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 50 to 109 for the year ended 28 February 2006 which comprise the income statement, the balance sheet, the statement of recognised income and expense, the cash flow statement and the related notes. We have also audited the statements of account of the Issue Department on pages 110 to 112, comprising the statement of balances at 28 February 2006, the account for the year then ended, and the related notes. These financial statements have been prepared under the accounting policies set out therein.

RESPECTIVE RESPONSIBILITIES OF THE MEMBERS OF COURT AND AUDITORS

Members of Court are responsible for preparing the financial statements of the Banking Department in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRS'), as modified by the Bank of England Act 1998, and the preparation and presentation of the statements of account of the Issue Department in accordance with the requirements of the Currency and Bank Notes Act 1928 and the National Loans Act 1968. Their responsibilities are set out on page 34.

Our responsibility is to audit the financial statements and the statements of account in accordance with relevant legal and regulatory requirements and International Standards on Auditing (United Kingdom and Ireland) issued by the Auditing Practices Board. This report, including the opinion, has been prepared for, and only for, the Governor and 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 into 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 are properly prepared, in all material respects, in accordance with the basis of preparation and accounting policies in note 2 on pages 54 to 61. We also report to you our opinion as to whether the statements of account of the Issue Department are properly prepared, in all material respects, in accordance with the basis of preparation and accounting policies in note 1 on page 111. 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 other information contained in the *Annual Report*, and consider whether it is consistent with the audited financial statements. This other information comprises only the Remuneration of Governors, Directors and MPC Members; the Governance, Financial Statements and Risk section; and the Report by the Non-executive Directors and the other information set out on the contents page. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with International Standards on Auditing (United Kingdom and Ireland) 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 judgments made by the 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 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 and the statements of account.

OPINION

In accordance with the Bank of England Act 1998, the financial statements of the Banking Department have been prepared in accordance with the basis of preparation and accounting policies in note 2 on pages 54 to 61 to comply with the requirements of the Companies Act and IFRS as adopted by the European Union except insofar as the Bank has not considered it appropriate to do so having regard to its functions.

In our opinion,

- The financial statements on pages 50 to 109 disclosing the financial position of the Banking Department as of 28 February 2006 and its financial performance and its cash flows for the year then ended have been properly prepared, in all material respects, in accordance with the basis of preparation and accounting policies in note 2 on pages 54 to 61.

- The statements of account on pages 110 to 112 disclosing the outcome of the transactions of the Issue Department for the year ended 28 February 2006 and its balances at that date have been properly prepared, in all material respects, in accordance with the basis of preparation and accounting policies in note 1 on page 111.

PRICEWATERHOUSECOOPERS LLP
Chartered Accountants and Registered Auditors

London
11 May 2006

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

Income statement for the year to 28 February 2006

	Notes	2006 £m	*2005* £m*
Profit after provisions and before tax	4	99	*106*
Corporation tax	7	(19)	*(37)*
Profit for the year attributable to shareholder		**80**	***69***

The following profit distribution was made for the year:

		2006 £m	*2005* £m*
Profit for the year attributable to shareholder		80	*69*
Tax relief on payment to HM Treasury		14	*11*
Profit after tax		94	*80*
Payment to HM Treasury under Section 1(4) of the Bank of England Act 1946	8	(47)	*(38)*
Profit retained for the year		**47**	***42***

* Comparative information has been presented in accordance with the new basis of accounting set out in note 2 but does not reflect the application of IAS 32 and IAS 39 which became effective from 1 March 2005. A reconciliation of profit between the old and new bases of accounting is provided in note 33.

Balance sheet as at 28 February 2006

	Notes	2006 £m	*2005* £m*
Assets			
Cash and balances with other central banks	9	185	*122*
Loans and advances to banks	10	14,554	*12,904*
Financial assets at fair value through profit or loss	11	5,663	–
Debt securities	11	–	*8,248*
Derivative financial instruments	12	291	–
Loans and advances to customers	13	6	*5*
Equity investments and participating interest	14	–	*40*
Available for sale securities	14	3,705	–
Investments in group undertakings	15	18	*18*
Intangible assets	16	17	*15*
Property, plant and equipment (formerly tangible fixed assets)	17	193	*214*
Investment properties	18	26	*8*
Deferred tax assets	19	12	*123*
Other assets	20	83	*572*
Total assets		**24,753**	***22,269***
Liabilities			
Deposits from central banks	21	11,380	*9,817*
Deposits from banks and building societies	22	3,208	*2,343*
Other deposits (formerly customer accounts)	23	1,081	*1,290*
Derivative financial instruments	12	98	–
Debt securities in issue	24	–	*5,914*
Financial liabilities at fair value through profit or loss	24	6,512	–
Other liabilities	25	354	*994*
Current tax liabilities		17	*14*
Retirement benefit obligations	26	371	*506*
Total liabilities		**23,021**	***20,878***
Equity			
Capital	27	15	*15*
Retained earnings (formerly profit and loss account)	28	1,305	*1,213*
Other reserves (formerly revaluation reserves)	28	412	*163*
Total equity attributable to shareholder		**1,732**	***1,391***
Total equity and liabilities		**24,753**	***22,269***

M A King Governor
J R Lomax Deputy Governor
T J Parker Chairman of NedCo
P A C Smout Finance Director

* Comparative information has been presented in accordance with the new basis of accounting set out in note 2 but does not reflect the application of IAS 32 and IAS 39 which became effective from 1 March 2005. A reconciliation of profit between the old and new bases of accounting is provided in note 33.

Banking Department continued

Statement of recognised income and expense for the year to 28 February 2006

	Note	2006 £m	*2005* £m*
Profit for the year attributable to shareholder		80	*69*
Tax relief on payment to HM Treasury	28	14	*11*
Revaluation of available for sale securities (net of deferred tax)	28	3	*–*
Revaluation of property, plant and equipment (net of deferred tax)	28	–	*8*
Actuarial gains/(losses) on retirement benefits (net of deferred tax)	28	51	*(202)*
Total recognised income and expense for the period attributable to shareholder		**148**	***(114)***
Adjustments arising from the application of IAS 32 and IAS 39 at 1 March 2005	28	240	*–*
Total		**388**	***(114)***

* Comparative information has been presented in accordance with the new basis of accounting set out in note 2 but does not reflect the application of IAS 32 and IAS 39 which became effective from 1 March 2005. Reconciliations of profit and the balance sheet between the old and new bases of accounting is provided in note 33.

Cash flow statement for the year ended 28 February 2006

	Note	2006 £m	*2005* £m*
Cash flows from operating activities			
Profit before taxation		99	*106*
Adjustments between operating profit and net cash (outflow)/inflow	32	(658)	*3,590*
Net cash (outflow)/inflow from operating activities before tax		(559)	*3,696*
Corporation tax paid		(20)	*(21)*
Net cash from operating activities		**(579)**	***3,675***
Cash flows from investing activities			
Dividends received		9	*9*
Net proceeds from sale of property, plant and equipment		25	*4*
Net cash from investing activities		**34**	***13***
Cash flows from financing activities			
Payment to HM Treasury under Section 1(4) of the Bank of England Act 1946		(38)	*(30)*
Net cash from financing activities		**(38)**	***(30)***
Net (decrease)/increase in cash and cash equivalents		**(583)**	***3,658***
Cash and cash equivalents at 1 March		6,388	*2,730*
Cash and cash equivalents at 28 February	32	**5,805**	***6,388***

* Comparative information has been presented in accordance with the new basis of accounting set out in note 2 but does not reflect the application of IAS 32 and IAS 39 which became effective from 1 March 2005. Reconciliations of profit and the balance sheet between the old and new bases of accounting is provided in note 33.

Notes to the Banking Department financial statements

1 GENERAL INFORMATION

The Bank of England is the central bank of the United Kingdom and is incorporated under a Royal Charter of 1694. Legislation covering its operations includes the Bank Charter Act 1844 and the Bank of England Acts 1946 and 1998. The functions and core purposes of the Bank are set out on page 3.

The Bank Charter Act 1844 requires that the Bank's note issue function be separated from its other activities. Accordingly, for accounting purposes, the Bank is divided into Issue Department and Banking Department, which are accounting designations and reporting entities. Neither is an organisational unit of the Bank. The Issue Department is solely concerned with the note issue and the assets backing the issue. The financial statements of Issue Department are given on pages 110 to 112, and show the note issue, the assets backing the issue, the income generated by those assets and the costs incurred in production, issue, custody and payment of notes. The entire profit of the note issue is paid over to HM Treasury. The Banking Department comprises all other activities of the Bank. The post-tax profits of Banking Department are shared equally with HM Treasury unless the Bank and HM Treasury agree otherwise (see note 8).

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all of the years presented, unless otherwise stated.

a Form of presentation of the financial statements

The financial statements of Banking Department comprise the income statement, the balance sheet, the statement of recognised income and expense, the cash flow statement and related notes.

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 Companies Act permits UK incorporated companies to prepare their financial statements either in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRS') or in accordance with UK Generally Accepted Accounting Principles (UK GAAP). The Bank has chosen to adopt the recognition and measurement requirements of IFRS (including International Financial Reporting Interpretations Committee (IFRIC) pronouncements) together with the presentation and disclosure framework explained below.

IFRS and the Companies Act have also been used as a model for the presentation and disclosure framework, to provide additional information and analysis of key items in the financial statements except insofar as the Bank considers certain disclosures inappropriate to its functions.

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 certain elements than would be required under either IFRS or UK GAAP. Disclosure limitations include:

- Constituent elements of the income statement
- Note disclosures for income and expenses, particularly relating to net interest income and provisions
- Related disclosures in the balance sheet, cash flow statement and notes to the financial statements
- Business segments
- Contingent liabilities and guarantees

The financial statements have been prepared on the historical cost basis of accounting, modified to include the revaluation of land and buildings (excluding investment properties), financial assets that are available for sale, derivative contracts and all other financial assets and financial liabilities that are held at fair value through profit and loss.

Adoption of new accounting framework

The Bank has adopted the new accounting framework outlined above with effect from 1 March 2004 and has followed the transitional provisions set out in IFRS 1 (First-time Adoption of IFRS) which is applied by entities using IFRS for the first time. In accordance with the exemptions under IFRS 1, IAS 32 (Financial Instruments: Disclosure and Presentation) and IAS 39 (Financial Instruments: Recognition and Measurement) have been applied only from 1 March 2005 (except for certain disclosures for IAS 32 in line with the limitations set out above) and therefore comparative amounts for financial instruments in respect of the year ended 28 February 2005 remain on a UK GAAP basis.

Reconciliations of the new accounting framework to UK GAAP and explanations of the differences are set out in note 33 for:

- Profit before and after tax for the year ended 28 February 2005
- Net assets as at 1 March 2004, 28 February 2005 and 1 March 2005

Early adoption of standards

The Bank has adopted early (from 1 March 2004) the revised IAS 19 (Employee Benefits) in order to adopt the option under which all actuarial gains and losses are recognised immediately in the financial statements through the statement of recognised income and expense. The Bank has also adopted early (from 1 March 2005) the amendment to IAS 39 relating to fair value of liabilities so allowing the Bank to show relevant assets and liabilities on a symmetric basis.

A number of new standards, amendments and interpretations to existing standards have been published, that whilst relevant to the Bank, are only effective after 1 March 2006 and have not been adopted early. These include:

- IFRS 7 (Financial Instruments: Disclosures) which replaces IAS 30 (Disclosures in the Financial Statements of Banks and Similar Financial Institutions) and certain of the disclosure provisions in IAS 32 (effective for annual periods beginning on or after 1 January 2007).
- Amendments to capital disclosures within IAS 1 (Presentation of Financial Statements) (effective for annual periods beginning on or after 1 January 2007).
- Two amendments to IAS 39 relating to cash flow hedge accounting and financial guarantee contracts (effective for annual periods beginning on or after 1 January 2006).

The Bank is reviewing IFRS 7 and the above amendments to IAS 1 and IAS 39 to determine the effect on its financial reporting going forward.

Applicable optional exemptions from full retrospective application of IFRS

In preparing these financial statements in accordance with IFRS 1, the Bank has applied the following optional exemptions from full retrospective application of IFRS:

- Exemption from restatement of comparatives under IAS 32 and IAS 39. The Bank has applied previous UK GAAP rules to financial assets, financial liabilities and derivatives for the 2005 comparative information. The adjustments required for differences between UK GAAP and IAS 32 and IAS 39 are determined and recognised at 1 March 2005. These adjustments are detailed in note 33.
- Designation of financial instruments. The Bank reclassified various financial instruments in accordance with IAS 32 and IAS 39 at the opening balance sheet date of 1 March 2005, the IAS 32 and IAS 39 transition date. The relevant adjustments are detailed in note 33.
- Employee benefits. The Bank has elected to apply the exemption under IFRS 1 paragraph 20a from providing four years' comparative amounts in respect of disclosures of the history of experience gains and losses.

b Consolidation

The financial statements of the Bank's subsidiaries 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. Investments in group undertakings are stated in the balance sheet at cost, less provision for impairment in value. Dividends from group undertakings are included as income when declared.

c Foreign currency translation

i Functional and presentational currency

The Bank's financial statements are presented in sterling, which is the Bank's functional and presentational currency.

ii Transactions and balances

Foreign currency transactions are translated into sterling using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Where a gain or loss on a non-monetary item is recognised directly in equity, such as unlisted equity investments classified as financial assets that are available for sale, the related exchange gain or loss is also recognised in equity.

d Derivative financial instruments

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, or valuation techniques, as appropriate. The best evidence of the fair value of a derivative at initial recognition is the transaction price (ie the fair value of the consideration given or received). All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Derivatives are used for matching exposures on assets and liabilities, both individually and for portfolios. The Bank has not applied the hedge accounting rules of IAS 39 and accordingly has recognised all gains and losses on derivatives in the income statement.

For the prior year, derivatives used as hedging instruments for general banking business, as well as non-sterling investment securities and Euro Notes, are recorded on an accruals basis to match the cash flows of the relevant hedged items. Derivatives held in the actively managed portfolio (consisting of other non-sterling securities funded by Euro Bills) are recorded at fair values. Derivative balances are recorded within other assets and other liabilities.

e Interest income and expense

Interest income and expense are recognised in the income statement for all instruments measured at amortised cost and for interest-bearing assets held as available for sale, using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument. The calculation includes all fees paid or received between parties, transaction costs and all other premiums or discounts.

If a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment.

For the prior year, interest income and expense were recognised in the income statement on a straight-line basis.

f Fees and commission income

Fees and commissions which are not included in the effective interest rate are generally recognised on an accruals basis as the service is provided.

g Financial assets

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and advances, investments that are held to maturity, and financial assets that are available for sale. The Bank determines the classification of its investments at initial recognition.

i Financial assets at fair value through profit or loss

A financial asset is classified in this category if it is acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are classified as held at fair value through profit or loss (see (d) above). The Bank does not currently hold financial assets for trading, but designates amounts matching the Bank's issued Euro Notes and Euro Bills as at fair value through profit or loss at inception. The relevant assets and liabilities together with the related derivatives are managed together and internal reporting is evaluated on a fair value basis.

For the prior year the same assets are distinguished between those matching Euro Notes (non-sterling investment securities) and those matching Euro Bills (other non-sterling securities) which are available for active management. The non-sterling investment securities are recorded at cost, in the currency of denomination, adjusted for the amortisation of premiums or discounts on a straight-line basis over the period to maturity. The other non-sterling securities are accounted for at fair value, with all gains and losses taken to the profit and loss account.

ii Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money or services directly to a counterparty with no intention of trading the receivable.

iii Held to maturity

Investments classified as held to maturity are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the intention and ability to hold to maturity. Were the Bank to sell other than an insignificant amount of such assets, the entire category would be reclassified as available for sale. The Bank does not currently have any assets classified as held to maturity.

iv Available for sale

These investments are those intended to be held for an indefinite period of time, which may be sold as part of the Bank's official operations or otherwise. They include sterling debt securities and unlisted equity investments.

For the prior year, British Government securities and other sterling debt securities held as investment securities are stated at cost adjusted for the amortisation of premiums and discounts on a straight-line basis over the period to maturity. Equity investments and the participating interest are held as long-term investments and are stated in the balance sheet at cost less provision for impairment where necessary.

Loans are recognised when cash is advanced to the borrowers. Purchases and sales of other financial assets are recognised on trade date, the date on which the Bank commits to purchase or sell the asset. Financial assets are initially recognised at fair value, plus transaction costs for financial assets not carried at fair value through the income statement. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all of the risks and rewards of ownership. Financial assets that are available for sale and financial assets at fair value through profit or loss are subsequently carried at fair value.

Loans and advances and investments that are held to maturity are carried at amortised cost using the effective interest method, less provision for impairment (see (j) below).

Gains and losses arising from changes in the fair value of assets classified as at fair value through profit or loss are included in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of financial assets that are available for sale are recognised directly in equity (net of related tax) until the financial asset is derecognised or impaired, at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement. Interest on such assets, calculated using the effective interest method, is recognised in the income statement. Dividends on equity investments that are available for sale are recognised in the income statement when the Bank's right to receive payment is established.

The fair values of quoted investments in active markets are based on current bid prices. In other cases, the Bank establishes fair value by using appropriate valuation techniques.

h Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the amounts recognised and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

i Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are reclassified in the financial statements as assets provided as collateral when the transferee has the right by contract or custom to sell or pledge the collateral; the counterpart liability is included in deposits from central banks, deposits from banks and building societies or other deposits, as appropriate. Securities purchased under agreements to resell ('reverse repos') are recorded as loans and advances to banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also reclassified in the financial statements as assets provided as collateral. Securities borrowed are not recognised in the financial statements, unless they are sold to third parties, in which case the obligation to return the securities is recorded at fair value as a liability.

j Impairment of financial assets

i Assets carried at amortised cost

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or group of assets is impaired. If there is objective evidence that an impairment loss on loans and advances has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate or current market rates for instruments with variable rates. The carrying amount of the asset is reduced and the amount of the loss is recognised in the income statement.

ii Assets carried at fair value

The Bank considers at each balance sheet date whether there is objective evidence that a financial asset or group of assets is impaired. If such evidence exists for financial assets that are available for sale, the cumulative loss measured as the difference between acquisition cost and the current fair value, less any impairment loss previously recognised, is removed from equity and recognised in the income statement.

k Intangible assets

Intangible assets comprise computer software. Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on the basis of the expected useful lives of the software, which range from three to five years. Costs associated with maintaining software programmes are recognised as an expense when incurred. Costs that are directly associated with the production of identifiable and unique software products, which are controlled by the Bank and which will probably generate economic benefits exceeding costs beyond one year, are also recognised as intangible assets. Direct costs include software development, employee costs and an appropriate portion of relevant overheads. Such costs are amortised over their estimated useful lives which range from three to five years.

l Property, plant and equipment

The Bank's properties were subject to a professional valuation as at 29 February 2004. The frequency of professional valuations is three years with subsequent additions included at cost, and provisions 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 balance sheet. Deferred tax is provided in respect of the liability that would arise if the properties were disposed of at their revalued amounts.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

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

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. Assets that are subject to amortisation are reviewed at each reporting date to assess whether there is any indication that an asset may be impaired. An asset's carrying amount is written down immediately to its recoverable amount if the carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value (less costs to sell) and value in use.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

m Investment properties

Investment properties are shown at cost. No properties were designated as investment properties on the adoption of IAS 40 (Investment Property) at 1 March 2004. For properties that have subsequently been classified as investment properties, the book value at the date of reclassification as investment properties has been deemed to be cost. For the Bank, at present, investment properties comprise only freehold land and accordingly are not depreciated.

Notes to the Banking Department Financial Statements continued

n Leases

i As lessee

The leases entered into by the Bank are operating leases. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

ii As lessor

Where the Bank has granted long leases on property, the land element is treated as an operating lease. The building element may be a finance lease if appropriate. For finance leases, the present value of the lease payments is recognised as a receivable. Lease income, including premiums, is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return. For operating leases, the rental income including any premium is recognised over the term of the lease.

o Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, consisting of cash and balances with other central banks, loans and advances to banks, other amounts due from banks and short-term government securities.

p Financial liabilities at fair value through profit or loss

These liabilities include three-year notes denominated in euro (Euro Notes) and three and six-month bills denominated in euro (Euro Bills). Both Euro Notes and Euro Bills are stated at fair value. They are translated into sterling at the exchange rate ruling at the balance sheet date. All gains and losses arising from exchange rate movements and other fair value movements on the Euro Notes and Euro Bills are taken to the income statement.

From 1 March 2005, these liabilities have been designated as fair value through profit or loss as they fund the portfolios of euro and other securities which have been designated as being at fair value through profit or loss. These assets and liabilities, together with the related derivatives, are managed together and internal reporting of performance is evaluated on a fair value basis. This treatment significantly reduces the measurement inconsistency that would arise were these liabilities to be measured on an amortised cost basis.

For the prior year, 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 in euros. Euro Bills are stated at issue proceeds plus accrued interest in euros. The liabilities are translated into sterling at the exchange rate prevailing at the balance sheet date.

If the Bank buys any of its own securities as part of its operations, these are removed from the balance sheet. The Bank may accept its own securities as collateral for reverse repos. Such reverse repo transactions are treated as collateralised and are treated in the same way as other reverse repo transactions.

q Provisions

Provisions for restructuring, redundancy and legal claims are recognised: when the Bank has a present legal or constructive obligation as a result of past events; and it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated.

r Retirement benefits

The Bank operates non-contributory defined benefit pension schemes providing defined 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 liability recognised in the balance sheet in respect of defined benefit pension schemes is the present value of the defined benefit obligation at the balance sheet date less the fair value of scheme assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit method. The present value of the defined benefit obligation is determined by discounting the estimated cash outflows using interest rates of high-quality sterling corporate bonds that have terms to maturity approximating to the terms of the related pension liability. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised immediately in equity and reflected in the statement of recognised income and expense. Past service costs are recognised immediately in the income statement.

Other post-retirement benefits, principally healthcare for certain pensioners, are accounted for on a similar basis to that used to account for pension obligations.

s Current and deferred tax

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates and laws that have been enacted and which are expected to apply when the related deferred tax asset or liability is realised.

The principal temporary differences arise from depreciation of property, plant and equipment, revaluation of certain financial assets and liabilities including derivative contracts, revaluations of property, and provisions for pensions and other post-retirement benefits.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred tax related to fair value remeasurement of available for sale securities and actuarial gains and losses on retirement benefit obligations, which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement together with the deferred gain or loss.

Corporation tax payable on profits, based on the United Kingdom tax laws, is recognised as an expense in the period in which profits arise. Tax relief on payments to HM Treasury is credited directly to equity.

t Commitments on behalf of HM Treasury

Commitments on behalf of HM Treasury in foreign currencies and gold 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.

u Bank capital

The entire capital comprising £14,553,000 of Bank Stock is held by the Treasury Solicitor on behalf of HM Treasury. It is treated as equity in these financial statements.

The payment under Section 1(4) of the Bank of England Act 1946 under which HM Treasury receive a share of the profits is recognised in equity in the year for which it is payable. According to the Bank of England Act 1946, HM Treasury will receive half the post-tax profits unless the Bank and HM Treasury agree otherwise. The payment is deductible for corporation tax and charged to equity together with the tax deduction.

3 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Notes to the Banking Department Financial Statements continued

a Impairment losses on loans and advances

The Bank reviews its loans and advances to assess impairment on a periodic basis. The nature of the Bank's activities is such that impairment of its loans and advances are very rare.

b Fair value of equity investments that are available for sale

Fair values of equity investments classified for accounting purposes as available for sale, which are held by the Bank for the long term as part of its central banking activities and which may not be readily saleable, have been established using techniques reflecting the benefit that the Bank derives from the investments (see note 14, which includes relevant sensitivity analysis).

c Post-retirement benefits

Post-retirement benefits are long-term liabilities whose value can only be estimated using assumptions about developments over a long period. The Bank has employed actuarial advice in arriving at the figures in the financial statements (see note 26, which includes relevant sensitivity analysis). Members of Court consider the assumptions used by the actuaries in their calculations to be appropriate for this purpose.

4 PROFIT AFTER PROVISIONS AND BEFORE TAX

a Income includes:

	2006	*2005*
	£m	*£m*
Charges for services to HM Government including charges to the Issue Department in respect of the Note Issue	60	*60*
Other operating income	47	*54*
Including: rental income from investment properties	2	*2*
Dividend income	9	*9*

b Expenses include:

	2006 £m	*2005* £m
Staff costs (note 5)	115	*103*
Legal fees (including VAT)	13	*20*
Depreciation of property, plant and equipment	8	*8*
Software expenditure	4	*5*
Amortisation of intangible assets	4	*3*
Operating lease rentals property	1	*1*
Operating lease rentals equipment	1	*1*
Other administrative expenses	50	*51*

5 STAFF COSTS

		2006	*2005*
	Notes	**£m**	*£m*
Wages and salaries		77	*76*
Social security costs		8	*8*
Pension and other post-retirement costs:			
Pension schemes	26	19	*7*
Redundancy provisions	26	5	*6*
Other unfunded pension schemes	26	1	*1*
Other post-retirement benefits	26	5	*5*
		115	***103***

The increase in the measured cost of pension schemes from £7 million in 2005 to £19 million in 2006 is the result of greater interest costs year on year resulting from the increased deficit at 28 February 2005 (see note 26).

Average number of employees

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

	2006	*2005*
Governors and other members of Executive Team	9	*9*
Managers and analysts	533	*477*
Other staff	1,345	*1,427*
	1,887	***1,913***

The number of persons employed by the Bank at the end of the year was 1,836, of which 1,639 were full-time and 197 were part-time (*2005 1901 with 1,713 full-time and 188 part-time*).

6 AUDITORS' REMUNERATION

	2006		*2005*	
	£000	**%**	£000	%
Audit of the Bank's financial statements:				
Recurring	233	35	*195*	*27*
Non-recurring	113	17	–	–
Further assurance services:				
Review of controls on payments systems	117	18	*114*	*16*
Other assurance services	24	4	*101*	*14*
Assurance services	487	74	*410*	*57*
Tax advisory services	77	12	*58*	*8*
Other non-audit services:				
Acting as liquidator of Minories Finance Ltd	47	7	*43*	*6*
Accounting advice on IFRS	–	–	*157*	*22*
Other services	45	7	*55*	*7*
Total	**656**	100	***723***	*100*
Of which, borne by the Bank	**609**		***680***	
Borne by subsidiaries	**47**		***43***	

The increase in the Bank's recurring audit fees arises as a consequence of additional audit work necessary to meet IFRS measurement and disclosure requirements and further procedures under International Standards on Auditing as adopted by the Auditing Practices Board. The non-recurring audit fee relates to IFRS transition work.

During the year ended 28 February 2006, an additional £46,000 (*2005 £53,000*) was paid for work performed as auditors of the Bank's pension funds, together with fees for non-audit services of £nil (*2005 £nil*). These fees were borne by the respective funds and are not included in the amounts above.

The Bank's policy is only to use its auditors for non-audit work 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.

Notes to the Banking Department Financial Statements *continued*

7 TAXATION

The corporation tax charge within the income statement is made up as follows:

	2006	*2005*
	£m	*£m*
Current United Kingdom corporation tax	39	*30*
Prior year corporation tax	(4)	*6*
Deferred tax — current year	(13)	*1*
Deferred tax — prior year	(3)	*–*
Tax charge on profit after provisions	**19**	***37***

The corporation tax charge credited directly to equity is made up as follows:

	2006	*2005*
	£m	*£m*
Tax relief on payment to HM Treasury (taken to equity)	(14)	*(11)*
Actuarial gains/(losses) on retirement benefits	22	*(87)*
Tax charge credited directly to equity	**8**	***(98)***

The charge for taxation is computed on the residual profit on ordinary activities after deduction of the amount payable to HM Treasury.

Further information about deferred tax is presented in note 19. The tax charge on the Bank differs from the amount that would arise using the basic rate of tax as follows:

	2006	*2005*
	£m	*£m*
Profit before tax	99	*106*
Tax calculated at rate of 30% (*2005 30%*)	30	*32*
Net non-taxable income for tax purposes	(4)	*(1)*
Prior year items	(7)	*6*
Current tax charge for the period	**19**	***37***

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

	2006	*2005*
	£m	*£m*
Payable 5 April	23	*20*
Payable 5 October	24	*18*
	47	***38***

The Bank of England Act 1946, as amended by the Bank of England Act 1998, requires the Bank to pay HM Treasury, in lieu of dividend on the Bank's capital, on 5 April and 5 October, a sum equal to 25% of the Banking Department's post-tax profit for the previous financial year or such other sum as the Bank and HM Treasury may agree. The overall effect is that the Bank and HM Treasury will normally share Banking Department's post-tax profits equally. The sum paid on 5 April was based on provisional figures. The balance is payable on 5 October. When the due date falls on a non-business day, the payment is made on the last business day before the due date. These payments have been accrued and charged to equity at 28 February 2006. The payments are deductible for corporation tax.

The dividend paid in 2005 was agreed by reference to profits generated under the old basis of accounting. It does not represent 50% of Banking Department's post-tax profits restated on the new accounting basis (see note 33).

9 CASH AND BALANCES WITH OTHER CENTRAL BANKS

	2006	2005
	£m	£m
Cash	6	4
Due from the European Central Bank in respect of TARGET (a)	176	112
Other balances with central banks (b)	3	6
	185	***122***

Carrying values for comparative figures relating to financial instruments are shown under the old accounting basis.

a Due from the European Central Bank in respect of TARGET

This balance, denominated in euro (2006 €258 million; *2005 €163 million*), 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 intraday between the central banks are netted into a single position with the European Central Bank. The balance with the European Central Bank bears interest at rates related to the monetary conditions in the euro area.

b Other balances with central banks

These balances are correspondent accounts with other central banks used for Bank and customer business. The practice is that such accounts between central banks do not normally bear interest.

10 LOANS AND ADVANCES TO BANKS

	2006	2005
	£m	£m
Items in course of collection from banks	465	351
Placements with banks	14,089	12,553
	14,554	***12,904***

These balances include advances and reverse repurchase agreements, arising as part of the Bank's open market operations, as well as advances matching deposits taken (notes 21–23). Amounts are stated after provisions for impairment, 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.

At 28 February 2006 loans and advances to banks included cash and cash equivalents of £5,620 million (*2005 £6,266 million*).

The Bank accepted listed securities with a fair value at 28 February 2006 of £6.8 billion (*2005 £6.1 billion*) as collateral for loans and advances to banks, the majority of which are in the form of reverse repurchase contracts. The Bank is permitted to sell, repo or re-pledge these securities to third parties but has not done so as at 28 February 2006 (*2005 £nil*).

Carrying values for comparative figures relating to financial instruments are shown under the old accounting basis.

As presented under UK GAAP, the maturity profile for placements with banks at 28 February 2005 was as follows:

	2005
	£m
Remaining maturity:	
Loans and advances	
over 5 years	1
5 years or less but over 1 year	2
1 year or less but over 3 months	3,842
3 months or less	8,539
Repayable on demand	169
	12,553

Notes to the Banking Department Financial Statements continued

11 FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2006	2005
	£m	£m
Financial assets designated at fair value through profit or loss at initial recognition:		
Listed foreign government securities	4,153	–
Listed non-sterling securities	1,510	–
	5,663	**–**

	2005		2005*	
			New accounting basis	
	Balance sheet	Market value	Financial assets at fair value through profit or loss	Available for sale securities (note 14)
	£m	£m	£m	£m
Investment securities:				
British Government securities, listed on a recognised UK exchange	1,839	1,949	–	1,839
Other sterling securities, listed on recognised exchanges	1,179	1,201	–	1,179
	3,018	***3,150***	**–**	***3,018***
Foreign government securities, listed on recognised exchanges	2,933	2,986	2,933	–
Other non-sterling securities, listed on recognised exchanges	356	361	356	–
	3,289	***3,347***	***3,289***	**–**
Other non-sterling securities:				
Foreign government securities, listed on recognised exchanges	1,310	1,310	1,310	–
Other non-sterling securities, listed on recognised exchanges	631	631	631	–
	1,941	***1,941***	***1,941***	**–**
	8,248	***8,438***	***5,230***	***3,018***
Due within one year	1,564	1,581		
Due one year and over	6,684	6,857		
	8,248	***8,438***		

Comparative figures have been reclassified but not remeasured.

	2005
	£m
Unamortised discounts on British Government and other sterling securities	18
Unamortised premiums on British Government and other sterling securities	(220)
	(202)

The portfolio of foreign government and other foreign securities is funded by the Bank's issue of Euro Notes and Euro Bills (note 24), and in the case of non-euro securities, a combination of 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 £2,820 million at 28 February 2006 (*2005 £2,331 million*), were used to generate this liquidity via intraday repo contracts. The remainder of the portfolio was mainly denominated in euro but with a portion in United States dollars and Japanese yen, with currency swaps into euro. These securities were designated as being held at fair value through profit or loss with effect from 1 March 2005, as explained in note 2. At 28 February 2005 £1,941 million were held at fair value and £3,289 million were held at amortised cost. Comparative figures above have been provided so as to reflect new disclosure classifications, but carrying values have not been adjusted to the new accounting basis.

No securities were provided as collateral under repurchase agreements with banks at 28 February 2006 (*2005 £nil*).

12 DERIVATIVE FINANCIAL INSTRUMENTS

The Bank uses the following derivative instruments. These are mainly used to minimise the currency and interest rate exposures on the Bank's portfolio of financial assets and financial liabilities at fair value through profit and loss (see notes 11 and 24). They may also be used as an instrument in monetary policy transactions.

Interest rate and bond futures are contractual obligations to receive or pay a net amount based on changes in currency rates or interest rates or to buy or sell foreign currency or a financial instrument on a future date at a specified price, established in an organised financial market. The credit risk is limited, as futures contracts are collateralised by cash or marketable securities, and changes in the price of the futures contract are settled daily with the exchange.

Currency and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies or interest rates (eg fixed rate for floating rate) or a combination of these (ie cross currency interest rate swaps). An exchange of principal occurs for currency swaps, but no such exchange of principal usually occurs for interest rate swaps. The Bank's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligations. This risk is monitored on an ongoing basis with reference to the current fair value, a proportion of the notional amount of the contracts and the liquidity of the market. To control the level of credit risk taken, the Bank assesses counterparties using the same techniques as for its lending activities and may take collateral where appropriate.

The notional amounts of derivative financial instruments provide a basis for comparison with instruments recognised in the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and therefore do not indicate the Bank's exposure to credit or price risks. The derivative instruments move into profit (in which case they are treated as assets) or loss (in which case they are treated as liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms. The aggregate contractual or notional amount of derivative financial instruments outstanding, the extent to which instruments are profitable or not and thus the aggregate fair values of derivative financial instruments and liabilities can fluctuate significantly from time to time. The fair values of derivative instruments are set out below.

Notes to the Banking Department Financial Statements continued

a Treatment for the year ended 28 February 2006

All derivatives have been recognised in the balance sheet at fair values with all gains and losses taken through profit or loss.

	Contract notional amount	Fair values	
		Assets	Liabilities
	£m	£m	£m
Derivatives related to non-sterling investment securities and Euro Note liabilities			
Interest rate swaps — positive value	483	7	–
Interest rate swaps — negative value	340	–	(1)
Cross currency interest rate swaps — positive value	758	63	–
Cross currency interest rate swaps —negative value	901	–	(67)
	2,482	**70**	**(68)**
Derivatives related to other non-sterling securities and Euro Bill liabilities			
Interest rate swaps — positive value	1,953	60	–
Interest rate swaps — negative value	287	–	(3)
Cross currency interest rate swaps — positive value	354	45	–
Cross currency interest rate swaps — negative value	–	–	–
	2,594	**105**	**(3)**
Other derivative instruments			
Foreign exchange swaps — positive value	4,438	116	–
Foreign exchange swaps — negative value	1,406	–	(27)
	5,844	**116**	**(27)**
Total recognised derivative assets/(liabilities)		**291**	**(98)**

At 28 February 2006 the Bank accepted cash of £63 million as collateral for derivative financial instruments.

b Treatment for the year ended 28 February 2005

In the year to 28 February 2005 the Bank followed UK GAAP under which derivatives designated as hedging the non-sterling investment securities and Euro Note liabilities were recognised on an accruals basis to match the treatment of the hedged items. Derivatives hedging other non-sterling securities and the Euro Bill liabilities were recognised at fair value with gains and losses taken to profit or loss. Other derivative instruments used to match currency and interest rate exposure in the banking book were also recognised on an accruals basis to match the treatment of the hedged items.

i Book values and fair values of derivatives

	Notional principal £m	Book value £m	Fair value £m
Derivatives related to non-sterling investment securities and Euro Note liabilities			
Cross currency swaps			
Positive value	942	112	113
Negative value	31	(21)	(21)
Interest rate swaps			
Positive value	742	10	12
Negative value	60	(2)	–
	1,775	**99**	**104**

	Notional principal £m	Positive fair value £m	Negative fair value £m
Derivatives related to other non-sterling securities and Euro Bill liabilities			
Cross currency swaps			
Positive value	401	79	–
Negative value	84	–	(4)
Interest rate swaps			
Positive value	2,664	154	–
Negative value	1,070	–	(32)
Foreign exchange swaps	52	–	(2)
	4,271	**233**	**(38)**

	Notional principal £m	Book value £m	Fair value £m
Other derivative instruments			
Foreign exchange swaps	**1,979**	**21**	**18**

At 28 February 2005 the Bank accepted cash of £167 million as collateral for derivative financial instruments.

Notes to the Banking Department Financial Statements continued

ii 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	
	1 year or less	More than 1 year but not more than 5 years
	£m	£m
Derivatives related to non-sterling investment securities and Euro Note liabilities		
Cross currency swaps		
Notional principal	310	663
Replacement cost	46	67
Foreign exchange swaps		
Notional principal	–	–
Interest rate swaps		
Notional principal	312	490
Replacement cost	7	5
Derivatives related to other non-sterling securities and Euro Bill liabilities		
Cross currency swaps		
Notional principal	127	358
Replacement cost	32	47
Foreign exchange swaps		
Notional principal	52	–
Replacement cost	–	–
Interest rate swaps		
Notional principal	2,717	1,017
Replacement cost	139	15
Other derivative instruments		
Foreign exchange swaps	1,979	–
Replacement cost	18	–
Total notional principal	**5,497**	**2,528**
Total replacement cost	**242**	**134**

All derivative counterparties were financial institutions. The maximum credit exposure after taking account of netting agreements was £304 million. The exposure, net of collateral held by the Bank, was £137 million.

iii Unrecognised gains and losses on hedging instruments

In the year to 28 February 2005, the Bank accounted for derivative instruments hedging certain foreign currency denominated securities and the related funding via Euro Notes on an accruals basis in line with the underlying items being hedged. Any gains or losses that would have occurred if these items were carried at market value were therefore not recognised in the profit or loss account until they matured or were sold.

At 28 February 2005, the unrecognised gains on financial instruments used for hedging were £2 million. Net gains arising before 1 March 2004 and recognised in the year to 28 February 2005 amounted to £77 million. Net losses of £62 million arose in the year to 28 February 2005 but were not recognised in the year. Of the unrecognised gains of £2 million at 28 February 2005, £9 million were expected to have been recognised in the year to 28 February 2006 had this accounting treatment continued and losses of £7 million were expected in subsequent years.

13 LOANS AND ADVANCES TO CUSTOMERS

	2006	*2005*
	£m	*£m*
Loans to staff and customers	6	*5*
	6	***5***

Carrying values for comparative figures relating to financial instruments are shown under the old accounting basis.

14 AVAILABLE FOR SALE SECURITIES

	2006	*2005*
	£m	*£m*
Debt securities at fair value		
British Government securities listed on a recognised UK exchange	2,211	–
Other sterling securities listed on a recognised exchange	1,282	–
	3,493	–
Unlisted equity investments at fair value	212	–
	3,705	–

Comparative figures for debt securities now classified as available for sale securities are included within note 11. Available for sale securities also include unlisted equity investments classified at 28 February 2005 as equity investments and participating interest at a book value (on a cost basis) of £40 million.

No gains or losses on available for sale securities were transferred to the income statement in the year.

a Debt securities

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. However, as the Bank can envisage circumstances in which they might be sold before maturity they have been classified as assets that are available for sale.

All debt securities have fixed coupons.

b Unlisted equity investments

The unlisted equity investments held by the Bank are held as part of its function as a central bank and are thus of a long-standing nature. The Bank's holdings in any particular institution may change from time to time as part of realignments of holdings among the shareholders and participants. Fair values of unlisted equity investments have been established using techniques reflecting the benefits that the Bank derives from the investments.

As at 28 February 2005 investments in unlisted equities were stated in the balance sheet at cost. The fair value of these investments at that date was £294 million.

The Bank's investment in the Bank for International Settlements (incorporated in Switzerland) consists of shares of 5,000 Special Drawing Rights which are 25% paid. At 28 February 2006 the holding represents 8.7% (*2005 8.7%*) of the issued share capital. The investment has been valued on a dividend yield basis providing a value of £210 million at the year end. A discount rate of 7% was used. Increasing the discount rate by 1% would deflate the valuation by £38 million, whilst decreasing the discount rate by 1% would inflate the valuation by £60 million.

The Bank's holding in the European Central Bank represents the Bank's contribution of €56 million to the capital of the European Central Bank. This contribution is non-refundable and therefore its fair value has deemed to be zero. It 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. The Bank's full share would equate to 14.4% (*2005 14.4%*) of the ECB's subscribed capital.

15 INVESTMENTS IN GROUP UNDERTAKINGS

	2006	*2005*
	£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 2006. The investment in this company is included in the Bank's balance sheet at 28 February 2006 at £12.5 million (*2005 £12.5 million*). The Bank expects to recover in excess of its investment and accordingly no provision for impairment 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. These subsidiaries, all of which are non-trading, are as follows:

BE Property Holdings Ltd	5,000,000 shares of £1
Securities Management Trust Ltd	1,000 shares of £1
Houblon Nominees Ltd	2 shares of £1
BE Museum Ltd	10,000 shares of £1
BE Services Ltd	5,000 shares of £1
BE Nominees Ltd	2 shares of £1

The aggregate net assets of these subsidiary companies are £6 million (*2005 £6 million*) which consist of balances held with the Bank.

16 INTANGIBLE ASSETS

Intangible assets comprise computer software. The net book value of intangible assets at 1 March 2004 was £12 million.

	2006	*2005*
	£m	*£m*
Cost		
At 1 March	20	*14*
Additions	6	*6*
At 28 February	**26**	***20***
Accumulated depreciation		
At 1 March	5	*2*
Charge for the year	4	*3*
At 28 February	**9**	***5***
Net book value at 28 February	**17**	***15***

Notes to the Banking Department Financial Statements continued

17 PROPERTY, PLANT AND EQUIPMENT

The net book value of property, plant and equipment at 1 March 2004 was £214 million.

	Freehold land and buildings £m	Equipment £m	Total £m
Cost or valuation			
At 1 March 2005	209	35	244
Reclassification as investment property*	(18)	–	(18)
Additions	2	3	5
At 28 February 2006	**193**	**38**	**231**
Accumulated depreciation			
At 1 March 2005	4	26	30
Charge for the year	4	4	8
At 28 February 2006	**8**	**30**	**38**
Net book value at 28 February 2006	**185**	**8**	**193**
Cost or valuation at 28 February 2006 comprised:			
At 2005 valuation	191	–	191
At cost	2	38	40
	193	**38**	**231**

	Freehold land and buildings £m	*Equipment £m*	*Total £m*
Cost or valuation			
At 1 March 2004	*203*	*63*	*266*
Reclassification as investment property*	*(8)*	*–*	*(8)*
Additions	*2*	*2*	*4*
Disposals	*–*	*(30)*	*(30)*
Revaluation of properties	*12*	*–*	*12*
At 28 February 2005	***209***	***35***	***244***
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	***205***	***9***	***214***
Cost or valuation at 28 February 2005 comprised:			
At 2005 valuation	*209*	*–*	*209*
At cost	*–*	*35*	*35*
	209	***35***	***244***

The figures for freehold land and buildings reflect professional valuations on a market value basis at 29 February 2004 by Nelson Bakewell, members of the Royal Institute of Chartered Surveyors. These revaluations have been incorporated into the financial statements. An interim revaluation by Nelson Bakewell at 28 February 2005 showed a surplus of £12 million which was also reflected in the revaluation reserve in that year. The revaluation surplus is not distributable under UK legislation.

* During the years ended 28 February 2005 and 28 February 2006, the Bank entered into long lease agreements on two of its properties. The relevant properties were subsequently reclassified as investment properties (note 18).

18 INVESTMENT PROPERTIES

Investment properties are held at cost. Where properties have been reclassified, the book value at the date of reclassification has been deemed cost. All investment properties relate to freehold land.

	2006	*2005*
	£m	*£m*
At 1 March	8	*–*
Reclassification from property, plant and equipment	18	*8*
At 28 February	**26**	***8***

The fair value of investment properties at 28 February 2006 was £37 million (*2005 £9 million*). Investment properties represent land owned by the Bank of which leases have been granted in excess of 100 years on land owned by the Bank.

19 DEFERRED TAX ASSETS AND LIABILITIES

Deferred tax is calculated on all temporary differences under the liability method using an effective tax rate of 30% (*2005 30%*).

The movement on the deferred tax account is as follows:

	2006	*2005*
	£m	*£m*
Deferred tax		
Net asset at 1 March	123	*38*
Adoption of IAS 39		
Deferred tax on available for sale securities	(105)	*–*
Adjusted balance at 1 March 2005	18	*38*
Profit and loss charge	16	*(1)*
Taken through statement of recognised income and expense		
Revaluation of property, plant and equipment	–	*(2)*
Property sold under long lease	–	*1*
Deferred tax on retirement benefit obligations	(22)	*87*
Net asset at 28 February	**12**	***123***

	2006	*2005*
	£m	*£m*
Deferred tax assets		
Timing differences in respect of retirement benefits obligations	119	*135*
Other provisions	3	*2*
	122	***137***

Notes to the Banking Department Financial Statements continued

	2006 £m	*2005 £m*
Deferred tax liabilities		
Accelerated capital allowances	–	*1*
Available for sale securities	100	*–*
Revaluation of property, plant and equipment	5	*5*
Other temporary differences	5	*8*
	110	***14***

	2006 £m	*2005 £m*
Deferred tax charge		
Pensions and other post-retirement benefits	(22)	*1*
Other provisions	11	*–*
	(11)	***1***

20 OTHER ASSETS

	2006 £m	*2005 £m*
Non-sterling debt securities interest and swap accruals	–	*217*
Sterling debt securities interest accruals	–	*58*
Fair value of derivatives		
currency swaps	–	*79*
interest rate swaps	–	*154*
Short-term debtors and other assets	83	*64*
	83	***572***

Carrying values for comparative figures relating to financial instruments are shown under the old accounting basis. Current year information relating to debt securities and derivatives is shown within notes 11, 12 and 14.

21 DEPOSITS FROM CENTRAL BANKS

	2006	*2005*
	£m	*£m*
Repayable on demand	1,337	*828*
Term deposits	10,043	*8,989*
	11,380	***9,817***

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

As presented under UK GAAP, the maturity profile for deposits from central banks at 28 February 2005 was as follows:

	2005
	£m
Remaining maturity:	
1 year or less but over 3 months	*3,817*
3 months or less but not repayable on demand	*5,172*
Repayable on demand	*828*
	9,817

22 DEPOSITS FROM BANKS AND BUILDING SOCIETIES

	2006	*2005*
	£m	*£m*
Items in course of settlement	2	*2*
Repayable on demand		
sterling	751	*29*
euro	170	*144*
Collateral for swaps	63	*167*
Cash ratio deposits	2,222	*2,001*
	3,208	***2,343***

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.

Notes to the Banking Department Financial Statements *continued*

As presented under UK GAAP, the maturity profile for deposits from banks and building societies at 28 February 2005 was as follows:

	2005
	£m
3 months or less but not repayable on demand:	
Other deposits	169
Repayable on demand:	
Euro deposits	144
Other deposits	29
Cash ratio deposits	2,001
	2,343

23 OTHER DEPOSITS

	2006	2005
	£m	£m
Deposit by Issue Department	53	74
Public deposits		
Current accounts repayable on demand	875	955
Term deposits	25	50
Other deposits repayable on demand	128	211
	1,081	**1,290**

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

As presented under UK GAAP, the maturity profile for other deposits at 28 February 2005 was as follows:

	2005
	£m
Remaining maturity:	
1 year or less but over 3 months:	
Public deposits	5
3 months or less but not repayable on demand:	
Public deposits	45
Repayable on demand:	
Public deposits	955
Deposit by Issue Department	74
Other deposits	211
	1,290

24 FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

Following the adoption of IAS 39 at 1 March 2005, the Bank designated its euro securities in issue as financial liabilities at fair value through profit or loss, so matching the portfolio of foreign securities designated as fair value through profit or loss (note 11). These liabilities were previously recorded at amortised cost. All changes in fair values since 1 March 2005 are considered attributable to changes in prevailing interest rates.

	2006	*2005*
	£m	*£m*
Financial liabilities designated at fair value through profit or loss:		
Euro Notes	4,073	–
Euro Bills	2,439	–
	6,512	**–**
Debt securities in issue:		
Reclassified as financial liabilities designated at fair value through profit or loss (note 33)		
Euro Notes	–	*3,443*
Euro Bills	–	*2,471*
	–	***5,914***

Comparative figures have been reclassified but not remeasured.

a Euro Notes

On 27 January 2006, €2.2 billion of the 2006 Euro Notes matured at par. The Bank created a new series of €3.3 billion of Euro Notes maturing on 27 January 2009. This was the sixth issue 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 €2.2 billion was sold on 24 January 2006 and a further auction of €1.1 billion was held on 28 March 2006. The Bank allots any roundings for the auction process to itself and normally retains €100 million of each tranche. In January 2006 an additional €100 million was retained in respect of the 2009 Euro Note. These roundings and amounts retained may be 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 2006 was as follows:

	2006		*2005*	
	£m	**€m**	*£m*	*€m*
	Fair value	**Nominal**	*Book value*	*Nominal*
Total amount issued	5,348	7,700	*4,549*	*6,600*
Held by Bank of England	(1,275)	(1,700)	*(1,106)*	*(1,600)*
Liabilities to third parties	**4,073**	**6,000**	***3,443***	***5,000***

Carrying values for comparative figures relating to financial instruments are shown under the old accounting basis.

Liabilities to third parties in sterling at 28 February 2006 include accrued interest of £10 million. At 28 February 2005 the corresponding accrued interest of £8 million was included within other liabilities.

Of the above liabilities to third parties, £1,496 million (*2005 £1,377 million*) falls due within one year.

Notes to the Banking Department Financial Statements continued

b Euro Bills

	2006		2005	
	£m	€m	£m	€m
	Fair value	Nominal	Book value	Nominal
Original maturity of Bills in issue:				
3 months	1,222	1,795	*1,237*	*1,799*
6 months	1,217	1,788	*1,234*	*1,799*
Liabilities to third parties	**2,439**	**3,583**	***2,471***	***3,598***

Carrying values for comparative figures relating to financial instruments are shown under the old accounting basis.

These Bills are issued by the Bank and denominated in euro. Of the above, £1,833 million (*2005 £1,856 million*) are due within three months or less.

25 OTHER LIABILITIES

	2006	2005
	£m	£m
Payable to HM Treasury	47	*38*
Due to subsidiaries	20	*20*
Non-sterling debt securities interest and swap accruals	–	*84*
Fair values of derivatives:		
currency swaps	–	*4*
interest rate swaps	–	*32*
foreign exchange swaps	–	*2*
Items in course of settlement	–	*714*
Short-term creditors, other liabilities and deferred income	287	*100*
	354	***994***

Carrying values for comparative figures relating to financial instruments are shown under the old accounting basis. Current year information relating to debt securities and derivatives is shown within notes 11, 12 and 14.

On 2 November 2005 the Liquidators of the Bank of Credit and Commerce International SA discontinued their misfeasance claim against the Bank. The proceedings were originally commenced in 1993. On 16 February 2006 the High Court issued an order regarding the costs incurred by the Bank in defending the proceedings, which directed that the Bank's costs of the proceedings, to be assessed if not agreed, be paid by the claimants on an indemnity basis. The order further provided that the monies paid by the claimants to the Bank on 23 and 25 November 2005 totalling £73.6 million are to be treated as interim payments on account of the Bank's costs subject to repayment by the Bank to the claimants with interest at the Bank's repo rate in the event of a lower overall figure being assessed or agreed. (£73.6 million is equal to the amount of the Bank's outstanding legal costs, before interest, up to 11 November 2005 as notified to the liquidators' solicitors on 17 November 2005.) In view of the fundamental uncertainty about what figure will eventually be assessed or agreed, in the opinion of the Bank's Court the amount of costs that will be recovered by the Bank cannot at this stage be measured reliably. Accordingly, at 28 February 2006, these monies have been treated as deferred income in the Bank's balance sheet. In its judgement of 12 April 2006 the High Court ruled that the Bank be entitled to be paid its cost on an indemnity basis through until the date of the hearing and explained why the Bank's officials should be exonerated of the allegations made against them.

26 RETIREMENT BENEFITS

The Bank operates non-contributory 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.

Valuation for funding purposes

The main pension scheme, the Bank of England Pension Fund, is valued at intervals of not more than three years by an independent qualified actuary, with interim reviews in the intervening years. The latest valuation was as at 28 February 2005; it used the current unit method, and thus the funding target was based on each active member's current earnings, with the effect of earnings increases on the accrued liabilities being included in normal future service contribution. The previous valuation, conducted at 28 February 2002, used the projected unit method.

	2005	*2002*
	£m	*£m*
Value of Fund assets	1,580	*1,431*
Actuarial value of scheme liabilities	(1,879)	*(1,281)*
Scheme (deficit)/surplus	(299)	*150*
Funding level	84%	*112%*
Future service contribution rate	41.3%	*24.2%*

For the 2005 valuation, the liabilities were valued by the actuary on an index-linked gilts yield discount rate, and no credit was taken in advance for the possibility that returns on investments held by the Fund would exceed the long-term interest rate. Allowance was made for past and prospective mortality improvements. The rate of RPI inflation used in the valuation and the pension increase assumption was 2.8% (*2002 2.5%*).

As a result of changes in longevity, and in the basis of valuation, the required future service contribution rate for the year to 28 February 2006 increased to 41.3% of pensionable earnings (*2005 24.2%*). Both contribution rates exclude the 3% cost of administration and other services set out in note 29. The Bank and the Pension Fund Trustee, with advice from the actuary, agreed that the deficit should be amortised over the period to March 2014, with four annual payments of £52.5 million followed by six annual payments of £26.7 million. The first amortisation payment was made during 2005/06.

Summary of amounts recognised in the financial statements under IAS 19

The Bank accounts for pension costs, other post-retirement benefits and redundancy provisions in accordance with IAS 19 (Employee Benefits). 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 in the balance sheet. The Bank has adopted the option of recognising actuarial gains and losses in full through the statement of recognised income and expense.

In the preparation of their valuations under IAS 19 referred to in this note, the actuaries have used the assumptions indicated below, which Members of Court have accepted for the purposes of accounting and disclosure under the standard.

Amounts recognised as liabilities in the balance sheet

		2006	*2005*
		£m	*£m*
Pension schemes	(a)	(147)	*(301)*
Unfunded post-retirement benefits			
Redundancy provisions	(b)	(68)	*(64)*
Other unfunded pension schemes	(c)	(5)	*(4)*
Other post-retirement benefits	(d)	(151)	*(137)*
		(371)	***(506)***

Notes to the Banking Department Financial Statements continued

Amounts recognised in the income statement

		2006 £m	2005 £m
Pension schemes	(a)	19	*7*
Unfunded post-retirement benefits			
Redundancy provisions	(b)	5	*6*
Other unfunded pension schemes	(c)	1	*1*
Other post-retirement benefits	(d)	5	*5*
		30	***19***

Amounts recognised in the statement of recognised income and expense

		2006 £m	2005 £m
Pension schemes	(a)	89	*(229)*
Unfunded post-retirement benefits			
Redundancy provisions	(b)	(4)	*(9)*
Other unfunded pension scheme	(c)	–	*(1)*
Other post-retirement benefits	(d)	(12)	*(50)*
		73	***(289)***

a Pension schemes

As described above, the Bank operates non-contributory 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 main pension scheme is the Bank of England Pension Fund. Members of the Executive Team participate in the Court Pension Scheme. Further details are given on page 32 of the Remuneration Report.

Summary of assumptions

Under IAS 19 measurement of scheme liabilities must be calculated under the projected unit method, which requires certain demographic and financial assumptions, including an assumption about future salary growth. The assumptions used are applied for the purposes of IAS 19 only.

The financial assumptions used by the independent actuaries to calculate scheme liabilities on an IAS 19 basis were:

	2006 %	2005 %
Inflation rate (RPI)	2.8	*2.8*
Discount rate	4.6	*5.1*
Expected return on assets	5.8	*6.7*
Rate of increase in salaries	4.6	*4.6*
Rate of increase of pensions in payment	2.8	*2.8*
Rate of increase for deferred pensioners	2.8	*2.8*

The discount rate assumption reflects the investment return on a Grade AA corporate bond at the balance sheet date.

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

	2006			*2005*		
	Long-term rate of return expected	**Value**	**Percentage of total value**	*Long-term rate of return expected*	*Value*	*Percentage of total value*
	%	£m	%	%	£m	%
Equities	7.3	999	52.3	*8.0*	*910*	*56.7*
Bonds	3.9	749	39.3	*4.6*	*562*	*35.0*
Properties	5.8	105	5.5	*6.6*	*88*	*5.5*
Cash and other assets	3.8	55	2.9	*3.8*	*44*	*2.8*
Total market value of investments	**5.8**	**1,908**	**100.0**	***6.7***	***1,604***	***100.0***

For the purposes of IAS 19, the asset values stated are at the balance sheet date. Market values of schemes' 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 arrangements of paragraph 106 of IAS 19. Expected rates of return are used for the purposes of calculating the annual charge to the income statement in the subsequent year, and have no impact on the deficit in the scheme as calculated on an IAS 19 basis. The assumptions used do not necessarily reflect the investment return that may be achieved.

The expected return on assets has been derived as the weighted average of expected returns from each of the main asset classes.

	2006	*2005*
	£m	*£m*
Present value of defined benefit obligations	(2,055)	*(1,905)*
Assets at fair value	1,908	*1,604*
Defined benefit liability	**(147)**	***(301)***

The deficit in the schemes before taxation, on an IAS 19 basis, decreased by £154 million to £147 million at the year end. The decrease has arisen principally as a result of higher than expected returns on Funds' assets and additional contributions made to the scheme (over and above regular payments), offset in part by an actuarial loss on scheme liabilities resulting from the application of a lower discount rate.

Sensitivity analysis provided by the actuaries suggests that a ±0.1% change to the discount rate would change the deficit on the main pension scheme by ±£35 million. The assumptions relating to future mortality rates were last revised in 2005 to reflect increased longevity. If mortality rates were adjusted such that individuals were assumed to live for an additional year, the main scheme liabilities at the year end would increase by approximately £50 million.

The Bank estimates that contributions of £84 million will be paid in the forthcoming year (*2005 £7 million*).

Notes to the Banking Department Financial Statements continued

Components of pension expense in the income statement

	2006 £m	2005 £m
Current service cost	28	*24*
Past service cost	1	*1*
Interest cost	95	*85*
Expected returns on assets	(105)	*(103)*
Total pension expense	**19**	***7***

The increase in interest costs year on year results from the greater deficit at 28 February 2005.

Amounts recognised in the statement of recognised income and expense

	2006 £m	2005 £m
Cumulative actuarial losses recognised at beginning of year	(229)	*–*
Actuarial loss on schemes' liabilities	(106)	*(291)*
Actuarial gain on Funds' assets	195	*62*
Cumulative actuarial losses recognised at end of year	**(140)**	***(229)***

Reconciliation of return on assets

	2006 £m	2005 £m
Expected return on Funds' assets (net of expenses)	105	*103*
Actuarial gain on Funds' assets	195	*62*
Actual return on Funds' assets (net of expenses)	**300**	***165***

Reconciliation of present value of defined benefit obligation

	2006 £m	2005 £m
Present value of defined benefit obligation at 1 March	1,905	*1,581*
Current service cost	28	*24*
Past service cost	1	*1*
Interest cost	95	*85*
Actuarial loss on schemes' liabilities	106	*291*
Defined benefits payments from Funds	(80)	*(77)*
Present value of defined benefit obligation at 28 February	**2,055**	***1,905***

Reconciliation of the fair value of assets

	2006	*2005*
	£m	*£m*
Fair value of Funds' assets at 1 March	1,604	*1,509*
Actual return on Funds' assets	300	*165*
Actual Bank contributions	84	*7*
Actual benefits paid from Funds	(80)	*(77)*
Fair value of Funds' assets at 28 February	**1,908**	***1,604***

Experience gains and losses

	2006	*2005*
	£m	*£m*
Experience gain on defined benefit obligation	20	*30*
Experience gain on Funds' assets	195	*62*

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, and represent the future cost of decisions that have already been taken. Provision is made for the costs of these benefits at the time the redundancy offer is announced based on actuarial advice.

The valuation of these provisions has been performed using the relevant assumptions applied for the IAS 19 valuation of pension schemes (see (a)).

	2006	*2005*
	£m	*£m*
Unfunded defined benefit liability	**(68)**	***(64)***

The Bank estimates that contributions of £5 million will be paid in the forthcoming year (*2005 £5 million*).

Components of pension expense in the income statement

	2006	*2005*
	£m	*£m*
Past service cost	2	*3*
Interest cost	3	*3*
Total pension expense	**5**	***6***

Notes to the Banking Department Financial Statements continued

Amounts recognised in the statement of recognised income and expense

	2006	*2005*
	£m	*£m*
Cumulative actuarial losses recognised at beginning of year	(9)	*–*
Actuarial loss on liabilities	(4)	*(9)*
Cumulative actuarial losses recognised at end of year	**(13)**	***(9)***

Reconciliation of present value of defined benefit obligation

	2006	*2005*
	£m	*£m*
Present value of defined benefit obligation at 1 March	64	*54*
Past service cost	2	*3*
Interest cost	3	*3*
Actuarial loss on liabilities	4	*9*
Defined benefits payments	(5)	*(5)*
Present value of defined benefit obligation at 28 February	**68**	***64***

Experience gains and losses

	2006	*2005*
	£m	*£m*
Experience loss on defined benefit obligation	(1)	*(1)*

c Other unfunded pension scheme

As explained in the Remuneration section of the *Annual Report* on page 32, for Governors subject to the pensions earnings cap introduced in the Finance Act 1989, the Bank offers additional unfunded pensions so that their total pensions broadly match what would have been provided by the Court scheme in the absence of a cap. Provision is made for these in the Bank's accounts. In addition, certain former Governors and Directors and the widows of some former Governors and Directors were granted ex-gratia pensions. Provision for these was made in the Bank's accounts when the grants were made. These provisions are revalued annually by the Court scheme actuary.

The valuation of this scheme has been performed using the relevant assumptions applied for the IAS 19 valuation of pension schemes (see (a)).

	2006	*2005*
	£m	*£m*
Unfunded defined benefit liability	**(5)**	***(4)***

Components of pension expense in the income statement

	2006	*2005*
	£m	*£m*
Service and interest cost	1	*1*
Total pension expense	**1**	***1***

Amounts recognised in the statement of recognised income and expense

	2006	*2005*
	£m	*£m*
Cumulative actuarial losses recognised at beginning of year	(1)	*–*
Actuarial loss on scheme liabilities	–	*(1)*
Cumulative actuarial losses recognised at end of year	**(1)**	***(1)***

Reconciliation of present value of defined benefit obligation

	2006	*2005*
	£m	*£m*
Present value of defined benefit obligation at 1 March	4	*3*
Service and interest cost	1	*1*
Actuarial loss on scheme liabilities	–	*1*
Benefit payments	–	*(1)*
Present value of defined benefit obligation at 28 February	**5**	***4***

Experience gains and losses

For the year ended 28 February 2006, experience losses on the defined benefit obligation were less than £1 million (*2005 less than £1 million*).

d Other post-retirement benefits

Some staff are entitled to receive healthcare benefits in retirement. Separate provision is made for these in the Bank's accounts as these cannot be paid out of the Pension Fund.

Summary of assumptions

The inflation and discount rates used for the purpose of measuring post-retirement benefit liabilities are the same as those used in the IAS 19 valuation of pension schemes liabilities (see (a)). Additionally, for accounting purposes the following assumptions have been in respect of medical expense inflation:

	2006	*2005*
	%	*%*
Initial medical trend	11.0	*12.0*
Ultimate medical trend	5.0	*5.0*
Years to ultimate	6.0	*7.0*

Notes to the Banking Department Financial Statements *continued*

	2006 £m	*2005 £m*
Unfunded defined benefit liability	**(151)**	***(137)***

Sensitivity analysis provided by the actuaries suggests that a ±0.1% change to the discount rate would change the deficit on the other post-retirement benefits by ±£3 million.

The Bank estimates that contributions of £2 million will be paid in the forthcoming year (*2005 £3 million*).

Components of pension expense in the income statement

	2006 £m	*2005 £m*
Service cost	2	*1*
Interest cost	3	*4*
Total pension expense	**5**	***5***

Amounts recognised in the statement of recognised income and expense

	2006 £m	*2005 £m*
Cumulative actuarial losses recognised at beginning of year	(50)	*–*
Actuarial loss on scheme liabilities	(12)	*(50)*
Cumulative actuarial losses recognised at end of year	**(62)**	***(50)***

Reconciliation of present value of defined benefit obligation

	2006 £m	*2005 £m*
Present value of defined benefit obligation at 1 March	137	*85*
Service cost	2	*1*
Interest cost	3	*4*
Actuarial loss on scheme liabilities	12	*50*
Defined benefits payments from Plan	(3)	*(3)*
Present value of defined benefit obligation at 28 February	**151**	***137***

Experience gains and losses

Experience loss on defined benefit obligation	–	*(2)*

27 CAPITAL

The entire capital comprising £14,553,000 of Bank Stock is held by the Treasury Solicitor on behalf of HM Treasury. It is treated as equity in these financial statements.

28 RESERVES AND RETAINED EARNINGS AND RECONCILIATION OF SHAREHOLDER'S FUNDS

As at 28 February 2005

	Share capital £m	Property revaluation reserve £m	Retained earnings £m	Total shareholder's funds £m
Balance as at 1 March 2004	15	162	1,366	1,543
Profit after tax for the year	–	–	69	69
Payment to HM Treasury	–	–	(38)	(38)
Transfer of revaluation gains on investment property	–	(7)	7	–
Items recognised through the statement of recognised income and expense:				
Revaluation of property, plant and equipment, net of deferred tax	–	8	–	8
Actuarial losses on retirement benefits, net of deferred tax	–	–	(202)	(202)
Tax relief on payment to HM Treasury	–	–	11	11
As at 28 February 2005	**15**	**163**	**1,213**	**1,391**

Notes to the Banking Department Financial Statements continued

As at 28 February 2006

	Share capital £m	Available for sale reserve £m	Property revaluation reserve £m	Retained earnings £m	Total shareholder's funds £m
As at 28 February 2005	15	–	163	1,213	1,391
Adoption of IAS 39:					
Effective interest on loans and advances	–	–	–	(1)	(1)
Effect of recognising available for sale securities	–	346	–	–	346
Fair value of financial assets	–	–	–	7	7
Fair value of financial liabilities	–	–	–	(10)	(10)
Fair value of derivatives	–	–	–	3	3
Deferred tax on above	–	(100)	–	(5)	(105)
Adjustments arising from application of IAS 139	–	246	–	(6)	240
Adjusted balance at 1 March 2005	**15**	**246**	**163**	**1,207**	**1,631**
Profit after tax for the year	–	–	–	80	80
Payment to HM Treasury	–	–	–	(47)	(47)
Items recognised through the statement of recognised income and expense					
Net change in available for sale securities, net of tax	–	3	–	–	3
Actuarial gains on retirement benefits, net of deferred tax	–	–	–	51	51
Tax relief on payment to HM Treasury	–	–	–	14	14
As at 28 February 2006	**15**	**249**	**163**	**1,305**	**1,732**

29 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 2006 were:

- provision of banking services, including holding the principal accounts of the Government
- management of the Exchange Equalisation Account
- management of the Note Issue
- operation of sanctions against specific countries.

The aggregate balances on HM Treasury and other public sector accounts are disclosed in note 23 as public deposits. The total charges made to the Government are disclosed in note 4.

b Group undertakings

All material transactions and balances between the Bank and its subsidiaries are disclosed in note 15 and note 25.

c Key management personnel

The following information is presented only in respect of those employees of the Bank who would be considered as key management personnel, as defined under IAS 24 (Related Party Disclosures). This comprises of the Governors, members of the Executive Team and Non-executive Directors. At 28 February 2006, the number of key management was 24 (*2005 25*).

The following particulars relate to loans and deposits between the Bank and key management personnel and persons connected with them:

Loans	**2006 £000**	*2005 £000*
Loans outstanding 1 March	38	*25*
Loans made during the year	23	*29*
Loans repaid during the year	(22)	*(16)*
Loans outstanding 28 February	**39**	***38***
Number of loans outstanding 28 February	4	*4*
Interest income earned during the year	1	*1*

No provisions have been recognised in respect of loans given to related parties (*2005: nil*).

Deposits	**2006 £000**	*2005 £000*
Deposits outstanding 1 March	433	*276*
Deposits taken during the year	644	*609*
Deposits repaid during the year	(710)	*(452)*
Deposits outstanding 28 February	**367**	***433***
Number of deposits at 28 February	8	*8*
Interest expense on above deposits	13	*11*

There were no other transactions that would be required to be shown under the provisions of the Companies Act 1985. None of the key management personnel 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.

All employees, including key management personnel, are entitled to season ticket loans (repayable monthly over ten months) and may choose to take personal loans (for periods up to three years at an interest rate of 3%) as part of their remuneration package. Staff may also apply for a medium-term loan secured by collateral at base rate plus 1%. All staff, including Governors and Executive Directors are entitled to banking facilities, including current and interest-bearing deposit accounts, at the Bank of England. Current accounts pay interest at commercial rates dependent upon the level of the balance.

Key management remuneration

	2006	*2005*
	£000	*£000*
Salaries and short-term benefits	1,907	*1,859*
Post-employment benefits	1,248	*984*
	3,155	***2,843***

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

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 2006 a charge of £2 million (*2005 £2 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 Funds during the year was £84 million (*2005 £7 million*). There were no other material transactions between the Bank and the pension schemes during the year to 28 February 2006. The balances on accounts held with the Bank were £1 million (*2005 £3 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.

30 CONTINGENT LIABILITIES AND COMMITMENTS

a 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. 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.

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 £147 million (*2005 £143 million*).

b Capital commitments

Contracts for capital expenditure authorised by Members of Court and outstanding at 28 February 2006 amounted to less than £1 million (*2005 less than £1 million*).

c Operating lease commitments — minimum lease payments

	2006		*2005*	
	Land and buildings	**Computer and other equipment**	*Land and buildings*	*Computer and other equipment*
	£000	**£000**	*£000*	*£000*
At the year end, minimum lease payments under non-cancellable operating leases were:				
Expiring within one year	–	793	*195*	*1,123*
Between one and five years	152	187	*151*	*364*
Expiring in five or more	517	–	*505*	*–*
	669	**980**	***851***	***1,487***

The Bank leases the premises occupied by its regional agencies.

31 FINANCIAL RISK MANAGEMENT

a Strategy in using financial instruments

By their nature, the Bank's activities involve the use of financial instruments, including derivatives.

With the exception of the note issue liabilities and the associated assets, all of the Bank's financial instruments are booked to Banking Department. The activities involving and the strategies employed in using these instruments are as follows:

- The implementation of monetary policy and the management of sterling banking system liquidity, in normal and stressed conditions. In its open market operations, the Bank adjusts its stock of sterling money market lending to offset the impact of flows on settlement balances held at the Bank. The principal short-term assets held by the Bank, ie advances to the banking system through open market operations, yield the MPC official rate. As set out on in the *Annual Report* (pages 19 to 20), the Bank's Money Market Reform programme will change the way in which the Bank implements monetary policy in the sterling money markets. The new system is due to be introduced on 18 May.

- The holding of foreign exchange reserves, financed with the proceeds of Euro Note and Euro Bill issuance programmes. The Bank uses cross-currency, foreign exchange and interest rate swaps and futures, when managing its interest rate and exchange rate exposures in this operation. Under arrangements introduced in May 1997, the Bank may undertake foreign currency intervention in support of its monetary policy objectives. Such operations would give rise to exchange rate exposures on the Bank's balance sheet. No such operations were conducted during the financial year. The Bank may use derivatives, particularly foreign exchange swaps, for managing liquidity in the context of monetary policy operations, but has not done so in the past year.

- Supporting the Bank's provision of payment services in sterling and euros. Foreign exchange assets are used to generate liquidity to meet the Bank's obligations as a member of the TARGET wholesale payment system.

- Supporting the Bank's provision of banking services to central banks, HM Government and others. The bank uses foreign exchange swaps to manage exchange rate exposures arising from these services.

- The maintenance of the value of the Bank's capital and reserves, and the generation of income to pay for policy-related functions, including reinvestment of cash ratio deposits. The Bank holds a portfolio of high-quality medium and long-term securities, which currently notionally matches a proportion of its capital and reserves.

- Maintaining the technical capability and know-how to conduct special operations to support financial stability.

Notes to the Banking Department Financial Statements continued

b Credit risk

The Bank is exposed to credit risk, which is the risk of loss arising from the failure of a borrower, issuer, counterparty or customer to meet its financial obligations to the Bank. Credit risk arises when the Bank provides liquidity to financial institutions via open market operations as part of monetary policy implementation; intraday in the Bank's provision of liquidity to facilitate the operation of the sterling and euro high-value payment systems (CHAPS and CHAPS euro); and the securities settlement system, CREST; and elsewhere in the Bank's management of its balance sheet, for example in the investment of the Bank's own funds and in the course of the banking services it provides to its customers.

The Bank's Credit Ratings Advisory Committee (CRAC), chaired by the Head of the Markets Directorate's Risk Management Division, reviews regularly the creditworthiness of market issuers, counterparties and customers to whom the Bank may take credit exposures. CRAC makes recommendations to the Executive Director for Markets, who is responsible for decisions on limits. CRAC is supported by a credit risk analysis team.

In providing liquidity via open market operations and, intraday, via the Bank's operation of wholesale payment systems, credit risk is managed by dealing with counterparties that meet appropriate credit and functional criteria, and by ensuring that exposures are fully collateralised (with appropriate margin) by high quality, marketable securities. These exposures are monitored on a regular basis, and additional margin is called as required.

Credit risk on the securities held by the Bank is managed by holding only high quality securities, issued chiefly by governments, government agencies and supranational organisations.

Banking services are provided to the United Kingdom government and other public sector entities, overseas central banks, international institutions, infrastructure providers, Bank staff and pensioners and other customers. The Bank may incur credit exposures to its customers in the course of providing such services. The reinvestment of customer deposits may also give rise to credit exposures.

Geographical concentration of assets and liabilities

The Bank undertakes its operations in the United Kingdom. It does, however, accept deposits from overseas central banks. An analysis of the Bank's assets and liabilities by geographical area is given below:

	2006	*2005*
Assets	**£m**	*£m*
United Kingdom	13,865	*12,579*
Rest of Europe	9,845	*8,386*
Rest of the World	1,043	*1,304*
	24,753	***22,269***

	2006	*2005*
Liabilities	**£m**	*£m*
United Kingdom	13,148	*12,001*
Rest of Europe	554	*1,044*
Rest of the World	11,051	*9,224*
	24,753	***22,269***

c Market risk

The Bank is exposed to market risk, principally through changes in the relative interest rates received on its assets and paid on its liabilities. Limited exposure may also be incurred to changes in exchange rates (see section (d)) and to shifts in general market conditions, such as the liquidity of asset markets. The Bank manages its exposures to market risk in ways that are consistent with the underlying purposes for which its operations are conducted. This is largely done through measuring and limiting the Value at Risk (VaR) of mismatched positions. VaR estimates, to a confidence level of 99%, the potential loss that might arise if existing positions were unchanged for ten business days, given the historical volatility of the returns on different assets, and the historical correlation between those returns.

d Currency risk

The Bank may take currency risk in the context of foreign exchange intervention, though no such operations were conducted in the year. Additionally, limited other foreign currency exposures may arise in the course of balance sheet management. However, the majority of these potential exposures are matched, including through the use of foreign exchange and currency swaps, and residual foreign exchange exposures are hedged on a regular basis. The tables below present the Bank's exposure to foreign currency exchange rate movements at the year end on a financial accounting rather than full market value basis.

As at year ended 28 February 2006

	Foreign currency monetary assets and liabilities				
	US dollar	Euro	Yen	Other	Total
	£m	£m	£m	£m	£m
Assets					
Cash and balances with central banks	1	176	1	1	179
Loans and advances to banks	3,253	6,799	–	893	10,945
Financial assets at fair value through profit or loss	128	4,666	869	–	5,663
Derivative financial instruments	(49)	1,221	(880)	–	292
Available for sale securities	–	1	–	211	212
Other assets	40	12	–	18	70
Total assets	**3,373**	**12,875**	**(10)**	**1,123**	**17,361**
Liabilities					
Deposits from central banks	4,467	1,357	–	1,039	6,863
Deposit from banks and building societies	63	170	–	2	235
Other deposits	51	81	–	–	132
Derivative financial instruments	27	84	(13)	–	98
Financial liabilities at fair value through profit or loss	–	6,512	–	–	6,512
Other liabilities	65	8	–	19	92
Total liabilities	**4,673**	**8,212**	**(13)**	**1,060**	**13,932**
Net balance sheet position	**(1,300)**	**4,663**	**3**	**63**	**3,429**
Notional values of derivatives	**1,353**	**(4,637)**	**(2)**	**148**	**3,138**

Included in assets denominated in US dollars are advances equivalent to £960 million (*2005 £1,172 million*) which are matched by foreign exchange swaps so that no significant foreign currency exposure arises.

Notes to the Banking Department Financial Statements *continued*

Included in assets denominated in euro are advances equivalent to £2,208 million (*2005 £704 million*) which are matched by foreign exchange swaps 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 £2,433 million (*2005 £2,510 million*) which are matched by foreign exchange swaps so that no significant foreign currency exposure arises. These advance, 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 currency, foreign exchange and interest rate swaps. The fair value of forward leg amounts of euro-yen swaps matching these securities are shown as derivative positions in the table above. The notional values are also shown to indicate net currency exposures.

As at year ended 28 February 2005

	Foreign currency monetary assets and liabilities				
	US dollar £m	*Euro £m*	*Yen £m*	*Other £m*	*Total £m*
Assets					
Cash and balances with central banks	*–*	*112*	*–*	*6*	*118*
Loans and advances to banks	*3,484*	*5,893*	*3*	*785*	*10,165*
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*
Total assets	***3,639***	***10,777***	***1,138***	***812***	***16,366***
Liabilities					
Deposits from central banks	*4,233*	*1,581*	*–*	*928*	*6,742*
Deposit by banks and building societies	*167*	*144*	*–*	*–*	*311*
Other deposits	*82*	*14*	*–*	*1*	*97*
Debt securities in issue	*–*	*5,914*	*–*	*–*	*5,914*
Other liabilities	*75*	*775*	*362*	*12*	*1,224*
Total liabilities	***4,557***	***8,428***	***362***	***941***	***14,288***
Net balance sheet position	***(918)***	***2,349***	***776***	***(129)***	***2,078***
Off balance sheet items	***918***	***(2,324)***	***(776)***	***131***	***(2,051)***

Exchange rates

The following exchange rates for the principal currencies were used to translate foreign currency assets and liabilities for reporting purposes:

	28 February 2006	*28 February 2005*
Euro/Sterling	0.6808	*0.6893*
Sterling/United States Dollar	1.7545	*1.9257*
Sterling/Yen	203.22	*200.83*

e Cash flow and interest rate risk

For accounting purposes, cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates, both in the United Kingdom and abroad. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The exposures to both kinds of interest rate risk arise in the course of the Bank's activities.

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 to assess broadly the sensitivity of the Bank's net income to interest rate movements. The assets and liabilities in the table are included at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

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

As at 28 February 2006

	Up to 1 month	1–3 months	3–12 months	1–5 years	Over 5 year	Cash ratio deposits	Derivatives at fair value	Non-interest bearing	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Assets									
Cash and balances with central banks	185	–	–	–	–	–	–	–	185
Loans and advances to banks	6,796	1,756	6,002	–	–	–	–	–	14,554
Financial assets at fair value through profit or loss	13	–	1,323	4,327	–	–	–	–	5,663
Derivative financial instruments	–	–	–	–	–	–	291	–	291
Loans and advances to customers	1	–	1	2	2	–	–	–	6
Available for sale securities	–	–	176	1,317	2,212	–	–	–	3,705
Investments in group undertakings	–	–	–	–	–	–	–	18	18
Intangible assets	–	–	–	–	–	–	–	17	17
Property, plant and equipment	–	–	–	–	–	–	–	193	193
Investment properties	–	–	–	–	–	–	–	26	26
Deferred tax assets	–	–	–	–	–	–	–	12	12
Other assets	–	–	–	–	–	–	–	83	83
Total assets	**6,995**	**1,756**	**7,502**	**5,646**	**2,214**	**–**	**291**	**349**	**24,753**
Liabilities									
Deposits from central banks	3,650	2,050	5,680	–	–	–	–	–	11,380
Deposits from banks and building societies	986	–	–		–	2,222	–	–	3,208
Other deposits	1,070	10	–	–	1	–	–	–	1,081
Derivative financial instruments	–	–	–	–	–	–	98	–	98
Financial liabilities at fair value through profit or loss	614	1,220	1,967	2,711	–	–	–	–	6,512
Other liabilities	–	–	–	–	–	–	–	354	354
Current tax liabilities	–	–	–	–	–	–	–	17	17
Retirement benefit obligations	–	–	–	–	–	–	–	371	371
Total liabilities	**6,320**	**3,280**	**7,647**	**2,711**	**1**	**2,222**	**98**	**742**	**23,021**
Interest rate repricing gap	**675**	**(1,524)**	**(145)**	**2,935**	**2,213**	**(2,222)**	**193**	**(393)**	**1,732**
Cumulative gap	**675**	**(849)**	**(994)**	**1,941**	**4,154**	**1,932**	**2,125**	**1,732**	

Notes to the Banking Department Financial Statements continued

As at 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								
Cash and balances with Central Banks	122	–	–	–	–	–	–	122
Loans and advances to banks and customers	8,076	1,065	2,777	2	1	351	632	12,904
Debt securities	124	–	838	3,253	2,092	–	1,941	8,248
Loans and advances to customers	–	–	–	5	–	–	–	5
Equity investments and participating interest	–	–	–	–	–	40	–	40
Investments in group undertakings	–	–	–	–	–	18	–	18
Intangible assets	–	–	–	–	–	15	–	15
Property, plant and equipment	–	–	–	–	–	214	–	214
Investment properties	–	–	–	–	–	8	–	8
Deferred tax assets	–	–	–	–	–	123	–	123
Other assets	151	–	26	52	–	110	233	572
Total assets	**8,473**	**1,065**	**3,641**	**3,312**	**2,093**	**879**	**2,806**	**22,269**
Liabilities								
Deposits from central banks	5,977	1,057	2,760	–	–	23	–	9,817
Deposits from banks and building societies	332	–	–	–	–	2,011	–	2,343
Customer accounts	892	5	–	–	–	393	–	1,290
Debt securities in issue	1,856	615	1,377	2,066	–		–	5,914
Other liabilities	471	–	12	9	–	161	341	994
Current tax liabilities	–	–	–	–	–	14	–	14
Retirement benefit obligations	–	–	–	–	–	506	–	506
Shareholders' funds: less funding to the actively managed portfolio	(1,856)	(615)	–	–	–	–	2,471	–
Total liabilities	**7,672**	**1,062**	**4,149**	**2,075**	**–**	**3,108**	**2,812**	**20,878**
Interest rate repricing gap	**801**	**3**	**(508)**	**1,237**	**2,093**	**(2,229)**	**(6)**	**1,391**
Cumulative gap	**801**	**804**	**296**	**1,533**	**3,626**	**1,397**	**1,391**	

The table below summarises the average effective interest rate for monetary financial instruments not carried at fair value through profit or loss for the year ended 28 February 2006:

	%
Assets	
Cash and balances with central banks	0.00
Loans and advances to banks	3.46
Loans and advances to customers	4.45
Liabilities	
Deposits from central banks	3.96
Deposits from banks and building societies	3.63
Cash ratio deposits	0.00
Other deposits	1.87

f Liquidity risk

The Bank is exposed to daily calls from overnight deposits, current accounts, maturing deposits and from margin and other calls on cash-settled derivatives. In sterling, such movements are reflected in the daily money market liquidity requirements and are taken into account in setting the level of market assistance provided by the Bank via open market operations. In foreign currency, in addition to holding appropriate cash balances, the Bank manages liquidity through cash flow matching and the use of foreign currency swaps; the Bank also holds a portfolio of liquid foreign currency securities.

The table below analyses the Bank's assets and liabilities at the balance sheet date into relevant maturity groupings based on the remaining period to the contractual maturity date. This table, which is required under IAS 30 (Disclosures in the Financial Statements of Banks and Similar Institutions) is however not well suited to the Bank which as the central bank is the ultimate source of sterling liquidity.

Notes to the Banking Department Financial Statements continued

As at 28 February 2006

	Up to 1 month £m	1–3 months £m	3–12 months £m	1–5 years £m	Over 5 years £m	Cash ratio deposits £m	Total £m
Assets							
Cash and balances with central banks	185	–	–	–	–	–	185
Loans and advances to banks	6,796	1,756	6,002	–	–	–	14,554
Financial assets at fair value through profit or loss	13	–	1,323	4,327	–	–	5,663
Derivative financial instruments	124	44	82	41	–	–	291
Loans and advances to customers	1	–	1	2	2	–	6
Available for sale securities	–	–	176	1,317	2,212	–	3,705
Investments in group undertakings	–	–	–	–	18	–	18
Intangible assets	–	–	–	–	17	–	17
Property, plant and equipment	–	–	–	–	193	–	193
Investment properties	–	–	–	–	26	–	26
Deferred tax assets	–	–	–	–	12	–	12
Other assets	22	22	39	–	–	–	83
Total assets	**7,141**	**1,822**	**7,623**	**5,687**	**2,480**	**–**	**24,753**
Liabilities							
Deposits from central banks	3,650	2,050	5,680	–	–	–	11,380
Deposits from banks and building societies	986	–	–	–	–	2,222	3,208
Other deposits	1,070	10	–	–	1	–	1,081
Derivative financial instruments	79	1	15	3	–	–	98
Financial liabilities at fair value through profit or loss	614	1,220	1,967	2,711	–	–	6,512
Other liabilities	91	31	95	130	7	–	354
Current tax liabilities	–	–	17	–	–	–	17
Retirement benefit obligations	–	–	–	–	371	–	371
Total liabilities	**6,490**	**3,312**	**7,774**	**2,844**	**379**	**2,222**	**23,021**
Net liquidity gap	**651**	**(1,490)**	**(151)**	**2,843**	**2,101**	**(2,222)**	**1,732**
Cumulative gap	**651**	**(839)**	**(990)**	**1,853**	**3,954**	**1,732**	

As at 28 February 2005

	Up to 1 month £m	1–3 months £m	3–12 months £m	1–5 years £m	Over 5 years £m	Cash ratio deposits £m	Total £m
Total assets	*8,392*	*1,837*	*4,878*	*4,651*	*2,511*	*–*	*22,269*
Total liabilities	*5,561*	*4,900*	*5,849*	*2,075*	*492*	*2,001*	*20,878*
Net liquidity gap	*2,831*	*(3,063)*	*(971)*	*2,576*	*2,019*	*(2,001)*	*1,391*
Cumulative gap	*2,831*	*(232)*	*(1,203)*	*1,373*	*3,392*	*1,391*	

g Fair values of financial assets, financial liabilities and derivatives

As at 28 February 2006

The table below compares the carrying value and fair value of financial assets and financial liabilities not presented on the balance sheet at their fair value. Bid prices are used to estimate fair value of assets, whereas offer prices are used to estimate fair value of liabilities.

		Carrying value 2006 £m	Fair value 2006 £m
Financial assets			
Cash and balances with other central banks	(i)	185	185
Loans and advances to banks	(ii)	14,554	14,700
Loans and advances to customers	(iii)	6	5
		14,745	**14,890**
Financial liabilities			
Deposits from central banks	(i)	11,380	11,273
Deposits from banks and building societies	(iv)	3,208	3,179
Other deposits	(v)	1,081	1,081
		15,669	**15,533**

(i) Represents advances and deposits from central banks in sterling, other currencies and gold.

(ii) This balance includes 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.

(iii) This balance represents advances to individuals.

(iv) Cash Ratio Deposits are computed on the basis of banks' and building societies' eligible liabilities and are interest free. Other deposits in both euro and sterling are held by banks for operational reasons connected with the settlement systems. Cash deposits in US dollars are taken from counterparties as collateral for certain currency swaps.

(v) Other deposits contains balances on HM Government accounts.

As at 28 February 2005

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.

Notes to the Banking Department Financial Statements continued

	2005 Book value £m	2005 Fair value £m
Assets		
Non-sterling investment securities	3,289	3,347
Other non-sterling securities	1,941	1,941
Sterling debt securities	3,018	3,150
	8,248	**8,438**
Liabilities		
Euro Notes	3,443	3,457
Euro Bills	2,471	2,471
	5,914	**5,928**

32 CASH FLOW STATEMENT

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

	2006 £m	2005 £m
Profit after provisions and before tax	99	106
Adjustments		
Decrease in prepaid expenses	1	1
(Increase)/decrease in accrued expenses	(10)	4
Depreciation	12	11
Effect of other deferrals and accruals on cash flow	501	191
Net inflow/(outflow) from Euro Notes	690	(14)
Net outflow from Euro Bills	(53)	(49)
Net inflow of euro deposits	87	71
Net (decrease)/increase in foreign currency deposits	(39)	3,448
Net increase in other deposits	2,186	2,162
Net increase in foreign currency advances to banks (including swaps)	(2,345)	(2,636)
Net increase in advances to banks and customers (including reverse repurchase agreements)	–	6
Purchase of non-sterling investment securities	(2,011)	(1,819)
Redemption of non-sterling investment securities	1,789	1,749
Purchase of other non-sterling securities	(1,778)	(222)
Redemption of other non-sterling securities	572	778
Purchase of sterling debt securities	(380)	(170)
Redemption of sterling debt securities	119	79
Net decrease in other assets	1	–
Total adjustments	**(658)**	**3,590**
Net cash (outflow)/inflow from operating activities	**(559)**	**3,696**

ii Analysis of cash balances

	At 1 March 2005 £m	Cash flows £m	**At 28 February 2006 £m**
Cash and balances with other central banks (note 9)	*122*	63	185
Loans and advances to banks (note 10)	*6,266*	(646)	5,620
	6,388	**(583)**	**5,805**

	At 1 March 2004 £m	Cash flows £m	At 28 February 2005 £m
Cash and balances with other central banks (note 9)	*102*	*20*	*122*
Loans and advances to banks (note 10)	*2,628*	*3,638*	*6,266*
	2,730	***3,658***	***6,388***

iii Stock of liquidity

For the purposes of the cash flow statement, cash and cash equivalents comprise cash in hand and amounts due from banks within three months from the date of acquisition. This definition, which is required by IAS 7 (Cash Flow Statements), covers the Bank's stock of liquidity for operational purposes, but is not well suited to the Bank which as the central bank is the ultimate source of sterling liquidity. These include advances to the money market and banks, and reverse repurchase agreements which are regarded as a pool of assets for these purposes. The allocation of this liquidity between the components depends upon prevailing market conditions.

33 RECONCILIATION OF EQUITY AND PROFIT BETWEEN OLD AND NEW BASIS OF ACCOUNTING

The Bank reported under UK GAAP in its previously published financial statements for the year ended 28 February 2005. The analysis below shows a reconciliation of net assets and profit as reported under UK GAAP as at 28 February 2005 to the revised net assets and profit as reported in these financial statements. In addition there is a reconciliation of net assets under UK GAAP to the new basis (as set out in note 2) at the transition date for the Bank, which was 1 March 2004. As the transition to IAS 32 and 39 took place at 1 March 2005 a reconciliation of net assets is also given at this date.

Notes to the Banking Department Financial Statements continued

a Reconciliation of profit before tax

	Notes	Year ended 28 February 2005 £m
Profit before tax as reported previously		100
Adjustments to profit before tax:		
Recognition of intangible asset (net of amortisation)	(iii)	3
Reclassification of property sold under long lease	(iv)	(1)
Retirement benefits	(viii)	4
Profit before tax as now reported		**106**

b Reconciliation of profit after tax

	Notes	Year to 28 February 2005 £m
Profit after tax as reported previously		38
Adjustments to profit before tax:		
Recognition of intangible assets (net of amortisation)	(iii)	3
Reclassification of property sold under long lease	(iv)	(1)
Retirement benefits	(viii)	4
		6
Tax effect of the above		(2)
		4
Payment to HM Treasury no longer included in income statement		38
Tax thereon		(11)
		27
Profit after tax as now reported		**69**

c Reconciliation of equity at 1 March 2004 (date of transition to new reporting basis)

	Notes	Previous accounting basis £m	Effect of reclassification £m	Effect of change in measurement £m	New accounting basis £m
Cash and balances with other central banks	(i)	–	98	–	98
Cash	(i)	5	(5)	–	–
Items in course of collection	(ii)	305	(305)	–	–
Due from European central bank in respect of TARGET	(i)	86	(86)	–	–
Loans and advances to banks and customers	(i),(ii)	5,891	(5,891)	–	–
Loans and advances to banks	(ii)	–	6,176	–	6,176
Debt securities		8,343	–	–	8,343
Loans and advances to customers	(ii)	–	13	–	13
Equity investments and participating interest		29	–	–	29
Investments in group undertakings		18	–	–	18
Intangible assets	(iii)	–	–	12	12
Property, plant and equipment (formerly tangible fixed assets)	(iv)	208	–	6	214
Prepayments, accrued income and other assets	(v)	628	(628)	–	–
Deferred tax assets	(v)	–	36	2	38
Other assets	(v)	–	592	–	592
Total assets		**15,513**	**–**	**20**	**15,533**
Deposits from central banks		4,684	–	–	4,684
Deposits from banks and building societies	(vi)	2,059	3	–	2,062
Other deposits (formerly customer accounts)	(vi)	1,027	(3)	–	1,024
Debt securities in issue		5,739	–	–	5,739
Other liabilities	(vii)	444	(196)	–	248
Current tax liabilities	(vii)	–	10	–	10
Retirement benefit obligations	(vii),(viii)	–	186	37	223
Total liabilities		**13,953**	**–**	**37**	**13,990**
Total assets less total liabilities		**1,560**	**–**	**(17)**	**1,543**
Capital		15	–	–	15
Retained earnings (formerly profit and loss account)	(iii),(iv),(viii)	1,387	–	(21)	1,366
Other reserves (formerly revaluation reserves)	(iv)	158	–	4	162
Total equity		**1,560**	**–**	**(17)**	**1,543**

Notes to the Banking Department Financial Statements continued

d Reconciliation of equity at 28 February 2005

	Notes	Previous accounting basis £m	Effect of reclassification £m	Effect of change in measurement £m	New accounting basis £m
Cash and balances with other central banks	(i)	–	122	–	122
Cash	(i)	4	(4)	–	–
Items in course of collection	(ii)	351	(351)	–	–
Due from European central bank in respect of TARGET	(i)	112	(112)	–	–
Loans and advances to banks and customers	(i),(ii)	12,564	(12,564)	–	–
Loans and advances to banks	(ii)	–	12,904	–	12,904
Debt securities		8,248	–	–	8,248
Loans and advances to customers	(ii)	–	5	–	5
Equity investments and participating interest		40	–	–	40
Investments in group undertakings		18	–	–	18
Intangible assets	(iii)	–	–	15	15
Property, plant and equipment (formerly tangible fixed assets)	(iv)	196	–	18	214
Investment properties	(iv)	–	–	8	8
Prepayments, accrued income and other assets	(v)	609	(609)	–	–
Deferred tax assets	(v)	–	38	85	123
Other assets	(v)	–	572	–	572
Total assets		**22,142**	**1**	**126**	**22,269**
Deposits from central banks		9,817	–	–	9,817
Deposits from banks and building societies	(vi)	2,341	2	–	2,343
Other deposits (formerly customer accounts)	(vi)	1,292	(2)	–	1,290
Debt securities in issue		5,914	–	–	5,914
Other liabilities	(iv),(vii)	1,180	(195)	9	994
Current tax liabilities	(vii)	–	14	–	14
Retirement benefit obligations	(vii),(viii)	–	182	324	506
Total liabilities		**20,544**	**1**	**333**	**20,878**
Total assets less total liabilities		**1,598**	**–**	**(207)**	**1,391**
Capital		15	–	–	15
Retained earnings (formerly profit and loss account)	(iii),(iv),(viii)	1,432	–	(219)	1,213
Other reserves (formerly revaluation reserve)	(iv)	151	–	12	163
Total equity		**1,598**	**–**	**(207)**	**1,391**

e Reconciliation of equity at 1 March 2005 (date of full adoption of IAS 39 and IAS 32)

	Notes	Balance at 28 February 2005 £m	Effect of reclassification £m	Effect of change in measurement £m	New accounting basis £m
Cash and balances with other central banks		122	–	–	122
Loans and advances to banks		12,904	–	(1)	12,903
Financial assets at fair value through profit or loss	(ix),(xi)	–	5,274	7	5,281
Debt securities	(ix),(xi)	8,248	(8,248)	–	–
Derivative financial instruments	(xii)	–	365	–	365
Loans and advances to customers		5	–	–	5
Equity investments and participating interest	(ix)	40	(40)	–	–
Available for sale securities	(ix),(x)	–	3,116	346	3,462
Investments in group undertakings		18	–	–	18
Intangible assets		15	–	–	15
Property, plant and equipment (formerly tangible fixed assets)		214	–	–	214
Investment properties		8	–	–	8
Deferred tax assets		123	–	–	123
Other assets	(ix),(xii)	572	(467)	–	105
Total assets		**22,269**	**–**	**352**	**22,621**
Deposits from central banks		9,817	–	–	9,817
Deposits from banks and building societies		2,343	–	–	2,343
Other deposits		1,290	–	–	1,290
Derivative financial instruments	(xii)	–	59	(3)	56
Debt securities in issue	(xiii)	5,914	(5,914)	–	–
Financial liabilities at fair value through profit or loss	(xiii)	–	5,922	10	5,932
Other liabilities	(xii),(xiii)	994	(67)	–	927
Current tax liabilities		14	–	–	14
Deferred tax liabilities		–	–	105	105
Retirement benefit obligations		506	–	–	506
Total liabilities		**20,878**	**–**	**112**	**20,990**
Total assets less total liabilities		**1,391**	**–**	**240**	**1,631**
Capital		15	–	–	15
Retained earnings (formerly profit and loss account)	(ix),(x),(xii),(xiii)	1,213	–	(6)	1,207
Other reserves — available for sale	(ix),(x)	–	–	246	246
Other reserves — revaluation		163	–	–	163
Total equity		**1,391**	**–**	**240**	**1,631**

Notes to the Banking Department Financial Statements continued

Explanation of reconciling items between old and new basis of accounting

(i) Cash of £4 million (*2004 £5 million*) and the balances due from the European Central Bank in respect of TARGET of £112 million (*2004 £86 million*) have been combined into cash and balances with other central banks. Balances with other central banks of £6m (*2004 £7 million*) previously included in loans and advances to customers have also been included in this category.

(ii) Loans and advances to banks and customers of £12,553 million (*2004 £5,871 million*) and items in course of collection of £351 million (*2004 £305 million*) have been reclassified as loans and advances to banks of £12,904 million (*2004 £6,176 million*). The remaining balances within loans and advances to banks and customers have been transferred to central banks: £6 million (*2004 £7 million*) and loans and advances to customers: £5 million (*2004 £13 million*).

(iii) Certain computer software previously charged as expenditure in the income statement has been recognised as an intangible asset to be amortised over its useful life. Assets with an amortised cost of £15 million at 28 February 2005 (*2004 £12 million*) have been recognised in the balance sheet together with a deferred tax effect of £5 million (*2004 £4 million*) included in retained earnings. An amount of £3 million has been included within profit or loss for the year ended 28 February 2005.

(iv) The basis of valuation of properties for IFRS is different to that under UK GAAP. The resulting increase in valuation of £18 million (*2004 £6 million*) net of deferred tax of £6 million (*2004 £2 million*) has been taken to the revaluation reserve.

The Bank has granted a long lease over one of its freehold properties. The granting of this lease has previously been recognised as a disposal and the gain taken to profit. Under IFRS such proceeds must be recognised over the life of the lease. As a consequence, £8 million has been included in investment properties, resulting in a deferred tax liability of £2 million and £9 million treated as deferred income with a deferred tax asset of £3 million. £1 million profit on sale was taken to profit or loss for the year ended 28 February 2005.

(v) Prepayments, accrued income and other assets of £609 million (*2004 £628 million*) have been reclassified as £572 million (*2004 £592 million*) to other assets and £38 million (*2004 £36 million*) to deferred tax assets.

(vi) Items in course of settlement of £2 million (2004 £3 million) previously reported in other deposits have been reclassified within deposits from banks and building societies.

(vii) Retirement benefits £182 million (*2004 £186 million*) and current taxation £14million (*2004 £10 million*) previously included in other liabilities, are shown separately on the face of the balance sheet.

(viii) Accounting for pensions and other post-retirement benefits in accordance with IAS 19 is different to the previous basis adopted by the Bank, being SSAP 24. Under IAS 19, the net pension surplus or deficit, as measured under the standard, are recognised in the Bank's balance sheet as an asset or liability. Returns on pension assets, pension costs and interest on pension liabilities are recognised in the income statement. The Bank has recognised an aggregate deficit of £223 million at 1 March 2004 and £506 million at 28 February 2005 as liabilities in its balance sheet. This represents an increase in the liability by £283 million (*2004 £37 million*) which has been reflected in retained earnings with an associated deferred tax asset of £85 million (*2004 £37 million*). An amount of £4 million has been included within profit or loss for the year ended 28 February 2005.

(ix) In accordance with IAS 39, assets formerly classified as debt securities of £8,248 million have been reclassified as financial instruments at fair value through profit or loss of £5,230 million and securities available for sale of £3,018 million. Equity investments of £40 million have also been classified as assets available for sale. Other assets of £44 million have been reclassified to financial instruments at fair value through the profit or loss and £58 million reclassified in respect of available for sale securities.

(x) In accordance with IAS 39, the Bank's holdings of British and other sterling-denominated bonds and some equity holdings, were classified with effect from 1 March 2005 as available for sale investments and shown at fair value in the balance sheet. The difference between fair value and the previous carrying value (which was on the basis of amortised cost) amounting to £127 million at 28 February 2005 and an associated deferred tax liability of £100 million have been taken to the available for sale reserve in equity with the exception of £4 million which is due to the difference in the basis of recognising interest income. This has been taken to profit via the income statement. In addition under IAS 39, equity investments and participating interest were reclassified as available for sale securities. The difference between the fair value and the previous carrying value (cost) was £215 million.

(xi) In accordance with IAS 39, with effect from 1 March 2005 the Bank has designated its holdings of non-sterling investment securities and other non-sterling securities as financial assets at fair value through profit or loss. The difference between fair value and the previous carrying value, amounting to a £7 million increase in assets has been included in retained earnings and an associated deferred tax liability of £3 million has been recognised in the balance sheet. The previous carrying value of £5,230 million comprised £3,289 million at amortised cost and £1,941 million at fair value.

(xii) In accordance with IAS 39, derivatives held by the Bank have to be carried at fair value with movements in the fair value being taken to the income statement. Previously, as described in note 12, derivatives with a net positive book value of £133 million were carried at amortised cost. Derivatives with a positive value of £233 million and negative value of £38 million were carried at fair value. At 1 March 2005 a decrease in derivative liabilities of £3 million was recognised in the balance sheet. A deferred tax liability of £1 million has been recognised accordingly. The net gain of £6 million has been included in retained earnings. Accrued interest and fair value of derivatives amounting to £233 million (Euro Bills), £122 million (Euro Notes) and £11 million (customer banking) previously reported in other assets has been reclassified to derivative financial instruments. Accrued interest and the fair value of derivatives amounting to £36 million (Euro Bills) and £23 million (Euro Notes) previously reported in other liabilities has been reclassified to derivative financial instruments.

(xiii) In accordance with IAS 39, with effect from 1 March 2005 the Bank has designated its debt securities in issue, comprising Euro Notes and Euro Bills as financial liabilities at fair value through profit or loss. The difference between fair value and the previous carrying value, amounting to £10 million less deferred tax of £3 million has been included in retained earnings. In addition accrued interest of £8 million previously reported in other liabilities has been reclassified to financial liabilities.

34 DATE OF APPROVAL

The Members of Court approved the financial statements on pages 50 to 109 on 11 May 2006.

Issue Department

Account for the period ended 28 February 2006

	Note	2006 £m	*2005 £m*
Income and profits:			
Securities of, or guaranteed by, the British Government		619	*641*
Other securities and assets		1,124	*1,022*
		1,743	***1,663***
Expenses:	2		
Cost of production of Bank notes		28	*31*
Cost of issue, custody and payment of Bank notes		14	*12*
Other expenses		3	*2*
		45	***45***
Payable to HM Treasury		**1,698**	***1,618***

Statement of balances: 28 February 2006

	Notes	2006 £m	*2005 £m*
Assets			
Securities of, or guaranteed by, the British Government	3	13,370	*14,059*
Other securities and assets including those acquired under reverse repurchase agreements	4	23,550	*21,361*
Total assets		**36,920**	***35,420***
Liabilities			
Notes issued:			
In circulation	5	36,914	*35,416*
In Banking Department		6	*4*
Total liabilities		**36,920**	***35,420***

M A King Governor
J R Lomax Deputy Governor
T J Parker Chairman of NedCo
P A C Smout Finance 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 quarterly and are stated in the balance sheet at that valuation. Longer-dated stocks are valued at mid-market prices. Bills are valued at an average price approximating to market price. No bills or longer-dated stocks were held at 28 February 2006.

c If the revaluation of securities shows a net gain it is included in income. A deficit is not taken against income but is settled by a transfer from the National Loans Fund. No such deficits occurred in the year to 28 February 2006 (*2005: £9 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

	2006	*2005*
	£m	*£m*
Treasury Bills	–	*689*
Ways and Means advance to the National Loans Fund	13,370	*13,370*
	13,370	***14,059***

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

	2006	*2005*
	£m	*£m*
Commercial bills	–	*29*
Deposit with Banking Department	53	*74*
Reverse repurchase agreements	23,497	*21,258*
	23,550	***21,361***

5 NOTES IN CIRCULATION

	2006	*2005*
	£m	*£m*
£5	1,052	*1,055*
£10	5,591	*5,670*
£20	22,690	*21,649*
£50	6,510	*6,082*
Other notes (a)	1,071	*960*
	36,914	***35,416***

(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. As at the year end 28 February 2006, the assets of Issue Department had the following repricing period profile; repricing in up to one month (£30.9 billion), repricing in greater than one but less than three months (£3.6 billion), repricing in greater than three but less than six months (£1.5 billion) and repricing in greater than six but less than twelve months (£0.9 billion). In the prior year, all assets (£35.4 billion) had a repricing profile of one month 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 110 to 112 on 11 May 2006.

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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 3009; and *Bank of England: Monetary and Financial Statistics* on 020 7601 4014.