Banking Department
Income Statement for the year to 28 February 2009

	Note	2009 £m	2008 £m
Profit before tax	4	995	197
Corporation tax net of tax relief on payment to HM Treasury	7	(162)	(36)
Profit for the year attributable to shareholder		**833**	**161**

The notes on pages 56 to 96 are an integral part of these financial statements.

Balance Sheet as at 28 February 2009

	Notes	**2009** **£m**	2008* £m
Assets			
Cash and balances with other central banks	9	1,516	226
Loans and advances to banks and other financial institutions	10	136,829	62,855
Financial assets designated at fair value through profit or loss	11	3,334	3,742
Derivative financial instruments	12	287	122
Other loans and advances	13	815	4
Available for sale securities	14	3,937	3,852
Investments in group undertakings	15	–	–
Intangible assets	16	17	19
Property, plant and equipment	17	176	217
Investment properties	18	26	26
Retirement benefit assets	19	294	404
Other assets	20	697	534
Total assets		**147,928**	**72,001**
Liabilities			
Money market instruments in issue	21	42,212	–
Deposits from central banks	22	24,356	18,594
Deposits from banks and other financial institutions	23	42,186	24,872
Other deposits	24	31,638	21,297
Financial liabilities designated at fair value through profit or loss	25	2,965	3,377
Derivative financial instruments	12	81	727
Current tax liabilities		235	10
Deferred tax liabilities	26	134	170
Retirement benefit liabilities	19	178	184
Other liabilities	27	622	477
Total liabilities		**144,607**	**69,708**
Equity			
Capital	28	15	15
Retained earnings	29	2,748	1,821
Other reserves	29	558	457
Total equity attributable to shareholder		**3,321**	**2,293**
		147,928	**72,001**

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

*Comparative figures have been restated as outlined in note 2.e.ii.

The notes on pages 56 to 96 are an integral part of these financial statements.

Statement of Recognised Income and Expense
for the year to 28 February 2009

	Note	2009 £m	2008 £m
Profit for the year attributable to the shareholder		833	161
Other recognised income and expense:			
Revaluation of available for sale securities		199	125
Gains transferred to income statement on disposal of available for sale securities		–	(3)
Revaluation of properties	17	(43)	(32)
Actuarial (losses)/gains on retirement benefits	19	(213)	408
Tax credited/(charged) on items directly to equity	7	5	(145)
Net (expense)/income recognised in equity	29	(52)	353
Total recognised income and expense for the period attributable to the shareholder		**781**	**514**

The notes on pages 56 to 96 are an integral part of these financial statements.

Cash Flow Statement for the year to 28 February 2009

	Note	2009 £m	2008 £m
Cash flows from operating activities			
Profit before taxation		995	197
Adjustments for non-cash items:			
Amortisation of intangibles	16	6	6
Depreciation of property, plant and equipment	17	7	8
Profit on sale of available for sale securities	14	(1)	(3)
Profit on sale of tangible fixed assets		–	–
Dividends received	4	(11)	(14)
Net movement in provisions, including pensions and accrued interest		581	(319)
Changes in operating assets and liabilities:			
Net increase in advances		(74,313)	(49,039)
Net decrease in financial assets designated at fair value through profit or loss		1,181	30
Net increase in money market instruments in issue		42,212	–
Net increase in deposits		33,422	31,384
Net decrease in financial liabilities designated at fair value through profit or loss		(1,791)	(472)
Net movement in financial derivatives		(811)	653
Net increase in other accounts		3	969
Corporation tax paid		(83)	–
Net cash from operating activities		**1,397**	**(16,600)**
Cash flows from investing activities			
Purchase of available for sale securities		(222)	(260)
Proceeds from sale or redemption of available for sale securities		265	223
Dividends received	4	11	14
Purchase of intangible assets		(5)	(6)
Purchase of property, plant and equipment		(10)	(8)
Net cash from investing activities		**39**	**(37)**
Cash flows from financing activities			
Cash generated from indemnified operations		476	–
Payment to HM Treasury under Section 1 (4) of the Bank of England Act 1946		(81)	(83)
Net cash from financing activities		**395**	**(83)**
Net increase/(decrease) in cash and cash equivalents		**1,831**	**(16,720)**
Cash and cash equivalents at 1 March	34	4,875	21,595
Cash and cash equivalents at 28 February	34	**6,706**	**4,875**

The notes on pages 56 to 96 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 1844, the Bank of England Acts 1946 and 1998 and the Banking Act 2009. The 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 97 to 99, 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 Bases of preparation

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) and International Financial Reporting Interpretations Committee (IFRICs) as adopted by the EU (together, '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.

No disclosure is made about individual usage of the Special Liquidity Scheme as the Bank does not believe such disclosure to be appropriate having regard to its functions.

Related Party disclosure is limited as set out in Note 31.

A number of new standards, amendments and interpretations to existing standards have been published, including amendments within IAS 1 (Presentation of Financial Statements) which have not been adopted early. The application of the updates to this standard in the 2008/09 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 group undertakings have not been consolidated with those of the Banking Department. The Bank of England Asset Purchase Facility Fund Ltd has not been consolidated as the Bank has no economic interest in its activities. The statements of the Bank's non-trading subsidiaries have not been consolidated 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 recognised in the income statement 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 remeasured 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 (i.e. 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 elected not to apply 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 Bases of preparation continued

e Financial instruments: assets

i Classification

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

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. Assets in this category include reverse repurchase agreements.

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 foreign currency securities at fair value through profit or loss. This designation eliminates, or significantly reduces, inconsistencies that would otherwise arise from measuring assets and liabilities on different bases. The relevant assets and liabilities together with the related derivatives are managed together and internal reporting is evaluated on a fair value basis.

Available for sale

Available for sale 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.

ii Initial recognition of financial assets

Loans and advances are recognised on a settlement date basis. In the prior year reverse repurchase agreements were recognised on a trade date basis and the comparative amounts have been adjusted by £810 million (note 10). A corresponding adjustment has been made to items in course of settlement included within other liabilities (note 27).

Purchases and sales of all other categories of financial assets are recognised on trade date basis. All financial assets are initially recognised at fair value.

iii Subsequent valuation of financial assets

Loans and advances and investments classified as held to maturity are carried at amortised cost less a provision for impairment where necessary (see (iv) 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 (see (iv) below), at which time the cumulative gain or loss previously recognised in equity is recognised in the Income Statement. Any premium or discount paid on the purchase of those assets is amortised through the Income Statement.

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. The policy for establishing fair values of securities in non-active markets is described in note 3 'Significant accounting estimates and judgements in applying accounting policies' on page 63.

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.

iv Impairment of financial assets

Loans and advances

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 the estimated future cash flows relating to that loan. 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 principal amount and, for a collateralised loan, when the proceeds from realising the security have been received.

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 through the Income Statement. Impairment losses recognised in the Income Statement on equity instruments are not reversed through the Income Statement except on realisation.

v Interest income

Interest income is recognised in the Income Statement 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.

vi Dividends

Dividends on equity investments that are available for sale are recognised in the Income Statement when declared.

f Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a current and 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.

g Collateral pledged under sale and repurchase agreements

Securities sold subject to repurchase agreements are assets provided as collateral when the transferee has the right by contract or custom to sell 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 repurchase remain on the balance sheet. Securities purchased under agreements to resell ('reverse repurchase agreements') 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.

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 repurchase agreements. Such reverse repurchase transactions are treated as collateralised and are treated in the same way as other reverse repurchase transactions.

Notes to the Banking Department Financial Statements continued

2 Bases of preparation continued

h 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.

i Property, plant and equipment
Full professional valuations of the Bank's properties are carried out each year with subsequent additions included at cost, and provisions made for depreciation as explained 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.

j 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.

k 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 consistent periodic rate of return.

ii As lessor

Long leases granted on property are treated as operating leases. Operating lease income is recognised on a straight-line basis.

l 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.

m Financial instruments: liabilities

i Money market instruments in issue

Money market instruments in issue at the year end consisted of one-week sterling bills issued by the Bank as part of their open market operations. These bills are recognised on a trade date basis and are issued at a discount which is amortised through the Income Statement on an effective interest rate basis.

ii 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 cost with interest income accruing on an effective interest rate basis.

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.

iii Financial liabilities at fair value through profit or loss

At the end of the year these liabilities comprised of two three-year bonds denominated in US dollars (US Dollar Bond), which were issued as part of the Bank's annual medium-term issuance programme.

These liabilities are recognised on a trade date basis and 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 the financial assets purchased with the proceeds of the Bonds issued and any associated derivate instruments, as detailed in note e (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.

n Fees and commission income

Fees and commissions other than those associated with financial instruments are recognised as the service is provided.

Notes to the Banking Department Financial Statements continued

2 Bases of preparation continued

o 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.

p 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 by the Bank in an independent trustee-administered fund. 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. The defined-benefit obligation is calculated annually by an independent actuary 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.

q 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 52B of IAS 12. The amount of tax relief in the current year is £117 million (2008: £24 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, and provisions for pensions and other post-retirement benefits. The Bank does not currently recognise deferred tax related to property revaluations due to changes in capital allowance legislation.

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 re-measurement 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.

r Equity 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 agreed at the end of the relevant year.

s Indemnified operations

The Bank may enter into arrangements where it is fully indemnified from loss by HM Treasury. Surpluses from such indemnified operations, after the deduction of fees, operating costs and tax, are treated as a capital contribution and taken directly to equity as distributable reserves.

t Commitments on behalf of HM Treasury

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

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 19 (a), which includes relevant sensitivity analysis). Members of Court consider the assumptions used by the actuary 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).

c Fair value in non-active markets

Where possible, the Bank uses a market price to value securities. Where no such market price exists, the Bank uses a model designed to deliver a price that is as close as possible to what a market price would be had such a price existed. Back-testing has been carried out to validate model-based prices. Pricing, the use of spreads in models and collateral are under regular review. A Collateral Review Committee is chaired by the Head of the Markets Directorate's Risk Management Division, and the Executive Director for Markets chairs a Special Liquidity Scheme Steering Group.

Notes to the Banking Department Financial Statements continued

4 Profit before tax

	Note	2009 £m	2008 £m
Income includes			
Charges for services to HM Government (including charges to the Issue Department in respect of the note issue)		82	70
Banking charges and tariff income		29	27
Rental income from investment properties		1	2
Dividend income		11	14
Expenses includes			
Staff costs	5	144	124
Legal fees		8	2
Depreciation of property, plant and equipment	17	7	8
Software expenditure		9	7
Amortisation of intangible assets	16	6	6
Operating lease rentals — property		1	1
— equipment		1	1
Other administrative expenses		103	93

5 Staff costs

	Note	2009 £m	2008 £m
Wages and salaries		85	79
Social security costs		8	8
Pension and other post-retirement costs:			
Pension schemes	19	35	25
Redundancy schemes	19	8	3
Other unfunded pension schemes	19	–	1
Other post-retirement benefits	19	8	8
		144	**124**

Average number of employees

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

	2009	2008
Governors and other members of Executive Team	9	9
Managers and analysts	674	625
Other staff	1,133	1,118
	1,816	**1,752**

The number of persons employed by the Bank at the end of the year was 1,857, of which 1,642 were full-time and 215 were part-time (2008: 1,753; of which 1,542 full-time and 211 part-time).

6 Auditor's remuneration

	2009 £000	2008 £000
Audit fees for the group statutory audit:		
— Fees relating to current year	313	252
— Fees relating to prior year	15	45
Fees payable to the primary auditor for the services provided to the Bank:		
— Tax services	215	533
— All other services*	846	4,164
	1,389	**4,994**

* During the year to 28 February 2009, the Bank recovered accounting fees of £556,000 (2008: £4,084,000) from third parties, £525,000 (2008: £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:

	2009 £m	2008 £m
Current United Kingdom corporation tax	137	19
Prior year corporation tax	2	–
Deferred tax — current year	26	17
— prior year	(3)	–
Tax charge on profit	**162**	**36**

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

	2009 £m	2008 £m
Profit before tax	995	197
Tax calculated at rate of 28.17% (2008: 30%)	280	59
Tax relief on payment to HM Treasury	(117)	(24)
Prior year items	(1)	–
Change in tax rate from 30%	–	1
Total tax charge for the period	**162**	**36**

Notes to the Banking Department Financial Statements continued

7 Taxation continued

Tax charged directly to equity comprises:

	2009 £m	2008 £m
Tax (credited)/charged to equity through the Statement of Recognised Income and Expense		
Current United Kingdom corporation tax	54	22
Deferred tax	(59)	123
Other tax charged directly to equity		
Current United Kingdom corporation tax	261	–
Tax charged directly to equity	**256**	**145**

Tax charged directly to equity is attributable as follows:

	2009 £m	2008 £m
Tax (credited)/ charged to equity through the Statement of Recognised Income and Expense		
Revaluation of available for sale securities	55	37
Revaluation of property	–	(1)
Actuarial gains on retirement benefits	(60)	122
Change in tax rate from 30%	–	(13)
Other tax charged directly to equity		
Surplus on indemnified operations	261	–
Tax charged directly to equity	**256**	**145**

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

	2009 £m	2008 £m
Payable 3 April (2008: 4 April)	203	39
Payable 5 October (2008: 3 October)	214	42
	417	**81**

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 28 February 2009. 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 3 April 2009 was based on provisional figures. The balance is payable on 5 October 2009.

9 Cash and balances with other central banks

	2009 £m	2008 £m
Cash	–	–
Due from the European Central Bank in respect of TARGET (a)	–	218
Other balances with central banks (b)	1,516	8
	1,516	**226**

a Due from the European Central Bank in respect of TARGET

This balance, denominated in euro, was £nil at 28 February 2009 (2008: €285 million). In previous years, the balance arose as a result of the Bank's participation in the TARGET settlement system. The Bank withdrew from TARGET on 19 May 2008.

b Other balances with central banks

These balances are correspondent accounts with other central banks used for Bank and customer business.

10 Loans and advances to banks and other financial institutions

	2009 £m	2008* £m
Items in course of collection	32	374
Reverse repurchase agreements	136,662	38,674
Other loans and advances to banks and other financial institutions	134	23,777
Other balances with banks and other financial institutions	1	30
	136,829	**62,855**

* Prior year figures have been adjusted to reflect reverse repurchase agreements on a settlement date basis (see note 2.e.ii).

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 22 to 24). 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 as described in the published 'Framework for the Bank of England's Operations in the Sterling Money Markets' (January 2008).

At 28 February 2009 loans and advances to banks and other financial institutions included cash and cash equivalents of £5.2 billion (2008: £4.7 billion).

Notes to the Banking Department Financial Statements continued

11 Financial assets designated at fair value through profit or loss

	2009 £m	2008 £m
Listed foreign government securities	2,107	2,437
Other listed securities	1,227	1,305
	3,334	**3,742**

The holdings of foreign government and other foreign securities are funded by the Bank's issuance of medium-term securities (note 25). In the current year, the securities issued related entirely to the Bank's foreign exchange reserves portfolio. As at 28 February 2009 this portfolio was financed by two $2 billion three-year bonds issued through the Bank's annual programme of syndicated foreign currency bond issuance. The assets in the portfolio are denominated in US dollars, euros and Japanese yen.

In the prior year, the holdings of these financial assets had been partly funded by a second distinct portfolio, denominated in euro, 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, and principally financed by the €3 billion Euro Note which matured on 27 January 2009, were used to generate this liquidity via intraday repurchase contracts. On 19 May 2008, the Bank ceased to participate in the TARGET system and accordingly no further Euro Notes were issued in this portfolio.

12 Derivative financial instruments

The Bank uses the derivative instruments described below. The main 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, interest rate swaps, and forward exchange contracts 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 28 February 2009

	Contract notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Derivatives related to foreign currency bond issuance programme			
Cross-currency interest rate swaps — positive value	1,489	163	–
— negative value	275	–	(3)
	1,764	**163**	**(3)**
Interest rate swaps — positive value	1,049	32	–
— negative value	1,208	–	(33)
	2,257	**32**	**(33)**
Other derivative instruments			
Forward exchange contracts — positive value	5,242	92	–
— negative value	3,070	–	(45)
	8,312	**92**	**(45)**
Total recognised derivative assets/(liabilities)		**287**	**(81)**

b As at 29 February 2008

	Contract notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Derivatives related to foreign currency bond issuance programme 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)**

13 Other loans and advances

	2009 £m	2008 £m
Term loans	815	4

Notes to the Banking Department Financial Statements continued

14 Available for sale securities

	2009 £m	2008 £m
Debt securities at fair value		
British Government securities listed on a recognised United Kingdom exchange	2,628	2,520
Other sterling securities listed on a recognised exchange	980	1,021
	3,608	3,541
Unlisted equity investments at fair value	329	311
	3,937	**3,852**

The movement in available for sale securities comprises:

	2009 £m	2008 £m
Available for sale debt securities		
At 1 March	3,541	3,494
Purchases	222	222
Redemptions	(265)	(220)
Mark-to-market movements through equity	179	70
Amortisation of premium/discount	(26)	(25)
Movement in accrued interest	(43)	–
At 28 February	**3,608**	**3,541**
Available for sale unlisted equity investments		
At 1 March	311	261
Revaluation of securities	19	53
Disposal of securities	(1)	(3)
At 28 February	**329**	**311**
	3,937	**3,852**

A profit of less than £1 million (2008: profit of £3 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 arm's 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 28 February 2009 the holding represents 8.7% (2008: 8.7%) of the issued share capital. The investment has been valued on a dividend yield basis providing a value of £324 million (2008: £307 million) at the year end. A discount rate of 7% was used. Increasing the discount rate by 1% would deflate the valuation by £62 million, while decreasing the discount rate by 1% would inflate the valuation by £104 million.

The Bank's holding in the European Central Bank represents the Bank's contribution of €59 million (2008: €56 million) to the capital of the European Central Bank. This represents 1.41% (2008: 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% (2008: 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 14.5% (2008: 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

	2009 **£m**	2008 £m
Cost of shares in group undertakings	–	–

a Bank of England Asset Purchase Facility Fund Ltd

The Bank holds 100 £1 ordinary shares in the Bank of England Asset Purchase Facility Fund Ltd ('BEAPFF') which was incorporated on 30 January 2009. This investment is held at cost on the Bank's balance sheet.

BEAPFF was set up to increase the availability of corporate credit by reducing the illiquidity of underlying assets through an asset purchase programme. The programme also provided a framework for the Monetary Policy Committee to use asset purchases for monetary policy purposes.

HM Treasury have indemnified BEAPFF and the Bank against any loss arising from the activities of BEAPFF and will receive any surplus arising. The Bank has not consolidated BEAPFF in its financial statements as it has no economic interest in its activities.

Transactions between BEAPFF and the Bank are disclosed in note 31.

Notes to the Banking Department Financial Statements continued

15 Investments in group undertakings continued

b Other group undertakings

Minories Finance Ltd, a wholly-owned subsidiary incorporated in Great Britain, has been in members' voluntary liquidation throughout the year ended 28 February 2009. During the year the Bank received less than £1 million (2008: £6 million) from the liquidators.

The Bank has a number of other 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 and 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. 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
Deposits Management (Edge) Ltd	1 ordinary share of £1

The aggregate net assets of these subsidiary companies are £1 million (2008: £1 million), which consist of balances held with the Bank.

16 Intangible assets

	2009 £m	2008 £m
Cost		
At 1 March	38	32
Additions	5	6
Disposals	(1)	–
At 28 February	**42**	**38**
Accumulated amortisation		
At 1 March	19	13
Charge for the year	6	6
On disposals	–	–
At 28 February	**25**	**19**
Net book value at 1 March	19	19
Net book value at 28 February	**17**	**19**

Intangible assets comprise computer software costs capitalised.

17 Property, plant and equipment

For the year to 28 February 2009

	Freehold land and buildings £m	Equipment* £m	Total £m
Cost or valuation			
At 1 March 2008	204	51	255
Additions	5	4	9
Revaluation of properties	(47)	–	(47)
At 28 February 2009	**162**	**55**	**217**
Accumulated depreciation			
At 1 March 2008	–	38	38
Charge for the year	4	3	7
Written back on revaluation	(4)	–	(4)
At 28 February 2009	**–**	**41**	**41**
Net book value at 1 March 2008	204	13	217
Net book value at 28 February 2009	**162**	**14**	**176**

* Net book value of equipment at 28 February 2009 includes £7 million held under finance leases.

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**

* Net book value of equipment at 29 February 2008 includes £7 million held under finance leases.

The figures for freehold land and buildings reflect independent professional valuations on a market value basis at 28 February 2009 by Drivers Jonas LLP (2008: 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.

Notes to the Banking Department Financial Statements continued

18 Investment properties

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

	2009 £m	2008 £m
Cost		
At 1 March	26	26
At 28 February	**26**	**26**

The fair value of investment properties at 28 February 2009 was £41 million (2008: £43 million). This value represents the deferred consideration on the lease remaining at 28 February 2009 plus the estimated reversionary value of the properties at the end of the lease terms, as provided by Drivers Jonas LLP (2008: 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 (2008: £0.1 million), increasing to £0.3 million per annum (2008: £0.3 million) after the initial five years of the contract.

19 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 by the Bank in an independent trustee-administered fund. The Bank also provides other post-retirement benefits, principally healthcare, for certain pensioners.

The investment policy of the pension fund is to invest in assets which match the scheme's accrued liabilities.

Valuation for funding purposes

The main pension scheme, the Bank of England Pension Fund, is valued for funding purposes at intervals of not 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 29 February 2008; 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 29 February 2008	£m
Value of Fund assets	2,214
Actuarial value of scheme liabilities	(2,449)
Scheme deficit	**(235)**

Funding level	91%
Future service contribution rate	54.6%

For the 2008 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%.

The Bank and the Pension Fund Trustees, with advice from the actuary, agreed that £41 million of the deficit would be paid in February 2009. The remaining six payments of £27 million of the previously agreed deficit reduction plan would be paid as planned. This would make good the deficit by 2014 on existing assumptions.

Excluded from the contribution rate is the cost of administration and other services set out in note 19 (d).

Summary of amounts recognised in the financial statements under IAS 19

The Bank accounts for pension costs, other post-retirement benefits and related 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 actuary has 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		2009 £m	2008 £m	2007 £m	2006 £m
Funded pension scheme	(a)	294	404	(22)	(147)
Unfunded post-retirement benefits:					
Redundancy provisions	(b)	(64)	(61)	(70)	(68)
Pension scheme	(c)	(6)	(6)	(6)	(5)
Other post-retirement benefits	(d)	(108)	(117)	(145)	(151)
		116	**220**	**(243)**	**(371)**

Pension expense recognised in the Income Statement		2009 £m	2008 £m
Funded pension scheme	(a)	35	25
Unfunded post-retirement benefits:			
Redundancy provisions	(b)	8	3
Other unfunded pension scheme	(c)	–	1
Other post-retirement benefits	(d)	8	8
		51	**37**

Gains/(losses) recognised in the Statement of Recognised Income and Expense		2009 £m	2008 £m
Funded pension scheme	(a)	(224)	367
Unfunded post-retirement benefits:			
Redundancy provisions	(b)	–	7
Other unfunded pension scheme	(c)	–	1
Other post-retirement benefits	(d)	11	33
		(213)	**408**

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 by the Bank in an independent trustee-administered fund.

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.

Notes to the Banking Department Financial Statements continued

19 Retirement benefits continued

The financial assumptions used by the independent actuary to calculate scheme liabilities over the life of the scheme on an IAS 19 basis were:

	2009 %	2008 %
Inflation rate (RPI)	2.8	2.8
Discount rate	5.9	5.9
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 increase in salaries assumption also includes an age-related promotion scale.

The assumption for life expectancy for the scheme assumes that a male member reaching 60 in 2009 will live for 27 years (2008: 27 years) and a female member 30 years (2008: 30 years), and a male member reaching 60 in 2019 will live for 28 years (2008: 28 years) and a female member 31 years (2008: 31 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 scheme.

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

	2009			2008		
	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
Bonds	4.3	2,028	94.5	4.1	2,049	92.5
Properties	–	1	–	–	76	3.4
Cash and other assets	4.3	116	5.5	4.1	48	2.2
Total market value of investments	**4.3**	**2,145**	**100.0**	**4.1**	**2,216**	**100.0**

For the purposes of IAS 19, the asset values stated are at the balance sheet date. Market values of the 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.

	2009 £m	2008 £m	2007 £m	2006 £m
Presented value of defined-benefit obligations	(1,851)	(1,812)	(2,022)	(2,055)
Assets at fair value	2,145	2,216	2,000	1,908
Defined-benefit asset/(liability)	**294**	**404**	**(22)**	**(147)**

The surplus in the scheme before taxation has declined, primarily due to a reduction in the fair value of the assets.

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 scheme's liabilities at the year end would increase by approximately £53 million.

The Bank expects to pay contributions of £61 million in the forthcoming year (2008: £82 million).

Components of pension expense in the Income Statement	2009 £m	2008 £m
Current service cost	22	33
Interest cost	105	98
Expected return on assets	(92)	(100)
Curtailment costs	–	(6)
Total pension expense	**35**	**25**

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 at the previous year end. Accordingly, the discount rate used for 2009 is 5.9% (2008: 4.9%).

Gains/(losses) recognised in the Statement of Recognised Income and Expense	2009 £m	2008 £m
Cumulative actuarial gains/(losses) recognised at the beginning of the year	287	(80)
Actuarial (loss)/gain on scheme liabilities	(10)	241
Actuarial (loss)/gain on scheme assets	(214)	126
Cumulative actuarial gains recognised at 28 February	**63**	**287**

Reconciliation of return on assets	2009 £m	2008 £m
Expected return on scheme assets (net of expense)	92	100
Actuarial (loss)/gain on scheme assets	(214)	126
Actual return on scheme assets (net of expense)	**(122)**	**226**

Notes to the Banking Department Financial Statements continued

19 Retirement benefits continued

Reconciliation of present value of defined-benefit obligation	2009 £m	2008 £m
Present value of defined-benefit obligation at 1 March	1,812	2,022
Current service cost	22	33
Interest cost	105	98
Actuarial loss/(gain) relating to scheme liabilities	10	(241)
Benefits paid from scheme	(98)	(94)
Curtailment benefits	–	(6)
Present value of defined-obligation at 28 Feburary	**1,851**	**1,812**

Reconciliation of the fair value of assets	2009 £m	2008 £m
Fair value of scheme assets at 1 March	2,216	2,000
Actual return on scheme assets	(122)	226
Bank contributions	149	84
Benefits paid from scheme	(98)	(94)
Fair value of scheme's assets at 28 February	**2,145**	**2,216**

Experience gains and losses	2009 £m	2008 £m	2007 £m	2006 £m
Experience (loss)/gain on defined-benefit obligation	(16)	(29)	(16)	20
Experience (loss)/gain on scheme assets	(214)	126	(14)	195

b Redundancy scheme

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 the pension scheme (see (a)).

	2009 £m	2008 £m	2007 £m	2006 £m
Unfunded defined-benefit liability	**(64)**	**(61)**	**(70)**	**(68)**

Components of pension expense in the Income Statement	2009 £m	2008 £m
Past service cost	3	–
Interest cost	5	3
Total pension expense	**8**	**3**

Gains/(losses) recognised in the Statement of Recognised Income and Expense	2009 £m	2008 £m
Cumulative actuarial losses recognised at beginning of year	(4)	(11)
Actuarial gain on liabilities	–	7
Cumulative actuarial losses recognised at 28 February	**(4)**	**(4)**

Reconciliation of present value of defined-benefit obligation	2009 £m	2008 £m
Present value of defined-benefit obligation at 1 March	61	70
Past service cost	3	–
Interest cost	5	3
Actuarial loss on scheme liabilities	–	(7)
Payments	(5)	(5)
Present value of defined-benefit obligation at 28 February	**64**	**61**

Experience gains and losses	2009 £m	2008 £m	2007 £m	2006 £m
Experience (loss)/gain on defined-benefit obligation	**(1)**	**1**	**–**	**(1)**

The Bank expects to make payments of £5 million in the forthcoming year (2008: £5 million).

c Other unfunded pension scheme

As explained in the Remuneration section of the *Annual Report* on page 33, 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 by using the relevant assumptions applied for the IAS 19 valuation of pension schemes (see (a)).

	2009 £m	2008 £m	2007 £m	2006 £m
Unfunded defined-benefit liability	**(6)**	**(6)**	**(6)**	**(5)**

Components of pension expense in the Income Statement	2009 £m	2008 £m
Service and interest cost	–	1
Total pension expense	**–**	**1**

Amounts recognised in the Statement of Recognised Income and Expense	2009 £m	2008 £m
Cumulative actuarial losses recognised at beginning of year	–	(1)
Actuarial gain on scheme liabilities	–	1
Cumulative actuarial losses recognised at end of year	**–**	**–**

Notes to the Banking Department Financial Statements continued

19 Retirement benefits continued

Reconciliation of present value of defined-benefit obligation	2009 £m	2008 £m
Present value of defined-benefit obligation at 1 March	6	6
Service and interest cost	–	1
Actuarial gain on scheme liabilities	–	(1)
Present value of defined-benefit obligation at 28 February	**6**	**6**

Experience gains and losses

For the year ended 28 February 2009, experience losses on the defined-benefit obligation were less than £1 million (as they were for the years 2006 to 2008).

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:

	2009	2008
Initial medical trend	10.0%	11.5%
Ultimate medical trend	5.0%	5.0%
Years to ultimate	4	5

	2009 £m	2008 £m	2007 £m	2006 £m
Unfunded defined-benefit liability	**(108)**	**(117)**	**(145)**	**(151)**

Sensitivity analysis provided by the actuary 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 £3 million.

The Bank expects to pay premiums of £3 million in the forthcoming year (2008: £3 million).

Components of pension expense in the Income Statement	2009 £m	2008 £m
Service cost	1	1
Interest cost	7	7
Total retirement benefit cost	**8**	**8**

Amounts recognised in the Statement of Recognised Income and Expense	2009 £m	2008 £m
Cumulative actuarial losses recognised at beginning of year	(17)	(50)
Actuarial gain on scheme liabilities	11	33
Cumulative actuarial losses recognised at end of year	**(6)**	**(17)**

Reconciliation of present value of defined-benefit obligation	2009 £m	2008 £m
Present value of defined-benefit obligation at 1 March	117	145
Service cost	1	1
Interest cost	7	7
Actuarial gain on scheme liabilities	(11)	(33)
Premiums paid	(6)	(3)
Present value of defined-benefit obligation at 28 February	**108**	**117**

Experience gains and losses	2009 £m	2008 £m	2007 £m	2006 £m
Experience gain on defined-benefit obligation	**11**	**12**	**7**	**–**

20 Other assets

	2009 £m	2008 £m
Items in course of settlement	108	–
Short-term debtors and other assets[1]	589	534
	697	**534**

(1) Includes less than £1 million (2008: £10 million) of accrued expenses that will be recharged to Issue Department.

21 Money market instruments in issue

	2009 £m	2008 £m
Sterling bills issued	**42,212**	**–**

Money market instruments in issue at 28 February 2009 consisted of one-week sterling bills. The Bank began issuing sterling bills on 29 September 2008 with the intent to offset the additional reserves taken up in its extended collateral long-term reverse repurchase operations.

22 Deposits from central banks

	2009 £m	2008 £m
Deposits repayable on demand	5,363	1,164
Term deposits	18,993	17,430
	24,356	**18,594**

Notes to the Banking Department Financial Statements continued

23 Deposits from banks and other financial institutions

	Note	2009 £m	2008 £m
Items in course of settlement		4	2
Repayable on demand:			
Sterling		37,732	21,526
Non-sterling		1,224	32
Repurchase agreements		602	371
Collateral for derivatives	30	181	5
Cash collateral	30	16	–
Cash Ratio Deposits		2,427	2,936
		42,186	**24,872**

Cash deposits in US dollars are taken from counterparties as collateral for certain derivatives (see note 30).

Cash Ratio Deposits are computed on the basis of banks' and building societies' eligible liabilities and are non-interest bearing. 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.

24 Other deposits

	2009 £m	2008 £m
Items in course of settlement	5	10
Deposit by Issue Department	29,225	19,211
Public deposits:		
Repayable on demand	1,362	1,587
Term deposits	10	10
Other deposits repayable on demand	1,036	479
	31,638	**21,297**

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

25 Financial liabilities designated at fair value through profit and loss

All changes in fair values since 1 March 2008 are considered attributable to changes in prevailing interest rates and movements in relative foreign currency exchange rates.

	2009 £m	2008 £m
Financial liabilities designated at fair value through profit or loss:		
Foreign currency bond issuance programme (a)	2,965	1,097
Euro Notes (b)	–	2,280
	2,965	**3,377**

a Foreign currency bond issuance programme

As part of the Bank's annual medium-term security issuance programme the Bank has issued two $2 billion three-year dollar bonds; the first maturing on the 22 March 2010 and the second on 17 March 2011.

	2009		2008	
	£m Fair value	$m Nominal	£m Fair value	$m Nominal
Total amounts issued to third parties	**2,965**	**4,000**	**1,097**	**2,000**

Of the above liabilities to third parties, £nil (2008: £nil) fall due within one year.

b Euro Notes

On 27 January 2009 the final €3 billion Euro Note matured.

	2009		2008	
	£m Fair value	€m Nominal	£m Fair value	€m Nominal
Total amount issued	–	–	2,508	3,300
Held by the Bank	–	–	(228)	(300)
Liabilities to third parties	**–**	**–**	**2,280**	**3,000**

26 Deferred tax liabilities

Deferred tax is calculated on all temporary differences under the liability method using an effective tax rate of 28% (2008: 28%).

The movement on the deferred tax account is as follows:

	Note	2009 £m	2008 £m
Deferred tax			
Net liability at 1 March		(170)	(30)
Income statement charge	7	(23)	(17)
Other recognised income and expense		59	(123)
Net liability at 28 February		**(134)**	**(170)**

Notes to the Banking Department Financial Statements continued

26 Deferred tax liabilities continued

	2009 £m	2008 £m
Deferred tax liability relates to:		
Property revaluation	–	1
Available for sale securities	(105)	(106)
Pensions and other post-retirement benefits	(32)	(69)
Other provisions	3	4
	(134)	**(170)**

27 Other liabilities

	2009 £m	2008* £m
Items in course of settlement	62	–
Payable to HM Treasury	417	81
Short-term creditors, other liabilities and deferred income	143	396
	622	**477**

* Prior year figures have been adjusted to reflect reverse repurchase agreements on a settlement date basis (see note 2.e.ii).

28 Capital

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

29 Retained earnings and other reserves

As at 28 February 2009

	Share capital £m	Available for sale reserve £m	Property revaluation reserve £m	Retained earnings £m	Total shareholder's funds £m
Balances as at 1 March 2008	15	296	161	1,821	2,293
Profit after tax for the year	–	–	–	833	833
Payment to HM Treasury	–	–	–	(417)	(417)
Post-tax surplus from indemnified operations*	–	–	–	664	664
Other items recognised through the Statement of Recognised Income and Expense	–	144	(43)	(153)	(52)
As at 28 February 2009	**15**	**440**	**118**	**2,748**	**3,321**

* At 28 February 2009 the post-tax surplus on indemnified operations included £573 million (2008: £nil) in relation to the Special Liquidity Scheme.

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**

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.

30 Collateral

At 28 February 2009 the Bank held collateral as follows:

- Securities with a fair value of £160 billion (2008: £47 billion) were held as collateral for reverse repurchase agreements with a total value of £137 billion (2008: £39 billion) (note 10). The Bank is permitted to sell all of these assets to third parties but had not done so at 28 February 2009 (2008: £nil).
- Cash collateral of £181 million (2008: £5 million) was held in respect of derivative financial instruments (note 12).
- Securities with a fair value of £245 billion (2008: £nil) and cash collateral of £16 million (2008: £nil) were held as collateral for Treasury Bills lent under the Special Liquidity Scheme with a face value of £185 billion. The Bank is permitted to sell all of these assets to third parties but had not done so at 28 February 2009 (2008: £nil).
- At 28 February 2009 the Bank had pledged assets with a fair value at 28 February 2009 of £592 million (2008: £364 million) as collateral for repurchase agreements of £602 million (2008: £371 million) (note 23).

31 Related parties

The Bank undertakes a number of transactions with individual banks as part of its regular operations. Transactions with those commercial banks, which are related parties but not wholly owned by HM Treasury, have not been disclosed as the Bank does not believe such disclosures to be appropriate having regard to its functions.

a HM Government

The Bank provides a range of activities to its shareholder, HM Treasury, and to other Government departments and bodies:

- Provision of banking services, including holding the principal accounts of Government.
- Management of the Exchange Equalisation Account.
- Management of the Note Issue.

Notes to the Banking Department Financial Statements continued

31 Related parties continued

The Bank also engaged in transactions with the Financial Services Compensation Scheme and other related parties. The aggregate balances on HM Treasury and other public sector accounts are disclosed in note 24 as public deposits. The total charges made to the Government are disclosed in note 4.

Debt Management Office

The Bank entered into agreements with the United Kingdom Debt Management Office (DMO) whereby the DMO lent Treasury bills to the Bank with the simultaneous agreement that the Bank would deliver equivalent Treasury bills to the DMO on termination.

At 28 February 2009 the Bank had borrowed Treasury bills with a fair value of £185 billion (2008: £nil) under the Bank's Special Liquidity Scheme.

In the period to 28 February 2009 the Bank paid the DMO loan fees for Treasury bills borrowed of £54 million (2008: £nil).

At 28 February 2009 the Bank had a loan from the DMO of £810 million in relation to the provision of funding to the Bank of England Asset Purchase Facility Fund Ltd. Interest on this loan is payable at Bank Rate.

HM Treasury

HM Treasury indemnified the Bank against any losses it may have incurred in connection with a number of its operations. Indemnities in relation to the Special Liquidity Scheme and the activities of the Bank of England Asset Purchase Facility Fund Ltd were outstanding at 28 February 2009.

In the period to 28 February 2009 fees of £19 million were paid to HM Treasury in respect of indemnified operations (2008: £nil).

Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS) is the United Kingdom's statutory fund of last resort for customers of authorised financial services firms set up under the Financial Services and Markets Act 2000 (FSMA). FSCS is independent from the Financial Services Authority, although accountable to it and ultimately to the Treasury.

During the year a number of loans and facilities were made available to the FSCS and indemnified by HM Treasury. By 28 February 2009 the responsibility for funding the FSCS had been transferred to HM Treasury and no facilities with the Bank remained outstanding. The total net income recognised by the Bank during the year in respect of these facilities was £110 million and this was recognised after the deduction of tax as a capital contribution via equity.

Bradford & Bingley plc

On 28 September 2008 under the Banking (Special Provisions) Act 2008 the Chancellor of the Exchequer announced that Bradford & Bingley plc's United Kingdom retail deposit business totalling £19.0 billion along with its branch network and its Isle of Man operations had been transferred to Abbey National. The remainder of the bank was taken into public ownership.

A temporary working capital facility of £5 billion was made available to Bradford & Bingley plc during the year, of which £2.3 billion was drawn. This facility was indemnified by HM Treasury. By 28 February 2009 the responsibility of providing the working capital facility had been transferred to HM Treasury and no facility with the Bank remained outstanding.

At 28 February 2009, Bradford & Bingley plc had £2.7 billion of reverse repurchase agreements outstanding, of which £1.2 billion were held with the Banking Department and £1.5 billion were held with the Issue Department. Deposits placed with the Banking Department at the year end amounted to £0.1 billion.

In the period to 28 February 2009 the Bank has included £14 million of income in relation to the indemnified temporary working capital facility, recognised after the deduction of tax as a capital contribution via equity, and £7 million of income in its pre-tax profit for the year.

Northern Rock plc

The Bank had loan facilities to Northern Rock plc, a subsidiary of the Treasury Solicitor acting on behalf of HM Treasury, which were repaid or refinanced by HM Treasury during the year (2008: £24 billion).

The Bank has included £4 million (2008: £26 million) of net income in its pre-tax profit for the year relating to facilities granted to and deposits placed by Northern Rock plc.

The margin over Bank Rate relating to certain facilities (PIK interest) made available during the year was transferred to HM Treasury and has not been recognised in the accounts.

HM Treasury had indemnified the Bank against any loss relating to advances under the working capital line and any unrecovered expenses incurred from 9 October 2007, when facilities were extended. Costs recovered from Northern Rock plc amounted to £4 million (2008: £9 million) including less than £1 million (2008: £2 million) charged from HM Treasury.

At 28 February 2009 Northern Rock plc had no reverse repurchase agreements outstanding (2008: £1.2 billion) and deposits with the Bank of £9.1 billion (2008: £0.1 billion). Interest on a portion of deposit balances was due to HM Treasury and during the year amounted to £73 million.

b Group undertakings

Deposits Management (Edge) Ltd

On 8 October 2008 the Financial Services Authority announced that Kaupthing Singer Friedlander (KSF) no longer met the threshold conditions for authorisation. The retail deposits obtained through the internet-based 'Edge' accounts were transferred to a new Bank of England subsidiary, Deposits Management (Edge) Ltd. These deposits totalling £3.1 billion were sold to ING Direct NV on 9 October 2008 for a profit of £5 million.

As at 28 February 2009, Deposits Management (Edge) Ltd held £5 million on deposit at the Bank.

Bank of England Asset Purchase Fund Facility Ltd

On 30 January 2009 Bank of England Asset Purchase Fund Facility Ltd (BEAPFF) was incorporated as an entity owned by the Bank.

The company was set up to increase the availability of corporate credit by reducing the illiquidity of underlying assets through an asset purchase programme. The programme also provided a framework for the Monetary Policy Committee to use asset purchases for monetary policy purposes. The intention of the MPC to undertake purchases of assets for that purpose was announced on 5 March.

In the initial phase of this programme the asset purchases were financed by lending from the DMO to the Bank and by the Bank to BEAPFF at Bank Rate.

At 28 February 2009 the loan from the DMO to the Bank and the loan from the Bank to BEAPFF were each £810 million. Costs recoverable from BEAPFF amounted to £1 million.

The Bank has not consolidated BEAPFF in its financial statements as it has no economic interest in its activities.

Details of the group undertakings of the Bank are disclosed in note 15.

Notes to the Banking Department Financial Statements continued

31 Related parties continued

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 28 February 2009, the number of key management personnel was 21 (2008: 25).

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

	2009 £000	2008 £000
Loans		
Balance brought forward	16	38
Loans made during year	–	–
Loans repaid during year	(14)	(22)
	2	**16**
Interest income earned	1	1
Number of loans at 28 February	1	4

No provisions have been recognised in respect of loans given to related parties (2008: £nil).

	2009 £000	2008 £000
Deposits		
Governors and Executive Directors		
Balance brought forward	323	372
Deposits taken during year	509	484
Deposits repaid during year	(633)	(533)
	199	**323**
Non-executive Directors		
Balance brought forward	10	29
Deposits taken during year	11,599	11
Deposits repaid during year	(18)	(30)
	11,591	**10**
Interest expense on above deposits	70	16
Number of deposits at 28 February	12	7

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, including Governors and Executive Directors, holding current and interest-bearing deposit accounts at the Bank of England receive interest at commercial rates.

Key management remuneration

	2009 £000	2008 £000
Salaries and short-term benefits	2,420	2,172
Post-employment benefits	747	769
	3,167	**2,941**

Full information on the remuneration (including pension arrangements) of the Members of Court is given in the Remuneration Report on pages 33 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 28 February 2009 a charge of less than £1 million (2008: £3 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 £149 million (2008: £84 million). There were no other material transactions between the Bank and the pension scheme during the year to 28 February 2009. At 28 February 2009 the balances on accounts held with the Bank were £110 million (2008: £25 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.

32 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 £174 million (2008: £145 million).

b Capital commitments

Contracts for capital expenditure authorised by Members of Court and outstanding at 28 February 2009 amounted to £3 million (2008: £7 million).

Notes to the Banking Department Financial Statements continued

32 Contingent liabilities and commitments continued

c Operating lease commitments — minimum lease payments

	2009		2008	
	Land and buildings £000	**Computer and other equipment £000**	Land and buildings £000	Computer and other equipment £000
At the year end, minimum lease payments under non-cancellable operating leases were:				
Expiring within one year	8	254	96	134
Between one and five years	1,149	146	1,140	219
Expiring in five years or more	429	–	514	–
	1,586	**400**	**1,750**	**353**

The Bank leases the premises occupied by its regional Agencies.

33 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.

The Risk Management Division within the Bank's Markets area is responsible for monitoring and reporting on the risks faced by the Bank in its operations in financial markets.

Risk Management Framework for non-routine operations

In the Bank's Special Liquidity Scheme, Extended-Collateral Long-Term Repo Operations, US Dollar Repo Operations and Discount Window Facility, the Bank may take a wider range of collateral than is taken in its routine operations. Depending on the facility, the collateral may include mortgage-backed securities, covered bonds backed by mortgages or public sector assets and other asset-backed securities (ABS) (such as ABS backed by credit card receivables, student loans and auto loans). The collateral must meet published eligibility criteria and is subject to ongoing risk management.

The Bank manages the risk in its wider collateral portfolios by applying haircuts to market prices to take account of liquidity (price) risk and credit risk. The Bank undertakes stress-testing of securities in order to ensure that haircuts are sufficient to protect against idiosyncratic risk in the underlying collateral pool and counterparty risk. The Bank may vary haircuts at its discretion.

The Bank values securities daily and calls for additional collateral where the haircut adjusted value is less than the value of liquidity provided. Where possible, the Bank uses a market price to value securities. Where no such market price exists, the Bank uses a model designed to deliver a price that is as close as possible to what a market price would be had such a price existed. Back-testing has been carried out to validate model-based prices. Pricing, the use of spreads in models and collateral are under regular review. A Collateral Review Committee is chaired by the Head of the Markets Directorate's Risk Management Division, and the Executive Director for Markets chairs a Special Liquidity Scheme Steering Group.

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 source of credit risk arises 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 intra day 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, intra day, via the Bank's operation of wholesale payment systems, credit risk is managed by ensuring that exposures are fully collateralised (with appropriate margin) by investment-grade securities. To address elevated pressures in short-term money markets, the Bank has accepted a wider range of investment-grade securities as collateral against funds advanced at the three-month maturity. A summary of eligible collateral can be found on the Bank's website.(1) All such exposures are monitored on a regular basis, and additional margin is called as required.

Credit risk on the securities held outright by the Bank is managed by holding only investment-grade 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.

In non-routine circumstances, the Bank will seek appropriate methods of mitigating credit risk, including indemnities from HM Treasury. Non-routine operations, such as the Special Liquidity Scheme, are covered in note (e) below.

(1) See www.bankofengland.co.uk/markets/money/eligiblesecurities.htm.

Notes to the Banking Department Financial Statements continued

33 Financial risk management continued

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:

	2009 £m	2008 £m
Assets		
United Kingdom	108,369	60,501
Rest of Europe	37,383	11,091
Rest of the world	2,176	409
	147,928	**72,001**
Liabilities		
United Kingdom	122,960	48,009
Rest of Europe	4,202	4,717
Rest of the world	20,766	19,275
	147,928	**72,001**

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. The Bank's market risk standard sets out high-level risk management parameters, governance and control frameworks as well as reporting arrangements for key risk indicators.

The Bank is exposed to interest rate risk principally via its three-month long-term reverse repurchase operations conducted as part of the sterling monetary framework. The Bank is also exposed to interest rate risk on the investment of the Bank's capital and Cash Ratio Deposits in investment-grade securities with maturity up to fifteen years, bought and held to maturity in normal circumstances with the intention of maintaining the value of the Bank's capital and generating income to pay for the Bank's policy functions.

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 is further supplemented by the daily monitoring and reporting of interest rate sensitivities as well as total foreign exchange exposures. The increase in VaR from 2008 to 2009 reflects both an increase in general market volatility and the expansion of long-term reverse repurchase agreements on the Bank's balance sheet.

Value at Risk	2009 £m	2008 £m
At 28 February	92.2	44.4
Average	70.5	37.7

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 are calculated on an end-of-day basis and do 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 £324 million (2008: £307 million). Excluding this the Bank's total foreign exchange exposure at 28 February 2009 was £12 million (2008: £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 reserves balances held with the Bank (see page 17). For this reason, the tables on pages 94 and 95 exclude sterling assets and liabilities.

For foreign currency, in addition to holding appropriate cash balances, the Bank manages liquidity through cash flow matching and the use of forward exchange contracts and currency swaps; the Bank also holds a portfolio of liquid foreign exchange reserves. In September 2008, the Bank commenced operations to lend US dollar funds against eligible collateral. Through a reciprocal swap agreement, the US Federal Reserve provided the Bank of England with US dollar funding to facilitate these operations.

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 cash flow and maturity mismatches, for bond holdings minimum issue size and concentrations limits are set as well as reporting requirements for key risk indicators. The following tables analyse the Bank's financial assets and liabilities at the balance sheet dates into relevant maturity groupings based on the remaining period to the contractual maturity date.

Notes to the Banking Department Financial Statements continued

33 Financial risk management continued

As at 28 February 2009

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Assets						
Loans and advances to banks and other financial institutions	6,669	11,299	1,383	–	–	19,351
Financial assets designated at fair value through profit or loss	4	160	1,049	2,188	–	3,401
Derivative financial instruments:						
Cash inflow	2,053	1,384	1,512	1,093	–	6,042
Cash outflow	(2,495)	(1,652)	(1,456)	(919)	–	(6,522)
Other assets	442	30	11	–	–	483
Total assets	**6,673**	**11,221**	**2,499**	**2,362**	**–**	**22,755**
Liabilities						
Deposits from central banks	5,966	10,984	1,422	–	–	18,372
Deposits from banks and other financial institutions	181	325	276	–	–	782
Derivative financial instruments:						
Cash inflow	(2,261)	(234)	(412)	(267)	–	(3,174)
Cash outflow	2,110	340	409	292	–	3,151
Financial instruments at fair value through profit or loss	100	–	–	2,941	–	3,041
Other liabilities	688	30	10	–	–	728
Total liabilities	**6,784**	**11,445**	**1,705**	**2,966**	**–**	**22,900**
Net liquidity gap	**(111)**	**(224)**	**794**	**(604)**	**–**	**(145)**
Cumulative gap	**(111)**	**(335)**	**459**	**(145)**	**(145)**	

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 central banks	226	–	–	–	–	226
Loans and advances to banks and other financial institutions	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 other financial institutions	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 instruments 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)**	

e Fair value 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.

Notes to the Banking Department Financial Statements continued

34 Cash and cash equivalents

i Analysis of cash balances

	Note	At 1 March 2008 £m	Cash flows £m	At 28 February 2009 £m
Cash and balances with other central banks	9	226	1,290	1,516
Loans and advances to banks and other financial institutions	10	4,649	541	5,190
		4,875	**1,831**	**6,706**

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.

35 Post balance sheet event

On 30 March 2009 DBS Bridge Bank Limited ('DBS'), a private limited company newly incorporated in Scotland and authorised by the UK Financial Services Authority, was set up as a group undertaking wholly owned by the Bank. As part of the resolution of Dunfermline Building Society (effected pursuant to the Bank's powers under the Banking Act 2009) on 30 March 2009, the loans and deposits associated with the social housing business of Dunfermline Building Society (the 'Business') were transferred to DBS. It is the Bank's intention that the Business is sold in due course, at which time the proceeds of sale (less certain costs) will be applied to the benefit of the resolution fund to be established by HM Treasury pursuant to section 52 (2) of the Banking Act 2009. The Bank will not consolidate DBS on the basis it has no economic interest in the company.

36 Date of approval

The Members of Court approved the financial statements on pages 52 to 96 on 14 May 2009.

Issue Department

Account for the period ended 28 February 2009

	Note	2009 £m	2008 £m
Income and Profits			
Securities of, or guaranteed by, the British Government		499	735
Other securities and assets		1,768	1,636
		2,267	**2,371**
Expenses	2		
Cost of production of Bank notes	8	48	23
Cost of issue, custody and payment of Bank notes		24	17
Other expenses		7	4
		79	**44**
Payable to HM Treasury		**2,188**	**2,327**

Statement of balances: 28 February 2009

	Note	2009 £m	2008 £m
Assets			
Securities of, or guaranteed by, the British Government	3	9,585	8,168
Other securities and assets including those acquired under reverse repurchase agreement	4	39,023	36,810
Total assets		**48,608**	**44,978**
Liabilities			
Notes issued:			
In circulation	5	48,608	44,978
Total liabilities		**48,608**	**44,978**

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 98 to 99 are an integral part of these statements of account.

Notes to the Issue Department Statements of Account

1 Bases of preparation

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, with purchased accrued interest, in the balance sheet at this valuation. The last valuation was made at 28 February 2009.
- 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 gain in the year to 28 February 2009 amounted to £294 million (2008: deficit less than £1 million).

2 Expenses

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

3 Securities of, or guaranteed by, the British Government

	2009 £m	2008 £m
British Government Stocks	5,443	798
Ways and Means advance to the National Loans Fund	4,142	7,370
	9,585	**8,168**

The Ways and Means advance earns interest at Bank Rate.

4 Other assets including those acquired under reverse repurchase agreements

	2009 £m	2008 £m
Deposit with Banking Department	29,225	19,211
Reverse repurchase agreements	9,798	17,599
	39,023	**36,810**

5 Notes in circulation

	2009 £m	2008 £m
£5	1,302	1,242
£10	6,304	6,115
£20	28,089	25,648
£50	8,691	7,526
Other notes*	4,222	4,447
	48,608	**44,978**

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

6 Assets and liabilities

a Interest rate exposure

As the liabilities of Issue Department are interest free, the income of Issue Department is directly exposed to movements in interest rates. As at the year end 28 February 2009, the assets of Issue Department had the following repricing period profile; repricing in up to one month £35 billion (2008: £34 billion), repricing in greater than one but less than three months £3 billion (2008: £4 billion), repricing in greater than three but less than six months £4 billion (2008: £4 billion), repricing in greater than six but less than twelve months £2 billion (2008: £2 billion) and, repricing greater than one year £5 billion (2008: £1 billion).

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 investment-grade securities.

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

7 Accrued interest

At 28 February 2009 the unrecognised accrued interest on the assets held on the Issue Department Statement of Balances was £235 million (2008: £251 million).

8 Accrued expenses

On an accruals basis, the cost of production of Bank notes for the year to 28 February 2008 was £38 million (2008: £33 million).

9 Date of approval

The Members of Court approved the statements of account on pages 97 to 99 on 14 May 2009.

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Enquiries relating to the Bank of England *Quarterly Bulletin* and *Inflation Report* may be made on 020 7601 4030 and *Financial Stability Report* on 020 7601 3009.

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