Banking Department
Income Statement for the year to 28 February 2010

	Note	2010 £m	2009 £m
Profit before tax	4	231	995
Corporation tax net of tax relief on payment to HM Treasury	7	(37)	(162)
Profit for the year attributable to shareholder		**194**	**833**

The notes on pages 51 to 90 are an integral part of these financial statements.

Statement of Comprehensive Income
for the year to 28 February 2010

	Note	**2010** **£m**	2009 £m
Profit for the year attributable to shareholder		194	833
Other comprehensive income:			
Revaluation of available for sale securities	14	36	199
Revaluation of properties	17	5	(43)
Actuarial losses on retirement benefits	19	(70)	(213)
Corporation tax relating to components of other comprehensive income	7	8	5
Other comprehensive income for the year, net of tax		(21)	(52)
Total comprehensive income for the year		**173**	**781**

The notes on pages 51 to 90 are an integral part of these financial statements.

Balance Sheet as at 28 February 2010

	Note	2010 £m	2009 £m
Assets			
Cash and balances with other central banks	9	486	1,516
Loans and advances to banks and other financial institutions	10	12,510	136,829
Securities held at fair value through profit or loss	11	4,085	3,334
Derivative financial instruments	12	361	287
Other loans and advances	13	199,935	815
Available for sale securities	14	4,390	3,937
Investments in subsidiaries	15	–	–
Intangible assets	16	13	17
Property, plant and equipment	17	181	176
Investment properties	18	26	26
Retirement benefit assets	19	269	294
Other assets	20	848	697
Total assets		**223,104**	**147,928**
Liabilities			
Money market instruments in issue	21	–	42,212
Deposits from central banks	22	11,429	24,356
Deposits from banks and other financial institutions	23	169,920	42,186
Other deposits	24	32,335	31,638
Foreign currency bonds in issue	25	4,126	2,965
Derivative financial instruments	12	263	81
Current tax liabilities		163	235
Deferred tax liabilities	26	146	134
Retirement benefit liabilities	19	208	178
Other liabilities	27	290	622
Total liabilities		**218,880**	**144,607**
Equity			
Capital	28	15	15
Retained earnings		3,621	2,748
Other reserves		588	558
Total equity attributable to shareholder		**4,224**	**3,321**
		223,104	**147,928**

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

M A King Governor
C R Bean Deputy Governor
Sir David Lees Chairman of Court
W R Jones Finance Director

The notes on pages 51 to 90 are an integral part of these financial statements.

Statement of Changes in Equity
for the year to 28 February 2010

	Attributable to equity shareholder				
	Share capital £m	Available for sale reserve £m	Property revaluation reserve £m	Retained earnings* £m	Total £m
Balance at 1 March 2008	15	296	161	1,821	2,293
Comprehensive income for the period	–	144	(43)	680	781
Post-tax surplus from indemnified operations	–	–	–	664	664
Payable to HM Treasury in lieu of dividend	–	–	–	(417)	(417)
Balance at 28 February 2009	**15**	**440**	**118**	**2,748**	**3,321**
Comprehensive income for the period	–	25	5	143	173
Post-tax surplus from indemnified operations	–	–	–	827	827
Payable to HM Treasury in lieu of dividend	–	–	–	(97)	(97)
Balance at 28 February 2010	**15**	**465**	**123**	**3,621**	**4,224**

*At February 2010 retained earnings included £1,400 million in relation to the Special Liquidity Scheme (2009: £573 million).

The notes on pages 51 to 90 are an integral part of these financial statements.

Statement of Cash Flows for the year to 28 February 2010

	Note	2010 £m	2009 £m
Cash flows from operating activities			
Profit before taxation		231	995
Adjustment items:			
Amortisation of intangibles	16	5	6
Depreciation of property, plant and equipment	17	9	7
Profit on sale of available for sale securities	14	–	(1)
Impairment of intangible assets		1	–
Dividends received	4	(12)	(11)
Net movement in provisions, including pensions and accrued interest		87	581
Changes in operating assets and liabilities:			
Loan advanced to Bank of England Asset Purchase Facility Fund Ltd		(199,122)	(810)
Net decrease/(increase) in other advances		123,408	(73,503)
Net (increase)/decrease in securities held at fair value through profit or loss		(402)	1,181
Net (decrease)/increase in money market instruments in issue		(42,212)	42,212
Net increase in deposits		114,801	33,422
Net increase/(decrease) in foreign currency bonds in issue		1,420	(1,791)
Net movement in financial derivatives		108	(811)
Net increase in other accounts		–	3
Corporation tax paid		(165)	(83)
Net cash (outflow)/inflow from operating activities		**(1,843)**	**1,397**
Cash flows from investing activities			
Purchase of available for sale securities		(837)	(222)
Proceeds from sale or redemption of available for sale securities	14	426	265
Dividends received	4	12	11
Purchase of intangible assets		(2)	(5)
Purchase of property, plant and equipment		(9)	(10)
Net cash (outflow)/inflow from investing activities		**(410)**	**39**
Cash flows from financing activities			
Cash generated from indemnified operations		1,152	476
Payment to HM Treasury under Section 1 (4) of the Bank of England Act 1946		(417)	(81)
Net cash inflow from financing activities		**735**	**395**
Net (decrease)/increase in cash and cash equivalents		**(1,518)**	**1,831**
Cash and cash equivalents at 1 March	29	6,706	4,875
Cash and cash equivalents at 28 February	29	**5,188**	**6,706**

The notes on pages 51 to 90 are an integral part of these financial statements.

Notes to the Banking Department Financial Statements

1 General information

The Bank of England is the central bank of the United Kingdom and is incorporated under a Royal Charter of 1694. Legislation covering its operations includes the Bank Charter Act 1844, 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 91 to 93, 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 the 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 the Banking Department comprise the Income Statement, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Statement of Cash Flows 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').

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 and all financial assets and financial liabilities (including derivatives) that are held at fair value through profit or loss.

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 reported 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 Statement of Cash Flows.

Notes to the Banking Department Financial Statements continued

2 Bases of preparation continued

- Operating segments.
- Contingent liabilities and guarantees.
- Information on credit risk.

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.

The following new standards have been applied in 2009/10 except insofar as the Bank considers disclosures inappropriate to its functions:

- Amendments to IAS 1 (Presentation of Financial Statements).
- Amendments to IFRS 7 (Financial Instruments: Disclosures).
- Amendments to IFRS 1 & IAS 27 (Cost of Investment in a Subsidiary, Jointly-Controlled Entity or Associate).
- IFRS 8 (Operating Segments).

The application of these standards had no material impact on the financial statements.

The amendments to IAS 17 (Leases) have not been adopted early. The Bank is in the process of assessing the impact of applying these amendments on its financial statements. No other new standards were both relevant to the Bank and available for early adoption in the year.

b Consolidation

The financial statements of the Bank of England Asset Purchase Facility Fund Ltd (BEAPFF) have not been consolidated as the Bank has no economic interest in its activities. BEAPFF's operations are fully indemnified for loss by HM Treasury and any surplus for these operations is due to HM Treasury. DBS Bridge Bank Ltd and Deposits Management (Edge) Ltd have also not been consolidated as the Bank has no economic interest in their activities.

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 subsidiaries are stated in the balance sheet at cost, less any provision for impairment in value. Dividends from subsidiaries 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 other comprehensive income, such as equity investments classified as financial assets that are available for sale, the related exchange gain or loss is also recognised in other comprehensive income.

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 (ie the fair value of the consideration given or received). All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Derivatives are used for matching exposures on assets and liabilities, both individually and of portfolios. The Bank has 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.

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 exclude reverse repurchase agreements designated at fair value through profit or loss.

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 must be held at fair value through profit or loss where the hedge accounting rules have not been applied (see (d) above). The Bank does not currently hold any financial assets for trading but designates the following at fair value through profit or loss at inception:

- Assets matching the Bank's issued foreign currency securities.
- Reverse repurchase agreements matching the fixed-term deposits placed at the Bank by other central banks.

This designation is to eliminate, or significantly reduce, inconsistencies that would otherwise arise from measuring assets and liabilities on different bases. The relevant assets and liabilities (including 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 and reverse repurchase agreements designated at fair value through profit or loss are recognised on a settlement date basis. Purchases of all other categories of financial assets are recognised on a trade date basis. All financial assets are initially recognised at fair value.

Notes to the Banking Department Financial Statements continued

2 Bases of preparation continued

iii Subsequent valuation of financial assets

Gains and losses arising from changes in the fair value of assets classified as 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 as other comprehensive income until the financial asset is derecognised or impaired (see (iv) below), at which time the cumulative gain or loss previously recognised as other comprehensive income is recognised in the Income Statement. Any premium or discount paid on the purchase of available for sale debt instruments is amortised through the Income Statement using the effective interest rate method.

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 61.

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 discounted at the asset's original effective interest rate. 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.

If, in a subsequent period, the fair value of an equity investment designated as available for sale increases the impairment loss is 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 amounts paid or received that are an integral part of the effective interest rate of a financial instrument, including 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 where the transferee has the right by contract or custom to sell the collateral. These securities remain on the balance sheet and the liability is included in deposits from banks and other financial institutions. Securities purchased under agreements to resell ('reverse repurchase agreements') are not recognised on the balance sheet; the asset is included in loans and advances to banks and other financial institutions. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements.

Securities lent to counterparties also remain on the balance sheet. Securities borrowed are not recognised on the balance sheet, 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.

h Special Liquidity Scheme

The Special Liquidity Scheme involves borrowing UK Treasury bills from the United Kingdom Debt Management Office ('DMO') and swapping them for securities held by banks and building societies.

The accounting for securities borrowing and lending has been determined in accordance with the recognition principles set out in IAS 39. Neither the bills borrowed from the DMO nor the collateral received from the counterparties to whom the bills are lent are recognised on the balance sheet as the Bank is not a party to the contractual provisions of those instruments.

The detail of the Treasury bills borrowed and collateral taken is set out in note 30.

i 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 over 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.

Notes to the Banking Department Financial Statements continued

2 Bases of preparation continued

j 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
IT equipment	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.

k 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.

l 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.

m Cash and cash equivalents

For the purposes of the Statement of Cash Flows, 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 and other financial institutions, amounts due from banks and short-term government securities.

n Financial instruments: liabilities

i Money market instruments in issue

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

ii Deposits

Deposits held are carried at cost with interest expense accruing on an effective interest rate basis. They arise when the Bank receives money or services directly from a counterparty with no intention of trading the payable.

Cash Ratio Deposits are taken to fund certain activities of the Bank in accordance with the Bank of England Act 1998. These deposits are held at cost and are interest free.

iii Financial liabilities at fair value through profit or loss

At the end of the year these liabilities comprised:

- Three three-year bonds denominated in US dollars, which were issued as part of the Bank's annual medium-term issuance programme; and
- Fixed-term deposits placed by other central banks.

All foreign currency liabilities 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.

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

o Fees and commission income

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

p 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.

Notes to the Banking Department Financial Statements continued

2 Bases of preparation continued

q Retirement benefits

The Bank operates a non-contributory defined-benefit pension scheme providing defined benefits based on final and career average pensionable pay. The final salary element of the scheme is closed to new members. 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 other comprehensive income. Current and 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 related redundancy provisions and healthcare for certain pensioners, which are accounted for on a similar basis to that used to account for pension obligations.

r 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 £28 million (2009: £117 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 remeasurement of available for sale securities and actuarial gains and losses on retirement benefit obligations, which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the Income Statement together with the current or deferred gain or loss if and when realised.

s 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.

t 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.

u Commitments on behalf of HM Treasury

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

3 Significant accounting estimates and judgements in applying accounting policies

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities. 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 19a, 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 14b, 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 methodology, 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.

d Intangible assets

Management has made certain judgements when capitalising intangible assets. Various costs incurred in the production of an internal project are capitalised if a number of criteria are met. Management has made judgements and assumptions when assessing whether a project meets these criteria and when measuring the costs and economic life attributable to such projects.

Notes to the Banking Department Financial Statements continued

4 Profit before tax

	Note	2010 £m	2009 £m
Income includes			
Charges for services to HM Government (including charges to the Issue Department in respect of the note issue)		81	82
Banking charges and tariff income		21	29
Rental income from investment properties		1	1
Dividend income		12	11
Expenses includes			
Staff costs	5	155	146
Legal fees		6	8
Amortisation of intangible assets	16	5	6
Depreciation of property, plant and equipment	17	9	7
Software expenditure		7	9
Operating lease rentals — property		1	1
— other		1	1
Other administrative expenses		102	103

5 Staff costs

	Note	2010 £m	2009 £m
Wages and salaries		93	87
Social security costs		9	8
Pension and other post-retirement costs:			
Funded pension schemes	19	38	35
Redundancy provisions	19	8	8
Other unfunded pension schemes	19	–	–
Other post-retirement benefits	19	7	8
		155	**146**

Wages and salaries include £1 million of costs capitalised as intangible assets (2009: £2 million).

Average number of employees

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

	2010	2009
Governors and other members of the Executive Team	9	9
Managers and analysts	738	674
Other staff	1,149	1,133
	1,896	**1,816**

The number of persons employed by the Bank at the end of the year was 1,904, of which 1,685 were full-time and 219 were part-time (2009: 1,857; of which 1,642 full-time and 215 part-time).

6 Auditor's remuneration

	2010 £000	2009 £000
Audit fees for the Bank audit:		
— Fees relating to current year	302	313
— Fees relating to prior year	16	15
Fees payable to the primary auditor for other services provided to the Bank:		
— Tax services	132	215
— All other services*	492	846
	942	**1,389**

*Of the amounts included in all other services £301,000 of accounting fees were recovered from third parties during the year to 28 February 2010 (2009: £556,000).

In addition, fees of £55,000 for audit services and £42,000 for tax services in relation to Bank of England Asset Purchase Facility Fund Ltd paid by the Bank were recovered via a management fee (2009: £nil).

7 Taxation

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

	2010 £m	2009 £m
Current United Kingdom corporation tax	34	137
Prior year corporation tax	(1)	2
Deferred tax — current year	4	26
— prior year	–	(3)
Tax charge on profit	**37**	**162**

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:

	2010 £m	2009 £m
Profit before tax	231	995
Tax calculated at rate of 28% (2009: 28.17%)	65	280
Tax relief on payment to HM Treasury	(28)	(117)
Non-deductible items	1	–
Prior year items	(1)	(1)
Total tax charge for the period	**37**	**162**

Notes to the Banking Department Financial Statements continued

7 Taxation continued

Tax charged directly to equity comprises:

	2010 £m	2009 £m
Tax charged to equity through other comprehensive income		
Current United Kingdom corporation tax	(16)	54
Deferred tax	8	(59)
	(8)	**(5)**
Other tax charged directly to equity		
Current United Kingdom corporation tax	321	261
Tax charged directly to equity	**313**	**256**

Tax charged directly to equity is attributable as follows:

	2010 £m	2009 £m
Tax charged/(credited) to equity through other comprehensive income		
Revaluation of available for sale securities	11	55
Actuarial losses on retirement benefits	(19)	(60)
	(8)	**(5)**
Other tax charged directly to equity		
Surplus on indemnified operations	321	261
Tax charged directly to equity	**313**	**256**

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

	2010 £m	2009 £m
Payable 1 April (2009: 3 April)	47	203
Payable 5 October	50	214
	97	**417**

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 2010. 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 1 April 2010 was based on provisional figures. The balance is payable on 5 October 2010.

9 Cash and balances with other central banks

	2010 £m	2009 £m
Cash	–	–
Balances with other central banks	486	1,516
	486	**1,516**

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

10 Loans and advances to banks and other financial institutions

	2010 £m	2009 £m
Items in course of collection	–	32
Reverse repurchase agreements held at amortised cost	3,597	136,662
Reverse repurchase agreements held at fair value through profit or loss	8,738	–
Other loans and advances	175	135
	12,510	**136,829**

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 2010 loans and advances to banks and other financial institutions included cash and cash equivalents of £4.2 billion (2009: £5.2 billion) which are disclosed in note 29(i).

11 Securities held at fair value through profit or loss

	2010 £m	2009 £m
Money market instruments	568	–
Listed foreign government securities	2,783	2,107
Other listed securities	734	1,227
	4,085	**3,334**

The holdings of foreign government and other foreign currency 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 2010 this portfolio was financed by three $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.

At 28 February 2010 securities held at fair value through profit or loss included cash and cash equivalents of £0.5 billion (2009: £nil) which are disclosed in note 29(i).

Notes to the Banking Department Financial Statements continued

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. 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 2010

	Contract notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Cross-currency interest rate swaps — positive value	715	82	–
— negative value	1,723	–	(100)
	2,438	**82**	**(100)**
Interest rate swaps — positive value	2,702	76	–
— negative value	2,552	–	(83)
	5,254	**76**	**(83)**
Forward exchange contracts — positive value	6,010	203	–
— negative value	4,818	–	(80)
	10,828	**203**	**(80)**
Total recognised derivative assets/(liabilities)		**361**	**(263)**

b As at 28 February 2009

	Contract notional amount £m	Fair values Assets £m	Fair values Liabilities £m
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)**
Forward exchange contracts — positive value	5,242	92	–
— negative value	3,070	–	(45)
	8,312	**92**	**(45)**
Total recognised derivative assets/(liabilities)		**287**	**(81)**

13 Other loans and advances

	2010 £m	2009 £m
Overdrafts	–	–
Loan to the Bank of England Asset Purchase Facility Fund Ltd	199,932	810
Term loans	3	5
	199,935	**815**

Loan to Bank of England Asset Purchase Facility Fund Ltd (BEAPFF)

Upon receipt of notification of BEAPPF's intention to draw down under the loan, the Bank is required to make the advance and may only obtain repayment with the agreement of BEAPFF. The loan is ultimately repayable on termination of BEAPFF's operations.

Notes to the Banking Department Financial Statements continued

14 Available for sale securities

	2010 £m	2009 £m
Debt securities at fair value		
British Government securities listed on a recognised UK exchange	3,321	2,628
Other sterling securities listed on a recognised exchange	636	980
	3,957	3,608
Unlisted equity investments at fair value	433	329
	4,390	**3,937**

The movement in available for sale securities comprises:

	2010 £m	2009 £m
Available for sale debt securities		
At 1 March	3,608	3,541
Purchases	880	222
Redemptions	(426)	(265)
Mark-to-market movements through equity	(68)	179
Amortisation of premium/discount	(32)	(26)
Movement in accrued interest	(5)	(43)
At 28 February	**3,957**	**3,608**
Available for sale unlisted equity investments		
At 1 March	329	311
Revaluation of securities	104	19
Disposal of securities	–	(1)
At 28 February	**433**	**329**
	4,390	**3,937**

No gains or losses on available for sale securities were transferred to the Income Statement during the year (2009: gain of less than £1 million).

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 2010 the holding represents 8.7% (2009: 8.7%) of the issued share capital. The investment has been valued on a dividend yield basis providing a value of £428 million (2009: £324 million) at the year end. A discount rate of 7% was used. Increasing the discount rate by 1 percentage point would deflate the valuation by £88 million, while decreasing the discount rate by 1 percentage point would inflate the valuation by £158 million.

The Bank's holding in the European Central Bank represents the Bank's contribution of €59 million (2009: €59 million) to the capital of the European Central Bank. This represents 1.41% (2009: 1.41%) of the European Central Bank's paid-up share capital. As a non euro area central bank the Bank is required to contribute 7% (2009: 7%) of its subscribed share capital. If the United Kingdom were to participate in Economic and Monetary Union a further contribution would be required and the Bank's paid-up share would then amount to 14.5% (2009: 14.5%) 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 £nil (2009: £nil).

15 Investments in subsidiaries

Bank of England Asset Purchase Facility Fund Ltd ('BEAPFF') is a wholly-owned subsidiary of the Bank. The investment of 100 £1 ordinary shares is held at cost on the Bank's balance sheet.

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

Deposits Management (Edge) Ltd is a wholly-owned subsidiary of the Bank. The investment of 1 £1 ordinary share is held at cost on the Bank's balance sheet. The Bank has not consolidated Deposits Management (Edge) Ltd in its financial statements as it has no economic interest in its activities.

DBS Bridge Bank Ltd, a wholly-owned subsidiary of the Bank, was in members' voluntary liquidation at the year end. The investment of 1 £1 ordinary share is held at cost on the Bank's balance sheet. The Bank has not consolidated DBS Bridge Bank Ltd in its financial statements as it has no economic interest in its activities.

Minories Finance Ltd, a wholly-owned subsidiary, has been in members' voluntary liquidation throughout the year ended 28 February 2010. During the year no distributions were received from the liquidators (2009: less than £1 million) other than a second and final specie distribution of £1. The Bank has not consolidated Minories Finance Ltd in its financial statements on the grounds of immateriality.

The Bank has a number of other non-trading subsidiaries, which are wholly-owned. 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
Bank of England Nominees Ltd	2 ordinary shares of £1
BE Pension Fund Trustees Ltd	2 ordinary shares of £1

The aggregate net assets of these subsidiary companies are £1 million (2009: £1 million), which consist of balances held with the Bank.

Notes to the Banking Department Financial Statements continued

16 Intangible assets

	2010 £m	2009 £m
Cost		
At 1 March	42	38
Additions	2	5
Impairment	(4)	(1)
At 28 February	**40**	**42**
Accumulated amortisation		
At 1 March	25	19
Charge for the year	5	6
Reversal due to impairment	(3)	–
At 28 February	**27**	**25**
Net book value at 1 March	17	19
Net book value at 28 February	**13**	**17**

Intangible assets comprise computer software costs capitalised.

17 Property, plant and equipment

For the year to 28 February 2010

	Freehold land and buildings £m	Equipment* £m	Total £m
Cost or valuation			
At 1 March 2009	162	55	217
Additions	5	4	9
Revaluation of properties	–	–	–
At 28 February 2010	**167**	**59**	**226**
Accumulated depreciation			
At 1 March 2009	–	41	41
Charge for the year	5	4	9
Written back on revaluation	(5)	–	(5)
At 28 February 2010	**–**	**45**	**45**
Net book value at 1 March 2009	162	14	176
Net book value at 28 February 2010	**167**	**14**	**181**

*Net book value of equipment at 28 February 2010 includes £6 million held under finance leases.

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.

The figures for freehold land and buildings reflect independent professional valuations on a market value basis at 28 February 2010 by Drivers Jonas Deloitte, 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 Valuation Standards.

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.

	2010 £m	2009 £m
Cost		
At 1 March	26	26
At 28 February	**26**	**26**

The fair value of investment properties at 28 February 2010 was £42 million (2009: £41 million). This value represents the deferred consideration on the lease remaining at 28 February 2010 plus the estimated market value of the properties as provided by Drivers Jonas Deloitte (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 £0.3 million per annum (2009: £0.1 million).

Notes to the Banking Department Financial Statements continued

19 Retirement benefits

The Bank operates a non-contributory defined-benefit pension scheme providing benefits based on final and career average pensionable pay. The final salary element of the scheme is closed to new members. 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 related redundancy provisions and healthcare for certain pensioners.

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

The assumptions used for the purposes of the valuation under IAS 19 are different from those used for the funding valuation. The effect of the liability matching investment policy is not therefore fully reflected in the accounting figures.

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 the 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 have agreed a deficit reduction plan. At the balance sheet date five payments of £27 million of the agreed plan remain to be paid.

Excluded from the contribution rate is the cost of administration expenses.

Summary of amounts recognised in the financial statements under IAS 19

The Bank accounts for pension costs and other post-retirement benefits 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 other comprehensive income.

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

		2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Funded pension scheme	(a)	269	294	404	(22)	(147)
Other post-retirement benefits:						
Redundancy provisions	(b)	(70)	(64)	(61)	(70)	(68)
Unfunded pension scheme	(c)	(6)	(6)	(6)	(6)	(5)
Healthcare benefits	(d)	(132)	(108)	(117)	(145)	(151)
		61	**116**	**220**	**(243)**	**(371)**

Pension expense recognised in the Income Statement

		2010 £m	2009 £m
Funded pension scheme	(a)	38	35
Other post-retirement benefits:			
Redundancy provisions	(b)	8	8
Unfunded pension scheme	(c)	–	–
Healthcare benefits	(d)	7	8
		53	**51**

(Losses)/gains recognised in other comprehensive income for the year

		2010 £m	2009 £m
Funded pension scheme	(a)	(46)	(224)
Othe post-retirement benefits:			
Redundancy provisions	(b)	(4)	–
Unfunded pension scheme	(c)	–	–
Healthcare benefits	(d)	(20)	11
		(70)	**(213)**

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.

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

	2010 %	2009 %
Inflation rate (RPI)	2.8	2.8
Discount rate	5.0	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 high-quality corporate bonds at the balance sheet date.

An age-related promotion scale has been added to the increase in salaries assumption.

Notes to the Banking Department Financial Statements continued

19 Retirement benefits continued

The assumption for life expectancy for the scheme assumes that a male member reaching 60 in 2010 will live for 27 years (2009: 27 years) and a female member 30 years (2009: 30 years), and a male member reaching 60 in 2020 will live for 28 years (2009: 28 years) and a female member 31 years (2009: 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:

	2010			2009		
	Long-term rate of return expected %	**Value £m**	**Percentage of total value %**	Long-term rate of return expected %	Value £m	Percentage of total value %
Bonds	4.5	2,339	99.1	4.3	2,028	94.5
Properties	–	–	–	–	1	–
Cash and other assets	4.5	20	0.9	4.3	116	5.5
Total market value of investments		**2,359**	**100.0**		**2,145**	**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 changes in the fair value of assets during the period as a result of actual contributions paid into the scheme and actual benefits paid out of the scheme. 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.

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Present value of defined-benefit obligations	(2,090)	(1,851)	(1,812)	(2,022)	(2,055)
Assets at fair value	2,359	2,145	2,216	2,000	1,908
Defined-benefit asset/(liability)	**269**	**294**	**404**	**(22)**	**(147)**

A +/- 0.1% change in the discount rate would change the surplus on the pension scheme by +/- £33 million (2009: +/- £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 £59 million (2009: £53 million).

The Bank expects to pay contributions of £67 million in the forthcoming year (2009: £59 million).

Components of pension expense in the Income Statement	**2010 £m**	2009 £m
Current service cost	24	22
Interest cost	106	105
Expected return on assets	(92)	(92)
Total pension expense	**38**	**35**

Gains recognised in other comprehensive income

	2010 £m	2009 £m
Cumulative actuarial gains recognised at 1 March	63	287
Actuarial loss on scheme liabilities	(207)	(10)
Actuarial gain/(loss) on scheme assets	161	(214)
Cumulative actuarial gains recognised at 28 February	**17**	**63**

Reconciliation of return on assets

	2010 £m	2009 £m
Expected return on scheme assets (net of expense)	92	92
Actuarial gain/(loss) on scheme assets	161	(214)
Actual return on scheme assets (net of expense)	**253**	**(122)**

Reconciliation of present value of defined-benefit obligation

	2010 £m	2009 £m
Present value of defined-benefit obligation at 1 March	1,851	1,812
Current service cost	24	22
Interest cost	106	105
Actuarial loss relating to scheme liabilities	207	10
Benefits paid from scheme	(98)	(98)
Present value of defined-benefit obligation at 28 February	**2,090**	**1,851**

Reconciliation of the fair value of assets

	2010 £m	2009 £m
Fair value of scheme assets at 1 March	2,145	2,216
Actual return on scheme assets	253	(122)
Bank contributions	59	149
Benefits paid from scheme	(98)	(98)
Fair value of scheme assets at 28 February	**2,359**	**2,145**

Experience gains and losses

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Experience gain/(loss) on defined-benefit obligation	66	(16)	(29)	(16)	20
Experience gain/(loss) on scheme assets	161	(214)	126	(14)	195

Notes to the Banking Department Financial Statements continued

19 Retirement benefits continued

b Redundancy provisions

As part of its previous redundancy arrangements with staff, the Bank gave 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 was made for the costs of these benefits at the time the redundancy offer was announced based on actuarial advice. The scheme was changed with effect from 5 April 2010 and no further similar entitlements will be given by the Bank.

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

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Unfunded defined-benefit liability	**(70)**	**(64)**	**(61)**	**(70)**	**(68)**

Components of pension expense in the Income Statement	**2010 £m**	2009 £m
Past service cost	4	3
Interest cost	4	5
Total pension expense	**8**	**8**

Losses recognised in other comprehensive income	**2010 £m**	2009 £m
Cumulative actuarial losses recognised at 1 March	(4)	(4)
Actuarial loss on liabilities	(4)	–
Cumulative actuarial losses recognised at 28 February	**(8)**	**(4)**

Reconciliation of present value of defined-benefit obligation	**2010 £m**	2009 £m
Present value of defined-benefit obligation at 1 March	64	61
Past service cost	4	3
Interest cost	4	5
Actuarial loss on scheme liabilities	4	–
Payments	(6)	(5)
Present value of defined-benefit obligation at 28 February	**70**	**64**

Experience gains and losses	**2010 £m**	2009 £m	2008 £m	2007 £m	2006 £m
Experience gain/(loss) on defined-benefit obligation	**2**	**(1)**	**1**	**–**	**(1)**

The Bank expects to make payments of £4 million in the forthcoming year (2009: £5 million).

c Unfunded pension scheme

As explained in the Remuneration section of the *Annual Report* on page 41, 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)).

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Unfunded defined-benefit liability	**(6)**	**(6)**	**(6)**	**(6)**	**(5)**

The Bank expects to make payments of less than £1 million in the forthcoming year (2009: less than £1 million).

During the year to 28 February 2010 the Bank incurred services costs of less than £1 million (2009: less than £1 million) and actuarial losses on the scheme liabilities of less than £1 million (2009: less than £1 million).

Experience gains and losses

For the year ended 28 February 2010, experience losses on the defined-benefit obligation were less than £1 million (as they were for the years 2006 to 2009).

d Healthcare 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 healthcare 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:

	2010	2009
Initial medical trend	9.0%	10.0%
Ultimate medical trend	5.0%	5.0%
Years to ultimate	4	4

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Unfunded defined-benefit liability	**(132)**	**(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 healthcare benefits by £2 million (2009: £2 million) and a 0.1% increase in the rate of medical claims by £3 million (2009: £2 million). If mortality rates were adjusted such that individuals were assumed to live for an additional year, the healthcare liabilities at the year end would increase by approximately £4 million (2009: £3 million).

The Bank expects to pay premiums of £4 million in the forthcoming year (2009: £3 million).

Notes to the Banking Department Financial Statements continued

19 Retirement benefits continued

Components of expense in the Income Statement	2010 £m	2009 £m
Service cost	1	1
Interest cost	6	7
Total healthcare benefit cost	**7**	**8**

Amounts recognised in other comprehensive income	2010 £m	2009 £m
Cumulative actuarial losses recognised at 1 March	(6)	(17)
Actuarial (loss)/gain on scheme liabilities	(20)	11
Cumulative actuarial losses recognised at 28 February	**(26)**	**(6)**

Reconciliation of present value of defined-benefit obligation	2010 £m	2009 £m
Present value of defined-benefit obligation at 1 March	108	117
Service cost	1	1
Interest cost	6	7
Actuarial loss/(gain) on scheme liabilities	20	(11)
Premiums paid	(3)	(6)
Present value of defined-benefit obligation at 28 February	**132**	**108**

Experience gains and losses	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Experience gain on defined-benefit obligation	–	11	12	7	–

20 Other assets

	2010 £m	2009 £m
Items in course of settlement	693	108
Short-term debtors and other assets*	155	589
	848	**697**

*Includes £4 million (2009: less than £1 million) of accrued receivables in respect of recharged expenses to Issue Department.

21 Money market instruments in issue

	2010 £m	2009 £m
Sterling bills issued	–	42,212

22 Deposits from central banks

	2010 £m	2009 £m
Deposits repayable on demand	1,515	5,363
Term deposits held at cost	–	18,993
Term deposits held at fair value through profit or loss	9,914	–
	11,429	**24,356**

23 Deposits from banks and other financial institutions

	Note	2010 £m	2009 £m
Items in course of settlement		–	4
Deposits repayable on demand:			
Sterling		166,290	37,732
Non-sterling		166	1,224
Repurchase agreements		684	602
Collateral for derivatives	30	206	181
Cash collateral	30	–	16
Cash Ratio Deposits		2,574	2,427
		169,920	**42,186**

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

	2010 £m	2009 £m
Items in course of settlement	–	5
Deposit by Issue Department	26,655	29,225
Public deposits:		
Repayable on demand	1,364	1,362
Term deposits	–	10
Other deposits repayable on demand	4,316	1,036
	32,335	**31,638**

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

Notes to the Banking Department Financial Statements continued

25 Foreign currency bonds in issue

All changes in fair values since 1 March 2009 are considered attributable to changes in prevailing interest rates and movements in relative foreign currency exchange rates.

As part of the Bank's annual medium-term security issuance programme the Bank has issued three $2 billion three-year dollar bonds (2009: two $2 billion three-year dollar bonds); the first maturing on 22 March 2010, the second on 17 March 2011 and the third on 19 March 2012.

	2010		2009	
	£m Fair value	$m Nominal	£m Fair value	$m Nominal
Total amounts issued to third parties	**4,126**	**6,000**	**2,965**	**4,000**

Of the above liabilities to third parties, £1,375 million (2009: £nil) fall due within one year.

26 Deferred tax liabilities

Deferred tax is calculated on all temporary differences under the liability method using an effective tax rate of 28% (2009: 28%).

The movement on the deferred tax account is as follows:

	Note	2010 £m	2009 £m
Deferred tax			
Net liability at 1 March		(134)	(170)
Income statement charge	7	(4)	(23)
Other comprehensive income	7	(8)	59
Net liability at 28 February		**(146)**	**(134)**

	2010 £m	2009 £m
Deferred tax liability relates to:		
Available for sale securities	(134)	(105)
Pensions and other post-retirement benefits	(17)	(32)
Other provisions	5	3
	(146)	**(134)**

27 Other liabilities

	Note	2010 £m	2009 £m
Items in course of settlement		47	62
Payable to HM Treasury	8	97	417
Short-term creditors, other liabilities and deferred income*		146	143
		290	**622**

*Includes £4 million (2009: less than £1 million) of accrued expenses that will be recharged to Issue Department.

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

The Bank regards its shareholder's funds as the capital it uses to support its normal operations. For special operations it may also obtain indemnities from HM Treasury, as for example in relation to the Special Liquidity Scheme.

29 Cash and cash equivalents

i Analysis of cash balances

	Note	At 1 March 2009 £m	Cash flows £m	At 28 February 2010 £m
Cash and balances with other central banks	9	1,516	(1,030)	486
Loans and advances to banks and other financial institutions	10	5,190	(966)	4,224
Securities held at fair value through profit or loss	11	–	478	478
		6,706	**(1,518)**	**5,188**

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.

30 Collateral
At 28 February 2010 the Bank held collateral as follows:

- Securities with a fair value of £229 billion (2009: £245 billion) and cash collateral of £nil (2009: £16 million) were held as collateral for Treasury bills lent under the Special Liquidity Scheme with a face value of £165 billion (2009: £185 billion). At 28 February 2010 the Bank had not sold any of these assets to third parties but is permitted to do so (2009: £nil). The basis for accounting for the Special Liquidity Scheme is set out in note 2(h).
- Securities with a fair value of £14 billion (2009: £160 billion) were held as collateral for reverse repurchase agreements with a total value of £12 billion (2009: £137 billion) (note 10). At 28 February 2010 the Bank had not sold any of these assets to third parties but is permitted to do so (2009: £nil).
- Cash collateral of £206 million (2009: £181 million) was held in respect of derivative financial instruments (note 12).

At 28 February 2010 the Bank had pledged assets with a fair value of £665 million (2009: £592 million) as collateral for repurchase agreements of £684 million (2009: £602 million) (note 23).

Notes to the Banking Department Financial Statements continued

31 Related parties

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.

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 has entered into agreements with the United Kingdom Debt Management Office (DMO) whereby the DMO lends UK government securities to the Bank with the simultaneous agreement that the Bank would deliver equivalent securities to the DMO on termination of those agreements.

At 28 February 2010 the Bank had borrowed Treasury bills with a fair value of £165 billion (2009: £185 billion) under the Bank's Special Liquidity Scheme.

In the period to 28 February 2010 the Bank incurred DMO loan fees for Treasury bills borrowed of £125 million (2009: £54 million).

At 28 February 2010 the Bank had a loan from the DMO of £48 million (2009: £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 and the total interest paid in respect of the period to 28 February 2010 was £1 million (2009: less than £1 million).

In addition, deposits placed with the Bank at the year end amounted to £819 million (2009: £970 million). During the period to 28 February 2010 interest of £3 million was payable to the DMO in respect of deposits placed (2009: £23 million).

HM Treasury

HM Treasury continued to indemnify the Bank against any cumulative loss it may separately incur in connection with the activities of each of the Special Liquidity Scheme, Bank of England Asset Purchase Facility Fund Ltd and Deposits Management (Edge) Ltd.

No fees were payable to HM Treasury in respect of indemnified operations in the period to 28 February 2010 (2009: £19 million).

The Bank has requested HM Treasury to require the FSCS to make a payment reimbursing the sum of £2.9 million in respect of expenses incurred by the Bank in connection with the resolution of DBS in accordance with the Financial Services and Markets Act 2000 (Contribution to Costs of Special Resolution Regime) Regulations 2009.

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). The FSCS is independent from the Financial Services Authority, although accountable to it and ultimately to the Treasury.

Deposits placed with the Banking Department at the year end amounted to £289 million (2009: £132 million) and are disclosed within note 24 as public deposits. During the period to 28 February 2010 interest of £0.1 million was payable to the FSCS in respect of deposits placed at the Bank (2009: less than £0.1 million).

Bradford & Bingley plc
Bradford & Bingley plc is a wholly-owned subsidiary of HM Treasury.

At 28 February 2010 Bradford & Bingley plc had no reverse repurchase agreements outstanding (2009: £2.7 billion, 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 £0.3 billion (2009: £0.1 billion) and are disclosed within note 23. During the period to 28 February 2010 interest of £3 million was payable to Bradford & Bingley plc in respect of deposits placed (2009: £12.7 million), of which £1 million (2009: less than £1 million) was paid directly to HM Treasury.

Northern Rock
With effect from 1 January 2010, Northern Rock was restructured into two separate entities, both wholly-owned subsidiaries of HM Treasury.

- Northern Rock (Asset Management) plc, the previous company renamed. This entity had deposits with the Banking Department at the year end of £6.7 billion (2009: £9.1 billion) which are disclosed within note 23. During the period to 28 February 2010, interest of £37 million (2009: £198 million) was payable to Northern Rock (Asset Management) plc in respect of deposits placed, of which £29 million (2009: £130 million) was paid directly to HM Treasury.
- Northern Rock plc, a new company. This entity had deposits with the Banking Department at year end of £8.8 billion (2009: £nil) which are disclosed within note 23. During the period to 28 February 2010, interest of £7 million was payable to the new Northern Rock entity in respect of deposits placed (2009: £nil).

b Subsidiaries
Full details of the subsidiaries of the Bank are disclosed in note 15.

Deposits Management (Edge) Ltd
Deposits Management (Edge) Ltd is a subsidiary wholly-owned by the Bank. As at 28 February 2010, the company held £5 million on deposit at the Bank (2009: £5 million). Interest is payable on this deposit at Bank Rate.

Bank of England Asset Purchase Facility Fund Ltd
BEAPFF is a wholly-owned subsidiary of the Bank. It was established on 30 January 2009 in order to fulfil the remit of the Chancellor of the Exchequer given to the Bank on 19 January 2009. This remit was subsequently expanded to enable BEAPFF to be used as a monetary policy tool at the request of the Monetary Policy Committee.

The financial statements of BEAPFF have not been consolidated as the Bank has no economic interest in its activities. BEAPFF's operations are fully indemnified for loss by HM Treasury and any surplus for these operations is due to HM Treasury.

Purchases of assets by BEAPFF are financed via a loan from the Bank. Prior to 6 March 2009 and from 4 February 2010 advances on this loan were financed by a loan from the DMO. From 6 March 2009 to 4 February 2010 advances on the loan from the Bank to BEAPFF were financed by the issuance of central bank reserves.

At 28 February 2010 the loan from the Bank to BEAPFF was £199.9 billion (2009: £810 million). Interest on this loan is receivable at Bank Rate and amounted to £626 million for the year ending 28 February 2010 (2009: less than £1 million).

Notes to the Banking Department Financial Statements continued

31 Related parties continued

At the year end the company held a deposit at the Bank of £3.8 billion (2009: less than £1 million), which is included in other deposits (note 24). Interest on this deposit is payable at Bank Rate and totalled £8.1 million for the year ending 28 February 2010 (2009: less than £1 million).

A management fee of £5 million was payable by BEAPFF to the Bank in respect of the year ended 28 February 2010 (2009: £1 million).

DBS Bridge Bank Ltd

Expenses incurred by the Bank of less than £0.1 million were recovered from DBS Bridge Bank Ltd.

c Key management personnel

Members of Court are covered by an indemnity from the Bank, granted in 2000 (see page 4).

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 2010, the number of key management personnel was 18 (2009: 21).

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

	2010 £000	2009 £000
Loans		
Balance brought forward	2	16
Loans made during year	29	–
Loans repaid during year	(7)	(14)
	24	**2**
Interest income earned	1	1
Number of key management personnel with loans at 28 February	2	1

No provisions have been recognised in respect of loans given to related parties (2009: £nil).

	2010 £000	2009 £000
Deposits		
Governors and Executive Directors		
Balance brought forward	199	323
Deposits taken during year	776	509
Deposits repaid during year	(511)	(633)
	464	**199**
Non-executive Directors		
Balance brought forward	11,591	10
Deposits taken during year	10	11,599
Deposits repaid during year	(7,067)	(18)
	4,534	**11,591**
Interest expense on above deposits	14	70
Number of key management personnel with deposits at 28 February	5	12

Loans and deposits repaid during the year include movements due to changes in key management personnel.

There were no other transactions that would be required to be shown under the provisions of the Companies Act 2006. 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, excluding the Governor, Deputy Governors, the Legal Adviser to the Governor and MPC members, are entitled to season ticket loans (repayable monthly over ten months) and may choose to take personal loans (for periods of up to three years and at an interest rate of 3%) as part of their remuneration package.

Staff, including Governors, Executive Directors and Non-executive Directors holding current and interest-bearing deposit accounts at the Bank of England receive interest at commercial rates. With effect from 1 June 2009, newly appointed Non-executive Directors may not open accounts at the Bank of England.

Key management remuneration

	2010 £000	2009 £000
Salaries and short-term benefits	2,264	2,420
Post-employment benefits	508	747
	2,772	**3,167**

Full information on the remuneration (including pension arrangements) of the Members of Court is given in the Remuneration report on pages 38 to 40.

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 2010 no charge was made for these services (2009: less than £1 million). These activities are undertaken on behalf of, and under the supervision of, the trustees of the scheme. The contribution paid to the scheme during the year was £59 million (2009: £149 million). There were no other material transactions between the Bank and the pension scheme during the year to 28 February 2010. At 28 February 2010 the balances on accounts held with the Bank were £16 million (2009: £110 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 £180 million (2009: £174 million).

Notes to the Banking Department Financial Statements continued

32 Contingent liabilities and commitments continued

b Capital commitments

Capital commitments authorised by Members of Court and outstanding at 28 February 2010 amounted to £17 million (2009: £3 million).

c Operating lease commitments — minimum lease payments

	2010		2009	
	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	–	177	8	254
Between one and five years	2,119	273	1,149	146
Expiring in five years or more	–	–	429	–
	2,119	**450**	**1,586**	**400**

The Bank leases the premises occupied by its regional Agencies.

33 Financial risk management

The Bank is required to manage the financial risks that arise on its balance sheet and as a consequence of its operations to deliver its policy objectives. These include credit risk, market 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 and financial risk standards approved by the Governor and documented delegated authorities for implementation of financial risk management and oversight of the Bank's operations to the Bank's senior management.

Specialist teams and committees support senior management in ensuring that agreed standards and policies are followed. These include an Asset and Liability Advisory Committee; Credit Ratings Advisory Committee; Markets Risk Committee; Operational Risk Committee and Collateral Review Committee.

The Risk Management Division (RMD) within the Bank's Markets Directorate is responsible for analysing the financial risks faced by the Bank in its operations in financial markets. RMD is responsible for the development of the appropriate framework, and articulation of appetite, for the management of financial risks. The Market Strategy and Risk Operations Division (MSROD) is responsible for the implementation of the agreed risk framework, including reporting on credit, market and liquidity risk. It is also responsible for operational risk management processes across the Markets Directorate and for preparations for contingencies with respect to financial operations.

a Credit risk

Credit risk is the risk of loss arising from the failure of a borrower, issuer, counterparty or customer to meet its financial obligations to the Bank. The Bank is exposed to credit risk both through direct exposures and through contingent exposures, such as via collateral or insurance contracts. The primary source of credit risk arises as a result of the Bank providing liquidity to financial institutions via the Sterling Monetary Framework; intraday in the Bank's provision of liquidity to facilitate the operation of the sterling high-value payment system (CHAPS); and the securities settlement system, CREST; and elsewhere in the Bank's management of its balance sheet, for example in the investment of the Bank's own funds and in the course of the banking services it provides to its customers. In addition, the Bank incurs credit risk in connection with any support operations it may undertake.

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

The Bank's Credit Ratings Advisory Committee (CRAC), chaired by the Head of RMD, reviews regularly the creditworthiness of issuers, counterparties and customers with whom the Bank may have 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.

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 UK 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 via secured on-placements may also give rise to credit exposures.

Collateral management

In providing liquidity via the Bank's Sterling Monetary Framework 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 haircuts) by investment-grade, marketable securities. A summary of eligible collateral can be found on the Bank's website.(1)

In the Bank's Special Liquidity Scheme, Extended-Collateral Long-Term Repo Operations and Discount Window Facility, the Bank may take a range of private sector collateral. 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 (such as asset-backed securities 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 this wider collateral portfolio by applying haircuts to market prices to take account of liquidity (price) risk and credit risk. Where appropriate 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, including on individual securities.

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

Notes to the Banking Department Financial Statements continued

33 Financial risk management continued

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 price designed to deliver a price that is as close as possible to what a market price would be had such a price existed. The valuations methodology, the use of spreads in models and the collateral are under review regularly. A Collateral Review Committee is chaired by the Head of RMD. The Committee reviews issues relating to the wider collateral portfolio and considers policy issues relating to stress testing, valuation and eligibility of collateral including in response to market specific entity conditions. This includes the monitoring of a securities watch list and considering changes to the status of individual securities.

In non-routine circumstances, the Bank will seek appropriate methods of mitigating credit risk, including indemnities from HM Treasury. The Bank has such an indemnity from HM Treasury in relation to the Special Liquidity Scheme.

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:

	2010 **£m**	2009 £m
Assets		
United Kingdom	211,208	108,369
Rest of Europe	10,388	37,383
Rest of the world	1,508	2,176
	223,104	**147,928**
Liabilities		
United Kingdom	205,920	122,960
Rest of Europe	7,141	4,202
Rest of the world	10,043	20,766
	223,104	**147,928**

b Market risk

Market risk is defined as the risk of loss as a result of changes in market risk factors, including 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 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 below) 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 in the sterling bond portfolio through the investment of the Bank's capital and Cash Ratio Deposits in high-quality securities with maturity up to fifteen years. These are 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 is also exposed to interest rate risk via its three-month extended collateral long-term reverse repurchase operations conducted as part of the Sterling Monetary Framework.

Value at Risk measurement

The Bank measures the Value at Risk (VaR) on all its positions. VaR estimates, to a confidence level of 99%, the potential loss that might arise if existing positions were unchanged for ten business days under normal market conditions, 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 the risk factors to which the Bank is exposed. VaR is reported daily and is further supplemented by the daily monitoring and reporting of interest rate sensitivities delta as well as total foreign exchange exposures. During the year VaR arose mostly from market volatility on the Bank's sterling bond portfolio.

Value at Risk	2010 £m	2009 £m
At 28 February	92.1	92.2
Average	93.5	70.5

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

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

The Bank undertakes a programme of back testing, which compares actual profit or loss to the VaR estimation. The results of the back-testing process are one of the methods by which the Bank monitors the ongoing suitability of its VaR model.

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 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 held at fair value of £428 million (2009: £324 million). Excluding this, the Bank's net foreign exchange exposure at 28 February 2010 was £1 million (2009: £12 million).

c Liquidity risk

Liquidity risk is the risk of encountering difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

In sterling, liquidity risk does not arise as the central bank is able to create sterling liquidity through its market operations.

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. This facility expired on 1 February 2010 and was subsequently re-established in May 2010.

Notes to the Banking Department Financial Statements continued

33 Financial risk management continued

The Bank's Balance Sheet Remit and Liquidity Risk standard and supporting policies set out risk tolerances and detailed parameters and controls to minimise the foreign currency liquidity risk that arises. These include limits over cash flow and maturity mismatches, and 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 undiscounted foreign currency financial assets and liabilities at the balance sheet dates into relevant maturity groupings based on the remaining period to the contractual maturity date.

Foreign currency liquidity risk

As at 28 February 2010

	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	472	–	–	–	–	472
Loans and advances to banks and other financial institutions	3,228	1,510	4,257	–	–	8,995
Securities held at fair value through profit or loss	705	472	478	2,472	–	4,127
Derivative financial instruments:						
Cash inflow	2,207	564	3,431	334	–	6,536
Cash outflow	(1,906)	(849)	(3,209)	(262)	–	(6,226)
Other assets	677	–	–	–	–	677
Total assets	**5,383**	**1,697**	**4,957**	**2,544**	**–**	**14,581**
Liabilities						
Deposits from central banks	2,648	635	3,587	–	–	6,870
Deposits from banks and other financial institutions	428	588	39	–	–	1,055
Other deposits	222	–	–	–	–	222
Foreign currency bonds in issue	1,439	–	–	2,723	–	4,162
Derivative financial instruments:						
Cash inflow	(1,845)	(667)	(744)	(1,183)	–	(4,439)
Cash outflow	2,413	1,311	1,694	1,292	–	6,710
Other liabilities	–	–	–	–	–	–
Total liabilities	**5,305**	**1,867**	**4,576**	**2,832**	**–**	**14,580**
Net liquidity gap	**78**	**(170)**	**381**	**(288)**	**–**	**1**
Cumulative gap	**78**	**(92)**	**289**	**1**	**1**	

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						
Cash and balances with central banks	1,516	–	–	–	–	1,516
Loans and advances to banks and other financial institutions	6,669	11,299	1,383	–	–	19,351
Securities held 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	**8,189**	**11,221**	**2,499**	**2,362**	**–**	**24,271**
Liabilities						
Deposits from central banks	5,997	10,984	1,422	–	–	18,403
Deposits from banks and other financial institutions	1,405	325	276	–	–	2,006
Other deposits	119	–	–	–	–	119
Foreign currency bonds in issue	100	–	–	2,941	–	3,041
Derivative financial instruments:						
Cash inflow	(2,261)	(234)	(412)	(267)	–	(3,174)
Cash outflow	2,110	340	409	292	–	3,151
Other liabilities	688	30	10	–	–	728
Total liabilities	**8,158**	**11,445**	**1,705**	**2,966**	**–**	**24,274**
Net liquidity gap	**31**	**(224)**	**794**	**(604)**	**–**	**(3)**
Cumulative gap	**31**	**(193)**	**601**	**(3)**	**(3)**	

Notes to the Banking Department Financial Statements continued

33 Financial risk management continued

d Fair value of financial assets and liabilities

The table below shows the financial instruments carried at fair value by valuation method:

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets				
Loans and advances to banks and other financial institutions	–	8,738	–	8,738
Securities held at fair value through profit or loss	3,517	568	–	4,085
Derivative financial instruments	–	361	–	361
Available for sale securities	3,957	–	433	4,390
	7,474	**9,667**	**433**	**17,574**
Liabilities				
Deposits from central banks	–	9,914	–	9,914
Foreign currency bonds in issue	4,126	–	–	4,126
Derivative financial instruments	–	263	–	263
	4,126	**10,177**	**–**	**14,303**

Level 1 Valued using unadjusted quoted prices in active markets for identical financial instruments.

Level 2 Valued using techniques where all the inputs that have a significant impact on the valuation are based on observable market data. During the year this category of instruments comprised derivatives, repurchase transactions, commercial paper and deposits.

Level 3 Valued using techniques where at least one input that could have a significant impact on the valuation is not based on observable market data. During the year this category consisted primarily of the Bank's investment in the Bank for International Settlements (note 14).

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

34 Date of approval

The Members of Court approved the financial statements on pages 46 to 90 on 27 May 2010.

Issue Department
Account for the period ended 28 February 2010

	Note	2010 £m	2009 £m
Income and profits			
Securities of, or guaranteed by, the British Government		160	499
Other securities and assets		403	1,768
		563	**2,267**
Expenses	2		
Cost of production of banknotes		38	48
Cost of issue, custody and payment of banknotes		26	24
Other expenses		8	7
		72	**79**
Payable to HM Treasury		**491**	**2,188**

Statement of balances: 28 February 2010

	Note	2010 £m	2009 £m
Assets			
Securities of, or guaranteed by, the British Government	3	5,679	9,585
Other securities and assets including those acquired under reverse repurchase agreement	4	44,541	39,023
Total assets		**50,220**	**48,608**
Liabilities			
Notes issued:			
In circulation	5	50,220	48,608
Total liabilities		**50,220**	**48,608**

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

M A King	Governor
C R Bean	Deputy Governor
Sir David Lees	Chairman of Court
W R Jones	Finance Director

The notes on pages 92 to 93 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 a 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 25 February 2010.
- If a revaluation of securities shows a net gain this is included in income. A deficit is not taken against income but is settled by a transfer from the National Loans Fund. Total such deficits in the year to 28 February 2010 amounted to £121 million (2009: net gain £294 million).

2 Expenses

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

On an accruals basis, the cost of note issue for the year to 28 February 2010 was £70 million (2009: £69 million).

3 Securities of, or guaranteed by, the British Government

	2010 £m	2009 £m
British Government Stocks	5,309	5,443
Ways and Means advance to the National Loans Fund	370	4,142
	5,679	**9,585**

The Ways and Means advance earns interest at Bank Rate.

4 Other securities and assets including those acquired under reverse repurchase agreements

	2010 £m	2009 £m
Deposit with Banking Department	26,655	29,225
Reverse repurchase agreements	17,886	9,798
	44,541	**39,023**

5 Notes in circulation

	2010 £m	2009 £m
£5	1,245	1,302
£10	6,399	6,304
£20	30,048	28,089
£50	9,248	8,691
Other notes*	3,280	4,222
	50,220	**48,608**

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

6 Assets and liabilities

a Interest rate exposure

As the liabilities of the Issue Department are interest free, the income of the Issue Department is directly exposed to movements in interest rates. As at the year end 28 February 2010, the assets of the Issue Department had the following repricing period profile; repricing in up to one month £30 billion (2009: £35 billion), repricing in greater than one but less than three months £9 billion (2009: £3 billion), repricing in greater than three but less than six months £4 billion (2009: £4 billion), repricing in greater than six but less than twelve months £2 billion (2009: £2 billion) and, repricing greater than one year £5 billion (2009: £5 billion).

b Currency exposure

All the assets and liabilities of the 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 2010 the unrecognised accrued interest on the assets held on the Issue Department Statement of Balances was £115 million (2009: £235 million).

8 Date of approval

The Members of Court approved the statements of account on pages 91 to 93 on 27 May 2010.

Contacts

Head Office

Threadneedle Street
London EC2R 8AH
020 7601 4444*

Regional Agencies

The South East and East Anglia
Threadneedle Street
London EC2R 8AH
020 7601 3954

Greater London
Threadneedle Street
London EC2R 8AH
020 7601 5504

Central Southern England
First Floor
Unit 4, Fulcrum 2
Solent Way
Solent Business Park
Whiteley
Fareham PO15 7FN
01489 570603

South West
11–15 Dix's Field
Exeter EX1 1QA
01392 438302

Wales
4 Village Way
Greenmeadow Springs
Tongwynlais
Cardiff CF15 7NE
029 2061 4678

West Midlands and Oxfordshire
Cornwall Court
19 Cornwall Street
Birmingham B3 2DT
0121 200 2599

East Midlands
6 Experian Way
ng2 Business Park
Nottingham NG2 1EP
0115 985 0174

Yorkshire and the Humber
Regent House
5 Queen Street
Leeds LS1 2TW
0113 242 0355

Northern Ireland
Harvester House
4–8 Adelaide Street
Belfast BT2 8GD
028 9024 1692

North East
Dobson Building
Prestwick Park
Newcastle Upon Tyne
NE20 9SJ
01661 871432

North West
Suite 401
Thomson House
Faraday Street
Birchwood Park
Warrington WA3 6GA
01925 813703

Scotland
177 West George Street
Glasgow G2 2LB
0141 221 7972

* General enquiries relating to the Bank may be made on 020 7601 4878 or by email to enquiries@bankofengland.co.uk. Information about the Bank and its publications and additional telephone numbers and email addresses are available on the Bank's website at www.bankofengland.co.uk.
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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