



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
MANAGEMENT DIVISION

DATE: December 3, 2003
 TO: Board of Governors
 VIA: *SRM* Stephen R. Malphrus and Governor Mark Olson
 FROM: *CAN* Carol A. Sanders, *J/C* Stephen J. Clark, and *HFP* H. Fay Peters
 SUBJECT: 2004-05 Proposed Budget

ACTIONS REQUESTED

Approval of the 2004-05 Board operations, capital, and extraordinary items budgets as itemized below:

1. An operating budget of \$528.6 million. This figure represents an operating budget increase of \$56.4 million for the biennium, or 5.8 percent annually. The budget includes 1,895 positions, a net increase of 2 positions.¹
2. A capital budget of \$28.5 million (see page 5).
3. An extraordinary items budget of \$10.0 million for two statistical survey projects (see page 6).
4. Approval for the Administrative Governor to adjust the operating and capital budgets during 2004-05 to reflect actions required to capitalize certain budgeted software developed or acquired for internal use.

	<u>Operations Budget</u>	<u>Extraordinary Items</u>
Proposed Operating Budget	\$528,570,097	\$10,000,000
Proposed Capital Budget	\$28,454,448	-
Requested Positions	1,895	-

¹ These figures do not include funding or positions for the Office of Inspector General or funding for currency purchased from the Bureau of Engraving and Printing.

OVERVIEW OF THE BUDGET

Process

Biennially, the Board and its senior staff undertake a process that produces a four-year strategic plan and a budget for the next two years. 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 Program Analysis and Budget Section of the Management Division, guided the process. The process is explained in detail in the appendix on page 11.

2002–03 Budget Performance

During the 2002–03 budget period, the operating budget was increased by \$17.2 million (3.8 percent) to a total of \$472.2 million largely to increase security as a result of September 11, 2001. A more detailed description of the current budget begins in the appendix on page 11.

Planning Issues

The Staff Planning Group reviewed the planning materials submitted by the Board’s divisions and offices and identified the 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

These issues are reflected in the resource allocation decisions of the Committee on Board Affairs that form the basis of the proposed 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 proposed budget includes the initiatives and projects for the 2004–05 period listed below. Additional division-specific initiatives and project discussions can be found in the appendix beginning on page 12.

- *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; an increase in the employee cash award program; a 4.1 percent merit increase for 2004 and a placeholder of 3.5 percent for 2005; and actions to enhance human capital, such as improved information technology equipment, access to enhanced data sets, and a slight increase in staffing to assist with current analysis.

- *Security and continuity*: Incremental funding for armed security staff authorized during the current biennium and other actions to enhance employee safety added significantly to the budget.
- *Information technology (IT)*: Funding is required for the Board to comply with e-government initiatives such as improved public access to data, section 508 compliance, and information security.
- *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 in order to comply with new laws that impact Board operations such as the Federal Information Security Management Act and supervisory responsibilities under the Sarbanes-Oxley Act, and to prepare for Basel II and other key initiatives.
- *Physical plant*: In line with the Board’s strategic plan, capital investments are planned for the three Board facilities, as discussed in the capital section below. Additional non-capital improvements are also planned at all three facilities, as outlined in the Management Division discussion on page 15.

Areas of Risk

Despite our best efforts in planning, we recognize the possibility that further developments could require significant resources beyond the current proposals. These developments could include the following:

- merit increase greater than the 3.5 percent provided for 2005
- significant changes in or shocks to the economy and/or financial system that create a material increase in workload
- additional terrorist activity resulting in more security and contingency requirements
- decision to fund a major Systemwide supervisory technology initiative such as the Shared National Credit Program
- changes to the position-vacancy-rate assumptions used in developing the salary budget and the resulting office space requirements should a change in staffing patterns occur

OPERATIONS BUDGET BY DIVISION AND ACCOUNT CLASSIFICATION

The Board’s overall operations budget is detailed by division in table I and by account classification in table II. Merit pay increases and security costs, including off-site mail handling, are the largest factors in the 5.8 percent annual increase in Board expenses. Without these two components the budget increase would have been 2.4 percent annually.

Personnel costs dominate the Board’s budget, and most of the increase in the 2004–05 budget is in this area. The proposed budget for personnel services (salaries, retirement, and insurance) is \$389.3 million, or \$42.5 million greater than the 2002–03 base (an average annual increase of 6.0 percent per year). Merit pay (\$22 million), promotions and reclassifications (\$2.8 million), and higher benefit costs (\$4.9 million) are large components of this increase. Incremental salary costs for positions added during the current biennium amounted to \$8.9 million for security-related positions (the new staff allowed a reduction of \$3.7 million for security officers in the contractual accounts) and \$1.3 million for positions added in the Division of Banking

Supervision and Regulation. The remainder of the increase is caused by a lower position-vacancy rate in certain divisions and the net increase of two positions in the budget.

The 2004–05 budget for goods and services is \$139.3 million, which is \$13.9 million greater than the 2002–03 base (an average annual increase of 5.4 percent per year). Much of this increase is attributable to the computer hardware, software, and contractor support for enhanced automation initiatives. Continuity of operations expenses for communications and a new relocation site are also significant. Depreciation expenses are increasing in response to 2002–03 capital expenditures including those associated with improved physical security. Finally, the elimination of a saving target affects this category of expense. Expenses by account classification are discussed in more detail beginning on page 15.

The increases discussed above would have been greater without programmatic reductions in areas throughout the Board. These include reduction of positions in three divisions (Board Members, Secretary, and Legal), a change in the allocation of Office of Employee Benefit expenses, and lower costs for off-site processing of mail.

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 System policy direction and oversight. Following is a summary discussion of the resources budgeted for each area for 2004–05. The cost data for each operational area include the share of overhead and support costs allocated to that area.

Monetary and Economic Policy

The 2004–05 budget for the monetary and economic policy function is \$210.2 million, an increase of \$20.1 million, or an average of 5.2 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, programmatic increases in this area will cover the acquisition of additional data to assist staff in their responsibilities. These data relate to credit risk, retail banking fees and services, global financial markets, and consumer credit. This funding will help contribute to the continued hiring and retaining of high-quality economists.

Supervision and Regulation

The 2004–05 budget for the supervision and regulation function is \$221.1 million, an increase of \$25.7 million, or an average of 6.4 percent per year.

In this budget, expenses for the supervision and regulation function at the Board exceed those of the monetary policy function. Programmatic increases include greater focus on the System's

anti-money-laundering program, international training and assistance to foreign governments, enhancement of domestic and international capital standards, modernization of information processing for Shared National Credit and Community Reinvestment, and a review of regulations and policies related to consumer protection. As risks to the financial sector grow, the staff will need to spend more time on bank examinations and monitoring as appropriate under the risk-based supervision model implemented over the past few years.

Services to Financial Institutions and the Public

The 2004–05 budget for oversight of Reserve Bank services to financial institutions and the public is \$10.3 million, an increase of \$1.3 million, or an average of 7.0 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 2004–05 budget for System policy direction and oversight is \$87.0 million, an increase of \$9.3 million, or an average of 5.8 percent per year.

This increase, aside from compensation initiatives, is due to the continued focus on security and contingency planning.

CAPITAL BUDGET

The Board's proposed 2004–05 capital budget is \$28.5 million (see table III). Of this total, \$15.8 million supports continued security enhancements and major building projects in the Eccles and Martin Buildings, as well as the New York Avenue (NYA) site. Major facility projects include perimeter security enhancements, a fire sprinkler system, Martin Building renovations, NYA security and office reconfigurations, and a new access control system to improve monitoring of individuals entering Board facilities.

Automation projects of \$4.6 million include server replacements, network infrastructure, and data security enhancements. Another \$6.8 million is for non-automation projects such as the enhancements to the Board's web site, a new telephone system, and the purchase of new vehicles.

The remaining \$1.3 million is for a new mainframe, software, furniture, and other miscellaneous items.

POSITIONS

For the 2004–2005 budget period, requests for a net increase of two positions to the Board's position authorization increase the total to 1,895 positions (see table IV).

A net increase of seven positions is requested in the Management Division for five maintenance staff for the New York Avenue facility, one industrial hygienist, and one construction assistant.

The Office of Board Members, Office of the Secretary, Legal Division, and Special Projects abolished a total of seven positions.

Four positions were transferred to the Office of Staff Director for Management from the Information Center staff within the Division of International Finance. The Division of Consumer and Community Affairs had a net increase of two policy-related positions, self-funded by reducing the level of current information technology resources.

EXTRAORDINARY ITEMS

The Board's extraordinary items budget for 2004–05 provides required funding for two surveys: the Survey of Small Business Finances (\$3.3 million) and the Survey of Consumer Finances (\$6.7 million). These surveys will improve the quality of economic data produced by the Board by gathering information on the economic behavior of U.S. households and the financial health of U.S. firms (see page 17 for more information).

**Operating Budget
by Division, Office, and Special Account**

Table I

Division	2002-03 Base	2004-05 Budget Request	Difference	Annual Percent Change
Office of Board Members	\$ 20,605,905	\$ 25,065,749	\$ 4,459,844	10.3%
Office of the Secretary	11,512,899	11,520,591	7,692	0.0%
Office of Staff Director for Management	11,467,920	16,105,000	4,637,080	18.5%
Division of Research and Statistics	69,598,953	75,803,370	6,204,417	4.4%
Division of International Finance	26,066,644	28,162,536	2,095,892	3.9%
Division of Monetary Affairs	21,730,062	23,055,615	1,325,553	3.0%
Division of Banking Supervision and Regulation	76,197,858	84,381,803	8,183,945	5.2%
Division of Consumer and Community Affairs	22,082,416	24,300,000	2,217,584	4.9%
Legal Division	21,724,747	23,846,317	2,121,570	4.8%
Division of Reserve Bank Operations and Payment Systems	35,662,781	38,100,000	2,437,219	3.4%
Division of Information Technology	83,143,918	90,831,970	7,688,052	4.5%
Management Division	91,790,274	106,200,000	14,409,726	7.6%
IRM Income	(37,798,669)	(39,306,406)	(1,507,737)	2.0%
Residual Retirement and Insurance Benefits	8,534,000	7,147,642	(1,386,358)	-8.5%
Special Projects	14,702,664	13,355,910	(1,346,754)	-4.7%
Savings and Reallocation	(4,869,183)	-	4,869,183	-100.0%
Total Board	\$ 472,153,189	\$ 528,570,097	\$ 56,416,908	5.8%
Extraordinary Items	\$ 1,560,000	\$ 10,000,000	\$ 8,440,000	...

**Operating Budget
by Account Classification**

Table II

Division	2002-03 Base	2004-05 Budget Request	Difference	Annual Percent Change
<i>Personnel services</i>				
Salaries	\$ 294,074,682	\$ 331,649,881	\$ 37,575,199	6.2%
Retirement	28,822,241	29,026,068	203,827	0.4%
Insurance	23,868,222	28,605,006	4,736,784	9.5%
<i>Subtotal</i>	\$ 346,765,145	\$ 389,280,955	\$ 42,515,810	6.0%
<i>Goods and services</i>				
Travel	\$ 14,039,350	\$ 13,808,314	\$ (231,036)	-0.8%
Postage and Expressage	1,571,085	1,176,000	(395,085)	-13.5%
Telecommunications	9,731,150	10,575,656	844,506	4.2%
Printing and Binding	2,517,764	2,963,000	445,236	8.5%
Publications	2,043,821	1,380,710	(663,111)	-17.8%
Stationery and Supplies	2,755,784	2,291,693	(464,091)	-8.8%
Software	12,994,014	14,538,573	1,544,559	5.8%
Furniture and Equipment	7,635,703	9,212,101	1,576,398	9.8%
Rentals	816,154	747,944	(68,210)	-4.3%
Books and Subscriptions	2,123,263	2,004,813	(118,450)	-2.8%
Utilities	5,586,900	5,916,391	329,491	2.9%
Building repairs and alterations	4,896,219	5,860,700	964,481	9.4%
Furniture repairs and maintenance	5,254,907	3,568,614	(1,686,293)	-17.6%
ARC Expense/R&S-MA	1,527,760	1,576,221	48,461	1.6%
ARC Income/R&S-MA	(1,527,760)	(1,576,220)	(48,460)	1.6%
Contingency processing center expenses	400,000	895,750	495,750	49.6%
Contractual professional services	39,557,297	41,437,486	1,880,189	2.3%
Interest Expense	80,000	180,985	100,985	50.4%
Tuition/registration and membership fees	3,809,814	4,405,061	595,247	7.5%
Subsidies and Contributions	1,739,120	1,285,233	(453,887)	-14.0%
All Other	4,761,334	5,272,799	511,465	5.2%
Savings an Reallocation	(4,961,915)	-	4,961,915	-100.0%
Depreciation	24,563,605	26,544,462	1,980,857	4.0%
Income	(16,622,815)	(14,803,097)	1,819,718	-5.6%
IRM User Charge	37,759,550	39,267,394	1,507,844	2.0%
Gain/Loss	134,609	64,965	(69,644)	-30.5%
IRM Income	(37,798,669)	(39,306,406)	(1,507,737)	2.0%
<i>Subtotal</i>	\$ 125,388,044	\$ 139,289,142	\$ 13,901,098	5.4%
Total Board	\$ 472,153,189	\$ 528,570,097	\$ 56,416,908	5.8%
Extraordinary Items	\$ 1,560,000	\$ 10,000,000	8,440,000	...

**Capital Budget
by Division, Office, and Special Account**

Table III

Division	2002-03 Base	2004-05 Budget Request	Difference
Office of Board Members	\$ 644,000	\$ 459,060	\$ (184,940)
Office of the Secretary	82,777	30,000	(52,777)
Office of Staff Director for Management	603,000	550,000	(53,000)
Division of Research and Statistics	600,000	600,000	-
Division of International Finance	50,000	102,000	52,000
Division of Monetary Affairs	-	-	-
Division of Banking Supervision and Regulation	1,234,567	-	(1,234,567)
Division of Consumer and Community Affairs	-	-	-
Legal Division	92,732	-	(92,732)
Division of Reserve Bank Operations and Payment Systems	-	-	-
Division of Information Technology	9,158,690	7,800,000	(1,358,690)
Management Division	24,581,180	18,913,388	(5,667,792)
IRM Income	-	-	-
Residual Retirement and Insurance Benefits	-	-	-
Special Projects	(660,909)	-	660,909
Total Board	\$ 36,386,037	\$ 28,454,448	\$ (7,931,589)

**Position Summary
by Division, Office, and Special Account**

Table IV

Division	2002-03 Authorization	2004-05 Proposed	Difference
Office of Board Members	79	78	(1)
Office of the Secretary	53	50	(3)
Office of Staff Director for Management	40	44	4 ¹
Division of Research and Statistics	275	275	-
Division of International Finance	120	116	(4) ¹
Division of Monetary Affairs	68	68	-
Division of Banking Supervision and Regulation	238	238	-
Division of Consumer and Community Affairs	81	83	2
Legal Division	82	80	(2)
Division of Reserve Bank Operations and Payment Systems	139	139	-
Division of Information Technology	289	289	-
Management Division	427	434	7
Special Projects	2	1	(1)
Total Board	1,893	1,895	2

¹ Transfer of Information Center staff from IF to OSDM

APPENDIX–SUPPLEMENTAL INFORMATION

Planning and Budgeting Process

The Board's budget covers a two-year period. The first year of the budget cycle—the even-numbered year—is used to update the strategic plan for the next four years, 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 2004–05 budget, in the fall of 2002). At that time, the Board's divisions examine their operating environments and look for any adjustments to their mission, priorities, activities, and associated resources that 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 result from its review. After any adjustment, the results are given 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 Staff Planning Group updates the strategic plan, which is used to prepare a preliminary budget objective that identifies the level and allocation of resources needed to support the plan. As part of this process, 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.

2002–03 Budget Performance

During the 2002–03 budget period, the operating budget was increased by \$17.2 million (3.8 percent) largely to increase security as a result of September 11, 2001. Personnel-related expenses increased by \$8.6 million (2.5 percent), while expenses for goods and services increased by \$7.5 million (5.6 percent). Income decreased by \$1.0 million (5.9 percent). Final expenses for Board operations are expected to be on target at \$472.2 million.

The increase in personnel-related expenses is a result of the decision to hire and develop a well-trained and armed security force, rather than hire outside contractors. Although the in-house security staff was supplemented with contractors through part of the biennium, the full staff should be assembled by January 2004.

Average employment during the 2002–03 biennium is estimated to be 1,724–114 employees (7.0 percent) higher than the 2000–01 average of 1,610. These additions are related to the aforementioned increase in security staff. The variable-pay program, which was created to increase recruitment and retention of economists, attorneys, and officers, has been successful in decreasing vacancies and will continue as a Board program.

The largest contributing factor in the increase in goods and services is contractual professional services for canine screening teams and private security guards to ensure the safety of Board staff and visitors. Increases in telecommunications expenses are primarily associated with the contingency site established to allow uninterrupted Board service to the public in any emergency.

2004-05 Operations Budget by Division

Key projects and initiatives associated with each divisional budget are discussed below.

Office of Board Members

The Office of the Board Members plans two major initiatives for the 2004–05 budget period. The first is the Content Management System, which will allow the Publications Department to store the meaningful content of individual web pages that are created and updated directly by staff in a database, create templates to standardize the appearance of different web pages, and generate output from the database in various formats and appearances if necessary. This will provide a more efficient and timelier method of publishing information. The second initiative is the downloadable data project, which will provide a facility for downloading data in multiple electronic formats and allow the public to generate easy-to-read and easy-to-print 508-compliant tables.

Office of the Secretary

The Office of the Secretary plans three major initiatives for the 2004–05 budget period. All three initiatives enhance the Federal Reserve Integrated Records Management Architecture (FIRMA), an electronic information system. The first two initiatives will expand FIRMA's capacity to accept documents in dissimilar formats, beginning with all word processing formats in 2004, and add improved search and retrieval functions to FIRMA. The third initiative concentrates on meeting the demands of contingency operations that arise during high-pressure situations by developing special records collections for contingency conditions tailored to each division's specifications. All initiatives will be completed with a staff that has been reduced by three for the 2004–05 budget period.

Office of the Staff Director for Management

The Office of the Staff Director for Management has budgeted a number of security-related initiatives for the 2004–05 budget. The division will continue to develop the infrastructure associated with the contingency relocation site. As part of our continuous efforts to ensure the safety of the Board's staff, the division plans to purchase protective gear for emergency employees, set up an Emergency Notification System, and provide additional emergency training for security staff.

Division of Research and Statistics

The division will focus on four broad initiatives: personnel, data, automation equipment, and academic conferences. First, the division created two positions in the Macroeconomic Analysis Section to alleviate the burdens of increasing demands for current analysis. Second, the division will use resources to fund the purchase of specialized data sets to help support financial, banking, and macroeconomic research. Third, Research and Statistics will continue to fund contingency initiatives (upgrade laptops, servers, software, and a contractor to

support the laptops and remote access). Finally, the division plans to host conferences to help recruit high-quality economists.

Division of International Finance

The major challenge for the division in 2004–05 will be similar to that of 2002–03. The changing global economic environment continues to drive the division’s mission, functions, and workloads. The division will continue to enhance its analytical abilities in order to better monitor and analyze ongoing changes in the world economy and in global financial markets. The new compensation structure, which was instituted after the start of the last budget, has helped the division hire and retain well-trained economists, thus contributing to higher morale among division employees.

Division of Monetary Affairs

The division faces three primary challenges in the coming biennium: managing the transition that will occur with the expected retirement of a number of senior officers; organizing division records in an electronic format to codify the collective experience of the staff over the past few decades; and increasing the diversity of division staff, especially in the senior ranks.

Division of Banking Supervision and Regulation

During the 2004–05 biennium, the division will work on refining its risk-focused supervision approach, particularly for large complex banking organizations; refining the Board’s role as umbrella supervisor of financial holding companies; increasing the use of information technology to improve supervisory information flow, analysis, and collaboration; continuing active involvement in the Basel II Capital Accord; providing technical support to foreign governments; enhancing domestic capital standards; and strengthening staff expertise and skill levels. The division will continue to place a particular focus on the identification of known and emerging risks, monitoring banks as credit quality continues to deteriorate, and reviewing the extent to which reliance on banks’ internal controls and auditors’ findings is justified. This approach requires frequent examinations with expanded scope and in-depth analysis in times of weakened banking conditions. This increased focus is placing a strain on the division. Additional demands continue to be placed on division staff to implement the provisions of the USA Patriot Act and enhance the anti-money-laundering and Bank Secrecy Act programs.

The Division of Banking Supervision and Regulation may also bring forward information technology initiatives for the supervision function as a whole during the biennium. The intention is to fund these Systemwide supervision initiatives through reductions in duplicate systems or through improvements in productivity resulting from a better use of resources. Under the supervision function's Strategic Plan Steering Committee (SPSC) and the SPSC IT subcommittee, three areas of IT-related enhancements are still underway: a Systemwide Electronic Document Management Initiative, a modernization of the IT support for the Shared National Credit Program, and a modernization of the Call Report System.

Division of Consumer and Community Affairs

During the 2004–05 biennium, the division will continue to focus on enforcement of financial privacy rules and initiatives to address predatory lending practices that target

vulnerable consumers. Programmatic changes include the examiner training program to assess large banks' performance under the Community Reinvestment Act (CRA) and a consumer education initiative, launched in conjunction with the Department of Defense, which will measure the effectiveness of financial education programs. The Division is also creating a unit dedicated entirely to emerging consumer protection issues and the associated implications for regulatory, supervisory, or other Board actions. Demands on Community Affairs staff for services and technical assistance remain high, and the division is making staff and system adjustments as appropriate; most notably, it has already launched the development of a new CRA examination tool for evaluating the performance of large state member banks.

Legal Division

The division faces an increasing workload related to both internal and external issues. During the 2004–05 biennium, efforts will focus on supervisory information-sharing arrangements with a number of countries and the EU, various financial issues arising in connection with the rebuilding of Iraq, and participation in the Treasury-led US-EU Financial Markets Regulatory Dialogue. Trade negotiations will also continue as the Treasury continues to work with the WTO and as international policy development increases.

Coordination with the Reserve Banks continues on the review of Regulation D, Reserve Requirements of Depository Institutions; ethics reviews; and legislation governing check collection and truncation. The number of investigations conducted by Litigation and Enforcement is expected to remain at a high level for the biennium, while internal reviews of Board law enforcement training, e-government, and Homeland Security will place additional pressure on the division.

The Legal Division will also remain focused on Boardwide EEO and human resource management issues.

Division of Reserve Bank Operations and Payment Systems

The division's budget reflects a strategy of focusing on three broad mission areas: Reserve Bank oversight; policy and regulation development; and payments research. To achieve its goals in these areas, the division will continue to develop sound, effective policies and regulations to foster payment system integrity, efficiency, and accessibility; produce high-quality assessments of Federal Reserve System operations that assist System management to foster sound internal controls; and conduct research and analysis to enhance policy development and promote an understanding of payment system dynamics and risk.

The division will continue its work on payment system policy issues in domestic and international arenas, and focus its research agenda on topics in the retail payments arena. As always, the division will respond in a timely fashion to external inquiries from Congress, private-sector organizations, foreign central banks, and the public regarding the Federal Reserve's payment policies and service.

Division of Information Technology

The Division of Information Technology is supporting a number of high-priority client initiatives during the 2004–05 budget period. The initiatives are the result of requests from

our customers and necessary enhancements to the Board's infrastructure and security environment. The major projects include replacing the Amdahl mainframe computer, improving information/data security, purchasing a new telephone system, replacing servers, upgrading data storage, and enhancing network infrastructure.

Working with the Office of Board Members, the division will be implementing a Content Management System for Board publications and a downloadable data project. In conjunction with the Office of the Secretary, the division will also be enhancing the Board's Federal Reserve Integrated Records Management Architecture (FIRMA).

Management Division

The Management Division will be working on numerous initiatives during the 2004–05 budget period. Consistent with the Board's highest priority to provide for the safety of its employees, the division will complete the transition to a well-trained and armed security force. Facilities maintenance and improvement projects include the installation of a fire sprinkler system in the Martin Building, Eccles roof replacement, implementation of an access control system, renovation of the Martin Building, replacing NYA electrical switchgear equipment, and substantial enhancements to perimeter security. The division will also be reviewing policies related to performance management, compensation, management succession, and other human resource related programs.

Special Projects – This budget, administered by the Management Division, provides funds for projects that do not appropriately fall within the realm of the Board's divisions or other special accounts. In 2004–05, varied projects are funded for Board operations in this budget, such as two salary-related initiatives, the employee relocation program, and the transportation subsidy. Other items included in this budget are the Reserve Bank audits, the Enhanced Foreign Economic Analysis Program, the Board's Van Pool Program, and the Board's share of Federal Financial Institutions Examination Council expenses.

Operations Budget by Account Classification

Following is a brief discussion of each account classification with major changes between budget periods.

Telecommunications (4.2 percent annual increase)

As a greater amount of the Board's work is handled with more and more complex technology, the amount of data being transmitted is significantly increasing. This budget also reflects requirements for more contingency circuits, to keep the remote sites current with the various data flows, as well as an enhanced wireless voice communication system.

Software (5.8 percent annual increase)

This increase is driven by various initiatives, including purchases made for the research divisions' automation contingency function and to support information security activities. In addition, upgrades are being made regarding content management and data downloads for the Board's public web site, and the Community Reinvestment Act analytical tool is being replaced by a Board-produced system. Slightly offsetting these increases is the completion of development and implementation of the Evolve software.

Furniture and Equipment (9.8 percent annual increase)

Increased costs in Furniture and Equipment are predominantly for additional equipment to support the Board's network infrastructure in the production and contingency environments. The purchase of Blackberries and Blueberries to improve staff communications during travel also increases Furniture and Equipment expenses; however, there will be a slight decrease in Rentals expenses, as pagers and the related airtime are discontinued. Additionally, updated servers will be installed at the relocation site.

Furniture Repairs and Maintenance (17.6 percent annual decrease)

The apparent decrease in Repairs and Maintenance is artificial; one division evaluated their accounting classifications and disbursed a significant portion of expenses to multiple, and more appropriate, account categories.

Contractual Professional Services (2.3 percent annual increase)

Although the increase in Contractual Professional Services looks relatively small, there is in fact a large decrease partially offsetting multiple new initiatives. The need for contractual canine screening teams and private security guards has been eliminated because the security force is nearly fully staffed. New initiatives include the purchase of data to monitor economic and financial developments to conduct research; an increase in the number and cost of online subscriptions; and outside contractor assistance with such items as the Board public web site, replacement of the CRA analytical tool, and enhancements to the Board's official records system.

Depreciation (4.0 percent annual increase)

New projects driving the increase in Depreciation include the new perimeter barrier system, security enhancements to the entrance of the New York Avenue building, upgrading of the mainframe, and installation of a new telephone system. Construction-related activity undertaken as a result of September 11, 2001, has also increased depreciation expense for this budget cycle.

Income (5.6 percent annual decrease)

The Board receives income from certain automation services sold to the FFIEC and the Reserve Banks. Lower rates for mainframe services and the implementation of a new rate structure for data storage media have decreased Outside Computer income.

Trends in Expenses and Employment

The rate of increase within the 2004–05 budget is 5.8 percent per year, which is less than the 6.3 percent projected average annual rate of increase since the 1994–95 biennium. The increase over this period is mainly attributable to strategic human capital initiatives and the increasing complexity of Board work over this period. The increased complexity required a net increase in positions and higher average grades, higher salaries, and increasingly sophisticated automation systems to manage ever increasing volumes of data. More recently, the Board has experienced sharply higher security costs.

Approximately three-fourths of the Board's operating expenses is for personnel; 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 1,865, a net increase of 221, or 13.4 percent. However, a large part of this increase in positions is for security precautions. 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 automation enhancements, 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 collected under 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 the cost of the new work.) The increasing complexity of monetary policy issues resulted in an increase of twenty-five 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 increased interest in private-sector companies important to the nation's financial infrastructure, nineteen positions were added. 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 acquisition of office space.

While the number of positions at the Board has fluctuated during the 1994-2005 period, the salary budget (not including retirement and insurance benefits) has remained relatively stable at roughly 63 percent of operating expenses. The portion of operating expenses devoted to retirement and insurance has increased approximately 1 percentage point over the period as a result of administrative actions to enhance benefits such as the Thrift Plan and the effect of significant rate increases for health insurance.

Over the 1994-2005 period, the average annual increase in expenses for goods and services has been 6.4 percent. The largest increase was in Contractual Professional Services. This growth resulted primarily from three 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; and (3) procurement of outside legal services. Partially offsetting the overall increase is a significant decrease in Rentals due to the purchase of the New York Avenue building.

Extraordinary Items

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 economic data 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. Preparations for the 2004 Survey of Consumer Finances have been underway since the first quarter of 2003.

During the course of 2003, Small Business Finances survey staff made a recommendation to the Board, issued a request for proposal, awarded a contract, and started preparing for the field work. Field work will begin about April 2004.