HM Treasury

Exchange Equalisation Account:

report and accounts 2019-20

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Performance Report

Overview

The Overview section provides information on the purpose and activities of the Exchange Equalisation Account and a summary of its performance.

Accounting Officer's statement

In 2019-20 HM Treasury (the Treasury), together with its agent the Bank of England (the Bank), continued to manage the Exchange Equalisation Account (EEA) to ensure it remained fit for purpose as a fund ready to be used, when necessary, to regulate the exchange value of sterling, and therefore the mechanism through which any UK government exchange rate intervention would be conducted.

Every year the Treasury agrees a set of Key Performance Indicators (KPIs) with the Bank with the purpose of providing a basket of indicators that can be used to assess the future effectiveness of the management of the EEA. An annual Service Level Agreement (SLA) between the Treasury and the Bank which specifies the parameters within which the reserves are managed is also agreed. All KPIs were met in 2019-20 and there were no significant breaches of the limits in the SLA.

In the Debt Management Report 2018/19, the government confirmed that it would provide £6 billion of additional sterling financing for the Official Reserves in 2019-20. This additional financing was successfully invested in a benchmark portfolio of reserve assets, agreed by the Treasury and the Bank, on the basis of a trade-off between risk, return and liquidity. This concludes the programme of additional financing which began in 2008 has seen an additional £72 billion invested over 12 years.

During the year the Bank continued to actively manage the reserves in order to minimise the net cost of holding the reserves to the taxpayer and maximise returns, subject to the EEA's risk framework. The return from the Bank's active management of the reserves against the benchmarks during the year was £61 million.

The EEA continued to provide cost effective foreign currency services to various government departments and agencies. Sales of foreign currency, to departments with foreign currency obligations, and purchases of foreign currency, from departments with foreign currency receipts, in aggregate totalled £12,956 million.

The Treasury and the Bank undertook a review during the year of the investment strategy to manage the portfolio of the UK's foreign currency assets, the outcomes of which will begin to take effect from 2020/21. The principal outcome of the investment strategy review is a change in approach to the trade-off between policy readiness, financial risk, and investment return. As a result, the reserves will optimise return whilst ensuring policy readiness by setting a minimum requirement for the safest and most liquid assets, and overlaying investment constraints to prudently manage financial risks (liquidity, credit, and market risk).

I would like to express my sincere appreciation to all Treasury staff and to colleagues at the Bank of England for their professionalism, commitment and support throughout the year. The successes of the EEA would not have been possible without their valued contribution.

Purpose and activities of the Exchange Equalisation Account

1. The Exchange Equalisation Account (EEA) holds the United Kingdom's reserves of gold, foreign currency assets and International Monetary Fund (IMF) Special Drawing Rights[1] (SDRs). Combined with the UK's Reserve Tranche Position (RTP) at the IMF and lending to the IMF under the New Arrangements to Borrow (NAB), these assets comprise the UK's official holdings of international reserves ('the Official Reserves'). The RTP and NAB loans are held in the National Loans Fund (NLF) for which separate accounts are published by HM Treasury (the Treasury).

2. The EEA was established in 1932 to provide a fund that could be used, when necessary, to regulate the exchange value of sterling, and therefore is the mechanism through which any UK government exchange rate intervention would be conducted.

3. Against this background, foreign currency reserves are held on a precautionary basis to meet any change in exchange rate policy in the future, if required, or in the event of any unexpected shocks. The reserves are also used to provide foreign currency services for government departments and agencies, to provide foreign exchange for making payments abroad and to buy, sell and hold SDRs as required by the UK's membership of the IMF.

4. Under the Exchange Equalisation Account Act 1979, the EEA is permitted to invest its funds in any assets denominated in the currency of any country, to purchase gold, and to acquire SDRs.

5. Under section 2 of the Exchange Equalisation Account Act 1979, the EEA is funded by central government through the NLF and the net assets of the EEA represent a liability to the NLF (see note 14 to the accounts for further detail). As the core functions of the EEA can be expected to continue for the foreseeable future, and there are no legislative changes in process, there is no reason to believe that funding will not continue to be forthcoming. Therefore, in accordance with the Government Financial Reporting Manual, it has been concluded as appropriate to adopt the going concern basis of preparation for the EEA Accounts.

Administration and Control

6. The EEA is under the control of the Treasury whose prime objective in managing the EEA on behalf of the government is to ensure the reserves are fit for purpose in order to meet current policy objectives and any potential future changes in policy. In support of that, the government's objective is to preserve the liquidity and security of the reserves and to ensure that the government maintains its capability to intervene in the foreign exchange market if required. Subject to this, the aim is to minimise the overall cost of holding the reserves, while ensuring exposure to financial risk is limited through the appropriate choice of portfolio and risk management practices. The Treasury's role is to ensure that its choice for the strategic composition for the benchmark asset allocation of the reserves, including gold, meets these policy objectives. Subject to this, the Treasury will make the benchmark asset allocation choice to trade off risk, return and liquidity in line with its risk preferences.

7. The Treasury has appointed the Bank of England (the Bank) to act as its agent in the day-to-day management of the EEA. The Bank executes foreign exchange transactions and invests the reserves in accordance with an agreed framework (see paragraph 10 below and paragraph 17 within the Performance Analysis).

8. The Bank also acts as the Treasury's agent for foreign currency liability management, including the issuance of foreign currency debt to finance some of the reserves. This debt is issued by, and is an obligation of, the NLF under the National Loans Act 1968 since it is that Act (rather than the Exchange Equalisation Account Act 1979) which provides the powers for the government to issue

[1] This and other terms are defined in the Glossary at the back of this document.

foreign currency securities. The foreign currency raised by issuing foreign currency debt is transferred to the EEA.

9. The Bank manages the foreign currency assets and liabilities associated with the reserves of the NLF in conjunction with those of the EEA as the Treasury's agent. This allows the foreign currency assets and liabilities associated with the reserves, and the associated risk exposures, to be managed collectively in an efficient way. These are the financial accounts of the EEA only, but where relevant the Performance Report commentary covers issues relating to the NLF assets and liabilities that are managed as part of the Official Reserves.

10. An annual Service Level Agreement (SLA)[2] between the Treasury and the Bank specifies the parameters within which the reserves are managed. In accordance with the SLA, the Bank manages the reserves so as to ensure adherence to Treasury policy aims and reports against this to the Treasury as described in the Governance Statement.

Benchmark Allocations

11. The Bank and the Treasury agree a series of benchmarks for the assets in which the reserves are invested which are made on the basis of a trade-off between risk, return and liquidity. These represent the high-level currency and asset allocation criteria, reflecting the policy objectives of the reserves, and also form the benchmark against which the Bank's active management is measured.

12. The reserves can be divided into two components: reserves hedged for currency and interest rate risk (the 'hedged reserves') and the remaining reserves which are unhedged (the 'unhedged reserves'). Separate benchmarks are set for each of these two components.

13. In order to determine the benchmark asset allocation for the hedged reserves, the Bank uses an asset allocation model, the parameters of which are agreed by the Treasury, which explicitly trades off liquidity and return.

14. The Treasury sets a benchmark for the currency allocation of the EEA's unhedged reserves, excluding gold and SDR holdings. This takes into account past patterns of risk and return, as well as other factors such as the currencies likely to be required in any intervention.

15. A short-term liquidity portfolio is used to manage cash flows arising from the hedged and unhedged reserves. The size of this portfolio is such that the scope for active management is small and, for that reason it does not have an explicit benchmark.

16. There is no benchmark for the IMF RTP and bilateral lending in the NLF given that there is no discretion, under IMF membership rules, to alter this holding.

17. Subject to ensuring that the reserves are liquid, secure and properly managed, the government will seek to minimise the cost to the taxpayer and maximise returns, subject to the EEA's risk framework. As part of that, the Bank will actively manage the reserves, taking currency or interest rate positions relative to the benchmark positions, subject to restrictions and limits laid out in the SLA. An active management return target is set each year.

Investment Policy

18. EEA investments need to be highly liquid so that they can be made available for use quickly, while minimising the costs of holding the reserves. Inevitably, these investments carry some element of credit risk. In order to reduce this risk and to ensure the necessary liquidity, the EEA predominantly

[2] A summary is included in a report produced by the Treasury entitled 'Management of the Official Reserves' available at https://www.gov.uk/government/publications/management-of-the-official-reserves.

holds securities issued or guaranteed by the national governments of the United States, Canada, euro area countries and Japan.

19. The EEA is permitted to use other financial instruments, including:

- conventional bonds, bills, discount notes and floating rate notes of any maturity and commercial paper issued by other national governments, supranational organisations and selected official sector agencies;
- foreign currency spot, forward and swap transactions;
- interest rate and currency swaps;
- overnight indexed swaps;
- bond and interest rate futures, swap notes and swap futures;
- repurchase and reverse repurchase agreements ('repos' and 'reverse repos');
- forward rate agreements;
- SDRs; and
- bank deposits.

20. Derivative transactions entered into by the EEA are documented and collateralised under ISDA Master Agreements with counterparties. Swaps and foreign exchange transactions are governed by these agreements. Repos and reverse repos are governed by bespoke foreign currency repo documentation.

Links between the International Monetary Fund and the Official Reserves

21. The primary means of financing the IMF is through members' quotas. Each member of the IMF is assigned a quota, based broadly on its relative size in the world economy, 25% of which is payable in a combination of SDRs or foreign currency and the rest in the member's own currency. The difference between a member's quota and the IMF's holdings of its currency is a member's RTP. As explained above, the UK's RTP is an asset of the NLF. A portion of the RTP is unremunerated and interest is earned on the remaining balance at the adjusted[3] SDR interest rate.

22. While quota subscriptions of member countries are the IMF's main source of financing, the IMF can supplement its resources through borrowing if it believes that resources might fall short of members' needs. Through a standing multilateral borrowing arrangement – the New Arrangements to Borrow (NAB) – a number of member countries and institutions, including the UK, stand ready to lend additional funds to the IMF. Any lending against this facility is an asset of the NLF.

23. The IMF has periodically issued SDRs and allocated them to members in proportion to their quotas. The UK's SDR allocation is a liability of the EEA and the resultant holding of SDRs by the UK is an asset of the EEA. Holdings of SDRs are also used to lend to the IMF's Poverty Reduction and Growth Trust (PRGT). IMF members are credited with interest on their holdings of SDRs and pay interest on their allocation of SDRs at the same rate.

24. The SDR market functions through voluntary trading arrangements. Under these arrangements a number of members, including the UK, have volunteered to buy or sell SDRs within limits defined by their respective arrangements. Following the 2009 SDR allocations, the number and size of the

[3] Additional burden sharing adjustments, for the financial consequences of protracted arrears, are also applied to both the basic rate of remuneration and the basic rate of charge. The adjusted rate of remuneration is used to pay interest (remuneration) to members on their remunerated reserve tranche position with the Fund.

voluntary arrangements has been expanded to ensure continued liquidity of the voluntary market. In the event that there is insufficient capacity under the voluntary trading arrangements to ensure the liquidity of the market, the IMF can activate the designated mechanism. Under this mechanism, members with sufficiently strong external positions are designated by the IMF to buy SDRs with freely useable currencies up to certain amounts for members with weak external positions. This arrangement guarantees the liquidity and the reserve asset character of the SDR.

Key issues and risks

25. The key issues and risks facing the EEA are considered in the Governance Statement. Financial risks related to the EEA are separately disclosed in note 18 ‘Risk management and control’.

26. In addition, the Bank also conducts regular stress tests for a range of scenarios. A range of historical and theoretical scenarios involving large shifts in interest rates, spreads between securities and changes in yield curve shapes are applied to both the overall EEA holdings and the active management positions/component. These results are reviewed by the Bank’s senior management and the associated risks accepted or actions taken. It is also presented to the Accounting Officer of the EEA.

Performance summary

1. In the EEA Statement of Financial Position, assets increased over the course of the year by £12,984 million to £144,071 million. The increase consisted primarily of rises in debt securities (£11,166 million), money market instruments (£5,790 million), gold (£3,000 million), reverse repos (£2,607 million) and SDR assets (£1,063 million), partly offset by a fall in cash balances (£11,262 million). A matching increase in EEA liabilities consisted primarily of increases in the liability to the NLF (£11,805 million), items in the course of transmission to banks (£1,356 million), derivative liabilities (£1,323 million) and SDR allocation (£354 million), partly offset by a fall in repurchase agreements (£1,985 million).

2. The EEA's Statement of Comprehensive Income for the year ended 31 March 2020 shows a total comprehensive gain for the year of £6,305 million (*2018-19: £1,936 million gain*).

3. The net trading gain for the year was £3,313 million *(2018-19: £1,435 million gain)* primarily due to exchange rate related gains as most reserve currencies appreciated against sterling. A full breakdown of net trading income by instrument is provided in note 2.

4. The price of gold rose from £994 to £1,296 per ounce, an increase of 30%, giving rise to a revaluation gain of £3,000 million.

5. The Treasury sets a target for active management return as part of the SLA, above the cost of managing the reserves. This target is confidential given market sensitivities, but the outturn is published here following the end of each financial year. The return from the Bank's active management of the reserves against the benchmarks during 2019-20 was £61 million (*2018-19: £49 million*).

6. The EEA continued to invest in high credit quality assets throughout the year, and has not crystallised any credit losses.

7. The Bank acts as the Treasury's agent for foreign currency liability management, including the issuance of foreign currency debt to finance some of the reserves. This debt is issued by, and is an obligation of, the NLF. The foreign currency raised by issuing foreign currency debt is transferred to the EEA. At 31 March 2020 there was no foreign currency debt outstanding in the NLF and no new securities denominated in foreign currencies were issued during the year.

8. The Treasury has agreed a set of Key Performance Indicators (KPIs) with the Bank with the purpose of providing a basket of indicators that can be used to assess the future effectiveness of the management of the EEA (see paragraphs 18-20 in the Performance Analysis). All KPIs were met in 2019-20 and there were no significant breaches of the limits in the SLA.

9. The EEA continued to provide foreign currency services to various government departments and agencies. Sales of foreign currency, to departments with foreign currency obligations, and purchases of foreign currency, from departments with foreign currency receipts, in aggregate totalled £12,956 million (*2018-19: £12,394 million*).

Performance analysis

1. Following the global financial crisis in 2008, successive governments provided additional financing for the Official Reserves. This additional financing has been intended to meet potential calls on the reserves that may arise and ensure that the level of foreign currency reserves held is sufficient for the UK to remain resilient to possible future shocks. A further £6 billion additional financing was provided in 2019-20. This concludes the programme of additional financing which has seen an additional £72 billion invested over 12 years.

2. The actual net sterling funding amount drawn down from the NLF shown in the Statement of Cash Flows was £5.5 billion for the year to 31 March 2020. This comprised an additional £5.9 billion of financing for the Official Reserves less £0.4 billion of sterling income paid to the NLF. This £5.9 billion of financing plus £0.1 billion decrease in the sterling cash balance comes to a total increase in reserves financing of £6.0 billion.

3. The relevant foreign currency assets and liabilities of the NLF are managed together with the EEA to enable a more integrated management of the overall UK official foreign currency reserves. The foreign currency elements of the UK's total Official Reserves are published in the monthly IMF Reserves Template.[4] The Template shows the net foreign currency position in the Official Reserves, which at 31 March 2020 was the equivalent of £62,743 million. The assets and liabilities in the Template differ from those of the EEA Statement of Financial Position on page 27 of these accounts. This is for a number of reasons but principally it is because the Template is designed to reflect the UK's foreign currency position. It therefore includes foreign currency assets and liabilities of the NLF (notably the RTP) and excludes all items denominated in domestic currency (i.e. sterling). The most significant of these are the liability of the EEA to the NLF and the valuation of the sterling leg of foreign currency forwards and currency swaps. These factors, coupled with the effects of differing treatment of unsettled items and short positions in debt securities, mean that gross reserve assets shown in the Template (the equivalent of £141,169 million at 31 March 2020) differ by £2,902 million from the assets held in the EEA. A reconciliation between the EEA's Statement of Financial Position and the Template is provided below.

[5] This can be viewed at: https://www.gov.uk/government/collections/statistical-release-uk-official-holdings-of-international-reserves

Reconciliation of EEA Statement of Financial Position to IMF Reserves Template

As at 31 March 2020:

	£ millions	$ millions
Total assets per EEA statement of financial position	**144,071**	
Adjustments to reflect IMF Reserves Template presentation:		
Sterling cash balance	(1,539)	
Reclassification between assets and liabilities	(6,569)	
Other adjustments[5]	80	
Reserve assets held in the EEA	136,043	
Reserve assets held in NLF	5,126	
Sterling total assets using Template presentation	**141,169**	
Dollar equivalent per Template		**175,122**
Total liabilities per EEA statement of financial position	**144,071**	
EEA's Reserves and liability to the NLF (see note 14)	(106,607)	
Adjustments to reflect IMF Reserves Template presentation:		
Sterling leg of derivative trades	47,523	
Reclassification between assets and liabilities	(6,569)	
Other adjustments	8	
Reserve liabilities held in NLF	-	
Sterling total liabilities using Template presentation	**78,426**	
Dollar equivalent per Template		**97,276**
Net assets per Template	**62,743**	**77,846**

Conversion rate into US dollars is 1.2405 as at close 31 March 2020

[5] Other adjustments include a bid-offer spread provision. Financial accounting assets and liabilities are reported using bid or offer prices as appropriate, whereas the reserves are reported using mid-point prices.

5. As described in the Overview, the UK's Official Reserves, of which £136,043 million *(2018-19: £125,136 million)* are held in the EEA and £5,126 million *(2018-19: £4,928 million)* are held in the NLF, can be divided into two components: the 'hedged reserves' £78,426 million (2018-*19: £87,327 million*), and the 'unhedged reserves' of £62,743 million (2018-*19: £42,737 million*). The decrease in the hedged reserves is due primarily to a proportion of redemptions being reinvested in the unhedged reserves, and the appreciation of reserve currencies against sterling. The increase in unhedged reserves is due to the investment of additional financing provided by the NLF, and the reinvestment of a proportion of redemptions from the hedged reserves.

6. The hedged reserves comprise portfolios of eligible US dollar, euro, yen, Canadian dollar and holdings of SDRs. Assets in the hedged reserves are hedged for currency risk either by being denominated in the same currency as the liabilities which finance them or by using currency swaps. The hedged reserves are also hedged against interest rate risk, through the use of swaps.

7. The hedged reserves have been financed by reinvesting ongoing redemptions in 2019-20 and swaps were used to hedge the currency and interest rate risks.

8. Financing of the hedged reserves as at 31 March 2020 included sterling swapped into foreign currencies of £47,523 million *(2018-19: £55,411 million*) and the SDR allocation of £11,150 million *(2018-19: £10,796 million*).

9. The unhedged reserves comprise dollar and euro denominated bonds, gold, renminbi denominated assets, IMF lending (which is part of the NLF) and yen exposure normally obtained through forward yen purchases. In 2019-20, the £6 billion of additional sterling financing for the Official Reserves (raised from the sale of gilts and advanced from the NLF) was invested in the unhedged reserves. A proportion of redemptions from the hedged reserves were reinvested into the unhedged reserves this year. The unhedged reserves are also financed out of sterling through accumulated retained earnings and a small element of the unhedged reserves is financed by the EEA's net SDR position.

10. The Treasury sets a benchmark for the currency allocation of the EEA's unhedged reserves, excluding gold and renminbi. As in the previous year, in 2019-20 this benchmark was 40% US dollar, 40% euro and 20% yen. In the unhedged reserves, the Treasury may decide, with advice from the Bank, to set deviations from the 40:40:20 currency benchmark or the interest rate benchmarks. Each currency within the unhedged reserves has a benchmark for the assets within it. In 2019-20 the benchmark for assets denominated in US dollars comprised of US Treasury bonds. The benchmark for euro denominated assets comprised euro denominated sovereign securities. For yen, the benchmark was derived from 1-3 month forward yen rates against the euro and the dollar.

11. In the EEA Statement of Financial Position, assets increased over the course of the year by £12,984 million to £144,071 million. The increase consisted primarily of rises in debt securities (£11,166 million), money market instruments (£5,790 million), gold (£3,000 million), reverse repos (£2,607 million) and SDR assets (£1,063 million), partly offset by a fall in cash balances (£11,262 million). A matching increase in EEA liabilities consisted primarily of increases in the liability to the NLF (£11,805 million), items in the course of transmission to banks (£1,356 million), derivative liabilities (£1,323 million) and SDR allocation (£354 million), partly offset by a fall in repurchase agreements (£1,985 million).

Analysis of returns for the period

12. The EEA's Statement of Comprehensive Income for the year ended 31 March 2020 shows a total comprehensive gain for the year of £6,305 million (*2018-19: £1,936 million gain*).

13. The price of gold rose from £994 to £1,296 per ounce, an increase of 30%, giving rise to a revaluation gain of £3,000 million.

14. The net trading gain for the year was £3,313 million *(2018-19: £1,435 million gain)* primarily due to exchange rate related gains as most reserve currencies appreciated against sterling. On a financial instrument basis, net trading gains on debt securities (net of short positions) of £6,960 million were the largest contributor to the overall net trading gain. This was partly offset by losses on currency swaps (£2,779 million) and interest rate swaps (£1,031 million). A full breakdown of net trading income by instrument is provided in note 2.

15. The Treasury sets a target for active management return as part of the Service Level Agreement (SLA), above the cost of managing the reserves. This target is set against the benchmarks for the portfolio (as detailed in the Purpose and activities of the EEA), and takes account of the limits on active management set as part of the SLA. This target is confidential for policy reasons. The return from the Bank's active management of the reserves against the benchmarks during the year was £61 million (*2018-19: £49 million*).

16. The EEA continued to invest in high credit quality assets throughout the year, and has not crystallised any credit losses.

Service Level Agreement

17. An annual SLA[6] between the Treasury and the Bank specifies the parameters within which the reserves are managed. The SLA outlines:

- benchmarks which specify the currency and asset composition of the reserves;
- limits to the Bank's discretion to take currency or interest rate positions relative to those benchmarks ('active management');
- the framework for controlling credit, market, liquidity and other risks;
- a target return for active management; and
- the programme for financing the reserves, covering the NLF's foreign currency borrowing and sterling financing from the NLF.

The SLA is a confidential document and the terms of the SLA can be reviewed during the year at the Bank's or the Treasury's request. There were no substantive changes made to the SLA for 2019-20.

Performance against Key Performance Indicators

18. The Treasury has agreed a set of Key Performance Indicators (KPIs) with the Bank with the purpose of providing a basket of indicators that can be used to assess the future effectiveness of the management of the EEA. The KPIs selected reflect the overall objectives for holding the reserves, as explained in the Purpose and activities of the EEA.

19. The KPIs for 2019-20 specified that:

(i) The foreign currency reserves, while not used in operations to deliver policy objectives, will be invested in assets that are liquid and secure and are monitored daily. Specifically:

- A minimum of 75% of assets will be held in cash or invested in securities on the Bank's Level A collateral list, which comprises securities expected to remain liquid in all but the most extreme circumstances.

[6] A summary is included in a report produced by the Treasury entitled 'Management of the Official Reserves' available at https://www.gov.uk/government/publications/management-of-the-official-reserves.

- With the exception of Renminbi assets, all official reserve assets to be securities that normally trade in liquid markets, and must be eligible to be accepted as collateral under the Bank of England's Level B collateral list and be in the list of assets eligible for the EEA.

(ii) The Bank will observe the limits as set out in the SLA. In line with that, all unauthorised breaches of the limits and/or any related operational errors will be reported to the Treasury as reportable incidents as soon as possible, along with advice if necessary as to how best to deal with them. Any significant breach will be reported publicly (e.g. in the annual accounts).

(iii) In order to aim to at least cover costs, and to ensure the Bank maintains its capability to intervene in the foreign exchange market if required, the Bank will actively manage the EEA portfolio against the benchmark to meet the active management return target set by the Treasury, while ensuring compliance with the limits as detailed in the SLA.

(iv) The Bank will ensure that all transactions related to Government departments and the IMF shall be handled efficiently, accurately and in a timely fashion.

(v) In carrying out its services, the Bank will as far as possible ensure that:

- its management and staff are of high repute and integrity;
- staff training and experience are appropriate for the tasks they are expected to undertake and consistent with the amount of risk they are authorised to take;
- its internal systems and controls are adequate for the size, nature and complexity of EEA operations and comply with best market practice so far as possible; and
- appropriate preparations are made for possible policy deployment of the reserves (e.g. FX intervention).

20. All KPIs were met in 2019-20 and there were no significant breaches of the limits in the SLA.

Intervention

21. No foreign exchange intervention was undertaken by the government in the foreign exchange market during the year. The last intervention was the coordinated G7 yen intervention of March 2011.

Provision of foreign currency services to Government departments

22. The EEA continued to provide foreign currency services to various government departments and agencies. Sales of foreign currency, to departments with foreign currency obligations, and purchases of foreign currency, from departments with foreign currency receipts, in aggregate totalled £12,956 million (*2018-19: £12,394 million*). These purchases and sales, both spot and forward, were hedged through offsetting trades with the market.

Long-term expenditure trends

Since the function of the EEA is primarily to hold foreign currency reserves on a precautionary basis to meet any change in exchange rate policy in the future, if required, or in the event of any unexpected shocks, it has no long-term expenditure trends.

Clare Lombardelli
Accounting Officer

10 September 2020

Accountability report

The accountability report contains a Corporate governance report and a Parliamentary accountability and audit report. The purpose of the corporate governance report is to explain the composition and organisation of the EEA's governance structures and how they support the achievement of the EEA's objectives. It includes the Statement of Accounting Officer's responsibilities and the Governance statement. The Parliamentary accountability and audit report includes key Parliamentary accountability information on regularity of expenditure and remote contingent liabilities as well as the Certificate and Report of the Comptroller and Auditor General to the House of Commons.

Corporate Governance report

Directors' Report

The operations and management of the EEA are undertaken by Treasury and Bank employees. The EEA does not have any employees of its own.

Directors' conflicts of interest

In 2019-2020, no material conflicts of interest have been noted by the senior management overseeing the EEA.

Personal data related incidents

The EEA does not hold any protected personal data.

Statement of the Accounting Officer's Responsibilities

Under the Exchange Equalisation Account Act 1979 (as amended by the Finance Act 2000), the Treasury is required to prepare for each financial year a statement of accounts in the form and on the basis set out in the Accounts Direction. The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of the EEA and its income and expenditure and cash flows for the financial year.

In preparing the accounts, the Accounting Officer is required to observe the applicable accounting standards and be consistent with the relevant requirements of the Government Financial Reporting Manual, and in particular to:

- observe the Accounts Direction issued by the Treasury, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards have been followed, and disclose and explain any material departures in the accounts;
- prepare the accounts on a going concern basis; and
- confirm that the Annual Report and Accounts as a whole is fair, balanced and understandable and take personal responsibility for the Annual Report and Accounts and the judgements required for determining that it is fair, balanced and understandable.

The Treasury has appointed its Chief Economic Adviser as the Accounting Officer of the EEA. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding the EEA’s assets, are set out in *Managing Public Money* published by the Treasury.

The Accounting Officer confirms that, as far as she is aware, there is no relevant audit information of which the EEA’s auditors are unaware, and that she has taken all the steps that she ought to have taken as Accounting Officer to make herself aware of any relevant audit information and to establish that the EEA’s auditors are aware of that information.

The Accounting Officer confirms that the annual report and accounts as a whole is fair, balanced and understandable and that she takes personal responsibility for the annual report and accounts and the judgments required for determining that it is fair, balanced and understandable.

Audit arrangements

The EEA accounts are audited by the Comptroller and Auditor General (C&AG) under the requirements of the Exchange Equalisation Account Act 1979 and in accordance with the Accounts Direction issued on 6 January 2012 (on page 55 to the accounts). The National Audit Office (NAO) bears the cost of all external audit work performed on the EEA. No non-audit work was undertaken by the NAO in relation to the EEA in 2019-20.

Governance Statement

1. Scope of responsibility

1.1 The Exchange Equalisation Account (EEA) is managed within the Treasury's overall risk and governance framework as set out in the Treasury's Annual Report and Accounts 2019-20. This includes the Treasury Board's assessment of its compliance with the *Corporate governance in central government departments: Code of Good Practice*. The Chancellor of the Exchequer, as Minister in charge of the Treasury, is responsible and answerable to Parliament on all the policies, decisions and actions of the Treasury and ultimately of the EEA.

1.2 As Accounting Officer for the EEA, I have responsibility for maintaining a sound system of internal control that supports the achievement of the policies, aims and objectives of the Exchange Equalisation Account Act 1979 (as amended by the Finance Act 2000) as well as the targets set by Treasury Ministers, whilst safeguarding the public funds and assets for which I am personally responsible, in accordance with the responsibilities assigned to me in *Managing Public Money*.

1.3 Overall management of the EEA is the responsibility of the Treasury which delegates day-to-day management to the Bank, which acts as its Agent and Advisor. The Debt and Reserves Management (DRM) team at the Treasury has oversight of the Bank's EEA operations and agrees an annual Service Level Agreement (SLA) with the Bank that specifies the parameters under which the reserves are managed. The SLA sets out the guidelines for investing the reserves, including risk limits and the associated management information required and is described in more detail in the Performance Report. The Exchequer Funds and Accounts (EFA) team at the Treasury reports directly to me on operational risk issues and works closely with the Bank to produce the annual accounts.

2. The purpose of the system of internal control

2.1 Although the reserves are not held in order to make a profit, consistent with the KPIs described in the Performance Report, the Treasury seeks to minimise the cost of holding the foreign currency reserves while avoiding exposing the public purse to unnecessary risk.

2.2 The system of internal control is designed to manage risk to an acceptable level, balancing the impact of potential risks with the resources to manage them, rather than to eliminate all risk. It can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of the EEA's policies, aims, and objectives; to evaluate the likelihood of those risks being realised and the impact should they be realised; and to manage them efficiently, effectively and economically. The system of internal control has been in place throughout the year ended 31 March 2020 and up to the date of approval of the annual report and accounts, and accords with Treasury guidance.

3. Capacity to handle risk

3.1 The risk management strategy is set annually via the SLA, which is signed by me as Accounting Officer. There is clear segregation of duties within the Bank and the Treasury for the management of the EEA and the supporting processes.

3.2 At the Bank, senior management are responsible for ensuring their staff have skills and receive training appropriate to their responsibilities. Those involved in managing financial and other risks have their objectives set accordingly, including responsibility for relevant aspects of the control framework. Policy and procedures manuals as well as job instructions are maintained to ensure staff carry out their responsibilities in a controlled manner. Where there are instances of control failure, staff are required to maintain a record in an incident log. These are reviewed on a regular basis to ensure lessons are learned and control improvements implemented. Control improvements and responses to control failures are summarised in the quarterly operational risk reports from the Bank to EFA described below. The Bank will also notify the Treasury immediately of any material incidents that have occurred, and any potential losses that may have arisen from the incidents.

3.3 At the Treasury, management ensures that specific DRM and EFA staff members are trained in risk appraisal and management. Job instructions are maintained for time and business-critical tasks.

4. The risk management framework

4.1 Within the Bank, the Financial Risk Management Division is responsible for financial risk analysis, risk methodologies, risk management information and for producing and reconciling the EEA financial and management accounts. Middle Office is responsible for the pricing, valuation and financial control of exposures and collateral positions arising from the EEA's market operations, including counterparty and instrument data management. The Markets & Banking, Payments and Innovation (BPI) Chief Operating Officer Division oversees management of operational risks and undertakes all Markets-wide crisis and contingency planning. Those teams are all separate from the Foreign Exchange Division where transactions are executed. The Financial Risk Management Division, Middle Office, Markets & BPI Chief Operating Officer Division, and Foreign Exchange Divisions are also separate from the Market Services, Central Banking Operations Division and Customer Banking Divisions in the BPI Directorate where the transactions are settled and custodian arrangements are managed.

4.2 The Bank has an overarching Risk Management Framework in order to provide consistency and transparency in operational risk management processes across the organisation. This framework is supported by the Bank's Risk Directorate. The framework identifies the roles and responsibilities of the key parties involved in the risk management processes; risk tolerances; policies for how risks are managed; and the reporting outputs that are generated. The Executive Risk Committee is responsible for the operation of the risk governance framework; including monitoring the Bank's risk profile against tolerance and prioritising mitigating actions. The framework is overseen by the Bank's Audit and Risk Committee (ARCo).

4.3 At the Treasury, EFA is responsible for monitoring the risk environment and providing the Accounting Officer with the assurance to sign off the Governance Statement. DRM is responsible for monitoring the performance of the Bank in managing the reserves. To support these processes, the Bank provides the following management information:

- monthly reports to the Treasury on the size, composition and liquidity of the reserves, their consistency with policy objectives, investment performance, returns made and risk exposures. The management accounts are reconciled to the financial accounts.
- the Bank's Executive Director for Markets provides me as the Accounting Officer with quarterly assurance that the processes and framework in place are sufficient to identify current and future sources of material risk, as well as appropriate mitigants, and adequately meet the quarterly assurance requirements relating to the Bank's management of the EEA business. The assurance also states that it is evidence which can be relied upon in making this Governance Statement. In addition, EFA are provided with quarterly management reports on operational risk. These reports contain information on significant risk events, control improvements and other factors relevant to the control environment. Any material incidents including SLA breaches are reported as they occur. This process is supported by Operational Risk Officers in each division and, with specific responsibility for the co-ordination of the quarterly reporting framework, the Markets & BPI Chief Operating Officer Division.

- EFA considers and discusses the information provided with the Bank and Exchequer Funds Internal Audit and provides me as the Accounting Officer with quarterly reports that highlight the key risks.
- the Bank's Internal Audit Division conducts an agreed internal audit programme. The Bank's Executive Director for Markets forwards the Internal Audit quarterly reports on this activity to me as the Accounting Officer and the results of all relevant internal audits are provided to EFA.
- Exchequer Funds Internal Audit provides an independent and objective opinion to me as the Accounting Officer on risk management, control and governance of the EEA. Assurance is provided following reviews of relevant Bank Internal Audit reports and EFA's oversight of the Bank's work, as agreed by me as the Accounting Officer and the Treasury Group Audit and Risk Committee. Exchequer Funds Internal Audit's reviews aim to measure and evaluate the effectiveness of the Treasury in achieving its agreed objectives in respect of the EEA. Exchequer Funds Internal Audit also reviews EFA's quarterly report to me as the Accounting Officer (mentioned above).
- Bank and Treasury officials meet quarterly to review performance against the parameters set out in the SLA and to consider wider operational and policy issues. The Markets & BPI Chief Operating Officer Division meet with EFA when needed to discuss operational risk issues. Additionally, I as the Accounting Officer and the Bank's Executive Director for Markets hold half-yearly meetings to discuss overall strategy and governance issues.

Bank accountancy professionals produce the financial accounts on behalf of the Treasury using Bank IT systems. EFA liaises with the Bank and DRM to produce the annual accounts. The Treasury Accountant in EFA reviewed and approved the 2019-20 financial accounts, Performance Report and Accountability Report in draft before I approved them formally.

4.4 The Treasury Audit and Risk Committee (ARC) provides independent, objective and constructive challenge on the robustness of the control mechanisms in place and the evidence provided to deliver the assurance needed by the Board. It supports the Permanent Secretary and the other core department Accounting Officers in their responsibilities for managing risk, control and governance. The Committee may consider any issue relating to the running of the Treasury as well as any delivery or reputational risk. The ARC has oversight of the production of the Treasury Annual Report and Accounts, Central Funds (Consolidated Fund, National Loans Funds, Contingencies Fund and Exchange Equalisation Account) and Whole of Government Accounts. Details on the overall risk and governance structure of HM Treasury can be found in the Governance Statement in the Treasury's Annual Report and Accounts.

4.5 The Permanent Secretary appoints members of the Committee for periods up to three years, extendable by one additional three-year period. The Chair of the Committee (Richards Meddings) reports directly to the Permanent Secretary and is also a non-executive member of the Treasury Board.

4.6 The membership of the Audit and Risk Committee at the close of 2019-20 was:

- Richard Meddings - Non-Executive Director, Credit Suisse Group AG; Non-Executive Director, TSB (September 2017 - present) and Chairman from 1 February 2018; Non-Executive Director, Deutsche Bank AG and their Chair of Audit committee (October 2015 – July 2019); Non-Executive Director JLT plc (September 2017 – April 2019); Non-Executive Director Teach First (February 2016 - present). Financial Reporting Review Panel in FRC (2008 – 2018) and Board member of International Chambers of Commerce UK (2007 – present); Non-executive Director, Legal & General plc (December 2014 to May 2017); Non-executive Director and Senior Independent Director of 3i Group plc (2008-2014) and Chair of Audit and Risk Committee; and Main Board Director (2002-2014) and Group Finance Director (2006–2014) Standard Chartered PLC.

- Tim Score - Tim's experience covers financial management and an in-depth knowledge of the technology sector. He was Chief Financial Officer of ARM Holdings plc from 2002 to 2015, Senior independent director, Chair of Audit and Interim Chairman at National Express Group (2005-2014), CFO of Rebus Group and William Baird PLC, Group Financial Controller at BTR Plc and LucasVarity PLC. Other roles: Chair of The British Land Company plc. Member of the Board of Trustees of Royal National Theatre; Chair of the Audit Committee of the Football Association; Non-executive director and Chair of Audit Committee at Pearson plc.

- Zarin Patel – Zarin Patel is a Non-Executive Director of John Lewis Partnership Plc, Anglian Water Services Limited and is a member of their respective Audit and Risk Committees. She is also a Trustee of National Trust and chairs its Audit and Risk Committee. She was appointed to the board of Post Office Limited in November 2019 and sits on its Audit and Risk Committee. She was formerly the Chief Financial Officer at the BBC and a member of its Executive Board.

- Sir Peter Estlin – Alderman, City of London; Independent Director, Rothschild & Co; Trustee, Trust for London (previously Group Financial Controller and acting Group CFO, Barclays).

4.7 The Treasury Audit and Risk Committee met six times during 2019-20. Pre-meeting discussions with the National Audit Office and Internal Auditors were held before each session. Attendance is outlined in the table below:

	Attended
Richard Meddings[7] (Chair)	6/6
Tim Score	5/6
Sir Peter Estlin[8]	1/1
Zarin Patel	5/6
Jacinda Humphry[9]	4/5

4.8 The Audit and Risk Committee has a robust Conflicts of Interest Policy, which requires members to excuse themselves from discussions where potential conflicts may occur. Members are required to inform the Permanent Secretary about any potential conflicts and highlight these at the start of each meeting as appropriate.

4.9 In addition to the independent members, the appropriate Accounting Officers, the Treasury's Group Director of Finance and the Treasury Accountant (or, in their absence, the Head of Exchequer Accounts) also attend Audit and Risk Committee meetings. Members have the opportunity for a pre-committee discussion with the National Audit Office, Group Head of Internal Audit for Treasury and Head of Exchequer Funds Internal Audit.

4.10 The Audit and Risk Committee challenged and approved the Internal Audit work programme throughout the year and followed up on management action to address audit recommendations.

[7] Requested suspension from 4 September 2018 for duration of his appointment as Executive Chairman of TSB. Returned on 1 May 2019
[8] Requested suspension from 1 July 2018 to 31 December 2019 whilst undertaking the role of Lord Mayor of the City of London for 2018-19.
[9] Stepped down 29 February 2020.

4.11 Outside of the planned committee meetings individual members have shared their commercial and professional expertise with key officials across the Treasury.

4.12 The Chair of the Audit and Risk Committee is invited to report concerns or issues to the Treasury Board (Sub-committee). EFA feeds into the Treasury's Quarterly Performance and Risk Report (QPRR) which assesses the level of risk to delivery of the department's strategic objectives. The QPRR is discussed by both the Treasury Executive Management Board and the Treasury Board (Sub-Comittee).

5. Risk profile

5.1 A detailed Risk and Control Self-Assessment is maintained by the Bank. In pursuit of its objectives, the EEA manages various risks which are inherent to trading in financial markets. These risks and the strategy for their management are kept under close review and if necessary additional mitigating actions are put in place to maintain the continuity and safe operation of the EEA, for example in response the COVID-19 pandemic. The key risks and associated controls are:

- **Transaction processing:** this includes the risk of a failure to instruct, execute or settle transactions correctly resulting in financial impact and/or trading with/across the wrong entity, identified/unidentified breach of policy (e.g. SLA Limits), or staff failing to meet compliance obligations when executing or settling trades. Processes are managed through control frameworks and independent review. Controls include validating trade confirmations with counterparties; reconciliations; dealer training; clear dealer mandates; segregation of duties, and assessment of incidents. There is system enforced checking of deals against limits and frequent risk reporting to identify and escalate breaches, as well as a clear operational governance framework and documentation. Markets has compliance policies specific to trading activities which are benchmarked and monitored by the Markets & BPI Chief Operating Officer Division, who also provide compliance training to staff. This includes contingency plans to ensure that all business critical functions continue to be operational while also protecting staff wellbeing. A central Bankwide compliance function and code of staff conduct are also in place.

- **IT systems and infrastructure:** this includes the risk that inadequate IT infrastructure and/or provision of IT services adversely impacts operations. To protect its information assets, including from cyber threat, the Bank maintains robust technology solutions, security policies and processes. The Bank aims to maintain a robust and flexible capability such that even if an event disrupts critical processes it is able to respond quickly and effectively (as demonstrated in the change in working arrangements due to COVID-19) and recover safely. Incidents are investigated with appropriate action taken where necessary and reported to Treasury. Locally there is proactive monitoring of all critical IT systems and the resources required to maintain and develop these, as well as change control procedures that are aligned to industry best practice.

- **Information security:** this includes the risk that confidential EEA information/data is compromised. The Bank seeks to operate within a highly secure environment and has established information security polices and processes in place, including standards for securing information both on and off premises.

- **Legal:** this includes failure to comply with legal requirements or regulations including non-UK Tax reporting and/or withholding requirements. The Bank has in place business processes to ensure compliance with legal requirements. Third party expertise is employed to advise and support on fulfilling requirements. Internally, the Bank operates cross-directorate oversight of tax issues led by the Finance Directorate and the Legal Directorate review legal agreements prior to execution.

- **Data integrity:** this includes the risk that static data loaded incorrectly into systems impacts business processes, and/or leads to an identified/unidentified breach of policy (e.g. credit limits). The Bank has established processes for data integrity that includes an annual review and attestation process for all static data managed through an agreed governance structure. Other controls include staff awareness training on principles and improved processes for the input and authorisation of static data requests.

- **People:** this includes the risk of insufficient or inadequate resources to deliver EEA objectives. The Bank is committed to attracting and retaining people of the highest calibre and relevant experience, and aims to be fully and appropriately resourced. It seeks to mitigate the risk of the loss of key skills and experience through training and developing staff. Staff turnover, experience levels and welfare statistics are regularly monitored by senior management who also perform ongoing reviews of business priorities. Proactive contingency planning ensures there is sufficiently experienced staff available to deal with infrequent or unexpected events such as credit defaults or the potential for high levels of illness.

5.2 As noted above, the risk management strategy is set annually via the SLA, which is signed by me as Accounting Officer. The exposures to credit and market risk are detailed in note 18.

6. Review of effectiveness

6.1 In line with HM Government guidance, set out within the Corporate Governance Code of Good Practice for central government departments, I have reviewed the effectiveness of the system of internal control. My review is informed by the work of Exchequer Funds Internal Audit and Bank Internal Audit, who both provided positive assurance as to the management and control of the EEA in 2019-20 and the executive managers within DRM, EFA and in the Bank, who have responsibility for the development and maintenance of the internal control framework, as well as comments made by external auditors in their management letter and other reports. I have been supported by the Treasury Group Audit and Risk Committee and risk owners in addressing weaknesses and ensuring continuous improvement of the system is in place. Information about the effectiveness of the Treasury's overall system of governance including board effectiveness, attendance, compliance with the Corporate Governance Code and quality of management information reviewed, is reported in the Treasury's Annual Report and Accounts.

6.2 The Treasury Group Audit and Risk Committee considered the 2019-20 accounts in draft and provided me with its views before I formally signed the accounts.

6.3 No significant control issues, including personal data related incidents, have been identified in 2019-20, and no significant new risks have been identified in the year. No ministerial directions have been given in 2019-20.

6.4 In my opinion, the system of internal control was effective throughout the financial year, and remains so on the date I sign this report.

Parliamentary accountability and audit report

Regularity of expenditure

The expenditure and income of the EEA have been applied to the purposes intended by Parliament.

The investments of the EEA have been applied to the purposes intended by Parliament.

The above statements have been audited.

Losses and special payments

The Official Reserves comprise two components: reserves that are hedged for currency and interest rate risk (the 'hedged reserves') and the remaining reserves which are unhedged for currency and interest rate risk (the 'unhedged reserves'). Any currency losses due to fluctuations in exchange rates are disclosed within the financial statements and the Annual Report.

The above statement has been audited.

Fees and charges

The EEA does not have any fees and charges.

The above statement has been audited.

Remote contingent liabilities

The EEA had no remote contingent liabilities as at 31 March 2020.

The above statement has been audited.

Clare Lombardelli
Accounting Officer 10 September 2020

THE CERTIFICATE AND REPORT OF THE COMPTROLLER AND AUDITOR GENERAL TO THE HOUSES OF PARLIAMENT

Opinion on financial statements

I certify that I have audited the financial statements of the Exchange Equalisation Account for the year ended 31 March 2020 under the Exchange Equalisation Act 1979 (as amended by the Finance Act 2000). The financial statements comprise: the Statements of Comprehensive Income, Financial Position, and Cash Flows; and the related notes, including the significant accounting policies. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Accountability Report that is described in that report as having been audited.

In my opinion:

- the financial statements give a true and fair view of the state of the Exchange Equalisation Account's affairs as at 31 March 2020 and of its total comprehensive income for the year then ended; and
- the financial statements have been properly prepared in accordance with the Exchange Equalisation Account Act 1979 (as amended by the Finance Act 2000) and HM Treasury directions issued thereunder.

Opinion on regularity

In my opinion, in all material respects the income and expenditure recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Basis of opinions

I conducted my audit in accordance with International Standards on Auditing (ISAs) (UK) and Practice Note 10 'Audit of Financial Statements of Public Sector Entities in the United Kingdom'. My responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of my certificate. Those standards require me and my staff to comply with the Financial Reporting Council's Revised Ethical Standard 2016. I am independent of the Exchange Equalisation Account in accordance with the ethical requirements that are relevant to my audit and the financial statements in the UK. My staff and I have fulfilled our other ethical responsibilities in accordance with these requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Conclusions relating to going concern

I have nothing to report in respect of the following matters in relation to which the ISAs (UK) require me to report to you where:

- the Exchange Equalisation Account's use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Exchange Equalisation Account has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Exchange Equalisation Account's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Responsibilities of the Accounting Officer for the financial statements

As explained more fully in the Statement of Accounting Officer's Responsibilities the Accounting Officer is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Auditor's responsibilities for the audit of the financial statements

My responsibility is to audit, certify and report on the financial statements in accordance with the Exchange Equalisation Account Act 1979 (as amended by the Finance Act 2000).

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs (UK), I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Exchange Equalisation Account's internal control.
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- conclude on the appropriateness of the Exchange Equalisation Account's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Exchange Equalisation Account's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my report. However, future events or conditions may cause the Exchange Equalisation Account to cease to continue as a going concern.

I communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

In addition, I am also required to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Other Information

The Accounting Officer is responsible for the other information. The other information comprises information included in the Performance Report and the Accountability Report, other than the parts of the Accountability Report described in that report as having been audited, the financial statements and my auditor's report thereon. My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon. In connection with my audit of the financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

Opinion on other matters

In my opinion:

- the parts of the Accountability Report to be audited have been properly prepared in accordance with HM Treasury directions made under the Exchange Equalisation Account Act 1979 (as amended by the Finance Act 2000);
- in the light of the knowledge and understanding of the Exchange Equalisation Account and its environment obtained in the course of the audit, I have not identified any material misstatements in the Performance Report or the Accountability Report; and
- the information given in the Performance and Accountability Reports for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I report by exception

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- adequate accounting records have not been kept or returns adequate for my audit have not been received from branches not visited by my staff; or
- the financial statements and the parts of the Accountability Report to be audited are not in agreement with the accounting records and returns; or
- I have not received all of the information and explanations I require for my audit; or
- the Governance Statement does not reflect compliance with HM Treasury's guidance.

Report

I have no observations to make on these financial statements.

Gareth Davies
Comptroller and Auditor General
17 September 2020

National Audit Office
157-197 Buckingham Palace Road
Victoria
London, SW1W 9SP

Statement of Comprehensive Income

For the year ended 31 March 2020:

	Note	2020 £ millions	*2019* *£ millions*
Net trading income	2	3,313	*1,435*
Fair value changes in gold		3,000	*508*
Fees and commissions		(2)	*(2)*
Management charge	3	(6)	*(5)*
Total comprehensive income/(loss) for the year		**6,305**	***1,936***

The notes on pages 29 to 54 form an integral part of these accounts.

Statement of Financial Position

	Note	31 March 2020 £ millions	*31 March 2019 £ millions*
Assets			
Cash	16	5,161	*16,423*
Items in the course of collection from banks	16	1,352	*351*
Money market instruments	4	8,969	*3,179*
Debt securities	5	92,158	*80,992*
Gold	6	12,918	*9,918*
Reverse repurchase agreements	7	8,824	*6,217*
Derivative financial assets	8	1,422	*1,827*
Other financial assets	9	403	*379*
Holdings of IMF Special Drawing Rights	13	12,864	*11,801*
Total assets		**144,071**	***131,087***
Liabilities			
Items in the course of transmission to banks	16	1,994	*638*
Debt securities - short positions	10	1,919	*1,776*
Repurchase agreements	11	16,411	*18,396*
Derivative financial liabilities	12	5,982	*4,659*
Other financial liabilities		8	*20*
SDR allocation	13	11,150	*10,796*
Liability to the National Loans Fund	14	106,607	*94,802*
Total liabilities		**144,071**	***131,087***

The notes on pages 29 to 54 form an integral part of these accounts.

Clare Lombardelli
Accounting Officer
10 September 2020

Statement of Cash Flows

For the year ended 31 March 2020:

	Note	2020 £ millions	*2019* *£ millions*
Net cash inflow/(outflow) from operating activities	15	**(14,611)**	***4,459***
Cash flows from financing activities:			
Cash inflow from National Loans Fund	14	10,250	*7,400*
Cash outflow to National Loans Fund	14	(4,750)	*(2,250)*
Net cash inflow from financing activities		**5,500**	***5,150***
Net increase/(decrease) in cash and cash equivalents during the year	16	**(9,111)**	***9,609***
Cash and cash equivalents at the beginning of the year	16	17,803	*8,194*
Cash and cash equivalents at the end of the year	16	**8,692**	***17,803***

The notes on pages 29 to 54 form an integral part of these accounts.

Notes to the Accounts

1 Accounting policies

Basis of preparation

The EEA produces accounts under the Exchange Equalisation Account Act 1979, as amended by the Finance Act 2000. These accounts have been prepared in accordance with the Accounts Direction, reproduced in the Annex to this report. The financial statements have been prepared in accordance with the current Government Financial Reporting Manual (FReM) issued by the Treasury. The accounting policies contained in the FReM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector context. Where the FReM permits a choice of accounting policy, the accounting policy which is judged to be most appropriate to the particular circumstances of the EEA for the purpose of giving a true and fair view has been selected. The particular policies adopted are described below. They have been applied consistently in dealing with items that are considered material to the accounts.

These accounts are prepared on a trade date basis and all assets and liabilities are initially recognised at cost on their trade dates and then subsequently in line with the relevant accounting policy. The EEA is stated in millions of pounds sterling (£m). Under section 2 of the Exchange Equalisation Account Act 1979, the EEA is funded by central government through the NLF and the net assets of the EEA represent a liability to the NLF (see note 14 to the accounts for further detail). As the core functions of the EEA can be expected to continue for the foreseeable future, and there are no legislative changes in process, there is no reason to believe that funding will not continue to be forthcoming. Therefore, in accordance with the Government Financial Reporting Manual, it has been concluded as appropriate to adopt the going concern basis of preparation for the EEA Accounts.

New and amended accounting standards

The accounting policies are consistent with the prior financial year, and there are no new or existing accounting standards, in issue or revised but not yet effective, that would impact on the EEA.

Recognition of financial assets and financial liabilities

The EEA is managed and its performance evaluated on a fair value and homogenous basis. With this in mind, and given its overarching purpose to remain liquid and secure at all times to ensure the capability to intervene at short notice, and the objective to realise cashflows through the sale of its assets, as per IFRS 9 (appendix B4.1.5 – B.4.1.6) satisfies the “other business models” classification. As such, irrespective of the outcome of the SPPI test, the financial assets and liabilities of the EEA are all effectively ‘held for trading’ and therefore held at fair value (as defined by IFRS 13), with gains and losses taken through the Statement of Comprehensive Income. In the case of the EEA’s liabilities, in accordance with IFRS 9 (paragraph 4.2.2), they are irrevocably measured at fair value through the Statement of Comprehensive Income, also eliminating accounting mismatches between the assets and liabilities of the portfolio. There have been no reclassifications of financial instruments during the year. Financial assets are derecognised when the rights to receive cash flows from them have expired or where the EEA has transferred substantially all the risks and rewards of ownership. Financial liabilities are derecognised when they are extinguished, that is, when the obligation is discharged, cancelled or expires.

Details of the methodologies used to revalue different instrument classes are given below.

i. Net trading income

Net trading income comprises all gains and losses from changes in the fair value of the EEA financial assets and liabilities, together with related interest income and expense. Realised gains and losses on disposal or maturity are also included.

ii. Special Drawing Rights (SDR) interest

The EEA earns interest (in SDRs) on its holdings of SDRs and pays interest on its SDR allocation. This is included within net trading income. Interest (in SDRs) on loans to the IMF, both the UK's Reserve Tranche Position (RTP) and any lending under the NAB (NLF assets), is also received by the EEA and is recognised in these accounts as net trading income. All SDR interest is accounted for on an accruals basis.

iii. Fees and commissions

Fees and commissions are not material and are recognised in the Statement of Comprehensive Income as incurred.

iv. Foreign currency translation

Transactions denominated in foreign currencies are recorded in sterling using the rate prevailing at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities at the Statement of Financial Position date are recognised in the Statement of Comprehensive Income within net trading income.

v. Cash and cash equivalents

For the purpose of the Statement of Cash Flows, cash comprises balances at central banks and loans and advances to banks. Cash equivalents comprise highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments normally have maturities of less than three months from the date of acquisition and include settlement balances and money market instruments. Longer term deposits have maturities of more than three months from the date of acquisition and are classified as other financial assets.

vi. Loans and advances to banks

Loans and advances to banks comprise short-term deposits and cash held at commercial banks. These are initially recorded at the cost of funds advanced and are then revalued using a discounted cash flow valuation technique. All inputs into the pricing model are externally sourced and assumptions used are supported by observable market prices. Changes in the fair value of loans and advances are recognised in the Statement of Comprehensive Income, within net trading income, when they arise.

vii. Items in course of collection from or transmission to other banks

Money market instruments, debt securities, loans and advances to banks, reverse repos, deposits by banks, debt security short positions and repos are recorded on a trade date basis. For these financial assets and liabilities, between trade date and settlement date, any amounts payable to or receivable from bank counterparties are recorded separately on the Statement of Financial Position, within items in the course of collection from banks or items in the course of transmission to banks, until settlement occurs.

viii. Money market instruments

Money market instruments are reported at fair value. Money market instruments are initially recognised at cost, as the best estimate of fair value and are subsequently revalued to their market price daily. Changes in the fair value of money market instruments are recognised in the Statement of Comprehensive Income, within net trading income, when they arise.

Fair values are either determined by reference to quoted market prices, or by using internal models where no market price is readily obtainable. All inputs into the pricing models are externally sourced and assumptions used are supported by observable market prices. Money market instruments are priced at bid prices.

ix. Debt securities (including short positions)

All debt securities are reported at fair value. Debt securities are initially recognised at cost, as the best estimate of fair value and are subsequently revalued to their market price daily. Changes in the fair value of debt securities are recognised in the Statement of Comprehensive Income, within net trading income, when they arise.

All bonds are valued directly by reference to published price quotations at 31 March 2020. Bonds are valued at bid prices. Short bond positions are valued at offer prices.

x. Gold

Gold is treated as being similar to a financial asset and, as such, is reported at fair value. Gold holdings on deposit are valued at the sterling equivalent of the dollar denominated spot bid price as at 31 March 2020. Revaluation gains and losses on gold assets are recognised within fair value changes in gold in the Statement of Comprehensive Income.

xi. Repurchase (repo) and reverse repurchase (reverse repo) agreements

Securities which have been sold with an agreement to repurchase remain on the Statement of Financial Position and the sale proceeds are recorded as a repo. Securities acquired in reverse sale and repurchase agreements are not recognised on the Statement of Financial Position and the purchase amount is recorded as a reverse repo.

Repurchase and reverse repurchase agreements are initially recognised at cost as the best estimate of fair value and subsequently revalued daily. These are valued using a discounted cash flow valuation technique. All inputs into the pricing model are externally sourced and assumptions used are supported by observable market prices. Changes in the fair value of repos and reverse repos are recognised in the Statement of Comprehensive Income, within net trading income, when they arise. Repos and reverse repos are marked to bid or offer prices, as appropriate.

xii. Derivative transactions

Derivative transactions are used to manage risk in the reserves. Such instruments include exchange rate forwards, currency swaps, interest rate swaps and interest rate and bond futures. Derivatives are carried at fair value and changes in the fair values are reported within net trading income in the Statement of Comprehensive Income. Fair values are either determined by reference to quoted market prices, or by using internal models where no market price is readily obtainable. All inputs into the pricing models are externally sourced and assumptions used are supported by observable market prices. Derivatives are marked to bid or offer prices, as appropriate.

Derivatives with positive fair values are recognised on the Statement of Financial Position within derivative financial assets. Derivatives with negative fair values are included within derivative financial liabilities.

Any cash flow receipts and payments relating to derivative transactions are recognised in net trading income as they occur.

xiii. International Monetary Fund Special Drawing Rights (SDRs)

SDRs are an international reserve asset created by the IMF. It is currently valued in terms of a weighted basket of five currencies (US dollar, sterling, yen, euro and renminbi). SDR exchange rates are published by the IMF and SDRs are recognised on the Statement of Financial Position at their closing sterling value.

xiv. Collateral and netting

The EEA enters into ISDA Master Agreements with counterparties requiring collateral to be pledged by both parties as appropriate. An ISDA Master Agreement contains close-out netting provisions which provide that, if an event of default occurs and a party chooses to close out its transaction(s) with its counterparty, all transactions documented under the ISDA Master Agreement with such counterparty will be closed-out at the same time and netted off against each other. A single resulting cash-flow will be owed from or to the EEA. The EEA also enters into bespoke foreign currency repo agreements with all repo counterparties, featuring close-out netting provisions.

Collateral is received in the form of cash or securities. Collateral received in the form of securities is not recorded on the Statement of Financial Position, and any coupons received are paid back to the counterparty. Collateral pledged remains on the Statement of Financial Position within Debt Securities.

Collateral received in the form of cash is recorded on the Statement of Financial Position with a corresponding liability, assigned to deposits by banks. Any interest arising on cash collateral received or pledged is recorded within net trading income.

Although master netting agreements are in place, the lack of intention to settle on a net basis results in the related assets and liabilities being reported gross in the Statement of Financial Position.

Critical accounting judgements and key sources of estimation uncertainty

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the entity’s accounting policies.

Judgement would be necessary in the valuation of financial instruments and gold should there be no readily available market prices. Further information about how financial instruments are valued in such circumstances is provided in the ‘Debt securities’ and ‘Derivative transactions’ accounting policies above. At 31 March 2020 there were no valuations which are not supported by observable market prices or rates (*2018-19: £nil*). Gold and gold assets are treated as being similar to a financial asset and are reported at fair value as described in the ‘Gold’ accounting policy. The valuation of gold at 31 March 2020 was £12,918 million (*2018-19: £9,918* million).

The financial assets and financial liabilities of the EEA are classified as held for trading, as they all form part of a portfolio that is managed as a whole and for which there is evidence of a recent pattern of short-term profit taking.

2 Net trading income

	2020 £ millions	*2019* *£ millions*
Money market instruments	(218)	*303*
Debt securities (incl. short positions)	6,960	*4,043*
Reverse repurchase agreements	1,026	*115*
Repurchase agreements	(421)	*(624)*
Futures	(19)	*(17)*
Foreign exchange transactions	(279)	*365*
Currency swaps	(2,779)	*(2,363)*
Interest rate swaps	(1,031)	*(379)*
Loans and deposits	9	*14*
Reserve Tranche Position	41	*41*
Special Drawing Rights	45	*(35)*
Nostros	(21)	*(28)*
Total	**3,313**	***1,435***

3 Management charge

There was a management charge of £6 million (*2018-19: £5 million*).

4 Money market instruments

	2020 £ millions	*2019* *£ millions*
Treasury bills	1,497	*1,802*
Commercial paper	7,472	*1,377*
Total	**8,969**	***3,179***

	2020 £ millions	*2019* *£ millions*
Amounts maturing:		
In not more than 3 months	4,173	*1,667*
In 1 year or less but over 3 months	4,796	*1,512*
Total	**8,969**	***3,179***

5 Debt securities

	2020 £ millions	*2019* *£ millions*
Issued by:		
Government	81,236	*74,474*
Other Public Sector	10,922	*6,518*
Total	**92,158**	***80,992***

	2020 £ millions	*2019* *£ millions*
Amounts maturing:		
Current	10,291	*8,460*
Non-current	81,867	*72,532*
Total	**92,158**	***80,992***

6 Gold

	2020 £ millions	*2019* *£ millions*
Gold Stock	12,918	*9,918*
Total	**12,918**	***9,918***

There were no gold loan/deposit or swap trades undertaken during the year *(2018-19: nil)*.

7 Reverse repurchase agreements

	2020 £ millions	*2019* *£ millions*
Amounts maturing:		
Current	8,824	*6,217*
Total	**8,824**	***6,217***

An analysis of reverse repos together with their backing collateral is provided in note 18.

The EEA is permitted under the terms of its reverse repo transactions to sell debt securities held as collateral. The carrying amount of short positions in debt securities arising as a result of selling collateral held is given in note 10.

8 Derivative financial assets

	2020 £ millions	*2019* *£ millions*
Foreign exchange transactions	684	*405*
Currency swaps	191	*556*
Interest rate swaps	547	*866*
Total	**1,422**	***1,827***

An analysis of derivative financial assets together with their backing collateral is provided in note 18.

9 Other financial assets

	2020 £ millions	*2019* *£ millions*
Margin accounts	10	*4*
Prepayments and accrued income	12	*27*
Longer term deposits	381	*348*
Total	**403**	***379***

10 Debt securities - short positions

	2020 £ millions	*2019* *£ millions*
Debt securities – short positions	1,919	*1,776*
Total	**1,919**	***1,776***

Short positions in securities relate to the sale of bonds acquired as collateral through reverse repurchase transactions (see note 7).

11 Repurchase agreements

	2020 £ millions	*2019* *£ millions*
Amounts maturing:		
Current	16,411	*18,396*
Total	**16,411**	***18,396***

An analysis of repos together with the collateral pledged is provided in note 18.

12 Derivative financial liabilities

	2020 £ millions	*2019* *£ millions*
Foreign exchange transactions	560	*337*
Currency swaps	4,440	*4,012*
Interest rate swaps	981	*310*
Futures	1	*-*
Total	**5,982**	***4,659***

An analysis of derivative financial liabilities together with the collateral pledged is provided in note 18.

13 SDR Allocation and SDR Holdings

The EEA has a liability to the IMF for those SDRs that have been allocated since the UK became a participant in the Special Drawing Rights Agreement. If the UK withdraws from participation or the Agreement is wound up, payment to the IMF would be required at current exchange rates. The SDR liability as at 31 March 2020 rose to £11,150 million *(2018-19: £10,796 million)* due to changes in exchange rates.

The SDR holdings of the EEA as at 31 March 2020 was £12,864 million (*2018-19: £11,801 million*). These holdings result from SDR allocations made by the IMF, any subsequent purchases and sales of SDRs from or to other IMF members and fair value changes. SDR holdings may include SDR denominated promissory notes issued by the IMF in return for the advance of SDRs via the Poverty Reduction and Growth Trust facility. At 31 March 2020 £1,456 million worth of such notes were held by the EEA (*2018-19: £1,412 million*). During 2019-20, the EEA purchased £623 million (net) worth of SDRs (*2018-19: purchased £1,586 million*).

Further detail on the SDRs is provided in paragraphs 23-24 in the Overview section of the Performance Report.

14 Liability to the National Loans Fund

The net assets of the EEA represent a liability to the NLF. There are two elements of the Liability to the NLF: a specific liability, recognised in accordance with the National Loans Act 1968 of £66,647 million at 31 March 2020 (*2018-19: £61,147* million) that represents the balance of advances made by the NLF and not repaid; and a separate amount that represents the EEA's total assets, less recognised liabilities. This second element consists of the capital contribution reserve and the accumulated income and expenditure reserve.

The EEA is funded by central government through the NLF. Over time, the NLF has advanced sterling to the EEA in order to finance the reserves. Similarly, when the NLF issues foreign currency securities in order to raise foreign currency finance, that would subsequently be transferred to the EEA. As a result, the EEA's net assets, having been derived from initial NLF financing, are ultimately due to the NLF, and are recognised as such on the Statement of Financial Position. If a policy decision is taken to reduce the assets of the EEA, the sterling excess raised via sale of foreign currency assets would be paid to the NLF, at the direction of the Treasury.

Specific liability to the NLF

The specific element of the liability to the NLF, described in the National Loans Act 1968, is the mechanism through which the EEA's day to day sterling cash flows are managed.

The sterling balance held by the EEA at the Bank of England is maintained within a range, agreed by management. When the balance falls below the minimum level, it can be increased by a fresh issue of capital from the NLF under the terms of section 7 of the National Loans Act 1968. This creates a liability of the EEA to the NLF. Conversely, when foreign currency is sold for sterling with the result that the sterling balance is in excess of the EEA's requirements, the Treasury can decide that some reduction should be made by a transfer from the EEA to the NLF.

If there is no outstanding specific liability to the NLF at the time of a sterling transfer from the EEA to the NLF, then the transfer is treated as a 'capital repayment' and is used to reduce the capital contribution reserve. The effect on the combined liability to the NLF, recognised in the Statement of Financial Position, is identical.

The remainder of the liability to the NLF consists of the capital contribution reserve and the accumulated income & expenditure reserve. These items are described in detail below.

Capital contribution reserve

When UK GAAP compliant accounts were prepared for the first time for the EEA, being for the year ended 31 March 2001, an amount equivalent to the total recognised assets, less liabilities, less the balance on the specific liability to the NLF in the opening Statement of Financial Position of that year, was taken to be the opening balance for the capital contribution reserve. The amount of the capital contribution reserve is periodically reduced, as explained above, because when there is no outstanding specific liability to the NLF, sterling repayments by the EEA to the NLF are taken to the capital contribution reserve. There were no reductions during the year (*2018-19: nil*).

Accumulated comprehensive income reserve

All gains and losses of the EEA, since UK GAAP compliant accounts were first prepared in 2001, have been taken to the accumulated comprehensive income reserve.

The following table shows the movements in each of the elements described above, and the overall liability to the NLF, during the year.

All amounts in £ millions	Accumulated comprehensive income reserve	Capital contribution reserve	Specific liability to the NLF	2020 Overall liability to the NLF
Balance at 1 April 2019	24,418	9,237	61,147	94,802
Transfers from the NLF	-	-	10,250	10,250
Repayments to the NLF	-	-	(4,750)	(4,750)
Total comprehensive income	6,305	-	-	6,305
Balance at 31 March 2020	**30,723**	**9,237**	**66,647**	**106,607**

All amounts in £ millions	*Accumulated comprehensive income reserve*	*Capital contribution reserve*	*Specific liability to the NLF*	*2019 Overall liability to the NLF*
Balance at 1 April 2018	*22,482*	*9,237*	*55,997*	*87,716*
Transfers from the NLF	-	-	*7,400*	*7,400*
Repayments to the NLF	-	-	*(2,250)*	*(2,250)*
Total comprehensive income	*1,936*	-	-	*1,936*
Balance at 31 March 2019	***24,418***	***9,237***	***61,147***	***94,802***

15 Reconciliation of Statement of Comprehensive Income to net cash outflow from operating activities

	2020 £ millions	*2019 £ millions*
Total comprehensive income/(loss) for the year	6,305	*1,936*
Net decrease/(increase) in money market instruments	(3,284)	*738*
Net decrease/(increase) in debt securities	(11,166)	*(7,436)*
Net decrease/(increase) in gold	(3,000)	*(508)*
Net decrease/(increase) in reverse repurchase agreements	(2,607)	*6,096*
Net decrease/(increase) in derivative financial assets	405	*1,188*
Net decrease/(increase) in other assets	(24)	*(91)*
Net decrease/(increase) in holding of SDRs	(1,063)	*(1,888)*
Net (decrease)/increase in debt securities - short positions	143	*723*
Net (decrease)/increase in repurchase agreements	(1,985)	*3,251*
Net (decrease)/increase in derivative financial liabilities	1,323	*145*
Net (decrease)/increase in other financial liabilities	(12)	*6*
Net (decrease)/increase in SDR allocation	354	*299*
Net cash (outflow)/inflow from operating activities	**(14,611)**	***4,459***

16 Cash and cash equivalents

	1 April 2019 £ millions	Cash flow £ millions	31 March 2020 £ millions
Cash at Central Banks	16,421	(11,261)	5,160
Loans and advances to banks	2	(1)	1
	16,423	(11,262)	5,161
Amounts with original maturity less than 3 months:			
Items in the course of collection from banks	351	1,001	1,352
Money market instruments	1,667	2,506	4,173
Items in the course of transmission to banks	(638)	(1,356)	(1,994)
	1,380	2,151	3,531
Total	**17,803**	**(9,111)**	**8,692**

	1 April 2018 £ millions	*Cash flow £ millions*	*31 March 2019 £ millions*
Cash at Central Banks	*5,635*	*10,786*	*16,421*
Loans and advances to banks	*73*	*(71)*	*2*
	5,708	*10,715*	*16,423*
Amounts with original maturity less than 3 months:			
Items in the course of collection from banks	*649*	*(298)*	*351*
Money market instruments	*2,370*	*(703)*	*1,667*
Items in the course of transmission to banks	*(533)*	*(105)*	*(638)*
	2,486	*(1,106)*	*1,380*
Total	***8,194***	***9,609***	***17,803***

17 Related Party Transactions

The Royal Bank of Scotland Group plc is regarded as a related party of the EEA. On 1 December 2008, the UK Government, through the Treasury[10], became the ultimate controlling party of The Royal Bank of Scotland Group plc. At 31 March 2020, the government's holding is 62.1%. During the year the EEA entered into various transactions with The Royal Bank of Scotland Group plc, which were all conducted on an arm's length basis and were part of the EEA's normal activity. There was an outstanding exposure at 31 March 2020 of £3 million *(31 March 2019: nil).*

During the year, the EEA has not entered into transactions with any other financial institutions in which the UK government has an investment.

The EEA has provided foreign currency services for a number of government departments and agencies during the year.

18 Risk management and control

A summary of the key features of the control framework for the EEA during the year and management's objectives and policies for managing risks is provided in the Governance Statement (page 16).

A detailed review of the financial risks to which the EEA is exposed and how they are managed is given below, along with quantitative data in respect of those risks. In each case, the data provided reflects the year-end position unless stated otherwise.

a. Market risk

Market risk is the risk arising from exposure to movements in market variables. The main market variables to which the EEA is exposed are interest rates and exchange rates.

The Official Reserves comprise two components: reserves that are hedged for currency and interest rate risk (the 'hedged reserves') and the remaining reserves which are unhedged for currency and interest rate risk (the 'unhedged reserves').

The composition of both elements of the reserves is determined by the benchmark allocations set out by the Treasury and market risk is taken into account when determining those benchmarks. Further detail on the policy processes for determining benchmark asset allocations is given in the Performance Report.

Active Management (where positions are taken relative to the benchmarks set for the reserves) may involve exposure to market risk over and above that of the benchmark positions.

Hedged reserves

Assets and liabilities in the hedged reserves are funded by either sterling swapped into foreign currency or through foreign currency issuances on the NLF. In either of these cases, the future cash flows from the assets held are swapped back into the currency and interest rate profile of the originating liability.

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[10] Details of HM Treasury's holdings can be found on UK Government Investments Ltd's website at http://www.ukgi.org.uk.

Currency swaps are used to hedge exchange rate risk, through an initial exchange of sterling for foreign currency at the spot rate, receiving back the same amount of sterling principal at maturity, and regular exchanges of floating interest payments on the principal amounts. Any residual foreign exchange risk is immaterial.

Interest rate risk is then hedged through interest rate swaps. Typically, this arrangement results in the EEA paying a fixed rate of interest on the foreign currency it has acquired, hedging the fixed interest income being earned in the same currency on the asset held. By swapping those fixed interest receipts for floating interest receipts in the same currency, the EEA acquires an income stream that matches its interest payment liability on the currency swap and thus minimises interest rate exposure.

The majority of the assets and liabilities of the EEA, after taking account of the effect of derivatives that alter the interest rate risk profile of instruments, earn/pay interest on a floating rate.

Unhedged reserves

The unhedged reserves are comprised of holdings of gold, cash, fixed income securities and the net of the SDR allocation and holdings. The benchmark currency position of the unhedged reserves is 40% US dollar, 40% euro, and 20% yen. The Treasury may decide, with advice from the Bank, to set deviations from the 40:40:20 currency benchmark or the interest rate benchmarks. The liability is in sterling.

Value at Risk

The Bank monitors and controls market risk primarily by using a Value at Risk (VaR) model, which estimates a loss level that will not be exceeded at a specified confidence level, over a defined period of time. VaR data is reported in USD primarily because the risk limits are based in USD and it is the main reporting currency used for performance and risk management purposes. VaR is supplemented by a suite of stress tests comprised of both static stress scenarios (e.g generic curve shifts or specific historic stress scenarios) and a range of dynamic stress scenarios calibrated to specifically target certain aspects of the EEAs current risk profile or exposure to prevailing market conditions.

For the calculation of the VaR on the hedged EEA portfolio and the active management of the EEA against the benchmarks, the Bank applies a 99% confidence interval and a 10-day holding period (i.e. it is expected that losses will not exceed the VaR figure in ninety nine out of a hundred days). The VaR estimates are based on the historic volatility of returns on different asset classes and the historic correlation between returns on those asset classes.

For the unhedged EEA portfolio, a simplified value-at-risk calculation gives an estimate of the level of losses not expected to be exceeded in ninety nine out of a hundred days.

Benchmark Reserves

The Bank reports the VaR on the benchmark reserves on a six-monthly basis. The values for the benchmark reserves are based on marked-to-market prices at the end of the period.

Hedged Reserves

	$ millions 2020	*$ millions 2019*
VaR as at 31 March	73	72
VaR as at 30 September	69	*78*

Unhedged Reserves

	$ millions 2020	*$ millions 2019*
VaR as at 31 March	2,973	*1,875*
VaR as at 30 September	2,227	*1,732*

Active Management

The Bank uses two VaR measures as part of its active management: an unweighted VaR where an equal weight is assigned to all historic market data, and an exponentially-weighted VaR which gives greater weight to more recent historic market data. The higher of these two numbers is then reported as the VaR.

The Bank measures the VaR on active management positions on a daily basis and undertakes regular back-testing of the VaR models. Assuming that both models are appropriate, and that the volatility and correlation inputs are an accurate reflection of current market conditions, losses greater than the VaR figure are expected to occur with a probability of 1%. The Bank reports the VaR back-testing results to the Treasury on a monthly basis.

Under the SLA, the Treasury sets the Bank a VaR limit for active management relative to benchmarks, with the VaR being calculated at close of business each day. In 2019-20 the VaR limit for active management was $20 million. During the year the Bank's use of VaR did not exceed $10.19 million. The average VaR during the year was $5.37 million and the lowest VaR at the end of any one day was $3.27 million.

Active management VaR during the year, (calculated at the close of business each day in US dollars), was as follows:

	$ millions 2020	*$ millions 2019*
VaR as at 31 March	10.08	*4.29*
Average during the year	5.37	*5.63*
Maximum VaR during the year	10.19	*9.45*
Minimum VaR during the year	3.27	*4.03*
VaR limit during the year	20.00	*20.00*

The minimum VaR is the higher of unweighted and exponentially weighted. For 2019-20, the minimum VaR reported was unweighted (*2018-19: unweighted*).

The Bank also measures the delta exposures on active management positions which measures the change in value of the portfolio from a one basis point shift in the relevant yield curve.

b. Credit risk

The reserves are exposed to credit risk through exposures to trading counterparties and to the issuers of securities. The creditworthiness of these counterparties and issuers is subject to regular scrutiny by the Bank, through analysis in the Financial Risk Management Division (FRMD) and review by the Bank's Credit Ratings Advisory Committee (CRAC) chaired by the Head of FRMD. Assessments are performed both routinely, and dynamically, in response to market or specific entity conditions.

Credit risk is controlled by counterparty and issuer limits and collateralisation. Exposure to issuers and counterparties is monitored against limits in real time wherever possible. In the case of derivatives contracts, exposure is measured as the marked-to-market value plus an estimate of the potential future exposure calculated using a parametric approach, volatility and correlation data. Limits are set for both individual entities and groups of related entities. Limits are also set on the maturity of repo, swaps and foreign exchange transactions with counterparties. Any limit excesses are reported to the Treasury each month.

The arrangements for custody of EEA assets in 2019-20 were as follows: US Treasury bonds and other US dollar denominated securities were held in custody at the Federal Reserve Bank of New York and Canadian dollar denominated securities were held in custody at Bank of Canada. Euro and renminbi denominated securities were held in custody at Clearstream. Japanese bonds were held in custody at the Bank of Japan. The gold bars and gold coin in the reserves were stored physically at the Bank's premises.

The EEA continued to invest in high credit quality assets throughout the year. Foreign currency assets held in the EEA inevitably carry some element of credit risk. In order to keep this risk at a low level, the majority of the EEA funds are invested in high quality sovereign or supranational bonds, and are predominantly invested in securities issued, or guaranteed by, the national Governments of the United States, Canada, euro area countries and Japan. The amount that best represents the EEA's maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements is the carrying value of the EEA's assets.

Concentration of exposure

Concentration of credit risk arises when a number of issuers or counterparties have comparable economic characteristics, or are engaged in similar activities or operate in the same geographical areas, so that their collective ability to meet contractual obligations is similarly affected by changes in economic, political or other conditions.

The tables below illustrate the concentration of the assets held by the EEA first by geographical region and, second, by credit rating.

Concentration of EEA assets by geographical region

2020

£ millions	United Kingdom	Europe	North America	Asia-Pacific	Other	Total
Cash	1,539	590	1,718	1,314	-	5,161
Items in course of collection from banks	47	904	-	401	-	1,352
Money market instruments	-	7,013	1,956	-	-	8,969
Debt Securities	20	38,427	48,669	5,011	31	92,158
Gold	-	-	-	-	12,918	12,918
Reverse repurchase agreements	2,170	6,225	429	-	-	8,824
Derivative financial assets	446	320	457	199	-	1,422
Other financial assets	10	71	-	311	11	403
IMF SDRs	-	-	-	-	12,864	12,864
Total Assets	**4,232**	**53,550**	**53,229**	**7,236**	**25,824**	**144,071**

2019

£ millions	*United Kingdom*	*Europe*	*North America*	*Asia-Pacific*	*Other*	*Total*
Cash	*1,593*	*13,463*	*156*	*1,211*	-	*16,423*
Items in course of collection from banks	*94*	*123*	*134*	-	-	*351*
Money market instruments	-	*3,179*	-	-	-	*3,179*
Debt Securities	-	*30,294*	*45,926*	*4,744*	*28*	*80,992*
Gold	-	-	-	-	*9,918*	*9,918*
Reverse repurchase agreements	*3,041*	*2,832*	*344*	-	-	*6,217*
Derivative financial assets	*687*	*383*	*685*	*72*	-	*1,827*
Other financial assets	*4*	-	-	*348*	*27*	*379*
IMF SDRs	-	-	-	-	*11,801*	*11,801*
Total Assets	***5,419***	***50,274***	***47,245***	***6,375***	***21,774***	***131,087***

Concentration of EEA assets by credit rating

2020

£ millions	1	2	3	Other	Total
Cash	2,309	1,313	-	1,539	5,161
Items in course of collection from banks	-	1,352	-	-	1,352
Money market instruments	7,855	1,114	-	-	8,969
Debt Securities	86,483	5,675	-	-	92,158
Gold	-	-	-	12,918	12,918
Reverse repurchase agreements	54	6,829	1,941	-	8,824
Derivative financial assets	198	1,051	99	74	1,422
Other financial assets	-	392	-	11	403
IMF SDRs	-	-	-	12,864	12,864
Total Assets	**96,899**	**17,726**	**2,040**	**27,406**	**144,071**

2019

£ millions	*1*	*2*	*3*	*Other*	*Total*
Cash	*13,619*	*1,211*	*-*	*1,593*	*16,423*
Items in course of collection from banks	*79*	*180*	*92*	*-*	*351*
Money market instruments	*2,514*	*665*	*-*	*-*	*3,179*
Debt Securities	*76,184*	*4,808*	*-*	*-*	*80,992*
Gold	*-*	*-*	*-*	*9,918*	*9,918*
Reverse repurchase agreements	*180*	*2,818*	*3,219*	*-*	*6,217*
Derivative financial assets	*339*	*1,212*	*167*	*109*	*1,827*
Other financial assets	*-*	*352*	*-*	*27*	*379*
IMF SDRs	*-*	*-*	*-*	*11,801*	*11,801*
Total Assets	***92,915***	***11,246***	***3,478***	***23,448***	***131,087***

The Bank carries out an internal, independent credit assessment of EEA counterparties and issuers. For the purposes of aggregated tables each internal rating has been assigned to category 1, 2 or 3.

Category ‘1’ comprises banks, banking groups, central banks, sovereigns and supranational organisations with a very low risk of default, approximately equivalent to an external rating agency rating of AA and above.

Category ‘2’ comprises banks, banking groups, central banks, sovereigns and supranational organisations with a low risk of default, approximately equivalent to an external rating agency rating of A to AA.

Category ‘3’ comprises exposures to counterparties and issuers which, although less able to withstand severe unexpected shocks without risk of insolvency, there are no immediate concerns about their credit worthiness, approximately equivalent to an external rating agency rating of below A.

Category ‘Other’ comprises unrated positions including Gold and SDR holdings and balances with UK Government agencies and the Bank of England.

None of the EEA’s financial assets are past due or impaired.

At 31 March 2020, credit exposures to issuers of money market instruments, debt securities (less debt securities – short positions) and bond futures stood at £100,707 million (*2018-19: £83,450 million).*

In addition to the use of credit limits, exposure to credit risk is managed through other mitigation measures, as outlined below.

Netting agreements and collateral

The EEA's credit exposure in respect of its derivative transactions is mitigated by provisions in the Bank's ISDA documentation, specifically those relating to collateral and netting arrangements. Additional collateral can be requested from a counterparty in response to changes in the market values of underlying transactions or a deterioration in such counterparty's credit standing. In the case of a counterparty defaulting on its obligations and the EEA closing-out such transactions, any resulting exposure will be netted across all outstanding transactions under the ISDA documentation with such counterparty, so as to produce a single cash flow.

Similar netting provisions are in place for transactions governed by bespoke foreign currency repo documentation.

For funds advanced under reverse repo, the EEA takes collateral in the form of high quality securities, which must be of a type that the EEA is authorised to hold as an investment and as agreed in the EEA's repo documentation.

For interest rate and cross currency swaps and foreign exchange transactions transacted under ISDA Master Agreements, collateral can take the form of high quality securities or, in exceptional circumstances, cash denominated in US dollar and euro.

Maximum exposure and effects of collateral

Reverse repos	2020 £ millions	*2019* *£ millions*
Reverse repos	8,824	*6,217*
less: securities received as collateral	(8,979)	*(6,397)*
less: margin called under terms of loan agreement	(172)	*(71)*
Reverse repos - collateral (surplus)	**(327)**	***(251)***

Derivatives	2020 £ millions	*2019* *£ millions*
Derivative assets gross exposure	1,422	*1,826*
less: securities received as collateral	(460)	*(170)*
Derivative asset - collateral deficit	**962**	***1,656***
Derivative liabilities gross exposure	(5,982)	*(4,659)*
less: securities pledged as collateral	4,520	*2,694*
Derivative liability – collateral (surplus)	**(1,462)**	***(1,965)***
Derivatives - net collateral (surplus)	**(500)**	***(309)***

Collateral pledged

The EEA has pledged the following amounts as collateral for liabilities:

	2020 £ millions	*2019* *£ millions*
Repos	16,253	*18,157*
Derivative liabilities	4,520	*2,694*
	20,773	***20,851***

Settlement processes

Wherever possible, trades are settled as Delivery versus Payment, with simultaneous exchange of cash and stock. Settlement limits are used to control FX settlement risk.

c. Liquidity risk

The NLF provides sterling funding to the EEA when required, and therefore the EEA, as an individual entity, is not exposed to sterling liquidity risk.

The EEA maintains a sterling account with the NLF that is used as the mechanism via which funding is transferred to the EEA, and excess cash is repaid to the NLF. This account is monitored daily and is maintained within a range. Forward looking cash flow forecasts are used to predict likely demand for cash in the EEA. Requests for funding from the NLF, and for repayments to be made, are processed when the account is forecasted to fall below, or to exceed, the range.

Undiscounted contractual cash flows of financial assets and liabilities

The tables below present the cash flows to/from the EEA arising from financial assets and liabilities until their contractual maturity date. The amounts disclosed in the tables are the contractual undiscounted cash outflows, whereas amounts are presented in the Statement of Financial Position at their carrying values, as detailed in note 1 – Accounting policies.

The maturity analysis for derivative financial assets and liabilities includes both known cash inflows and outflows projected by current forward rates for the floating leg of currency and interest rate swaps.

Undiscounted contractual cash flows of financial assets

As at 31 March 2020:

All amounts in £ millions	**Up to 1 month**	**1 to 3 months**	**3 to 12 months**	**1 to 5 years**	**More than 5 years**	**Undated**	**Total**
Cash balances	5,161	-	-	-	-	-	5,161
Items in course of collection from banks	1,352	-	-	-	-	-	1,352
Money market instruments	1,209	2,965	4,798	-	-	-	8,972
Debt securities	735	917	9,947	78,015	2,560	-	92,174
Gold	-	-	-	-	-	12,918	12,918
Reverse repurchase agreements	5,850	2,972	-	-	-	-	8,822
Derivative financial assets - inflow	5,675	7,950	5,990	11,690	24	-	31,329
Derivative financial assets - outflow	(5,573)	(7,738)	(5,595)	(10,886)	(7)	-	(29,799)
Other financial assets	115	145	144	-	-	-	404
SDR Holdings	-	-	-	-	-	12,864	12,864
Total	**14,524**	**7,211**	**15,284**	**78,819**	**2,577**	**25,782**	**144,197**

Undiscounted contractual cash flows of financial liabilities

As at 31 March 2020:

All amounts in £ millions	**Up to 1 month**	**1 to 3 months**	**3 to 12 months**	**1 to 5 years**	**More than 5 years**	**Undated**	**Total**
Items in the course of transmission to banks	(1,994)	-	-	-	-	-	(1,994)
Debt securities – short positions	(1,919)	-	-	-	-	-	(1,919)
Repurchase agreements	(7,604)	(5,459)	(3,351)	-	-	-	(16,414)
Derivative financial liabilities – inflows	3,845	5,597	12,940	31,806	1,426	-	55,614
Derivative financial liabilities – outflows	(4,136)	(5,825)	(15,001)	(35,034)	(1,559)	-	(61,555)
Other financial liabilities	(8)	-	-	-	-	-	(8)
SDR Allocation	-	-	-	-	-	(11,150)	(11,150)
Liability to the NLF	-	-	-	-	-	(106,607)	(106,607)
Total	**(11,816)**	**(5,687)**	**(5,412)**	**(3,228)**	**(133)**	**(117,757)**	**(144,033)**

Undiscounted contractual cash flows of financial assets

As at 31 March 2019: All amounts in £ millions	***Up to 1 month***	***1 to 3 months***	***3 to 12 months***	***1 to 5 years***	***More than 5 years***	***Undated***	***Total***
Cash balances	*16,423*	-	-	-	-	-	*16,423*
Items in course of collection from banks	*351*	-	-	-	-	-	*351*
Money market instruments	*1,363*	*306*	*1,508*	-	-	-	*3,177*
Debt securities	*288*	*652*	*9,349*	*66,804*	*6,702*	-	*83,795*
Gold	-	-	-	-	-	*9,918*	*9,918*
Reverse repurchase agreements	*5,299*	*919*	-	-	-	-	*6,218*
Derivative financial instruments – inflow	*6,411*	*6,087*	*5,848*	*20,916*	*2,823*	-	*42,085*
Derivative financial instruments – outflow	*(6,359)*	*(5,889)*	*(5,587)*	*(19,615)*	*(2,828)*	-	*(40,278)*
Other financial assets	*119*	*227*	*35*	-	-	-	*381*
SDR Holdings	-	-	-	-	-	*11,801*	*11,801*
Total	***23,895***	***2,302***	***11,153***	***68,105***	***6,697***	***21,719***	***133,871***

Undiscounted contractual cash flows of financial liabilities

As at 31 March 2019: All amounts in £ millions	***Up to 1 month***	***1 to 3 months***	***3 to 12 months***	***1 to 5 years***	***More than 5 years***	***Undated***	***Total***
Items in the course of transmission to banks	*(638)*	-	-	-	-	-	*(638)*
Debt securities – short positions	*(1,776)*	-	-	-	-	-	*(1,776)*
Repurchase agreements	*(12,232)*	*(6,173)*	-	-	-	-	*(18,405)*
Derivative financial liabilities – inflows	*4,044*	*4,036*	*11,780*	*27,834*	*3,803*	-	*51,497*
Derivative financial liabilities – outflows	*(4,389)*	*(4,255)*	*(13,183)*	*(31,094)*	*(3,966)*	-	*(56,887)*
Other financial liabilities	*(20)*	-	-	-	-	-	*(20)*
SDR Allocation	-	-	-	-	-	*(10,796)*	*(10,796)*
Liability to the NLF	-	-	-	-	-	*(94,802)*	*(94,802)*
Total	***(15,011)***	***(6,392)***	***(1,403)***	***(3,260)***	***(163)***	***(105,598)***	***(131,827)***

d. Derivatives

The EEA uses derivatives to manage its exposure to interest rate and exchange rate risks. All derivative instruments are held at their fair values. Fair values are determined by reference to market rates prevailing on the date of valuation or by discounting future cash flows. The notional principal amounts of these instruments indicate the volume of transactions outstanding as at 31 March 2020 and are not a representation of the amount of risk.

Notional principal amounts and fair values of trading instruments entered into with third parties were as follows:

All amounts in £ millions

	2020			*2019*		
	Notional Principal Amounts	Fair values Assets	Fair values Liabilities	*Notional Principal Amounts*	*Fair values Assets*	*Fair values Liabilities*
Exchange rate contracts:						
Forwards	36,791	684	(560)	*31,913*	*405*	*(337)*
Currency swaps	51,296	191	(4,440)	*59,450*	*556*	*(4,012)*
	88,087	875	(5,000)	*91,363*	*961*	*(4,349)*
Interest rate swaps	51,506	547	(981)	*77,051*	*866*	*(310)*
Futures	4,662	-	(1)	*1,154*	*-*	*-*
	56,168	547	(982)	*78,205*	*866*	*(310)*
Total	**144,255**	**1,422**	**(5,982)**	***169,568***	***1,827***	***(4,659)***

19 Fair Value Valuation Basis

The table below provides an analysis of the various bases described in the notes which have been deployed for valuing the financial instruments measured at fair value in the financial statements.

The valuations of financial instruments have been classified into three levels according to the quality and reliability of information used to determine the fair values.

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 financial year no financial instruments were measured at fair value with significant unobservable inputs (*2018-19: nil*). There were no significant transfers between Level 1 and Level 2 of the fair value hierarchy.

As at 31 March 2020

Assets	Level 1 £ millions	Level 2 £ millions	Level 3 £ millions	Total £ millions
Money market instruments	1,497	7,472	-	8,969
Debt securities	92,158	-	-	92,158
Reverse repurchase agreements	-	8,824	-	8,824
Derivative financial assets	-	1,422	-	1,422
Other financial assets	403	-	-	403
Holding of IMF Special Drawing Rights	12,864	-	-	12,864
Total assets	**106,922**	**17,718**	**-**	**124,640**

Liabilities				
Debt securities – short positions	1,919	-	-	1,919
Repurchase agreements	-	16,411	-	16,411
Derivative financial liabilities	-	5,982	-	5,982
Other financial liabilities	8	-	-	8
SDR allocation	11,150	-	-	11,150
Total liabilities	**13,077**	**22,393**	**-**	**35,470**

As at 31 March 2019

Assets	*Level 1 £ millions*	*Level 2 £ millions*	*Level 3 £ millions*	*Total £ millions*
Money market instruments	*1,802*	*1,377*	-	*3,179*
Debt securities	*80,992*	-	-	*80,992*
Reverse repurchase agreements	-	*6,217*	-	*6,217*
Derivative financial assets	-	*1,827*	-	*1,827*
Other financial assets	*379*	-	-	*379*
Holdings of IMF Special Drawing Rights	*11,801*	-	-	*11,801*
Total assets	***94,974***	***9,421***	-	***104,395***

Liabilities				
Debt securities – short positions	*1,776*	-	-	*1,776*
Repurchase agreements	-	*18,396*	-	*18,396*
Derivative financial liabilities	-	*4,659*	-	*4,659*
Other financial liabilities	*20*	-	-	*20*
SDR allocation	*10,796*	-	-	*10,796*
Total liabilities	***12,592***	***23,055***	-	***35,647***

20 Events after the Reporting Period

There are no events after the reporting period to report.

21 Date of Authorisation for Issue of Account

These financial statements have been authorised for issue by the Accounting Officer on the same date as the Comptroller and Auditor General's Audit Certificate.

ANNEX A

ACCOUNTS DIRECTION GIVEN BY HM TREASURY UNDER THE EXCHANGE EQUALISATION ACCOUNT ACT 1979[11]

1. This direction applies to the Exchange Equalisation Account.
2. The Treasury shall prepare accounts for the Exchange Equalisation Account ("the Account") for the year ending 31 March 2012 and each subsequent financial year, which give a true and fair view of the state of affairs of the Account at the reporting date, and of its income and expenditure and cash flows for the year then ended.
3. The accounts shall be prepared in accordance with the requirements of the relevant version of the Government Financial Reporting Manual (FReM).
4. The accounts shall present a Statement of Comprehensive Income, a Statement of Financial Position and a Statement of Cash Flows. The Statement of Financial Position shall present assets and liabilities in order of liquidity.
5. The notes to the accounts shall include disclosure of assets and liabilities, and of income and expenditure, relating to other Central Government funds, including the National Loans Fund, and shall also include disclosure of management costs.
6. The report shall include:
    - (i) a brief history of the Account, and its statutory background;
    - (ii) an outline of the scope of the Account, its relationship to HM Treasury and other central funds, and its management operations;
    - (iii) a management commentary including appropriate information on financial performance and position reflecting the relationship between the Account and other central funds;
    - (iv) a governance statement.
7. Compliance with the requirements of the FReM will, in all but exceptional circumstances, be necessary for the accounts to give a true and fair view. If, in these exceptional circumstances, compliance with the requirements of the FReM is inconsistent with the requirement to give a true and fair view, the requirements of the FReM should be departed from only to the extent necessary to give a true and fair view. In such cases, informed and unbiased judgement should be used to devise an appropriate alternative treatment which should be consistent with both the economic characteristics of the circumstances concerned and the spirit of the FReM. Any material departure from the FReM should be discussed in the first instance with the Treasury.
8. This Accounts Direction shall be reproduced as an appendix to the accounts.
9. This Accounts Direction supersedes that issued on 17 March 2010.

Chris Wobschall
Deputy Director, Assurance and Financial Reporting Policy, HM Treasury
6 January 2012

[11] As amended by the Finance Act 2000

Glossary

Active management is the difference between actual returns and the returns which would have been achieved from a passive investment strategy (see "Benchmark" below).

Basis point (bp) is equal to 100th of a percentage point, e.g. 0.5% is equal to 50bp.

Benchmark is the neutral or passive investment strategy for the reserve portfolio. Active management performance is measured against a target return over the benchmark.

Certificate of deposit is a savings certificate entitling the holder to receive interest and principle.

Corporate commercial paper is a short–term debt issued by companies.

Counterparty is the other party that participates in a financial transaction.

Credit risk is the risk of financial loss arising from a counterparty to a transaction defaulting on its financial obligations under that transaction.

Currency risk is the risk of financial loss arising from fluctuations in exchange rates.

Custodian is a bank or other financial institution that keeps custody of assets of the EEA.

Delta measures the change in the value of a portfolio for each one basis point shift in the relevant yield curve.

Derivatives are a collective name for contracts whose value is derived from the prices of another (underlying) investment. For the EEA, the main derivatives are futures, forwards and swaps.

Discount note is a short–term debt instrument issued at a discount to its face value.

Euro area is the area of 19 nations which have adopted the euro as a single currency.

Floating rate note is a debt instrument that pays a variable interest rate.

Foreign currency reserves consists of bonds and notes, money market instruments, foreign currency deposits and reverse repos, less unsettled trades.

Forward rate agreement is a contract obligating two parties to exchange the difference between two interest rates at some future date; one rate being fixed now and the other being a rate to be fixed in the future.

Forward transaction is an agreement to pay a specific amount at a specific time in the future for a currency or financial instrument.

Future is a contract to buy or sell a specified asset at a fixed price at some future point in time.

Government Financial Reporting Manual (FReM) – is the technical accounting guide that complements guidance on the handling of public funds published separately by the relevant authorities.

Hedge – is an asset or derivative whose market risk offsets the risk in another asset held or liability. Hedge refers to the economic purpose of an instrument and is not used in the accounting sense to imply the use of hedge accounting.

Hedged reserves refers to that part of the reserves, financed by repo or sterling swapped into foreign currencies or foreign currency securities, on which currency and interest rate exposure is hedged.

Interest rate risk is the risk of financial loss arising from fluctuations in interest rates.

Intervention is the purchase or sale of a currency by central banks or governments with the intention of influencing its market exchange rate.

Issuer is a legal entity, i.e. a government, supranational or corporation, that develops, registers and sells securities to investors in order to finance its own operations.

Liquidity is the ease with which one financial claim can be exchanged for cash as a result of the willingness of third parties to transact in these assets. Liquidity risk is the risk that financial claims can only be turned into cash with a delay or at some cost, or both.

Mark to market – refers to recording the price or fair value of a security, portfolio or account to reflect its current market value rather than its book value.

Market risk is the risk of financial loss arising from movements in market variables such as in interest rates or exchange rates.

National Loans Fund (NLF) is the account used for most of the Government's borrowing transactions, payments of debt interest and some domestic lending transactions.

New Arrangements to Borrow (NAB) is a set of credit arrangements between the IMF and 38 member countries and institutions, including the UK. The NAB is used in circumstances in which the IMF needs to supplement its quota resources for lending purposes.

Nostros – refers to accounts that the EEA holds foreign currency with at other banks.

Operational risk is the risk of loss arising from failures in the transaction, settlement and resource management processes associated with reserves and liability management. This broad definition includes risks such as fraud risk, settlement risk, IT risks, legal risk, accounting risk, personnel risk and reputational risk.

Reserve Tranche Position (RTP) is the difference between the IMF's holdings of sterling and the UK's subscription (or quota) to the IMF. It is in effect, the amount of the UK's subscription the IMF has called. The RTP is a reserve asset as in the event of need, the UK could exchange sterling for useable foreign currencies up to the value of its RTP.

Reserves – refers to the UK holdings of international reserves, reported on a gross basis. Gross reserves consist of foreign currency reserves, IMF position (the RTP, NAB and the net SDR position) and gold holdings.

Sale and repurchase agreements (repo) refers to the sale of an asset with an obligation to repurchase it at a fixed price at some future date: essentially, a form of secured borrowing.

Special Drawing Rights (SDRs) are an international reserve asset created by the IMF in 1969 as a supplement to the then existing reserve assets. It is currently valued in terms of a weighted basket of five currencies (US dollar, sterling, yen, euro and renminbi).

Spot transaction is an agreement to pay the prevailing market price for a currency or financial instrument for delivery usually in two days' time.

Supranational refers to an international government or quasi-government organisation.

Swap is a financial transaction in which two counterparties agree to exchange streams of payments occurring over time according to predetermined rules. Swaps can be used to change the currency or interest rate exposure associated with investments or liabilities.

Unhedged reserves refers to the part of the reserves where the currency and interest rate exposure is not hedged.

Value at Risk (VaR) measures the aggregate market risk on a portfolio. VaR is an estimate of a loss level that will not be exceeded with a certain confidence level during a certain period of time. For example, losses will not exceed $10 million 99% of the time over a two week period.

Yield curve plots the relationship between bonds' maturity and their yield.

HM Treasury contacts

This document can be downloaded from
www.gov.uk

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