REPORT OF THE AUDITORS

To the Governor and Company of the Bank of England

We have audited the financial statements of the Banking Department on pages 76-97, and the statements of account of the Issue Department on pages 98-99.

Respective responsibilities of directors and auditors

As described on page 72, 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 judgments 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 76-97 present fairly, on the basis referred to above, the state of affairs of the Banking Department at 28 February 1998 and the profit, total recognised gains and cash flows for the year then ended.

2 The statements of account on pages 98-99 present fairly, on the basis described on page 99, the outcome of the transactions of the Issue Department for the year ended 28 February 1998 and its balances at that date.

COOPERS & LYBRAND

Chartered Accountants
and Registered Auditors

London
13 May 1998

BANKING DEPARTMENT

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 28 FEBRUARY 1998

	Notes	1998 £m	*1997 £m*
Profit after provisions and before tax	2	179	*121*
Payable to HM Treasury under Section 1(4) of the Bank of England Act 1946	5	(70)	*(49)*
Tax on profit on ordinary activities	6	(39)	*(23)*
Retained profit for the year	19	70	*49*

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 1998

	1998 £m	*1997 £m*
Profit transferred to reserves	70	*49*
Unrealised surplus on revaluation of property	10	*10*
Total recognised gains and losses for the year	80	*59*

BANKING DEPARTMENT

BALANCE SHEET AS AT 28 FEBRUARY 1998

	Notes	1998	*1997*
		£m	*£m*
Assets			
Cash		2	*9*
Items in course of collection		278	*298*
Treasury and other eligible bills	8	4	*3*
Loans and advances to banks, the money market and customers	9	11,336	*4,173*
Debt securities	10	1,363	*1,275*
Equity shares and participating interest	11	64	*76*
Shares in group undertakings	12	18	*18*
Tangible fixed assets	13	368	*367*
Prepayments, accrued income and other assets		158	*88*
Total assets		**13,591**	***6,307***
Liabilities			
Deposits by central banks	14	1,060	*1,082*
Deposits by banks	15	2,797	*1,936*
Customer accounts	16	8,211	*1,883*
Other liabilities	17	301	*264*
		12,369	*5,165*
Capital	18	15	*15*
Revaluation reserves	19	235	*225*
Profit and loss account	19	972	*902*
Shareholder's funds	20	1,222	*1,142*
Total liabilities		**13,591**	***6,307***

E A J GEORGE	Governor
D C CLEMENTI	Deputy Governor
SHEILA MASTERS	Director
G MIDGLEY	Deputy Director

CASH FLOW STATEMENT FOR THE YEAR ENDED 28 FEBRUARY 1998

	Notes	1998 £m	*1997 restated £m*
Net cash inflow/(outflow) from operating activities	21	373	*(378)*
Corporation tax paid		(48)	*(23)*
Capital expenditure and financial investment	21	(9)	*11*
		316	***(390)***
Payment to HM Treasury under Section 1(4) of the Bank of England Act 1946		(49)	*(88)*
Increase/(decrease) in cash	21	**267**	***(478)***

The cash flow statement has been prepared under the revised FRS1 and is therefore presented on a different basis from previous years. The comparative figures have been restated on the same basis.

NOTES TO THE BANKING DEPARTMENT FINANCIAL STATEMENTS

1 Accounting policies

(a) Form of presentation of the 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.

Changes to the regime for preparing the Bank's financial statements under the Bank of England Act 1998 are described on page 67 of the Annual Report.

(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 interest

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 are held as investments and are stated in the balance sheet at cost. The participating interest is stated in the balance sheet at its original cost in foreign currency, translated at the exchange rate ruling at the balance sheet date.

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 plus the cost of subsequent additions and less depreciation. 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 it is necessary to adopt SSAP 19 in order to present a fair view and accordingly the investment property has been revalued and not depreciated. If this policy had not been adopted, the profit for the year would have been reduced by depreciation on this property of £5 million *(1997 £5 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 when held for the long term are stated at cost, being the sterling equivalent of the foreign currency at the date of acquisition of the asset. The participating interest is translated into sterling at the exchange rate ruling at the balance sheet date. Income and expenditure are translated into sterling at the exchange rate ruling at the time of the transaction. Foreign currency swaps used in operations are carried at market value.

(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 or asset will crystallise in the foreseeable future.

(j) Group undertakings

Shares in group undertakings are stated in the balance sheet at cost less provision for permanent diminution in value. Dividends from group 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

	1998 £m	*1997 £m*
Profit after provisions and before tax is stated after:		
(i) Surplus on liquidation of Slater, Walker Limited	-	*3*
(ii) Staff costs (inc. Governors and Executive Directors):		
- wages and salaries	97	*96*
- social security costs	8	*8*
- other pension costs and post-retirement benefits	15	*9*
- cost of severance schemes	6	*17*
(iii) Income:		
- charges for services to HM Government, including charges to the Issue Department in respect of the Note Issue	79	*84*
- rents	12	*12*
(iv) Charges:		
- operating lease rentals	2	*2*
- depreciation of premises and equipment	21	*26*
- retrenchment costs (see note below)	10	*-*

The auditors' remuneration was £132,000 *(1997 £132,000)*

The auditors' remuneration for non-audit work was £290,000 *(1997 £170,000)*

For subsidiary companies which are not consolidated, the auditors' remuneration was £45,000 *(1997 £50,700)* and fees for non-audit work were £47,800 *(1997 £48,700)*.

As noted in the Directors' Report, the decision has been taken that the Bank will consolidate its activities and staff in London into one building. Provision has been made in this year's accounts for the costs of this consolidation, including the decommissioning of other buildings, and this is disclosed above as retrenchment costs.

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

3 Emoluments of Directors

	1998 £	*1997 £*
Fees	25,334	*18,500*
Remuneration of Governors and Executive Directors	992,580	*964,777*
Payments in respect of notional benefits of travel on Bank business	4,853	*1,863*
	1,022,767	*985,140*
Pension costs in respect of - current Directors	224,054	*238,697*
- former Directors	327,976	*284,956*
	1,574,797	***1,508,793***

An analysis of emoluments is given below.

	Salary & fees (Note i) £	Bonuses and other payments (Notes ii and vi) £	Benefits (Note iii) £	Total 1998 £	*Total 1997 £*
Governors					
Governor					
Mr E A J George	227,000	-	5,272	232,272	*230,402*
Deputy Governor					
Mr D C Clementi	95,750	-	-	95,750	-
(from 1 September 1997)					
Mr H J Davies	95,138	-	1,688	96,826	*184,083*
(resigned 31 July 1997)					
Executive Directors					
Mr M A King	153,000	-	1,443	154,443	*145,886*
Mr I Plenderleith	142,167	-	5,907	148,074	*142,336*
Mr M D K W Foot	125,500	10,000	8,760	144,260	*131,228*
Mr T A Clark	125,500	-	5,683	131,183	-
Mr P H Kent	-	-	-	-	*138,205*
(retired 28 February 1997)					
Non-Executive Directors					
(notes v and vi)	5,959	14,000	-	19,959	*13,000*
	970,014	**24,000**	**28,753**	**1,022,767**	***985,140***

(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 page 70. 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 1998, a non-pensionable bonus of £10,000 was paid to Mr Foot. 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 payments in respect of notional benefits of travel on Bank business. The total of all benefits was £28,753 *(1997 £15,640)*.

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. Due to the scheme being in surplus, the Bank made no contribution for the year to 28 February 1998. For the year to 28 February 1997, the contribution was 11 per cent of pensionable salaries.

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 financial statements. The total provision in the balance sheet for such unfunded pensions at 28 February 1998 was £1,475,000 *(1997 £1,361,000)*, of which £477,000 *(1997 £254,000)* relates to current members of Court.

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 per cent of the member's base pension (55 per cent 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 Prices Index.

For members subject to the pensions cap introduced in the Finance Act 1989, the Bank offers additional unfunded pensions so that their total pensions broadly match those provided by the Court scheme. During the year ended 28 February 1998, there were three capped members - the Deputy Governor, Mr King and Mr Davies. Provision for these is made in the Bank's accounts as mentioned above. These unfunded pensions are included in the table below.

	Age at 28 February 1998	Years of service to 28 February 1998	Accrued pension as at 28 February 1998 £	Increase in accrued pension in 1998* £
Mr E A J George	59	37	156,800	-
Mr D C Clementi (from 1 September 1997)	49	-	3,200	3,200
Mr H J Davies (resigned 31 July 1997)	47	2	11,500	2,400
Mr M A King	49	7	34,900	5,200
Mr I Plenderleith	54	32	78,800	3,200
Mr M D K W Foot	51	28	65,000	1,100
Mr T A Clark	49	26	59,100	200

* The increase in accrued pension during the year excludes any increase for inflation.

(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 1998 *(1997 12)*. In accordance with the Bank's Charter of 1946, a fee of £500 *(1997 £500)* per annum is payable to each Director.

(vi) Sir David Scholey, who retired on 28 February 1998, received a fee of £14,000 *(1997 £7,000)* in respect of his service as a member of the Board of Banking Supervision.

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 per cent 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 future service contribution rate for the year to 28 February 1998 was 21.6 per cent *(1997 21.2* per cent*)* of pensionable earnings. For the purposes of the Bank's 1998 financial statements, some allowance has been made for the estimated effect of the abolition of the tax credit for UK equity dividends. Subject to review at the next triennial actuarial valuation (due as at 28 February 1999), the principal assumptions have been amended such that the long term rate of return has been reduced by 0.25 per cent per annum. This means that, over the long term, the return on new investments would exceed the rate of increase in salaries by 2.25 per cent (reduced from 2.5 per cent) and the rate of increase in pensions by 4.25 per cent (reduced from 4.5 per cent). It was also assumed that the equity dividend growth would equal the rate of future pension increases. The surplus remains of such a size that the Bank has no need to make a contribution and accordingly has not done so.

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

The total cost of all post-retirement benefits for the year was £15 million *(1997 £9 million)*. £17 million *(1997 £21 million)*, representing the excess of the pension amounts funded over the cost, is included in other assets. £102 million *(1997 £94 million)* representing the provision in respect of other post-retirement benefits is included in other liabilities.

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

	1998 £m	*1997 £m*
Payable 5 April	35	*24*
Payable 5 October	35	*25*
	70	*49*

6 Tax on profit on ordinary activities

	1998 £m	*1997 £m*
United Kingdom corporation tax at an average rate of 31.2 per cent (1997 33 per cent)	39	*49*
Prior year - corporation tax	(1)	*(6)*
- deferred tax	1	*(1)*
Deferred taxation	(1)	*(19)*
- adjustment on account of changes in the tax rate	1	*-*
	39	*23*

The charge for taxation is computed on the residual profit on ordinary activities after deduction of the amount payable to HM Treasury. For 1998, the actual tax rate was higher than that calculated using the average UK corporation tax rate of 31.2 per cent as a deferred tax asset has not been recognised in respect of certain timing differences. The corporation tax rate was changed from 33 per cent to 31 per cent with effect from 1 April 1997.

The deferred tax asset of £7 million *(1997 £8 million)*, included in other assets, is comprised as follows:

	1998 £m	*1997 £m*
Short-term timing differences	-	*(1)*
Accelerated capital allowances	2	*2*
Other timing differences	(9)	*(9)*
	(7)	*(8)*

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

	£m
At 1 March 1997	(8)
Adjustment on account of changes in the tax rate	1
At 28 February 1998	(7)

Tax of £1 million *(1997 £1 million)* has not been provided in respect of further accelerated capital allowances as the provision at 28 February 1998 is considered adequate.

7 Assets and liabilities

	1998 £m	*1997 £m*
Sterling/non-sterling analysis of assets and liabilities:		
Assets:		
Denominated in sterling	9,529	*5,232*
Denominated in currencies other than sterling	4,062	*1,075*
	13,591	***6,307***
An analysis of the foreign currencies held is given below		
Gold	627	*664*
$US	3,329	*312*
Other	106	*99*
	4,062	***1,075***
Liabilities:		
Denominated in sterling	12,516	*5,235*
Denominated in currencies other than sterling	1,075	*1,072*
	13,591	***6,307***
An analysis of the foreign currencies held is given below		
Gold	627	*664*
$US	345	*312*
Other	103	*96*
	1,075	***1,072***

Included in assets denominated in foreign currencies are US dollar deposits of £2,983 million arising from swap transactions and on which no significant exchange exposure arises. The forward leg of the transactions is valued at market value and included in other assets or other liabilities, as appropriate. These swaps have been undertaken as part of the Bank's operations in the money market.

The total assets and liabilities of the Bank at 28 February 1998 reflected particular market conditions at that date. The background to these market conditions is given on page 69 of the Directors' Report. Since the end of the Bank's financial year, the balance sheet has returned to a more normal size.

8 Treasury and other eligible bills

	1998 £m	*1997 £m*
British government Treasury bills	4	*3*

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

	1998 £m	*1997 £m*
Remaining maturity:		
Loans and advances		
- over 5 years	4	*4*
- 5 years or less but over 1 year	3	*4*
- 1 year or less but over 3 months	112	*95*
- 3 months or less	10,758	*3,885*
- Repayable on demand	459	*185*
	11,336	***4,173***

Included in the above are assets acquired under reverse repurchase agreements amounting to £nil *(1997 £2,426 million)*

	1998 £m	*1997 £m*
The gross amount due from subsidiaries, before provisions, (note 12), also included in the above	**137**	***162***

10 Debt securities

	1998		*1997*	
	Balance sheet £m	Market value £m	*Balance sheet £m*	*Market value £m*
Investment securities:				
- British government securities, listed on a recognised UK Exchange	1,363	1,602	*1,275*	*1,464*
Due within one year	8	10	*18*	*18*
Due one year and over	1,355	1,592	*1,257*	*1,446*
	1,363	**1,602**	***1,275***	***1,464***

	£m	*£m*
Net unamortised discounts and premiums	**55**	***80***

Movements in debt securities were as follows:

	Cost £m	Discounts and premiums £m	Carrying value £m
At 1 March 1997	1,184	91	1,275
Amortisation of discounts and premiums		12	12
Purchases	96	(2)	94
Redemptions	(15)	(3)	(18)
At 28 February 1998	**1,265**	**98**	**1,363**

11 Equity shares and participating interest

	1998		*1997*	
	Balance sheet-cost £m	Directors' valuation £m	*Balance sheet-cost £m*	*Directors' valuation £m*
Investment securities - unlisted equity shares	1	67	*1*	*79*
Participating interest - unlisted	63	63	*75*	*69*
	64	130	*76*	*148*

(a) Investment securities

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

	Percentage held 1998	*1997*
Bank for International Settlements shares of 2,500 Swiss gold francs (25 per cent paid) (Incorporated in Switzerland)	9.2	*9.2*

(b) Participating interest

This is the sterling equivalent 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 per cent, are invested by the European Monetary Institute to provide it with the income needed to finance its operations. The contribution is expected to be repaid within 12 months, following the dissolution of the EMI, and has 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). In previous years both contribution and deposit have been accounted for at cost being the sterling value at the date of transaction. As the contribution and the deposit are expected to be repaid within 12 months both are recorded at the exchange rate ruling at 28 February 1998.

12 Shares in group undertakings

	1998 £m	*1997 £m*
Cost of shares in group undertakings (all of which are subsidiaries)	18	*18*
In addition, gross advances to subsidiaries, before provisions, included under loans and advances to banks, the money market and customers (note 9) amount to	137	*162*

The accounts of the subsidiaries detailed 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.

(a) The NMB Group plc

Throughout the year ended 28 February 1998, the Bank held the entire issued share capital of 75 million £1 ordinary shares in The NMB Group plc (NMB), which is incorporated in Great Britain. 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 has been reduced to £85 million at 28 February 1998, of which £83 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 and 28 February 1997.

Included in the Bank's balance sheet within 'loans and advances to banks' is £137 million *(1997 £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 1998, which bear an unqualified audit report, show:

The NMB Group plc	**1998 £m**	***1997 £m***
Mortgage loans	82	*105*
Current assets	59	*61*
	141	*166*
Creditors:		
Bank of England	(137)	*(162)*
Other liabilities	(4)	*(4)*
	(141)	*(166)*
	nil	***nil***
Equity share capital	75	*75*
Accumulated deficit	(75)	*(75)*
	nil	***nil***

(b) Minories Finance Ltd

Throughout the year ended 28 February 1998, the Bank held the entire issued share capital of 12.5 million £1 ordinary shares in Minories Finance Ltd (MFL), which is incorporated in Great Britain. The investment in this company is included in the Bank's balance sheet at 28 February 1998 at £13 million *(1997 £13 million)*. As a condition of reductions in capital in June 1987 and November 1996, the Bank gave indemnities whereby any future deficit in MFL's shareholders' funds would be made good by the Bank up to a maximum of £63 million in total.

MFL's accounts as at 31 December 1997 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 £1 million has been declared and reflected in the Bank's accounts.

The accounts of MFL show:

Profit for the year to 31 December 1997	£1 million
Accumulated reserves as at 31 December 1997 after provision for dividends	£7 million
Net assets at 31 December 1997 after provision for dividends	£19 million

(c) 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 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 subsidiary companies attributable to the Bank, which have not been dealt with in the financial statements 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 1998	-
Accumulated profits since formation	1

The aggregate net assets of these subsidiary companies are £6 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 1997	171	151	2	117	441
Additions	10	-	-	5	15
Disposals	-	(2)	-	(11)	(13)
Revaluation	-	10	-	-	10
At 28 February 1998	181	159	2	111	453
Accumulated depreciation					
At 1 March 1997	-	-	-	74	74
Charge for the year	10	-	-	11	21
On disposals	-	-	-	(10)	(10)
At 28 February 1998	10	-	-	75	85
Net book value at 28 February 1998	**171**	**159**	**2**	**36**	**368**
Net book value at 28 February 1997	*171*	*151*	*2*	*43*	*367*
Cost or valuation at 28 February 1998 comprised:					
At 1998 valuation	-	156	-	-	156
At 1997 valuation	171	3	2	-	176
At cost	10	-	-	111	121
	181	159	2	111	453

Included in leasehold premises (50 years and over) is an investment property held at open market value of £156 million *(1997 £146 million)* which was valued by St Quintin, Chartered Surveyors as at 28 February 1998. The figures for other property interests reflect a professional valuation of Bank freehold and leasehold properties as at 28 February 1997. Certain properties that the Bank intends to vacate and which are available for sale 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 1998 totalled £1 million *(1997 £6 million)*.

14 Deposits by central banks

	1998 **£m**	*1997* *£m*
Remaining maturity:		
- 1 year or less but over 3 months	110	*92*
- 3 months or less but not repayable on demand	652	*674*
Repayable on demand	298	*316*
	1,060	***1,082***

15 Deposits by banks

	1998 **£m**	*1997* *£m*
Cash ratio deposits	2,562	*1,901*
Other deposits repayable on demand	235	*35*
	2,797	***1,936***

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. Changes to the cash ratio deposits regime are set out on pages 66-67 of the Annual Report.

16 Customer accounts

	1998 £m	*1997 £m*
Remaining maturity:		
1 year or less but over 3 months:		
- Public deposits	62	*73*
3 months or less but not repayable on demand:		
- Public deposits	3	*30*
- Other deposits	1	*6*
Repayable on demand:		
- Public deposits	371	*367*
- Deposit by Issue Department	7,337	*900*
- Other deposits	437	*507*
	8,211	*1,883*

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

	1998 £m	*1997 £m*
Include:		
Payable to HM Treasury	70	*49*
Due to subsidiaries	7	*9*
Provision for post-retirement benefits	102	*94*

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

£m

	Profit and loss account	Revaluation reserve	Investment property revaluation reserve	Total
Balance at 1 March 1997	902	117	108	1,127
Retained profit for the year	70	-	-	70
Surplus on revaluation of property	-	-	10	10
Balance at 28 February 1998	972	117	118	1,207

20 Statement of reconciliation of shareholder's funds

	1998 £m	*1997 £m*
Shareholder's funds at 1 March	1,142	*1,083*
Retained profit for the year	70	*49*
Surplus on revaluation of property	10	*10*
Shareholder's funds at 28 February	1,222	*1,142*

21 Cash flow statement

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

	1998 £m	*1997 restated £m*
Profit after provisions and before tax	179	*121*
Increase in interest receivable and prepaid expenses	(60)	*(2)*
Increase in interest payable and accrued expenses	9	*(1)*
Depreciation	21	*26*
Effect of other deferrals and accruals on cash flow	(9)	*9*
Net increase/(decrease) in foreign currency deposits	14	*(48)*
Net increase in other deposits	7,164	*145*
Net (increase)/decrease in foreign currency advances to banks	(2,857)	*61*
Net (increase)/decrease in Treasury and other eligible bills	(1)	*16*
Net increase in advances to banks and customers (including reverse repurchase agreements)	(4,021)	*(557)*
Increase in debt securities held	(81)	*(128)*
Net (increase)/decrease in other assets	(5)	*4*
Decrease/(increase) in items in course of collection	20	*(24)*
Net cash inflow/(outflow) from operating activities	**373**	***(378)***

(ii) Capital expenditure and financial investment

	1998 £m	*1997 restated £m*
Repayment of capital by subsidiary undertaking	-	*25*
Purchases of premises and equipment	(12)	*(15)*
Proceeds from sales of premises and equipment	3	*1*
	(9)	*11*

(iii) Analysis of the balances of cash as shown in the balance sheet

	At 1 March 1997 £m	Cashflows £m	At 28 February 1998 £m
Cash	9	(7)	2
Advances to banks repayable on demand	185	274	459
	194	267	461

(iv) The cash flow statement has been prepared under the revised FRS1 and is therefore presented on a different basis to previous years. The comparative figures have been restated on the same basis. The definition of cash in the standard is not wholly appropriate to the Bank. The Bank requires a stock of liquidity for operational purposes and regards advances to the money market and banks, Treasury and other eligible bills, and reverse repurchase agreements as a pool of assets for these purposes. The allocation of this liquidity between the components depends upon prevailing market conditions. The Bank's total liquidity position at 28 February 1998 was as follows:

	At 1 March 1997 £m	Cashflows £m	At 28 February 1998 £m
Cash	9	(7)	2
Advances to money market and certain banks			
(including reverse repurchase agreements)	3,031	7,227	10,258
Treasury and other eligible bills	3	1	4
	3,043	7,221	10,264

The change in the liquidity position reflects the changes in deposits, principally the Issue Department deposit (note 16) and is a consequence of market conditions at the end of the financial year.

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 during the year to 28 February 1998 were:-

- 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 Government are disclosed in note 2.

(b) Group 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:

	1998		*1997*	
	Total amount outstanding £000	**Number**	***Total amount outstanding £000***	***Number***
Directors	287	4	*259*	*4*
Officers	965	12	*1,240*	*17*

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 million. This advance was repaid to the Bank during the year to 28 February 1998.

Under the Bank of England Act 1998, the Governor and Chief Cashier will cease to be ex-officio members of the Board with effect from 1 June 1998, from when the Governor will also cease to appoint the remaining members. The Deputy Governor responsible for Financial Stability will be a member of the Board ex-officio. The Bank will no longer provide the Secretariat for the Board but will continue to provide banking facilities, excluding an advance facility. It is considered that the Board will cease to be a related party of the Bank.

(e) The Bank's pension schemes

The Bank provides the secretariat, the investment management and some custodial services to the Bank's pension schemes. In the year to 28 February 1998 no charge was made for these services. 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 1998.

(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 Post balance sheet events

The Financial Services Authority

From 1 June 1998, the responsibility under the Banking Act for banking supervision will transfer from the Bank to the Financial Services Authority (FSA), whose chairman is a Non-Executive Director of the Bank. The Bank's Supervision and Surveillance divisions with around 470 staff will transfer to the FSA on this date. Until the relevant staff actually move to the FSA's own premises - expected to be mainly in the autumn of this year - the Bank will provide, and charge for, accommodation and other services for these staff.

24 General

(i) Operating lease commitments

	1998		*1997*	
	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	-	1	*-*	*1*
expiring in five years or more	1	-	*1*	*-*
	1	1	*1*	*1*

(ii) Average number of employees

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

	1998	*1997*
Governors and Executive Directors	6	*6*
Managers and analysts	529	*511*
Clerical staff	1,757	*1,854*
Technical/other	1,091	*1,226*
	3,383	*3,597*

25 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.

On 30 July 1997, Mr Justice Clarke dismissed all the claims against the Bank. This decision is subject to an appeal by the plaintiffs. The Bank's Directors are of the opinion that the Bank has a strong defence against the claim and will oppose the appeal vigorously. Accordingly no provision is made in these financial statements.

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 £151 million *(1997 £184 million)*.

26 Date of approval

The Court of Directors approved the financial statements on pages 76-97 on 13 May 1998.

ISSUE DEPARTMENT

ACCOUNT FOR THE YEAR ENDED 28 FEBRUARY 1998

	Notes	1998 £m	*1997 £m*
Income and profits:			
Securities of, or guaranteed by, the British Government		977	*839*
Other securities		604	*441*
		1,581	***1,280***
Expenses:	2		
Cost of production of Bank notes		31	*39*
Cost of issue, custody and payment of Bank notes		19	*20*
Other expenses		3	*3*
		53	*62*
Payable to HM Treasury		**1,528**	***1,218***

STATEMENT OF BALANCES: 28 FEBRUARY 1998

	Notes	1998 £m	*1997 £m*
Assets			
Securities of, or guaranteed by, the British Government	3	1,162	*10,374*
Other securities and assets including those acquired under reverse repurchase agreements	4	22,388	*11,646*
Total assets		**23,550**	***22,020***
Liabilities			
Notes issued:			
In circulation	5	23,548	*22,011*
In Banking Department		2	*9*
Total liabilities		**23,550**	***22,020***

E A J GEORGE	Governor
D C CLEMENTI	Deputy Governor
SHEILA MASTERS	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 26 February 1998.

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 British Government 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

	1998	*1997*
	£m	*£m*
Commercial bills	1,087	*2,898*
Deposit with Banking Department	7,337	*900*
Other assets	13,964	*7,848*
	22,388	*11,646*

5 Notes in circulation

	1998	*1997*
	£m	*£m*
£1 (a)	55	*56*
£5	1,034	*1,047*
£10	5,960	*5,915*
£20	10,621	*9,559*
£50	3,636	*3,273*
Other notes (b)	2,242	*2,161*
	23,548	*22,011*

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 98-99 on 13 May 1998.

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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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