

February 14, 2002

To the Board of Directors of the
Federal Reserve Bank of Dallas:

The management of the Federal Reserve Bank of Dallas (FRBD) is responsible for the preparation and fair presentation of the Statement of Condition, Statement of Income, and Statement of Changes in Capital as of December 31, 2001 (the "Financial Statements"). The Financial Statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System and as set forth in the Financial Accounting Manual for the Federal Reserve Banks, and as such, include amounts, some of which are based on judgments and estimates of management.

The management of the FRBD is responsible for maintaining an effective process of internal controls over financial reporting including the safeguarding of assets as they relate to the Financial Statements. Such internal controls are designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation of reliable Financial Statements. This process of internal controls contains self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in the process of internal controls are reported to management, and appropriate corrective measures are implemented.

Even an effective process of internal controls, no matter how well designed, has inherent limitations, including the possibility of human error, and therefore can provide only reasonable assurance with respect to the preparation of reliable Financial Statements.

The management of the FRBD assessed its process of internal controls over financial reporting including the safeguarding of assets reflected in the Financial Statements, based upon the criteria established in the "Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, the management of the FRBD believes that the FRBD maintained an effective process of internal controls over financial reporting including the safeguarding of assets as they relate to the Financial Statements.



President

Federal Reserve Bank of Dallas



First Vice President

Federal Reserve Bank of Dallas

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors of the
Federal Reserve Bank of Dallas:

We have examined management's assertion that the Federal Reserve Bank of Dallas ("FRB Dallas") maintained effective internal control over financial reporting and the safeguarding of assets as they relate to the Financial Statements as of December 31, 2001, included in the accompanying Management's Assertion. The assertion is the responsibility of FRB Dallas management. Our responsibility is to express an opinion on the assertions based on our examination.

Our examination was made in accordance with standards established by the American Institute of Certified Public Accountants, and accordingly, included obtaining an understanding of the internal control over financial reporting, testing, and evaluating the design and operating effectiveness of the internal control, and such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that the FRB Dallas maintained effective internal control over financial reporting and over the safeguarding of assets as they relate to the Financial Statements as of December 31, 2001, is fairly stated, in all material respects, based upon criteria described in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.



March 4, 2002
Dallas, Texas

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Governors of the Federal Reserve System
and the Board of Directors of the Federal Reserve Bank of Dallas:

We have audited the accompanying statements of condition of the Federal Reserve Bank of Dallas (the "Bank") as of December 31, 2001 and 2000, and the related statements of income and changes in capital for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 3, the financial statements were prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System. These principles, policies, and practices, which were designed to meet the specialized accounting and reporting needs of the Federal Reserve System, are set forth in the "Financial Accounting Manual for Federal Reserve Banks" and constitute a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 2001 and 2000, and results of its operations for the years then ended, on the basis of accounting described in Note 3.



March 4, 2002
Dallas, Texas

Statements of Condition (in millions)

	December 31, 2001	December 31, 2000
ASSETS		
Gold certificates	\$ 477	\$ 514
Special drawing rights certificates	98	98
Coin	128	91
Items in process of collection	202	334
Loans to depository institutions	—	4
U.S. government and federal agency securities, net	10,183	15,341
Investments denominated in foreign currencies	398	513
Accrued interest receivable	103	179
Interdistrict settlement account	4,041	—
Bank premises and equipment, net	164	168
Other assets	49	48
Total assets	\$ 15,843	\$ 17,290
LIABILITIES AND CAPITAL		
Liabilities		
Federal Reserve notes outstanding, net	\$ 14,378	\$ 9,754
Deposits:		
Depository institutions	695	939
Other deposits	3	3
Deferred credit items	350	298
Interest on Federal Reserve notes due U.S. Treasury	29	30
Interdistrict settlement account	—	5,829
Accrued benefit costs	54	53
Other liabilities	6	8
Total liabilities	\$ 15,515	\$ 16,914
Capital		
Capital paid-in	164	188
Surplus	164	188
Total capital	\$ 328	\$ 376
Total liabilities and capital	\$ 15,843	\$ 17,290

The accompanying notes are an integral part of these financial statements.

Statements of Income (in millions)

FOR THE YEARS ENDED

December 31, 2001 December 31, 2000

INTEREST INCOME

Interest on U.S. government and federal agency securities	\$ 637	\$ 1,098
Interest on investments denominated in foreign currencies	9	9
Interest on loans to depository institutions	—	1
Total interest income	\$ 646	\$ 1,108

OTHER OPERATING INCOME

Income from services	\$ 64	\$ 58
Reimbursable services to government agencies	12	14
Foreign currency losses, net	(40)	(46)
U.S. government securities gains (losses), net	6	(3)
Other income	2	2
Total other operating income	\$ 44	\$ 25

OPERATING EXPENSES

Salaries and other benefits	\$ 96	\$ 92
Occupancy expense	14	13
Equipment expense	11	10
Assessments by Board of Governors	14	17
Other expenses	33	55
Total operating expenses	\$ 168	\$ 187

Net income prior to distribution

\$ 522	\$ 946
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DISTRIBUTION OF NET INCOME

Dividends paid to member banks	\$ 10	\$ 12
Transferred to (from) surplus	(24)	100
Payments to U.S. Treasury as interest on Federal Reserve notes	536	834
Total distribution	\$ 522	\$ 946

The accompanying notes are an integral part of these financial statements.

**Statements of Changes in Capital
for the Years Ended December 31, 2001,
and December 31, 2000 (in millions)**

	Capital Paid-In	Surplus	Total Capital
BALANCE AT JANUARY 1, 2000			
(4.2 million shares)	\$ 211	\$ 211	\$ 422
Net income transferred to surplus	—	100	100
Surplus transfer to the U.S. Treasury	—	(123)	(123)
Net change in capital stock redeemed (0.4 million shares)	(23)	—	(23)
	<u> </u>	<u> </u>	<u> </u>
BALANCE AT DECEMBER 31, 2000			
(3.8 million shares)	\$ 188	\$ 188	\$ 376
Transferred from surplus	—	(24)	(24)
Net change in capital stock redeemed (0.5 million shares)	(24)	—	(24)
	<u> </u>	<u> </u>	<u> </u>
BALANCE AT DECEMBER 31, 2001			
(3.3 million shares)	\$ 164	\$ 164	\$ 328
	<u> </u>	<u> </u>	<u> </u>

The accompanying notes are an integral part of these financial statements.

1. ORGANIZATION

The Federal Reserve Bank of Dallas (“Bank”) is part of the Federal Reserve System (“System”) created by Congress under the Federal Reserve Act of 1913 (“Federal Reserve Act”), which established the central bank of the United States. The System consists of the Board of Governors of the Federal Reserve System (“Board of Governors”) and 12 Federal Reserve Banks (“Reserve Banks”). The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. Other major elements of the System are the Federal Open Market Committee (“FOMC”) and the Federal Advisory Council. The FOMC is composed of members of the Board of Governors, the president of the Federal Reserve Bank of New York (“FRBNY”), and, on a rotating basis, four other Reserve Bank presidents.

Structure

The Bank and its branches in El Paso, Houston, and San Antonio serve the Eleventh Federal Reserve District, which includes Texas and portions of Louisiana and New Mexico. In accordance with the Federal Reserve Act, supervision and control of the Bank are exercised by a board of directors. Banks that are members of the System include all national banks and any state-chartered bank that applies and is approved for membership in the System.

Board of Directors

The Federal Reserve Act specifies the composition of the board of directors for each of the Reserve Banks. Each board is composed of nine members serving three-year terms: three directors, including those designated as chairman and deputy chairman, are appointed by the Board of Governors, and six directors are elected by member banks. Of the six elected by member banks, three represent the public and three represent member banks. Member banks are divided into three classes according to size. Member banks in each class elect one director representing member banks and one representing the public. In any election of directors, each member bank receives one vote, regardless of the number of shares of Reserve Bank stock it holds.

2. OPERATIONS AND SERVICES

The System performs a variety of services and operations. Functions include formulating and conducting monetary policy; participating actively in the payments mechanism, including large-dollar transfers of funds, automated clearinghouse operations, and check processing; distributing coin and currency; performing fiscal agency functions for the U.S. Treasury and certain federal agencies; serving as the federal government’s bank; providing short-term loans to depository institutions; serving the consumer and the community by providing educational materials and information regarding consumer laws; supervising bank holding companies and state member banks; and administering other regulations of the Board of Governors. The Board of Governors’ operating costs are funded through assessments on the Reserve Banks.

The FOMC establishes policy regarding open market operations, oversees these operations, and issues authorizations and directives to the FRBNY for its execution of transactions. Authorized transaction types include direct purchase and sale of securities, matched sale–purchase transactions, purchase of securities under agreements to resell, and lending of U.S. government securities. The FRBNY is also authorized by the FOMC to hold balances of and to execute spot and forward foreign exchange (“F/X”) and securities contracts in nine foreign currencies; maintain reciprocal currency arrangements (“F/X swaps”) with various central banks; and “warehouse” foreign currencies for the U.S. Treasury and Exchange Stabilization Fund (“ESF”) through the Reserve Banks.

3. SIGNIFICANT ACCOUNTING POLICIES

Accounting principles for entities with the unique powers and responsibilities of the nation’s central bank have not been formulated by the Financial Accounting Standards Board. The Board of Governors has developed specialized accounting principles and practices that it believes are appropriate for the significantly different nature and function of a central bank as compared to the private sector. These accounting principles and practices are documented in the “Financial Accounting Manual for Federal Reserve Banks” (“Financial Accounting Manual”), which is issued by the Board of Governors. All Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the Financial Accounting Manual.

The financial statements have been prepared in accordance with the Financial Accounting Manual. Differences exist between the accounting principles and practices of the System and accounting principles generally accepted in the United States of America ("GAAP"). The primary differences are the presentation of all security holdings at amortized cost, rather than at the fair value presentation requirements of GAAP, and the accounting for matched sale-purchase transactions as separate sales and purchases, rather than secured borrowings with pledged collateral, as is generally required by GAAP. In addition, the Bank has elected not to present a Statement of Cash Flows. The Statement of Cash Flows has not been included as the liquidity and cash position of the Bank are not of primary concern to users of these financial statements. Other information regarding the Bank's activities is provided in, or may be derived from, the Statements of Condition, Income, and Changes in Capital. Therefore, a Statement of Cash Flows would not provide any additional useful information. There are no other significant differences between the policies outlined in the Financial Accounting Manual and GAAP.

Effective January 2001, the System implemented procedures to eliminate the sharing of costs by Reserve Banks for certain services a Reserve Bank may provide on behalf of the System. Data for 2001 reflect the adoption of this policy. Major services provided for the System by this Bank, for which the costs will not be redistributed to the other Reserve Banks, include the Bulkdata Transmission Utility, Check Electronic Access and Delivery, Check Standardization, Centralized Loans Automated System, and National Examination Data System.

The preparation of the financial statements in conformity with the Financial Accounting Manual requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Certain amounts relating to the prior year have been reclassified to conform to the current-year presentation. Unique accounts and significant accounting policies are explained below.

a. Gold Certificates

The Secretary of the Treasury is authorized to issue gold certificates to the Reserve Banks to monetize gold held by the U.S. Treasury. Payment for the gold certificates by the Reserve Banks is made by crediting equivalent amounts in dollars into the account established for the U.S. Treasury. These gold certificates held by the Reserve Banks are required to be backed by the gold of the U.S. Treasury. The U.S. Treasury may reacquire the gold certificates at any time, and the Reserve Banks must deliver them to the U.S. Treasury. At such time, the U.S. Treasury's account is charged and the Reserve Banks' gold certificate accounts are lowered. The value of gold for purposes of backing the gold certificates is set by law at \$42-2/9 a fine troy ounce. The Board of Governors allocates the gold certificates among Reserve Banks once a year based upon average Federal Reserve notes outstanding in each District.

b. Special Drawing Rights Certificates

Special drawing rights ("SDRs") are issued by the International Monetary Fund ("Fund") to its members in proportion to each member's quota in the Fund at the time of issuance. SDRs serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for United States participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates, somewhat like gold certificates, to the Reserve Banks. At such time, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDRs, at the direction of the U.S. Treasury, for the purpose of financing SDR certificate acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates amounts among Reserve Banks based upon Federal Reserve notes outstanding in each District at the end of the preceding year. There were no SDR transactions in 2001.

c. Loans to Depository Institutions

The Depository Institutions Deregulation and Monetary Control Act of 1980 provides that all depository institutions that maintain reservable transaction accounts or nonpersonal time deposits, as defined in Regulation D issued by the Board of Governors, have borrowing privileges at the discretion of the Reserve Banks. Borrowers execute certain lending agreements and deposit sufficient collateral before credit is extended. Loans are evaluated for collectibility, and currently all are considered collectible and fully collateralized. If any loans were deemed to be uncollectible, an appropriate reserve would be established. Interest is accrued using the applicable discount rate established at least every 14 days by the boards of directors of the Reserve Banks, subject to review by the Board of Governors. Reserve Banks retain the option to impose a surcharge above the basic rate in certain circumstances.

d. U.S. Government and Federal Agency Securities and Investments Denominated in Foreign Currencies

The FOMC has designated the FRBNY to execute open market transactions on its behalf and to hold the resulting securities in the portfolio known as the System Open Market Account (“SOMA”). In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes and directs the FRBNY to execute operations in foreign markets for major currencies in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC in carrying out the System’s central bank responsibilities. Such authorizations are reviewed and approved annually by the FOMC.

Matched sale–purchase transactions are accounted for as separate sale and purchase transactions. Matched sale–purchase transactions are transactions in which the FRBNY sells a security and buys it back at the rate specified at the commencement of the transaction.

The FRBNY has sole authorization by the FOMC to lend U.S. government securities held in the SOMA to U.S. government securities dealers and to banks participating in U.S. government securities clearing arrangements on behalf of the System, in order to facilitate the effective functioning of the domestic securities market. These securities-lending transactions are fully collateralized by other U.S. government securities. FOMC policy requires FRBNY to take possession of collateral in excess of the market values of the securities loaned. The market values of the collateral and the securities loaned are monitored by FRBNY on a daily basis, with additional collateral obtained as necessary. The securities loaned continue to be accounted for in the SOMA.

Foreign exchange contracts are contractual agreements between two parties to exchange specified currencies, at a specified price, on a specified date. Spot foreign contracts normally settle two days after the trade date, whereas the settlement date on forward contracts is negotiated between the contracting parties, but will extend beyond two days from the trade date. The FRBNY generally enters into spot contracts, with any forward contracts generally limited to the second leg of a swap/warehousing transaction.

The FRBNY, on behalf of the Reserve Banks, maintains renewable, short-term F/X swap arrangements with two authorized foreign central banks. The parties agree to exchange their currencies up to a prearranged maximum amount and for an agreed-upon period of time (up to 12 months) at an agreed-upon interest rate. These arrangements give the FOMC temporary access to foreign currencies that it may need for intervention operations to support the dollar and give the partner foreign central bank temporary access to dollars it may need to support its own currency. Drawings under the F/X swap arrangements can be initiated by either the FRBNY or the partner foreign central bank, and must be agreed to by the drawee. The F/X swaps are structured so that the party initiating the transaction (the drawer) bears the exchange rate risk upon maturity. The FRBNY will generally invest the foreign currency received under an F/X swap in interest-bearing instruments.

Warehousing is an arrangement under which the FOMC agrees to exchange, at the request of the Treasury, U.S. dollars for foreign currencies held by the Treasury or ESF over a limited period of time. The purpose of the warehousing facility is to supplement the U.S. dollar resources of the Treasury and ESF for financing purchases of foreign currencies and related international operations.

In connection with its foreign currency activities, the FRBNY, on behalf of the Reserve Banks, may enter into contracts that contain varying degrees of off-balance-sheet market risk, because they rep-

resent contractual commitments involving future settlement and counterparty credit risk. The FRBNY controls credit risk by obtaining credit approvals, establishing transaction limits, and performing daily monitoring procedures.

While the application of current market prices to the securities currently held in the SOMA portfolio and investments denominated in foreign currencies may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Reserve Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio from time to time involve transactions that can result in gains or losses when holdings are sold prior to maturity. However, decisions regarding the securities and foreign currencies transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, earnings and any gains or losses resulting from the sale of such currencies and securities are incidental to the open market operations and do not motivate its activities or policy decisions.

U.S. government and federal agency securities and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Interest income is accrued on a straight-line basis and is reported as “Interest on U.S. government and federal agency securities” or “Interest on investments denominated in foreign currencies,” as appropriate. Income earned on securities-lending transactions is reported as a component of “Other income.” Gains and losses resulting from sales of securities are determined by specific issues based on average cost. Gains and losses on the sales of U.S. government and federal agency securities are reported as “U.S. government securities gains (losses), net.” Foreign currency-denominated assets are revalued daily at current market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on investments denominated in foreign currencies are reported as “Foreign currency losses, net.” Foreign currencies held through F/X swaps, when initiated by the counterparty, and warehousing arrangements are revalued daily, with the unrealized gain or loss reported by the FRBNY as a component of “Other assets” or “Other liabilities,” as appropriate.

Balances of U.S. government and federal agency securities bought outright, securities loaned, investments denominated in foreign currency, interest income, securities lending fee income, amortization of premiums and discounts on securities bought outright, gains and losses on sales of securities, and realized and unrealized gains and losses on investments denominated in foreign currencies, excluding those held under an F/X swap arrangement, are allocated to each Reserve Bank. Income from securities lending transactions undertaken by the FRBNY are also allocated to each Reserve Bank. Securities purchased under agreements to resell and unrealized gains and losses on the revaluation of foreign currency holdings under F/X swaps and warehousing arrangements are allocated to the FRBNY and not to other Reserve Banks.

Statement of Financial Accounting Standards No. 133, as amended and interpreted, became effective on January 1, 2001. For the periods presented, the Reserve Banks had no derivative instruments required to be accounted for under the Standard.

e. Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over estimated useful lives of assets ranging from 2 to 50 years. New assets, major alterations, renovations, and improvements are capitalized at cost as additions to the asset accounts. Maintenance, repairs, and minor replacements are charged to operations in the year incurred. Internally developed software is capitalized based on the cost of direct materials and services and those indirect costs associated with developing, implementing, or testing software.

f. Interdistrict Settlement Account

At the close of business each day, all Reserve Banks and branches assemble the payments due to or from other Reserve Banks and branches as a result of transactions involving accounts residing in other Districts that occurred during the day’s operations. Such transactions may include funds settlement, check clearing and automated clearinghouse operations, and allocations of shared expenses. The cumulative net amount due to or from other Reserve Banks is reported as the “Interdistrict settlement account.”

g. Federal Reserve Notes

Federal Reserve notes are the circulating currency of the United States. These notes are issued through the various Federal Reserve agents to the Reserve Banks upon deposit with such agents of certain classes of collateral security, typically U.S. government securities. These notes are identified as issued to a specific Reserve Bank. The Federal Reserve Act provides that the collateral security tendered by the Reserve Bank to the Federal Reserve agent must be equal to the sum of the notes applied for by such Reserve Bank. In accordance with the Federal Reserve Act, gold certificates, special drawing rights certificates, U.S. government and federal agency securities, tri-party agreements, loans to depository institutions, and investments denominated in foreign currencies are pledged as collateral for net Federal Reserve notes outstanding. The collateral value is equal to the book value of the collateral tendered, with the exception of securities, whose collateral value is equal to the par value of the securities tendered. The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the Federal Reserve notes. The Reserve Banks have entered into an agreement that provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes of all Reserve Banks in order to satisfy their obligation of providing sufficient collateral for outstanding Federal Reserve notes. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, as obligations of the United States, Federal Reserve notes are backed by the full faith and credit of the U.S. government.

The "Federal Reserve notes outstanding, net" account represents Federal Reserve notes reduced by currency held in the vaults of the Bank of \$19,062 million and \$22,713 million at December 31, 2001, and December 31, 2000, respectively.

h. Capital Paid-in

The Federal Reserve Act requires that each member bank subscribe to the capital stock of the Reserve Bank in an amount equal to 6 percent of the capital and surplus of the member bank. As a member bank's capital and surplus change, its holdings of the Reserve Bank's stock must be adjusted. Member banks are those state-chartered banks that apply and are approved for membership in the System and all national banks. Currently, only one-half of the subscription is paid-in, and the remainder is subject to call. These shares are nonvoting with a par value of \$100. They may not be transferred or hypothecated. By law, each member bank is entitled to receive an annual dividend of 6 percent on the paid-in capital stock. This cumulative dividend is paid semiannually. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

i. Surplus

The Board of Governors requires Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks would be required to call on member banks for additional capital. Reserve Banks are required by the Board of Governors to transfer to the U.S. Treasury excess earnings, after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in.

The Consolidated Appropriations Act of 2000 (Public Law 106-113, Section 302) directed the Reserve Banks to transfer to the U.S. Treasury additional surplus funds of \$3,752 million during the federal government's 2000 fiscal year. The Federal Reserve Bank of Dallas transferred \$123 million to the U.S. Treasury. Reserve Banks were not permitted to replenish surplus for these amounts during fiscal year 2000, which ended September 30, 2000; however, the surplus was replenished by December 31, 2000.

In the event of losses or a substantial increase in capital, payments to the U.S. Treasury are suspended until such losses are recovered through subsequent earnings. Weekly payments to the U.S. Treasury may vary significantly.

j. Income and Costs Related to Treasury Services

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States. By statute, the Department of the Treasury is permitted, but not required, to pay for these services. The costs of providing fiscal agency and depository services to the Treasury Department that have been billed but not paid are immaterial and included in "Other expenses."

k. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property, which are reported as a component of "Occupancy expense."

4. U.S. GOVERNMENT AND FEDERAL AGENCY SECURITIES

Securities bought outright are held in the SOMA at the FRBNY. An undivided interest in SOMA activity, with the exception of securities held under agreements to resell and the related premiums, discounts, and income, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of interdistrict clearings. The settlement, performed in April of each year, equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding. The Bank's allocated share of SOMA balances was 1.813 percent and 2.959 percent at December 31, 2001, and December 31, 2000, respectively.

The Bank's allocated share of securities held in the SOMA at December 31 that were bought outright was as follows (in millions):

	2001	2000
Par value:		
Federal agency	\$ —	\$ 4
U.S. government		
Bills	3,301	5,289
Notes	4,821	7,106
Bonds	1,879	2,745
Total par value	\$ 10,001	\$ 15,144
Unamortized premiums	205	288
Unaccreted discounts	(23)	(91)
Total allocated to Bank	\$10,183	\$15,341

Total SOMA securities bought outright were \$561,701 million and \$518,501 million at December 31, 2001, and December 31, 2000, respectively.

The maturity distribution of U.S. government and federal agency securities bought outright, which were allocated to the Bank at December 31, 2001, were as follows (in millions):

Maturities of Securities Held	Par value		
	U.S. Government Securities	Federal Agency Obligations	Total
Within 15 days	\$ 194	\$ —	\$ 194
16 days to 90 days	2,258	—	2,258
91 days to 1 year	2,368	—	2,368
Over 1 year to 5 years	2,776	—	2,776
Over 5 years to 10 years	967	—	967
Over 10 years	1,438	—	1,438
Total	\$ 10,001	\$ —	\$ 10,001

At December 31, 2001, and December 31, 2000, matched sale-purchase transactions involving U.S. government securities with par values of \$23,188 million and \$21,112 million, respectively, were outstanding, of which \$420 million and \$625 million were allocated to the Bank. Matched sale-purchase transactions are generally overnight arrangements.

At December 31, 2001, and December 31, 2000, U.S. government securities with par values of \$7,345 million and \$2,086 million, respectively, were loaned from the SOMA, of which \$133 million and \$62 million were allocated to the Bank.

5. INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and the Bank for International Settlements and invests in foreign government debt instruments. Foreign government debt instruments held include both securities bought outright and securities held under agreements to resell. These investments are guaranteed as to principal and interest by the foreign governments.

Each Reserve Bank is allocated a share of foreign currency-denominated assets, the related interest income, and realized and unrealized foreign currency gains and losses, with the exception of unrealized gains and losses on F/X swaps and warehousing transactions. This allocation is based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. The Bank's allocated share of investments denominated in foreign currencies was approximately 2.731 percent and 3.275 percent at December 31, 2001, and December 31, 2000, respectively.

The Bank's allocated share of investments denominated in foreign currencies, valued at current exchange rates at December 31, was as follows (in millions):

	2001	2000
European Union euro:		
Foreign currency deposits	\$ 125	\$ 152
Government debt instruments including agreements to resell	74	89
Japanese yen:		
Foreign currency deposits	52	90
Government debt instruments including agreements to resell	145	180
Accrued interest	2	2
Total	\$398	\$513

Total investments denominated in foreign currencies were \$14,559 million and \$15,670 million at December 31, 2001, and December 31, 2000, respectively.

The maturity distribution of investments denominated in foreign currencies that were allocated to the Bank at December 31, 2001, were as follows (in millions):

Maturities of Investments Denominated in Foreign Currencies	
Within 1 year	\$ 375
Over 1 year to 5 years	11
Over 5 years to 10 years	12
Over 10 years	—
Total	\$ 398

At December 31, 2001, and December 31, 2000, there were no open foreign exchange contracts or outstanding F/X swaps.

At December 31, 2001, and December 31, 2000, the warehousing facility was \$5 billion, with zero outstanding.

6. BANK PREMISES AND EQUIPMENT

A summary of bank premises and equipment at December 31 is as follows (in millions):

	2001	2000
Bank premises and equipment:		
Land	\$ 30	\$ 30
Buildings	115	114
Building machinery and equipment	24	24
Construction in progress	3	—
Furniture and equipment	76	79
	248	247
Accumulated depreciation	(84)	(79)
Bank premises and equipment, net	\$164	\$168

Depreciation expense was \$10 million and \$11 million for the years ended December 31, 2001, and December 31, 2000, respectively.

On June 30, 2000, the Houston office sold its building for \$4 million, net of costs of the sale of \$309,000, with a corresponding leaseback agreement allowing the Houston office use of the facility for up to five years while a new building is under construction. The sale is considered a sale-leaseback, with the lease classified as an operating lease. The sale resulted in a loss of \$2 million. Seventy-five percent of the sales price is financed with a promissory note due when the premises are vacated, but no sooner than four years from the date of purchase. The note, which contains no stated rate of interest, was discounted using the then current Treasury borrowing rate of 6.298 percent. The leaseback agreement stipulates that no rent is due during the lease term, with the Houston office responsible for property taxes and maintenance. Deferred rent expense of \$1 million was imputed using current rental rates for a comparable facility with similar stipulations.

7. COMMITMENTS AND CONTINGENCIES

At December 31, 2001, the Bank was obligated under noncancelable leases for premises and equipment with terms ranging from one to approximately four years. These leases provide for increased rentals based upon increases in real estate taxes, operating costs, or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance, and maintenance when included in rent), net of sublease rentals, was \$2 million and \$699,000 for the years ended December 31, 2001, and December 31, 2000, respectively. Certain of the Bank's leases have options to renew.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with terms of one year or more, at December 31, 2001, were as follows (in thousands):

	Operating
2002	\$ 578
2003	262
2004	142
2005	38
Total	\$ 1,020

At December 31, 2001, there were no other commitments and long-term obligations in excess of one year.

Under the Insurance Agreement of the Federal Reserve Banks dated March 2, 1999, each of the Reserve Banks has agreed to bear, on a per-incident basis, a pro rata share of losses in excess of 1 percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio that a Reserve Bank's capital paid-in bears to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under such agreement at December 31, 2001, or December 31, 2000.

The Bank is involved in certain legal actions and claims arising in the ordinary course of business. Although it is difficult to predict the ultimate outcome of these actions, in management's opinion, based on discussions with counsel, the aforementioned litigation and claims will be resolved without material adverse effect on the financial position or results of operations of the Bank.

8. RETIREMENT AND THRIFT PLANS

Retirement Plans

The Bank currently offers two defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the Bank's employees participate in the Retirement Plan for Employees of the Federal Reserve System ("System Plan") and the Benefit Equalization Retirement Plan ("BEP"). The System Plan is a multi-employer plan with contributions fully funded by participating employers. No separate accounting is maintained of assets contributed by the participating employers. The Bank's projected benefit obligation and net pension costs for the BEP at December 31, 2001, and December 31, 2000, and for the years then ended, are not material.

Thrift Plan

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System (“Thrift Plan”). The Bank’s Thrift Plan contributions totaled \$3 million for each of the years ended December 31, 2001, and December 31, 2000, and are reported as a component of “Salaries and other benefits.”

9. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS AND POSTEMPLOYMENT BENEFITS

Postretirement Benefits Other Than Pensions

In addition to the Bank’s retirement plans, employees who have met certain age and length-of-service requirements are eligible for both medical benefits and life insurance coverage during retirement.

The Bank funds benefits payable under the medical and life insurance plans as due and, accordingly, has no plan assets. Net postretirement benefit costs are actuarially determined using a January 1 measurement date.

Following is a reconciliation of beginning and ending balances of the benefit obligation (in millions):

	2001	2000
Accumulated postretirement benefit obligation at January 1	\$ 34.9	\$ 32.7
Service cost—benefits earned during the period	1.0	1.0
Interest cost of accumulated benefit obligation	2.8	2.3
Actuarial loss	6.2	0.1
Contributions by plan participants	0.3	0.3
Benefits paid	(1.7)	(1.5)
Plan amendments, acquisitions, foreign currency exchange rate changes, business combinations, divestitures, curtailments, settlements, special termination benefits	(2.0)	—
Accumulated postretirement benefit obligation at December 31	\$ 41.5	\$ 34.9

Following is a reconciliation of the beginning and ending balance of the plan assets, the unfunded postretirement benefit obligation, and the accrued postretirement benefit cost (in millions):

	2001	2000
Fair value of plan assets at January 1	\$ —	\$ —
Contributions by the employer	1.4	1.2
Contributions by plan participants	0.3	0.3
Benefits paid	(1.7)	(1.5)
Fair value of plan assets at December 31	\$ —	\$ —
Unfunded postretirement benefit obligation	\$ 41.5	\$ 34.9
Unrecognized prior service cost	15.3	14.4
Unrecognized net actuarial loss	(9.2)	(3.2)
Accrued postretirement benefit costs	\$ 47.6	\$ 46.1

Accrued postretirement benefit costs are reported as a component of “Accrued benefit costs.”

At December 31, 2001, and December 31, 2000, the weighted-average discount rate assumptions used in developing the benefit obligation were 7.0 percent and 7.5 percent, respectively.

For measurement purposes, a 10.0 percent annual rate of increase in the cost of covered health care benefits was assumed for 2002. Ultimately, the health care cost trend rate is expected to decrease gradually to 5.0 percent by 2008, and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A 1 percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2001 (in millions):

	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	\$ 0.1	\$ (0.1)
Effect on accumulated postretirement benefit obligation	1.2	(1.1)

The following is a summary of the components of net periodic postretirement benefit costs for the years ended December 31 (in millions):

	2001	2000
Service cost—benefits earned during the period	\$ 1.0	\$ 1.0
Interest cost of accumulated benefit obligation	2.8	2.3
Amortization of prior service cost	(1.0)	(1.0)
Recognized net actuarial loss	0.1	—
Net periodic postretirement benefit costs	\$ 2.9	\$ 2.3

Net periodic postretirement benefit costs are reported as a component of “Salaries and other benefits.”

Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined and include the cost of medical and dental insurance, survivor income, and disability benefits. Costs were projected using the same discount rate and health care trend rates as were used for projecting postretirement costs. The accrued postemployment benefit costs recognized by the Bank at December 31, 2001, and December 31, 2000, were \$6 million each year. This cost is included as a component of “Accrued benefit costs.” Net periodic postemployment benefit costs included in 2001 and 2000 operating expenses were \$1 million each year.

Volume of Operations**(UNAUDITED)**

	Number of Items Handled (Thousands)		Dollar Amount (Millions)	
	2001	2000	2001	2000
SERVICES TO DEPOSITORY INSTITUTIONS				
CASH SERVICES				
Federal Reserve notes processed	2,394,863	2,181,705	37,720	37,128
Currency received from circulation	2,448,543	2,327,013	38,533	38,054
Coin received from circulation	1,383,392	1,117,063	173	141
CHECK PROCESSING				
Commercial—processed	1,321,166	1,285,998	818,354	754,315
Commercial—fine sorted	81,087	112,186	92,803	37,657
U.S. government checks	29,390	22,795	24,877	21,400
ELECTRONIC PAYMENTS				
Funds transfers processed	13,659	13,050	15,748,657	15,524,004
Book-entry security transfers processed	73	84	1,916,375	1,791,126
LOANS				
Advances made	202*	613*	350	2,497
SERVICES TO THE U.S. TREASURY AND GOVERNMENT AGENCIES				
Issues and reinvestments of Treasury securities	70	39	2,535	1,575

*Individual loans, not in thousands.