Banking Department
Income Statement for the year to 29 February 2008

	Note	2008 £m	2007 £m
Profit before tax	4	197	191
Corporation tax net of tax relief on payment to HM Treasury	7	(36)	(25)
Profit for the year attributable to the shareholder		**161**	**166**

The notes on pages 56 to 91 are an integral part of these financial statements.

Balance Sheet as at 29 February 2008

	Note	2008 £m	2007 £m
Assets			
Cash and balances with other central banks	9	226	99
Loans and advances to banks	10	63,745	31,552
Financial assets designated at fair value through profit or loss	11	3,742	3,298
Derivative financial instruments	12	122	121
Loans and advances to customers	13	4	5
Available for sale securities	14	3,852	3,755
Investments in group undertakings	15	–	13
Intangible assets	16	19	19
Property, plant and equipment	17	217	247
Investment properties	18	26	26
Current tax assets		–	31
Retirement benefit assets	26	404	–
Other assets	20	534	197
Total assets		**72,891**	**39,363**
Liabilities			
Deposits from central banks	21	18,594	11,519
Deposits from banks and building societies	22	24,872	20,778
Other deposits	23	21,297	1,083
Financial liabilities designated at fair value through profit or loss	24	3,377	3,328
Derivative financial instruments	12	727	72
Other liabilities	25	1,367	450
Current tax liabilities		10	–
Deferred tax liabilities	19	170	30
Retirement benefit liabilities	26	184	243
Total liabilities		**70,598**	**37,503**
Equity			
Capital	27	15	15
Retained earnings	28	1,821	1,417
Other reserves	28	457	428
Total equity attributable to the shareholder		**2,293**	**1,860**
Total equity and liabilities		**72,891**	**39,363**

On behalf of the Governor and Company of the Bank of England:

M A King	Governor
C R Bean	Deputy Governor
T J Parker	Chairman of NedCo
W R Jones	Finance Director

The notes on pages 56 to 91 are an integral part of these financial statements.

Statement of Recognised Income and Expense
for the year to 29 February 2008

	Note	2008 £m	2007 £m
Profit for the year attributable to the shareholder		161	166
Other recognised income and expense:			
Revaluation of available for sale securities		122	(93)
Revaluation of properties	17	(32)	55
Actuarial gains on retirement benefits	26	408	74
Tax (charged)/credited on items directly to equity	7	(145)	9
Net income recognised in equity	28	353	45
Total recognised income and expense for the period attributable to the shareholder		**514**	**211**

The notes on pages 56 to 91 are an integral part of these financial statements.

Cash Flow Statement for the year to 29 February 2008

	Note	2008 £m	2007 £m
Cash flows from operating activities			
Profit before taxation		197	191
Adjustments between operating profit and net cash inflow/(outflow):			
Amortisation of intangible assets	16	6	5
Depreciation of property, plant and equipment	17	8	7
(Profit)/loss on sale of available for sale securities	14	(3)	2
Dividends received	4	(14)	(10)
Pension expense	26	37	38
Cash contributions to retirement schemes		(92)	(92)
Increase/(decrease) in deferred income		6	(75)
(Increase)/decrease in net income accruals		(270)	244
Net decrease from Euro Notes		(1,489)	(628)
Net decrease from Euro Bills		–	(2,467)
Net increase from US Dollar Bonds		1,017	–
Net increase in deposits		31,384	17,711
Net increase in advances		(49,039)	(1,170)
Net redemption/sale of financial assets at fair value through profit or loss		30	2,176
Purchase of available for sale securities		(260)	(379)
Redemption of available for sale securities		223	246
Net movement in financial derivatives		653	144
Other non-cash items		969	(85)
Net cash (outflow)/inflow from operating activities before tax		**(16,637)**	**15,858**
Corporation tax paid		–	(22)
Net cash from operating activities		**(16,637)**	**15,836**
Cash flows from investing activities			
Dividends received	4	14	10
Proceeds from sale of property, plant and equipment		–	5
Purchase of intangible assets		(6)	(7)
Purchase of property, plant and equipment		(8)	(7)
Net cash from investing activities		**–**	**1**
Cash flows from financing activities			
Payment to HM Treasury under Section 1 (4) of the Bank of England Act 1946		(83)	(47)
Net cash from financing activities		**(83)**	**(47)**
Net (decrease)/increase in cash and cash equivalents		**(16,720)**	**15,790**
Cash and cash equivalents at 1 March	32	21,595	5,805
Cash and cash equivalents at 29 February	32	**4,875**	**21,595**

The notes on pages 56 to 91 are an integral part of these financial statements.

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 1.

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 statements of account of the Issue Department are given on pages 92 to 94, 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 net income of the Issue Department is paid over to HM Treasury. The Banking Department comprises all other activities of the Bank. The post-tax profits of Banking Department are effectively 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 the financial statements of the Banking Department 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 financial statements of the Banking Department have been prepared in accordance with the measurement and recognition requirements of the International Financial Reporting Standards (IFRS) as adopted by the EU ('adopted IFRS').

Adopted IFRS and the Companies Act have 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 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 financial statements of the Banking Department disclose less detail of certain elements than would be required under either adopted IFRS or the Companies Act. 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 and Cash Flow Statement.
- Business segments.
- Contingent liabilities and guarantees.
- Information on credit risk.

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 financial assets and financial liabilities that are held at fair value through profit or loss.

The following new IFRS standard has been applied in 2007/08 except insofar as the Bank considers disclosures inappropriate to its functions:

- IFRS 7 (Financial Instruments: Disclosures)

There is no material financial impact of applying this standard and amendments and the financial statements have been updated to include the new disclosure requirements, as appropriate.

A number of new standards, amendments and interpretations to existing standards have been published. Whilst these maybe relevant to the Bank, they are only effective for periods beginning on or after 1 January 2008 and have not been adopted early. The relevant standards include:

- Amendments within IAS 1 (Presentation of Financial Statements) (effective for annual periods beginning on or after 1 January 2009).

The application of this standard in the 2007/08 accounts would not have had any financial impact on the financial statements as it is only concerned with the presentation and format of the primary statements and notes.

The Bank will continue to review amendments to IAS 1 to determine the effect on its future financial reporting.

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 financial statements of the Banking Department 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 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, such as discounted cash flow models. Generally 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 of 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.

Notes to the Banking Department Financial Statements continued

2 Summary of significant accounting policies continued

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 on initial recognition. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument, and any revisions to these estimates are recognised in the Income Statement. The calculation includes all fees paid or received between parties, transaction costs and all other premiums or discounts.

f Fees and commission income
Fees and commissions other than those associated with financial instruments are recognised 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. The Bank does not currently have any assets classified as held to maturity.

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 at inception assets matching the Bank's issued Euro Notes, US Dollar Bonds and Euro Bills as at fair value through profit or loss. This designation eliminates, or significantly reduces, inconsistencies that would otherwise arise from measuring assets and liabilities on a different basis. The relevant assets and liabilities together with the related derivatives are managed together and internal reporting is evaluated on a fair value basis.

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.

iv Available for sale
All other financial assets are designated as '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.

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 directly attributable transaction costs for financial assets not carried at fair value through the Income Statement. Financial assets that are available for sale and financial assets at fair value through profit or loss are subsequently carried at fair value. 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.

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 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, while the securities subject to repo remain on the balance sheet. Securities purchased under agreements to resell ('reverse repos') are recorded as loans and advances to banks or customers. 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 retained in the financial statements. 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.

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.

j Impairment of financial assets

i Assets carried at amortised cost

At each balance sheet date the Bank assesses 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 asset's original effective interest rate adjusted for changes in benchmark rates for assets with variable rates. The carrying amount of the asset is reduced and the amount of the loss is recognised in the Income Statement. A loan is normally written off, either partially or in full, when there is no realistic prospect of recovery of the principle amount and, for a collateralised loan, when the proceeds from realising the security have been received.

ii Available for sale financial assets

At each balance sheet date the Bank assesses 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. If, in a subsequent period, the fair value of a debt instrument designated as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, the impairment loss is reversed though the Income Statement. Impairment losses recognised in the Income Statement on equity instruments are not reversed through the Income Statement except on realisation.

Notes to the Banking Department Financial Statements continued

2 Summary of significant accounting policies continued

k Intangible assets

Intangible assets consist of computer software and the costs associated with the development of software for internal use. 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 are recognised as intangible assets. 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 programs are recognised as an expense when incurred. Intangible assets are tested for impairment annually. Intangible assets are also subject to an impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

l Property, plant and equipment

Full professional valuations of the Bank's properties are carried out every three years with subsequent additions included at cost, and provisions made for depreciation as explained below. In the intervening years a desk-top review is performed by the professional valuers. If this shows a significant change to the value at which these properties are carried an adjustment is made to the carrying value as detailed below.

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 reliably measured. All other repairs and maintenance are charged to the Income Statement during the financial period in which they are incurred.

Any surplus arising on revaluation is recognised directly in a revaluation reserve within equity, except to the extent that the surplus reverses a previous revaluation deficit on the same asset recognised in the Income Statement, in which case the credit is to the Income Statement.

The depreciable amount of a revalued asset is based on its revalued amount. The revaluation surplus is not transferred to retained earnings until the asset's ultimate disposal.

Land is not depreciated. Depreciation on other property, plant and equipment is charged on a straight-line basis:

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 depreciation 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. Where properties have subsequently been classified as investment properties, the carrying value at the date of reclassification as investment properties has been deemed to be cost. At present, investment properties mainly comprise freehold land and accordingly are not depreciated.

n Leases

i As lessee

The leases entered into by the Bank are primarily 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.

Where property, plant and equipment have been financed by lease agreements under which substantially all the risks and rewards of ownership are transferred to the Bank, they are treated as if they have been purchased outright and classified as finance leases. Finance leases are capitalised at the commencement of the lease at the lower of the present value of the minimum lease payments or the fair value of the leased asset. Finance charges payable are recognised over the period of the lease based on the interest rate implicit in the lease to give a constant periodic rate of return.

ii As lessor

Where the Bank has granted long leases on property, the land element is treated as an operating lease. Operating lease income is recognised on a straight-line basis.

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, amounts due from banks and short-term government securities.

p Financial liabilities

i Deposits

Deposits are non-derivative financial liabilities with fixed or determinable receipts that are not quoted in an active market. They arise when the Bank receives money or services directly from a counterparty with no intention of trading the payable. Deposits held are carried at amortised cost using the effective interest rate method.

ii Financial liabilities at fair value through profit or loss

At the end of the year these liabilities included a three-year note denominated in euros (Euro Note) and a three-year bond denominated in US dollars (US Dollar Bond), which was issued during the year as part of the Bank's new annual medium-term issuance programme. 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 these liabilities are taken to the Income Statement. These liabilities are managed together with certain bonds as detailed in note g (i) above and have been designated at fair value through profit or loss to eliminate or significantly reduce recognition inconsistencies.

If the Bank buys any of its own securities as part of its operations, these are removed from the Balance Sheet.

iii Cash Ratio Deposits

Cash Ratio Deposits are taken to fund certain activities of the Bank in accordance with the Bank of England Act 1998 and are interest free. As such deposits are held on a statutory basis they fall outside the scope of IAS 39 and are held at cost.

q Provisions

Provisions are recognised in respect of restructuring, redundancy and legal claims arising from past events where it is probable 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 a non-contributory defined-benefit pension scheme providing defined benefits based on final and career average pensionable pay. The assets of the scheme are held separately by the Bank in independent trustee-administered funds.

Notes to the Banking Department Financial Statements continued

2 Summary of significant accounting policies continued

The asset recognised in the Balance Sheet in respect of the defined-benefit pension scheme is the fair value of the scheme's assets less the present value of the defined-benefit obligation at the balance sheet date less the fair value of the scheme's 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 comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what actually occurred), as well as the effects of changes in actuarial assumptions. Actuarial gains and losses 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. Any net defined benefit surplus is limited to the benefit that is available to the Bank.

The Bank also provides other post-retirement benefits, principally healthcare for certain pensioners, which are accounted for on a similar basis to that used to account for pension obligations.

s Current and deferred tax

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 the Income Statement in accordance with paragraph 52 (b) of IAS 12. The amount of tax relief in the current year is £24 million (2007: £25 million).

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 or substantially 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, 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 and losses can be utilised.

Deferred tax related to fair value remeasurement of available for sale 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 current or deferred gain or loss when and if realised.

t Bank capital

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

Under Section 1 (4) of the Bank of England Act 1946, subsequent to the end of each year HM Treasury receives payments of half the post-tax profits unless the Bank and HM Treasury agree otherwise. The payments are deductible for corporation tax and charged to equity in the year to which they relate on the basis as agreed at the end of the relevant year.

u 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.

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.

a 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 (a), which includes relevant sensitivity analysis). Members of Court consider the assumptions used by the actuaries in their calculations to be appropriate for this purpose.

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 generally been established by discounting expected future dividends reflecting the benefit that the Bank derives from the investments (see note 14 (b), which includes relevant sensitivity analysis).

4 Profit before tax

	Note	**2008 £m**	2007 £m
Income includes			
Charges for services to HM Government (including charges to the Issue Department in respect of the Note Issue)		70	64
Other operating income		70	48
Including: rental income from investment properties		2	2
Dividend income		14	10
Expenses includes			
Staff costs	5	124	123
Legal fees(1)		2	2
Depreciation of property, plant and equipment	17	8	7
Software expenditure		7	6
Amortisation of intangible assets	16	6	5
Operating lease rentals — property		1	1
— equipment		1	1
Other administrative expenses(1)		49	50
Repayment of BCCI legal fees(2)		–	(74)

(1) Excludes costs in relation to assistance provided to Northern Rock (see note 29).
(2) On 7 June 2006, a full and final settlement was agreed on costs in the proceedings brought by the liquidators of BCCI against the Governor and Company of the Bank of England. The Bank retained £73.6 million paid to it by the liquidators in November 2005.

5 Staff costs

	Note	**2008 £m**	2007 £m
Wages and salaries		79	77
Social security costs		8	8
Pension and other post-retirement costs:			
Funded pension schemes	26	25	19
Unfunded redundancy provisions	26	3	9
Other unfunded pension schemes	26	1	1
Other post-retirement benefits	26	8	9
		124	**123**

Notes to the Banking Department Financial Statements continued

5 Staff costs continued

Average number of employees

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

	2008	2007
Governors and other members of Executive Team	9	9
Managers and analysts	625	635
Other staff	1,118	1,145
	1,752	**1,789**

The number of persons employed by the Bank at the end of the year was 1,753, of which 1,542 were full-time and 211 were part-time (2007: 1,744; of which 1,555 full-time and 189 part-time).

6 Auditor's remuneration

	2008 £000	2007 £000
Audit fees		
Fees relating to current year	252	210
Fees relating to prior year	45	–
Fees payable to the auditor for other services provided to the Bank:		
Tax services	533	400
All other services(1)	4,164	30
	4,994	**640**

(1) In 2007/08, the Bank recovered accounting fees of £4,084,000 from third parties, £3,970,000 of which was in relation to a forensic accounting investigation into the loss to the Bank of seigniorage income at Loomis Cash Management, a subsidiary of Securitas AB.

7 Taxation

The tax charged within the Income Statement is made up as follows:

	2008 £m	2007 £m
Current United Kingdom corporation tax	19	19
Prior year corporation tax	–	(8)
Deferred tax — current year	17	13
— prior year	–	1
Tax charge on profits	**36**	**25**

The tax charge within the Income Statement differs from the amount calculated at the basic rate of tax on the profit for the year as follows:

	2008 £m	2007 £m
Profit before tax	197	191
Tax calculated at rate of 30% (2007: 30%)	59	57
Tax relief on payment to HM Treasury	(24)	(25)
Prior year items	–	(7)
Change in tax rate to 28%	1	–
Total tax charge for the period	**36**	**25**

The tax charged/(credited) directly to equity comprises:

	2008 £m	2007 £m
Current United Kingdom corporation tax	22	(37)
Deferred tax	123	28
Tax charged/(credited) directly to equity	**145**	**(9)**

The tax charged/(credited) is attributable as follows:

	2008 £m	2007 £m
Revaluation of available for sale assets	37	(27)
Related to properties	(1)	(4)
Actuarial gain on retirement benefits	122	22
Change in tax rate to 28%	(13)	–
Tax charged/(credited) directly to equity	**145**	**(9)**

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

	2008 £m	2007 £m
Payable 4 April	39	41
Payable 3 October	42	42
	81	**83**

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. 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 29 February 2008. The payments are deductible for corporation tax in the year to which the payments relate. The overall effect is that the Bank and HM Treasury will normally share Banking Department's post-tax profits equally. The sum paid on 4 April was based on provisional figures. The balance is payable on 3 October.

9 Cash and balances with other central banks

	2008 £m	2007 £m
Due from the European Central Bank in respect of TARGET (a)	218	97
Other balances with central banks (b)	8	2
	226	**99**

a Due from the European Central Bank in respect of TARGET

This balance, denominated in euro, was €285 million at 29 February 2008 (2007: €143 million) and 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 at the close of business each day. The balance with the European Central Bank bears interest at rates related to the monetary conditions in the euro area.

Notes to the Banking Department Financial Statements continued

9 Cash and balances with other central banks continued

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

	2008 £m	2007 £m
Items in course of collection from banks	374	441
Reverse repurchase agreements	39,564	25,374
Other loans and advances to banks	23,807	5,737
	63,745	**31,552**

These balances include advances and reverse repurchase agreements arising as part of the Bank's open market operations, as well as advances matching the 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 on movements in the Bank's balance sheet described in the published 'Framework for the Bank of England's Operations in the Sterling Money Markets' (January 2008).

At 29 February 2008 loans and advances to banks included cash and cash equivalents of £4.7 billion (2007: £21.5 billion). The Bank held securities as collateral for reverse repurchase agreements with a fair value at 29 February 2008 of £47.3 billion (2007: £26.7 billion). The Bank is permitted to sell, repo or re-pledge some of these assets to third parties but had not done so at 29 February 2008 (2007: £nil).

In respect of the loans to Northern Rock the Bank holds as security certain residential mortgages and a fixed and floating charge as detailed in note 29.

11 Financial assets designated at fair value through profit or loss

	2008 £m	2007 £m
Listed foreign government securities	2,437	2,121
Other listed securities	1,305	1,177
	3,742	**3,298**

The holdings of foreign government and other foreign securities are funded by the Bank's issuance of medium-term securities (note 24) and held in two distinct portfolios. The first portfolio comprises the Bank's foreign exchange reserves. As at 29 February 2008 this portfolio was financed by a $2 billion three-year bond — the first bond in the Bank's annual programme of syndicated foreign currency issuance, the assets in the portfolio are denominated in US dollars and euros. In steady state, the foreign currency reserves funded by this programme will total £3 billion equivalent. The second portfolio, denominated in euro, is held to enable the Bank to provide liquidity in the TARGET settlement system (note 9). These securities, amounting to £1,483 million at 29 February 2008 (2007: £2,282 million), and principally financed by the €3 billion Euro Note maturing on 27 January 2009, were used to generate this liquidity via intraday repurchase contracts.

12 Derivative financial instruments

The Bank uses the derivative instruments described below. The purpose of these is to minimise the currency and interest rate exposures on the Bank's portfolio of financial assets and financial liabilities. They may also be used as an instrument in monetary policy transactions.

Interest rate and bond futures are exchange-traded contractual obligations to receive or pay a net amount based on changes in interest rates or to buy or sell a financial instrument on a future date at a specified price. The credit risk is limited because changes in the price of the contracts are settled daily with the exchange.

Cross currency interest rate swaps, forward exchange contracts, 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. An exchange of principal occurs for cross currency interest rate swaps and forward exchange contracts, 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 will take collateral if the replacement cost of all transactions with the counterparty breaches relevant thresholds.

The notional amounts of derivative financial instruments provide a basis for comparison with other 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 prices relative to their terms. The aggregate contractual or notional amount of derivative financial instruments outstanding, the extent to which instruments have moved into profit 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.

a As at 29 February 2008

	Contract notional amount £m	Fair values Assets £m	Liabilities £m
Derivatives related to non-sterling investment securities and Euro Note liabilities			
Cross currency interest rate swaps — positive value	210	28	–
— negative value	632	–	(51)
	842	**28**	**(51)**
Other derivative instruments			
Forward exchange contracts — positive value	3,738	94	–
— negative value	15,205	–	(676)
	18,943	**94**	**(676)**
Total recognised derivative assets/(liabilities)		**122**	**(727)**

At 29 February 2008 the Bank held cash of £5 million as collateral for derivative financial instruments (note 22).

Notes to the Banking Department Financial Statements continued

12 Derivative financial instruments continued

b As at 28 February 2007

	Contract notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Derivatives related to non-sterling investment securities and Euro Note liabilities			
Cross currency interest rate swaps — positive value	609	70	–
— negative value	–	–	–
	609	**70**	**–**
Other derivative instruments			
Forward exchange contracts — positive value	3,463	51	–
— negative value	3,672	–	(72)
	7,135	**51**	**(72)**
Total recognised derivative assets/(liabilities)		**121**	**(72)**

At 28 February 2007 the Bank held cash of £45 million as collateral for derivative financial instruments (note 22).

13 Loans and advances to customers

	2008 £m	2007 £m
Term loans	4	5

14 Available for sale securities

	2008 £m	2007 £m
Debt securities at fair value		
British Government securities listed on a recognised UK exchange	2,520	2,445
Other sterling securities listed on a recognised exchange	1,021	1,049
	3,541	3,494
Unlisted equity investments at fair value	311	261
	3,852	**3,755**

A profit of £3 million (2007: loss of £2 million) on the sale of available for sale securities was transferred to the Income Statement during 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 functions 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 reflect the price that a knowledgeable willing party would pay in an arms length transaction.

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 29 February 2008 the holding represents 8.7% (2007: 8.7%) of the issued share capital. The investment has been valued on a dividend yield basis providing a value of £307 million at the year end. A discount rate of 7% was used. Increasing the discount rate by 1% would deflate the valuation by £66 million, whilst decreasing the discount rate by 1% would inflate the valuation by £119 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 represents 1.36% (2007: 1.36%) of the European Central Bank's paid up share capital. As a non-euro area central bank the Bank is required to contribute 7% (2007: 7%) of its subscribed share capital. If the United Kingdom were to participate in the European and Monetary Union a further contribution would be required and the Bank's paid-up share would then amount to 13.9% (2007: 13.9%) of the European Central Bank's share capital. Contributions are non-refundable and no dividends are expected. The fair value of the holding has therefore been assessed as zero.

15 Investments in group undertakings

	2008 £m	2007 £m
Cost of shares in group undertakings	**–**	**13**

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 29 February 2008. During the year the Bank recovered £5.6 million (2007: £nil) in excess of its investment. After these recoveries the investment in this company is included in the Bank's balance sheet at 29 February 2008 at £nil (2007: £12.5 million).

b Other group undertakings

The Bank has a number of non-trading subsidiaries, which are wholly owned and incorporated in Great Britain. They are stated in the Bank's balance sheet at an aggregate cost under £1 million. These are:

The Securities Management Trust Ltd	1,000 ordinary shares of £1
Houblon Nominees Ltd	2 ordinary shares of £1
BE Museum Ltd	10,000 ordinary shares of £1
BE Nominees Ltd	2 ordinary shares of £1
BE Pension Fund Trustees Ltd	2 ordinary shares of £1

The aggregate net assets of these subsidiary companies are £1 million (2007: £1 million) which consist of balances held with the Bank.

Notes to the Banking Department Financial Statements continued

16 Intangible assets

Intangible assets comprise computer software costs capitalised.

	2008 £m	2007 £m
Cost		
At 1 March	32	26
Additions	6	7
Disposals	–	(1)
At 29 February	**38**	**32**
Accumulated amortisation		
At 1 March	13	9
Charge for the year	6	5
On disposals	–	(1)
At 29 February	**19**	**13**
Net book value at 1 March	19	17
Net book value at 29 February	**19**	**19**

17 Property, plant and equipment

For the year to 29 February 2008	Freehold land and buildings £m	Equipment* £m	Total £m
Cost or valuation			
At 1 March 2007	234	47	281
Additions	6	4	10
Revaluation of properties	(36)	–	(36)
At 29 February 2008	**204**	**51**	**255**
Accumulated depreciation			
At 1 March 2007	–	34	34
Charge for the year	4	4	8
Written back on revaluation	(4)	–	(4)
At 29 February 2008	**–**	**38**	**38**
Net book value at 1 March 2007	234	13	247
Net book value at 29 February 2008	**204**	**13**	**217**

* Equipment at 29 February 2008 includes £7 million held under finance leases.

For the year to 28 February 2007	Freehold land and buildings £m	Equipment* £m	Total £m
Cost or valuation			
At 1 March 2006	193	38	231
Additions	1	10	11
Disposals	(5)	(1)	(6)
Revaluation of properties	45	–	45
At 28 February 2007	**234**	**47**	**281**
Accumulated depreciation			
At 1 March 2006	8	30	38
Charge for the year	2	5	7
Disposals	–	(1)	(1)
Written back on revaluation	(10)	–	(10)
At 28 February 2007	**–**	**34**	**34**
Net book value at 1 March 2006	185	8	193
Net book value at 28 February 2007	**234**	**13**	**247**

* Equipment at 28 February 2007 includes £6 million held under finance leases.

The figures for freehold land and buildings reflect independent professional valuations on a market value basis at 29 February 2008 by NB Real Estate, members of the Royal Institution of Chartered Surveyors (RICS). These valuations have been incorporated into the financial statements and were performed in accordance with the RICS Appraisal and Valuation manual.

18 Investment properties

Investment properties are held at cost. Where properties have been reclassified, the carrying value at the date of reclassification has been deemed cost. The investment properties substantially relate to freehold land on which the Bank has granted leases to third parties in excess of 100 years.

	2008 £m	2007 £m
Cost		
At 1 March	26	26
At 29 February	**26**	**26**

The fair value of investment properties at 29 February 2008 was £43 million (2007: £43 million). This value represents the deferred consideration on the lease remaining at 29 February 2008 plus the estimated reversionary value of the properties at the end of the lease terms, as provided by NB Real Estate (see note 17).

The Bank leases land and buildings to third parties. At the year end, minimum lease receivables under cancellable operating leases expiring in five or more years were £0.1 million per annum (2007: £0.1 million), increasing to £0.3 million after five years (2007: £0.3 million).

Notes to the Banking Department Financial Statements continued

19 Deferred tax liabilities

Deferred tax is calculated on all temporary differences under the liability method using an effective tax rate of 28% (2007: 30%).

The movement on the deferred tax account is as follows:

	Note	2008 £m	2007 £m
Deferred tax			
Net (liability)/asset at 1 March		(30)	12
Profit and loss charge	7	(17)	(14)
Other recognised income and expense	7	(123)	(28)
Net liability at 29 February		**(170)**	**(30)**

	2008 £m	2007 £m
Deferred tax liability relates to:		
Property revaluation	1	–
Available for sale securities	(106)	(106)
Pensions and other post-retirement benefits	(69)	62
Other provisions	4	14
	(170)	**(30)**

20 Other assets

	2008 £m	2007 £m
Short-term debtors and other assets[1]	**534**	**197**

(1) This includes £10 million (2007: nil) of accrued expenses that will be recharged to Issue Department.

21 Deposits from central banks

	2008 £m	2007 £m
Repayable on demand	1,164	938
Term deposits	17,430	10,581
	18,594	**11,519**

22 Deposits from banks and building societies

	Note	2008 £m	2007 £m
Items in course of settlement		2	3
Repayable on demand:			
Sterling		21,526	17,999
Euro		32	106
Repurchase agreements		371	57
Collateral for derivatives	12	5	45
Cash Ratio Deposits		2,936	2,568
		24,872	**20,778**

Cash deposits in US dollars are taken from counterparties as collateral for certain derivatives (see note 12).

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.

The Bank pledged assets with a fair value at 29 February 2008 of £364 million (2007: £57 million) as collateral for repurchase agreements.

23 Other deposits

	2008 £m	2007 £m
Deposit by Issue Department	19,211	49
Public deposits:		
Current accounts repayable on demand	1,587	900
Term deposits	10	5
Other deposits repayable on demand	489	129
	21,297	**1,083**

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

Notes to the Banking Department Financial Statements continued

24 Financial liabilities designated at fair value through profit or loss

All changes in fair values since 1 March 2007 are considered attributable to changes in prevailing interest rates.

	2008 £m	2007 £m
Financial liabilities designated at fair value through profit or loss		
Foreign Currency Bond Issuance Programme (a)	1,097	–
Euro Notes (b)	2,280	3,328
	3,377	**3,328**

a Foreign Currency Bond Issuance Programme

As part of the Bank's new annual medium-term security issuance programme the Bank issued a $2 billion three-year dollar bond maturing on the 22 March 2010. Under the programme securities will be issued on an annual basis and in steady state the programme will total £3 billion equivalent. The position at 29 February 2008 was as follows:

	2008		2007	
	£m Fair value	$m Nominal	£m Fair value	$m Nominal
Total amount issued	1,097	2,000	–	–
Liabilities to third parties	**1,097**	**2,000**	**–**	**–**

Of the above liabilities to third parties, £nil (2007: £nil) fall due within one year.

b Euro notes

As at 29 February 2008 a €3 billion legacy Euro Note, maturing on 27 January 2009, remained outstanding.
An additional 10% of this issue, plus any residual arising from rounding down the auction bids, is held by the Bank and may be made available for sale and repurchase transactions with market makers in the old Euro Note programme.
The positions at 29 February 2008 and 28 February 2007 were as follows:

	2008		2007	
	£m Fair value	€m Nominal	£m Fair value	€m Nominal
Total amount issued	2,508	3,300	3,661	5,500
Held by the Bank	(228)	(300)	(333)	(500)
Liabilities to third parties	**2,280**	**3,000**	**3,328**	**5,000**

Of the above liabilities to third parties £2,280 million (2007: £1,334 million) fall due within one year.

25 Other liabilities

	2008 £m	2007 £m
Payable to HM Treasury	81	83
Items in course of settlement	890	38
Short-term creditors, other liabilities and deferred income	396	329
	1,367	**450**

26 Retirement benefits

The Bank operates a non-contributory defined-benefit pension scheme providing benefits based on final and career average pensionable pay. The assets of the scheme are held separately by the Bank in an independent trustee-administered fund. 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 for funding purposes at intervals of no more than three years by an independent qualified actuary, with interim reviews in the intervening years. The latest valuation for funding purposes 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 future earnings increases on the accrued liabilities being included in normal future service contribution.

The valuation as at 28 February 2005	£m
Value of Fund assets	1,580
Actuarial value of scheme liabilities	(1,879)
Scheme deficit	**(299)**
Funding level	84%
Future service contribution rate	41.3%

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%).

The Bank and the Pension Fund Trustees, 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.

Excluded from the contribution rate is a 3% cost of administration and other services set out in note 29 (d).

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 assets/(liabilities) in the Balance Sheet		**2008 £m**	2007 £m	2006 £m	2005 £m
Funded pension scheme	(a)	404	(22)	(147)	(301)
Unfunded post-retirement benefits:					
Redundancy provisions	(b)	(61)	(70)	(68)	(64)
Pension schemes	(c)	(6)	(6)	(5)	(4)
Other post-retirement benefits	(d)	(117)	(145)	(151)	(137)
		220	**(243)**	**(371)**	**(506)**

Notes to the Banking Department Financial Statements continued

26 Retirement benefits continued

Pension expense recognised in the Income Statement		2008 £m	2007 £m
Funded pension scheme	(a)	25	19
Unfunded post-retirement benefits:			
Redundancy provisions	(b)	3	9
Pension schemes	(c)	1	1
Other post-retirement benefits	(d)	8	9
Total pension expense		**37**	**38**

Gains recognised in the Statement of Recognised Income and Expense		2008 £m	2007 £m
Funded pension scheme	(a)	367	60
Unfunded post-retirement benefits:			
Redundancy provisions	(b)	7	2
Other unfunded pension schemes	(c)	1	–
Other post-retirement benefits	(d)	33	12
		408	**74**

a Funded pension scheme

As described above, the Bank operates a non-contributory defined-benefit pension scheme providing benefits based on final and career average pensionable pay. The assets of the scheme are held separately by the Bank in an independent trustee-administered fund. During the year the main pension scheme and the Court pension scheme were amalgamated. Further details are given in the Remuneration Report on page 34 of the *Annual Report*. References to the Fund or Scheme in this note refer to the amalgamated fund or the two separate schemes as appropriate.

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:

	2008 %	2007 %
Inflation rate (RPI)	2.8	2.8
Discount rate	5.9	4.9
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 assumption for life expectancy for the scheme assumes that a male member reaching 60 in 2008 will live for 27 years (2007: 27 years) and a female member 30 years (2007: 28 years), and a male member reaching 60 in 2018 will live for 28 years (2007: 28 years) and a female member 31 years (2007: 29 years).

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with both current industry experience and the actual experience of the relevant schemes.

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

	2008			2007		
	Long-term rate of return expected* **%**	**Value** **£m**	**Percentage of total value** **%**	Long-term rate of return expected %	Value £m	Percentage of total value %
Equities	–	43	1.9	7.2	897	44.9
Bonds	4.1	2,049	92.5	4.6	922	46.1
Properties	–	76	3.4	6.0	121	6.0
Cash and other assets	4.1	48	2.2	4.6	60	3.0
Total market value of investments	**4.1**	**2,216**	**100.0**	**5.7**	**2,000**	**100.0**

For the purposes of IAS 19, the asset values stated are at the balance sheet date. Market values of scheme's 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 surplus in the scheme as calculated on an IAS 19 basis. The assumptions used do not necessarily reflect the investment return that may be achieved.

* Substantially all of the equity and property assets were being disposed of subsequent to the year end and the proceeds invested in gilts. The expected long-term rate of return on all assets is thus shown as the expected yield for gilts.

	2008 **£m**	2007 £m	2006 £m	2005 £m
Present value of defined-benefit obligations	(1,812)	(2,022)	(2,055)	(1,905)
Assets at fair value	2,216	2,000	1,908	1,604
Defined-benefit asset/(liability)	**404**	**(22)**	**(147)**	**(301)**

The deficit in the schemes before taxation, on an IAS 19 basis in 2007 has become a surplus in 2008. This change has arisen as a result of a higher discount rate being applied to the obligations, the increase in the value of the assets in the scheme and additional contributions made to the scheme.

A +/- 0.1% change to the discount rate would change the surplus on the pension scheme by +/- £26 million. 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 £52 million.

The Bank expects to pay contributions of £82 million in the forthcoming year (2007: £84 million).

Components of pension expense in the Income Statement	**2008** **£m**	2007 £m
Current service cost	33	36
Past service cost	–	3
Interest cost	98	93
Expected returns on assets	(100)	(113)
Curtailment benefits	(6)	–
Total pension expense	**25**	**19**

Notes to the Banking Department Financial Statements continued

26 Retirement benefits continued

The decrease in current service costs results primarily from a rise in the discount rate used in the calculation. Costs are calculated based on the discount rate used for the previous year end. Accordingly, the discount rate used for 2008 is 4.9% (2007: 4.6%).

Gains/(losses) recognised in the Statement of Recognised Income and Expense	**2008 £m**	2007 £m
Cumulative actuarial losses recognised at the beginning of the year	(80)	(140)
Actuarial gain on scheme liabilities	241	74
Actuarial gain/(loss) on scheme assets	126	(14)
Cumulative actuarial gains/(losses) recognised at 29 February	**287**	**(80)**

Reconciliation of return on assets	**2008 £m**	2007 £m
Expected return on scheme assets (net of expense)	100	113
Actuarial gain/(loss) on scheme assets	126	(14)
Actual return on scheme assets (net of expense)	**226**	**99**

Reconciliation of present value of defined-benefit obligation	**2008 £m**	2007 £m
Present value of defined-benefit obligation at 1 March	2,022	2,055
Current service cost	33	36
Past service cost	–	3
Interest cost	98	93
Actuarial gain relating to scheme liabilities	(241)	(74)
Benefits paid from scheme	(94)	(91)
Curtailment benefits	(6)	–
Present value of defined-benefit obligation at 29 February	**1,812**	**2,022**

Reconciliation of the fair value of assets	**2008 £m**	2007 £m
Fair value of scheme assets at 1 March	2,000	1,908
Actual return on scheme assets	226	99
Bank contributions	84	84
Benefits paid from scheme	(94)	(91)
Fair value of scheme assets at 29 February	**2,216**	**2,000**

Experience gains and losses	**2008 £m**	2007 £m	2006 £m	2005 £m
Experience (loss)/gain on defined-benefit obligation	(29)	(16)	20	30
Experience gain/(loss) on scheme assets	126	(14)	195	62

b Redundancy schemes

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)).

	2008 £m	2007 £m	2006 £m	2005 £m
Unfunded defined-benefit liability	**(61)**	**(70)**	**(68)**	**(64)**

Components of redundancy scheme expense in the Income Statement	**2008 £m**	2007 £m
Past service cost	–	6
Interest cost	3	3
Total redundancy scheme expense	**3**	**9**

Losses recognised in the Statement of Recognised Income and Expense	**2008 £m**	2007 £m
Cumulative actuarial losses recognised at beginning of year	(11)	(13)
Actuarial gain on scheme liabilities	7	2
Cumulative actuarial losses recognised at 29 February	**(4)**	**(11)**

Reconciliation of present value of defined-benefit obligation	**2008 £m**	2007 £m
Present value of defined-benefit obligation at 1 March	70	68
Past service cost	–	6
Interest cost	3	3
Actuarial gain on scheme liabilities	(7)	(2)
Payments	(5)	(5)
Present value of defined-benefit obligation at 29 February	**61**	**70**

Experience gains and losses	**2008 £m**	2007 £m	2006 £m	2005 £m
Experience loss on defined-benefit obligation	(1)	–	(1)	(1)

The Bank expects to make payments of £5 million in the forthcoming year (2007: £5 million).

Notes to the Banking Department Financial Statements continued

26 Retirement benefits continued

c Other unfunded pension scheme

As explained in the Remuneration section of the *Annual Report* on page 34, 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 former 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.

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

	2008 £m	2007 £m	2006 £m	2005 £m
Unfunded defined-benefit liability	**(6)**	**(6)**	**(5)**	**(4)**

Components of other unfunded pension scheme expense in the Income Statement	**2008 £m**	2007 £m
Service and interest cost	1	1
Total other unfunded pension scheme expense	**1**	**1**

Amounts recognised in the Statement of Recognised Income and Expense	**2008 £m**	2007 £m
Cumulative actuarial losses recognised at beginning of year	(1)	(1)
Actuarial gain on scheme liabilities	1	–
Cumulative actuarial losses recognised at end of year	**–**	**(1)**

Reconciliation of present value of defined-benefit obligation	**2008 £m**	2007 £m
Present value of defined-benefit obligation at 1 March	6	5
Service and interest cost	1	1
Actuarial gain on scheme liabilities	(1)	–
Present value of defined-benefit obligation at 29 February	**6**	**6**

Experience gains and losses

For the year ended 29 February 2008, experience losses on the defined-benefit obligation were less than £1 million (2007: less than £1 million, 2006: less than £1 million and 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 purposes of measuring post-retirement benefit liabilities are the same as those used in the IAS 19 valuation of pension scheme liabilities (see (a)). Additionally, for accounting purposes the following assumptions have been made in respect of medical expense inflation:

	2008	2007
Initial medical cost trend	11.5%	13.0%
Ultimate medical cost trend	5.0%	5.0%
Years to ultimate	5	6

	2008 £m	2007 £m	2006 £m	2005 £m
Unfunded defined-benefit liability	**(117)**	**(145)**	**(151)**	**(137)**

Sensitivity analysis provided by the actuaries indicates that a 0.1% decrease in the discount rate would change the deficit on the other post-retirement benefits by £2 million, and a 0.1% increase in the rate of medical claims by £2 million. If mortality rates were adjusted such that individuals were assumed to live for an additional year, the other post-retirement liabilities at the year end would increase by approximately £5 million.

The Bank expects to pay premiums of £3 million in the forthcoming year (2007: £3 million).

Components of other post retirement benefit expense in the Income Statement	**2008 £m**	2007 £m
Service cost	1	2
Interest cost	7	7
Total other post retirement benefit expense	**8**	**9**

Losses recognised in the Statement of Recognised Income and Expense	**2008 £m**	2007 £m
Cumulative actuarial losses recognised at beginning of year	(50)	(62)
Actuarial gain on scheme liabilities	33	12
Cumulative actuarial losses recognised at end of year	**(17)**	**(50)**

Reconciliation of present value of defined-benefit obligation	**2008 £m**	2007 £m
Present value of defined-benefit obligation at 1 March	145	151
Service cost	1	2
Interest cost	7	7
Actuarial gain on scheme liabilities	(33)	(12)
Premiums paid	(3)	(3)
Present value of defined-benefit obligation at 29 February	**117**	**145**

Experience gains and losses	**2008 £m**	2007 £m	2006 £m	2005 £m
Experience gain on defined-benefit obligation	12	7	–	2

Notes to the Banking Department Financial Statements continued

27 Capital

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

28 Capital, retained earnings and other reserves

As at 29 February 2008	Share capital £m	Available for sale reserve £m	Property revaluation reserve £m	Retained earnings £m	Total equity and reserves £m
Balances as at 1 March 2007	15	206	222	1,417	1,860
Profit after tax for the year	–	–	–	161	161
Payment to HM Treasury	–	–	–	(81)	(81)
Other items recognised through the Statement of Recognised Income and Expense	–	90	(31)	294	353
Transfer	–	–	(30)	30	–
As at 29 February 2008	**15**	**296**	**161**	**1,821**	**2,293**

As at 28 February 2007	Share capital £m	Available for sale reserve £m	Property revaluation reserve £m	Retained earnings £m	Total equity and reserves £m
Balances as at 1 March 2006	15	249	163	1,305	1,732
Profit after tax for the year	–	–	–	166	166
Payment to HM Treasury	–	–	–	(83)	(83)
Other items recognised through the Statement of Recognised Income and Expense	–	(66)	59	52	45
Transfer	–	23	–	(23)	–
As at 28 February 2007	**15**	**206**	**222**	**1,417**	**1,860**

The available for sale reserve represents cumulative fair value movements on assets which are still held at the balance sheet date and are classified as available for sale.

The property revaluation reserve represents cumulative fair value movements on properties which are still held at the balance sheet date and are classified as freehold land and buildings.

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 29 February 2008 were:

- provision of banking services, including holding the principal accounts of the Government;
- management of the Exchange Equalisation Account;
- management of the Note Issue; and
- operation of sanctions against specific countries (transferred to HM Treasury on 24 October 2007).

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.

On 22 February 2008 Northern Rock plc, a company to which the Bank had extended loan facilities, was taken into public ownership and became a subsidiary of the Treasury Solicitor acting on behalf of HM Treasury.

The extended loan facilities outstanding with Northern Rock at 29 February 2008 totalled £24.3 billion and comprised:

- A reverse repurchase facility of £2.3 billion at a margin over Bank Rate secured on investment securities;
- Facility A of £4.0 billion at a margin over Bank Rate secured primarily on residential mortgages, but also secured on all Northern Rock's other assets;
- Facility B which represents a secured working capital line with £18.0 billion outstanding at a margin over Bank Rate, after netting a deposit of £0.7 billion, secured against all Northern Rock's assets.

As at 29 February no further drawings were permitted under the reverse repo facility or Facility A.

The Bank has included £26 million of net income in its pre-tax profit for the year relating to facilities granted to Northern Rock, including income from Facility A accruing before 9 October 2007.

The margin over Bank Rate relating to Facilities A and B (PIK interest) from 9 October 2007 will be passed to HM Treasury when received from the company. This has not been recognised in the accounts.

HM Treasury has indemnified the Bank against any loss relating to advances under the working capital line and any unrecovered expenses incurred from 9 October 2007, when the facilities were extended.

Costs amounting to £9.1 million in relation to assistance provided to Northern Rock in the period to 29 February 2008, including £1.6 million charged from HM Treasury, have been recharged to the company.

As at 29 February 2008 these facilities were due to be repaid on the 17 March 2008. This was subsequently extended to 30 April 2008.

The existing Bank of England facilities were amended as of 30 April 2008 and remain on the same financial terms; however, the original Facility B (now B1) was frozen and at the same time a new committed secured revolving loan facility (B2) was made available to the company for contingency purposes until 2010, indemnified by HM Treasury on the same terms as Facility B. The amended facilities (including the committed reserve facility) are subject to appropriate clearance being obtained from the European Commission for state aid, and are secured against the assets of the company.

The Government intends to replace the funding from the Bank by the end of 2008.

In addition to the extended loan facilities, Northern Rock had £1.2 billion of reverse repurchase agreements outstanding at 29 February 2008, of which £0.9 billion were held with the Banking Department and £0.3 billion were held with the Issue Department. A further £0.1 billion deposits were placed with Banking Department at year end.

b Group undertakings
Material transactions and balances between the Bank and its subsidiaries are disclosed in note 15.

c Key management personnel
Members of Court are covered by an indemnity from the Bank, granted in 2000 (see page 6).

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 comprised the Governors, members of the Executive Team and Non-executive Directors. At 29 February 2008, the number of key management personnel was 25 (2007: 26).

Notes to the Banking Department Financial Statements continued

29 Related parties continued

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

	2008 £000	2007 £000
Loans		
Loans outstanding at 1 March	38	39
Loans made during the year	–	24
Loans repaid during the year	(22)	(25)
Loans outstanding at 29 February	**16**	**38**
Interest income earned during the year	1	1
Number of loans outstanding 29 February	4	5

No provisions have been recognised in respect of loans given to related parties (2007: £nil).

	2008 £000	2007 £000
Deposits		
Deposits outstanding at 1 March	401	367
Deposits taken during the year	495	797
Deposits repaid during the year	(563)	(763)
Deposits outstanding at 29 February	**333**	**401**
Interest expense on above deposits	16	15
Number of deposits outstanding at 29 February	7	10

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 a rate of 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	**2008 £000**	2007 £000
Salaries and short-term benefits	2,172	2,140
Post-employment benefits	769	1,256
	2,941	**3,396**

Full information on the remuneration (including pension arrangements) of the Members of Court is given in the Remuneration Report on pages 34 to 36.

d The Bank's pension scheme

The Bank provides the secretariat, investment management and some banking and custodial services to the Bank's funded pension scheme. In the year to 29 February 2008 a charge of £3 million (2007: £2 million) was made for these services. These activities are undertaken on behalf of, and under the supervision of, the trustees of the scheme. The contribution paid to the Fund during the year was £84 million (2007: £84 million). There were no other material transactions between the Bank and the pension scheme during the year to 29 February 2008. At 29 February 2008 the balances on accounts held with the Bank were £25 million (2007: £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.

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 £145 million (2007: £137 million).

b Capital commitments

Contracts for capital expenditure authorised by Members of Court and outstanding at 29 February 2008 amounted to £7 million (2007: £8 million).

c Operating lease commitments — minimum lease payments

	2008		2007	
	Land and buildings £000	**Computer and other equipment £000**	Land and buildings £000	Computer and other equipment £000
At the year-end, minimum annual lease payments under non-cancellable operating leases were:				
Expiring within one year	80	987	314	847
Expiring between one and five years	292	73	117	189
Expiring in five or more years	148	–	329	–
	520	**1,060**	**760**	**1,036**

The Bank leases the premises occupied by its regional agencies.

Notes to the Banking Department Financial Statements continued

31 Financial risk management

The Bank is required to manage financial risks that arise as a consequence of its operations to deliver its policy objectives as well as in the course of managing the Bank's balance sheet. These include interest rate risk, foreign exchange risk, credit risk and liquidity risk.

The Bank's management seek to ensure that effective risk management processes exist for assessing, managing and monitoring risk, within clear risk policies. There are governance arrangements set out in a Balance Sheet Remit approved by the Court of Directors and documented delegated authorities that pass responsibility for financial risk management and oversight of the Bank's operations to the Bank's senior management.

Oversight of the Bank's risk management framework is provided by the Business Risk Committee (BRC) which is responsible for developing, approving and regularly reviewing the Bank's risk framework and risk tolerances as well as monitoring outcomes against risk policies. Reports are produced regularly for the BRC, as well as the Bank's Court of Directors, on compliance with risk policies.

Specialist teams and committees support senior management in ensuring that agreed standards and polices are followed. These include an Asset and Liability Committee; Credit Ratings Advisory Committee; Market Risk Committee and Operational Risk Committee. The Risk Management Division within the Bank's Markets area is also responsible for reporting on the risks faced by the Bank in its operations in financial markets and for monitoring and producing management information on these operations.

a Credit risk

Credit risk is the risk of loss arising from the failure of a borrower, issuer, counterparty or customer to meet its financial obligations to the Bank. The Bank is exposed to credit risk both through direct exposures and through contingent exposures, such as via collateral or insurance contracts. The primary sources of credit risk arise as a result of the Bank providing 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. In addition, the Bank incurs credit risk in connection with any support operations it may undertake.

The Bank's credit risk policies define high level risk parameters under which credit risk is monitored and controlled. Credit exposures are controlled by a system of limits based on internal credit ratings. This system applies to all credit exposures, including intraday exposures, foreign exchange settlement exposures and exposures arising from settling securities trades for customers. Separately, limits exist to control the maximum outright (uncollateralised) exposures to a single entity, as a percentage of the Bank's capital base.

Regular credit assessments are performed on all market counterparties, issuers and customers to which the Bank may be exposed. These are performed both regularly, following a timetable that reflects the risk of the actual or potential exposure and dynamically, in response to market or specific entity conditions. Credit assessments have been performed more frequently during the current year.

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 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 internal credit ratings. CRAC is supported by a credit risk analysis team.

In providing liquidity via routine open market operations and, intraday, via the Bank's operation of wholesale payment systems, credit risk is managed by ensuring that exposures are fully collateralised (with appropriate margin) by high-quality, marketable securities. To address elevated pressures in short-term money markets, the Bank has accepted a wider range of high-quality securities as collateral against funds advanced at the three-month maturity. All such exposures are monitored on a regular basis, and additional margin is called as required. Margin ratios are between 1.0025 and 1.47. In non-routine circumstances, such as the current situation with Northern Rock, the Bank will seek appropriate methods of mitigating credit risk. Additional protection against the increased credit risk exposure arising from advances to Northern Rock includes an indemnity from HM Treasury and a fixed and floating charge over the assets of Northern Rock, as stated in notes 10 and 29.

Credit risk on the securities held by the Bank is managed by holding only high-quality securities in routine circumstances, 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:

	2008 £m	2007 £m
Assets		
United Kingdom	60,964	31,249
Rest of Europe	11,523	7,536
Rest of the World	404	578
	72,891	**39,363**
Liabilities		
United Kingdom	48,619	26,998
Rest of Europe	4,997	1,159
Rest of the World	19,275	11,206
	72,891	**39,363**

b Market risk

Market risk is defined as the risk of loss as a result of changes in market risk factors, these include prices, interest rates, foreign exchange rates, commodity prices and credit spreads. The Bank is exposed to market risk, as a consequence of its operations to deliver its policy objectives as well as in the course of managing the Bank's balance sheet, 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 (c)) and to shifts in general market conditions, such as the liquidity of asset markets.

All market risk is managed within the Bank's Markets directorate, subject to the constraints of the risk tolerances set out in the Bank's market risk standard. This sets out high-level risk management parameters, governance and control frameworks as well as reporting arrangements for key risk indicators.

The Bank manages its exposures to market risk in ways that are consistent with the underlying purposes for which its operations are conducted. The Bank is exposed to interest rate risk principally via the investment of the Bank's capital and Cash Ratio Deposits in high-quality securities with maturity of up to fifteen years. This portfolio is designed to maintain the value of the Bank's capital and generate income to pay for policy-related functions and is bought and held to maturity in normal circumstances. The Bank is also exposed to interest rate risk on funds advanced in its expanded three-month long-term repo open market operations against a wider range of high-quality collateral.

Notes to the Banking Department Financial Statements continued

31 Financial risk management continued

The Bank measures 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.

VaR on the Bank's balance sheet is calculated against all risk factors to which the Bank is exposed. Risk data are captured and reported daily and are further supplemented by the daily monitoring and reporting of interest rate sensitivities as well as total foreign exchange exposures.

Value at Risk	**2008 £m**	2007 £m
At 29 February	44.4	37.8
Average	37.7	37.5

Although VaR is an important tool for measuring market risk, the assumptions on which the model is based do give rise to some limitations, including the following:

- A 99% confidence level does not reflect losses that may occur beyond this level. Even within the model used there is a 1% probability that losses could exceed the VaR.
- A ten-day holding period assumes that it is possible to hedge or dispose of positions within that period. This is a realistic assumption in almost all cases but may not be the situation where there is severe market illiquidity.
- VaR data is calculated on an end-of-day basis and does not reflect exposures that may arise on positions during the day.
- The use of historical data as a basis for determining the possible ranges of outcomes may not always cover all possible scenarios, especially those of an exceptional nature.

c Currency risk

The Bank may take currency risk in the context of foreign exchange intervention, though no such operations were conducted in the current or preceding 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, mainly through the use of forward exchange contracts and currency swaps, and residual foreign exchange exposures are hedged on a regular basis. Therefore the Bank has no significant net foreign currency exposure, other than the Bank's investment in the Bank for International Settlements which is denominated in Special Drawing Rights and fair valued at £307 million (2007: £257 million). Excluding this the Bank's total net foreign exchange exposure at 29 February 2008 was £4.2 million (2007: £0.4 million).

d Liquidity risk

Liquidity risk is the risk that the Bank is unable to provide sterling or foreign currency to the market in a manner consistent with achieving its policy goals or to meet its foreign currency obligations as they fall due, or is only able to do so by incurring significant costs. These risks arise as a result of mismatches in the timing of cash flows. 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, liquidity risk does not arise as the central bank is able to create sterling liquidity through its daily market operations. Any increase in sterling liquidity would be reflected in daily market liquidity requirements and would be taken into account in setting the level of sterling market liquidity provided by the Bank via open market operations and, in the interim, by altering the level of reserve balances held with the Bank (see page 19). For this reason, the tables on pages 89 and 90 exclude sterling assets and liabilities. For foreign currency, in addition to holding appropriate cash balances, the Bank manages liquidity through cashflow matching and the use of forward exchange contracts and currency swaps; the Bank also holds a portfolio of liquid foreign exchange reserves.

The Bank's balance sheet remit and liquidity risk management policies set out risk tolerances and detailed parameters and controls to minimise the foreign currency liquidity risk that arises. These include guidelines over cashflow and maturity mismatches, for bond holdings minimum issue size and concentrations limits are set as well as reporting requirements for key risk indicators. The tables below analyse the Bank's foreign currency financial assets and liabilities at the balance sheet dates into relevant maturity groupings based on the remaining period to the contractual maturity date.

As at 29 February 2008	Up to 1 month £m	1–3 months £m	3–12 months £m	1–5 years £m	Over 5 years £m	Total £m
Assets						
Cash and balances with other central banks	226	–	–	–	–	226
Loans and advances to banks	5,747	4,183	8,988	113	–	19,031
Financial assets designated at fair value through profit or loss	9	341	1,340	2,196	–	3,886
Derivative financial instruments:						–
Cash inflow	1,636	318	1,954	–	–	3,908
Cash outflow	(1,567)	(380)	(1,876)	–	–	(3,823)
Other assets	901	72	285	4	–	1,262
Total assets	**6,952**	**4,534**	**10,691**	**2,313**	**–**	**24,490**
Liabilities						
Deposits from central banks	4,913	3,005	7,405	117	–	15,440
Deposits from banks and building societies	73	335	–	–	–	408
Other deposits	193	–	–	–	–	193
Derivative financial instruments:						–
Cash inflow	(4,185)	(2,521)	(5,266)	(721)	–	(12,693)
Cash outflow	4,850	3,678	7,017	790	–	16,335
Financial liabilities designated at fair value through profit or loss	47	–	2,358	1,099	–	3,504
Other liabilities	960	59	318	9	–	1,346
Total liabilities	**6,851**	**4,556**	**11,832**	**1,294**	**–**	**24,533**
Net liquidity gap	**101**	**(22)**	**(1,141)**	**1,019**	**–**	**(43)**
Cumulative gap	**101**	**79**	**(1,062)**	**(43)**	**(43)**	

Notes to the Banking Department Financial Statements continued

31 Financial risk management continued

As at 28 February 2007	Up to 1 month £m	1–3 months £m	3–12 months £m	1–5 years £m	Over 5 years £m	Total £m
Assets						
Cash and balances with others central banks	99	–	–	–	–	99
Loans and advances to banks	1,973	2,364	6,512	–	–	10,849
Financial assets designated at fair value through profit or loss	–	50	883	2,545	–	3,478
Derivative financial instruments:						
Cash inflow	644	192	884	189	–	1,909
Cash outflow	(802)	(301)	(2,680)	(166)	–	(3,949)
Other assets	117	53	263	–	–	433
Total assets	**2,031**	**2,358**	**5,862**	**2,568**	**–**	**12,819**
Liabilities						
Deposits from central banks	1,525	1,765	3,699	–	–	6,989
Deposits from banks and building societies	154	57	–	–	–	211
Other deposits	112	–	–	–	–	112
Derivative financial instruments:						–
Cash inflow	(247)	(541)	(1,195)	–	–	(1,983)
Cash outflow	362	1,039	2,294	–	–	3,695
Financial liabilities designated at fair value through profit or loss	–	–	1,442	2,083	–	3,525
Other liabilities	44	59	184	–	–	287
Total liabilities	**1,950**	**2,379**	**6,424**	**2,083**	**–**	**12,836**
Net liquidity gap	**81**	**(21)**	**(562)**	**485**	**–**	**(17)**
Cumulative gap	**81**	**60**	**(502)**	**(17)**	**(17)**	

e Fair values of financial assets and liabilities

The fair values of financial assets and liabilities classified as loans and receivables and deposits approximate to their carrying values due to their short-term nature.

32 Cash and cash equivalents

i Analysis of cash balances

	Note	At 1 March 2007 £m	Cash flows £m	At 29 February 2008 £m
Cash and balances with other central banks	9	99	127	226
Loans and advances to banks	10	21,496	(16,847)	4,649
		21,595	**(16,720)**	**4,875**

ii 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 Date of approval

The Members of Court approved the financial statements on pages 52 to 91 on 3 July 2008.

Issue Department
Account for the period ended 29 February 2008

	Note	2008 £m	2007 £m
Income and profits			
Income from securities of, or guaranteed by, the British Government		735	628
Income from other assets including those acquired under reverse repurchase agreements		1,636	1,082
		2,371	**1,710**
Expenses	2		
Cost of production of Bank notes		23	36
Cost of issue, custody and payment of Bank notes		17	17
Other expenses		4	4
		44	**57**
Payable to HM Treasury		**2,327**	**1,653**

Statement of balances: 29 February 2008

	Note	2008 £m	2007 £m
Assets			
Securities of, or guaranteed by, the British Government	3	8,168	13,370
Other assets including those acquired under reverse repurchase agreements	4	36,810	25,079
Total assets		**44,978**	**38,449**
Liabilities			
Notes issued:			
In circulation	5	44,978	38,449
Total liabilities		**44,978**	**38,449**

On behalf of the Governor and Company of the Bank of England:

M A King Governor
C R Bean Deputy Governor
T J Parker Chairman of NedCo
W R Jones Finance Director

The notes on pages 93 to 94 are an integral part of these statements of account.

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.

- The statements of account are prepared on the basis of amounts received and paid as modified by the effects of the revaluation of securities.
- All securities are revalued quarterly at their clean mid-market price and are stated in the balance sheet at this valuation. The last valuation was made at 28 February 2008.
- If a revaluation of securities shows a net gain this is included in income. A deficit is not taken against income but is settled by a transfer from the National Loans Fund. Total such deficits in the year to 29 February 2008 amounted to £0.4 million (2007: £nil).

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

	2008 £m	2007 £m
British Government Stocks	798	–
Ways and Means advance to the National Loans Fund	7,370	13,370
	8,168	**13,370**

The Ways and Means advance earns interest at Bank Rate.

4 Other assets including those acquired under reverse repurchase agreements

	2008 £m	2007 £m
Deposit with Banking Department	19,211	49
Reverse repurchase agreements	17,599	25,030
	36,810	**25,079**

5 Notes in circulation

	2008 £m	2007 £m
£5	1,242	1,100
£10	6,115	5,886
£20	25,648	23,740
£50	7,526	6,705
Other notes[(a)]	4,447	1,018
	44,978	**38,449**

(a) Includes higher value notes used as cover for the note issues of banks in Scotland and Northern Ireland in excess of their fiduciary issues.

Notes to the Issue Department Statements of Account continued

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 29 February 2008, the assets of Issue Department had the following repricing period profile: repricing in up to one month £34 billion (2007: £26 billion); repricing in greater than one but less than three months £4 billion (2007: £6 billion); repricing in greater than three but less than six months £4 billion (2007: £4 billion); repricing in greater than six but less than twelve months £2 billion (2007: £2 billion) and, repricing greater than one year £1 billion (2007: £nil).

b Currency exposure

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

c Credit risk

Credit risk is the risk of loss arising from the failure of a borrower, issuer, counterparty or customer to meet its financial obligations to the Bank. The Bank is exposed to credit risk both through direct exposures and through contingent exposures, such as via collateral. The source of credit risk arises as a result of the Bank providing liquidity to financial institutions via open market operations.

In providing liquidity via routine open market operations and, intraday, via the Bank's operation of wholesale payment systems, credit risk is managed by ensuring that exposures are fully collateralised (with appropriate margin) by high-quality, marketable securities.

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

7 Accrued income

At 29 February 2008 the unrecognised accrued interest on the assets held on the Issue Department Statement of Balances was £251 million (2007: £271 million).

In addition £28 million was received on 24 June in relation to the settlement between Securities AB and the Bank of England regarding declarations made by Loomis Cash Management Ltd that did not comply with the rules of the Bank of England's Note Circulation Scheme. This will be recognised in the income payable to the Treasury in the 2008/09 accounts.

8 Accrued expenses

At 29 February 2008 the unrecognised accrued expenses on the Issue Department Account was £10 million (2007: £nil).

9 Date of approval

The Members of Court approved the statements of account on pages 92 to 94 on 3 July 2008.

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ISSN 1467-016x
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