REPORT OF THE AUDITORS

LONDON 14 MAY 1997

To the Governor and Company of the Bank of England

We have audited the financial statements of the Banking Department on pages 60 to 81, and the statements of account of the Issue Department on pages 82 and 83.

Respective responsibilities of directors and auditors

As described on pages 57 to 58, the Bank's Court of Directors is responsible for the preparation of the financial statements and the statements of account. It is our responsibility to form an independent opinion, based on our audit, on the financial statements and the statements of account and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Bank's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements, the basis of which is described in note 1(a).

Opinion

The financial statements of the Banking Department have been prepared on the basis set out in note 1(a) to comply with the requirements of Schedule 9 to the Companies Act 1985 and applicable Accounting Standards in the United Kingdom in so far as they are appropriate to a central bank.

In our opinion

1 The financial statements on pages 60 to 81 present fairly, on the basis referred to above, the state of affairs of the Banking Department at 28 February 1997 and the profit, total recognised gains and cash flows for the year then ended.

2 The statements of account on pages 82 and 83 present fairly, on the basis described on page 83, the outcome of the transactions of the Issue Department for the year ended 28 February 1997 and its balances at that date.

COOPERS & LYBRAND

Chartered Accountants
and Registered Auditors

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 28 FEBRUARY 1997

	Notes	1997 £m	*1996 £m*
Profit after provisions and before tax	2	121.3	*214.4*
Payment to HM Treasury under Section 1(4) of the Bank of England Act 1946	5	(48.7)	*(88.0)*
Tax on profit on ordinary activities	6	(23.8)	*(38.1)*
Retained profit for the year	19	48.8	*88.3*

All activities are regarded as continuing. There is no material difference between the retained profit for the year disclosed above, and its historical cost equivalent.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES FOR THE YEAR ENDED 28 FEBRUARY 1997

	1997 £m	*1996 £m*
Profit transferred to reserves	48.8	*88.3*
Unrealised surplus/(deficit) on revaluation of properties	9.7	*(12.0)*
Total recognised gains and losses for the year	58.5	*76.3*

BANKING DEPARTMENT

BALANCE SHEET AS AT 28 FEBRUARY 1997

	Notes	1997	*1996*
		£m	*£m*
Assets			
Cash		9.4	*12.2*
Items in course of collection		298.3	*274.8*
Treasury and other eligible bills	8	2.4	*18.9*
Loans and advances to banks, the money market and customers	9	4,173.3	*4,152.0*
Debt securities	10	1,275.1	*1,137.7*
Equity shares and participating interests	11	76.2	*76.2*
Shares in subsidiary undertakings	12	17.6	*59.6*
Tangible fixed assets	13	367.4	*379.1*
Prepayments, accrued income and other assets		87.5	*85.4*
Total assets		**6,307.2**	***6,195.9***
Liabilities			
Deposits by central banks	14	1,082.2	*1,082.9*
Deposits by banks	15	1,935.7	*1,728.4*
Customer accounts	16	1,883.5	*2,000.3*
Other liabilities	17	263.9	*300.9*
		5,165.3	***5,112.5***
Capital	18	14.6	*14.6*
Revaluation reserves	19	225.5	*215.8*
Profit and loss account	19	901.8	*853.0*
Shareholder's funds	20	**1,141.9**	***1,083.4***
Total liabilities		**6,307.2**	***6,195.9***

E A J GEORGE Governor
H J DAVIES Deputy Governor
DAVID SCHOLEY Director
G MIDGLEY Deputy Director

CASH FLOW STATEMENT FOR THE YEAR ENDED 28 FEBRUARY 1997

	Notes	1997 £m	*1996 £m*
Operating activities			
Net cash inflow/(outflow) from operating activities	21	211.9	*(1,317.2)*
Payments to HM Treasury under Section 1(4) of the Bank of England Act 1946		(88.0)	*(102.2)*
Taxation			
UK corporation tax (paid)/received		(23.1)	*9.0*
		100.8	***(1,410.4)***
Investing activities			
Repayment of capital by subsidiary undertaking		25.0	*-*
Surplus on liquidation of subsidiary undertaking		0.2	*-*
Disposal of investment securities		-	*136.0*
Purchases of premises and equipment		(14.5)	*(26.6)*
Sales of premises and equipment		0.6	*0.5*
		11.3	*109.9*
Increase/(decrease) in cash and cash equivalents	21	**112.1**	***(1,300.5)***

NOTES TO THE BANKING DEPARTMENT FINANCIAL STATEMENTS

1 Accounting Policies

a Form of presentation of financial statements

Although the Bank's financial statements are not subject to the requirements of the Companies Acts, they have been prepared so as to present fairly the state of affairs of the Banking Department and its profit, cash flows and total recognised gains and losses and in accordance with Section 255 of, and Part 1 of, Schedule 9 to the Companies Act 1985 and applicable Accounting Standards in the United Kingdom in so far as they are appropriate to a central bank: that is with the limitations explained below.

In exceptional circumstances, as part of its central banking responsibilities, the Bank may act as "lender of last resort" to financial institutions in difficulty in order to prevent a loss of confidence spreading through the financial system as a whole. In some cases confidence can best be sustained if the Bank's support is disclosed only when conditions giving rise to potentially systemic disturbance have improved. Accordingly, although the financial effects of such operations will be included in the financial statements in the year in which they occur, these financial statements may not explicitly identify the existence of such support. However, the existence of such support will be disclosed in the Annual Report when the need for secrecy or confidentiality has ceased.

As a result, the Bank's financial statements disclose less detail of the constituent elements of the profit and loss account, particularly of interest income and expense and any provisions for bad and doubtful debts, together with consequential restrictions in detailed disclosures in the balance sheet, cash flow statement and the notes to the financial statements, than would be required under the Companies Acts and applicable Accounting Standards.

The financial statements have been prepared on the historical cost basis of accounting, modified to include the revaluation of certain fixed assets. The accounting policies set out below have been applied consistently.

The Directors consider that the Banking Department constitutes a single business all conducted in the United Kingdom. The Bank of England has no branches or operations abroad. Accordingly, no further analysis into business or geographic segments is appropriate in the financial statements.

b Treasury and other eligible bills

Treasury and other eligible bills are stated at cost plus accrued interest.

c Debt securities, equity shares and participating interests

British government securities are held as investment securities and are stated at cost adjusted for the amortisation of premiums or discounts on a straight line basis over the period to maturity; income includes the amortisation of premiums or discounts.

Reverse repurchase agreements (repos) are accounted for as advances.

Equity shares and participating interests are held as investments and are stated in the balance sheet at cost.

Profits and losses on realisation are taken into the profit and loss account in the year in which they arise.

d Tangible fixed assets

The Bank's properties are stated at a professional valuation as at 28 February 1997. No account is taken of any liability to taxation which could arise if the premises were disposed of at their revalued amounts. One leasehold property is classified as an investment property and in accordance with SSAP 19 is revalued annually as at end-February and stated at a professional valuation on an open-market basis. The surplus or deficit on revaluation is transferred to a revaluation reserve. No depreciation is charged on this property. The requirement of the Companies Act 1985 is to depreciate all properties, but this requirement conflicts with the generally accepted accounting principle set out in SSAP 19. The Directors consider that to depreciate the investment property would not present a fair view and that it is necessary to adopt SSAP 19 in order to present a fair view. If this policy had not been adopted, the profit for the year would have been reduced by depreciation on this property of £5.1 million (1996 £5.6 million).

Freehold land is not depreciated.
Equipment is stated at cost less depreciation.

Depreciation, on a straight line basis, is charged as follows:

Freehold buildings	over the estimated future lives which range from ten to thirty years
Leasehold land and buildings	over the period of lease or estimated future lives which range from ten to thirty years
Plant within buildings	over periods ranging from five to twenty years
Computers	over periods ranging from three to five years
Other equipment	over periods ranging from three to twenty years

e Bad and doubtful debts

Provision for bad and doubtful debts is made as considered necessary having regard to both specific and general factors. The general element arises in relation to existing losses which, although not separately identified, are known from experience to be present in any portfolio of bank advances. Provision made (less amounts released) during the year is charged against profits.

f Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the exchange rates ruling at the balance sheet date. Other assets denominated in foreign currency are stated at cost, being the sterling equivalent of the foreign currency at the date of acquisition of the asset. Foreign currency liabilities intended to hedge assets denominated in foreign currency follow the policy adopted for the hedged asset. Income and expenditure are translated into sterling at the exchange rate ruling at the time of the transaction.

g Commitments on behalf of HM Treasury

Commitments on behalf of HM Treasury in foreign currencies and gold, or on a gold basis, arising in the course of operating the Exchange Equalisation Account, are not included in these accounts as the Bank is concerned in such transactions only as agent.

h Deferred tax

Deferred tax is provided, at the estimated rates at which future taxation will become payable, on all material timing differences where it is probable that a liability to taxation will crystallise in the foreseeable future.

j Subsidiary undertakings

Shares in subsidiary undertakings are stated in the balance sheet at cost less provision for permanent diminution in value. Dividends from subsidiary undertakings are included as income when declared.

k Leasing

Operating lease rentals are charged to the profit and loss account as incurred.

l Retirement benefits

The cost of pensions is assessed in accordance with the advice of an independent actuary and accounted for on the basis of charging the cost to the profit and loss account, on a systematic basis, over the employees' service lives using the projected unit method. Variations from the regular cost are spread over the remaining service lives of the members of the scheme.

Other post-retirement benefits, principally healthcare for certain pensioners, are accounted for on a basis similar to that used to account for pension obligations. A deferred tax asset has been recognised in full in respect of this liability under UITF 6.

2 Profit after provisions and before tax

	1997 £m	***1996 £m***
Profit after provisions and before tax is stated after:		
(i) Surplus on liquidation of Slater, Walker Limited	3.0	-
(ii) Profit arising on the sale of shares in 3i Group plc	-	*118.4*
(iii) Staff costs (inc. Governors and Executive Directors):		
- wages and salaries	95.5	*97.3*
- social security costs	8.0	*8.1*
- other pension costs and post-retirement benefits	9.2	*20.5*
- cost of severence schemes	16.8	*19.2*
(iv) Income:		
- charges for services to HM Government, including charges to the Issue Department in respect of the Note Issue	84.2	*83.5*
- rents	12.3	*12.5*
(v) Charges:		
- operating lease rentals	1.7	*1.7*
- depreciation of premises and equipment	25.9	*22.4*

The auditors' remuneration was £132,000 *(1996 £135,000)*
The auditors' remuneration for non-audit work was £170,000 *(1996 £250,000)*
For subsidiary companies which are not consolidated, the auditors' remuneration was £50,700 *(1996 £74,000)* and fees for non-audit work were £48,700 *(1996 £84,000)*

More details of the Bank's operations during the year are given in the Directors' Report and Operational Reviews.

3 Emoluments of Directors

	1997 £	*1996 £*
Fees	18,500	*11,136*
Remuneration of Governors and Executive Directors	964,777	*931,940*
Payment in respect of notional benefits of travel on Bank business	1,863	*3,728*
	985,140	*946,804*
Pension contributions	238,697	*186,106*
Pensions to former Directors and widows of former Directors	109,978	*100,744*
	1,333,815	***1,233,654***

An analysis of emoluments is given below.

	Salary & fees (Note i) £	Bonuses and other payments (Notes ii and vi) £	Benefits (Note iii) £	Total 1997 £	*Total 1996 £*
Governors					
Governor					
Mr E A J George	227,000	-	3,402	230,402	*232,423*
Deputy Governor					
Mr H J Davies	183,167	-	916	184,083	*86,466*
Mr R L Pennant-Rea	-	-	-	-	*57,106*
Executive Directors					
Mr M A King	145,500	-	386	145,886	*137,384*
Mr P H Kent	136,500	-	1,705	138,205	*133,542*
Mr I Plenderleith	133,833	5,000	3,503	142,336	*131,003*
Mr M D K W Foot (from 1 March 1996)	125,500	-	5,728	131,228	-
Mr B Quinn	-	-	-	-	*162,880*
Non-Executive Directors					
(notes v and vi)	6,000	7,000	-	13,000	*6,000*
	957,500	**12,000**	**15,640**	**985,140**	***946,804***

(i) The Bank's Charter of 1946 provides for the payment of fees at the rate of £2,000 per annum to the Governor, £1,500 to the Deputy Governor, and £500 per annum to the other Directors. The Charter also provides for the payment of salaries to the Executive members of Court - the Governors and Executive Directors. The salaries are determined by the Non-Executive members of Court on the advice of the Remuneration Committee, the membership of which is set out on pages 55 to 56. The Governor's salary and fees are fixed for the current term of his office from 1 July 1993 to 30 June 1998.

The Remuneration Committee seeks to establish levels of pay for the Bank's most senior officials which adequately reflect their qualifications, experience, responsibilities and performance, while also taking account of the Bank's position within the public sector.

It takes into account, with the benefit of professional advice as appropriate, the levels of pay and benefits in comparable institutions.

(ii) In addition to recommending salary levels, the Remuneration Committee may recommend the payment of bonuses as a means of rewarding special services. For the year ended 28 February 1997, a non-pensionable bonus of £5,000 was paid to Mr Plenderleith.

(iii) The Remuneration Committee also keeps under review other benefits available to Directors, including medical insurance and beneficial loans for housing and other purposes. The latter are available to Governors and Executive Directors on the same basis as for Bank staff, subject to any limitations that would apply to a banking company incorporated under the Companies Acts.

The principal benefits received during the year were beneficial loans and medical insurance, together with the notional benefit of travel on Bank business. The total of all benefits was £15,640 *(1996 £15,373)*.

Payments in respect of notional benefits of travel on Bank business arise because of the Inland Revenue's practice of treating travel by spouses accompanying a Governor or Director on official business as a taxable benefit. The presence of the spouse on certain official business is regarded by the Bank as necessary and accordingly the Bank meets any tax liability that may arise in respect of such occasions.

The Remuneration Committee is also responsible for reviewing the pension arrangements for current and former Executive members of Court. These are generally provided through the Court pension scheme, which is separate from the scheme for staff. The contributions to the scheme are assessed annually in accordance with actuarial advice in order to fund, over a number of years, the benefits payable to members. The Bank's contribution for the year to 28 February 1997 was 11% *(1996 19%)* of pensionable salaries and this is included in the first table on page 66.

In certain circumstances Court, on the advice of the Remuneration Committee, may grant additional pensions or pension entitlements to Directors, former Directors or the widows of former Directors. These are unfunded, but provision, based on actuarial advice, is made for them in the Bank's accounts. The total provision in the balance sheet for such unfunded pensions at 28 February 1997 was £1,361,000 *(1996 £1,145,000)*, of which £254,000 *(1996 £103,000)* relates to current members of Court. The increase reflects both the extra pension entitlement arising during the year and a recalculation of the provision based on actuarial advice.

The Court scheme, in which the Governors and Executive Directors participate, is non-contributory and is governed by an independent trust. The normal retirement age is 60 which allows members to achieve a maximum pension of two-thirds of their pensionable salary at normal retirement age after 20 years service. The scheme also provides for early retirement in certain circumstances (including ill-health), payment of a lump sum in the event of death in service, and allowances for spouses and dependants. Directors who were members of the Staff pension scheme (note 4) prior to their appointment to Court may transfer their accrued benefits from the Staff fund to the Court scheme and their previous service is aggregated with their period on Court.

In the event of death in service, the scheme provides for the payment of a lump sum, surviving spouse's pensions of 50% of the member's base pension (55% from age 80), and discretionary dependants' allowances. With the agreement of Court, members may retire at any time after age 50 and receive an immediate pension. This pension may be reduced to reflect early payment. Pensions and deferred pensions are reviewed annually and are normally increased in line with the rise in the Retail Price Index.

For members subject to the pensions cap introduced in the Finance Act 1989, the Bank offers unfunded benefits which broadly match those provided by the Court scheme. There are currently two capped members - the Deputy Governor and Mr King. Provision for these unfunded benefits is made in the Bank's accounts as mentioned above. These unfunded benefits are included in the table below.

	Age at 28 February 1997	Years of service to 28 February 1997	Accrued pension as at 28 February 1997	Accrued pension as at 29 February 1996	Extra entitlement accrued during the year
Mr E A J George	58	36	151,700	144,200	7,500
Mr H J Davies	46	1	8,700	2,500	6,200
Mr M A King	48	6	28,700	22,900	5,800
Mr P H Kent	59	37	92,200	85,400	6,800
Mr I Plenderleith	53	31	73,000	67,300	5,700
Mr M D K W Foot	50	27	61,700	59,500	2,200

(iv) No Governor or Executive Director has a service contract with the Bank, and the terms of their employment contain no provision for compensation on early termination of employment. Governors and Executive Directors are required to provide services only to the Bank. With Court's approval other directorships relevant to the Bank's work may be accepted, but any fees must be paid to the Bank.

(v) A total of 12 Non-Executive Directors served during the year ended 28 February 1997 *(1996 12)*. In accordance with the Bank's Charter of 1946, a fee of £500 *(1996 £500)* was paid to each Director.

(vi) Following his appointment as a member of the Board of Banking Supervision during the year, Sir David Scholey received the fee from this position which, for his period of service to 28 February 1997, amounted to £7,000.

4 Pension costs and other post-retirement benefits

The Bank operates defined benefit pension schemes providing benefits based on final pensionable pay. The assets of the schemes are held separately by the Bank in independent trustee-administered funds. The Bank also provides other post-retirement benefits, principally healthcare, for certain pensioners.

The main pension scheme, the Bank of England Pension Fund, is valued every three years by an independent qualified actuary. The latest actuarial valuation was as at 29 February 1996, used the projected unit method and showed that the actuarial value of the Fund's assets represented 120% of the benefits that had accrued to members at that date, after allowing for future increases in earnings and pensions in payment. The market value of the Fund's assets at that time was £1,348 million and the required contribution rate was 21.2% of pensionable earnings. The surplus is of such a size that the Bank has no need to make any contribution and accordingly has not done so. The principal assumptions were that, over the long term, the return on new investments would exceed the rate of increase in salaries by 2.5% and the rate of increase in pensions by 4.5%. It was also assumed that the equity dividend growth would equal the rate of future pension increases.

The other post-retirement benefits are unfunded and provision, based on actuarial advice, is made for the liability in the accounts. The principal assumption used in determining the required provisions was that the rate of increase in medical costs would exceed the rate of inflation by 3%.

The total cost of all post-retirement benefits for the year was £9.2 million *(1996 £20.5 million)*. £21.0 million *(1996 £20.4 million)*, representing the excess of the pension amounts funded over the cost, is included in other assets. £94.4 million *(1996 £87.4 million)* representing the provision in respect of other post-retirement benefits is included in other liabilities.

5 Payment to HM Treasury under Section 1(4) of the Bank of England Act 1946

	1997	***1996***
	£m	***£m***
Payable 5 April	23.5	*47.0*
Payable 5 October	25.2	*41.0*
	48.7	***88.0***

6 Tax on profit on ordinary activities

	1997	***1996***
	£m	***£m***
United Kingdom corporation tax at 33%	48.6	*44.0*
Tax credit on franked investment income	-	*0.4*
Prior year - corporation tax	(5.5)	*(1.2)*
- deferred tax	(0.7)	*0.1*
Deferred taxation	(18.6)	*(5.2)*
	23.8	***38.1***

The charge for taxation is computed on the residual profit on ordinary activities after deduction of the payment to HM Treasury. For 1996, the charge was lower than that calculated using the UK corporation tax rate of 33% as the profit on the sale of shares in 3i Group plc was subject to tax computed according to Capital Gains Tax rules, which produced a lower effective rate of tax.

The deferred tax asset of £8.1 million, included in other assets, *(1996 liability of £11.2 million)* is comprised as follows:

	1997	***1996***
	£m	***£m***
Short-term timing differences	(1.1)	*11.4*
Accelerated capital allowances	2.0	*2.0*
Other timing differences	(9.0)	*(2.2)*
	(8.1)	***11.2***

The movement on the provision for deferred taxation is as follows:

	£m
At 1 March 1996	11.2
Profit and loss account	(19.3)
At 28 February 1997	(8.1)

The movement in deferred tax shown above has largely arisen due to the changes in the rules governing the taxing of income on British government securities, which took effect from 1 April 1996.

Tax of £1.0 million *(1996 £6.0 million)* has not been provided in respect of further accelerated capital allowances as the provision at 28 February 1997 is considered adequate.

7 Assets and liabilities

	1997 £m	*1996 £m*
Sterling/non-sterling analysis of assets and liabilities:		
Assets		
Denominated in sterling	5,231.9	*5,072.9*
Denominated in currencies other than sterling	1,075.3	*1,123.0*
	6,307.2	***6,195.9***
Liabilities		
Denominated in sterling	5,235.6	*5,076.6*
Denominated in currencies other than sterling	1,071.6	*1,119.3*
	6,307.2	***6,195.9***

8 Treasury and other eligible bills

	1997 £m	*1996 £m*
British government Treasury bills	2.4	*18.9*

9 Loans and advances to banks, the money market and customers

	1997 £m	*1996 £m*
Remaining maturity:		
Loans and advances		
- over 5 years	4.2	*5.5*
- 5 years or less but over 1 year	4.3	*6.5*
- 1 year or less but over 3 months	95.0	*221.7*
- 3 months or less	3,884.8	*3,258.1*
- Repayable on demand	185.0	*660.2*
	4,173.3	***4,152.0***

Included in the above are assets acquired under reverse repurchase agreements amounting to £2,426.3 million *(1996 £nil)*

The gross amount due from subsidiary undertakings, before provisions, (note 12), also included in the above	**162.2**	*240.2*

10 Debt securities

	1997 Balance sheet £m	1997 Market value £m	*1996 Balance sheet £m*	*1996 Market value £m*
Investment securities:				
- British government securities,				
listed on a recognised UK Exchange	**1,275.1**	**1,463.7**	*1,137.7*	*1,296.8*
Due within one year	17.9	18.3	*35.0*	*35.0*
Due one year and over	1,257.2	1,445.4	*1,102.7*	*1,261.8*
	1,275.1	**1,463.7**	*1,137.7*	*1,296.8*
Unamortised discounts and premiums	**80.1**		**85.9**	

Movements in debt securities were as follows:

	Cost £m	Discounts and premiums £m	Carrying value £m
At 1 March 1996	1,049.0	88.7	1,137.7
Amortisation of discounts and premiums		11.5	11.5
Purchases	160.7	0.2	160.9
Redemptions	(25.3)	(9.7)	(35.0)
At 28 February 1997	**1,184.4**	**90.7**	**1,275.1**

11 Equity shares and participating interests

	1997 Balance sheet-cost £m	1997 Directors' valuation £m	*1996 Balance sheet-cost £m*	*1996 Directors' valuation £m*
Investment securities - unlisted equity shares	1.5	79.6	*1.5*	*62.7*
Participating interests - unlisted	74.7	68.8	*74.7*	*81.1*
	76.2	**148.4**	*76.2*	*143.8*

(a) Investment securities

The principal holding of equity shares included in investment securities is as follows:

	Percentage held **1997**	*1996*
Bank for International Settlements		
shares of 2,500 Swiss gold francs (25% paid)		
(Incorporated in Switzerland)	9.2	*10.1*

(b) Participating interests

This is the cost in sterling of the Bank's contribution of ECU 94.5 million to the financial resources of the European Monetary Institute, a body established by European Treaty. These resources, of which the Bank's share is 15.35%, are invested by the European Monetary Institute to provide it with the income needed to finance its operations. The contributions are repayable on the dissolution of the EMI and have accordingly been accounted for as an investment. The majority of the Bank's contribution is hedged against movements in exchange rates by a deposit, also denominated in ECU (note 16). The valuation of the interest disclosed above represents the Bank's share of the EMI's net assets translated at the exchange rate ruling at 28 February 1997.

12 Shares in subsidiary undertakings

	£m
Cost at 1 March 1996	59.6
Capital repayment	(25.0)
Liquidation of subsidiary	(17.0)
Cost at 28 February 1997	17.6

	1997 £m	*1996 £m*
In addition, gross advances to subsidiaries, before provisions, included under loans and advances to banks, the money market and customers (note 9) amount to	162.2	*240.2*

The accounts of the subsidiaries detailed in (a), (b) and (e) below have not been consolidated with those of the Banking Department because, in the opinion of the Directors, the effect of including their assets, liabilities and results with those of the Banking Department would not be material. The accounts of CRESTCo Ltd, up to the date the company ceased to be a subsidiary of the Bank, have similarly not been consolidated.

(a) The NMB Group plc (formerly The National Mortgage Bank PLC)

Throughout the year ended 28 February 1997, the Bank held the entire issued share capital of 75 million £1 ordinary shares of The NMB Group plc (NMB), formerly The National Mortgage Bank PLC, which is incorporated in Great Britain. The company changed its name on 13 December 1996, consequent on the surrender of its banking licence earlier in the year. The investment in this company is included in the Bank's balance sheet at a nominal £1.

NMB was one of several institutions supported by the Bank in 1991/92, in an operation designed to prevent liquidity problems facing a few small banks from spreading more widely through the banking system. The acquisition of NMB by the Bank in September 1994 changed the form of the Bank's support, but not the substance.

The provision in relation to support operations remains at £95.0 million at 28 February 1997, of which £92.5 million relates to NMB. This follows reductions from £115 million as at 28 February 1993 to £105 million at 28 February 1994, and to £95 million at 29 February 1996.

Included in the Bank's balance sheet within "loans and advances to banks" is £162 million lent to NMB which is the NMB group's principal funding. In addition, the Bank has given an indemnity against losses on the NMB's asset portfolio. After taking account of this indemnity, the NMB group's accounts show net assets of nil and the result for the year is similarly nil, as any change in the underlying position of NMB is reflected in a movement in provisions.

The consolidated accounts of The NMB Group plc as at 28 February 1997, which bear an unqualified audit report, show:

The NMB Group plc	**1997** **£m**	***1996*** ***£m***
Mortgage loans	104.6	*187.2*
Current assets	61.6	*61.2*
	166.2	*248.4*
Creditors:		
Bank of England	(162.0)	*(240.0)*
Other liabilities	(4.2)	*(8.4)*
	(166.2)	*(248.4)*
	nil	*nil*
Equity Share Capital	75.0	*75.0*
Accumulated deficit	(75.0)	*(75.0)*
	nil	*nil*

(b) Minories Finance Ltd

Throughout the year ended 28 February 1997, the Bank held the entire issued share capital of Minories Finance Ltd (MFL), which is incorporated in Great Britain. With the agreement of the court, MFL's capital was reduced on 29 November 1996 from £37.5 million £1 ordinary shares to £12.5 million £1 ordinary shares, and £25 million was repaid to the Bank. The investment in this company is included in the Bank's balance sheet at 28 February 1997 at £12.5 million *(1996 £37.5 million)*. As a condition of this reduction in capital, the Bank gave an indemnity whereby any future deficit in MFL's shareholders' funds would be made good by the Bank up to a maximum of £25 million. This is in addition to an indemnity of up to £37.5 million given in respect of a previous capital reduction in June 1987.

MFL's accounts as at 31 December 1996 bear an unqualified audit report. The company has continued its principal activity of realisation of loans and other non-liquid assets which, with income generating monetary assets, comprise its remaining assets. MFL will continue to pursue repayment of its remaining outstanding loans and advances. A dividend of £2.0 million has been declared and reflected in the Bank's accounts.

The accounts of MFL show:

Profit for the year to 31 December 1996	£2.1 million
Accumulated reserves as at 31 December 1996 after provision for dividends	£6.9 million
Net assets at 31 December 1996 after provision for dividends	£19.4 million

(c) Subsidiary in liquidation

A wholly owned subsidiary, Slater, Walker Ltd, which the Bank acquired through support operations and which had been in members' voluntary liquidation for several years was wound up during the year. The investment in this company was included in the Bank's balance sheet at 29 February 1996 at £17 million and the liquidation resulted in a surplus of some £3 million.

(d) CRESTCo Ltd

CRESTCo Ltd, a company incorporated in Great Britain, was established by the Bank to develop and subsequently own and run the CREST settlement system. The company's capital comprised 100 £1 temporary controlling shares owned by the Bank and 24,060 redeemable fixed dividend non-voting shares of £250 each held by financial institutions. The temporary controlling shares owned by the Bank during the development process lost their voting rights on 1 July 1996 when CREST commenced operations. The non-voting shares acquired voting rights on that date. The company therefore ceased to be a subsidiary of the Bank on that date but the Bank continues to hold its shares.

(e) Other subsidiaries

Investments in other subsidiary companies, all of which are wholly owned and incorporated in Great Britain, are stated in the Bank's balance sheet at an aggregate cost of £5.1 million and include:

Debden Security Printing Ltd	100,000 shares of £1
BE Services Ltd (ceased operations 31 March 1997)	5,000 shares of £1
B.E. Property Holdings Ltd (Non-trading)	5,000,000 shares of £1
B.E. Museum Ltd (Non-trading)	10,000 shares of £1
The Securities Management Trust Ltd (Non-trading)	1,000 shares of £1

The net aggregate results of the trading subsidiary companies attributable to the Bank, which have not been dealt with in the accounts of the Banking Department, and which are stated by reference to audited accounts (all of which bear unqualified audit reports) are as follows:

	£m
For the year ended 28 February 1997	(0.4)
Accumulated profits since formation	1.3

The aggregate net assets of the other subsidiary companies are £6.4 million.

13 Tangible fixed assets

	Freehold land and buildings	Leases of 50 years or more unexpired	Leases of less than 50 years unexpired	Equipment	Total
					£m
Cost or valuation					
At 1 March 1996	197.9	153.1	2.4	112.3	465.7
Additions	4.7	-	-	9.3	14.0
Disposals	(0.2)	-	-	(4.7)	(4.9)
Revaluation	(31.3)	(1.7)	(0.2)	-	(33.2)
At 28 February 1997	171.1	151.4	2.2	116.9	441.6
Accumulated depreciation					
At 1 March 1996	18.0	0.9	0.2	67.5	86.6
Charge for the year	14.7	0.4	0.1	10.7	25.9
On disposals	-	-	-	(4.0)	(4.0)
Write back on revaluation	(32.7)	(1.3)	(0.3)	-	(34.3)
At 28 February 1997	-	-	-	74.2	74.2
Net book value					
At 28 February 1997	171.1	151.4	2.2	42.7	367.4
Net book value					
At 29 February 1996	*179.9*	*152.2*	*2.2*	*44.8*	*379.1*
Cost or valuation at 28 February 1997 comprised:					
At 1997 valuation	171.1	151.4	2.2	-	324.7
At cost	-	-	-	116.9	116.9
	171.1	151.4	2.2	116.9	441.6

The net surplus on revaluation was £1.1 million. Of this, a surplus of £9.7 million has been taken to revaluation reserves and £8.6 million charged to profit and loss.

All freehold and leasehold properties have been professionally valued by St Quintin, Chartered Surveyors, as at 28 February 1997. Included in leasehold premises (50 years and over) is an investment property held at open-market value of £145.5 million *(1996 £145.0 million)*. Certain properties that the Bank intends to vacate and which will be made available for sale during 1997 have been valued at an open market value. The figures relating to other property interests reflect a valuation on an open market value for existing use basis.

The Bank occupies a small proportion of the investment property for its own purposes. The Bank occupies its other properties for its own purposes with the exception of an immaterial proportion.

Contracts for capital expenditure authorised by the Directors and outstanding at 28 February 1997 totalled £6.1 million *(1996 £5.2 million)*. Further capital expenditure authorised at that date, but for which no contracts had been placed totalled £7.1 million *(1996 £7.8 million)*.

14 Deposits by central banks

	1997 £m	*1996 £m*
Remaining maturity:		
- 1 year or less but over 3 months	92.1	*218.1*
- 3 months or less but not repayable on demand	674.1	*524.8*
Repayable on demand	316.0	*340.0*
	1,082.2	*1,082.9*

15 Deposits by banks

	1997 £m	*1996 £m*
Cash ratio deposits	1,901.2	*1,688.4*
Other deposits repayable on demand	34.5	*40.0*
	1,935.7	*1,728.4*

Included in cash ratio deposits as at 29 February 1996 was a deposit of £0.9 million by a subsidiary, The NMB Group plc (formerly The National Mortgage Bank PLC). This deposit was repaid during the year to 28 February 1997.

Cash ratio deposits are computed on the basis of banks' eligible liabilities. Any change in the amount due, as a result of either the gain or loss of authorisation under the Banking Act 1987, the twice yearly recalculation of deposits or a change in the percentage used for calculation, is payable immediately.

16 Customer accounts

	1997 £m	*1996 £m*
Remaining maturity:		
5 years or less but over 1 year:		
- Public deposits	-	*72.6*
1 year or less but over 3 months:		
- Public deposits	72.6	-
- Other deposits	0.1	*0.7*
3 months or less but not repayable on demand:		
- Public deposits	30.4	*24.4*
- Other deposits	6.6	*237.2*
Repayable on demand:		
- Public deposits	367.3	*339.6*
- Deposit by Issue Department	899.5	*1,016.3*
- Other deposits	507.0	*309.5*
	1,883.5	*2,000.3*

Public deposits are the balances on government accounts, including Exchequer, National Loans Fund, National Debt Commissioners and dividend accounts and include a deposit, denominated in ECU, from the Exchange Equalisation Account.

17 Other liabilities

	1997 £m	*1996 £m*
Include:		
Payable to HM Treasury	48.7	*88.0*
Due to subsidiaries	8.9	*27.8*
Provision for post-retirement benefits	94.4	*87.4*

18 Capital

The entire capital comprising £14,553,000 of Bank Stock is held by the Treasury Solicitor on behalf of Her Majesty's Treasury.

19 Reserves

	Profit and loss account	Revaluation reserve	Investment property revaluation reserve	£m Total
Balance at 1 March 1996	853.0	108.0	107.8	1,068.8
Retained profit for the year	48.8	-	-	48.8
Surplus on revaluation of properties	-	9.2	0.5	9.7
Balance at 28 February 1997	901.8	117.2	108.3	1,127.3

20 Statement of reconciliation of shareholder's funds

	1997 £m	*1996 £m*
Shareholder's funds at 1 March	1,083.4	*1,007.1*
Retained profit for the year	48.8	*88.3*
Surplus/(deficit) on revaluation of properties	9.7	*(12.0)*
Shareholder's funds at 28 February	1,141.9	*1,083.4*

21 Cash flow statement

(i) Reconciliation of operating profit to net cash inflow/(outflow) from operating activities

	1997 £m	*1996 £m*
Profit after provisions and before tax	121.3	*214.4*
(Increase)/decrease in interest receivable and prepaid expenses	(2.3)	*2.4*
(Decrease)/increase in interest payable and accrued expenses	(1.3)	*3.7*
Depreciation	25.9	*22.4*
Profit on sale of investment securities	-	*(118.4)*
Surplus on liquidation of subsidiary	(0.2)	-
Loss/(profit) on sale of tangible fixed assets	0.3	*(0.1)*
Effect of provisions, deferrals and accruals on operating activity cash flow	9.2	*(1.7)*
Net cash inflow from trading activities	**152.9**	***122.7***
Net decrease in foreign currency deposits	(47.8)	*(199.4)*
Net increase/(decrease) in other deposits	144.7	*(1,511.9)*
Net decrease in foreign currency accounts with banks	47.7	*199.2*
Net decrease in advances to banks and customers	62.3	*23.1*
Net decrease/(increase) in other assets	3.5	*(3.2)*
Increase in securities held	(127.9)	*(60.2)*
(Increase)/decrease in items in course of collection	(23.5)	*112.5*
Net cash inflow/(outflow) from operating activities	**211.9**	***(1,317.2)***

(ii) Analysis of changes in cash and cash equivalents during the year

	1997 £m	*1996 £m*
Balance at 1 March	2,931.0	*4,231.5*
Net cash inflow/(outflow)	112.1	*(1,300.5)*
Balance at 28 February	**3,043.1**	***2,931.0***

(iii) Analysis of the balances of cash and cash equivalents

	1997 £m	Change in year £m	*1996 £m*
Cash	9.4	(2.8)	*12.2*
Advances to money market and certain banks (including reverse repurchase agreements)	3,031.3	131.4	*2,899.9*
Treasury and other eligible bills	2.4	(16.5)	*18.9*
	3,043.1	**112.1**	***2,931.0***

Advances to money market and certain banks and Treasury and other eligible bills are treated as cash equivalents as they represent the Bank's principal liquidity. The allocation of this liquidity between advances and bills depends on prevailing market conditions.

22 Related Parties

(a) HM Government

The Bank provides several services to its shareholder, HM Treasury, and to other Government departments and bodies.

The main services are:-

- provision of banking services, including holding the principal accounts of the Government
- debt management, including management of the issue, on behalf of the Government, of short and long- term debt and provision of registration services in respect of gilt-edged stocks
- management of the Exchange Equalisation Account
- management of the Note Issue, including printing of notes
- operation of sanctions against specific countries.

The aggregate balances on HM Treasury and other public sector accounts are disclosed in note 16 as public deposits. The total charges made to the Government are disclosed in note 2.

(b) Subsidiary undertakings

All material transactions and balances between the Bank and its subsidiaries are disclosed in note 12.

(c) Directors and Officers

The following particulars relate to loans given or arranged by the Bank of England to Directors and Officers of the Bank and persons connected with them:

	1997		***1996***	
	Total amount outstanding £000	Number	*Total amount outstanding £000*	*Number*
Directors	259	4	*213*	*4*
Officers	1,240	17	*907*	*18*

There were no other transactions that would be required to be shown under the provisions of the Companies Act 1985. None of the Directors or Officers had a material interest, directly or indirectly, at any time during the year in any other significant transaction or arrangement with the Bank or any of its subsidiaries.

The above information concerning Officers is presented only in respect of those employees of the Bank who would be considered as managers, either within the meaning of the Banking Act 1987 or as defined under Financial Reporting Standard 8.

(d) The Deposit Protection Board

The Bank provides, and charges for, the Secretariat for the Deposit Protection Board, a separate legal entity established under the Banking Act 1987. The Governor, Deputy Governor and Chief Cashier are ex-officio members of the Board. The remaining members of the Board are appointed by the Governor and include the Executive Director responsible for Supervision and Surveillance. The Bank also provides banking facilities to the Board, including advances within limits agreed with HM Treasury. The balance due from the Board at 28 February 1997 was £10.3 million.

(e) The Bank's pension schemes

The Bank provides, the secretariat, the investment management and some custodial services to the Bank's pension schemes. These activities are undertaken on behalf of, and under the supervision of, the trustees of the schemes. There were no material transactions between the Bank and the pension schemes during the year to 28 February 1997.

(f) Other entities with links to the Bank

In the normal course of its activities as a central bank, the Bank has relationships, involving some representation at management level and participation in funding, with international and domestic institutions. With the exception of the European Monetary Institute, in which it has a participating interest as disclosed in note 11, the Bank does not consider these institutions to be related parties. There were no material transactions with the European Monetary Institute during the year.

23 General

(i) Operating lease commitments

	1997		***1996***	
	Land and buildings £m	Computer and other equipment £m	*Land and buildings £m*	*Computer and other equipment £m*
At the year end, annual commitments under non-cancellable operating leases were:				
expiring:				
- within one year	-	0.7	*0.1*	*-*
- between one and five years	-	0.3	*0.5*	*0.3*
- in five years or more	0.7	-	*0.7*	*-*
	0.7	**1.0**	*1.3*	*0.3*

(ii) Average number of employees

The average number of persons employed by the Bank during the year was made up as follows:

	1997	***1996***
Governors and Executive Directors	6	*6*
Managers and analysts	511	*485*
Clerical staff	1,854	*2,001*
Technical/Other	1,226	*1,340*
	3,597	*3,832*

24 Contingent liabilities

Contingent liabilities and commitments, some of which are offset by corresponding obligations of third parties, arise in the normal course of business, including contingent liabilities in respect of guarantees and indemnities in connection with liquidity support operations. There are also forward contracts for the purchase and sale of foreign currencies. Provision is made for any estimated irrecoverable liability that may arise from these transactions.

As part of its normal business, the Bank acts as custodian of its customers' assets and fulfils an agency role. No significant irrecoverable liability arises from these transactions.

In 1993 and 1994, writs were issued against the Bank by certain depositors in the Bank of Credit and Commerce International SA claiming substantial but unquantified damages. The Bank's Directors are of the opinion that the Bank has a strong defence against the claim and will defend the action vigorously. Accordingly no provision is made in these accounts.

Since 1930 there has also been a contingent liability, denominated in Swiss gold francs, in respect of uncalled capital on the Bank's investment in the Bank for International Settlements. The sterling equivalent of this liability based on the gold market price at the balance sheet date was £184 million *(1996 £219 million)*.

25 Date of approval

The Court of Directors approved the financial statements on pages 60 to 81 on 14 May 1997.

ISSUE DEPARTMENT

ACCOUNT FOR THE YEAR ENDED 28 FEBRUARY 1997

	Notes	1997 £m	1996 £m
Income and profits:			
Securities of, or guaranteed by, the British Government		838.9	1,012.9
Other securities		441.3	336.5
Other income		0.3	0.4
		1,280.5	***1,349.8***
Expenses:	2		
Cost of production of Bank of England notes		38.8	32.6
Cost of issue, custody and payment of Bank of England notes		20.1	19.2
Other expenses		3.3	3.6
		62.2	55.4
Payable to HM Treasury		**1,218.3**	***1,294.4***

STATEMENT OF BALANCES: 28 FEBRUARY 1997

	Notes	1997 £m	1996 £m
Assets			
Securities of, or guaranteed by, the British Government	3	10,374.0	9,633.2
Other securities and assets including those acquired under reverse repurchase agreements	4	11,646.0	10,026.8
Total assets		**22,020.0**	***19,660.0***
Liabilities			
Notes issued:			
In circulation	5	22,010.8	19,648.0
In Banking Department		9.2	12.0
Total liabilities		**22,020.0**	***19,660.0***

E A J GEORGE Governor
H J DAVIES Deputy Governor
DAVID SCHOLEY Director
G MIDGLEY Deputy Director

NOTES TO THE ISSUE DEPARTMENT STATEMENTS OF ACCOUNT

1 Accounting policies

The statements of account are prepared in accordance with the requirements of the Currency and Bank Notes Act 1928 and the National Loans Act 1968. All profits of the note issue are payable to the National Loans Fund.

a The statements of account are prepared on the basis of amounts received and paid as modified by the effects of the revaluation of securities.

b All securities are revalued and are stated in the balance sheet at this valuation. Longer-dated stocks are valued at mid-market prices. Bills are valued at an average price approximating to market price. The last valuation was made at 27 February 1997.

c If the revaluation of securities shows a net gain this is included in income. A deficit is not taken against income but is settled by a transfer from the National Loans Fund.

2 Expenses

The expenses shown here represent charges from the Banking Department for costs incurred in relation to the Note Issue.

3 Securities of, or guaranteed by, the British Government

These include stocks, Treasury bills and any Ways and Means advance to the National Loans Fund.

4 Other securities and assets including those acquired under reverse repurchase agreements

	1997	*1996*
	£m	*£m*
Commercial bills	2,898.3	*3,663.2*
Promissory notes	-	*513.2*
Deposit with Banking Department	899.5	*1,016.3*
Assets acquired under reverse repurchase agreements	7,848.2	*4,834.1*
	11,646.0	***10,026.8***

5 Notes in circulation

	1997	*1996*
	£m	*£m*
£1 (a)	55.6	*56.1*
£5	1,047.2	*1,067.5*
£10	5,915.3	*5,687.6*
£20	9,558.5	*8,579.1*
£50	3,273.4	*3,103.7*
Other notes (b)	2,160.8	*1,154.0*
	22,010.8	***19,648.0***

a No £1 notes have been issued since 1984.

b Includes higher value notes used internally in the Bank, for example as cover for the note issues of banks in Scotland and Northern Ireland in excess of their permitted issues.

6 Date of approval

The Court of Directors approved the statements of account on pages 82 and 83 on 14 May 1997.

LONDON	Head Office	Threadneedle Street London EC2R 8AH	0171-601 4444*
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GLOUCESTER	Registrar's Department	Southgate House Southgate Street Gloucester GL1 1UW	01452 398000
LEEDS	Cash Centre	King Street Leeds LS1 1HT	0113-244 1711
AGENCIES	East Anglia and the South East	1 New Change London EC4M 9AA	0171-601 4335
	Greater London	1 New Change London EC4M 9AA	0171-601 5001
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Information about the Bank and its publications and additional telephone numbers and e-mail addresses are available on the Bank's Web site at http://www.bankofengland.co.uk

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Enquiries relating to the *Bank of England Quarterly Bulletin* and *Inflation Report* may be made on 0171-601 4030; *Financial Stability Review* on 0171-601 5191; and *Bank of England: Monetary and Financial Statistics* on 0171-601 5353.

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