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 2014, set out on pages 70 to 122, and the statements of account of the Issue Department ('statements of account') for the year ended 28 February 2014, set out on pages 123 to 127. 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 Members of Court and auditor

As explained more fully in the Statement of the Responsibilities of the Court of Directors set out on page 67, the Members of Court are responsible for the preparation of the financial statements and statements of account in accordance with applicable law and the bases of preparation set out in note 1 on page 75 and note 2 on pages 75 to 83 respectively.

Our responsibility is to audit, and express an opinion on, the financial statements and statements of account in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practice's Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements and statements of account

An audit involves obtaining evidence about the amounts and disclosures in the financial statements and statements of account sufficient to give reasonable assurance that the financial statements and statements of account are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Bank's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Members of Court; and the overall presentation of the financial statements and statements of account. In addition, we read all the financial and non-financial information in the *Annual Report* to identify material inconsistencies with the audited financial statements and statements of account. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements and statements of account

In our opinion:

- the financial statements of the Banking Department on pages 70 to 122 for the year ended 28 February 2014 have been properly prepared, in all material respects, in accordance with the bases of preparation set out in note 2 on pages 75 to 83.
- the statements of account of the Issue Department on pages 123 to 127 for the year ended 28 February 2014 have been properly prepared, in all material respects, in accordance with the bases of preparation set out in note 1 on page 125.

Opinion on other matter

In our opinion the information given in the Remuneration report, the Financial Review, the Risk Management and Business Practices, and the Report of the Oversight Committee for the financial year for which the financial statements and statements of account are prepared is consistent with the financial statements and statements of account.

David Todd
for and on behalf of KPMG Audit Plc
Statutory Auditor
Chartered Accountants
15 Canada Square
Canary Wharf
London E14 5GL

4 June 2014

Banking Department income statement
for the year to 28 February 2014

	Note	2014 £m	2013 £m
Profit before tax		**180**	**125**
Corporation tax net of tax relief on payment to HM Treasury	7	(20)	(15)
Profit for the year attributable to shareholder		**160**	**110**

The notes on pages 75 to 122 are an integral part of these financial statements.

Statement of comprehensive income
for the year to 28 February 2014

	2014 £m	2013 £m
Profit for the year attributable to shareholder	**160**	**110**
Other comprehensive (loss)/income that may be recycled to profit or loss:		
Available for sale reserve		
Net (losses) from changes in fair value	(326)	(44)
Current and deferred tax	81	21
Property Revaluation Reserve		
Net gains from changes in fair value	17	–
Deferred tax	(3)	–
Total comprehensive (loss) that may be recycled to profit or loss	**(231)**	**(23)**
Other comprehensive (loss)/income not recycled to profit or loss:		
Retirement benefit remeasurements	(202)	(95)
Deferred tax	48	28
Other comprehensive (loss) for the period	**(385)**	**(90)**
Total comprehensive (loss)/income for the year	**(225)**	**20**

The notes on pages 75 to 122 are an integral part of these financial statements.

Balance sheet
as at 28 February 2014

	Note	2014 £m	2013 £m
Assets			
Cash and balances with other central banks	9	584	787
Loans and advances to banks and other financial institutions	10	9,899	11,719
Other loans and advances	11	375,197	375,196
Securities held at fair value through profit or loss	12	6,090	3,573
Derivative financial instruments	13	179	334
Current tax assets		–	12
Available for sale securities	14	6,342	5,179
Investments in subsidiaries	15	–	–
Property, plant and equipment	16	262	243
Intangible assets	17	11	11
Retirement benefit assets	18	312	460
Other assets	19	465	211
Total assets		**399,341**	**397,725**
Liabilities			
Deposits from central banks	20	14,854	14,371
Deposits from banks and other financial institutions	21	318,735	297,124
Other deposits	22	58,103	78,063
Foreign currency bonds in issue	23	3,599	4,007
Derivative financial instruments	13	465	229
Deferred tax liabilities	24	60	166
Retirement benefit liabilities	18	197	202
Other liabilities	25	281	211
Total liabilities		**396,294**	**394,373**
Equity			
Capital	26	15	15
Retained earnings		2,391	2,465
Other reserves		641	872
Total equity attributable to shareholder		**3,047**	**3,352**
		399,341	**397,725**

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

Mr M Carney Governor
Mr C R Bean Deputy Governor
Sir David Lees Chairman of Court
Mr R Coates Finance Director

Statement of changes in equity
for the year to 28 February 2014

		Attributable to equity shareholder				
	Note	Share capital £m	Available for sale reserve £m	Property revaluation reserve £m	Retained earnings £m	Total £m
Balance at 1 March 2012		**15**	**750**	**145**	**2,477**	**3,387**
Post-tax comprehensive income/(loss) for the period		–	(23)	–	43	20
Payable to HM Treasury in lieu of dividend	8	–	–	–	(55)	(55)
Balance at 28 February 2013		**15**	**727**	**145**	**2,465**	**3,352**
Post-tax comprehensive income/(loss) for the period		–	(245)	14	6	(225)
Payable to HM Treasury in lieu of dividend	8	–	–	–	(80)	(80)
Balance at 28 February 2014		**15**	**482**	**159**	**2,391**	**3,047**

The notes on pages 75 to 122 are an integral part of these financial statements.

Statement of cash flows
for the year to 28 February 2014

	Note	2014 £m	2013 £m
Cash flows from operating activities			
Profit before taxation		**180**	**125**
Adjustments for:			
Amortisation of intangibles	17	2	4
Depreciation of property, plant and equipment	16	14	11
Dividends received	4	(17)	(14)
Net movement in accrued interest and provisions, including pensions		59	125
Changes in operating assets and liabilities:			
Increase in loan advanced to the Bank of England Asset Purchase Facility Fund Ltd	11	–	(88,614)
Net decrease in other advances		2,463	1,120
Net increase in securities held at fair value through profit or loss		(3,011)	(214)
Net increase in deposits		2,134	87,035
Net (decrease)/increase in foreign currency bonds in issue		(3)	7
Net decrease/(increase) in financial derivatives	13	391	124
Net increase in other accounts		2	(54)
Corporation tax overpayment/(paid)		12	(56)
Net cash inflow/(outflow) from operating activities		**2,226**	**(401)**
Cash flows from investing activities			
Purchase of available for sale securities		(1,768)	(235)
Proceeds from redemption of available for sale securities	14	242	297
Dividends received	4	17	14
Purchase of intangible assets	17	(2)	(5)
Purchase of property, plant and equipment	16	(24)	(37)
Net cash inflow/(outflow) from investing activities		**(1,535)**	**34**
Cash flows from financing activities			
Tax on financing activities		–	633
Payment to HM Treasury under Section 1 (4) of the Bank of England Act 1946		(55)	(2,298)
Net cash (outflow)/inflow from financing activities		**(55)**	**(1,665)**
Net increase/(decrease) in cash and cash equivalents		**636**	**(2,032)**
Cash and cash equivalents at 1 March	27	4,140	6,172
Cash and cash equivalents at 28 February	**27**	**4,776**	**4,140**

Notes to the Banking Department financial statements

1 General information

The Bank of England is the central bank of the UK and is incorporated under a Royal Charter of 1694. Legislation covering its operations includes the Bank Charter Acts of 1694 and 1844, the Bank of England Acts 1946 and 1998, the Banking Act 2009 and the Financial Services Act 2012.

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 123 to 127, 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 National Loans Fund. Securities held on Issue Department are revalued quarterly at their clean market price. 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. 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.

Notes to the Banking Department financial statements continued

2 Bases of preparation continued

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.
- Contingent liabilities and guarantees.
- Information on credit risk.
- Fair value of collateral pledged and held.
- Related party disclosure.
- Off balance sheet arrangements.

b New and amended accounting standards

The Bank has considered the potential effect of forthcoming EU endorsed 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 Bank's subsidiaries, including the Bank of England Asset Purchase Facility Fund Ltd and the Prudential Regulation Authority, have not been consolidated. Under the Bank of England Act 1998 the financial statements are prepared on a non-consolidated basis. 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 presentation 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 those 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. The Bank does not currently hold any financial assets for trading but designates the following at fair value through profit or loss at inception:

- Securities and reverse repurchase agreements matching the Bank's issued foreign currency securities; and
- Securities and 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 83.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has either transferred substantially all of the risks and rewards of ownership or the Bank deems that it no longer retains control of the risks and rewards of ownership.

Banking Department
Notes to the 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 does not apply the hedge accounting rules of IAS 39.

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.

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
Leasehold improvements	over the estimated remaining life of the lease
Plant within buildings	over periods ranging from five to twenty years
IT equipment	over periods ranging from three to seven 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.

Banking Department
Notes to the financial statements continued

2 Bases of preparation continued

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.

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

ii As lessor

Long leases granted on property owned by the Bank are 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 primarily 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 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 liabilities

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:

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

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 obligation to pay cash flows relating to the financial liabilities has 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 UK tax laws, is recognised as an expense in the period in which profits arise. The Bank is entitled to tax relief on the amount due to HM Treasury as a payment in lieu of a dividend in accordance with section 1(4) Bank of England Act 1946. Tax relief on amount due 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 is 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. Remeasurements on retirement benefits 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. Remeasurements on retirement benefits 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 to redundancy provisions and healthcare for certain pensioners, which are accounted for on a similar basis to the accounting for pension obligations.

Banking Department
Notes to the financial statements continued

2 Bases of preparation continued

Staff transferred to the Bank from the Financial Services Authority (FSA) in April 2013 retained the employment terms and conditions of the FSA. These staff members continue to be active members within the FSA Pension Plan, which operates on a defined contribution basis. The Bank makes fixed contributions for employees into this scheme which are accounted for as contributions in the period they relate to.

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, as amended by the Bank of England Act 1998, 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.

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. Where the level of fee is contingent on a particular outcome, the Bank only recognises the fee that is known to be recoverable.

q Provisions

Provisions are recognised in respect of restructuring, onerous leases 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 loaned 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 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 18, 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

The Bank's accounting policy for the valuation of financial instruments is described in note 2 (e) and (k). The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. The majority of valuation techniques employ only observable market data, and so the reliability of the fair value measurement is high. Details of valuation techniques for the different classifications are given in note 28. Fair values of equity investments classified for accounting purposes as available for sale rely to a greater extent on unobservable inputs and therefore require a greater level of management judgement to calculate a fair value than those based on wholly observable inputs. These equity investments, disclosed in note 14, are held by the Bank for the long term as part of its central banking activities and may not be readily saleable. The values 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 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.

d Onerous lease provision

The Bank has recognised an onerous lease provision in respect to certain leased property occupied by the FSA which was vacated on the commencement of the new regulatory regime.

In determining the provision Management has made certain judgements in respect of; the likelihood of sub-letting space, the anticipated income receivable and an appropriate discount rate. The provision is included within note 25.

e Restructuring provision

The result of the Bank's Value for Money review, announced in January 2014, estimates that between 80–100 job redundancies will occur. The affected staff population has been assessed and a provision has been recognised based on the best estimate of the cost of these redundancies. The provision is included within note 25.

Banking Department
Notes to the financial statements continued

4 Profit before tax

	Note	2014 £m	2013 £m
Income includes			
Charges for services to HM Government (including charges to the Issue Department in respect of the Note Issue)		79	88
Funding for Lending Scheme income		89	10
Banking charges and tariff income		23	21
Onerous lease provision release		7	–
Dividend income		17	14
Expenses include			
Staff costs including restructuring provision	5	272	132
Legal fees		5	2
Amortisation of intangible assets	17	2	4
Depreciation of property, plant and equipment	16	14	11
Software expenditure		7	9
Operating lease rentals – property		5	1
– other		–	–
Onerous lease provision		–	19
Other administrative expenses		127	99

The expenses above include £9m of costs incurred in the year to 28 February 2014 (2013: £49m) in relation to the Prudential Regulation Authority transition. A receivable has been recognised on the balance sheet. The PRA Board agreed to recover these costs from fee-payers over a period of five years.

The Bank initially meets all the expenses of the PRA. In the year the Bank has recharged £132m of direct expenditure (of which £98m is included in staff costs but the remainder is excluded from the figures above) and has received £59m of income in respect of corporate services provided by the Bank to the PRA.

5 Staff costs

	Note	2014 £m	2013 £m
Wages and salaries		208	105
Social security costs		22	11
Pension and other post-retirement costs	18	33	16
Costs of restructuring		9	–
		272	**132**

Wages and salaries contain the cost of all Bank staff including those who work exclusively in the PRA. The amount directly recovered from the PRA in respect of staff costs was £98m (2013: £nil). It also includes £2m of costs capitalised as intangible assets (2013: £2m).

Average number of employees

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

	2014	2013
Governors and other members of Executive Directors Committee	14	13
Managers and analysts	1,921	855
Other staff	1,554	1,305
	3,489	**2,173**

Of which deemed to work exclusively for the PRA:

	2014	2013
Governors and other members of Executive Directors Committee	1	–
Managers and analysts	833	–
Other staff	119	–
	953	**–**

The number of people employed by the Bank at the end of February 2014 was 3,625 of which 3,224 were full time and 401 part time (2013: 2,307; with 2,029 full time and 278 part time). These include 1,045 persons deemed to have worked exclusively for the PRA of which 951 were full time and 94 part time. The average staff numbers for the PRA included in the table reflect the full year. The average staff number for the 11 months that the PRA was operational following legal cutover is 1,038.

Mr Bailey is deemed to have worked exclusively for the PRA in the table above. Mr Bailey is remunerated by the Bank but the total cost of his remuneration is recharged to the PRA.

Banking Department
Notes to the financial statements continued

6 Auditor's remuneration

	2014 £000	2013 £000
Audit fees for the Bank's audit		
– Fees relating to current year	260	260
– Fees relating to prior year	–	–
Fees payable to the Auditor for services provided to the Bank		
– Audit related services	43	43
– Taxation advisory services	16	38
– All other non-audit services	149	70
	468	**411**

In addition, fees of £30,000 for audit services and £7,900 for other services in relation to Bank of England Asset Purchase Facility Fund Ltd paid by the Bank were recovered via a management fee (2013: £30,000 and £9,000 respectively). Audit related services includes £25,000 for providing assurance to HM Treasury on the allocation of costs (2013: £25,000), and £18,000 for the submission for Whole Government Accounts (2013: £18,000). Other non-audit fees principally relate to advisory services to the Bank.

7 Taxation

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

	2014 £m	2013 £m
Current year corporation tax	6	6
Prior year corporation tax	–	–
Deferred tax – current year	14	9
Tax charge on profit	**20**	**15**

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:

	2014 £m	2013 £m
Profit before tax	**180**	**125**
Tax calculated at rate of 23.08% (2013: 24.17%)	41	30
Tax relief on payment to HM Treasury	(18)	(13)
Non-deductible expenses	1	1
Dividend not subject to corporation tax	(3)	(3)
Movement in unrecognised deferred tax on properties	–	–
Change in tax rate to 20% (2013: 23%)	(1)	–
Total tax charge for the period	**20**	**15**

Tax (credited)/charged to equity comprises:

	2014 £m	2013 £m
Tax (credited) to equity through the statement of comprehensive income		
Current year corporation tax	(6)	(5)
Deferred tax	(120)	(44)
Tax (credited) to equity	**(126)**	**(49)**

Tax (credited)/charged to equity is attributable as follows:

	2014 £m	2013 £m
Tax (credited)/charged to equity through the statement of comprehensive income		
Revaluation of available for sale securities	(75)	(11)
Revaluation of the property	4	–
Remeasurements on retirement benefits	(47)	(23)
Change in tax rate to 20% (2013: 23%)	(8)	(15)
Tax (credited) to equity	**(126)**	**(49)**

The main UK corporation tax rate is 23% with effect from 1 April 2013. The rate reduction on the deferred tax balances as at 28 February 2014 has been disclosed in note 24.

Banking Department
Notes to the financial statements continued

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

	2014 £m	2013 £m
Payable 4 April (2013: 5 April)	34	25
Payable 3 October (2013: 4 October)	46	30
	80	**55**

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 2014. 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

	2014 £m	2013 £m
Cash	–	–
Balances with other central banks	584	787
	584	**787**

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

	2014 £m	2013 £m
Reverse repurchase agreements held at amortised cost	670	570
Reverse repurchase agreements held at fair value through profit or loss	8,979	11,145
Other loans and advances	250	4
	9,899	**11,719**

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 Bank of England's *Sterling Monetary Framework* (updated January 2014).

At 28 February 2014 loans and advances to banks and other financial institutions included cash and cash equivalents of £3,998m (2013: £3,353m) which are disclosed in note 27 i.

11 Other loans and advances

	2014 £m	2013 £m
Loan to the Bank of England Asset Purchase Facility Fund Ltd	375,193	375,193
Term loans	4	3
	375,197	**375,196**

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

In January 2009, the Chancellor of the Exchequer authorised the Bank to set up an Asset Purchase Facility (APF) to buy high-quality assets financed by the issue of Treasury bills and the Debt Management Office's (DMO) cash management operations. The aim of the Facility was to improve liquidity in credit markets. The Chancellor also announced that the APF provided an additional tool that the Monetary Policy Committee (MPC) could use for monetary policy purposes. When the APF is used for monetary policy purposes, purchases of assets are financed by the creation of central bank reserves.

The Asset Purchase Facility transactions are undertaken by a subsidiary company of the Bank of England – the Bank of England Asset Purchase Facility Fund Limited (BEAPFF). The transactions are funded by a loan from the Bank.

In line with the MPC's most recent decision in relation to the asset purchase programme; the APF has purchased £375,000m of assets by the creation of central bank reserves. Additionally, the APF continues to operate its corporate facilities, with purchases financed by the issue of Treasury bills and the DMO's cash management operations. The loan in relation to the corporate facilities is £193m. The total loan from the Bank to BEAPFF is £375,193m (2013: £375,193m).

12 Securities held at fair value through profit or loss

	2014 £m	2013 £m
Money market instruments	2,235	–
Listed foreign government securities	3,855	3,573
	6,090	**3,573**

The holdings of foreign government securities are funded by the Bank's issuance of medium-term securities (note 23) and fixed term deposits placed by other central banks.

At 28 February 2014 securities held at fair value through profit or loss included cash and cash equivalents of £194m (2013: £nil) which are disclosed in note 27i.

Banking Department
Notes to the financial statements continued

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.

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. The 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, either securities or cash, if the net 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 2014

	Contract notional amount £m	Fair Values	
		Assets £m	Liabilities £m
Cross-currency interest rate swaps	2,694	118	(48)
Interest rate swaps	6,141	14	(29)
Forward exchange contracts	13,164	47	(388)
Total recognised derivative assets/(liabilities)		**179**	**(465)**

b As at 28 February 2013

	Contract notional amount £m	Fair Values	
		Assets £m	Liabilities £m
Cross-currency interest rate swaps	2,712	163	–
Interest rate swaps	7,928	36	(59)
Forward exchange contracts	13,350	135	(170)
Total recognised derivative assets/(liabilities)		**334**	**(229)**

14 Available for sale securities

	2014 £m	2013 £m
Debt securities at fair value		
British Government securities listed on a recognised UK exchange	5,543	4,265
Other sterling securities listed on a recognised exchange	397	435
	5,940	4,700
Unlisted equity investments at fair value	402	479
	6,342	**5,179**

The movement in available for sale securities comprises:

	2014 £m	2013 £m
Available for sale debt securities		
At 1 March	4,700	4,852
Purchases	1,792	235
Redemptions	(242)	(297)
Mark-to-market movements through equity	(249)	(35)
Amortisation of premium/discount	(62)	(52)
Movement in accrued interest	1	(3)
At 28 February	**5,940**	**4,700**
Available for sale unlisted equity investments		
At 1 March	479	488
Revaluation of securities	(77)	(9)
Disposal of securities	–	–
At 28 February	**402**	**479**
	6,342	**5,179**

There were no gains or losses on the sale of available for sale securities transferred to the income statement during the year (2013: £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.

Banking Department
Notes to the financial statements continued

14 Available for sale securities continued

b Unlisted equity investments

The unlisted equity investments held by the Bank are held as part of its functions as a central bank and are thus of a long-standing nature. The Bank's holdings in any particular institution may change from time to time as part of realignments of holdings among the shareholders and participants. Fair values of unlisted equity investments reflect the price that a knowledgeable willing party would pay in an arm's length transaction.

The Bank's investment in the Bank for International Settlements (incorporated in Switzerland) consists of shares of 5,000 Special Drawing Rights, which are 25% paid. At 28 February 2014 the holding represents 8.5% (2013: 8.5%) of the issued share capital. The investment has been valued on a dividend yield basis providing a value of £397m (2013: £474m) at the year end. A discount rate of 6.78% (2013: 6.5%) was used. Increasing the discount rate by one percentage point would deflate the valuation by £81m, while decreasing the discount rate by one percentage point would inflate the valuation by £139m.

The Bank's holding in the European Central Bank (ECB) represents 0.7% (2013: 0.8%) of the ECB'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 €56m (2013: 3.75% amounting to €59m) of its total allocation of the ECB's subscribed capital of €1.5bn (2013: €1.6bn). 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 13.7% (2013: 14.5%). On 1 January 2014, the ECB capital key was changed as a result of the quinquennial review and Latvia adopting the euro. As part of this change the Bank received back €3m from the ECB.

Contributions to the ECB 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 (2013: £nil).

15 Investments in subsidiaries

The Bank has a number of subsidiaries, which are wholly owned, that are stated in the Bank's balance sheet at an aggregate cost under £1m. These are:

The Securities Management Trust Ltd	1,000 ordinary shares of £1
Bank of England Asset Purchase Facility Fund Ltd	100 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
Prudential Regulation Authority Ltd	1 ordinary share of £1
Olive 863 Ltd	1 ordinary share of £1

16 Property, plant and equipment

For the period to 28 February 2014	Freehold land and buildings £m	Leasehold improvements £m	Equipment* £m	Total £m
Cost or valuation				
At 1 March 2013	210	10	57	277
Additions	10	1	13	24
Disposals/write-offs	–	–	(6)	(6)
PRA disposals	–	–	(9)	(9)
Revaluation of properties	10	–	–	10
At 28 February 2014	**230**	**11**	**55**	**296**
Accumulated depreciation				
At 1 March 2013	–	–	34	34
Charge for the period	7	1	6	14
Disposals/write-offs	–	–	(6)	(6)
PRA disposals	–	–	(1)	(1)
Revaluation of properties	(7)	–	–	(7)
At 28 February 2014	–	**1**	**33**	**34**
Net book value at 1 March 2013	210	10	23	243
Net book value at 28 February 2014	**230**	**10**	**22**	**262**

*Net book value of equipment at 28 February 2014 included £3m held under finance leases.

PRA disposals relate to assets purchased by the Bank in respect of the set-up of the PRA. These assets were transferred to the PRA on the 1 April 2013 when the new regulatory regime commenced.

Banking Department
Notes to the financial statements continued

16 Property, plant and equipment continued

For the period to 28 February 2013	Freehold land and buildings £m	Leasehold improvements £m	Equipment* £m	Total £m
Cost or valuation				
At 1 March 2012	204	–	50	254
Additions	13	10	14	37
Disposals/write-offs	(1)	–	(7)	(8)
Revaluation of properties	(6)	–	–	(6)
At 28 February 2013	**210**	**10**	**57**	**277**
Accumulated depreciation				
At 1 March 2012	–	–	36	36
Charge for the year	6	–	5	11
Disposals/write-offs	–	–	(7)	(7)
Revaluation of properties	(6)	–	–	(6)
At 28 February 2013	**–**	**–**	**34**	**34**
Net book value at 1 March 2012	204	–	14	218
Net book value at 28 February 2013	**210**	**10**	**23**	**243**

*Net book value of equipment at 28 February 2013 included £4m held under finance leases.

The figures for freehold land and buildings reflect independent professional valuations on a market value basis as at 28 February 2014 by Deloitte LLP, 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

	2014 £m	2013 £m
Cost		
At 1 March	37	35
Additions	2	5
Disposals/write offs	(3)	(3)
At 28 February	**36**	**37**
Accumulated amortisation		
At 1 March	26	25
Charge for the year	2	4
Disposals/write offs	(3)	(3)
At 28 February	**25**	**26**
Net book value at 1 March	11	10
Net book value at 28 February	**11**	**11**

Intangible assets primarily comprise computer software and related costs.

Banking Department
Notes to the financial statements continued

18 Retirement benefits

a Defined contribution

Staff transferred to the Bank from the Financial Services Authority (FSA) in April 2013 retained the employment terms and conditions of the FSA. These staff members continue to be active members within the FSA Pension Plan, which operates on a defined contribution basis. The Bank makes fixed contributions for employees into this scheme which are accounted for as contributions in the period they relate to. During the year total contributions made by the Bank were £8m (2013: £nil). No contributions were outstanding at the year end.

b Defined benefit and career average

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 pension scheme is an HMRC registered pension scheme and is subject to standard UK pensions and tax law. This means that the payment of contributions and benefits are subject to the appropriate tax treatments and restrictions and the scheme is subject to the scheme funding requirements outlined in section 224 of the Pensions Act 2004.

In accordance with UK trust and pensions law, the pension scheme has appointed trustees who are independent of the Bank. Although the Bank bears the financial cost of the scheme, the responsibility for the management and governance of the scheme lies with the trustees, who have a duty to act in the best interest of members at all times.

The pension scheme's assets are mostly invested in fixed interest and index-linked gilts which are intended to match the nature of the future benefit payments due from the scheme. This helps to reduce volatility in the funding level on the scheme funding basis and, to a lesser extent, in the statement of financial position in the Bank's accounts. The effect of the liability-matching investment policy is not fully reflected in the accounting figures as the assumptions dictated for the purposes of the valuation under IAS 19 are different from those used for the funding valuation.

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 2014 triennial valuation is being prepared as at 28 February 2014 and the results are not yet available. The latest valuation for funding purposes was as at 28 February 2011; it used the current unit method, and thus the funding target was based on each active member's current earnings, with the effect of future earnings increases on the accrued liabilities being included in normal future service contribution.

The valuation as at 28 February 2011	**£m**
Value of Fund assets	2,522
Actuarial value of scheme liabilities in respect of:	
– In-service members	(442)
– Deferred pensioners	(499)
– Current pensioners and dependants	(1,682)
– Members' additional voluntary contributions	(4)
Total	(2,627)
Scheme (deficit)	**(105)**
Funding level	96%
Future service contribution rate	29.7%

For the 2011 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 3.1%.

The Bank and the Pension Fund Trustees had previously agreed a deficit reduction plan following the 2008 valuation. This was reviewed after the valuation in 2011 and it was agreed to maintain the plan. At the balance sheet date there was one payment of £27m which remains to be paid.

Excluded from the contribution rate is the cost of administration and other services which is met by the Bank.

The 2014 valuation is currently underway and expected to be completed by the time the Bank publishes its 2015 *Annual Report*.

Summary of amounts recognised in the financial statements under IAS 19

In the statutory financial statements the Bank accounts for pension costs, other post-retirement benefits and related redundancy provisions in accordance with IAS19 (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 accounting value is different from the result obtained using the funding basis.

The accounts show the main scheme in surplus, while the Bank is making good the deficit revealed by the funding valuation. The main reason for this is the different assumptions used to value the liabilities in the accounting and funding valuations for the main scheme. The aim of the liability matching policy is that by investing in a range of assets (mostly government bonds) that broadly match the expected future benefit payments from the scheme, no surplus or deficit will arise.

The funding valuation, therefore, discounts expected future benefit payments at the appropriate yield available on government bonds to produce the value of the funding liabilities. The accounting standard requires that expected future benefit payments are discounted at the appropriate yield available on high quality corporate bonds, which is higher than the corresponding yield available on government bonds. The value placed on the liabilities for accounting purposes is, therefore, lower than the funding valuation.

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.

Banking Department
Notes to the financial statements continued

18 Retirement benefits continued

Amounts recognised as assets/(liabilities) in the balance sheet

	Note	2014 £m	2013 £m
Funded pension schemes	(i)	312	460
Unfunded post-retirement benefits:			
Redundancy provisions	(ii)	(79)	(81)
Other pension schemes	(iii)	(8)	(8)
Medical scheme	(iv)	(110)	(113)
		115	**258**

Pension expense recognised in the income statement

	Note	2014 £m	2013 £m
Funded pension schemes	(i)	17	4
Unfunded post-retirement benefits:			
Redundancy provisions	(ii)	3	4
Other pension schemes	(iii)	–	–
Medical scheme	(iv)	5	8
		25	**16**

Remeasurements recognised in the statement of comprehensive income

	Note	2014 £m	2013 £m
Funded pension schemes	(i)	(205)	(148)
Unfunded post-retirement benefits:			
Redundancy provisions	(ii)	(1)	(4)
Other pension schemes	(iii)	–	(1)
Medical scheme	(iv)	4	58
		(202)	**(95)**

(i) Funded pension scheme

As described above, the Bank has a final salary section within the pension scheme that provides pensions based on members' pensionable service and final salary at retirement. The pension is payable for life and increases in payment in line with inflation. Existing members of this section of the scheme continue to accrue future benefit but it is closed to new members.

For new employees, the Bank offers a career average revalued earnings (CARE) section of the pension scheme that provides pensions based on members' earnings each year revalued in line with inflation up to retirement.

The pension is payable for life and increases in payment in line with inflation.

(ii) Redundancy provisions

As part of redundancy arrangements with staff in place until 5 April 2010, the Bank could 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 was made for the costs of these benefits at the time the redundancy offer was announced based on actuarial advice. 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 pension schemes and updated annually.

(iii) Other pension schemes

As explained in the Remuneration section of the *Annual Report* on page 51, 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 Pension 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 and updated annually.

(iv) Medical scheme

Some current and former 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 scheme. The defined benefit liability is the expected cost to the Bank of the claims anticipated from the eligible members once in retirement.

Banking Department
Notes to the financial statements continued

18 Retirement benefits continued

Risks

The main risks to which the Bank is exposed in relation to the funded pension scheme are:

– Mortality risk – the assumptions adopted by the Bank make allowance for future improvements in life expectancy. However, if life expectancy improves at a faster rate than assumed, this would result in greater payments from the Fund and consequently increases in the scheme's liabilities. The Bank and the scheme's trustees review the mortality assumption on a regular basis to minimise the risk of using an inappropriate assumption;

– Investment risk – the Fund invests the vast majority of its assets in a portfolio of UK government bonds as the changes in the value of the bonds most closely match the movements in the Fund's liabilities. There remains the residual risk that the selected portfolio does not match the liabilities closely enough or that as it matures there is a risk of not being able to reinvest the assets at the assumed rates. The scheme's trustees review the structure of the portfolio on a regular basis to minimise these risks;

– Yield risk – a fall in government bond yields will increase both the scheme's assets and liabilities. As the scheme's liabilities, on the funding basis used to calculate the Bank's contributions to the scheme, are greater than its assets until the deficit is made good, during that time the liabilities may grow by more in monetary terms, increasing the deficit in the scheme; and

– Inflation risk – the majority of the scheme's liabilities increase in line with inflation and so if inflation is greater than expected, the liabilities will increase. The scheme's investment strategy is to hold government bonds that are also linked to inflation so this risk is mostly mitigated.

The redundancy provision and other pension schemes are primarily exposed to the mortality and inflation risks above. As they are not backed by any assets, these risks cannot be so easily managed. However, these arrangements (and therefore the risks associated with them) are small in comparison to the funded pension scheme.

The two main risks to which the Bank is exposed in relation to the medical scheme are mortality risk, as described above, and increases in the costs incurred being greater than assumed, either due to inflation of future medical costs or the frequency of members' claims.

Components of pension expense in the income statement

			2014			2013
	Main pension scheme £m	Other pensions £m	Medical scheme £m	Main pension scheme £m	Other pensions £m	Medical scheme £m
Current service cost	38	–	1	32	–	1
Net interest on the net defined (liability)/asset	(21)	3	4	(28)	4	7
Total pension expense	**17**	**3**	**5**	**4**	**4**	**8**

Remeasurements recognised in other comprehensive income

	2014			2013		
	Main pension scheme £m	Other pensions £m	Medical scheme £m	Main pension scheme £m	Other pensions £m	Medical scheme £m
Remeasurements recognised at the beginning of the period	75	(26)	5	223	(21)	(53)
Actuarial gains arising from changes in demographic assumptions	–	–	5	62	–	68
Actuarial (losses) arising from changes in financial assumptions	(48)	(1)	(2)	(210)	(5)	(12)
Actuarial gains/(losses) arising from experience on the scheme's liabilities	8	–	1	(18)	–	2
Return on schemes' assets excluding interest income	(165)	–	–	18	–	–
Remeasurements recognised at the end of the period	**(130)**	**(27)**	**9**	**75**	**(26)**	**5**

Reconciliation of present value of defined-benefit obligation

	2014			2013		
	Main pension scheme £m	Other pensions £m	Medical scheme £m	Main pension scheme £m	Other pensions £m	Medical scheme £m
Present value of defined-benefit obligation at the beginning of the period	2,676	89	113	2,470	85	167
Current service cost	38	–	1	32	–	1
Interest expense	108	3	4	109	4	7
Actuarial (gains) arising from changes in demographic assumptions	–	–	(5)	(62)	–	(68)
Actuarial losses arising from changes in financial assumptions	48	1	2	210	5	12
Actuarial (gains)/losses arising from experience on the scheme's liabilities	(8)	–	(1)	18	–	(2)
Benefits paid out	(104)	(6)	(4)	(101)	(5)	(4)
Present value of defined obligation at the end of the period	**2,758**	**87**	**110**	**2,676**	**89**	**113**

During the reporting period there have been no plan amendments, curtailments or settlements.

Banking Department
Notes to the financial statements continued

18 Retirement benefits continued

Reconciliation of the fair value of assets

	2014			2013		
	Main pension scheme £m	Other pensions £m	Medical scheme £m	Main pension scheme £m	Other pensions £m	Medical scheme £m
Fair value of schemes' assets at the beginning of the period	3,136	–	–	3,034	–	–
Interest income	129	–	–	137	–	–
Return on schemes' assets excluding interest income	(165)	–	–	18	–	–
Bank contributions	74	6	4	48	5	4
Benefits paid out	(104)	(6)	(4)	(101)	(5)	(4)
Fair value of schemes assets at the end of the period	**3,070**	**–**	**–**	**3,136**	**–**	**–**

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

	2014 %	2013 %
Discount rate	4.0	4.1
Rate of increase in salaries	4.55	4.55
Rate of increase of pensions in payment*	3.1	3.1
Rate of increase for deferred pensioners*	**3.1**	3.1

* This represents a weighted average of RPI and CPI, which are the indices used in the scheme.

The discount rate assumption reflects the investment return on a high quality corporate bond at the balance sheet date, as required by the standard.

The assumption on salary growth is for the long term over the life of the scheme. For the purposes of the valuation this assumption has been modified to reflect the Bank continuing to abide by public sector pay guidelines.

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 2014 will live for 29.8 years (28 February 2013: 29.6 years) and a female member 30.5 years (28 February 2013: 30.3 years), and a male member reaching 60 in 2034 will live for 32.8 years (28 February 2013: 32.7 years) and a female member 33.4 years (28 February 2013: 33.3 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 were:

	Value £m	2014 Percentage of total value %	Value £m	2013 Percentage of total value %
UK Government fixed interest bonds	250	8.1	242	7.7
UK Government index-linked bonds	2,302	75.0	2,468	78.7
Corporate index-linked bonds	498	16.2	405	12.9
Cash and other assets	20	0.7	21	0.7
Total market value of investments	**3,070**	**100.0**	**3,136**	**100.0**

For the purposes of IAS 19, the asset values stated are at the balance sheet date. Market values of the scheme's assets, which are not intended to be realised in the short-term, may be subject to significant change before they are realised. Of the corporate index-linked bonds £182m were quoted and £316m were unquoted (2013: £93m quoted and £312m unquoted). Of the unquoted bonds £294m (2013: £290m) were guaranteed by the UK Government.

Main scheme

	2014 £m	2013 £m
Present value of defined-benefit obligations	(2,758)	(2,676)
Assets at fair value	3,070	3,136
Defined-benefit asset	**312**	**460**

The duration of the pension scheme liabilities is in the region of 19 years. A +/- 0.1% change to the discount rate would change the surplus on the pension scheme by +/- £50m (28 February 2013: +/- £48m).

A +/- 0.1% change to the to the assumed difference between CPI and RPI inflation would change the present value of defined-benefit obligations for the pension scheme by +/- £40m with a similar offsetting change expected in the value of the pension scheme's assets given the matching nature of the investment strategy.

A +/- 0.5% change to the assumed rate of increases in salaries would change the surplus on the pension scheme by +/- £33m.

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 £74m (28 February 2013: £71m).

The Bank expects to pay contributions of £83m in the forthcoming year (2013: £74m).

Banking Department
Notes to the financial statements continued

18 Retirement benefits continued

Redundancy provisions

	2014 £m	2013 £m
Unfunded defined-benefit liability	**(79)**	**(81)**

The Bank expects to make payments of £5m in the forthcoming year (2013: £5m).

Other pension schemes

	2014 £m	2013 £m
Unfunded defined-benefit liability	**(8)**	**(8)**

The Bank expects to make payments of less than £1m in the forthcoming year (2013: less than £1m).

During the year to 28 February 2014 the Bank incurred services costs of less than £1m (2013: less than £1m).

Medical scheme

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 discount rates used for the purposes of measuring post-retirement benefit liabilities is the same as used in the IAS 19 valuation of pension scheme liabilities. Following a review of the recent experience of the medical scheme, the level at which claims are assumed to arise on average has been updated. This has resulted in a reduction of £5m in the unfunded defined-benefit recognised. Additionally, for accounting purposes the following assumptions have been made in respect of medical expense inflation:

	2014 %	2013 %
Initial medical trend	5.0%	5.5%
Ultimate medical trend	5.0%	5.0%
Years to ultimate	–	1

Post-retirement benefits – medical

	2014 £m	2013 £m
Unfunded defined-benefit liability	**(110)**	**(113)**

Sensitivity analysis provided by the actuary indicates that 0.1% decrease in the discount rate would change the deficit on the other post-retirement benefits by £2m (28 February 2013: £2m) and a 1% increase in the rate of medical claims by £20m (28 February 2013: £22m). If the 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 £4m (28 February 2013: £4m). The Bank expects to pay premiums of £4m in the forthcoming year (2013: £4m).

19 Other assets

	2014 £m	2013 £m
Finance lease receivables	6	6
Short term debtors and other assets	381	140
Amounts due from the PRA	78	65
	465	**211**

The amount owed by the PRA includes £44m due in more than one year (2013: £50m). Finance lease receivables also include £6m due in more than one year (2013: £6m).

20 Deposits from central banks

	2014 £m	2013 £m
Deposits repayable on demand	1,926	1,994
Term deposits held at fair value through profit or loss	12,928	12,377
	14,854	**14,371**

21 Deposits from banks and other financial institutions

	2014 £m	2013 £m
Deposits repayable on demand		
Sterling	314,588	294,488
Non-sterling	69	157
Cash Ratio Deposits	4,078	2,479
	318,735	**297,124**

The majority of deposits repayable on demand comprise of reserves accounts held at the Bank. Reserves accounts are sterling current accounts for banks and building societies. They are the most liquid asset a bank or building society can hold and are the ultimate means of settlement between banks and building societies.

The rate paid by the Bank on reserves account balances is also the means by which the Bank keeps market interest rates in line with Bank Rate. All reserves balances are remunerated at Bank Rate.

Under the Cash Ratio Deposit (CRD) scheme, institutions place non-interest bearing deposits at the Bank of England. The Bank invests these deposits (mainly in gilts) and the income earned is used to fund the costs of its monetary policy and financial stability operations, which benefit sterling deposit takers.

Banking Department
Notes to the financial statements continued

21 Deposits from banks and other financial institutions continued

Under the Bank of England Act 1998, the percentage and threshold used in calculating the CRDs is set by HM Treasury, having regard to the financial needs of the Bank and subject to approval of both Houses of Parliament. This is reviewed, at the latest, every five years and was last reviewed in May 2013.

22 Other deposits

	2014 £m	2013 £m
Deposit by Issue Department	55,109	52,744
Public deposits repayable on demand	1,611	949
Other deposits repayable on demand	1,383	24,370
	58,103	**78,063**

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

23 Foreign currency bonds in issue

	2014		2013	
	£m Fair value	US$m Nominal	£m Fair value	US$m Nominal
Total amounts issued to third parties	**3,599**	**6,000**	**4,007**	**6,000**

All changes in fair values since 1 March 2013 are considered attributable to changes in prevailing interest rates and movements in relative foreign currency exchange rates.

At 28 February 2014, as part of the Bank's annual medium-term security issuance programme the Bank had three US$2bn three-year US dollar bonds in issue (2013: three US$2bn three-year dollar bonds); the first maturing on 7 March 2014, the second on 6 March 2015 and the third on 21 March 2016.

The most recent bond (the eighth in the overall programme) was issued on 10 March 2014 with settlement on 17 March 2014. This bond matures on 17 March 2017.

Of the above liabilities to third parties, £1,201m (2013: £1,339m) 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 20% (2013: 23%). A reduction in the UK corporation tax rate from 24% (effective from 1 April 2012) to 23% (effective 1 April 2013) was substantively enacted on 3 July 2012. Further reductions to 21% (effective from 1 April 2014) and 20% (effective from 1 April 2015) were substantively enacted on 2 July 2013. This will reduce the Bank's future current tax charge accordingly. The deferred tax liability at 28 February 2014 has been calculated based on the rate of 20% substantively enacted at the balance sheet date.

The movement on the deferred tax account is as follows:

	Note	2014 £m	2013 £m
Deferred tax			
Net liability at 1 March		(166)	(201)
Income statement charge	7	(14)	(9)
Tax credited/(charged) directly to equity		120	44
Net liability at 28 February		**(60)**	**(166)**

	2014 £m	2013 £m
Deferred tax liability relates to:		
Available for sale equity investment through comprehensive income	(78)	(110)
Fair value losses on available for sale debt securities recognised in other comprehensive income	42	–
Pensions and other post-retirement benefits	(23)	(59)
Other provisions	(1)	3
	(60)	**(166)**

25 Other liabilities

i Analysis of other liabilities

	2014 £m	2013 £m
Items in course of collection	26	1
Payable to HM Treasury	82	55
Short term creditors and other liabilities	157	136
Provisions	16	19
	281	**211**

Payable to HM Treasury includes £80m payment in lieu of dividend (note 8) and a further £2m which relates to the over recovery of costs associated with the management of the notes issue and the Exchange Equalisation Account.

Banking Department
Notes to the financial statements continued

25 Other liabilities continued

ii Analysis of provisions

	Restructuring provision £m	Onerous lease provision £m	Total £m
Balance at 1 March 2013	–	19	19
Provisions made during the year	8	–	8
Provisions used during the year	–	(4)	(4)
Provisions reversed during the year	–	(7)	(7)
Balance at 28 February 2014	**8**	**8**	**16**

Onerous lease provision

The Bank has undertaken to bear the costs arising from certain leased property previously occupied by the Financial Services Authority and which was vacated upon the commencement of the new regulatory regime. The amount provided for represents the net present value of the future lease payments and the costs of dilapidations required as part of the lease less any expected lease income from sub-letting the floor space.

The estimated future inflow of income from sub-letting the floor space has been revised and as such has led to a gain of £7m released through the income statement for the year to 28 February 2014.

The estimated net cash outflow arising has therefore decreased from £15m to £8m as at 28 February 2014.

The lease expires in November 2018. Of the above provision £2m (2013: £4m) falls due within one year. The cash flows are discounted at a risk free rate at 28 February 2014. The impact of the discount unwind is negligible.

Restructuring provision

The result of the Bank's Value for Money review, announced in January 2014, estimates that between 80–100 job redundancies will occur. The affected staff population has been assessed and a provision has been recognised based on the best estimate of the cost of these redundancies. Of these costs less than £1m is expected to be paid in more than one year.

26 Capital

	2014 £m	2013 £m
Capital	**15**	**15**

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.

27 Cash and cash equivalents

i Analysis of cash balances

	Note	At 1 March 2013 £m	Cash flows £m	At 28 February 2014 £m
Cash and balances with other central banks	9	787	(203)	584
Loans and advances to banks and other financial institutions	10	3,353	645	3,998
Securities held at fair value through profit or loss	12	–	194	194
		4,140	**636**	**4,776**

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.

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

The Bank applies fundamentally the same risk management policies for off-balance sheet risks as it does for its on-balance sheet risks. In the case of commitments to lend, customers and counterparties will be subject to the same credit management policies as for loans and advances.

Specialist teams and committees support senior management in ensuring that agreed standards and policies are followed.

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.

Banking Department
Notes to the financial statements continued

28 Financial risk management continued

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 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; intra-day 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. Unsecured credit exposures are controlled by a system of limits based on internal credit ratings. This system applies to all unsecured credit exposures, including intra day exposures, foreign exchange settlement exposures and exposures arising from settling securities trades for customers. Separately, limits exist to control the maximum outright (uncollateralised) exposures to a single entity. 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 the creditworthiness of issuers, counterparties and customers to 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.

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.

Credit risk on the securities held outright by the Bank is managed by holding only securities internally rated as equivalent to investment-grade in routine circumstances, which are issued chiefly by governments, government agencies and supranational organisations; and by a schedule of credit limits that vary based on internal rating.

Collateral management

In providing short-term liquidity via the Bank's Sterling Monetary Framework operations and, intra-day, via the Bank's operation of wholesale payment systems, credit risk is managed by ensuring that exposures are fully collateralised (with appropriate haircuts) by securities, which are issued chiefly by governments, government agencies and supranational organisations, which meet the Bank's minimum standards of liquidity and credit risk. A summary of eligible collateral can be found on the Bank's website.[34]

In the Bank's Indexed Long-Term Repo Operations, Discount Window Facility, Contingent Term Repo Facility and Funding for Lending Scheme, the Bank may take a wide range of private sector collateral. Depending on the facility, the collateral may include mortgage-backed securities, covered bonds backed by mortgages or public sector securities, other asset-backed securities (such as asset-backed securities backed by credit card receivables, student loans or auto loans), or pools of loans. The collateral must meet published eligibility criteria.

The Bank manages the risk in this wider collateral portfolio by applying haircuts to take account of liquidity risk, credit risk and all other material risks to the realisable value of the collateral. 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.

34 www.bankofengland.co.uk/boe-ar2014/links

The Bank values securities daily and calls for additional collateral where the haircut-adjusted value is less than the value of its exposure. 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 have been had such a price existed. The valuations methodology, the use of spreads in models and collateral eligibility are under regular review. A Collateral Risk Committee chaired by the Head of RMD reviews issues relating to the wider collateral portfolio and considers policy issues relating to stress testing, valuation and eligibility of collateral including market or entity specific conditions.

In the Bank's Indexed Long-Term Repo Operations, Discount Window Facility, Contingent Term Repo Facility and Funding for Lending Scheme, the Bank may take portfolios of loans in unsecuritised form as collateral. A Collateral Eligibility Committee chaired by the Head of RMD reviews the eligibility of a counterparty to pledge portfolios of loans as collateral, based on an assessment of the firm's risk management policies and also reviews eligibility of individual portfolios.

In non-routine circumstances, the Bank may seek other methods of mitigating credit risk, which may include indemnities from HM Treasury.

Geographical concentration of assets and liabilities

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

	2014 £m	2013 £m
Assets		
UK	388,101	389,508
Rest of Europe	9,741	6,133
Rest of the world	1,499	2,084
	399,341	**397,725**
Liabilities and equity		
UK	371,054	369,064
Rest of Europe	13,956	14,993
Rest of the world	14,331	13,668
	399,341	**397,725**

b Market risk

Market risk is defined as the risk of loss as a result of changes in market prices, 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 and, 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 and to shifts in general market conditions, such as the liquidity of asset markets.

The Bank's market risk policies set out risk management parameters, governance and control frameworks as well as reporting arrangements for key risk indicators.

The Bank is exposed to interest rate risk through the investment of the Bank's capital and Cash Ratio Deposits in high-quality securities in the sterling bond portfolio. These are bought and, in normal circumstances, held to maturity with the intention of maintaining the value of the Bank's capital and generating income to pay for the Bank's policy functions.

Banking Department
Notes to the financial statements continued

28 Financial risk management continued

Value at Risk measurement

The Bank measures the Value at Risk (VaR) of all its positions. VaR estimates the potential loss that might arise if existing positions were unchanged for 10 working 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. During the year VaR arose mostly from market risk on the Bank's sterling bond portfolio.

Value at Risk

	2014 £m	2013 £m
At 28 February	98.2	76.7
Average	94.8	86.5

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 from 1 March 2012 to 28 February 2014 on 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.

To mitigate the fourth limitation above, the Bank has developed 'stressed' VaR which is calibrated not on recent data, but on data drawn from the two-year period of maximum volatility since January 2000. Stressed VaR avoids the understatement problem as changes generally arise from a change in the underlying portfolio, rather than a short-run change in market volatility. The Bank introduced the stressed VaR in June 2013; at 28 February 2014, stressed VaR was £162.92m.

Currency risk

The Bank may take currency risk in the context of foreign exchange intervention and 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 (note 14b) which is denominated in Special Drawing Rights and held at fair value of £397m (2013: £474m). Excluding this, the Bank's net foreign exchange exposure at 28 February 2014 was £1m (2013: £17m).

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 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. Throughout 2013/14, the Bank continued weekly tender operations (which had recommenced in May 2010) to lend US dollar funds for seven days against eligible collateral. Since October 2011, monthly US dollar tender operations with a 3-month term have also been offered. US dollar funding to facilitate these operations would be provided through a reciprocal swap agreement with the US Federal Reserve.

In view of the improvement in US dollar funding conditions and the low demand for US dollar liquidity-providing operations, the Bank of England, in co-ordination with other central banks, has decided to phase out its current US dollar liquidity-providing operations during 2014. The network of bilateral central bank liquidity swap arrangements, moved on to a standing basis in October 2013, provide a framework for the reintroduction of US liquidity operations if warranted by market conditions.

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.

Banking Department
Notes to the financial statements continued

28 Financial risk management continued

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.

Foreign currency liquidity risk

As at 28 February 2014	Up to 1 month £m	1–3 months £m	3–12 months £m	1–5 years £m	Over 5 years £m	Total £m
Assets						
Cash and balances with other central banks	584	–	–	–	–	584
Loans and advances to banks and other financial institutions	2,972	4,404	1,606	–	–	8,982
Securities held at fair value through profit and loss	413	1,425	2,851	1,599	–	6,288
Derivative financial instruments:						
Cash inflow	1,034	1	128	631	–	1,794
Cash outflow	(1,705)	(764)	(462)	(561)	–	(3,492)
Other assets	–	–	–	–	–	–
Total assets	**3,298**	**5,066**	**4,123**	**1,669**	**–**	**14,156**
Liabilities						
Deposits from central banks	1,903	4,387	3,247	–	–	9,537
Deposits from banks and other financial institutions	69	–	–	–	–	69
Other deposits	488	–	–	–	–	488
Foreign currency bonds in issue	1,208	–	6	2,398	–	3,612
Derivative financial instruments:						
Cash inflow	(2,611)	(4,391)	(3,139)	(1,198)	–	(11,339)
Cash outflow	2,616	4,684	3,232	1,256	–	11,788
Other liabilities	–	–	–	–	–	–
Total liabilities	**3,673**	**4,680**	**3,346**	**2,456**	**–**	**14,155**
Net liquidity gap	**(375)**	**386**	**777**	**(787)**	**–**	**1**
Cumulative gap	**(375)**	**11**	**788**	**1**	**1**	

Foreign currency liquidity risk

As at 28 February 2013	Up to 1 month £m	1–3 months £m	3–12 months £m	1–5 years £m	Over 5 years £m	Total £m
Assets						
Cash and balances with other central banks	786	–	–	–	–	786
Loans and advances to banks and other financial institutions	1,344	6,040	3,766	–	–	11,150
Securities held at fair value through profit and loss	564	483	470	2,059	–	3,576
Derivative financial instruments:						
Cash inflow	2,427	4,128	2,032	1,869	–	10,456
Cash outflow	(2,121)	(4,037)	(1,982)	(1,731)	–	(9,871)
Other assets	–	–	–	–	–	–
Total assets	**3,000**	**6,614**	**4,286**	**2,197**	**–**	**16,097**
Liabilities						
Deposits from central banks	1,240	4,384	3,698	–	–	9,322
Deposits from banks and other financial institutions	157	–	–	–	–	157
Other deposits	410	–	–	–	–	410
Foreign currency bonds in issue	1,351	–	12	2,654	–	4,017
Derivative financial instruments:						
Cash inflow	(1,574)	(302)	(1,691)	(4)	–	(3,571)
Cash outflow	1,885	2,042	1,789	29	–	5,745
Other liabilities	–	–	–	–	–	–
Total liabilities	**3,469**	**6,124**	**3,808**	**2,679**	**–**	**16,080**
Net liquidity gap	**(469)**	**490**	**478**	**(482)**	**–**	**17**
Cumulative gap	**(469)**	**21**	**499**	**17**	**17**	

Banking Department
Notes to the 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 2014	Note	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets					
Loans and advances to banks and other financial institutions	10	–	8,979	–	8,979
Securities held at fair value through profit or loss	12	6,090	–	–	6,090
Derivative financial instruments	13	–	179	–	179
Available for sale securities	14	5,940	–	402	6,342
		12,030	**9,158**	**402**	**21,590**
Liabilities					
Deposits from central banks	20	–	12,928	–	12,928
Foreign currency bonds in issue	23	3,599	–	–	3,599
Derivative financial instruments	13	–	465	–	465
		3,599	**13,393**	**–**	**16,992**

As at 28 February 2013	Note	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets					
Loans and advances to banks and other financial institutions	10	–	11,145	–	11,145
Securities held at fair value through profit or loss	12	3,573	–	–	3,573
Derivative financial instruments	13	–	334	–	334
Available for sale securities	14	4,700	–	479	5,179
		8,273	**11,479**	**479**	**20,231**
Liabilities					
Deposits from central banks	20	–	12,377	–	12,377
Foreign currency bonds in issue	23	4,007	–	–	4,007
Derivative financial instruments	13	–	229	–	229
		4,007	**12,606**	**–**	**16,613**

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 that rely upon relevant observable market data curves. 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 14b).

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 Off balance sheet arrangements – Funding for Lending Scheme

The Funding for Lending Scheme (FLS) has been designed to incentivise banks and other financial institutions to boost their lending to UK households and businesses.

FLS does this by providing funding for an extended period with a direct link between the quantity and price of funding available from the scheme and participants' performance in lending to the real economy.

	Up to 1 year £m	1 to 3 years £m	3 to 5 years £m	2014 Nominal £m	2014 Fair value £m	2013 Nominal £m	2013 Fair value £m
Securities lent to banks and other financial institutions	–	13,486	27,919	41,405	41,334	15,166	15,139
Securities borrowed from DMO	–	(13,486)	(27,919)	(41,405)	(41,334)	(15,166)	(15,139)
Total obligations	–	–	–	–	–	–	–

As of the end of February 2014 there were 47 banking groups signed up to the scheme out of which 39 have outstanding drawings. Treasury bills with a market value of £41.3bn had been lent to the participants at year-end (2013: £15.1bn). The Bank has borrowed these Treasury bills from the DMO to whom they are owed back.

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 £166m (2013: £179m).

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 2019.

Banking Department
Notes to the financial statements continued

30 Contingent liabilities and commitments continued

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 €56m (2013: 3.75% amounting to €59m) 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 2014 amounted to £11m (2013: £11m).

In addition the Bank did not have any contingent capital commitments outstanding at 28 February 2014 (2013: £nil).

c Operating lease commitments – minimum lease payments

	2014 Land and buildings £000	2014 Computer and other equipment £000	2013 Land and buildings £000	2013 Computer and other equipment £000
At the year end, minimum lease payments under non-cancellable operating leases were				
Expiring within one year	7,700	251	7,865	194
Between one and five years	30,944	133	31,353	282
Expiring in five years or more	44,257	–	50,884	–
	82,901	**384**	**90,102**	**476**

The Bank leases the premises occupied by its Agencies and the PRA.

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 and Debt Management Account

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

At 28 February 2014 the Bank had a loan from the DMA of £193m (2013: £193m) in relation to the provision of funding to the Bank of England Asset Purchase Facility Fund Ltd.

At 28 February 2014 the Bank had borrowed Treasury bills with a nominal value of £41.4bn (2013: £15.2bn) under the Bank's Funding for Lending Scheme. The Bank has paid the DMA a loan fee for the Treasury bills borrowed.

In addition, the DMA placed interest bearing deposits with the Bank during the year, which is included within note 22 as public deposits.

HM Treasury

HM Treasury continued to indemnify the activities of the Bank of England Asset Purchase Facility Fund Ltd during the year.

The Bank has requested HM Treasury to require the Financial Services Compensation Scheme (FSCS) to make a payment reimbursing the sum of £2.9m 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 UK'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 PRA and FCA (formerly the FSA), although accountable to them and ultimately to HM Treasury.

The FSCS placed interest bearing deposits with the Bank during the year, which are included within note 22 as public deposits.

Bradford & Bingley plc and Northern Rock (Asset Management) plc

Bradford & Bingley plc and Northern Rock (Asset Management) plc are wholly-owned by HM Treasury through the holding company UK Asset Resolution Ltd and placed interest bearing deposits with the Bank during the year, which are included within note 21.

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.

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. From 6 March 2009 to 4 February 2010 and from 7 October 2011 advances on this loan were financed by the issuance of central bank reserves. Prior to 6 March 2009 and from 4 February 2010 to 6 October 2011 advances on this loan were financed by a loan from the DMO.

At 28 February 2014 the loan from the Bank to BEAPFF was £375.2bn (2013: £375.2bn). Interest on this loan is receivable at Bank Rate and amounted to £1.9bn for the year ending 28 February 2014 (2013: £1.7bn).

At the year end BEAPFF held a deposit at the Bank of £1.0bn (2013: £24.1bn), which is included in other deposits (note 22). Interest on this deposit is payable at Bank Rate and totalled £47m for the year ending 28 February 2014 (2013: £132m).

A management fee of £2m was payable by BEAPFF to the Bank in respect of the year ended 28 February 2014 (2013: £2m).

Banking Department
Notes to the financial statements continued

31 Related parties continued

Prudential Regulation Authority (PRA)

PRA is a wholly-owned subsidiary of the Bank. The company was established on 21 November 2011 and began to operate when the new regulatory framework for the UK's financial sector came into effect on 1 April 2013. To fulfil the requirements of the Financial Services Act 2012 the PRA is responsible for the prudential regulation of banks, building societies and credit unions, insurers and major investment firms. As prudential regulator, the PRA will promote the safety and soundness of these firms, seeking to minimise the adverse effects that they can have on the stability of the UK financial system; and contribute to ensuring that insurance policyholders are appropriately protected.

The Bank initially pays all of the expenses of the PRA. The Bank will then recharge relevant expenditure, such as the costs of 20 Moorgate the building from which the PRA operates, directly to the PRA. During the year the Bank recharged expenditure of £132.0m. Additionally the Bank provides central services and support functions, such as IT, finance, property and procurement, and human resources, to the PRA for which it charges a management fee on a monthly basis. In the year the management fee charged was £59.4m. As at 28 February 2014 the Bank was owed £19.1m by the PRA in respect of recharged expenditure and management fee, this amount is included in Note 19.

Additionally the Bank incurred further costs in relation to the set up of the PRA of £9.2m in the year (2013: £48.5m) and has charged the current year's costs to the PRA. The PRA Board had previously agreed that the costs of the transition will be recovered from the fee-payers over a period of five years. As a result the PRA has a liability to the Bank and the Bank has a receivable from the PRA as at the year end of £59.0m (2013: £64.7m) which is disclosed as a receivable within note 19. The Bank held on balance sheet as at 28 February 2014 £14.3m (2013: £22.8m) at cost of property, plant and equipment related to the set up of the PRA which is disclosed within note 16. During the year property, plant and equipment of £7.9m was transferred from the Bank to the PRA at net book value, of which £0.3m was transferred post legal cutover.

c Key management personnel

Members of Court are covered by an indemnity from the Bank, granted in 2000 (see page 7).

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 2014, the number of key management personnel was 26 (2013: 22).

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

	2014 £000	2013 £000
Loans		
Balance brought forward	28	32
Loans made during year	35	22
Loans repaid during year	(20)	(26)
	43	**28**
Interest income earned	2	2
Number of key management personnel with loans at 28 February	**5**	3

No provisions have been recognised in respect of loans given to related parties (2013: £nil).

	2014 £000	2013 £000
Deposits		
Governors and Executive Directors		
Balance brought forward	872	745
Deposits taken during year	512	592
Deposits repaid during year	(1,104)	(465)
	280	**872**
Non-executive Directors		
Balance brought forward	6,159	5,548
Deposits taken during year	12	611
Deposits repaid during year	–	–
	6,171	**6,159**
Interest expense on above deposits	17	16
Number of key management personnel with deposits at 28 February	5	7

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 external MPC members, are entitled to season ticket loans (repayable monthly over five to 12 months) and may choose to take personal loans (for periods of up to five years and at a variable interest rate equal to HMRC's Official Rate of Interest currently 4%) 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.

Banking Department
Notes to the financial statements continued

31 Related parties continued
Key management remuneration

	2014 £000	2013 £000
Salaries and short-term benefits	4,836	3,329
Post-employment benefits	873	374
	5,709	**3,703**

Post-employment benefits have been estimated using an expected cost of pension on a funding valuation basis.

Full information on the remuneration (including pension arrangements) of the Members of Court is given in the Remuneration report on pages 50 to 55.

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 2014 no charge was made for these services (2013: £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 £48m (2013: £48m). There were no other material transactions between the Bank and the pension scheme during the year to 28 February 2014. At 28 February 2014 the balances on accounts held with the Bank were £11m (2013: £11m).

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 70 to 122 on 4 June 2014.

Issue Department Account
for the period ended 28 February 2014

	2014 £m	2013 £m
Income and profits		
Securities of, or guaranteed by, the British Government	238	330
Other securities and assets	275	262
	513	**592**
Expenses		
Cost of production of banknotes	36	40
Cost of issue, custody and payment of banknotes	25	27
Other expenses	9	8
	70	**75**
Paid to National Loans Fund	**443**	**517**

Issue Department
Statement of balances
for the period ended 28 February 2014

	Note	2014 £m	2013 £m
Assets			
Securities of, or guaranteed by, the British Government	3	4,594	5,263
Other securities and assets including those acquired under reverse repurchase agreements	4	55,604	52,759
Total assets		**60,198**	**58,022**
Liabilities			
Notes issued:			
In circulation	5	60,198	58,022
Total liabilities		**60,198**	**58,022**

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

Mr M Carney Governor
Mr C R Bean Deputy Governor
Sir David Lees Chairman of Court
Mr R Coates Finance Director

The notes on pages 125 to 127 are an integral part of these statements of accounts.

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 Acts 1928 and 1954, the National Loans Act 1968 and the Currency Act 1983. All profits of the Issue Department 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 as at 27 February 2014.

– 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 gains taken to income in the year to 28 February 2014 amounted to £nil (2013: £82m) and total deficits paid by the National Loans Fund amounted to £282m (2013: £195m).

– Notes in circulation exclude those old series notes which have been written off. The value of the note is still given by the Bank on presentation. The Bank is reimbursed by HM Treasury in these instances.

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 2014 was £72m (2013: £78m).

3 Securities of, or guaranteed by, the British Government

	2014 £m	2013 £m
British Government Stocks	4,224	4,893
Ways and Means advance to the National Loans Fund	370	370
	4,594	**5,263**

The Ways and Means advance earns interest at Bank Rate.

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

	2014 £m	2013 £m
Deposit with Banking Department	55,109	52,744
Reverse repurchase agreements	495	15
	55,604	**52,759**

The deposit with Banking Department earns interest at Bank Rate.

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 custody arrangements and holdings of collateral. Credit risk arises in the course of the operations of the Note Circulation Scheme, Agency Notes Store and Notes Printing Contract; and as a result of the Bank providing liquidity to financial institutions via open market operations.

In providing liquidity via routine open market operations credit risk is managed by ensuring that exposures are fully collateralised (with appropriate margin) by internally rated as equivalent to investment-grade securities.

Credit risk on the securities held by the Bank is managed by holding only internally rated as equivalent to investment-grade securities in routine circumstances, issued chiefly by governments and central banks.

7 Accrued interest

At 28 February 2014 the unrecognised accrued interest on the assets held on the Issue Department statement of balances was £68m (2013: £80m).

8 Date of approval

The Members of Court approved the statements of account on pages 123 to 127 on 4 June 2014.