Governance, financial statements and risk

Governance of the Bank

The role of the Court of Directors and its Committees, and the names of the members of the Court of Directors, together with the principal outside appointments of the Non-executive Directors are given on pages 6–9.

Statement of the responsibilities of the Court of Directors in relation to the financial statements

The Court of Directors is responsible for ensuring that the financial statements of the Banking Department are properly prepared on the basis set out therein, as at 28 February 2009 and for the year to that date. The statements of account of the Issue Department are prepared in accordance with provisions agreed between the Bank and HM Treasury to implement the requirements of the Currency and Bank Notes Act 1928 and the National Loans Act 1968. The Court of Directors is responsible for ensuring that the statements of account are prepared in accordance with these requirements.

The Court of Directors is responsible for ensuring proper accounting records are kept, which disclose at any time the financial position of the Bank and enable Court to ensure that the financial statements comply with the requirements set out in note 2 thereto. The Court of Directors is also responsible for safeguarding the assets of the Bank and its subsidiaries, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Court of Directors confirms that suitable accounting policies, consistently applied and supported by reasonable and prudent judgement and estimates, have been used in the preparation of the financial statements of the Banking Department. The accounting framework adopted is set out on pages 56–63.

The directors who held office at the date of approval of this *Report* confirm that, so far as they are aware, there is no relevant audit information of which the Bank's auditors are unaware; and each director has taken all steps that they ought to have taken as a director to make themselves aware of any relevant information and to establish that the Bank's auditors are aware of that information.

Principal activities and review of operations

The Bank's Core Purposes are set out on page 1. The Governor's Foreword, the Review of 2009/10 and the Expenditure Review give a detailed account of the Bank's activities and operations during the year.

Financial results

The Banking Department's financial statements for the year ended 28 February 2009 are given on pages 52–96, and show a profit before tax of £995 million (2007/08: £197 million). After a tax charge of £162 million (2007/08: £36 million) and a payment in lieu of dividend of £417 million (2007/08: £81 million), the profit transferred to reserves amounts to £417 million (2007/08: £80 million).

The statements of account for the Issue Department (which are given on pages 97–99) show that the profits of the note issue were £2.2 billion (2007/08: £2.3 billion). These profits are all payable to HM Treasury.

Banking Department balance sheet

The Banking Department balance sheet expanded during 2008/09, to £147.9 billion at 28 February 2009 (2007/08: £72 billion).

Almost all of the change in Banking Department assets can be attributed to 'loans and advances to banks', which increased to £136.8 billion at 28 February 2009 (2007/08: £62.8 billion). The Bank expanded the use of three-month reverse repos during 2008/09 and introduced US dollar reverse repos. Loans and advances to Northern Rock were repaid during the year (2007/08: £24.3 billion).

The composition of Banking Department liabilities changed during 2008/09. The Bank introduced seven-day sterling bills, with £42.2 billion outstanding at 28 February 2009 (2007/08: £ nil), and the Issue deposit with Banking Department stood at £29.2 billion at 28 February 2009 (2007/08: £19.2 billion). US dollar reverse repos were funded by borrowing from the US Federal Reserve and, in total, sterling and foreign currency deposits taken from central banks increased during the course of the year, to £24.4 billion (2007/08: £18.6 billion). During 2008/09, the Bank provided deposit facilities to Northern Rock, with £9.1 billion outstanding at 28 February 2009 (2007/08: £0.1 billion). In total, deposits from banks and other financial institutions at 28 February 2009 were £42.2 billion (2007/08: £24.9 billion) including reserve balances.

At 28 February 2009, the Banking Department balance sheet contained £3 billion of liabilities associated with the management of the Bank's foreign exchange reserves (2007/08: £3.4 billion). In March 2008, the Bank launched a $2 billion three-year RegS/144A Eurobond; a further $2 billion bond was issued shortly after the

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2008/09 financial year end. In January 2009, €3.3 billion of the Bank's three-year denominated notes (originally issued in 2005) matured. Proceeds are invested in foreign currency assets, and swaps are held to minimise exposure to interest rate, currency and liquidity risks.

The Banking Department balance sheet also contains the Bank's capital and reserves and Cash Ratio Deposits (CRDs). These are predominantly invested in gilts and supranational sterling bonds. At end-February, capital and reserves totalled £3.3 billion (2007/08: £2.3 billion). The increase on the year reflected higher retained profit, largely in relation to the long-term reverse repos, and a surplus from operations indemnified from HM Treasury, in particular the Special Liquidity Scheme. CRDs were £2.4 billion at 28 February 2009 (2007/08: £2.9 billion). The level of CRDs declined following a reduction in the CRD ratio on 2 June 2008 following the public consultation undertaken in 2007. The Banking Department's holdings of gilts securities were £2.6 billion at 28 February 2009 (2007/08: £2.5 billion) and holdings of other supranational sterling bonds were £980 million (2007/08: £1,021 million).

Issue Department balance sheet

Banknote liabilities continued to increase year on year, and were £48.6 billion on 28 February 2009 (2007/08: £45 billion).

Gilt purchases on Issue Department, introduced in January 2008, continued, and the value of gilt securities at 28 February 2009 was £5.4 billion (2007/08: £0.8 billion); the Ways and Means advance to HM Treasury was £4.1 billion at 28 February 2009 (2007/08: £7.4 billion).

Reverse repos outstanding at 28 February 2009 were £9.8 billion (2007/08: £17.6 billion), and the Issue Department's deposit with Banking Department, netted out in the consolidated balance sheet, was £29.2 billion (2007/08: £19.2 billion).

A combined balance sheet

The separation of Banking from Issue in the Accounts is required by statute. A summary combined Bank balance sheet as at 28 February 2009 is set out below. It is provided for information purposes only, to assist comparison with other central banks.

In summary, the combined balance sheet increased by £69.5 billion. Sterling bills in issue were £42.2 billion, sterling and foreign currency deposits taken increased by £23.4 billion and banknote liabilities increased by £3.6 billion. This funded an increase in loans and advances of £68.3 billion, increased outright gilt purchases by £4.8 billion offset by a reduction in the Ways and Means advance by £3.2 billion.

Summary combined balance sheet

	2009 £m	2008 £m
Assets		
Ways and Means advance	4,142	7,370
Loans and advances	148,958	80,684
Financial assets designated at fair value through profit or loss	3,334	3,742
Derivative financial instruments	287	122
Available for sale securities	9,380	4,650
Other assets	1,210	1,200
Total assets	**167,311**	**97,768**
Liabilities		
Notes in circulation	48,608	44,978
Money markets instruments in issue	42,212	–
Deposits	68,955	45,552
Derivative financial instruments	81	727
Financial liabilities designated at fair value through profit or loss	2,965	3,377
Other liabilities	1,169	841
Capital and reserves	3,321	2,293
Total equity and liabilities	**167,311**	**97,768**

Payment in lieu of dividend to HM Treasury

The Bank of England Act 1946, as amended by the Bank of England Act 1998, requires the Bank to pay to HM Treasury, in lieu of dividend on the Bank's capital, on the fifth day of April and October (or prior working day), a sum equal to 25% of the Bank's post-tax profit for the previous financial year or such other sum as the Bank and HM Treasury may agree. The overall effect is that the Bank and HM Treasury will normally share post-tax profits equally. Accordingly, the Bank paid £39 million in April 2008 and £42 million in October 2008 in respect of the year to 29 February 2008. On 3 April 2009, the Bank paid the first payment of £203 million in respect of the financial year ended 28 February 2009, based on provisional full-year figures. The balance will be paid on 5 October 2009.

Risk management

In order to effectively and efficiently deliver its Core Purposes and Strategy the Bank is required to identify, assess and manage a wide range of risks to its business. The Bank's risks are managed through an overarching framework in order to apply consistency and transparency across the organisation. The framework identifies the roles and responsibilities of key parties in the risk management process, the policies for how risks are managed, the tools and processes used and the reporting outputs that are generated.

The Bank's risk framework

The Bank's risk management framework is designed to facilitate the identification, assessment, mitigation and management of risks which may impede the Bank's achievement of its Core Purposes and Strategy. This includes ensuring that suitable risk management processes are implemented across the Bank, and that management develop suitable mitigating actions for those exposures deemed unacceptable.

Risks are divided into three high-level categories, although there can be overlap between these:

- Strategic: Policy risks, governance issues or external factors which directly impact the Bank's ability to meet its Core Purposes.
- Operational: Risk arising as a result of weaknesses in business processes, systems, or through staff or third-party actions which have an impact on the delivery of the Bank's key business functions or on its reputation.
- Financial: Risks to the Bank's capital that may arise through crystallisation of market, credit or liquidity risks in the Bank's balance sheet.

The risk framework is designed to ensure that the above risk types are managed in a consistent and efficient way, and that decisions to accept or mitigate risks are taken expediently and transparently. This includes ensuring risk tolerance levels are set, exceptions and incidents are monitored and that decisions and actions are taken where necessary.

The Bank's process for identifying, evaluating and managing significant risks is in accord with the guidance contained in the Combined Code issued by the Financial Reporting Council. An annual review of the effectiveness of the Bank's system of internal control is undertaken by the Executive Directors, and its findings are reported to Audit Committee and Court.

Risk policy

The Bank's risk policy and appetite is articulated in a set of eleven Risk Standards. The Standards are a high-level articulation of how key categories of risk are identified, assessed, controlled and monitored within the Bank. The existing Risk Standards are designed to cover the risk categories of most significance to the Bank's risk profile. This assessment will be updated regularly, and changes to the population of Standards may be proposed in future. Each Risk Standard is owned by a member of the Executive Team. The Standards are reviewed on an annual basis, and updated accordingly.

Risk governance

The key elements of the risk framework governance structure are listed below:

The Court of Directors: Court's overall responsibilities include determining the Bank's objectives and strategy, and ensuring the effective discharge of the Bank's functions and the most efficient use of the Bank's resources. Within this Court takes responsibility for the overall governance framework of the Bank, including the Bank's risk framework and system of internal controls.

The Audit Committee: The Audit Committee assists Court in meeting its responsibilities for an effective system of financial reporting, internal control and risk management. It has responsibility for reviewing the findings of internal

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and external auditors and monitoring outstanding actions for timely completion. It is supported by the Bank's Internal Audit function. Audit Committee receives reports on the operation of the risk framework and the risk management processes and systems in place in the Bank.

The Executive Team (ET): ET members are responsible for managing the risks within their Directorates, and ET itself is responsible for managing overarching issues and risks faced by the whole institution, particularly strategic and policy risks.

The Business Risk Committee (BRC): The BRC ensures that the risk framework provides the risk information required by the Bank's senior management to manage the Bank's risk profile, and that the risk profile fully articulates those risks which may impact the Bank's ability to achieve its objectives. This includes ensuring that the framework delivers risk profile reports, that associated exception items are cleared, and that action plans are implemented by the risk owners on timely basis. BRC responsibilities can be summarised in three areas:

- Risk framework oversight — ensuring that the risk framework is fit for purpose and operates effectively.
- Operational risk profile oversight — ensuring that the Bank's operational risk profile is managed within the Bank's risk appetite. This includes responsibility for reviewing plans for key Bank-wide risk mitigants, such as insurance.
- Risk reporting — ensuring that the appropriate operational risk profile issues are reported to ET and Court. This includes significant risk issues, incidents, out of tolerance items (such as Key Risk Indicators) and past due action plans.

Risk Oversight Unit (ROU): The Risk Oversight Unit, in the Finance Directorate, is responsible for providing senior management with the Bank-wide risk profile; the two key reporting outputs being the Quarterly Risk Report to BRC and the Quarterly Risk Report to Executive Team and Court. ROU supports BRC, acting as a secretariat function and reporting to BRC on the implementation and operation of the risk framework throughout the Bank.

The ROU designs and implements risk management methodologies to fulfil the activities in the risk management life cycle; identification, assessment, mitigation and monitoring. This includes initial statements of risk appetite, operational risk assessment and quantification methodologies, and (in conjunction with risk owners) Key Risk Indicator (KRI) thresholds. ROU manages the Bank-wide risk information systems (the central risk register system, and the incident management system) and associated reporting structures.

Assets and Liabilities Advisory Committee (ALCO): ALCO supports and advises the Executive Director, Markets on the management of the Bank's balance sheet under the terms of the Balance Sheet Remit from the Governor. In the context of the Remit and risk framework, it monitors the financial performance and risk profile of the Bank's main financial activities, and of the balance sheet as a whole.

Risk Management Division (RMD), Markets : RMD is responsible for analysing the financial risks faced by the Bank in its operations in financial markets, whether on behalf of HM Government or on the Bank's own account. RMD is responsible for the development of the appropriate framework, and articulation of appetite, for the management of financial risks, as set out in the three financial risk standards. This includes analysis of the creditworthiness of counterparties, issuers and central bank customers to whom the Bank and/or EEA may have credit exposures and the establishment of eligibility criteria for assets taken as collateral.

Markets Strategy and Risk Operations (MSRO), Markets: MSRO is responsible for the implementation of the agreed risk framework, including reporting on credit, market and liquidity risk. It is also responsible for operational risk management processes across the Markets Directorate and for preparations for contingencies with respect to financial operations.

Governance of operational risk management within Directorates

Each Directorate has staff that are given responsibility for co-ordinating risk management activities for that business area. In the case of Banking Services and Markets there are dedicated organisational units set up to deliver the risk framework locally; for Markets this responsibility lies with Markets Strategy and Risk Operations Division (see above), in Banking Services the Banking Risk Unit (BRU) is responsible for developing and implementing a framework to ensure that Banking Services risks are effectively managed. The responsibilities of BRU cover:

- Operational Risk and Control (including Compliance);

- Credit and Regulatory Risk (including Anti-Money Laundering); and
- Business Continuity (including Financial Crisis management).

BRU liaise with Risk Oversight Unit and Risk Management Division on an ongoing basis in its performance of these functions.

Other risk management committees

The executive committees and organisational units described above are in place to provide assurance to Court on the management of operational, financial and strategic risks. A number of additional committees have been established within business areas, or across the organisation, to manage specific risk types. Outputs from all of these committees feed into the overarching framework described above — either through BRC (for operational risks) or through ALCO (for financial risks).

Markets Directorate has established additional committees to oversee specific risks arising as a result of new market operations undertaken during the past financial year, including the Special Liquidity Scheme and the Asset Purchase Facility.

Collateral management

The range of collateral eligible under the Bank's market operations has expanded significantly in the past year. The Risk Management Division in Markets Directorate is responsible for the risk management of non-sovereign collateral accepted under the Special Liquidity Scheme, Discount Window Facility, Asset Purchase Facility and extended long-term repo operations. The headcount for this team has increased in the last year to reflect the increased workload. Investment has also been made in new systems to manage collateral, and further projects to improve systems and processes are planned for 2009/10.

The management of financial risk is discussed in note 33 to the Financial Statements.

Exchange Equalisation Account

The Bank acts as agent for HM Treasury in managing the United Kingdom's foreign currency assets and gold reserves, and its foreign currency liabilities. These funds are not held on the Bank's balance sheet, but in HM Government's Exchange Equalisation Account (EEA). The risks incurred in conducting this business are similar to those in relation to the Bank's own business, namely credit, market, liquidity and operational risk; and the controls applied parallel those applied in respect of Bank business. The management of the EEA is conducted within a framework agreed annually with HM Treasury, which is described in the *EEA Report and Accounts* published by HM Treasury.

Employees

Details of the Bank's employees, employee relations, development and performance management and the Bank's continued work on equal opportunities are given on pages 23–24.

Health and safety

Effective health, safety and risk management is a priority for the Bank. The Bank's safety management system delivers a safe working environment by continuous and effective assessment. Health and safety issues and incidents are monitored by the Bank's Safety, Health and Environment Committee.

The environment

The Bank monitors the impact of its operations on the environment, which is mainly through the use of power and the generation of waste. The Bank tries to minimise its impact through better use of its premises, using increasingly power-efficient equipment and by improved waste management. 10% of the electricity used in the Bank's premises is from renewable (green) sources. Although the Bank's Head Office building is accredited under the Carbon Trust's Energy Efficiency Accreditation Scheme, in 2008 the building received a Display Energy Certificate rating in Band G. The building was constructed in the 1930s and has substantial heating and cooling challenges for modern occupation, including high electricity consumption by energy-intensive information technology equipment. The Bank's Head Office building was awarded the Corporation of London's Clean City Gold award (with special commendation) for waste management in 2008. More than 98% of waste produced by the Bank at its two main sites in London and Essex is recycled or re-used in some form. The Bank's publications, including this *Report*, are printed on paper which contains 50% recovered waste and 50% virgin fibre and is certified as a Forest Stewardship Council mixed sources product.

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Political and charitable donations

No donation was made for any political purpose. The Bank allows staff to take part in local political and community activity and may grant time off for such activity. No such time was granted for political interests in 2008/09 (2007/08: nil).

The Bank continued to play an active role in community initiatives and supported voluntary work undertaken by its staff. During 2008/09 the Bank contributed £582,000 in support of its community programme (2007/08: £587,000). Donations in cash totalled £331,000 (2007/08: £343,000), this included £15,000 via the Bank of England Court Awards through which donations are made to community organisations in recognition of outstanding volunteering commitment by members of staff; £5,000 for the David Sharp School Governor Awards; £55,000 to community organisations via the Staff Volunteering Award Scheme, and £32,000 matched funding under the payroll Give-As-You-Earn scheme. The cost of other community contributions, including time spent by staff on community involvement, was £251,000 (2007/08: £244,000), and donations to academic research amounted to £61,000 (2007/08: £93,000).

Policy on payment of suppliers

The Bank subscribes to the principles and practices of the Better Payment Practice Code.[1] The Bank estimates that the average trade creditor payment days for 2008/09 was 10.9 working days (2007/08: 11.1).

(1) For details about the Code, see www.payontime.co.uk.