

# Report of the Independent Auditor

## Independent Auditor's Report to the Governor and Company of the Bank of England and its Shareholder

We have audited the financial statements of the Banking Department ('financial statements') for the year ended 28 February 2011, set out on pages 48 to 93, and the statements of account of the Issue Department ('statements of account') for the year ended 28 February 2011, set out on pages 94 to 96. The financial reporting framework that has been applied in their preparation is applicable law and the accounting policies set out therein.

This report is made solely to the Governor and Company of the Bank of England and its Shareholder in accordance with Section 7 of the Bank of England Act 1998. Our audit work has been undertaken so that we might state to the Governor and Company of the Bank of England and its Shareholder those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Governor and Company of the Bank of England and its Shareholder for our audit work, for this report or for the opinions we have formed.

### Respective responsibilities of the Members of Court and the auditor

The responsibilities of the Members of Court for preparing the *Annual Report*, including the financial statements and statements of account, in accordance with applicable law and the bases of preparation set out in note 2 on pages 53 to 60 and note 1 on page 95 respectively are described in the Statement of the responsibilities of the Court of Directors in relation to the financial statements on page 35.

Our responsibility is to audit the financial statements and statements of account in accordance with relevant legal and regulatory requirements and having regard to International Standards on Auditing (United Kingdom and Ireland).

We report to you our opinion as to whether the financial statements of the Banking Department and statements of account of the Issue Department have been properly prepared in accordance with the bases of preparation set out in note 2 on pages 53 to 60 and note 1 on page 95 respectively. We also report to you whether, in our opinion, the information given in the Remuneration report, the Financial Review, the Risk Management and Business Practices report, and the Report by the Non-executive Directors on pages 30 to 45 is consistent with the financial statements and statements of account.

In addition we report to you if, in our opinion, the Bank has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding remuneration to Members of Court or other transactions are not disclosed.

We read the other information contained in the *Annual Report* and consider whether it is consistent with the audited financial statements and statements of account. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements or statements of account. Our responsibilities do not extend to any other information.

### Basis of audit opinion

We conducted our audit having regard to International Standards on Auditing (United Kingdom and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and statements of account. It also includes an assessment of the significant estimates and judgements made by the Members of Court in the preparation of the financial statements and statements of account, and of whether the accounting policies are appropriate to the Bank's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and statements of account are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements, the basis of which is described in note 2 on pages 53 to 60, and in the statements of account, the basis of which is described in note 1 on page 95.

## Opinion

In our opinion:

- The financial statements of the Banking Department on pages 48 to 93 for the year ended 28 February 2011 have been properly prepared in accordance with the basis of preparation set out in note 2 on pages 53 to 60.
- The statements of account of the Issue Department on pages 94 to 96 for the year ended 28 February 2011 have been properly prepared in accordance with the basis of preparation set out in note 1 on page 95.

The information given in the Remuneration report, Financial Review, the Risk Management and Business Practices report, and the Report by the Non-executive Directors is consistent with the financial statements and statements of account.

**M StJ Ashley**

**for and on behalf of KPMG Audit Plc**

*Chartered Accountants, Registered Auditor*

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28 June 2011

## Banking Department

### Income Statement for the year to 28 February 2011

	Note	2011 £m	2010 £m
Profit before tax	4	132	231
Corporation tax net of tax relief on payment to HM Treasury	7	(5)	(37)
<b>Profit for the year attributable to shareholder</b>		<b>127</b>	<b>194</b>

## Statement of Comprehensive Income for the year to 28 February 2011

	Note	2011 £m	2010 £m
Profit for the year attributable to shareholder		127	194
Other comprehensive income:			
Revaluation of available for sale securities	14	(16)	36
Revaluation of properties	16	27	5
Actuarial losses on retirement benefits	18	(139)	(70)
Corporation tax relating to components of other comprehensive income	7	49	8
Other comprehensive income for the year, net of tax		(79)	(21)
<b>Total comprehensive income for the year</b>		<b>48</b>	<b>173</b>

## Balance Sheet as at 28 February 2011

	Note	2011 £m	2010* £m
<b>Assets</b>			
Cash and balances with other central banks	9	326	486
Loans and advances to banks and other financial institutions	10	17,570	12,510
Other loans and advances	11	199,808	199,935
Securities held at fair value through profit or loss	12	4,752	4,085
Derivative financial instruments	13	314	361
Available for sale securities	14	4,941	4,390
Investments in subsidiaries	15	–	–
Property, plant and equipment	16	216	181
Intangible assets	17	10	13
Retirement benefit assets	18	191	269
Other assets	19	1,471	854
<b>Total assets</b>		<b>229,599</b>	<b>223,084</b>
<b>Liabilities</b>			
Deposits from central banks	20	13,836	11,429
Deposits from banks and other financial institutions	21	154,405	169,920
Other deposits	22	50,043	32,335
Foreign currency bonds in issue	23	5,037	4,126
Derivative financial instruments	13	366	263
Current tax liabilities		16	163
Deferred tax liabilities	24	105	149
Retirement benefit liabilities	18	231	208
Other liabilities	25	1,137	254
<b>Total liabilities</b>		<b>225,176</b>	<b>218,847</b>
<b>Equity</b>			
Capital	26	15	15
Retained earnings		3,800	3,634
Other reserves		608	588
<b>Total equity attributable to shareholder</b>		<b>4,423</b>	<b>4,237</b>
		<b>229,599</b>	<b>223,084</b>

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

**Sir Mervyn King** Governor  
**Mr C R Bean** Deputy Governor  
**Sir David Lees** Chairman of Court  
**Mr W R Jones** Finance Director

\*Comparative figures have been restated as outlined in note 2b.

The notes on pages 53 to 93 are an integral part of these financial statements.

## Statement of Changes in Equity for the year to 28 February 2011

	Attributable to equity shareholder				Total £m
	Share capital £m	Available for sale reserve £m	Property revaluation reserve £m	Retained earnings* £m	
Balance at 1 March 2009	15	440	118	2,748	3,321
Prior year adjustment (note 2b)	–	–	–	13	13
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)
<b>Balance at 28 February 2010</b>	<b>15</b>	<b>465</b>	<b>123</b>	<b>3,634</b>	<b>4,237</b>
Comprehensive income for the period	–	(7)	27	28	48
Post-tax surplus from indemnified operations	–	–	–	202	202
Payable to HM Treasury in lieu of dividend	–	–	–	(64)	(64)
<b>Balance at 28 February 2011</b>	<b>15</b>	<b>458</b>	<b>150</b>	<b>3,800</b>	<b>4,423</b>

\*At February 2011 retained earnings included £1,602 million in relation to the Special Liquidity Scheme (2010: £1,400 million).

## Statement of Cash Flows for the year to 28 February 2011

	Note	2011 £m	2010 £m
<b>Cash flows from operating activities</b>			
Profit before taxation		132	231
<b>Adjustment for non-cash items:</b>			
Amortisation of intangibles	17	6	5
Depreciation of property, plant and equipment	16	9	9
Write-down of intangible assets		–	1
Dividends received	4	(32)	(12)
Net movement in accrued interest and provisions, including pensions		73	87
<b>Changes in operating assets and liabilities:</b>			
Decrease/(increase) in loan advanced to the Bank of England Asset Purchase Facility Fund Ltd	11	128	(199,122)
Net (increase)/decrease in other advances		(1,863)	123,408
Net increase in securities held at fair value through profit or loss		(90)	(402)
Net decrease in money market instruments in issue		–	(42,212)
Net increase in deposits		5,082	114,801
Net (decrease)/increase in foreign currency bonds in issue		(16)	1,420
Net movement in financial derivatives	13	150	108
Net decrease in other accounts		(7)	–
Corporation tax paid		(32)	(165)
<b>Net cash inflow/(outflow) from operating activities</b>		<b>3,540</b>	<b>(1,843)</b>
<b>Cash flows from investing activities</b>			
Purchase of available for sale securities		(911)	(837)
Proceeds from sale or redemption of available for sale securities	14	260	426
Dividends received	4	32	12
Purchase of intangible assets	17	(3)	(2)
Purchase of property, plant and equipment	16	(17)	(9)
<b>Net cash outflow from investing activities</b>		<b>(639)</b>	<b>(410)</b>
<b>Cash flows from financing activities</b>			
Cash generated from indemnified operations		316	1,397
Tax on financing activities		(193)	(245)
Payment to HM Treasury under Section 1 (4) of the Bank of England Act 1946		(97)	(417)
<b>Net cash inflow from financing activities</b>		<b>26</b>	<b>735</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>2,927</b>	<b>(1,518)</b>
Cash and cash equivalents at 1 March	27	5,188	6,706
<b>Cash and cash equivalents at 28 February</b>	<b>27</b>	<b>8,115</b>	<b>5,188</b>

The notes on pages 53 to 93 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 94 to 96, 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 applied consistently 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, 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 and related disclosures in the Balance Sheet and Statement of Cash Flows.
- Operating segments.



## Notes to the Banking Department Financial Statements continued

### 2 Bases of preparation continued

- Contingent liabilities and guarantees.
- Information on credit risk.
- Individual usage of the Special Liquidity Scheme.
- Related party disclosure.

#### b New accounting standards

The following new standard has been applied in 2010/11:

##### *Amendments to IAS 17 (Leases)*

The amendments to IAS 17 effective for periods starting on or after 1 January 2010 have been applied for the first time. As a result, land held subject to long leases previously treated as operating leases has been reclassified as finance leases. All changes have been made retrospectively in line with IAS 8 (Accounting Policies, Changes in Accounting Estimates and Errors). The impact on the opening balance sheet at 1 March 2009 and periods following is the removal of £26 million of assets held as investment properties, £36 million of deferred income within other liabilities, £3 million of deferred tax assets and a £13 million increase in retained earnings. An increase of £6 million in other assets has been recognised representing the finance lease receivable.

In addition the Bank has considered the potential effect of forthcoming EU adopted standards which have not been adopted in the financial statements; none of these is expected to materially impact the Bank.

#### c 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 by HM Treasury and in return any surplus for these operations after deduction of fees, operating costs and any tax payable is due to HM Treasury.

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 within 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.

#### d Foreign currency translation

##### i Functional and presentational currency

The financial statements of the Banking Department are presented in sterling, which is also the Bank's functional 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.

## e Financial instruments: assets

### i Classification of financial assets

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 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 which are 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 (f)). 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.

### 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.

## Notes to the Banking Department Financial Statements continued

### 2 Bases of preparation continued

#### 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, after taking into account any value of the security which has been realised.

##### *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 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.

## g 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.

## h Property, plant and equipment

### i Initial recognition

Expenditure on property, plant and equipment is capitalised if the asset is expected to have a useful economic life of three years or more. The amount capitalised at initial recognition is the purchase price of the asset along with any further costs incurred in bringing the asset to its present condition and location.

### ii Subsequent valuation

Subsequent costs are added to an 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.

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.

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.

### iii Depreciation

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 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.

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.

### iv Gain or losses on the disposal of property, plant and equipment

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

## i 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.

## Notes to the Banking Department Financial Statements continued

### 2 Bases of preparation continued

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

Following the amendment to IAS 17 referred to in note 2b, long leases granted on property owned by the Bank are now treated as finance leases. Finance lease receivables are stated in the balance sheet at the amount of the net investment in the lease being the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Finance lease income is allocated across accounting periods giving a constant periodic rate of return before tax on the net investment. Unguaranteed residual values are subject to regular review to identify potential impairment. If there has been a reduction in the estimated unguaranteed residual value, the income allocation is revised and any reduction in respect of amounts accrued is recognised immediately.

#### j Intangible assets

Intangible assets consist of computer software and the costs associated with the development of software for internal use. Costs associated with externally purchased software and costs directly associated with the internal production of unique and separately identifiable software products, which are controlled by the Bank and which will probably generate economic benefits exceeding those 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.

#### k Financial instruments: liabilities

##### i Classification of financial assets

The Bank classifies its financial liabilities in the following categories: liabilities measured at amortised cost and financial liabilities at fair value through profit and loss.

##### *Liabilities measured at amortised cost*

Short-term customer deposits held are carried at cost with interest expense accruing on an effective interest rate basis.

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

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.

##### *Financial liabilities at fair value through profit or loss*

The Bank designates the following financial liabilities at fair value through profit or loss:

- Four 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.

##### ii Initial recognition of financial liabilities

Fixed-term deposits taken from central banks are recognised on a settlement date basis. Money market instruments issued, short-term deposits and bonds issued by the Bank are recognised on a trade date basis.

### iii Subsequent valuation of financial liabilities

Gains and losses arising from changes in the fair value of liabilities classified at fair value through profit or loss are included in the income statement in the period in which they arise.

The fair values of these liabilities are based on current offer prices.

Financial liabilities are derecognised when the right to pay cash flows relating from the financial liabilities have expired. If the Bank buys any of its own securities as part of its operations, these are removed from the balance sheet.

## l 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.

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, property revaluations, and provisions for pensions and other post-retirement benefits.

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

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

## m 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.

## n 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.

## Notes to the Banking Department Financial Statements continued

### 2 Bases of preparation continued

#### o 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.

#### p Fees and commission income

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

#### q Provisions

Provisions are recognised in respect of restructuring, redundancy and legal claims arising from past events where it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

#### r Indemnified operations

The Bank may enter into arrangements where it is fully indemnified, without charge, 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.

#### s 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.

#### t 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 does not obtain substantially all the risks and rewards of ownership of those instruments.

#### 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 18a, 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 of collateral 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 and the use of spreads in models 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	2011 £m	2010 £m
<b>Income includes</b>			
Charges for services to HM Government (including charges to the Issue Department in respect of the note issue)		87	83
Banking charges and tariff income		16	19
Dividend from the Bank for International Settlements		32	12
<b>Expenses includes</b>			
Staff costs	5	140	155
Legal fees		2	6
Amortisation of intangible assets	17	6	5
Depreciation of property, plant and equipment	16	9	9
Software expenditure		7	7
Operating lease rentals — property		1	1
— other		—	1
Other administrative expenses		98	102

**5 Staff costs**

	Note	2011 £m	2010 £m
Wages and salaries		93	93
Social security costs		9	9
Pension and other post-retirement costs	18	38	53
		<b>140</b>	<b>155</b>

Wages and salaries include £1 million of costs capitalised as intangible assets (2010: £1 million).

**Average number of employees**

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

	2011	2010
Governors and other members of the Executive Team	11	9
Managers and analysts	732	738
Other staff	1,102	1,149
	<b>1,845</b>	<b>1,896</b>

The number of persons employed by the Bank at the end of February 2011 was 1,839, of which 1,613 were full-time and 226 were part-time (2010: 1,904; of which 1,685 full-time and 219 part-time).

## 6 Auditor's remuneration

	2011 £000	2010 £000
<b>Audit fees for the Bank's audit:</b>		
— Fees relating to current year	285	302
— Fees relating to prior year	(9)	16
<b>Fees payable to the Auditor for services provided to the Bank:</b>		
— Tax services	42	132
— All other services*	73	492
	<b>391</b>	<b>942</b>

\*Of the amounts included in all other services £nil of accounting fees were recovered from third parties during the year to 28 February 2011 (2010: £301,000).

In addition, fees of £40,000 for audit services and £3,000 for tax services in relation to Bank of England Asset Purchase Facility Fund Ltd paid by the Bank were recovered via a management fee (2010: £55,000 and £42,000 respectively).

## 7 Taxation

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

	2011 £m	2010 £m
Current UK corporation tax	1	34
Prior year corporation tax	(4)	(1)
Deferred tax — current year	10	4
— prior year	(2)	—
<b>Tax charge on profit</b>	<b>5</b>	<b>37</b>

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:

	2011 £m	2010 £m
Profit before tax	132	231
Tax calculated at rate of 28%	37	65
Tax relief on payment to HM Treasury	(18)	(28)
Non-deductible expenses	—	1
Dividend not subject to corporation tax*	(9)	—
Prior year items	(6)	(1)
Change in tax rate to 27%	1	—
<b>Total tax charge for the period</b>	<b>5</b>	<b>37</b>

\*Bank for International Settlement dividends received by the Bank from 1 July 2009 are exempt from UK corporation tax following the legislation changes introduced by CTA 2009 (S931F and S931G) on foreign distributions received on non-redeemable ordinary shareholdings. Included in the prior year items is the removal of a £3 million provision made in 2009/10 in respect of dividends actually received on 2 July 2009.

## Notes to the Banking Department Financial Statements continued

**7 Taxation continued**

Tax charged to equity comprises:

	2011 £m	2010 £m
<b>Tax (credited)/charged to equity through the Statement of Comprehensive Income</b>		
Current UK corporation tax	3	(16)
Deferred tax	(52)	8
	<b>(49)</b>	<b>(8)</b>
<b>Other tax charged directly to equity</b>		
Current UK corporation tax	78	321
<b>Tax charged to equity</b>	<b>29</b>	<b>313</b>

Tax charged to equity is attributable as follows:

	2011 £m	2010 £m
<b>Tax (credited)/charged to equity through the Statement of Comprehensive Income</b>		
Revaluation of available for sale securities	(5)	11
Actuarial gains on retirement benefits	(39)	(19)
Change in tax rate to 27%	(5)	–
	<b>(49)</b>	<b>(8)</b>
<b>Other tax charged directly to equity</b>		
Surplus on indemnified operations	78	321
<b>Tax charged to equity</b>	<b>29</b>	<b>313</b>

The main UK corporation tax rate reduced from 28% to 27% with effect from 1 April 2011. The rate reduction on the deferred tax balances as at 28 February 2011 has been disclosed in note 24.

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

	2011 £m	2010 £m
Payable 5 April (2010: 1 April)	26	47
Payable 5 October	38	50
	<b>64</b>	<b>97</b>

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 2011 based on the agreement between the Bank and HM Treasury on that date. 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.

## 9 Cash and balances with other central banks

	2011 £m	2010 £m
Cash	–	–
Balances with other central banks	326	486
	<b>326</b>	<b>486</b>

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

	2011 £m	2010 £m
Items in course of collection	1	–
Reverse repurchase agreements held at amortised cost	3,019	3,597
Reverse repurchase agreements held at fair value through profit or loss	12,536	8,738
Other loans and advances	2,014	175
	<b>17,570</b>	<b>12,510</b>

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 20 to 22). 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* (updated December 2010).

At 28 February 2011 loans and advances to banks and other financial institutions included cash and cash equivalents of £7.4 billion (2010: £4.2 billion) which are disclosed in note 27i.

## 11 Other loans and advances

	2011 £m	2010 £m
Overdrafts	–	–
Loan to the Bank of England Asset Purchase Facility Fund Ltd	199,804	199,932
Term loans	4	3
	<b>199,808</b>	<b>199,935</b>

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

Upon receipt of notification of BEAPFF'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

### 12 Securities held at fair value through profit or loss

	2011 £m	2010 £m
Money market instruments	385	568
Listed foreign government securities	3,892	2,783
Other listed foreign currency securities	475	734
	<b>4,752</b>	<b>4,085</b>

The holdings of foreign government and other foreign currency securities are funded by the Bank's issuance of medium-term securities (note 23). In the current year, the securities issued related entirely to the Bank's foreign exchange reserves portfolio. As at 28 February 2011 this portfolio was financed by four \$2 billion three-year bonds (2010: three \$2 billion three-year bonds) issued through the Bank's annual programme of syndicated foreign currency bond issuance. In March 2010, the Bank launched a \$2 billion three-year bond replacing the 2007 bond which matured on 22 March 2010; a further \$2 billion bond was issued on 28 February 2011, to replace the 2008 bond which matured on 17 March 2011. The assets in the portfolio are denominated in US dollars, euros and Japanese yen.

At 28 February 2011 securities held at fair value through profit or loss included cash and cash equivalents of £0.4 billion (2010: £0.5 billion) which are disclosed in note 27i.

### 13 Derivative financial instruments

The Bank uses the derivative instruments described below. The main purpose of these is to manage 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 counterparty 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 coupons (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 exceeds 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 over time. The fair values of derivative instruments are set out below.

## a As at 28 February 2011

	Contract notional amount £m	Fair values	
		Assets £m	Liabilities £m
Cross-currency interest rate swaps — positive value	972	39	–
— negative value	1,924	–	(101)
	<b>2,896</b>	<b>39</b>	<b>(101)</b>
Interest rate swaps — positive value	5,312	75	–
— negative value	6,154	–	(63)
	<b>11,466</b>	<b>75</b>	<b>(63)</b>
Forward exchange contracts — positive value	5,411	200	–
— negative value	7,912	–	(202)
	<b>13,323</b>	<b>200</b>	<b>(202)</b>
<b>Total recognised derivative assets/(liabilities)</b>		<b>314</b>	<b>(366)</b>

## b As at 28 February 2010

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

## Notes to the Banking Department Financial Statements continued

**14 Available for sale securities**

	2011 £m	2010 £m
<b>Debt securities at fair value</b>		
British Government securities listed on a recognised UK exchange	3,967	3,321
Other sterling securities listed on a recognised exchange	557	636
	4,524	3,957
Unlisted equity investments at fair value	417	433
	<b>4,941</b>	<b>4,390</b>

The movement in available for sale securities comprises:

	2011 £m	2010 £m
<b>Available for sale debt securities</b>		
At 1 March	3,957	3,608
Purchases	868	880
Redemptions	(260)	(426)
Mark-to-market movements through equity	–	(68)
Amortisation of premium/discount	(44)	(32)
Movement in accrued interest	3	(5)
At 28 February	<b>4,524</b>	<b>3,957</b>
<b>Available for sale unlisted equity investments</b>		
At 1 March	433	329
Revaluation of securities	(16)	104
At 28 February	<b>417</b>	<b>433</b>
	<b>4,941</b>	<b>4,390</b>

No gains or losses on available for sale securities were transferred to the Income Statement during the year (2010: £nil).

**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. The investment has been valued on a dividend yield basis providing a value of £412 million (2010: £428 million) at the year end. A discount rate of 7% (2010: 7%) was used. Increasing the discount rate by 1 percentage point would deflate the valuation by £93 million, while decreasing the discount rate by 1 percentage point would inflate the valuation by £152 million.

The Bank's holding in the European Central Bank (ECB) represents 1.10% (2010: 1.41%) of the European Central Bank's paid-up share capital. In accordance with the Treaty on the Functioning of the European Union, and in line with other non euro area national central banks, the Bank is only required to pay up 'a minimal percentage' by way of contribution to the operational costs of the ECB; in the Bank's case this is currently 3.75% amounting to €59 million (2010: 7% amounting to €59 million) of its total allocation of the ECB's subscribed capital of €1.6 billion (2010: €0.8 billion). 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 capital would then amount to 14.5% (2010: 14.5%). Contributions are non-refundable and as a non euro area member the Bank is not entitled to any dividends. The fair value of the holding has therefore been assessed as £nil (2010: £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 ordinary shares of £1 are 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 in return will receive any surplus. The Bank has not consolidated BEAPFF in its financial statements as it has no economic interest in its activities.

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
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 £1.2 million (2010: £1.2 million), which consist of balances held with the Bank.

Minorities Finance Ltd, a wholly-owned subsidiary, has been in members' voluntary liquidation throughout the year ended 28 February 2011. During the year a distribution of £0.2 million from the liquidators was accrued (2010: £nil).

BE Museum Ltd, a wholly-owned subsidiary, has been in members' voluntary liquidation since 30 November 2010. During the year no distributions were received from the liquidators (2010: £nil).

Deposits Management (Edge) Ltd and DBS Bridge Bank Ltd, wholly-owned subsidiaries of the Bank, were dissolved during the year. The Bank has not consolidated either company in its financial statements as it has no economic interest in their activities.



## Notes to the Banking Department Financial Statements continued

**16 Property, plant and equipment****For the year to 28 February 2011**

	Freehold land and buildings £m	Equipment* £m	Total £m
<b>Cost or valuation</b>			
At 1 March 2010	167	59	226
Additions	14	3	17
Disposals	–	(12)	(12)
Reclassification	1	(1)	–
Revaluation of properties	21	–	21
<b>At 28 February 2011</b>	<b>203</b>	<b>49</b>	<b>252</b>
<b>Accumulated depreciation</b>			
At 1 March 2010	–	45	45
Charge for the year	5	4	9
Disposals	–	(12)	(12)
Reclassification	1	(1)	–
Revaluation of properties	(6)	–	(6)
<b>At 28 February 2011</b>	<b>–</b>	<b>36</b>	<b>36</b>
Net book value at 1 March 2010	167	14	181
<b>Net book value at 28 February 2011</b>	<b>203</b>	<b>13</b>	<b>216</b>

\*Net book value of equipment at 28 February 2011 included £5 million held under finance leases.

**For the year to 28 February 2010**

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

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

The figures for freehold land and buildings reflect independent professional valuations on a market value basis as at 28 February 2011 by Deloitte LLP (trading as 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.

## 17 Intangible assets

	2011 £m	2010 £m
<b>Cost</b>		
At 1 March	40	42
Additions	3	2
Disposals	(10)	(4)
<b>At 28 February</b>	<b>33</b>	<b>40</b>
<b>Accumulated amortisation</b>		
At 1 March	27	25
Charge for the year	6	5
Disposals	(10)	(3)
<b>At 28 February</b>	<b>23</b>	<b>27</b>
Net book value at 1 March	13	17
<b>Net book value at 28 February</b>	<b>10</b>	<b>13</b>

Intangible assets primarily comprise computer software and related costs.

## Notes to the Banking Department Financial Statements continued

### 18 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 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	<b>(235)</b>
Funding level	91%
Future service contribution rate	54.6%

The future service contribution rate at 28 February 2011 was set at 56.5% (2010: 55.1%).

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 four payments of £27 million of the previously agreed plan remain to be paid.

Excluded from the contribution rate is the cost of administration and other services set out in note 31d.

The 2011 triennial valuation is being prepared as at 28 February 2011 and the results are not yet available.

#### Summary of amounts recognised in the financial statements under IAS 19

The Bank accounts for pension costs, other post-retirement benefits and related redundancy provisions in accordance with IAS 19 (Employee Benefits). Under the standard, the difference between the market values of scheme assets and the present value of scheme liabilities is reported as a surplus or deficit in the balance sheet. The Bank has adopted the option of recognising actuarial gains and losses in full through the Statement of 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**

		2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Funded pension scheme	(a)	191	269	294	404	(22)
Unfunded post-retirement benefits:						
Redundancy provisions	(b)	(75)	(70)	(64)	(61)	(70)
Pension scheme	(c)	(7)	(6)	(6)	(6)	(6)
Other post-retirement benefits	(d)	(149)	(132)	(108)	(117)	(145)
		<b>(40)</b>	<b>61</b>	<b>116</b>	<b>220</b>	<b>(243)</b>

**Pension expense recognised in the income statement**

		2011 £m	2010 £m
Funded pension scheme	(a)	27	38
Unfunded post-retirement benefits:			
Redundancy provisions	(b)	3	8
Other unfunded pension scheme	(c)	–	–
Other post-retirement benefits	(d)	8	7
		<b>38</b>	<b>53</b>

**Losses recognised in other comprehensive income for the year**

		2011 £m	2010 £m
Funded pension scheme	(a)	(118)	(46)
Unfunded post-retirement benefits:			
Redundancy provisions	(b)	(7)	(4)
Other unfunded pension scheme	(c)	(1)	–
Other post-retirement benefits	(d)	(13)	(20)
		<b>(139)</b>	<b>(70)</b>

**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:

	2011 %	2010 %
Discount rate	4.9	5.0
Rate of increase in salaries	4.6	4.6
Rate of increase of pensions in payment*	3.1	2.8
Rate of increase for deferred pensioners*	3.1	2.8

\*This represents RPI, which is the index used in the scheme. The increase of 0.3 percentage points in 2010/11 is consistent with ONS analysis of the difference between RPI and CPI inflation,<sup>(1)</sup> previously assumed to be 0.8 percentage points.

(1) See [www.statistics.gov.uk/downloads/theme\\_economy/info-note-cpiandrpi-impact-formula-effect2010.pdf](http://www.statistics.gov.uk/downloads/theme_economy/info-note-cpiandrpi-impact-formula-effect2010.pdf).

## Notes to the Banking Department Financial Statements continued

### 18 Retirement benefits continued

The discount rate assumption reflects the investment return on a high-quality corporate bond at the balance sheet date.

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

The assumption for life expectancy for the scheme assumes that a male member reaching 60 in 2011 will live for 28 years (2010: 27 years) and a female member 30 years (2010: 30 years), and a male member reaching 60 in 2021 will live for 30 years (2010: 28 years) and a female member 31 years (2010: 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:

	2011			2010		
	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	4.2	2,497	99.2	4.5	2,339	99.1
Cash and other assets		21	0.8		20	0.9
<b>Total market value of investments</b>		<b>2,518</b>	<b>100.0</b>		<b>2,359</b>	<b>100.0</b>

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.

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Presented value of defined-benefit obligations	(2,327)	(2,090)	(1,851)	(1,812)	(2,022)
Assets at fair value	2,518	2,359	2,145	2,216	2,000
<b>Defined-benefit asset/(liability)</b>	<b>191</b>	<b>269</b>	<b>294</b>	<b>404</b>	<b>(22)</b>

A +/- 0.1% change to the discount rate would change the surplus on the pension scheme by +/- £40 million (2010: +/- £33 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 £68 million (2010: £59 million).

The Bank expects to pay contributions of £67 million in the forthcoming year (2010: £67 million).

#### Components of pension expense in the income statement

	2011 £m	2010 £m
Current service cost	32	24
Interest cost	102	106
Expected return on assets	(107)	(92)
<b>Total pension expense</b>	<b>27</b>	<b>38</b>

<b>(Losses)/gains recognised in other comprehensive income</b>	<b>2011 £m</b>	<b>2010 £m</b>
Cumulative actuarial gains recognised at the beginning of the year	17	63
Actuarial loss on scheme liabilities	(204)	(207)
Actuarial gain on scheme assets	86	161
<b>Cumulative actuarial (losses)/gains recognised at 28 February</b>	<b>(101)</b>	<b>17</b>

<b>Reconciliation of return on assets</b>	<b>2011 £m</b>	<b>2010 £m</b>
Expected return on scheme assets (net of expense)	107	92
Actuarial gain on scheme assets	86	161
<b>Actual return on scheme assets (net of expense)</b>	<b>193</b>	<b>253</b>

<b>Reconciliation of present value of defined-benefit obligation</b>	<b>2011 £m</b>	<b>2010 £m</b>
Present value of defined-benefit obligation at 1 March	2,090	1,851
Current service cost	32	24
Interest cost	102	106
Actuarial loss relating to scheme liabilities	204	207
Benefits paid out	(101)	(98)
<b>Present value of defined-benefit obligation at 28 February</b>	<b>2,327</b>	<b>2,090</b>

<b>Reconciliation of the fair value of assets</b>	<b>2011 £m</b>	<b>2010 £m</b>
Fair value of scheme assets at 1 March	2,359	2,145
Actual return on scheme assets	193	253
Bank contributions	67	59
Benefits paid out	(101)	(98)
<b>Fair value of scheme assets at 28 February</b>	<b>2,518</b>	<b>2,359</b>

<b>Experience gains and losses</b>	<b>2011 £m</b>	<b>2010 £m</b>	<b>2009 £m</b>	<b>2008 £m</b>	<b>2007 £m</b>
Experience (loss)/gain on defined-benefit obligation	(15)	66	(16)	(29)	(16)
Experience (loss)/gain on scheme assets	86	161	(214)	126	(14)

## Notes to the Banking Department Financial Statements continued

**18 Retirement benefits continued****b Redundancy provisions**

As part of redundancy arrangements with staff, the Bank may give enhanced pension entitlement in the form of added years service or early pension rights. The costs of such benefits cannot be charged to the Pension Fund. The costs are therefore borne in the Bank's accounts, and represent the future cost of decisions that have already been taken. Provision is made for the costs of these benefits at the time the redundancy offer is announced based on actuarial advice. The scheme was changed with effect from 5 April 2010 and no further similar entitlements will be given by the Bank.

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

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
<b>Unfunded defined-benefit liability</b>	<b>(75)</b>	<b>(70)</b>	<b>(64)</b>	<b>(61)</b>	<b>(70)</b>

The Bank expects to make payments of £5 million in the forthcoming year (2010: £4 million).

**Components of pension expense in the income statement**

	2011 £m	2010 £m
Past service cost	–	4
Interest cost	3	4
<b>Total pension expense</b>	<b>3</b>	<b>8</b>

**Losses recognised in other comprehensive income**

	2011 £m	2010 £m
Cumulative actuarial losses recognised at beginning of year	(8)	(4)
Actuarial loss on liabilities	(7)	(4)
<b>Cumulative actuarial losses recognised at 28 February</b>	<b>(15)</b>	<b>(8)</b>

**Reconciliation of present value of defined-benefit obligation**

	2011 £m	2010 £m
Present value of defined-benefit obligation at 1 March	70	64
Past service cost	–	4
Interest cost	3	4
Actuarial loss on schemes' liabilities	7	4
Defined-benefits payments	(5)	(6)
<b>Present value of defined-benefit obligation at 28 February</b>	<b>75</b>	<b>70</b>

**Experience gains and losses**

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
<b>Experience (loss)/gain on defined-benefit obligation</b>	<b>(1)</b>	<b>2</b>	<b>(1)</b>	<b>1</b>	<b>–</b>

### c Unfunded pension scheme

As explained in the Remuneration section of the *Annual Report* on pages 40 to 42, 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)).

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
<b>Unfunded defined-benefit liability</b>	<b>(7)</b>	<b>(6)</b>	<b>(6)</b>	<b>(6)</b>	<b>(6)</b>

The Bank expects to make payments of less than £1 million in the forthcoming year (2010: less than £1 million).

During the year to 28 February 2011 the Bank incurred services costs of less than £1 million (2010: less than £1 million).

#### Amounts recognised in other comprehensive income

	2011 £m	2010 £m
Cumulative actuarial losses recognised at beginning of year	(1)	(1)
Actuarial loss on scheme liabilities	(1)	–
<b>Cumulative actuarial losses recognised at end of year</b>	<b>(2)</b>	<b>(1)</b>

#### Reconciliation of present value of defined-benefit obligation

	2011 £m	2010 £m
Present value of defined-benefit obligation at 1 March	6	6
Service and interest cost	–	–
Defined-benefit payments	–	–
Actuarial loss on scheme liabilities	1	–
<b>Present value of defined-benefit obligation at 28 February</b>	<b>7</b>	<b>6</b>

#### Experience gains and losses

For the year ended 28 February 2011, experience losses on the defined-benefit obligation were less than £1 million (as they were for the years 2007 to 2010).

### 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 post-retirement benefit liabilities are the same as those used in the IAS 19 valuation of pension scheme liabilities (see (a)). Additionally, for accounting purposes the following assumptions have been made in respect of medical expense inflation:

	2011	2010
Initial medical trend	7.5%	9.0%
Ultimate medical trend	5.0%	5.0%
Years to ultimate	3	4



## Notes to the Banking Department Financial Statements continued

## 18 Retirement benefits continued

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
<b>Unfunded defined-benefit liability</b>	<b>(149)</b>	<b>(132)</b>	<b>(108)</b>	<b>(117)</b>	<b>(145)</b>

Sensitivity analysis provided by the actuary indicates that a 0.1% decrease in the discount rate would change the deficit on the other post-retirement benefits by £3 million (2010: £2million) and a 1% increase in the rate of medical claims by £30 million (2010: £25 million). If mortality rates were adjusted such that individuals were assumed to live for an additional year, the other post-retirement liabilities at the year end would increase by approximately £5 million (2010: £4 million).

The Bank expects to pay premiums of £4 million in the forthcoming year (2010: £4 million).

## Components of expense in the income statement

	2011 £m	2010 £m
Service cost	1	1
Interest cost	7	6
<b>Total retirement benefit cost</b>	<b>8</b>	<b>7</b>

## Amounts recognised in other comprehensive income

	2011 £m	2010 £m
Cumulative actuarial losses recognised at beginning of year	(26)	(6)
Actuarial loss on schemes' liabilities	(13)	(20)
<b>Cumulative actuarial losses recognised at end of year</b>	<b>(39)</b>	<b>(26)</b>

## Reconciliation of present value of defined-benefit obligation

	2011 £m	2010 £m
Present value of defined-benefit obligation at 1 March	132	108
Service cost	1	1
Interest cost	7	6
Actuarial loss on schemes' liabilities	13	20
Premiums paid	(4)	(3)
<b>Present value of defined-benefit obligation at 28 February</b>	<b>149</b>	<b>132</b>

## Experience gains and losses

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
<b>Experience (loss)/gain on defined-benefit obligation</b>	<b>(1)</b>	<b>–</b>	<b>11</b>	<b>12</b>	<b>7</b>

## 19 Other assets

	2011 £m	2010* £m
Items in course of settlement	1,366	693
Finance lease receivables	6	6
Short-term debtors and other assets	99	155
	<b>1,471</b>	<b>854</b>

\*Comparative figures have been restated as outlined in note 2b.

**20 Deposits from central banks**

	2011 £m	2010 £m
Deposits repayable on demand	869	1,515
Term deposits held at fair value through profit or loss	12,967	9,914
	<b>13,836</b>	<b>11,429</b>

**21 Deposits from banks and other financial institutions**

	Note	2011 £m	2010 £m
Deposits repayable on demand:			
Sterling		151,289	166,290
Non-sterling		188	166
Repurchase agreements		431	684
Cash collateral for derivatives	29	53	206
Cash Ratio Deposits		2,444	2,574
		<b>154,405</b>	<b>169,920</b>

Cash deposits in US dollars are taken from counterparties as collateral for certain derivatives (see note 29).

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 or threshold used for calculation, is payable immediately. Under the Bank of England Act 1998, the percentage and threshold 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.

**22 Other deposits**

	2011 £m	2010 £m
Deposit by Issue Department	36,284	26,655
Public deposits:		
Repayable on demand	1,309	1,364
Term deposits	–	–
Other deposits repayable on demand	12,450	4,316
	<b>50,043</b>	<b>32,335</b>

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

### 23 Foreign currency bonds in issue

All changes in fair values since 1 March 2010 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 four \$2 billion three-year dollar bonds (2010: three \$2 billion three-year dollar bonds); the first maturing on 17 March 2011, the second on 19 March 2012, the third on 18 March 2013 and the fourth on 7 March 2014.

The fourth bond was issued on 28 February 2011 with settlement on 7 March 2011. This bond matures on 7 March 2014.

	2011		2010	
	£m Fair value	\$m Nominal	£m Fair value	\$m Nominal
<b>Total amounts issued to third parties</b>	<b>5,037</b>	<b>8,000</b>	<b>4,126</b>	<b>6,000</b>

Of the above liabilities to third parties, £1,260 million (2010: £1,375 million) fall due within one year.

### 24 Deferred tax liabilities

Deferred tax is calculated on all temporary differences under the liability method using an effective tax rate of 27% (2010: 28%).

On 22 June 2010 the Chancellor announced that the main rate of UK corporation tax would reduce from 28% to 27% with effect from 1 April 2011. This tax change became substantively enacted in July 2010 and therefore the effect of the rate reduction on the deferred tax balances as at 28 February 2011 has been included in the figures below.

On 23 March 2011 the Chancellor announced a further reduction in the main rate of UK corporation tax to 26% with effect from 1 April 2011. This change became substantively enacted on 29 March 2011 and therefore the effect of the rate would create an additional reduction in the deferred tax liability of approximately £4 million. This has not been reflected in the figures above as it was not substantively enacted at the balance sheet date.

The Chancellor also proposed changes to further reduce the main rate of corporation tax by 1% per annum to 23% by 1 April 2014, but these changes have not yet been substantively enacted and therefore are not included in the figures above. The overall effect of the further reductions from 27% to 23%, if these applied to the deferred tax balance at 28 February 2011 would be to reduce the deferred tax liability by approximately £16 million.

The movement on the deferred tax account is as follows:

	Note	2011 £m	2010* £m
<b>Deferred tax</b>			
Net liability at 1 March		(149)	(137)
Income statement charge	7	(8)	(4)
Tax credited/(charged) directly to equity		52	(8)
<b>Net liability at 28 February</b>		<b>(105)</b>	<b>(149)</b>

\*Comparative figures have been restated as outlined in note 2b.

	2011 £m	2010* £m
<b>Deferred tax liability relates to:</b>		
Available for sale securities	(121)	(134)
Pensions and other post-retirement benefits	11	(17)
Other provisions	5	2
	<b>(105)</b>	<b>(149)</b>

\*Comparative figures have been restated as outlined in note 2b.

## 25 Other liabilities

	Note	2011 £m	2010* £m
Items in course of collection		992	47
Payable to HM Treasury	8	64	97
Short-term creditors and other liabilities		81	110
		<b>1,137</b>	<b>254</b>

\*Comparative figures have been restated as outlined in note 2b.

## 26 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.

## 27 Cash and cash equivalents

### i Analysis of cash balances

	Note	At 1 March 2010 £m	Cash flows £m	At 28 February 2011 £m
Cash and balances with other central banks	9	486	(160)	326
Loans and advances to banks and other financial institutions	10	4,224	3,180	7,404
Securities held at fair value through profit or loss	12	478	(93)	385
		<b>5,188</b>	<b>2,927</b>	<b>8,115</b>

### 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.

## Notes to the Banking Department Financial Statements continued

### 28 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 to the Bank's senior management, and documented delegated authorities for implementation of financial risk management and oversight of the Bank's operations.

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; Collateral Review Committee; and New Collateral 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 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 unsecured 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. Discretionary secured credit exposures and 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.<sup>(1)</sup>

In the Bank's Special Liquidity Scheme (SLS), Indexed 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 or auto loans). The collateral must meet published eligibility criteria and is subject to active risk management.

The Bank manages the risk in this wider collateral portfolio by applying haircuts to market or, where necessary, model 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.

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 SLS.

### 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:

	2011 £m	2010* £m
<b>Assets</b>		
United Kingdom	215,498	211,188
Rest of Europe	12,558	10,388
Rest of the world	1,543	1,508
	<b>229,599</b>	<b>223,084</b>
<b>Liabilities and equity</b>		
United Kingdom	213,376	205,900
Rest of Europe	2,996	7,141
Rest of the world	13,227	10,043
	<b>229,599</b>	<b>223,084</b>

\*Comparative figures have been restated as outlined in note 2b.

(1) See [www.bankofengland.co.uk/markets/money/eligiblesecurities.htm](http://www.bankofengland.co.uk/markets/money/eligiblesecurities.htm).

## Notes to the Banking Department Financial Statements continued

### 28 Financial risk management continued

#### b Market risk

Market risk is defined as the risk of loss as a result of changes in market risk factors, including prices of securities, 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 was exposed to interest rate risk via its three-month extended collateral long-term reverse repurchase operations as part of the Sterling Monetary Framework, during the year these were replaced by indexed long-term reverse repurchase operations (ILTRs) which do not generate interest rate risk.

#### Value at Risk measurement

The Bank measures the Value at Risk (VaR) of 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	2011 £m	2010 £m
At 28 February	83.6	92.1
Average	96.4	93.5

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 back tests its VaR by comparing 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.

The Bank also undertakes stress tests on positions on its balance sheet. The results of the stress testing complement the VaR measure in informing management about financial risk on the balance sheet.

### 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 £412 million (2010: £428 million). Excluding this, the Bank's net foreign exchange exposure at 28 February 2011 was £4 million (2010: £1 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 May 2010, the Bank recommenced operations (which had previously been suspended in January 2010) to lend US dollar funds against eligible collateral. Through a reciprocal swap agreement, the US Federal Reserve provided the Bank of England with US dollar funding to facilitate these operations.

The Bank's Balance Sheet Remit and Liquidity Risk 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 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.



## Notes to the Banking Department Financial Statements continued

## 28 Financial risk management continued

Foreign currency liquidity risk  
As at 28 February 2011

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
<b>Assets</b>						
Cash and balances with other central banks	326	–	–	–	–	326
Loans and advances to banks and other financial institutions	4,610	2,380	5,842	–	–	12,832
Securities held at fair value through profit or loss	643	472	423	3,317	–	4,855
Derivative financial instruments:						
Cash inflow	2,222	280	3,108	806	–	6,416
Cash outflow	(2,310)	(478)	(3,742)	(788)	–	(7,318)
Other assets	1,366	–	–	–	–	1,366
<b>Total assets</b>	<b>6,857</b>	<b>2,654</b>	<b>5,631</b>	<b>3,335</b>	<b>–</b>	<b>18,477</b>
<b>Liabilities</b>						
Deposits from central banks	3,846	1,302	3,509	–	–	8,657
Deposits from banks and other financial institutions	370	117	84	–	–	571
Other deposits	409	–	–	–	–	409
Foreign currency bonds in issue	1,310	–	8	3,800	–	5,118
Derivative financial instruments:						
Cash inflow	(2,815)	(1,375)	(472)	(1,844)	–	(6,506)
Cash outflow	2,847	2,223	2,182	1,988	–	9,240
Other liabilities	992	–	–	–	–	992
<b>Total liabilities</b>	<b>6,959</b>	<b>2,267</b>	<b>5,311</b>	<b>3,944</b>	<b>–</b>	<b>18,481</b>
<b>Net liquidity gap</b>	<b>(102)</b>	<b>387</b>	<b>320</b>	<b>(609)</b>	<b>–</b>	<b>(4)</b>
<b>Cumulative gap</b>	<b>(102)</b>	<b>285</b>	<b>605</b>	<b>(4)</b>	<b>(4)</b>	

## 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
<b>Assets</b>						
Cash and balances with other 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
<b>Total assets</b>	<b>5,383</b>	<b>1,697</b>	<b>4,957</b>	<b>2,544</b>	<b>–</b>	<b>14,581</b>
<b>Liabilities</b>						
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	–	–	–	–	–	–
<b>Total liabilities</b>	<b>5,305</b>	<b>1,867</b>	<b>4,576</b>	<b>2,832</b>	<b>–</b>	<b>14,580</b>
<b>Net liquidity gap</b>	<b>78</b>	<b>(170)</b>	<b>381</b>	<b>(288)</b>	<b>–</b>	<b>1</b>
<b>Cumulative gap</b>	<b>78</b>	<b>(92)</b>	<b>289</b>	<b>1</b>	<b>1</b>	

## Notes to the Banking Department Financial Statements continued

## 28 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:

## As at 28 February 2011

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<b>Assets</b>				
Loans and advances to banks and other financial institutions	–	12,536	–	12,536
Securities held at fair value through profit or loss	4,367	385	–	4,752
Derivative financial instruments	–	314	–	314
Available for sale securities	4,524	–	417	4,941
	<b>8,891</b>	<b>13,235</b>	<b>417</b>	<b>22,543</b>
<b>Liabilities</b>				
Deposits from central banks	–	12,967	–	12,967
Foreign currency bonds in issue	5,037	–	–	5,037
Derivative financial instruments	–	366	–	366
	<b>5,037</b>	<b>13,333</b>	<b>–</b>	<b>18,370</b>

## As at 28 February 2010

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<b>Assets</b>				
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
	<b>7,474</b>	<b>9,667</b>	<b>433</b>	<b>17,574</b>
<b>Liabilities</b>				
Deposits from central banks	–	9,914	–	9,914
Foreign currency bonds in issue	4,126	–	–	4,126
Derivative financial instruments	–	263	–	263
	<b>4,126</b>	<b>10,177</b>	<b>–</b>	<b>14,303</b>

There have been no transfers between levels in the year.

- 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.

## 29 Collateral

At 28 February 2011 the Bank held collateral as follows:

- Securities with a fair value of £132 billion (2010: £229 billion) were held as collateral for Treasury bills lent under the Special Liquidity Scheme with a face value of £91 billion (2010: £165 billion). At 28 February 2011 the Bank had not sold any of these assets to third parties but is permitted to do so (2010: £nil). The basis for accounting for the Special Liquidity Scheme is set out in note 2t.
- Securities with a fair value of £17 billion (2010: £14 billion) were held as collateral for reverse repurchase agreements with a total value of £16 billion (2010: £12 billion) (note 10). At 28 February 2011 the Bank had not sold any of these assets to third parties but is permitted to do so (2010: £nil).
- Cash collateral of £53 million (2010: £206 million) (note 21) and securities with a fair value of £25 million (2010: £nil) were held in respect of derivative financial instruments (note 13).

At 28 February 2011 the Bank had pledged assets with a fair value of £421 million (2010: £665 million) as collateral for repurchase agreements of £431 million (2010: £684 million) (note 21).

## 30 Contingent liabilities and commitments

### a Contingent liabilities

Contingent liabilities and commitments, some of which are offset by corresponding obligations of third parties, arise in the normal course of business, including contingent liabilities in respect of guarantees and indemnities in connection with liquidity support operations.

As part of its normal business, the Bank acts as custodian of its customers' assets and fulfils an agency role. No significant irrecoverable liability arises from these transactions.

Since 1930 there has also been a contingent liability in respect of uncalled capital on the Bank's investment in the Bank for International Settlements, now denominated in Special Drawing Rights (SDR). The sterling equivalent of this liability based on the SDR price at the balance sheet date was £173 million (2010: £180 million).

The Bank has been required to subscribe to the share capital of the European Central Bank (ECB) since its establishment in 1998. Subscriptions depend on shares which are fixed in accordance with Article 29.3 of the European System of Central Banks (ESCB) Statute and which must be adjusted every five years and on the accession of new states to the European Union. The next quinquennial adjustment is due in 2014.

In accordance with the Treaty on the Functioning of the European Union, and in line with other non euro area national central banks, the Bank is only required to pay a 'minimal percentage' of its subscribed share capital, currently 3.75% amounting to €59 million (2010: 7% amounting to €59 million) by way of contribution to the operational costs of the ECB. The 'minimal percentage' can be varied by the General Council of the ECB. The Bank has not been notified of any intentions to change the 'minimal percentage'.

### b Capital commitments

Capital commitments outstanding at 28 February 2011 amounted to £6 million (2010: £17 million).

## Notes to the Banking Department Financial Statements continued

### c Operating lease commitments — minimum lease payments

	2011		2010	
	Land and buildings £000	Computer and other equipment £000	Land and buildings £000	Computer and other equipment £000
<b>At the year end, minimum lease payments under non-cancellable operating leases were:</b>				
Expiring within one year	51	4	–	177
Between one and five years	1,506	–	2,119	273
Expiring in five years or more	792	–	–	–
	<b>2,349</b>	<b>4</b>	<b>2,119</b>	<b>450</b>

The Bank leases the premises occupied by its Agencies.

### 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 22 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 2011 the Bank had borrowed Treasury bills with a face value of £91 billion (2010: £165 billion) under the Bank's Special Liquidity Scheme.

In the year to 28 February 2011 the Bank paid the DMO loan fees for Treasury bills borrowed of £93 million (2010: £125 million).

At 28 February 2011 the Bank had a loan from the DMO of £508 million (2010: £48 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 the year to 28 February 2011 was £2 million (2010: £1 million).

In addition, deposits placed with the Bank at the year end amounted to £761 million (2010: £819 million). During the year to 28 February 2011 interest of £3 million was payable to the DMO in respect of deposits placed (2010: £3 million).

#### HM Treasury

HM Treasury continued to indemnify the Bank against any losses it may incur in connection with the Special Liquidity Scheme and the activities of the Bank of England Asset Purchase Facility Fund Ltd.

No fees were payable to HM Treasury in respect of indemnified operations in the year to 28 February 2011 (2010: £nil).

The Bank has requested HM Treasury to require the Financial Services Compensation Scheme (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 Dunfermline Building Society 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 £229 million (2010: £289 million) and are disclosed within note 22 as public deposits. During the year to 28 February 2011 interest of less than £0.1 million was payable to the FSCS in respect of deposits placed at the Bank (2010: £0.1 million).

#### Bradford & Bingley plc

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

Deposits placed with the Banking Department at the year end amounted to £300 million (2010: £334 million) and are disclosed within note 21. During the year to 28 February 2011 interest of £1 million was payable to Bradford & Bingley plc in respect of deposits placed (2010: £3 million), of which £1 million (2010: £1 million) was paid directly to HM Treasury.

#### Northern Rock

Northern Rock (Asset Management) plc and Northern Rock plc are wholly-owned subsidiaries of HM Treasury.

Northern Rock (Asset Management) plc had deposits with the Banking Department at the year end of £7.1 billion (2010: £6.7 billion) which are disclosed within note 21. During the year to 28 February 2011, interest of £36 million (2010: £37 million) was payable to Northern Rock (Asset Management) plc in respect of deposits placed, of which £36 million (2010: £29 million) was paid directly to HM Treasury.

Northern Rock plc had deposits with the Banking Department at the year end of £3.4 billion (2010: £8.8 billion) which are disclosed within note 21. During the year to 28 February 2011, interest of £29 million was payable to Northern Rock plc in respect of deposits placed (2010: £7 million).

### b Subsidiaries

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

#### Bank of England Asset Purchase Facility Fund Ltd (BEAPFF)

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 the Fund 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 2011 the loan from the Bank to BEAPFF was £199.8 billion (2010: £199.9 billion). Interest on this loan is receivable at Bank Rate and amounted to £1.0 billion for the year ending 28 February 2011 (2010: £0.6 billion).

## Notes to the Banking Department Financial Statements continued

### 31 Related parties continued

At the year end BEAPFF held a deposit at the Bank of £11.8 billion (2010: £3.8 billion), which is included in other deposits (note 22). Interest on this deposit is payable at Bank Rate and totalled £44 million for the year ending 28 February 2011 (2010: £8 million).

A management fee of £3 million was payable by BEAPFF to the Bank in respect of the year ended 28 February 2011 (2010: £5 million).

#### 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 2011, the number of key management personnel was 21 (2010: 18).

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

	2011 £000	2010 £000
<b>Loans</b>		
Balance brought forward	24	2
Loans made during year	34	29
Loans repaid during year	(14)	(7)
	<b>44</b>	<b>24</b>
Interest income earned	1	1
Number of key management personnel with loans at 28 February	3	2

No provisions have been recognised in respect of loans given to related parties (2010: £nil).

	2011 £m	2010 £m
<b>Deposits</b>		
<b>Governors and Executive Directors</b>		
Balance brought forward	464	199
Deposits taken during year	1,082	776
Deposits repaid during year	(697)	(511)
	<b>849</b>	<b>464</b>
<b>Non-executive Directors</b>		
Balance brought forward	4,534	11,591
Deposits taken during year	2,004	10
Deposits repaid during year	(2,000)	(7,067)
	<b>4,538</b>	<b>4,534</b>
Interest expense on above deposits	13	14
Number of key management personnel with deposits at 28 February	6	5

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 and 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

	2011 £000	2010 £000
Salaries and short-term benefits	2,712	2,264
Post-employment benefits	690	508
	<b>3,402</b>	<b>2,772</b>

Full information on the remuneration (including pension arrangements) of the Members of Court is given in the Remuneration report on pages 40 to 42.

#### d The Bank's pension scheme

The Bank provides the secretariat, accounting services and some banking and custodial services to the Bank's funded pension scheme. In the year to 28 February 2011 no charge was made for these services (2010: £nil). These activities are undertaken on behalf of, and under the supervision of, the Trustee of the Pension Fund. The contribution paid to the scheme during the year was £67 million (2010: £59 million). There were no other material transactions between the Bank and the pension scheme during the year to 28 February 2011. At 28 February 2011 the balances on accounts held with the Bank were £18 million (2010: £16 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 Date of approval

The Members of Court approved the financial statements on pages 48 to 93 on 28 June 2011.



## Issue Department

### Account for the period ended 28 February 2011

	Note	2011 £m	2010 £m
<b>Income and profits</b>			
Securities of, or guaranteed by, the British Government		292	160
Other securities and assets		255	403
		<b>547</b>	<b>563</b>
<b>Expenses</b>			
Cost of production of banknotes	2	40	38
Cost of issue, custody and payment of banknotes		23	26
Other expenses		9	8
		<b>72</b>	<b>72</b>
<b>Payable to HM Treasury</b>		<b>475</b>	<b>491</b>

## Statement of Balances: 28 February 2011

	Note	2011 £m	2010 £m
<b>Assets</b>			
Securities of, or guaranteed by, the British Government	3	5,687	5,679
Other securities and assets including those acquired under reverse repurchase agreements	4	46,507	44,541
<b>Total assets</b>		<b>52,194</b>	<b>50,220</b>
<b>Liabilities</b>			
Notes issued:			
In circulation	5	52,194	50,220
<b>Total liabilities</b>		<b>52,194</b>	<b>50,220</b>

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

**Sir Mervyn King** Governor  
**Mr C R Bean** Deputy Governor  
**Sir David Lees** Chairman of Court  
**Mr W R Jones** Finance Director

## 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 2011.
- 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 gains in the year to 28 February 2011 amounted to £8 million (2010: net deficit £121 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 2011 was £74 million (2010: £70 million).

### 3 Securities of, or guaranteed by, the British Government

	2011 £m	2010 £m
British Government Stocks	5,317	5,309
Ways and Means advance to the National Loans Fund	370	370
	<b>5,687</b>	<b>5,679</b>

The Ways and Means advance earns interest at Bank Rate.

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

	2011 £m	2010 £m
Deposit with Banking Department	36,284	26,655
Reverse repurchase agreements	10,223	17,886
	<b>46,507</b>	<b>44,541</b>

### 5 Notes in circulation

	2011 £m	2010 £m
£5	1,355	1,245
£10	6,493	6,399
£20	30,973	30,048
£50	9,940	9,248
Other notes*	3,433	3,280
	<b>52,194</b>	<b>50,220</b>

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

## Notes to the Issue Department Statements of Account continued

### 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 2011, the assets of the Issue Department had the following repricing period profile; repricing in up to one month £41 billion (2010: £30 billion), repricing in greater than one but less than three months £5 billion (2010: £9 billion), repricing in greater than three but less than six months £1 billion (2010: £4 billion), repricing in greater than six but less than twelve months £nil (2010: £2 billion) and repricing greater than one year £5 billion (2010: £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 2011 the unrecognised accrued interest on the assets held on the Issue Department Statement of Balances was £101 million (2010: £115 million).

### 8 Date of approval

The Members of Court approved the statements of account on pages 94 to 96 on 28 June 2011.

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