections has not been determined.

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

Reclassifications — Certain 2006 amounts have been reclassified to conform with 2007 presentation.

SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* - The Board initially applied the provisions of SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, at December 31, 2006. This accounting standard requires recognition of the overfunded or underfunded status of a defined benefit postretirement plan in the Balance Sheets, and recognition of changes in the funded status in the years in which the changes occur through comprehensive income. The transition rules for implementing the standard required applying the provisions as of the end of the year of initial implementation, and the effect as of December 31, 2006 is recorded as "Adjustment to initially apply SFAS No. 158" in the Statements of Revenues and Expenses and Changes in Cumulative Results of Operations.

4. PROPERTY AND EQUIPMENT

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

	2007	2006
Land	\$ 18,640,314	\$ 18,640,314
Buildings and improvements	149,968,504	147,504,169
Furniture and equipment	55,625,014	47,271,434
Software in use	14,745,157	13,681,508
Software in process	2,064,438	941,912
Construction in process	<u>1,550,565</u>	<u>360,967</u>
	242,593,992	228,400,304
Less accumulated depreciation and amortization	<u>(89,243,112)</u>	<u>(77,194,918)</u>
Property and equipment — net	<u>\$ 153,350,880</u>	<u>\$ 151,205,386</u>

Construction in process includes costs incurred in 2007 and 2006 for long-term security projects and building enhancements.

The Board entered into capital leases for printing equipment, which terminate in 2008. Furniture and equipment includes \$1,230,000 in 2007 and 2006 for capitalized leases. Accumulated depreciation includes \$1,123,000 and \$867,000 for capitalized leases as of 2007 and 2006, respectively. The Board paid interest related to these capital leases in the amount of \$31,000 and \$54,000 for 2007 and 2006, respectively.

The future minimum lease payments required under the capital leases and the present value of the net minimum lease payments as of December 31, 2007, are as follows:

	2008
Total minimum lease payments	\$ 138,279
Less: Amount representing maintenance	<u>(26,743)</u>
Net minimum lease payments	111,536
Less: Amount representing interest	<u>(2,781)</u>
Present value of net minimum lease payments	108,755
Less: Current maturities of capital lease payments	<u>(108,755)</u>
Long-term capital lease obligations	<u>\$ -</u>

5. ACCUMULATED 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 provides retirement benefits to employees of the Board, the Federal Reserve Banks, and the Office of Employee Benefits of the Federal Reserve System (OEB). The Federal Reserve Bank of New York, on behalf of the System, recognizes the net asset and costs associated with the System Plan in its financial statements. Costs associated with the System Plan are not redistributed to other participating employers.

Employees of the Board who became employed prior to 1984 are covered by a contributory defined benefits program under the System Plan. Employees of the Board who became employed 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. Based on actuarial calculations, it was determined that employer funding contributions were not required for the years 2007 and 2006, and the Board was not assessed a contribution for these years.

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 due to limitations imposed by Sections 401(a)(17), 415(b) and 415(e) of the Internal Revenue Code of 1986. Activity for the BEP for 2007 and 2006 is summarized in the following tables:

	2007	2006
Change in Projected Benefit Obligation:		
Benefit obligation — beginning of year	\$ 1,354,662	\$ 536,339
Service cost	329,282	185,483
Interest cost	87,837	45,004
Plan participants' contributions		
Plan amendments		
Actuarial (gain)/loss	453,526	596,114
Benefits paid	<u>(23,632)</u>	<u>(8,278)</u>
Benefit obligation — end of year	<u>\$ 2,201,675</u>	<u>\$ 1,354,662</u>
Accumulated benefit obligation — end of year	\$ 685,170	\$ 546,854
Weighted-average assumptions used to determine benefit obligation as of December 31:		
Discount rate	6.25 %	5.75 %
Rate of compensation increase	5.00 %	4.50 %
Change in Plan Assets:		
Fair value of plan assets — beginning of year	\$ -	\$ -
Employer contributions	23,632	8,278
Plan participants' contributions		
Benefits paid	<u>(23,632)</u>	<u>(8,278)</u>
Fair value of plan assets — end of year	<u>\$ -</u>	<u>\$ -</u>

	2007	2006
Reconciliation of Funded Status — End of Year:		
Funded status	\$ (2,201,675)	\$ (1,354,662)
Net actuarial (gain) loss	1,006,257	580,386
Prior service (credit) cost	<u>(233,404)</u>	<u>(247,417)</u>
Prepaid (Accrued) pension cost	<u>\$ (1,428,822)</u>	<u>\$ (1,021,693)</u>
Amounts recognized in the financial statements consist of:		
Prepaid benefit cost	\$ -	\$ -
Accrued benefit liability	(1,428,822)	(1,021,693)
Intangible asset		
Accumulated other comprehensive income	<u>(772,853)</u>	<u>(332,969)</u>
Net amount recognized	<u>\$ (2,201,675)</u>	<u>\$ (1,354,662)</u>
Components of net periodic benefit cost:		
Service cost — benefits earned during the period	\$ 329,282	\$ 185,483
Interest cost on projected benefit obligation	87,837	45,004
Expected return on plan assets		
Amortization of prior service (credit) cost	(14,013)	(14,013)
Amortization of (gains) losses	27,655	
Amortization of initial (asset) obligation		
Net periodic benefit cost (credit)	<u>\$ 430,761</u>	<u>\$ 216,474</u>
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31:		
Discount rate	6.00 %	5.75 %
Rate of compensation increase	4.50 %	4.50 %
Expected Cash Flows:		
Expected employer contributions:		
2008	\$ 82,134	
Expected benefit payments:		
2008	\$ 82,134	
2009	96,170	
2010	109,602	
2011	120,750	
2012	127,690	
2013–2017	724,518	
Estimated amounts that will be amortized from accumulated other comprehensive income into net periodic benefit cost (credit) in 2008 are shown below:		
Net actuarial (gain) loss	\$ 79,561	
Prior service (credit) cost	<u>(14,013)</u>	
Total	<u>\$ 65,548</u>	

A relatively small number of Board employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). These defined benefit plans are administered by the U.S. Office of Personnel Management, which determines the required employer contribution levels. The Board's contributions to these plans totaled \$316,000 and \$334,000 in 2007 and 2006, respectively. The Board has no liability for future payments to retirees under these programs and is not accountable for the assets of the plans.

Employees of the Board may also participate in the Federal Reserve System's Thrift Plan. Board contributions to members' accounts are based upon a fixed percentage of each member's basic contribution and were \$9,542,000 and \$8,964,000 in 2007 and 2006, respectively.

6. ACCUMULATED POSTRETIREMENT BENEFITS

The Board provides certain life insurance programs for its active employees and retirees. Activity for 2007 and 2006 is summarized in the following tables:

	2007	2006
Change in Benefit Obligation:		
Benefit obligation — beginning of year	\$ 8,111,829	\$ 8,273,831
Service cost	198,791	230,567
Interest cost	479,903	470,256
Plan participants' contributions		
Plan amendments		
Actuarial (gain)/loss	(533,208)	(603,500)
Benefits paid	<u>(284,846)</u>	<u>(259,325)</u>
Benefit obligation — end of year	<u>\$ 7,972,469</u>	<u>\$ 8,111,829</u>
Weighted-average assumptions used to determine benefit obligation as of December 31:		
Discount rate	6.25 %	6.00 %
Change in Plan Assets:		
Fair value of plan assets — beginning of year	\$ -	\$ -
Employer contribution	284,846	259,325
Plan participants' contributions		
Benefits paid	<u>(284,846)</u>	<u>(259,325)</u>
Fair value of plan assets — end of year	<u>\$ -</u>	<u>\$ -</u>
Reconciliation of Funded Status at End of Year:		
Benefit obligations	\$ (7,972,469)	\$ (8,111,829)
Unrecognized net actuarial (gain)/loss		
Unrecognized prior service cost		
Amount recognized — end of year	<u>\$ (7,972,469)</u>	<u>\$ (8,111,829)</u>

	2007	2006
Amounts recognized in the financial statements consist of		
Liability:		
Accrued benefit cost	\$ (7,972,469)	\$ (8,111,829)
Accumulated other comprehensive income		
Net amount recognized	<u>\$ (7,972,469)</u>	<u>\$ (8,111,829)</u>
Amounts recognized in accumulated other comprehensive income consist of:		
Net actuarial loss (gain)	\$ 803,702	\$ 1,422,398
Prior service cost (credit)	(89,741)	(99,560)
Transition obligation (asset)		
Deferred curtailment (gain) loss		
	<u>\$ 713,961</u>	<u>\$ 1,322,838</u>
Components of net periodic benefit cost:		
Service cost — benefits earned during the period	\$ 198,791	\$ 230,567
Interest cost on projected benefit obligation	479,902	470,256
Expected return on plan assets		
Amortization of prior service (credit) cost	(9,818)	(9,818)
Amortization of (gains) losses	85,487	120,022
Amortization of initial (asset) obligation		
Net periodic benefit cost (credit)	<u>\$ 754,362</u>	<u>\$ 811,027</u>
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31:		
Discount rate	5.75 %	5.50 %
Expected Cash Flows —		
Expected employer contributions — 2008	\$ 293,767	
Expected benefit payments:		
2008	\$ 293,767	
2009	326,227	
2010	352,683	
2011	368,728	
2012	384,026	
2013-2017	2,300,954	
Estimated amounts that will be amortized from accumulated other comprehensive income into net periodic benefit cost (credit) in 2008 are shown below:		
Net actuarial (gain) loss	\$ 7,425	
Prior service (credit) cost	<u>(9,818)</u>	
Total	<u>\$ (2,393)</u>	

The above accumulated postretirement benefit obligation is related to the Board-sponsored life insurance programs. The Board has no liability for future payments to employees who continue coverage under the federally sponsored life and health programs upon retiring. Contributions for active employees

participating in federally sponsored health programs totaled \$10,311,000 and \$9,607,000 in 2007 and 2006, respectively.

7. ACCUMULATED POSTEMPLOYMENT BENEFITS

The Board provides certain postemployment benefits to eligible former or inactive employees and their dependents during the period subsequent to employment but prior to retirement. Postemployment costs were actuarially determined using a December 31 measurement date and discount rates of 5.75 percent as of December 31, 2007 and 2006. The accrued postemployment benefit costs recognized by the Board for the years ended December 31, 2007 and 2006, were \$3,055,000 and \$1,963,000, respectively.

8. ACCUMULATED OTHER COMPREHENSIVE INCOME

Following is a reconciliation of beginning and ending balances of accumulated other comprehensive income.

	Amount Related to Defined Benefit Retirement Plans	Amount Related to Postretirement Benefits Other than Pensions	Total Accumulated Other Comprehensive Income (Loss)
Balance at January 1, 2006	\$ -	\$ -	\$ -
Adjustment to initially apply SFAS No. 158	<u>332,969</u>	<u>1,322,837</u>	<u>(1,655,806)</u>
Balance December 31, 2006	332,969	1,322,837	(1,655,806)
Change in funded status of benefit plans:			
Amortization of prior service costs	14,013	9,818	(23,831)
Amortization of net actuarial gain (loss)	(27,655)	(85,487)	113,142
Net actuarial (gain) loss arising during the year	<u>453,526</u>	<u>(533,207)</u>	<u>79,681</u>
Change in funded status of benefit plans — other comprehensive income gain (loss)	<u>439,884</u>	<u>(608,876)</u>	<u>168,992</u>
Balance at December 31, 2007	<u>\$ 772,853</u>	<u>\$ 713,961</u>	<u>\$ (1,486,814)</u>

Additional detail regarding the classification of accumulated other comprehensive income is included in notes 5 and 6.

9. COMMITMENTS AND CONTINGENCIES

Leases — The Board has entered into several operating leases to secure office, training and warehouse space. Minimum annual payments under the operating leases having an initial or remaining noncancelable lease term in excess of one year at December 31, 2007, are as follows:

2008	\$ 1,623,970
2009	1,961,223
2010	2,013,281
2011	1,944,142
After 2011	<u>9,118,887</u>
	<u>\$ 16,661,503</u>

Rental expenses under the operating leases were \$539,000 and \$193,000 in 2007 and 2006, respectively.

Deferred Leases — The Board's operating leases contain rent abatements and scheduled rent increases. According to accounting principles generally accepted in the United States of America, rent abatements and scheduled rent increases must be considered in determining the annual rent expense to be recognized. The deferred rent represents the difference between the actual lease payments and the rent expense recognized. The current balance of deferred rent is \$318,000 and \$8,000 in 2007 and 2006, respectively.

Commitments — The Board has entered into an agreement with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, through the Federal Financial Institutions Examination Council (the "Council") to fund a portion of enhancements and maintenance fees for a central data repository project through 2013. The estimated total Board expense to support this effort is \$7.5 million.

In 2007, the Council began a rewrite of the Home Mortgage Disclosure Act processing system, for which the Board provides data processing services. The estimated total Board expense to support this effort is \$3.2 million through 2010.

Litigation — The Board is subject to contingent liabilities which include litigation cases. These contingent liabilities arise in the normal course of operations and their ultimate disposition is unknown. Based on information currently available to management, it is management's opinion that the expected outcome of these matters, individually or in the aggregate, will not have a materially adverse effect on the financial statements. Management believes the Board has substantial defenses and that the likelihood of an adverse judgment is remote.

10. FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

The Board is one of the five member agencies of the Council, and currently performs certain management functions for the Council. The five agencies which are represented on the Council are the Board, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision. The Board's financial statements do not include financial data for the Council. Activity related to the Board and Council for 2007 and 2006 is summarized in the following table:

	2007	2006
Council expenses charged to the Board:		
Assessments for operating expenses	\$ 108,163	\$ 109,760
Central Data Repository	1,167,449	740,003
Uniform Bank Performance Report	<u>192,026</u>	<u>204,617</u>
Total Council expenses charged to the Board	<u>\$ 1,467,638</u>	<u>\$ 1,054,380</u>
Board expenses charged to the Council:		
Data processing related services	\$ 4,457,647	\$ 3,429,499
Administrative services	<u>190,800</u>	<u>183,000</u>
Total Board expenses charged to the Council	<u>\$ 4,648,447</u>	<u>\$ 3,612,499</u>
Accounts receivable due from the Council	\$ 384,142	\$ 395,551
Accounts payable due to the Council	\$ 64,087	\$ 54,870

11. FEDERAL RESERVE BANKS

The Board performs certain functions for the Reserve Banks in conjunction with its responsibilities for the System, and the Reserve Banks provide certain administrative functions for the Board. Activity related to the Board and Reserve Banks for 2007 and 2006 is summarized in the following table:

	<u>As of December 31,</u>	
	2007	2006
Reserve Bank expenses charged to the Board:		
Data processing and communication	\$ 2,064,110	\$ 2,161,298
Contingency site	<u>1,152,166</u>	<u>1,087,429</u>
Total Reserve Bank expenses charged to the Board	<u>\$ 3,216,276</u>	<u>\$ 3,248,727</u>
Board expenses charged to the Reserve Banks:		
Assessments for currency costs	\$ 576,306,073	\$ 491,962,202
Assessments for operating expenses of the Board	296,124,700	301,013,500
Data processing	<u>704,840</u>	<u>731,999</u>
Total Board expenses charged to the Reserve Banks	<u>\$ 873,135,613</u>	<u>\$ 793,707,701</u>
Accounts receivable due from the Reserve Banks	\$ 1,270,582	\$ 854,142
Accounts payable due to the Reserve Banks	\$ 10	\$ 12,417

12. THE OFFICE OF EMPLOYEE BENEFITS OF THE FEDERAL RESERVE SYSTEM

OEB administers certain System benefit programs on behalf of the Board and the Reserve Banks, and costs associated with the OEB's activities are assessed to the Board and Reserve Banks. The Board was assessed \$2,866,676 and \$2,380,474 in 2007 and 2006, respectively.

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Board of Governors of the Federal Reserve System:

We have audited the financial statements of the Board of Governors of the Federal Reserve System (the "Board") as of and for the year ended December 31, 2007, and have issued our report thereon dated March 19, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the Board's internal control over financial reporting as a basis for designing our audit procedures for the purposes of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Board's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Board's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Board's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Board's financial statements that is more than inconsequential will not be prevented or detected by the Board's internal controls. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Board's internal control.

During our audit, we noted certain control deficiencies within the general computer control environment within the Board of Governors related to logical access controls, which affect several financial system platforms supporting the Board's financial statements. These deficiencies individually are not considered significant deficiencies, however, when considered collectively, aggregate to a significant deficiency. We have considered these matters in conjunction with our audit of the financial statements and noted no material misstatements or omissions in the Board's financial statements that were caused by these various control deficiencies. Management has taken steps to address these deficiencies by correcting the cause of a deficiency and/or by implementing additional compensating controls and processes. Due to the sensitive nature of these deficiencies, the technical details related to these deficiencies have been provided to Board of Governors' management in a separate, limited distribution communication.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we do not believe that the significant deficiency described above is a material weakness.

We have communicated to management, in a separate communication dated March 19, 2008, other control deficiencies involving the Board's internal control over financial reporting and other matters that we identified during our audit.

COMPLIANCE AND OTHER MATTERS

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

DISTRIBUTION

This report is intended solely for the information and use of the Board, management, and others within the organization, the Office of Inspector General, and the United States Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLP

March 19, 2008