Report of the Independent Auditors

TO THE GOVERNOR AND COMPANY OF THE BANK OF ENGLAND

We have audited the financial statements of the Banking Department on pages 48 to 81, and the statements of account of the Issue Department on pages 82 to 84.

RESPECTIVE RESPONSIBILITIES OF THE MEMBERS OF COURT AND AUDITORS

The responsibilities of the Members of Court for preparing the *Annual Report*, including the financial statements and statements of account, in accordance with applicable United Kingdom law and accounting standards, are set out on page 37.

Our responsibility is to audit the financial statements and the statements of account. We have taken this responsibility to be that which would have applied if it had been established primarily by the United Kingdom Companies Act and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for, and only for, the Governor and the Company of the Bank of England and its Shareholder in accordance with Section 7 of the Bank of England Act 1998 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or in to whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements of the Banking Department give a fair presentation and are properly prepared on the basis of note 1(a). We also report to you our opinion as to whether the statements of account of the Issue Department give a fair presentation and are properly prepared on the basis described on page 83. Furthermore, we report to you if, in our opinion, the Governance, Financial Statements and Risk section on pages 34 to 41 is not consistent with the financial statements and the statements of account, if the Bank has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

We read the other information contained in the *Annual Report* and consider the implications for our *Report* if we become aware of any apparent mis-statements or material inconsistencies with the financial statements or the statements of account. The other information contained in the *Annual Report* comprises the Remuneration of Governors, Directors and MPC Members; the Governance, Financial Statements and Risk section; the Report by the Non-executive Directors; and other reports.

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 and the statements of account. It also includes an assessment of the significant estimates and judgements made by the Members of Court in the preparation of the financial statements and the statements of account, 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 and the statements of account are free from material mis-statement, 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 of the Banking Department, the basis of which is described in note 1(a), and in the statements of account of the Issue Department, the basis of which is described on page 83.

OPINION

In accordance with the Bank of England Act 1998, 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 except insofar as the Bank has not considered it appropriate to do so having regard to its functions.

In our opinion

1 The financial statements on pages 48 to 81 present fairly, on the basis referred to above, the state of affairs of the Banking Department at 28 February 2005 and the profit and cash flows for the year then ended.

2 The statements of account on pages 82 to 84 present fairly, on the basis described on page 83, the outcome of the transactions of the Issue Department for the year ended 28 February 2005 and its balances at that date.

PRICEWATERHOUSECOOPERS LLP
Chartered Accountants and Registered Auditors

London
12 May 2005

Notes
The maintenance and integrity of the Bank of England website is the responsibility of the Members of Court; the work carried out by the independent auditors does not involve consideration of these matters and, accordingly, the independent auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Banking Department

Profit and loss account for the year ended 28 February 2005

	Notes	2005 £m	2004 £m
Profit after provisions and before tax	2	100	*72*
Payable to HM Treasury under Section 1(4) of the Bank of England Act 1946	5	(38)	*(30)*
Tax on profit on ordinary activities	6	(24)	*(12)*
Retained profit for the year	22	**38**	***30***

The difference between the reported profit before tax and retained profit and their historical cost equivalents is shown in note 2(c).

Statement of total recognised gains and losses for the year ended 28 February 2005

		2005 £m	2004 £m
Profit transferred to reserves		38	*30*
Surplus on revaluation of properties	14	–	*24*
		38	***54***

Balance Sheet as at 28 February 2005

	Notes	**2005** £m	*2004* £m
Assets			
Cash		4	*5*
Items in course of collection	8	351	*305*
Due from the European Central Bank in respect of TARGET	9	112	*86*
Loans and advances to banks and customers	10	12,564	*5,891*
Debt securities	11	8,248	*8,343*
Equity investments and participating interest	12	40	*29*
Shares in group undertakings	13	18	*18*
Tangible fixed assets	14	196	*208*
Prepayments, accrued income and other assets	15	609	*628*
Total assets		**22,142**	***15,513***
Liabilities			
Deposits by central banks	16	9,817	*4,684*
Deposits by banks and building societies	17	2,341	*2,059*
Customer accounts	18	1,292	*1,027*
Debt securities in issue	19	5,914	*5,739*
Other liabilities	20	1,180	*444*
		20,544	***13,953***
Capital	21	15	*15*
Revaluation reserves	22	151	*158*
Profit and loss account	22	1,432	*1,387*
Shareholder's funds	23	1,598	*1,560*
Total liabilities		**22,142**	***15,513***

M A King Governor
A M B Large Deputy Governor
T J Parker Chairman of NedCo
J R E Footman Executive Director, Central Services

Banking Department continued

Cash flow statement for the year ended 28 February 2005

	Notes	**2005** £m	*2004* £m
Net cash inflow/(outflow) from operating activities	24	123	*(500)*
Corporation tax paid		(21)	*(24)*
Capital expenditure and financial investment	24	(7)	*(3)*
		95	***(527)***
Payment to HM Treasury under Section 1(4) of the Bank of England Act 1946		(30)	*(34)*
Increase/(decrease) in cash	24	**65**	***(561)***

Notes to the Banking Department financial statements

1 ACCOUNTING POLICIES

a Form of presentation of the financial statements

Under the Bank of England Act 1998, the Bank, in preparing the financial statements of the Banking Department, is subject to requirements corresponding to the Companies Act requirements relating to a banking company. The Bank may, however, disregard a requirement to the extent that it considers it appropriate to do so having regard to its functions. The financial statements have, therefore, 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 the requirements of Section 255 of, and Part 1 of Schedule 9 to, the Companies Act 1985, applicable Accounting Standards in the United Kingdom, guidance pronouncement of the Urgent Issues Task Force (UITF) and Statements of Recommended Accounting Practice issued by the British Bankers' Association, insofar as they are appropriate having regard to its functions: that is, in particular, with the limitations explained below.

In exceptional circumstances, as part of its central banking functions, 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 Banking Department's 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 Act and applicable Accounting Standards.

The financial statements have been prepared on the historical cost basis of accounting, modified to include the revaluation of land and buildings. The Bank has adopted the transitional arrangements of FRS 17 (Retirement Benefits) which require supplementary disclosures and these are provided in note 4. The accounting policies set out below have been applied consistently.

The Bank of England has no branches or operations abroad. The Members of Court consider that the activities of the Banking Department constitute a single business conducted in the United Kingdom and, accordingly, that no further analysis by business unit or geographic segment is appropriate for financial reporting purposes.

b Sterling debt securities

British Government securities and other sterling debt 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.

The treatment of non-sterling securities of foreign governments or other foreign institutions is described in (c) and (d) below.

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

Notes to the Banking Department Financial Statements continued

c Non-sterling investment securities and the matching funding

Certain securities of foreign governments or other foreign institutions denominated in euro and other foreign currencies are held as investment securities by the Bank. Some of these securities are used via repo contracts to provide intra-day liquidity to the TARGET settlement system. The securities are recorded at cost, in currency of denomination, adjusted for the amortisation of premiums or discounts on a straight-line basis over the period to maturity. They are translated into sterling at the exchange rates ruling at the balance sheet date. These securities are funded by three-year Euro Notes, and in the case of non-euro securities, cross currency and interest rate swaps. Accordingly, the Notes and swaps are treated as hedging the foreign exchange and interest rate exposure of the non-euro securities.

Euro Notes are stated at issue proceeds, adjusted for the amortisation of premiums and discounts on a straight-line basis over the period to maturity. They are translated into sterling at the exchange rate ruling at the balance sheet date. Accrued interest is included in other liabilities. The treatment of swaps is disclosed in note (e) below.

Repurchase agreements are accounted for as financing transactions.

Any net residual unrealised gain arising from exchange rate movements on the portfolio and the swaps, repurchase agreements and Notes used to fund it is taken to an investment revaluation reserve. Any net unrealised loss is taken to the profit and loss account.

d Other non-sterling securities and the matching funding

A further portfolio of securities of foreign governments or other foreign institutions denominated in foreign currencies and related currency and interest rate swaps was re-designated as available for active management with effect from 1 March 2003. Accordingly the portfolio and the related swaps are accounted for at fair values, with all gains and losses taken to the profit and loss account. This portfolio is funded by a rolling programme of Euro Bills.

Euro Bills are stated at issue proceeds plus accrued interest in euro. They are translated into sterling at the exchange rate ruling at the balance sheet date.

Repurchase agreements are accounted for as financing transactions.

All exchange gains or losses arising from exchange rate movements on the portfolio and the swaps, repurchase agreements and Bills used to fund it are taken to the profit and loss account.

e Financial instruments

Financial instruments, including interest rate, currency and foreign exchange swaps, are held as hedging instruments for general banking business, as well as the non-euro foreign securities and Euro Notes as described in (c) above. Instruments used for these purposes are recorded on an accruals basis to match the cash flows of the relevant hedged items. Financial instruments, including interest rate, currency and foreign exchange swaps, held in the actively managed portfolio are recorded at fair values. Where applicable, foreign exchange swaps used in open market operations are also recorded at fair value.

f Equity investments and participating interest

Equity investments and the participating interest are held as long-term investments and stated in the balance sheet at cost less any provision for impairment where necessary. The cost of the participating interest in the European Central Bank is its original cost in foreign currency, translated at the exchange rates ruling at the dates of acquisition.

g Tangible fixed assets

The Bank's properties are stated at a professional valuation as at 29 February 2004. The frequency of professional valuations is three years, with subsequent additions included at cost, and provision made for depreciation as explained below. In the intervening years, Members of Court consider whether there is any circumstance which would necessitate a significant change to the value at which these properties are carried in the Bank's books. No account is taken of any liability to taxation which could arise if the properties were disposed of at their revalued amounts, except in respect of properties where a binding sale contract has been agreed.

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 twenty-five 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

h 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.

Specific provisions relate to identified advances at risk and are raised when it is considered that recovery of the outstanding balance is in serious doubt. The provision is the amount necessary to reduce the carrying value of the advance to its expected net realisable value including available collateral.

The general provision is reviewed on a regular basis to ensure that it remains appropriate in the context of the perceived risk inherent in the lending portfolio and the prevailing economic climate.

i 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 financial statements as the Bank is concerned in such transactions only as agent.

j Deferred tax

Deferred tax is provided, at the estimated rates at which future taxation will become payable, on all material timing differences, and on property revaluations where there is a binding sale contract. Deferred tax balances are not discounted.

k Group undertakings

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

l Leasing

Operating lease rentals are charged to the profit and loss account on a straight-line basis over the period to which they relate.

m 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.

Additional disclosures are made under the transitional arrangements of FRS 17.

n 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, namely equity investments and participating interests, 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. Income and expenditure are translated into sterling at the exchange rate ruling at the time of the transaction.

Notes to the Banking Department Financial Statements continued

2 PROFIT AFTER PROVISIONS AND BEFORE TAX

a Profit after provisions and before tax is stated after:

	2005	2004
	£m	£m
i Staff costs (including Governors):		
wages and salaries	79	77
social security costs	8	7
pension costs and other post-retirement benefits	17	14
cost of severance schemes	6	10
ii Income:		
charges for services to HM Government, including charges to the Issue Department in respect of the Note Issue	60	61
iii Charges:		
operating lease rentals: property	1	2
equipment	1	1
depreciation of premises and equipment	8	13
legal fees (including VAT)	20	22
net effect of reclassification of security portfolio funded by Euro Bills and related swaps	–	4

b Fees paid to the auditors

	2005		2004	
	£000	%	£000	%
Audit of the Bank's financial statements	195	27	168	27
Further assurance services:				
Review of controls on payments systems	114	16	110	18
Other assurance services	101	14	184	29
Sub-total for assurance services	410	57	462	74
Tax advisory services	58	8	30	5
Other non-audit services:				
Acting as liquidator of Minories Finance Ltd	43	6	40	6
Accounting advice on International Financial Reporting Standards	157	22	–	–
Other services	55	7	94	15
Total	**723**	100	626	100
Of which borne by the Bank	**680**		586	
Borne by subsidiaries	**43**		40	

During the year ended 28 February 2005, an additional £53,000 *(2004 £51,000)* was paid for work performed as auditors of the Bank's pension funds, together with fees for non-audit services of £nil *(2004 £7,000)*. These fees were borne by the respective funds and are not included in the amounts above.

The Bank's policy is to use its auditors for non-audit work only where it is appropriate to do so in the light of their expertise and experience of the Bank and the nature of the work being performed, or where they are selected on a competitive basis. All such work is notified to the Finance Director, so that it can be assessed if it is appropriate, on both financial and independence grounds. The Chairman of the Audit Committee will be notified of major items before work commences. The Audit Committee also receives a breakdown of all such fees.

c Note of historical cost profits and losses for the year ended 28 February 2005

	2005	*2004*
	£m	*£m*
Reported profit before taxation	100	*72*
Realisation of property revaluation gains of previous years	7	*–*
Difference between a historical cost depreciation charge and the actual depreciation charge for the year calculated on the revalued amount	(1)	*4*
Historical cost profit before taxation	**106**	***76***
Historical cost profit for the year retained after taxation and payments in lieu of dividend	**44**	***34***

3 EMOLUMENTS OF GOVERNORS AND NON-EXECUTIVE DIRECTORS

	2005	*2004*
	£	*£*
Remuneration of Governors and Non-Executive Directors	817,863	*774,642*
Payment in respect of notional benefits of travel on Bank business	108	*880*
	817,971	***775,522***

Full information on the remuneration (including pension arrangements) of the Members of Court (including the highest paid Member of Court) is given in the Remuneration Report on pages 30 to 33.

4 PENSION COSTS, OTHER POST-RETIREMENT BENEFITS AND REDUNDANCY PROVISIONS

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.

SSAP 24

The Bank accounts for pension costs, other post-retirement benefits and redundancy provisions in accordance with Statement of Standard Accounting Practice No. 24: Pension Costs (SSAP 24). Under SSAP 24, the balance sheet includes provision for unfunded pension obligations, other post-retirement benefits and redundancy provisions, and for the cumulative difference between pension charges included in the profit and loss account and actual payments to the schemes.

a Pension costs and other post-retirement benefits in the financial statements

In computing the pension cost for the profit and loss account, the actuarial surplus, based on the assumptions under the actuarial valuation and funding described below, is being spread over the average remaining service lives of the current employees, which is assessed at 12 years.

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%.

£5 million *(2004 £3 million)*, representing the excess of the cost over the pension amounts funded, is included in other liabilities. £121 million *(2004 £126 million)* representing the provision in respect of other post-retirement benefits is included in other liabilities. The total cost of all post-retirement benefits for the year was £17 million *(2004 £14 million)*.

b Redundancy provisions

As part of redundancy arrangements with staff, the Bank may give enhanced pension entitlement in the form of added years' service or early pension rights. The costs of such benefits cannot be charged to the pension fund. The costs are therefore borne in the Bank's accounts. Provision is made for the costs of these benefits at the time the redundancy offer is announced based on actuarial advice. The provisions (a separate one is made in respect of each offer) are revalued by the actuary every three years with the latest being in 2004, using the same assumptions as for the pension fund. Interest is added to the provisions at inflation plus 4% on the advice of the actuary. The cost for the year was £6 million *(2004 £10 million)*. Total provisions at 28 February 2005 were £53 million *(2004 £53 million)*.

Actuarial scheme valuation and funding

The main pension scheme, the Bank of England Pension Fund, is valued every three years by an independent qualified actuary with interim reviews in the intervening years. The latest available actuarial valuation was as at 28 February 2002; it used the projected unit method, and showed that the actuarial value of the Fund's assets at 28 February 2002 represented 112% 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 28 February 2002 was £1,611 million and the required future service contribution rate for the year to 28 February 2005 was 27.2% *(2004 27.2%)* of pensionable earnings. The principal assumptions used in the valuation were that, over the long term, the return on new investments would exceed the rate of increase in salaries by 2.25% p.a. and the rate of increase in pensions by 4.0% p.a. It was also assumed that the equity dividend growth would exceed the rate of future pensions increases by 1.0% p.a. The rate of inflation used in the valuation in 2002 was 2.5%. For the year ended 28 February 2005, the interim review was performed using the 2002 actuarial valuation updated with assets taken at a 2004 assessed value.

The Bank believes that there are considerable uncertainties around pension fund valuations and, even though the scheme is in actuarial surplus, the Bank made a contribution of 10% of pensionable earnings in respect of the year ended 28 February 2005 and intends to contribute at this rate for the next financial year. This will be reviewed in the light of the next triennial valuation.

FRS 17: additional information required under the transitional arrangements

FRS 17 adopts a different basis of accounting for pension costs, other post-retirement benefits and redundancy provisions. Under the transitional arrangements of FRS 17 certain disclosures are required in the periods prior to full adoption. Under the standard, the difference between the market values of scheme assets and the present value of scheme liabilities is reported as a surplus or deficit, net of deferred tax.

In the preparation of their valuations under FRS 17 referred to in this note, the actuaries have used the assumptions indicated, which Members of Court have accepted for the purposes of accounting and disclosure under the terms of the standard.

Measurement of scheme liabilities must be calculated under the projected unit method, which requires certain demographic and financial assumptions, including an assumption regarding future salary growth. The assumptions used are applied only for the purposes of FRS 17.

The financial assumptions used by the independent actuaries to calculate scheme liabilities on a FRS 17 basis were:

	2005	*2004*	*2003*
	%	*%*	*%*
Rate of increase in salaries	4.6	*4.3*	*4.3*
Rate of increase in pensions in payment	2.8	*2.5*	*2.5*
Discount rate	5.1	*5.4*	*5.3*
Inflation assumption (RPI)	2.8	*2.5*	*2.5*

The discount rate assumption reflects the investment return on a Grade AA corporate bond at the balance sheet date. The RPI assumption for 2005 is consistent with the new CPI based target set under the monetary framework.

The assets in the scheme and the expected rates of return were:

	2005		*2004*		*2003*	
	Long-term rate of return expected	**Assets**	*Long-term rate of return expected*	*Assets*	*Long-term rate of return expected*	*Assets*
	%	**£m**	*%*	*£m*	*%*	*£m*
Equities	8.0	910	*7.9*	*1,035*	*8.8*	*958*
Bonds	4.6	563	*4.7*	*360*	*4.6*	*203*
Properties	6.6	90	*6.6*	*84*	*7.0*	*96*
Cash and other assets	3.8	44	*4.0*	*34*	*4.0*	*19*
Total market value of investments	6.7	**1,607**	*6.9*	***1,513***	*7.9*	***1,276***
Present value of scheme liabilities		**1,894**		***1,572***		***1,569***
Deficit in the scheme:		**(287)**		***(59)***		***(293)***
Related deferred tax asset		86		*18*		*88*
Net pension liability		**(201)**		***(41)***		***(205)***

For the purposes of FRS 17 the asset values stated are at the balance sheet date. Market values of scheme assets, which are not intended to be realised in the short term, may be subject to significant change before they are realised. The long-term expected rates of return have been determined after applying due consideration to the requirements of paragraph 54 of FRS 17. Expected rates of return are used for the purposes of calculating the annual charge to the profit and loss account in the subsequent year, and have no impact on the deficit in the scheme as calculated on an FRS 17 basis. The assumptions used do not necessarily reflect the investment return that may be achieved.

The deficit in the scheme before taxation, on an FRS 17 basis, has increased by £228 million to £287 million *(2004 £59 million)*. The increase has arisen principally as a result of changes to assumptions which have had a total effect on the deficit of £279 million. Within the demographic assumptions, the assumption relating to future mortality rates has been revised to reflect increased longevity. This has had the effect of adding an estimated £90 million to the scheme deficit. The reduction in the real discount rate has increased the scheme deficit by approximately another £189 million.

Notes to the Banking Department Financial Statements continued

If FRS 17 had been adopted in full in the financial statements, the Bank's profit and loss account and Statement of Total Recognised Gains and Losses would have been affected as follows:

Analysis of the amount chargeable to operating profit:

	2005	*2004*
	£m	*£m*
Current service cost	26	*26*
Past service cost	1	*3*
Gain on curtailment	–	*(8)*
Total operating charge	**27**	***21***

Analysis of the amount recognisable in income:

	2005	*2004*
	£m	*£m*
Expected return on pension scheme assets	103	*98*
Interest on pension scheme liabilities	(83)	*(81)*
Net return	**20**	***17***

Analysis of the amount recognisable in the Statement of Total Recognised Gains and Losses

	2005	*2004*
	£m	*£m*
Actual return, less expected return on pension scheme assets	62	*203*
Experience (losses)/gains arising on the scheme liabilities	(12)	*3*
Changes in assumptions underlying the present value of the scheme liabilities	(279)	*24*
Actuarial (loss)/gain recognised in the Statement of Total Recognised Gains and Losses	**(229)**	***230***

Movement in (deficit)/surplus during year:

	2005	*2004*
	£m	*£m*
Deficit in scheme at beginning of year	(59)	*(293)*
Movement in year:		
Contributions paid	8	*8*
Current service cost	(26)	*(26)*
Past service cost	(1)	*(3)*
Other finance income	20	*17*
Gain on curtailment	–	*8*
Actuarial (loss)/gain	(229)	*230*
Deficit in scheme at end of year	**(287)**	***(59)***

History of experience gains and losses:

	2005	*2004*	*2003*
	£m	*£m*	*£m*
Difference between the expected and the actual return on scheme assets	62	*203*	*(401)*
Percentage of the scheme's assets	4%	*13%*	*32%*
Experience (losses)/gains on scheme liabilities	(12)	*3*	*12*
Percentage of the present value of the scheme's liabilities	1%	*–*	*1%*
Total (loss)/gain recognised in the Statement of Total Recognised Gains and Losses	(229)	*230*	*(513)*
Percentage of the present value of the scheme's liabilities	12%	*15%*	*33%*

If FRS 17 had been adopted in full in the financial statements, the Bank's assets and liabilities (including profit and loss reserve) at 28 February 2005 would have been as follows:

	2005	*2004*
	£m	*£m*
Assets per balance sheet	22,142	*15,513*
Less deferred tax asset (included in other assets)	(37)	*(36)*
Total assets under FRS 17	**22,105**	***15,477***
Total liabilities excluding shareholder's funds per balance sheet	20,544	*13,953*
Less provisions already made for unfunded post-retirement benefits and redundancy costs	(174)	*(179)*
Pension balance under SSAP24	(5)	*(3)*
Deferred tax other than in respect of post-retirement assets and liabilities	17	*19*
	20,382	*13,790*
Unfunded post-retirement and redundancy liability under FRS 17 (net of deferred tax)	141	*104*
Pension liabilities (net of deferred tax)	201	*41*
Total liabilities including pension liabilities	20,724	*13,935*
Profit and loss account per balance sheet	1,432	*1,387*
Add pension balance under SSAP24 (net of deferred tax)	3	*2*
Add provisions made for unfunded post-retirement benefits and redundancy costs (net of deferred tax)	122	*125*
	1,557	*1,514*
Pension reserve	(342)	*(145)*
Profit and loss account	1,215	*1,369*
Share capital	15	*15*
Revaluation reserve	151	*158*
Total liabilities and shareholder's funds including pension reserve under FRS 17	**22,105**	***15,477***

Other post-retirement benefits, calculated under FRS 17 using the above assumptions, together with a medical claims escalation rate of 12%, reducing to 5% over 7 years *(2004: 5.6%; 2003: 5.6%)* would be £137 million *(2004 £94 million)*, with an associated deferred tax asset of £41 million *(2004 £28 million)*. The charge to the profit and loss account in respect of these would be £5 million *(2004 £4 million)*, and a loss of £50 million *(2004 £21 million)*, recognised in the Statement of Total Recognised Gains and Losses. The provisions for redundancy-related pension costs arising under (b) above, if calculated according to the requirements of FRS 17, would amount to £65 million *(2004 £55 million)* with an associated deferred tax asset of £20 million *(2004 £17 million)*. The charge to the profit and loss account in respect of these would be £6 million *(2004 £3 million)* and a loss of £9 million *(2004 gain £1 million)* recognised in the Statement of Total Recognised Gains and Losses. The increase in the provision for other post-retirement benefits under FRS 17 is due to the change in the medical claims escalation rate assumption.

Notes to the Banking Department Financial Statements continued

5 PAYABLE TO HM TREASURY UNDER SECTION 1(4) OF THE BANK OF ENGLAND ACT 1946

	2005	*2004*
	£m	*£m*
Payable 5 April	20	*14*
Payable 5 October	18	*16*
	38	***30***

6 TAX ON PROFIT ON ORDINARY ACTIVITIES

	2005	*2004*
	£m	*£m*
United Kingdom corporation tax at an average rate of 30% *(2004 30%)*	19	*20*
Prior year — corporation tax	6	*(1)*
Deferred taxation	(1)	*(7)*
	24	***12***

The charge for taxation is computed on the residual profit on ordinary activities after deduction of the amount payable to HM Treasury. The current tax liability of £14 million *(2004 £10 million)* is included in other liabilities.

A reconciliation of the reported current tax charge for the year to the charge that would result from applying the standard UK corporation tax rate to profit before tax is given below:

	2005	*2004*
	£m	*£m*
Profit on ordinary activities before tax and after payments in lieu of dividend	**62**	***42***
Profit on ordinary activities multiplied by standard rate of corporation tax in UK of 30%	19	*13*
Capital allowances in excess of depreciation	(1)	*1*
Post-retirement cost not allowable in year	2	1
Other	(1)	*5*
Current tax charge for period	**19**	***20***

The deferred tax asset of £37 million *(2004 £36 million)*, included in other assets, is comprised as follows:

	2005	*2004*
	£m	*£m*
Accelerated capital allowances	1	*1*
Timing differences in respect of post-retirement benefits and redundancy costs	(45)	*(45)*
Other timing differences	7	*8*
	(37)	***(36)***

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

	2005	*2004*
	£m	*£m*
At 1 March 2004	(36)	*(29)*
Profit and loss account	(1)	*(7)*
At 28 February 2005	**(37)**	***(36)***

No material tax liability would arise if the properties were sold at their current book values. Where fair values of certain financial instruments are disclosed but not recognised, tax estimated at £52 million *(2004 £38 million)* would be payable if the instruments were realised at these values.

7 Assets and liabilities

a Sterling/non-sterling analysis of assets and liabilities

	2005	*2004*
	£m	*£m*
Assets:		
Denominated in sterling	5,776	*5,036*
Denominated in currencies other than sterling	16,366	*10,477*
	22,142	***15,513***
Liabilities:		
Denominated in sterling	7,854	*5,952*
Denominated in currencies other than sterling	14,288	*9,561*
	22,142	***15,513***

An analysis by currency of the assets and liabilities denominated in foreign currency is given in table (d) below. Major movements in the balance sheet are described on page 35 of the *Annual Report*.

b Derivatives and other financial instruments

The Bank may use foreign exchange swaps as a technique for its open market operations or as hedges for currency exposure in the deposit book. The Bank also uses cross currency, foreign exchange and interest rate swaps to hedge the non-euro foreign currency denominated investment securities (including those held in relation to TARGET), financed via the Euro Note issue. The effect of these instruments is included in the interest rate repricing and currency analysis tables. These tables include short-term debtors and creditors.

In addition, the Bank uses cross currency, foreign exchange and interest rate swaps to match the interest rate and exchange rate risks in the actively managed portfolio. Instruments used in this portfolio are included in the interest rate repricing and currency analysis tables and in the Value-at-Risk (VaR) disclosures for market risk in (e) below.

Further information about the Bank's use of financial instruments and the management of the associated risks is given in the Governance, Financial Statements and Risk section. In particular, market risk is covered on page 38.

c Interest rate repricing

The following table summarises the Bank's interest rate exposure in the form of an interest rate repricing table. This shows when the interest rate earned or charged on assets and liabilities can change. The table can therefore be used as the basis for an assessment of the sensitivity of the Bank's net income to interest rate movements.

Notes to the Banking Department Financial Statements continued

As at year ended 28 February 2005

	Not more than 3 months	More than 3 months but not more than 6 months	More than 6 months but not more than 1 year	More than 1 year but not more than 5 years	More than 5 years	Non interest bearing	Actively managed portfolio	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Assets:								
Due from the European Central Bank in respect of TARGET	112	–	–	–	–	–	–	112
Loans and advances to banks and customers	8,087	1,065	2,777	2	1	–	632	12,564
Debt securities (sterling)	118	–	–	808	2,092	–	–	3,018
Equity investments and participating interest	–	–	–	–	–	40	–	40
Debt securities (non-sterling)	6	–	838	2,445	–	–	1,941	5,230
Other assets:								
financial	151	–	26	52	–	466	233	928
non-financial	–	–	–	–	–	250	–	250
Total assets	**8,474**	**1,065**	**3,641**	**3,307**	**2,093**	**756**	**2,806**	**22,142**
Liabilities:								
Deposits by central banks	5,977	1,057	2,760	–	–	23	–	9,817
Deposit by banks and building societies	330	–	–	–	–	2,011	–	2,341
Customer accounts	894	5	–	–	–	393	–	1,292
Debt securities in issue	1,856	615	1,377	2,066	–	–	–	5,914
Other liabilities:								
financial	471	–	12	9	–	87	341	920
non-financial	–	–	–	–	–	260	–	260
Shareholder's funds	–	–	–	–	–	1,598	–	1,598
Less: funding of the actively managed portfolio	(1,856)	(615)	–	–	–	–	2,471	–
Total liabilities	**7,672**	**1,062**	**4,149**	**2,075**	**–**	**4,372**	**2,812**	**22,142**
Off balance sheet items	(32)	–	14	18	–	–	–	–
Interest rate repricing gap	770	3	(494)	1,250	2,093	(3,616)	(6)	
Cumulative gap	770	773	279	1,529	3,622	6	–	

A positive repricing gap means that more assets than liabilities reprice in this period. Subject to the broad time bands above and the mix of currencies involved, a positive repricing gap means that the Bank's net interest income would benefit in that time band as a result of an increase in interest rates. A negative repricing gap indicates the reverse.

As at year ended 29 February 2004

	Not more than 3 months £m	More than 3 months but not more than 6 months £m	More than 6 months but not more than 1 year £m	More than 1 year but not more than 5 years £m	More than 5 years £m	Non interest bearing £m	Actively managed portfolio £m	Total £m
Assets:								
Due from the European Central Bank in respect of TARGET	86	–	–	–	–	–	–	86
Loans and advances to banks and customers	4,020	928	880	3	2	–	58	5,891
Debt securities (sterling)	–	–	79	830	2,046	–	–	2,955
Equity investments and participating interest	–	–	–	–	–	29	–	29
Debt securities (non-sterling)	–	–	192	3,010	–	–	2,186	5,388
Other assets:								
financial	30	13	13	–	–	641	205	902
non-financial	–	–	–	–	–	262	–	262
Total assets	**4,136**	**941**	**1,164**	**3,843**	**2,048**	**932**	**2,449**	**15,513**
Liabilities:								
Deposits by central banks	2,770	932	958	–	–	24	–	4,684
Deposits by banks and building societies	233	–	–	–	–	1,826	–	2,059
Customer accounts	662	5	–	–	–	360	–	1,027
Debt securities in issue	1,803	598	1,335	2,003	–	–	–	5,739
Other liabilities:								
financial	–	–	–	–	–	148	48	196
non-financial	–	–	–	–	–	248	–	248
Shareholder's funds	–	–	–	–	–	1,560	–	1,560
Less: funding of the actively managed portfolio	(1,803)	(598)	–	–	–	–	2,401	–
Total liabilities	**3,665**	**937**	**2,293**	**2,003**	**–**	**4,166**	**2,449**	**15,513**
Off balance sheet items	(29)	–	–	29	–	–	–	–
Interest rate repricing gap	442	4	(1,129)	1,869	2,048	(3,234)	–	
Cumulative gap	442	446	(683)	1,186	3,234	–		

Notes to the Banking Department Financial Statements continued

d Currency exposure as at year ended 28 February 2005

	Foreign currency monetary assets and liabilities					
	US dollar £m	Gold £m	Euro £m	Yen £m	Other £m	Total £m
Assets						
Due from the European Central Bank in respect of TARGET	–	–	112	–	–	112
Loans and advances to banks and customers	3,484	114	5,893	3	677	10,171
Debt securities	121	–	4,028	1,074	7	5,230
Equity investments and participating interest	–	–	38	–	2	40
Other assets	34	–	706	61	12	813
	3,639	**114**	**10,777**	**1,138**	**698**	**16,366**
Liabilities:						
Deposits by central banks	4,233	114	1,581	–	814	6,742
Deposit by banks and building societies	167	–	144	–	–	311
Customer accounts	82	–	14		1	97
Debt securities in issue	–	–	5,914	–	–	5,914
Other liabilities	75	–	775	362	12	1,224
	4,557	**114**	**8,428**	**362**	**827**	**14,288**
Net	**(918)**	**–**	**2,349**	**776**	**(129)**	**2,078**
Off balance sheet items	**918**	**–**	**(2,324)**	**(776)**	**131**	**(2,051)**

The functional currency of all operations is sterling.

Included in assets denominated in US dollars are advances equivalent to £1,172 million *(2004 £749 million)* which are matched by foreign exchange swaps that are off balance sheet so that no significant foreign currency exposure arises.

Included in assets denominated in euro are advances equivalent to £704 million *(2004 £19 million)* which are matched by foreign exchange swaps that are off balance sheet so that no significant foreign currency exposure arises.

These advances, together with the swaps, match sterling deposits taken in from central banks and other customers.

Included in assets denominated in euro are advances equivalent to £2,510 million *(2004 £nil)* which are matched by foreign exchange swaps that are off balance sheet so that no significant foreign currency exposure arises.

These advances, together with swaps, match United States and Australian dollars deposits taken from central banks and other customers.

Included in assets denominated in euro and Japanese yen are various securities and deposits. These assets were predominantly matched by Euro Bills and Euro Notes together with cross currency, foreign exchange and interest rate swaps. The swaps matching the non-sterling investment securities are held off balance sheet. The forward leg amounts of euro-yen swaps matching these securities are shown as an off balance sheet item in the table above.

The above table includes other non-sterling securities carried at fair value and the related funding by Euro Bills. The market risk on these securities is also included in (e) below.

Currency exposure as at year ended 29 February 2004

	Foreign currency monetary assets and liabilities					
	US dollar	Gold	Euro	Yen	Other	Total
	£m	£m	£m	£m	£m	£m
Assets:						
Due from the European Central Bank in respect of TARGET	–	–	86	–	–	86
Loans and advances to banks, the money market and customers	2,499	229	1,601	–	125	4,454
Debt securities	57	–	4,143	1,181	7	5,388
Equity investments and participating interest	–	–	27	–	2	29
Other assets	86	–	374	58	2	520
	2,642	**229**	**6,231**	**1,239**	**136**	**10,477**
Liabilities:						
Deposits by central banks	1,511	229	1,473	–	119	3,332
Deposits by banks and building societies	134	–	74	–	–	208
Customer accounts	106	–	18	–	1	125
Debt securities in issue	–	–	5,739	–	–	5,739
Other liabilities	6	–	124	24	3	157
	1,757	**229**	**7,428**	**24**	**123**	**9,561**
Net	**885**	**–**	**(1,197)**	**1,215**	**13**	**916**
Off balance sheet items	**(885)**	**–**	**1,225**	**(1,216)**	**(12)**	**(888)**

e Market risk exposure

The Bank uses VaR as the primary mechanism for monitoring and controlling market risk on the balance sheet. VaR is an estimate, with a confidence level of 99%, of the potential loss which might arise if existing positions were held unchanged for ten business days. A summary of the VaR figures for the actively managed portfolio are given in the table below.

Actively managed portfolio VaR for year ended 28 February 2005

	Average	High	Low	Year-end
	£m	£m	£m	£m
	0.46	0.89	0.31	0.89
For year ended 29 February 2004	*1.24*	*2.12*	*0.62*	*0.62*

Notes to the Banking Department Financial Statements continued

f Fair values of financial assets, financial liabilities and derivatives

The table below compares the book value and fair value of financial assets, financial liabilities and derivatives where there is a fair value which can be ascertained. No meaningful fair values can readily be obtained for the other assets and liabilities, in the absence of appropriate liquid markets.

	2005		*2004*	
	Book value £m	**Fair value £m**	*Book value £m*	*Fair value £m*
Assets				
Non-sterling investment securities	3,289	3,347	*3,202*	*3,355*
Other non-sterling securities	1,941	1,941	*2,186*	*2,186*
Sterling debt securities	3,018	3,150	*2,955*	*3,119*
	8,248	**8,438**	***8,343***	***8,660***
Liabilities				
Euro Notes	3,443	3,457	*3,338*	*3,387*
Euro Bills	2,471	2,471	*2,401*	*2,401*
	5,914	**5,928**	***5,739***	***5,788***

		2005			*2004*	
	Notional principal £m	**Book value £m**	**Fair value £m**	*Notional principal £m*	*Book value £m*	*Fair value £m*
Derivatives hedging non-sterling investment securities and Euro Note liabilities:						
Cross currency swaps						
Positive value	942	112	113	*749*	*94*	*170*
Negative value	31	(21)	(21)	*48*	*(32)*	*(36)*
Interest rate swaps						
Positive value	742	10	12	*367*	*5*	*8*
Negative value	60	(2)	–	*414*	*(9)*	*(3)*
	1,775	**99**	**104**	***1,578***	***58***	***139***

	2005			2004		
	Notional value principal £m	**Positive fair value £m**	**Negative fair value £m**	*Notional value principal £m*	*Positive fair value £m*	*Negative fair value £m*
Derivatives hedging other non-sterling securities and Euro Bill liabilities						
Cross currency swaps						
Positive value	401	79	–	*681*	*99*	*–*
Negative value	84	–	(4)	*33*	*–*	*(3)*
Interest rate swaps						
Positive value	2,664	154	–	*2,464*	*106*	*–*
Negative value	1,070	–	(32)	*1,396*	*–*	*(45)*
Foreign exchange swaps	52	–	(2)	*–*	*–*	*–*
	4,271	**233**	**(38)**	***4,574***	***205***	***(48)***
Other derivative instruments used as hedges:						
Foreign exchange swaps	**1,979**	**21**	**18**	***825***	***(57)***	***3***

Notes to fair value tables:

i Market values have been used to determine the fair values for Treasury and other eligible bills, debt securities, Euro Notes and Euro Bills.

ii Non-sterling debt securities and foreign exchange swaps are translated into sterling at the rates ruling at the balance sheet date. Euro Notes and Euro Bills are translated into sterling at the rates ruling at the balance sheet date.

iii The forward legs of the transactions, which hedge the currency exposure, are translated at the same exchange rates as the underlying positions.

iv Fair values of swaps are based on discounted cash flows.

v Fair values of swaps included within the balance sheet are included within other assets and other liabilities.

Notes to the Banking Department Financial Statements continued

g Maturity of notional principal amounts and replacement costs

At 28 February 2005, the notional principal amounts and replacement costs, by residual maturity, of the Bank's derivatives were as follows:

	2005		*2004*	
	1 year or less	**More than 1 year but not more than 5 years**	*1 year or less*	*More than 1 year but not more than 5 years*
	£m	**£m**	*£m*	*£m*
Derivatives hedging investment securities and Euro Note liabilities:				
Cross currency swaps				
Notional principal	310	663	*36*	*761*
Replacement cost	46	67	*5*	*165*
Interest rate swaps				
Notional principal	312	490	*–*	*781*
Replacement cost	7	5	*–*	*8*
Derivatives hedging other non-sterling securities and Euro Bill liabilities				
Cross currency swaps				
Notional principal	127	358	*225*	*489*
Replacement cost	32	47	*40*	*59*
Foreign exchange swaps				
Notional principal	52	–	*–*	*–*
Replacement cost	–	–	*–*	*–*
Interest rate swaps				
Notional principal	2,717	1,017	*756*	*3,104*
Replacement cost	139	15	*20*	*86*
Other derivative instruments used as hedges				
Foreign exchange swaps	1,537	–	*825*	*–*
Replacement cost	71	–	*3*	*–*
Total notional principal	**5,055**	**2,528**	***1,842***	***5,135***
Total replacement cost	**295**	**134**	***68***	***318***

All derivative counterparties are financial institutions. The maximum credit exposure after taking account of netting agreements was £304 million (*2004 £226 million*). The exposure, net of collateral held by the Bank was £137 million (*2004 £92 million*).

h Unrecognised gains and losses on hedging instruments

As explained above, the Bank uses cross currency, foreign exchange and interest rate swaps to hedge exposures in relation to certain non-euro foreign currency denominated securities and the related funding via Euro Notes. These swaps are accounted for on an accruals basis in line with the underlying items being hedged. Any gains or losses that would occur if these items were carried at market value are therefore not recognised in the profit and loss account until they mature or are sold.

At 28 February 2005, the unrecognised gains on financial instruments used for hedging were £2 million *(2004 £141 million)*. Net gains arising before 1 March 2004 and recognised in the year to 28 February 2005 amounted to £77 million *(2004 £15 million)*. Net gains for 2004 included losses of £33 million recognised on 1 March 2003 on those swaps held within the portfolio designated as available for active management. Net losses of £62 million arose in the year to 28 February 2005 *(2004 gains £213 million)* but were not recognised in the year. Of the unrecognised gains of £2 million at 28 February 2005 *(2004 £141 million)*, £9 million *(2004 £71 million)* are expected to be recognised in the year to 28 February 2006 and losses of £7 million *(2004 £70 million)* in subsequent years.

8 ITEMS IN COURSE OF COLLECTION

These represent uncleared items due from banks.

9 DUE FROM THE EUROPEAN CENTRAL BANK IN RESPECT OF TARGET

This balance, denominated in euro, arises from the operation of the TARGET settlement system. This system, which links the real-time settlement systems in countries of the European Union (EU), enables payments to be made across borders within the EU. Such payments result in claims arising between the central banks in the member countries and with the European Central Bank. The individual positions that arise intra-day between the central banks are netted into a single position with the European Central Bank.

	2005		*2004*	
	£m	**€m**	*£m*	*€m*
Due from the European Central Bank in respect of TARGET	**112**	**163**	*86*	*129*

10 LOANS AND ADVANCES TO BANKS AND CUSTOMERS

These balances include advances and reverse repos, arising as part of the Bank's open market operations, as well as advances matching the deposits taken from central banks (note 16). Amounts are stated after provisions, where appropriate. The level and composition of the Bank's open market operations, including the split between Banking and Issue Departments, depends upon market conditions.

	2005	*2004*
	£m	*£m*
Remaining maturity:		
Loans and advances		
over 5 years	1	*2*
5 years or less but over 1 year	2	*3*
1 year or less but over 3 months	3,842	*1,807*
3 months or less	8,550	*3,976*
Repayable on demand	169	*103*
	12,564	***5,891***

Notes to the Banking Department Financial Statements continued

11 DEBT SECURITIES

	2005 Balance sheet £m	2005 Market value £m	*2004 Balance sheet £m*	*2004 Market value £m*
Investment securities:				
British Government securities, listed on a recognised UK exchange	1,839	1,949	*1,760*	*1,900*
Other sterling securities, listed on recognised exchanges	1,179	1,201	*1,195*	*1,219*
	3,018	**3,150**	***2,955***	***3,119***
Foreign government securities, listed on recognised exchanges	2,933	2,986	*3,161*	*3,310*
Other non-sterling securities, listed on recognised exchanges	356	361	*41*	*45*
	3,289	**3,347**	***3,202***	***3,355***
Other non-sterling securities:				
Foreign government securities, listed on recognised exchanges	1,310	1,310	*1,485*	*1,485*
Other non-sterling securities, listed on recognised exchanges	631	631	*701*	*701*
	1,941	**1,941**	***2,186***	***2,186***
	8,248	**8,438**	***8,343***	***8,660***
Due within one year	1,564	1,581	*816*	*825*
Due one year and over	6,684	6,857	*7,527*	*7,835*
	8,248	**8,438**	***8,343***	***8,660***

	Cost £m	Discounts & (premiums) £m	Carrying value £m
British Government and other sterling securities:			
At 1 March 2004	2,955	–	2,955
Amortisation of discounts		5	5
Amortisation of premiums		(32)	(32)
Purchases	173	1	174
Redemptions	(73)	(11)	(84)
At 28 February 2005	**3,055**	**(37)**	**3,018**

	2005 £m	*2004 £m*
Unamortised discounts on British Government and other sterling securities	18	*24*
Unamortised premiums on British Government and other sterling securities	(220)	*(237)*
	(202)	***(213)***

British Government securities and other sterling securities are held as investments and are one of the principal sources of income for the Bank. The Bank holds these securities for the long term, generally to maturity.

Foreign government and other non-sterling securities held as investment securities

	Cost	Discounts & (premiums)	Carrying value
	£m	£m	£m
At 1 March 2004	3,307	(105)	3,202
Amortisation of premiums		(68)	(68)
Purchases	1,417	(20)	1,397
Redemptions	(1,439)	54	(1,385)
Foreign currency revaluation effects	147	(4)	143
At 28 February 2005	**3,432**	**(143)**	**3,289**

	2005	*2004*
	£m	*£m*
Unamortised premiums on non-sterling securities	**(123)**	***(120)***

The portfolio of foreign government and other foreign securities held as investment securities is funded by the Bank's issue of Euro Notes, and in the case of non-euro securities, a combination of cross currency and interest rate swaps. Part of the portfolio, denominated in euro, is held to enable the Bank to provide liquidity in the TARGET settlement system (note 9). These securities, amounting to £1,797 million at 28 February 2005 *(2004 £1,711 million)*, are used to generate this liquidity via intra-day repo contracts. Securities amounting to £534 million *(2004 £450 million)* held within 'other non-sterling securities' were also used for this purpose at the year end. The remainder of the non-sterling investment portfolio was mainly denominated in euro but with a portion in United States dollars and Japanese yen, with currency swaps into euro. Of these securities, £nil million *(2004 £8 million)* were subject to other ('longer-term') repo contracts at the year end.

12 EQUITY INVESTMENTS AND PARTICIPATING INTEREST

	2005		*2004*	
	Balance sheet-cost	**Members of Court valuation**	*Balance sheet-cost*	*Members of Court valuation*
	£m	**£m**	*£m*	*£m*
Investment securities – unlisted equity investments	2	256	*2*	*107*
Participating interest – unlisted	38	38	*27*	*27*
	40	**294**	***29***	***134***

Notes to the Banking Department Financial Statements continued

a Investment securities

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

	Percentage held	
	2005	*2004*
Bank for International Settlements (shares of 5,000 Special Drawing Rights (25% paid)) (incorporated in Switzerland)	**8.7**	*8.7*

b Participating interest

The European Central Bank

This is the sterling cost of the Bank's contribution of €56.0 million *(2004 €39.9 million)* to the capital of the European Central Bank. This contribution, which is not refundable, represents 7% of the capital contribution of the United Kingdom's full share (of the European Central Bank's capital) that would have been payable had the UK participated in economic and monetary union. This contribution has been accounted for as an investment. Changes in the relative shares of central banks in the capital of the European Central Bank are required every five years under the statute of the European Central Bank, the last such change being 1 January 2004. On 1 May 2004, the Bank subscribed further capital of €16.1 million to the European Central Bank, as a contribution to the increase in the European Central Bank's costs caused by the accession of ten new countries. This accession has also led to a realignment of the shareholdings in the capital of the European Central Bank of existing member countries. The Bank's shareholding decreased from 15.9764% to 14.3822% as a result of this change.

13 SHARES IN GROUP UNDERTAKINGS

	2005	*2004*
	£m	*£m*
Cost of shares in group undertakings	**18**	*18*

The financial statements of the subsidiaries detailed below have not been consolidated with those of the Banking Department because, in the opinion of the Members of Court, the effect of including their assets, liabilities and results with those of the Banking Department would not be material.

a Minories Finance Ltd (in members' voluntary liquidation)

Minories Finance Ltd (MFL), a wholly-owned subsidiary which is incorporated in Great Britain, has been in members' voluntary liquidation throughout the year ended 28 February 2005. The investment in this company is included in the Bank's balance sheet at 28 February 2005 at £12.5 million *(2004 £12.5 million)*. The Bank expects to recover in excess of its investment and accordingly no provision has been made in these financial statements.

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 £62.5 million in total.

b Other group undertakings

Investments in other group undertakings, 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 the following subsidiary:

B.E. Property Holdings Ltd (non-trading) 5,000,000 shares of £1

The aggregate net assets of these subsidiary companies are £5 million.

14 TANGIBLE FIXED ASSETS

	Freehold land and buildings £m	Equipment £m	Total £m
Cost or valuation			
At 1 March 2004	197	63	260
Additions	2	2	4
Disposals	(8)	(30)	(38)
At 28 February 2005	**191**	**35**	**226**
Accumulated depreciation			
At 1 March 2004	–	52	52
Charge for the year	4	4	8
On disposals	–	(30)	(30)
At 28 February 2005	**4**	**26**	**30**
Net book value at 28 February 2005	**187**	**9**	**196**
Net book value at 29 February 2004	***197***	***11***	***208***
Cost or valuation at 28 February 2005 comprised:			
At 2004 valuation	189	–	189
At cost	2	35	37
	191	**35**	**226**

The figures for property interests reflect a professional valuation, on an existing use value basis, of Bank properties at 29 February 2004. The valuation was performed by Nelson Bakewell, members of the Royal Institute of Chartered Surveyors.

The Bank principally occupies its properties for its own purposes. One of the Bank's properties is currently vacant.

Contracts for capital expenditure authorised by the Members of Court and outstanding at 28 February 2005 amounted to less than £1 million *(2004 £1 million)*.

Notes to the Banking Department Financial Statements continued

15 PREPAYMENTS, ACCRUED INCOME AND OTHER ASSETS

	2005 £m	2004 £m
Non-sterling debt securities interest and swaps accruals	217	234
Sterling debt securities interest accruals	58	58
Fair values of derivatives of actively managed portfolio:		
currency swaps	79	99
interest rate swaps	154	106
Deferred tax (note 6)	37	36
Short-term debtors and other assets	64	95
	609	***628***

16 DEPOSITS BY CENTRAL BANKS

	2005 £m	2004 £m
Remaining maturity:		
1 year or less but over 3 months	3,817	1,890
3 months or less but not repayable on demand	5,172	2,366
Repayable on demand	828	428
	9,817	***4,684***

The Bank takes deposits from central banks in sterling, other currencies and gold.

17 DEPOSITS BY BANKS AND BUILDING SOCIETIES

	2005 £m	2004 £m
3 months or less but not repayable on demand:		
Repurchase agreements	–	8
Other deposits	167	134
Repayable on demand:		
Euro deposits	144	66
Other deposits	29	34
Cash ratio deposits	2,001	1,817
	2,341	***2,059***

Cash ratio deposits are computed on the basis of banks' and building societies' eligible liabilities and are interest free. Any change in the amount due, as a result of either becoming or ceasing to be an eligible institution for the purpose of the Bank of England Act 1998, the twice-yearly recalculation of deposits or a change in the percentage used for calculation, is payable immediately. Under the Bank of England Act 1998, the percentage used in calculating the cash ratio deposits is set by HM Treasury, having regard to the financial needs of the Bank and subject to the approval of both Houses of Parliament.

Other deposits in both euro and sterling are held by banks for operational reasons connected to settlement systems. Cash deposits in US dollars are taken from counterparties as collateral for certain currency swaps.

18 CUSTOMER ACCOUNTS

	2005 £m	*2004 £m*
Remaining maturity:		
1 year or less but over 3 months:		
Public deposits	5	*5*
3 months or less but not repayable on demand:		
Public deposits	45	*55*
Repayable on demand:		
Public deposits	955	*691*
Deposit by Issue Department	74	*53*
Other deposits	213	*223*
	1,292	***1,027***

Public deposits are the balances on HM Government accounts, including Exchequer, National Loans Fund, Debt Management Office, National Debt Commissioners and dividend accounts.

19 DEBT SECURITIES IN ISSUE

a Summary

	2005 £m	*2004 £m*
Euro Notes	3,443	*3,338*
Euro Bills	2,471	*2,401*
	5,914	***5,739***

b Euro Notes

On 28 January 2005, €2.2 billion of the 2005 Euro Notes matured at par. The Bank created a new series of €2.2 billion of Euro Notes maturing on 28 January 2008. This is the fifth issue in the series of three-year Bank of England Euro Notes. As with the previous issues of Notes, these securities were sold by auction; the first tranche of €1,000 million was sold in January 2005 and a further auction of €1,000 million was held on 15 March 2005. The Bank allots any roundings for the auction process to itself and also retains €100 million of each tranche, which may be made available for sale and repurchase transactions with market makers in the programme. Pending sale to third parties, the Notes are retained by the Bank. It is appropriate to show only the Notes sold to third parties as liabilities on the balance sheet. The position at 28 February 2005 was as follows:

	2005		*2004*	
	£m	€m nominal	*£m*	*€m nominal*
Total amount issued	4,549	6,600	*4,410*	*6,600*
Held by the Bank of England	(1,106)	(1,600)	*(1,072)*	*(1,600)*
Liabilities to third parties	**3,443**	**5,000**	***3,338***	***5,000***

Of the above liabilities to third parties, £1,377 million (*2004 £1,335 million*) fall due within one year.

Notes to the Banking Department Financial Statements continued

c Euro Bills

Original maturity of Bills in issue

	2005	*2004*
	£m	*£m*
3 months	1,237	*1,202*
6 months	1,234	*1,199*
	2,471	***2,401***

These Bills are issued by the Bank and denominated in euro. They form a regular rolling programme on the Bank's balance sheet. Of the above, £1,856 million *(2004 £1,803 million)* are due within three months or less.

20 OTHER LIABILITIES

	2005	*2004*
	£m	*£m*
Payable to HM Treasury	38	*30*
Due to subsidiaries	20	*20*
Provision for post-retirement benefits (note 4)	121	*126*
Provision for redundancy costs (note 4)	53	*53*
Current tax liability (note 6)	14	*10*
Non-sterling debt securities interest and swaps accruals	84	*89*
Fair values of derivatives hedging actively managed portfolio:		
currency swaps	4	*3*
interest rate swaps	32	*45*
foreign exchange swaps	2	*–*
Items in course of settlement	714	*11*
Short-term creditors and other liabilities	98	*57*
	1,180	***444***

21 CAPITAL AND INCORPORATION

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

The Bank of England is incorporated under a Royal Charter of 1694. Legislation covering its operations includes the Bank Charter Act of 1844 and the Bank of England Acts 1946 and 1998.

22 RESERVES

	Profit and loss account	Revaluation reserves	Total
			£m
Balance at 1 March 2004	1,387	158	1,545
Retained profit for the year	38	–	38
Net revaluation surplus on property sold	7	(7)	–
Balance at 28 February 2005	**1,432**	**151**	**1,583**

The revaluation reserve for the non-sterling investment securities and the matching funding is less than £1 million and accordingly is not shown separately in the above table. Foreign exchange movements in the year ended 28 February 2005 gave rise to a net revaluation loss. In accordance with accounting policy, this loss has been taken to the profit and loss account.

23 STATEMENT OF RECONCILIATION OF SHAREHOLDER'S FUNDS

	2005 **£m**	*2004* *£m*
Shareholder's funds at 1 March 2004	1,560	*1,506*
Retained profit for the year	38	*30*
Surplus on revaluation of properties	–	*24*
Shareholder's funds at 28 February 2005	**1,598**	***1,560***

Notes to the Banking Department Financial Statements continued

24 CASH FLOW STATEMENT

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

	2005 £m	2004 £m
Profit after provisions and before tax	100	72
Decrease in interest receivable and prepaid expenses	1	8
(Increase)/decrease in interest payable and accrued expenses	4	(7)
Depreciation	8	13
Effect of other deferrals and accruals on cash flow	219	241
Net (outflow)/inflow from Euro Notes	(14)	34
Net outflow from Euro Bills	(49)	(24)
Net inflow/(outflow) of euro deposits	71	(155)
Net increase/(decrease) in foreign currency deposits	3,448	(346)
Net increase/(decrease) in other deposits	2,162	(707)
Increase in TARGET balances with European Central Bank	(26)	(54)
Net (increase)/decrease in foreign currency advances to banks (including swaps)	(5,192)	190
Net (increase)/decrease in advances to banks and customers (including reverse repurchase agreements)	(958)	37
Purchase of non-sterling investment securities	(1,819)	(1,466)
Redemption of non-sterling investment securities	1,749	1,671
Purchase of other non-sterling securities	(222)	(489)
Redemption of other non-sterling securities	778	541
Purchase of sterling debt securities	(170)	(243)
Redemption of sterling debt securities	79	92
Net decrease in other assets	–	3
(Increase)/decrease in items in course of collection	(46)	89
Net cash inflow/(outflow) from operating activities	**123**	**(500)**

b Capital expenditure and financial investment

	2005 £m	2004 £m
Increase in Bank's contribution to the European Central Bank	(11)	(2)
Purchases of premises and equipment	(5)	(11)
Proceeds from sale of premises and equipment	9	–
Proceeds from sale of printing operations	–	10
	(7)	**(3)**

c Analysis of cash balances

	At 1 March 2004 £m	Cash flows £m	At 28 February 2005 £m
Cash	5	(1)	4
Advances to banks repayable on demand	103	66	169
	108	**65**	**173**

d The cash flow statement has been prepared under FRS1 (revised). 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 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 2005 was as follows:

	At 1 March 2004 £m	Cash flows £m	**At 28 February 2005 £m**
Cash	*5*	(1)	4
Advances to money market and certain banks (including reverse repurchase agreements)	*1,406*	964	2,370
	1,411	**963**	**2,374**

25 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 2005 were:

– provision of banking services, including holding the principal accounts of the Government

– provision of registration services in respect of gilt-edged stocks (ceased December 2004)

– management of the Exchange Equalisation Account

– management of the Note Issue

– operation of financial sanctions against specific countries.

The aggregate balances on HM Treasury and other public sector accounts are included in note 10 as advances or note 18 as public deposits. The total charges made to the Government are disclosed in note 2.

b Group undertakings

All material transactions and balances between the Bank and its subsidiaries are disclosed in note 13 and note 20.

c Governors, Non-Executive Directors and Officers

The following particulars relate to loans given or arranged by the Bank of England to Governors, Non-Executive Directors and Officers (including Executive Directors) of the Bank and persons connected with them:

	2005		*2004*	
	Total amount outstanding £000	**Number**	*Total amount outstanding £000*	*Number*
Officers	81	13	*80*	*14*

There were no loans outstanding to Governors and Non-Executive Directors as at 28 February 2005 *(2004 £nil)*.

There were no other transactions that would be required to be shown under the provisions of the Companies Act 1985. None of the Governors, Non-Executive 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 Financial Services and Markets Act 2000 or as defined under FRS 8. All employees, including Officers as defined above, are entitled to season ticket loans and may choose to take personal loans as part of their remuneration package.

d The Bank's pension schemes

The Bank provides the Secretariat, the investment management and some banking and custodial services to the Bank's pension schemes. In the year to 28 February 2005 a charge of £1.8 million *(2004 £1.7 million)* was made for these services. These activities are undertaken on behalf of, and under the supervision of, the trustees of the schemes. The contribution paid to the Fund is set out in note 4. There were no other material transactions between the Bank and the pension schemes during the year to 28 February 2005. The balances on accounts held with the Bank were £3 million *(2004 £4 million)*.

e 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. The Bank does not consider these institutions to be related parties.

26 GENERAL

a Operating lease commitments

	2005		*2004*	
	Land and buildings £000	**Computer and other equipment £000**	*Land and buildings £000*	*Computer and other equipment £000*
At the year end, annual commitments under non-cancellable operating leases were:				
expiring within one year	195	1,123	*485*	*802*
between one and five years	151	364	*662*	*–*
expiring in five years or more	505	–	*635*	*–*
	851	**1,487**	***1,782***	***802***

b Average number of employees

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

	2005	*2004*
Governors and Executive Directors	8	*7*
Managers and analysts	478	*459*
Clerical staff	895	*888*
Technical/other	532	*578*
	1,913	***1,932***

The number of persons employed by the Bank at the end of the year is given in the Review of Performance on page 24 of the *Annual Report*.

27 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.

The trial of the misfeasance claim brought against the Bank by the Liquidators of the Bank of Credit and Commerce International SA *('BCCI')* in the names of depositors in BCCI started in January 2004 and continues. Judgement is not expected until late 2005 or 2006. The allegations of misfeasance relate to the period leading to the licensing of BCCI in 1980 through to the closure of BCCI in 1991. The writs against the Bank were issued in 1993 and 1994. In the light of legal advice, the Bank's Court believes that the Bank has a strong defence and is determined that these allegations of misfeasance should be vigorously defended. The current trial is about liability, not the amount of any damages. In June 2001, the Liquidators provided figures as to the amount of their claim whilst reserving the right to amend those figures. The Liquidators said: 'In summary the Liquidators' best estimate of the value of the depositor claimants' deposits as at 30 April 2001 is approximately £577 million applying simple interest of 8% or £748 million applying interest of 8% *per annum* compounded annually'. Quite apart from its rejection of the claim itself, the Bank does not accept that the Liquidators have provided adequate particulars or set out a proper basis for calculation of the claim. No provision is made in these financial statements.

Since 1930 there has also been a contingent liability in respect of uncalled capital on the Bank's investment in the Bank for International Settlements, now denominated in Special Drawing Rights (SDR). The sterling equivalent of this liability based on the SDR price at the balance sheet date was £143 million *(2004 £143 million)*.

28 DATE OF APPROVAL

The Members of Court approved the financial statements on pages 48 to 81 on 12 May 2005.

Issue Department

Account for the period ended 28 February 2005

	Notes	**2005** **£m**	*2004* *£m*
Income and profits:			
Securities of, or guaranteed by, the British Government		641	*525*
Other securities and assets		1,022	*756*
		1,663	***1,281***
Expenses:	2		
Cost of production of Bank notes		31	*31*
Cost of issue, custody and payment of Bank notes		12	*13*
Other expenses		2	*3*
		45	***47***
Payable to HM Treasury		**1,618**	***1,234***

Statement of balances: 28 February 2005

	Notes	**2005** **£m**	*2004* *£m*
Assets			
Securities of, or guaranteed by, the British Government	3	14,059	*14,839*
Other securities and assets including those acquired under reverse repurchase agreements	4	21,361	*21,181*
Total assets		**35,420**	***36,020***
Liabilities			
Notes issued:			
In circulation	5	35,416	*36,015*
In Banking Department		4	*5*
Total liabilities		**35,420**	***36,020***

M A King Governor
A M B Large Deputy Governor
T J Parker Chairman of NedCo
J R E Footman Executive Director, Central Services

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 quarterly 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 25 February 2005.

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. Total such deficits in the year to 28 February 2005 amounted to £9 million *(2004 £20 million)*.

2 EXPENSES

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

3 SECURITIES OF, OR GUARANTEED BY, THE BRITISH GOVERNMENT

	2005	*2004*
	£m	*£m*
British Government Stocks	–	*116*
Treasury Bills	689	*1,353*
Ways and Means advance to the National Loans Fund	13,370	*13,370*
	14,059	***14,839***

The Ways and Means advance earns interest at the Bank's repo rate.

4 OTHER SECURITIES AND ASSETS INCLUDING THOSE ACQUIRED UNDER REVERSE REPURCHASE AGREEMENTS

	2005	*2004*
	£m	*£m*
Commercial bills	29	*19*
Deposit with Banking Department	74	*53*
Reverse repurchase agreements	21,258	*21,109*
	21,361	***21,181***

5 NOTES IN CIRCULATION

	2005	2004
	£m	£m
£5	1,055	1,025
£10	5,670	5,714
£20	21,649	20,070
£50	6,082	5,741
Other notes (a)	960	3,465
	35,416	**36,015**

(a) 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 ASSETS AND LIABILITIES

a Interest rate exposure

As the liabilities of Issue Department are interest free, the income of Issue Department is directly exposed to movements in interest rates. With the exception of the British Government stocks, all the assets of Issue Department have a repricing period of three months or less.

b Currency exposure

All the assets and liabilities of Issue Department are denominated in sterling. The collateral provided under reverse repurchase operations may be in currencies other than sterling but this does not give rise to any direct currency exposure.

7 DATE OF APPROVAL

The Members of Court approved the statements of account on pages 82 to 84 on 12 May 2005.

Addresses and Telephone Numbers

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Enquiries relating to the Bank of England *Quarterly Bulletin* and *Inflation Report* may be made on 020 7601 4030; *Financial Stability Review* on 020 7601 3095; and *Bank of England: Monetary and Financial Statistics* on 020 7601 5353.

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