

Financial review

The Bank draws up its medium-term spending plans within the context of its financial framework which has three main tenets:

- First, that the Bank will set a budget for spending on policy functions — monetary policy and financial stability — consistent with the figure given in the 2003 review of the Cash Ratio Deposit (CRD) scheme — ie £575 million over the five-year period from March 2003 to February 2008. This was the estimated product of the CRD regime, under which banks and building societies are required to place a percentage of their deposit base (0.15% of 'eligible liabilities') at the Bank interest-free. The Bank then invests those deposits in interest-yielding assets, generating income to fund its policy functions. The CRD ratio applies above a minimum threshold, designed to exempt small institutions.
- Second, that the other, remunerated, activities of the Bank will be expected to break even over the medium term. In these areas the focus will be on net spending, although the Bank will remain committed to providing value for money, without running undue risks. Any losses or gains from these activities will not flow through to the CRD-payer, but instead affect the Bank's capital.
- Third, that if spending on policy functions is in line with CRD income and other functions break even, the profit of the Bank is equivalent to the return on the assets in which its capital and reserves are invested — largely gilts and other AAA-rated sterling-denominated bonds. In recent years, spending on BCCI legal fees have been excluded from these calculations. The post-tax profit of Banking Department is shared 50:50 with HM Treasury.

Court considers the operation of the Bank's financial framework in fulfilling its responsibilities under the 1998 Bank of England Act.

Spending in 2006/07

Spending on the Bank's policy functions (net of recoveries) has remained flat in nominal terms in 2006/07, and well within the spending projection contained in the 2003 CRD review. There has also been an accelerated growth in CRD income.

The 2006/07 outturn for net expenditure on policy functions was £104.1 million, compared to a 2005/06 outturn of £104.3 million.

The 2006/07 outturn was £2.4 million below the budget for policy functions. In the Monetary Analysis and Statistics and Financial Stability areas, there was a shortfall in direct expenditure and staff costs, in part reflecting efficiency savings and convergence to lower spending and staff numbers projected for 2007/08 on a quicker time path than expected. Risk to spending tends to be on the downside, as staff turnover generates vacancies that are not immediately filled, and some staff gaps remain.

The Bank received in 2006/07 a rebate relating to VAT payments in prior years and the introduction of a new partial exemption formula. These receipts have been recorded as an offset to the Bank's legacy costs in 2006/07.

The net spending position on remunerated functions was close to budget, with a surplus of £4.6 million.

In June 2006, a full and final settlement was agreed on costs in the proceedings brought by the Liquidators of BCCI against the Bank of England. The Bank's 2006/07 accounts reflect the retention of £73.6 million paid to it by the Liquidators in November 2005.

Bank expenditure by function

£ millions	2005/06 Actuals	2006/07 Budget	2006/07 Actuals	2007/08 Budget ⁽¹⁾
Policy functions				
Monetary policy ⁽²⁾	60.9	63.9	64.2	65.8
Financial stability	44.2	43.8	41.8	42.2
Contingency reserve	–	–	–	1.2
Gross expenditure on policy functions	105.1	107.7	106.0	109.2
Recoveries	-0.8	-1.2	-1.9	-3.1
Net expenditure on policy functions	104.3	106.5	104.1	106.1
CRD income	119.7	122.1	129.1	143.7
Remunerated functions				
Note issue	46.1	58.1	54.0	60.4
Government agency services	9.9	9.7	9.4	9.7
Payment and settlement	13.6	12.3	12.2	12.4
Banking services	35.1	35.9	36.3	33.9
Other ⁽³⁾	15.9	13.5	13.1	13.4
Gross expenditure on remunerated functions	120.6	129.5	125.0	129.8
Income from remunerated functions	123.2	135.0	129.6	128.5
Surplus (-) / deficit (+) on remunerated functions	-2.6	-5.5	-4.6	+1.3
BCCI legal fees	13.5	2.4	0.6	–
Legacy costs ⁽⁴⁾	–	6.0	4.4	6.9
Total gross expenditure⁽⁵⁾	239.2	245.6	236.0	245.9
BCCI recoveries	–	–	-73.6	–

(1) From 2007/08, income offsets to the Bank's overheads are no longer netted. As a result, the levels of monetary policy, financial stability and related recoveries have all increased.

(2) From 2006/07, the costs of FX reserves have been included within monetary policy; previously published as part of 'Other'.

(3) 2005/06 restated to show gross costs of pension fund administration, the sports centre and tenants, and FX reserves.

(4) Pensioner benefits and interest on severance provisions (charged to policy functions and remunerated functions prior to 2006/07).

(5) From the Bank's management accounts; figures contain reporting differences to the statutory financial accounts, such as the inclusion of notional interest charges.

Financial review continued

Budget for 2007/08

The Bank's budget plans for policy functions in the year ahead reflect cuts in real spending and increased efficiency. Planned policy functions expenditure in 2007/08 — including a small contingency reserve — is broadly flat compared to the 2006/07 budget. Further streamlining and downwards pressure on the costs of the business processes are planned for each area of the Bank.

The Bank's spending on policy functions is projected to remain below the level of CRD income. The 2003 CRD settlement expires at the end of February 2008. The CRD scheme will be reviewed in 2007/08 by HM Treasury.

Budget plans for 2007/08 imply a deficit (£1.3 million) for remunerated functions. This follows a period of small annual surpluses. The Bank's aim remains to recover fully the costs of remunerated functions and to break even over the medium term.

These spending plans are underpinned by investment proposals of nearly £27 million in 2007/08. This figure is higher than in recent years, and reflects the large scale of planned investment in the banknote function and in the security of the Bank's premises. Annual investment spending is expected to fall back to its more typical range of £15–£20 million in subsequent years.

Proposals for major projects supporting the strategic priorities include:

Strategic priority	Project	Forecast total spend (£ millions)	Start date	Completion date
Monetary policy	Data uncertainty	1.0	2005/06 Q3	2007/08 Q3
Financial stability	Systemic risk assessment model (SRAM)	0.7	2006/07 Q4	2009/10 Q2
Money market operations	Money Market Reform 2	1.6	2006/07 Q2	2008/09 Q1
Banking operations	Upgrade software for the Bank's main banking system	1.9	2006/07 Q2	2007/08 Q2
	Custody, settlement and liquidity programme	4.3	2006/07 Q2	2008/09 Q4
	Customer business transition — phase 2	–(1)	2006/07 Q2	2010/11 Q2
Banknotes	Notes Division processes and IT infrastructure	7.0	2006/07 Q1	2008/09 Q2

(1) Funded from recurrent budget.