
NORGES BANK'S SUPERVISORY COUNCIL REPORT FOR 2010

TWO THOUSAND AND TEN

2010



**NORGES BANK'S SUPERVISORY COUNCIL
REPORT FOR 2010**

TO THE STORTING

Norges Bank's Supervisory Council is elected by the Norwegian parliament – the Storting – and charged with supervising the Bank's activities and ensuring that the rules governing the Bank's operations are observed, including the management of the Government Pension Fund Global. The Council approves the Bank's budget and adopts its annual accounts.

Norges Bank has a well-established governance structure which is under continuous development. The Storting passed amendments to the Norges Bank Act in 2009 and 2010 concerning the duties and responsibilities of the Supervisory Council. These changes mean that a report on the supervision of the Bank is now to be submitted directly to the Storting. The new rules also clarify the authority and responsibilities of both the Council and the Executive Board.

The Supervisory Council has considered Norges Bank's annual report and adopted its annual accounts for 2010. The annual report on the management of the Government Pension Fund Global for 2010 has also been considered. Reference is made to these reports for a more detailed presentation of the operations and accounts of the central bank.

The Council adopted this report on the supervision of Norges Bank in 2010 at its meeting of 17 March 2011, and it is hereby presented it to the Storting.

Oslo, 6 April 2011

Reidar Sandal
Chairman, Norges Bank's Supervisory Council

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1. SUMMARY

Pursuant to section 5 of the Norges Bank Act, the Supervisory Council supervised the Bank's activities and ensured that the rules governing the Bank's operations were observed in 2010.

Under the Act, executive and advisory authority at the Bank is vested in the Executive Board, which is in charge of the Bank's operations and manages its resources. The Supervisory Council ensures that the Board's management and control of the Bank's administration and operations are satisfactory and that appropriate procedures have been established so that the Bank's activities are conducted in accordance with legislation, agreements, decisions and other regulatory frameworks. The Council approves the Bank's budget and adopts its annual accounts.

The Supervisory Council performed its duties in 2010 on the basis of consideration of minutes, matters and statements from the Executive Board. Reports and statements from the Office of the Supervisory Council and the external auditor were also considered.

The Council received all of the information it requested in connection with this work.

The Executive Board's proposed budget for Norges Bank for 2010 was approved by the Supervisory Council, which had no remarks on the implementation of the budget. Norges Bank's annual accounts for 2010, including the financial reporting for the Government Pension Fund Global, were adopted by the Council in March 2011.

The Council did not minute any particular remarks on the Executive Board's minutes in 2010.

The Supervisory Council is of the opinion that the Executive Board exercised satisfactory management and control of Norges Bank's operations in 2010 in accordance with the Norges Bank Act, the guidelines for the management of the Government Pension Fund Global and the Regulation on Risk Management and Internal Control at Norges Bank. The supervision of the Bank's activities and compliance with the rules for its operations revealed no cause for special remarks under the Act.

This report provides an overview of the Council's activities, use of resources and methodological approach. It also presents the Council's supervision of the Executive Board's minutes and its management and control system, and the Council's supervision of central banking and investment management activities. Work on the budget and accounts is described in a separate section.

The Council considered numerous important matters during the year. The supervision of investment management was given high priority. In this context, particular attention was paid to the Bank's management and control of external management. The Council also paid close attention to the conversion project at Norges Bank's head office.

The Council worked on the implementation of a new audit and supervision system based on the amendments to the Norges Bank Act in 2009 and 2010. The Council is of the opinion that the new system provides a sound basis for the continued development of management and control at the Bank and has further clarified the Council's role and the requirements for public disclosure, especially when it comes to the management of the Government Pension Fund Global.

All in all, Norges Bank has an extensive supervision and control regime, especially for the management of the Government Pension Fund Global. The Supervisory Council has attached importance to establishing appropriate dialogue and coordination between the various internal and external audit and control bodies. In this context, the Council also focused on collaboration with the Office of the Auditor General.

2. THE SUPERVISORY COUNCIL'S ROLE AND RESPONSIBILITIES

Section 75c of the Norwegian Constitution requires the Storting to “supervise the monetary affairs of the Realm”. This role is performed partly by Norges Bank's Supervisory Council pursuant to the Norges Bank Act¹.

Norges Bank's governing bodies are the Executive Board and the Supervisory Council. The Council's authority and duties are set out in the third and fourth paragraphs of section 5 of the Norges Bank Act:

“The Supervisory Council shall supervise the Bank's activities and ensure that the rules governing the Bank's operations are observed. The Supervisory Council shall in this respect supervise the Executive Board to ensure that the Board's management and control of the Bank's administration and operations are satisfactory and that appropriate procedures have been established so that the Bank's activities are conducted in accordance with legislation, agreements, decisions and other regulatory frameworks. The Executive Board's exercise of discretionary authority under the Act is not subject to the Supervisory Council's supervision.”

The last sentence means that the Council is not to appraise the Executive Board's discretionary assessments within the regulatory framework for Norges Bank, including the exercise of its executive authority, monetary policy decisions and advice. The general supervision of the Bank's activities will, however, include the organisation and processes established by the Bank as a basis for the exercise of this discretionary authority.

“The Supervisory Council may, on the proposal of the Executive Board, decide that the production of banknotes and coin or other commercial activities that fall within the scope of this Act shall be performed by companies that are partly or wholly owned by the Bank. The Supervisory Council shall be responsible for supervising such companies.”

Norges Bank does not currently have any such companies.

“The Supervisory Council adopts the annual accounts of the Bank and, on the proposal of the Executive Board, approves the budget.”

The Council appoints the external auditor and is required by law to have a secretariat. The Council also has statutory powers in a number of specific areas.

“The Supervisory Council has the right of access with respect to all of the Bank's affairs and may conduct any investigations it deems necessary in order to fulfil its responsibilities under the Act. The Supervisory Council issues a statement on the minutes of the meetings of the Executive Board, the supervision of the Bank and matters submitted to it by the Executive Board.”

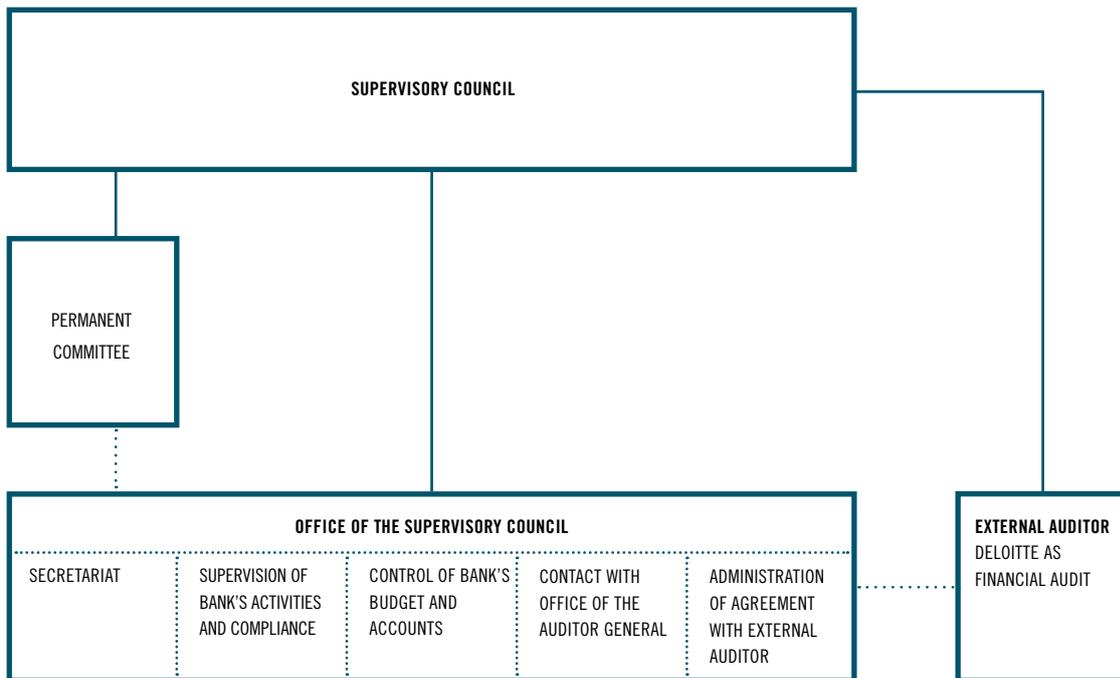
Section 30 of the Act requires the Council to submit a statement to the Storting at least once a year, which:

- “... shall, at the minimum, comprise the following:*
- 1. an account of how the supervision of the Bank has been organised,*
 - 2. an account of supervisory activities conducted and the Supervisory Council's priorities for its activities ahead,*
 - 3. an account of the Council's supervision of the Bank's investment management activities,*
 - 4. the Council's assessment of the Executive Board's management and control of the Bank's administration and operations, cf. section 5, third paragraph, second sentence,*
 - 5. an account of the Council's work in connection with its approval of the Bank's budget and adoption of the accounts, cf. section 5, fourth paragraph, second sentence,*
 - 6. any particular remarks arising from supervisory activities.”*

This information is provided in the present report.

¹ Act No. 28 of 24 May 1985 relating to Norges Bank and the Monetary System etc. (the Norges Bank Act), last amended on 17 December 2010.

FIGURE 1. THE COUNCIL'S ORGANISATION AND DUTIES



3. THE SUPERVISORY COUNCIL'S COMPOSITION AND ORGANISATION

The Supervisory Council has 15 members elected by the Storting for a four-year term. From among the members, the Storting elects a chairman and deputy chairman for a term of two years. A named alternate is also elected for each full member.

Pursuant to the Norges Bank Act, the Council has established a Permanent Committee consisting of the chairman, deputy chairman and three other members of the Council. The Committee has no decision-making powers but prepares and makes recommendations on matters to be considered by the Council.

The members of the Council and the Committee for 2010-2011 are shown in Table 1.

Appendix 1 provides a full list of members and alternates with their terms of office.

The Norges Bank Act requires the Council to have a secretariat – the Office of the Supervisory Council – which performs supervisory and control work, administers the agreement with the external auditor, and provides secretariat functions for the Council.

The Office also serves as a coordinator between Norges Bank, the external auditor and the Office of the Auditor General, especially when it comes to the Government Pension Fund Global. The Office is professionally and administratively independent of Norges Bank. The Supervisory Council issues standing instructions for the Office, appoints its director and approves the director's job description and terms of employment.

The Council adopts annual supervision plans, budgets and accounts for the Office.

In December 2009 the Supervisory Council appointed Deloitte AS external auditor for Norges Bank and signed an engagement agreement running for six years from May 2010. The external auditor's main task is the audit of Norges Bank's

annual accounts, including the financial reporting for the Government Pension Fund Global. The agreement also covers the review of the quarterly reports for the Fund and the possibility of other assurance and advisory services to be agreed separately.

The Supervisory Council's organisation structure is shown in Figure 1.

TABLE 1. MEMBERS OF NORGES BANK'S SUPERVISORY COUNCIL AND THE PERMANENT COMMITTEE 2010-2011

SUPERVISORY COUNCIL

Reidar Sandal, *chairman*
 Frank Sve, *deputy chairman*
 Tormod Andreassen
 Eva Karin Gråberg
 Runbjørg Bremset Hansen
 Kåre Harila
 Marianne Lie
 Morten Lund
 Terje Ohnstad
 Monica Salthella
 Synnøve Søndergaard
 Tom Thoresen
 Gunvor Ulstein
 Erland Vestli
 Reidar Åsgård

PERMANENT COMMITTEE

Reidar Sandal, *chairman*
 Frank Sve, *deputy chairman*
 Runbjørg Bremset Hansen
 Monica Salthella
 Tom Thoresen



From left:

MONICA SALTHELLA
KÅRE HARILA

REIDAR SANDAL, CHAIRMAN
RUNBJØRG BREMSET HANSEN

TERJE OHNSTAD
ERLAND VESTLI
TORMOD ANDREASSEN
SYNNØVE SØNDERGAARD
MORTEN LUND
MARIANNE LIE



FRANK SVE, DEPUTY CHAIRMAN

EVA KARIN GRÅBERG

GUNVOR ULSTEIN

TOM THORESEN

REIDAR ÅSGÅRD



4. INTRODUCTION OF A NEW AUDIT AND SUPERVISION SYSTEM

The Supervisory Council worked on implementing a new audit and supervision system in 2010 based on changes to the Norges Bank Act. The Storting passed amendments to the Act in 2009 and 2010 which clarified and made a number of changes to the Council's areas of authority. The background to this process and the amendments has been the growth and increased complexity of Norges Bank's management of the Government Pension Fund Global and general developments in corporate governance and accounting standards.

Until 2007 Norges Bank had a single audit unit, Central Bank Audit, which came under the Supervisory Council.

The Executive Board set up an Audit Committee in 2006 and an internal audit unit in 2007. The requirement for Norges Bank to have an internal audit unit is laid down in the Norges Bank Act and the Regulation on Risk Management and Internal Control at Norges Bank which entered into force on 1 January 2010.

In 2007 the Supervisory Council entered into an agreement with accountancy firm Deloitte AS on auditing the accounts for the Government Pension Fund Global in collaboration with Central Bank Audit. This model continued until May 2010 when Deloitte AS took over the auditing of Norges Bank in its entirety. Central Bank Audit's supervisory and secretariat duties were taken over by the Office of the Supervisory Council.

Following the changes in the law, the Supervisory Council's report on the supervision of Norges Bank is to be submitted directly to the Storting. Previously a statement was sent to the Ministry of Finance for submission to the King in Council and communication to the Storting. The form and content of the report are now specified in the Norges Bank Act. In

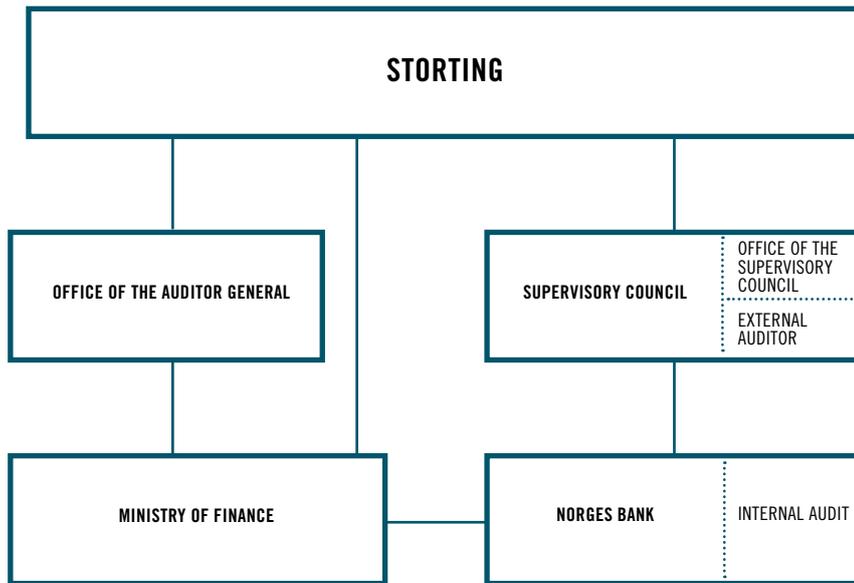
addition, responsibility for determining the remuneration of the members of the Supervisory Council has been transferred from the Ministry of Finance to the Storting from 2011. In the opinion of the Council, these changes will help to underline its status as an independent control body for the Storting and strengthen supervisory and audit work at Norges Bank in general.

From the 2011 financial year, Norges Bank is directly required to comply with the Accounting Act and International Financial Reporting Standards. Until 2010 the accounts were prepared using accounting policies based on the provisions of the Accounting Act and approved by the Supervisory Council. In a regulation of 8 November 2010, the Ministry of Finance issued a new mandate for the management of the Government Pension Fund Global entering into force on 1 January 2011. With this mandate the Ministry has introduced more stringent requirements for following up risk in investment management and reporting.

DIVISION OF ROLES AND RESPONSIBILITIES BETWEEN THE SUPERVISORY COUNCIL AND THE OFFICE OF THE AUDITOR GENERAL

The role of the Office of the Auditor General as the Storting's audit and control body is set out in broad terms in section 75k of the Norwegian Constitution and in the Auditor General Act. The Norges Bank Act and the Instructions concerning the Activities of the Auditor General specifically require the Office of the Auditor General to monitor the way the minister exercises his or her authority over Norges Bank. The Supervisory Council has mainly had contact with the Office of the Auditor General in connection with Norges Bank's management of the Government Pension Fund Global.

FIGURE 2. DIVISION OF ROLES AND RESPONSIBILITIES BETWEEN NORGES BANK'S SUPERVISORY COUNCIL AND THE OFFICE OF THE AUDITOR GENERAL



In the Government Pension Fund Act, the Storting delegates responsibility for managing the Fund to the Ministry of Finance. The Fund is not a separate legal entity but the name of a specific part of the government's wealth which is deposited in an account at Norges Bank² and managed by the Bank in line with detailed rules issued by the Ministry. These assets are managed in the Bank's name and included in the Bank's accounts.

The division of roles and responsibilities between the Supervisory Council, Norges Bank's external auditor and the Office of the Auditor General was described in the preparatory work on the amendments to the Norges Bank Act in 2009³ and the Ministry of Finance's report to the Storting on the management of the Government Pension Fund in 2009⁴.

The division of duties is also specified in the Standing Committee on Scrutiny and Constitutional Affairs' recommendation to the Storting on the Office of the Auditor General's report on the annual financial audit and control for the budget year 2009 (Recommendation 138 S (2010-2011)). Section 5.2 of the recommendation states that:

"... the Supervisory Council is required by the Norges Bank Act to supervise the Bank's activities, including investment management. The Committee also notes that the Office of the Auditor General is required by section 9 of the Auditor General Act to audit the central government accounts and scrutinise the Ministry of Finance's exercise of powers in relation to the two funds. The Committee has taken as its basis the division of duties that follows from the provisions of the Government Pension Fund Act and the Norges Bank Act, and the Storting's consideration of last year's report on the

Pension Fund. This means that the Office of the Auditor General is to ensure that the Ministry of Finance manages the Fund in accordance with the Storting's requirements and decisions, while the Supervisory Council, based on the work of the external auditor, is to ensure that Norges Bank's management adheres to the guidelines issued by the Ministry. The Bank's internal audit unit is to ensure that internal guidelines issued by the Executive Board within the Bank's mandate are followed up."

The Supervisory Council refers to the division of roles and responsibilities in the recommendation from the Standing Committee on Scrutiny and Constitutional Affairs. The Council would also draw attention to the role played by the Office of the Supervisory Council in performing supervisory and control procedures on behalf of the Council. This division of roles and responsibilities is outlined in Figure 2.

Central Bank Audit and the Office of the Auditor General entered into an agreement in 1997 on the latter's access to audit work performed by the former. In 2010 the Supervisory Council and the Office of the Auditor General established a new collaboration model tailored to the new audit and supervision system at Norges Bank. An agreement on the general principles for the exchange of information and coordination between the two bodies in relation to the Government Pension Fund Global was signed on 1 December 2010 (Appendix 2).

In the opinion of the Supervisory Council, the Storting's elaboration and the guidelines agreed with the Office of the Auditor General will provide sound foundations for future interaction with the Office of the Auditor General.

² Cf. Proposition No. 58 (2008-2009) to the Odelsting on Amendments to Act No. 28 of 24 May 1985 relating to Norges Bank and the Monetary System etc. (new accounting and auditing system etc.), section 3.2.

³ Proposition No. 58 (2008-2009) to the Odelsting, section 5.1

⁴ Report No. 10 (2009-2010) to the Storting, section 4.2.



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5. NORGES BANK'S OPERATIONS, ORGANISATION AND GOVERNANCE SYSTEM

NORGES BANK'S OPERATIONS AND ORGANISATION

The Supervisory Council's supervision requires a sound knowledge of Norges Bank's operations and organisation and its management and control system. The following presents the main elements of the Bank's organisation and its management and control structure. For more detailed information, reference should be made to Norges Bank's annual report and the annual report on the management of the Government Pension Fund Global for 2010.

Norges Bank's operations are governed by the Norges Bank Act. In addition, the Bank manages the Government Pension Fund Global in accordance with the Government Pension Fund Act and detailed rules issued by the Ministry of Finance.

Norges Bank's annual accounts show total assets of NOK 3,460bn at the end of 2010, divided into investments for the Government Pension Fund Global of NOK 3,074bn, foreign exchange reserves of NOK 309bn and lending to banks of NOK 60bn. These assets were financed with capital of NOK 65bn, notes and coins in circulation of NOK 54bn, deposits from banks of NOK 80bn and external debt of NOK 50bn. Deposits from central government totalled NOK 3,211bn, of which deposits in the krone account for the Government Pension Fund Global accounted for NOK 3,074bn.

The Bank recorded a profit of NOK 12.6bn in 2010. The return on the Government Pension Fund Global's investments was NOK 255.4bn and was transferred to the krone account. Operating expenses totalled NOK 3.8bn, of which NOK 2.9bn related to the management of the Government Pension Fund Global.

Norges Bank's overall organisation structure is shown in Figure 3 on page 18.

Norges Bank had 589 employees at the end of 2010, divided into 311 in central banking and 278 in investment management (Norges Bank Investment Management (NBIM)). In addition, some operational tasks are performed by external suppliers in Norway and abroad.

The Executive Board's authority and duties are set out in the second paragraph of section 5 of the Norges Bank Act:

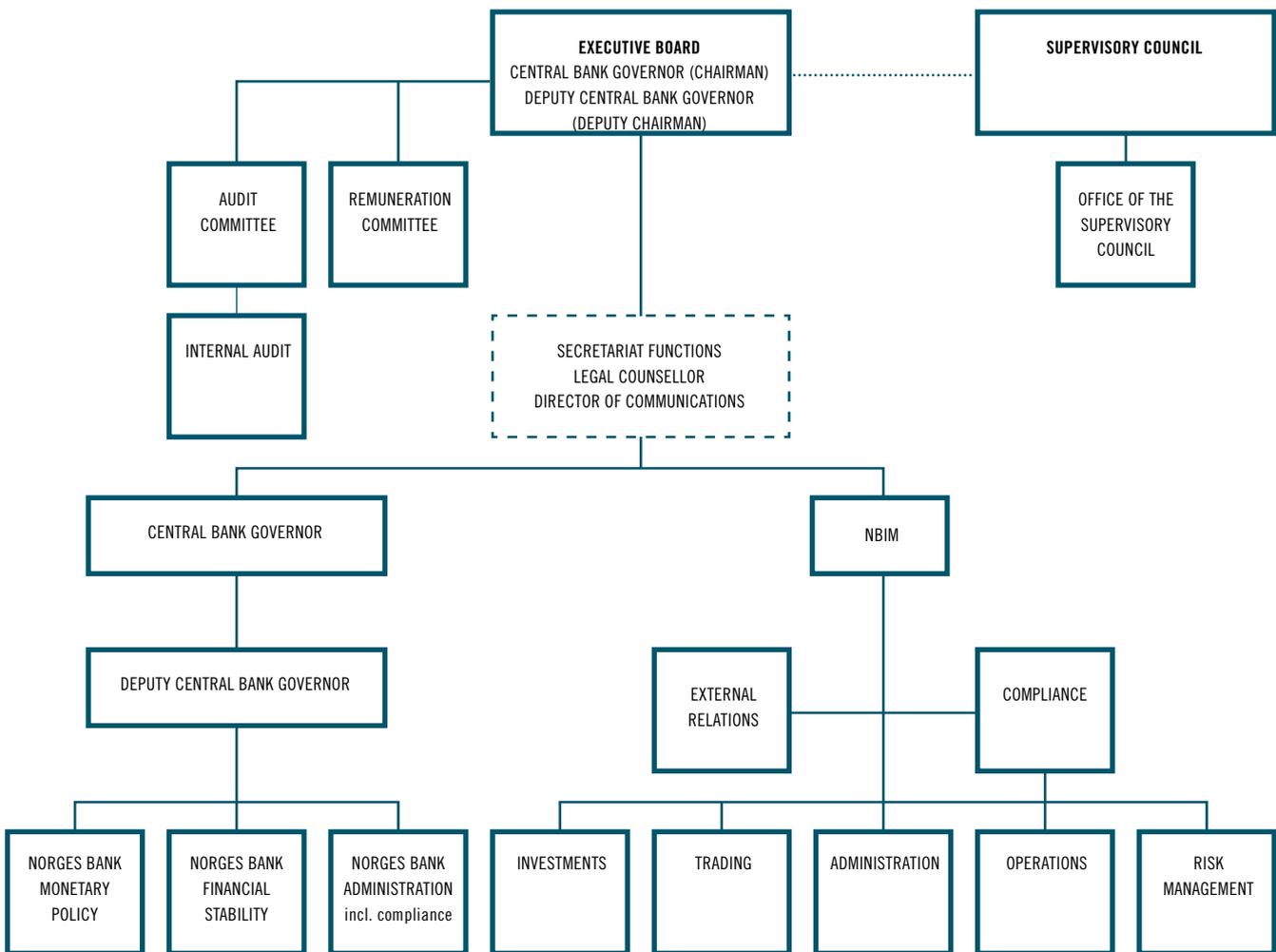
"Under this Act, executive and advisory authority is vested in the Executive Board. The Board is in charge of the Bank's operations and manages its resources. The Executive Board shall be responsible for the organisation of, and for establishing satisfactory frameworks, objectives and principles for, the sound operations of the Bank. The Executive Board shall ensure that the Bank's operations, including accounting and asset management, are under satisfactory governance and control. The Executive Board shall supervise the Bank's administration and other activities."

The Executive Board established an Audit Committee in 2006, which has been regulated since 2010⁵. The Committee is a preparatory and advisory body for the Executive Board for matters concerning the Board's oversight functions and responsibility for risk management and internal control. It reports to, and is solely responsible to, the Executive Board on the performance of its duties. The Committee consists of three of the Board's five external members.

The Executive Board established a Remuneration Committee in 2009 as a preparatory body for the Board responsible for providing independent treatment of matters concerning pay and remuneration arrangements at the Bank. It reports to, and is responsible solely to, the Executive Board on the performance of its duties. The Committee consists of two of the Board's five external members.

⁵ Regulation on Risk Management and Internal Control at Norges Bank, issued by the Ministry of Finance on 17 December 2009.

FIGURE 3. NORGES BANK'S ORGANISATION



The responsibilities of the Central Bank Governor are set out in the Norges Bank Act and authorisations from the Executive Board. Norges Bank is by law a single and separate legal entity. Its operations are organised into central banking activities and investment management activities (NBIM). The Executive Board has delegated the management of operational activities to the Central Bank Governor and the Chief Executive Officer of NBIM.

Central banking activities comprise the core areas of monetary policy and financial stability. The administration area is responsible for staff and support functions and for the systems and shared processes for risk management and control. Each area of the Bank is headed by an executive director who reports to the Central Bank Governor and Deputy Central Bank Governor.

A compliance unit was created in 2010 as the Central Bank Governor's advisory and control body for central banking activities. In organisational terms, it comes under Norges Bank Administration. The unit's role is to help ensure that the Bank does not incur public sanction, financial loss or loss of reputation due to failure to comply with laws, regulations and internal rules.

NBIM manages the Government Pension Fund Global and the bulk of Norges Bank's foreign exchange reserves. Until the end of 2010 NBIM also managed the Government Petroleum Insurance Fund, but it was wound up with effect from 31 December 2010 and its assets transferred to the Government Pension Fund Global. Norges Bank Monetary Policy manages the money market portfolio that also forms part of the Bank's foreign exchange reserves.

Besides the operational departments, NBIM has a risk management department which monitors market, credit and counterparty risk. NBIM also has a compliance department which monitors operational risk and compliance. NBIM has branch offices in London, New York, Shanghai and Singapore. The Chief Executive Officer of NBIM reports directly to the Executive Board and is subject to continuous oversight by the Central Bank Governor on behalf of the Board.

NORGES BANK'S MANAGEMENT AND CONTROL SYSTEM

Norges Bank has established a formalised governance model on the basis of the Norges Bank Act and other external laws and rules. The Bank's governance model is an important starting point for the Supervisory Council's supervision. A set of policy documents define the premises and limits for activities, roles and responsibilities. These documents are issued at various levels, vary in detail and may cover all or parts of the Bank's activities.

The Ministry of Finance has issued a Regulation on Risk Management and Internal Control at Norges Bank, which entered into force on 1 January 2010 and supplements the Norges Bank Act's rules on the Executive Board's and Central Bank Governor's responsibility for the management and control of Norges Bank's activities. The regulation largely corresponds to the financial supervisory authority Finanstilsynet's Regulations on Risk Management and Internal Control⁶, which Norges Bank previously used as a basis for its management and control system.

In accordance with the regulation, the Executive Board has introduced general principles and guidelines for risk management and internal control. Norges Bank is exposed primarily to market, credit, counterparty and foreign exchange risk. Developments, particularly in the management of the Government Pension Fund Global, are resulting in higher levels of operational and reputational risk.

⁶ Issued by Kredittilsynet (now Finanstilsynet) on 22 September 2008 pursuant to Act No. 1 of 7 December 1956 on the Supervision of Financial Institutions etc. (the Financial Supervision Act), last amended by the regulation of 18 December 2009.

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NORGES BANK

Innløsting	Value
	1000
	500
	200
	100
	50
	20
	10
	5
	2
	1

Norges Bank's risk management is integrated into its operational management, and importance is attached to risk management helping to strike a balance between goals, risks and control procedures for the Bank's key processes. An underlying framework and systems have been established in the organisation for the identification of significant risks, assessment of risk-reducing control measures and reporting. When entering into agreements on outsourcing services, the Bank insists on the right to assess and audit the supplier's risk management and internal control system.

The Executive Board has laid down principles for risk management and internal control, ethical rules for employees, principles and guidelines for security, contingency planning and crisis management, and principles and guidelines for whistle-blowing. The Board has also established a separate governance framework for NBIM, including a job description and investment mandate for the Chief Executive Officer of NBIM.

The Executive Board adopts three-yearly overall strategies for the Bank. These are operationalised through strategies and long-term action plans for each of the Bank's areas. The annual governance cycle is based on action plans and budgets, interim reports and annual reports.

Risk management and internal control are an integral part of Norges Bank's governance system and managerial responsibilities. The system is also followed up by the compliance functions in the central banking and investment management areas and by the internal audit unit. Regular reports are given to the Executive Board and the Supervisory Council in this area.

NORGES BANK'S INTERNAL AUDIT UNIT

The internal audit unit is an important resource for the Executive Board in the management and control of the Bank's activities. The unit is charged with helping Norges Bank to achieve its goals on behalf of the Executive Board. It is to ensure that adequate and effective management of significant risks is established and implemented, and that internal controls are appropriate and reassuring.

The director of the unit reports to the Executive Board via the Board's Audit Committee.

The Audit Committee considers the annual audit plan and all reports from the internal audit unit prior to their consideration by the Executive Board.



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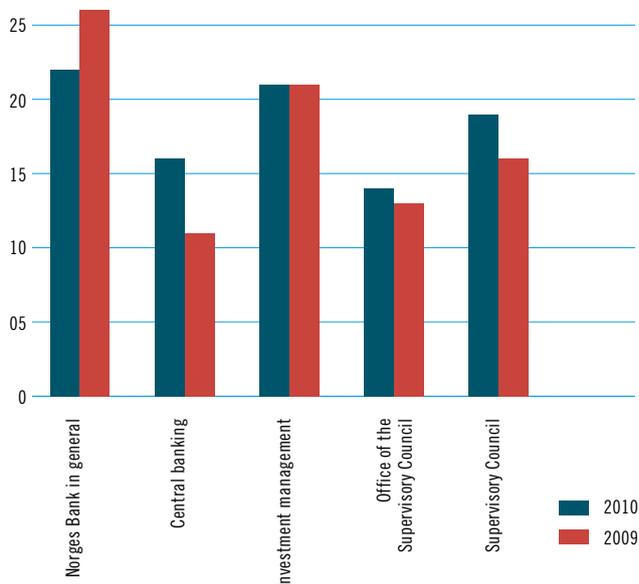
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6. THE SUPERVISORY COUNCIL'S ACTIVITIES AND USE OF RESOURCES IN 2010

The Supervisory Council held six meetings and considered 92 matters in 2010. The Permanent Committee held 11 meetings. The matters considered can be divided into those concerning the supervision of Norges Bank's core areas and administrative matters relating to the Office of the Supervisory Council and the Council itself. Figure 4 shows a breakdown of these matters.

FIGURE 4. BREAKDOWN OF MATTERS CONSIDERED BY THE SUPERVISORY COUNCIL IN 2010



In 2009 and 2010 the Supervisory Council and the Office of the Supervisory Council put a great deal of work into the establishment of a new audit and supervision system and the preparation of a new accounting framework for Norges Bank.

It has become a tradition for the Council to hold an annual study trip and seminar. In 2010 the seminar took place in London, with the main focus on investment management and changes in the regulation and supervision of global financial markets.

The Supervisory Council's use of resources in 2010 totalled NOK 32.6m. Table 2 breaks down these costs between the Council's own activities, the Office of the Supervisory Council and the external auditor.

TABLE 2. THE SUPERVISORY COUNCIL'S USE OF RESOURCES (NOK THOUSANDS)

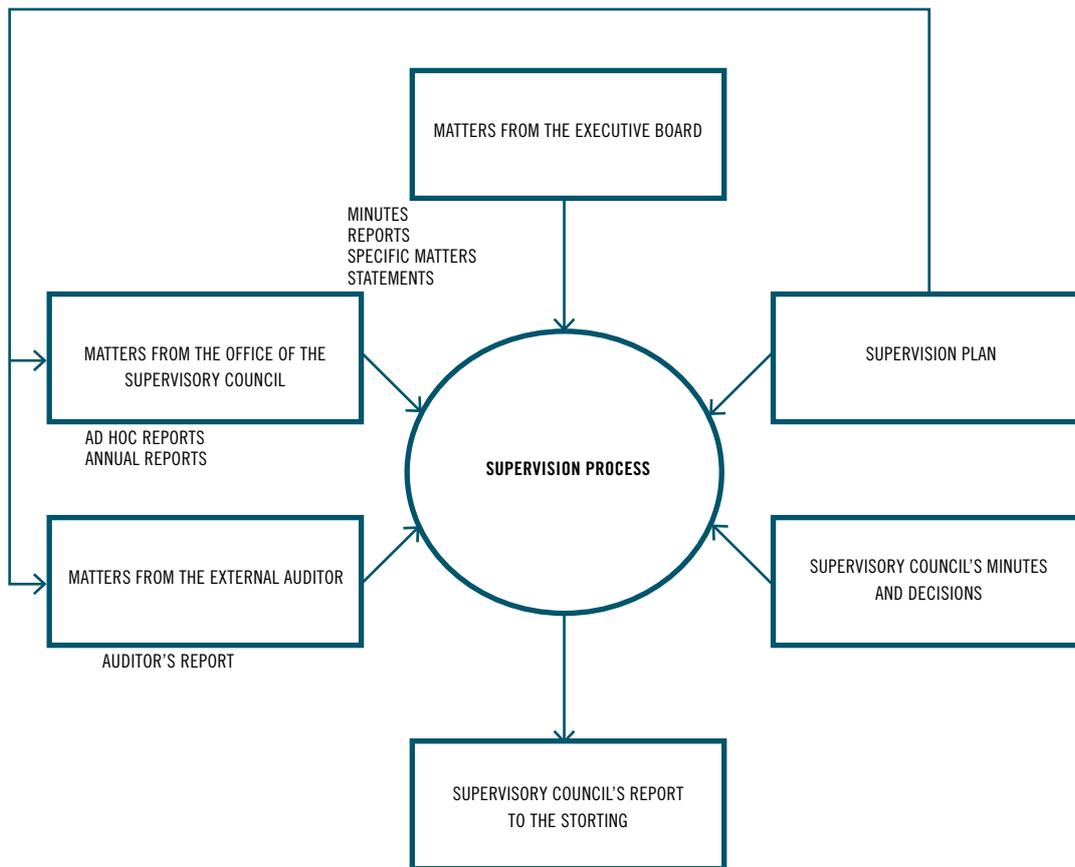
UNIT	2010	2009
SUPERVISORY COUNCIL	1936	1845
OFFICE OF THE SUPERVISORY COUNCIL (and former Central Bank Audit)	11220	10306
DELOITTE AS – assurance services	5000	3250
DELOITTE AS – financial auditing	14483	12387
TOTAL	32639	27788

The Office of the Supervisory Council had eight employees (7.5 full-time equivalents) at the end of the year. Costs payable to Deloitte AS by the Supervisory Council totalled NOK 19.5m in 2010. Assurance services relate entirely to investment management, while 80 per cent of the costs for financial auditing relate to investment management. Deloitte AS also supplied services costing NOK 2.1m directly to Norges Bank in connection with the implementation of the new accounting framework.

The chairman of the Supervisory Council receives an annual fee of NOK 43,000, the deputy chairman NOK 27,000 and the other full members NOK 21,000, while alternates receive an annual fee of NOK 3,500. Members of the Permanent Committee receive an additional annual fee of NOK 43,000. Total fees to members and alternates in 2010 came to NOK 623,000.

The Supervisory Council sets the salary of the director of the Office of the Supervisory Council, which was NOK 1,543,000 in 2010. The director recruits and sets the salaries of employees at the Office within limits laid down by the Council. In 2010 the Council approved a one-off payment of one month's salary to employees at the Office in connection with the change process carried out and the reorganisation of the audit and supervision system. Employees at the Office are members of Norges Bank's pension fund.

FIGURE 5. THE SUPERVISORY COUNCIL'S SUPERVISORY PROCESS



7. METHODOLOGICAL APPROACH TO SUPERVISORY WORK

The starting point for supervisory work is the Supervisory Council's supervision of the Executive Board. The focus is on whether the Executive Board has exercised satisfactory management and control of Norges Bank's administration and operations, and whether appropriate procedures have been established for compliance with legislation, agreements, decisions and other regulatory frameworks.

The Council's supervision is based on an assessment of risk and materiality. It entails considering a combination of minutes and matters from the Executive Board and matters from the Office of the Supervisory Council and the external auditor. The Council can request the provision of further documentation and written statements from the Board.

Figure 5 illustrates the Council's supervisory process.

The Council's chairman calls meetings as often as deemed necessary, or where requested by five or more of its members or by the Executive Board. The Council ordinarily meets five or six times a year. The Council reaches concrete decisions on matters arising, and the minutes of the meetings are sent to the Ministry of Finance and the Office of the Auditor General.

The Central Bank Governor and Deputy Central Bank Governor are to attend these meetings unless the Council decides otherwise or there is another valid reason. Other members of the Executive Board may also attend and speak unless the Council decides otherwise. The employee representatives on the Executive Board generally attend. The Central Bank Governor may elaborate on matters and answer questions during their consideration and can bring along experts where necessary.

The Supervisory Council arranges regular technical seminars as part of the general development of its expertise or to gain more in-depth knowledge of a specific area.

The Office of the Supervisory Council keeps constantly abreast of Norges Bank's activities, partly by reviewing policy documents, reports and case documents from meetings of the Executive Board. When relevant matters are considered, the director of the Office of the Supervisory Council may attend meetings of the Executive Board and the Audit Committee. The director attends meetings of the Permanent Committee and the Supervisory Council, and may make supplementary comments on matters being considered.

The Office of the Supervisory Council performs special supervisory and control procedures on selected themes in line with an annual supervision plan set by the Council. The plan is prioritised on the basis of risk and materiality considerations. Supervision and control procedures are performed as general document-based supervision or more extensive audit and assurance reviews. Supervision is normally based on the laws and rules for the Bank's activities and the Executive Board's management and control processes. The Office of the Supervisory Council summarises its work in an annual report to the Council. Major reviews are reported on separately.

The Council examines the external auditor's audit plan, statutory auditor's reports and other audit reports. The Office of the Supervisory Council monitors the external auditor's work during the year.

Altogether Norges Bank has an extensive supervision and control regime, especially when it comes to the management of the Government Pension Fund Global. In addition to ongoing supervision and audit work performed by the Office of the Supervisory Council and the external auditor, the Bank's internal audit unit carries out ongoing auditing activities. The Ministry of Finance may also have specific needs when following up Norges Bank's management of the Government Pension Fund Global. The Office of the Auditor General's audit of the central government accounts and scrutiny of the Ministry of Finance's exercise of powers in relation to the Government Pension Fund Global has also resulted in audit activities at Norges Bank.

The Supervisory Council has focused on helping build a complete and balanced control and supervision regime at Norges Bank, partly through appropriate dialogue and coordination between the Office of the Supervisory Council, Deloitte AS, the internal audit unit and the Office of the Auditor General when it comes to the Government Pension Fund Global. One goal is for each principal's legitimate needs to be addressed while attempting to build on one another's work.

There is regular contact between the Office of the Supervisory Council, the external auditor and the internal audit unit. The Office and the external auditor review the internal audit unit's reports and work, and assess whether this can be used in their supervisory work and financial auditing. The director of the Office participates in the consideration of the internal audit unit's reports by the Audit Committee. Collaboration with the Office of the Auditor General is presented in section 4 of this report.

In 2009 the Supervisory Council introduced a programme for the performance of independent assurance engagements by an external auditor. The programme covers assessments of various operational risk management issues in investment management. These are areas which the Ministry of Finance has also had a need to scrutinise, and there has been dialogue with the Ministry during the planning process. The decision on implementation is considered annually by the Supervisory Council as part of its approval of the supervision plan. This collaboration with the Ministry of Finance is based on Proposition No. 58 (2008-2009) to the Odelsting. The Council informed the Ministry about its planned programme in its letter of 17 September 2009.

The programme comprises six projects:

- Part 1: Organisation structure and management controls
- Part 2: Operational risk and internal control
- Part 3: Framework for assessment of counterparty risk
- Part 4: Monitoring external managers
- Part 5: Capital inflows and exposure to the chosen benchmark portfolio
- Part 6: Risk management in relation to active management

Parts 1, 2, 4 and 5 were carried out in 2009-2010 and are discussed in section 10 of this report. Reports on these reviews were submitted to the Ministry of Finance and the Office of the Auditor General after being considered by the Supervisory Council. The Ministry mentioned the programme in its report to the Storting on the management of the Government Pension Fund in 2009 (Report No. 10 (2009-2010)).

8. SUPERVISION OF THE EXECUTIVE BOARD'S MINUTES AND ITS MANAGEMENT AND CONTROL SYSTEM

REVIEW OF THE EXECUTIVE BOARD'S MINUTES

The Norges Bank Act requires the Supervisory Council to issue a statement on the minutes of Executive Board meetings. A review of the Board's minutes is a permanent item on the agenda at meetings of the Council. These minutes give the Council an overview of the Board's activities and an insight into the Board's discussions and decisions on specific matters. They also give the Council a basis for asking questions and obtaining statements from the Central Bank Governor on specific matters and the Board's treatment of these matters.

The Council had questions about specific items in the Board's minutes in 2010. Supplementary information was provided by the Governor. On the basis of questions and comments arising at meetings of the Council in 2010, the Governor also reported on the Board's practice for keeping minutes and formulating decisions.

The Council did not minute any remarks on the Executive Board's minutes in 2010.

SUPERVISION OF THE EXECUTIVE BOARD'S MANAGEMENT AND CONTROL SYSTEM

Reference should be made to section 5 of this report for a description of Norges Bank's organisation and its management and control system. In 2010 the Supervisory Council considered a number of matters as part of its supervision of the Executive Board's systematic work in this area.

These included:

- ~ Strategic plan for central banking activities 2011-2013
- ~ Strategic plan for NBIM 2011-2013
- ~ Governance model for central banking activities at Norges Bank
- ~ Principles for risk management at Norges Bank and principles for risk management at NBIM
- ~ The Executive Board's investment mandate and job description for the Chief Executive Officer of NBIM

- ~ Strategy and framework for the management of Norges Bank's foreign exchange reserves
- ~ Plans and budgets for Norges Bank for 2010 and 2011, including assessments of operational risk and action plans
- ~ Status of operational risk management, action plans and budgets as at 30 June 2010
- ~ Overall annual assessment of internal control and the risk situation in central banking
- ~ Annual review of operational risk management and internal control at NBIM

The Council received extensive documentation in relation to the above matters. Many of the matters were elaborated on further at its meetings with presentations and oral statements by the Central Bank Governor.

The Regulation on Risk Management and Internal Control at Norges Bank requires a general assessment of the risk situation to be submitted to the Executive Board at least once a year and forwarded to the Council. The Council is of the opinion that this is covered by the overall annual report for central banking and quarterly and annual reports for investment management.

The Council also dealt with matters raised by the Executive Board concerning the work of the internal audit unit in 2010. These matters comprised the Board's audit plan, 12 audit reports and the internal audit unit's annual report. It has become an established practice for the Council to receive an annual statement from the Audit Committee's chairman on the Committee's activities.

The Supervisory Council's supervision has provided documentation that the Executive Board implemented processes in 2010 to update the overall management and control system at Norges Bank. In addition, the Council has had it documented, through material from the Executive Board and statements from the Central Bank Governor, that the Board regularly follows up targets, action plans, internal control and the risk situation on the basis of this system.



9. SUPERVISION OF CENTRAL BANKING ACTIVITIES

GENERAL OVERSIGHT OF CENTRAL BANKING ACTIVITIES

The Supervisory Council considered various matters from the Executive Board in 2010 which gave the Council important updates on central banking activities and a sound basis for its supervision.

These included the following reports:

- ~ Annual and quarterly reports on the management of Norges Bank's money market portfolio
- ~ Semi-annual reports on financial stability
- ~ Semi-annual cashier's reports
- ~ Annual report on payment systems
- ~ Annual report on notes and coins
- ~ Annual report on Norges Bank's settlement system and collateral for banks' lending
- ~ Annual report and accounts for Norges Bank
- ~ Annual report and accounts for Norges Bank's pension fund

These reports were supplemented with statements and elaborations by the Central Bank Governor at meetings of the Council. Specific aspects of monetary policy were also presented.

Norges Bank's internal audit unit performed two audit projects for the Executive Board in the central banking area in 2010. Summaries of the reports were considered by the Supervisory Council.

On the basis of the supervision performed, the Council is of the opinion that the Executive Board exercised satisfactory management and control of central banking activities.

The Council's consideration of specific matters in this area is presented below.

SPECIFIC MATTERS

Norges Bank's role and responsibilities in work on financial stability

The Supervisory Council is kept informed about Norges Bank's analyses, assessments and actions in its work on promoting economic stability in Norway. This is achieved through reviews of the Executive Board's minutes and presentations by the Central Bank Governor on specific matters. The Council also receives the Bank's reports on financial stability.

The Council was informed about the recommendations for the bank crisis resolution system made by Norges Bank in its letter to the Ministry of Finance in connection with Financial Stability 2/2010.

Against the background of the global financial crisis, the Supervisory Council received a statement from the Executive Board in June 2010 on the work under way internationally on organising the supervision of banks, including the need to clarify the division of roles and responsibilities between the authorities concerned. The Council took note of this statement and will monitor the Board's further assessments of these issues.

In connection with its study trip to London in September 2010, the Council was informed by the Bank of England about developments internationally in the regulation and supervision of the banking and financial sector. There was a special report on the organisation of macro supervision under the central bank.

The Council has received statements that Norges Bank believes that experience from the financial crisis shows a need to strengthen the monitoring of the financial system as a whole. A series of measures are planned, including greater emphasis on macro supervision and monitoring systemic risk.

The Council can confirm that the Executive Board is focusing on further developing the supervision and monitoring of the financial system in Norway, including the Bank's role in developing systems and methods.

Notes and coins

Norges Bank is responsible for issuing notes and coins. Nokas AS supplies depot services for the Bank in five locations around Norway. Det Norske Myntverket AS handles the production of Norwegian circulation and commemorative coins under an agreement with the Bank. The Bank has also entered into agreements with two foreign banknote producers on the production of Norwegian banknotes.

The notes and coins area is generally given high priority by the Supervisory Council, due partly to the inherent risk of irregularities, reputational risk and the low tolerance for errors. The Office of the Supervisory Council reviewed selected parts of Norges Bank's management and control in this area in 2010.

The Office reviewed the processes for the production and purchase of Norwegian banknotes from external suppliers. The aim was to assess whether general requirements had been met and whether processes and follow-up procedures had been established in line with Norges Bank's management model. A supervision visit was made to one supplier in this context. The Office's report to the Supervisory Council in June 2010 drew favourable conclusions in terms of the measurement criteria for the review.

The Executive Board provided a written statement on the profitability of purchasing notes and coins abroad. This revealed satisfactory profitability, and the Council took note of this report.

The Council had no remarks concerning Norges Bank's processes and control procedures in the notes and coins area in 2010.

Security and contingency planning

Work on security and contingency planning is a priority area at Norges Bank. The consequences of any incidents can be serious. The Executive Board updated the principles for the management of security, contingency planning and crisis management at Norges Bank in 2010. These take account of, among other things, the requirements of the Security Act, Personal Data Act and Working Environment Act and new public guidelines and standards for security. The Supervisory Council has reviewed and taken note of these principles.

Norges Bank performs regular threat assessments of factors that could affect the Bank's security and interests nationally and internationally. These assessments are reported regularly to the Executive Board. The Supervisory Council was informed about these threat assessments and related measures and actions in 2010. At the Council's request, a special statement was produced on background checks for foreign employees and suppliers.

The supervision of this area in 2010 supports the Council's view that Norges Bank gives work on security and contingency planning high priority.

Government deposits at Norges Bank

Treasury deposits are held in sight deposit accounts at Norges Bank, and a group account system has been set up as part of the government's financial management. Central government deposits at Norges Bank totalled NOK 137bn at the end of 2010.

An agreement has been reached between the Ministry of Finance and the Bank on the operation and management of the government's accounts at the Bank. This work is to be performed in accordance with the Norges Bank Act, the rules for financial management in the central government sector and the guidelines for settlement accounts in the group account system at Norges Bank, among others.

The agreement requires an independent audit or control body to submit an annual assurance statement to the Ministry on the Bank's compliance with specific requirements in the agreement. Previously this role was performed by Central Bank Audit. With the understanding of the Ministry, the Office of the Supervisory Council submitted a statement to the Supervisory Council for 2010.

The Council has taken note of this statement, which was unqualified, and submitted it to the Ministry.

Administrative matters

Norges Bank has its own pension fund, set up to provide pensions for its members and their survivors. The Fund is an independent legal entity and produces its own accounts. Norges Bank and the pension fund have entered into an agreement on a pension scheme. The Executive Board has the authority to make changes to the scheme, but important matters are to be referred to the Supervisory Council and the pension fund's board before a decision is made.

New rules for the state retirement pension entered into force on 1 January 2011, and the necessary changes to the Bank's pension scheme were made on the same date. Proposed amendments to the pension agreement and the pension fund's articles of association were put before the Council in 2010.

The Supervisory Council had no special remarks concerning this matter. The Council can confirm that the Executive Board has made adjustments to Norges Bank's pension scheme in line with the new state pension arrangements.

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10. SUPERVISION OF INVESTMENT MANAGEMENT ACTIVITIES

GENERAL OVERSIGHT OF INVESTMENT MANAGEMENT ACTIVITIES

The Supervisory Council considered various matters from the Executive Board in 2010 material to the Council's being updated on investment management and the general supervision of these activities.

These included the following reports:

- ~ Annual and quarterly reports on the management of the Government Pension Fund Global
- ~ Annual and quarterly reports on the foreign exchange reserves
- ~ Annual and quarterly reports on the Government Petroleum Insurance Fund
- ~ Quarterly report on return and risk for the fourth quarter of 2010
- ~ Quarterly reports on operational risk management and internal control at NBIM
- ~ Quarterly reports on compliance at NBIM

The reports were supplemented where necessary with statements and elaborations by the Central Bank Governor at meetings of the Council.

Norges Bank's internal audit unit performed nine audit projects for the Executive Board in the investment management area in 2010. Summaries of these reports were considered by the Supervisory Council.

On the basis of the supervision performed, the Council is of the opinion that the Executive Board exercised satisfactory management and control of investment management activities.

The Council's consideration of specific matters in this area is presented below.

SPECIFIC MATTERS

Operational risk management

Norges Bank has a large and complex investment management operation, and there will always be a risk of operational errors and incidents. Operational errors could lead to direct financial losses or gains, and loss of reputation. In its supervision the Supervisory Council has focused on the Executive Board setting premises for and systematically following up operational risks and incidents.

The Council and the Office of the Supervisory Council have been regularly informed about developments in NBIM's organisation, framework and systems for the identification, management and reporting of operational risk.

In 2009 Deloitte AS carried out an assurance engagement on behalf of the Council to assess whether Norges Bank had designed and implemented its organisation structure and system for the management of operational risk in line with accepted practice and relevant standards. The review also included an assessment of whether the Bank had followed up the recommendations of the external report from a review of risk management in 2007. The assurance report concluded favourably for the most part in relation to the measurement criteria, with a few comments.

The report was made public when submitted to the Ministry of Finance in March 2010. The report is also mentioned by the Ministry in its report to the Storting on the management of the Government Pension Fund Global in 2009. In 2010 the Supervisory Council received confirmation that the Bank has followed up, or is in the process of following up, the comments made.

The Executive Board considers monthly and quarterly reports from NBIM on developments in the risk outlook and significant incidents. The quarterly reports are passed on to the Supervisory Council. This material also presents potential consequences and actions taken, and provides an overview of the status of the follow-up of audit and supervision reports.

Significant incidents in the management of the Government Pension Fund Global have also been included in the public quarterly reports from 2010 onwards. Detailed descriptions of operational risk management were also provided in the annual report for 2010. Key incidents from this reporting in 2010 were bank accounts that were not accounted for, failure to repay withholding taxes, and errors made when voting at general meetings.

The Supervisory Council has received a statement on the Executive Board's process for setting tolerance limits for operational risk at NBIM in 2010. The Board has determined that there must be less than a 20 per cent probability of operational risk factors resulting in gains and losses totalling NOK 500m or more in a 12-month period. This limit is to guide NBIM's limits for the level of internal control so that risks fall within the established tolerance. Norges Bank reports on this tolerance limit in its annual report on the management of the Government Pension Fund Global for 2010.

The Supervisory Council received documentation during the year that the Executive Board regularly follows up operational risk management in investment management activities. The Council also received independent confirmation that an organisation structure and system have been created in line with the Regulation on Risk Management and Internal Control at Norges Bank and generally accepted standards. The Council is positive about the Bank's increased openness in this area. It helps to give the public an insight into the Bank's investment management activities.

External management

NBIM uses external managers to manage parts of the portfolio. This is in keeping with the strategy adopted by the Executive Board and with the Ministry of Finance's guidelines for the Government Pension Fund Global. There were a total of 62 external mandates managed by 46 different organisations at the end of 2010, and external management accounted for about 10 per cent of the overall portfolio managed for the Fund. The Supervisory Council has received

updates and reports from the Executive Board about external management as part of its ordinary ongoing supervision of investment management. Norges Bank's annual report on the management of the Fund in 2010 provides a detailed account of external management.

In 2010 there was a sharp focus on Norges Bank's use of external managers and performance fees, partly in the light of the Office of the Auditor General's report on the annual financial audit and control for the budget year 2009 (Document No. 1 (2010-2011)).

Performance fees to external managers increased substantially in 2009 due to good results. The Council monitored this development through its consideration of the quarterly reports. Central Bank Audit and Deloitte AS carried out ordinary audit procedures on these fees as part of the audit of the annual accounts for 2009, which included visiting an external equity manager. The review of a selection of individual mandates revealed no breaches of applicable agreements, frameworks or control procedures.

Norges Bank's internal audit unit conducted a review of external management for the Executive Board in 2010. A summary of the report was considered by the Supervisory Council in September 2010.

The Supervisory Council engaged Deloitte AS to perform an independent assurance review of NBIM's system for risk management and control in relation to external managers during the year. The aim was to assess whether a system had been designed and implemented in accordance with accepted practice and relevant standards. The review covered the Bank's organisation and responsibilities, and the monitoring and control of risk and return in relation to externally managed mandates. The process for selecting and monitoring external managers was also considered.

The report concluded that the system for risk management and control of external managers has been designed and implemented in line with the measurement criteria. The report was presented to the Supervisory Council in March 2011 and made public in connection with its submission to the Ministry of Finance.

In addition the Office of the Supervisory Council conducted a review of a selection of agreements with external managers to assess specific elements of the mandate and fee structure. The review revealed that these agreements contained a performance fee with a ceiling or a fixed fee. Control procedures were also carried out to confirm that the portfolios are managed in Norges Bank's name and that the agreements can be terminated with immediate effect. The review also confirmed that a process is under way at NBIM to renew and update the fee structure.

The Standing Committee on Scrutiny and Constitutional Affairs' recommendation to the Storting on the Office of the Auditor General's report on the annual financial audit and control for the budget year 2009 (Recommendation 138 S (2010-2011)) was considered by the Storting on 7 December 2010. The recommendation states: "... *the Office of the Auditor General has criticised an agreement entered into by Norges Bank with one of its external managers on the grounds that it did not set a ceiling for performance fees and that this resulted in a fee of NOK 500m.*" *The Committee also writes: "... that a fee this size challenges the legitimacy of the fund's management" and "... is hard to see as compatible with a general perception of fairness.*"

In addition the Committee notes that "... *the Office of the Auditor General did not identify any breaches of rules or guidelines in this case. Rather it appears that the premise of the lion's share of excess return – when applying performance fees – has been exceeded by a clear margin.*"

The Supervisory Council understands the considerable attention given to the payment of fees to external managers in 2009. Fees of this magnitude seem high. In its supervision

the Supervisory Council considered the matter in relation to the return generated and compared this with the Ministry of Finance's guidelines for the management of the Government Pension Fund Global. On this basis the Council can confirm that the audit and supervisory reviews in 2009 and 2010 did not reveal any lapse or breach of the Ministry of Finance's rules or any errors in the reporting. The Council has received an independent assurance statement that Norges Bank has designed and implemented processes for the management and control of external managers in line with relevant standards.

Capital inflows into the Government Pension Fund Global and exposure to the benchmark portfolio

The management of the Government Pension Fund Global is measured against benchmark indices set by the Ministry of Finance. Capital is transferred to the Fund during the year for Norges Bank to invest efficiently in financial instruments. Inflows from the government totalled NOK 182bn in 2010.

The Supervisory Council engaged Deloitte AS to perform an independent assurance review of NBIM's system for risk management and control of capital inflows into the Fund and exposure to the chosen benchmark portfolio during the year. The aim of the review was to assess whether the Bank has designed and implemented a system in accordance with criteria established by accepted practice and relevant standards. In this context it was also considered whether the Bank has followed the recommendations of the external report from the review of risk management in 2007.

The review gave the Council independent confirmation that the risk management and control system in this area has been designed and implemented in accordance with the measurement criteria.

The report was submitted to the Council in March 2011 and was made public in connection with its submission to the Ministry of Finance.

Compliance with the Ministry of Finance's guidelines for the management of the Government Pension Fund Global

The risk management guidelines laid down by the Ministry of Finance for the Government Pension Fund Global are principles-based. The Executive Board has formulated internal guidelines based on relevant and recognised standards.

The Board considers the monthly and quarterly reports from NBIM on compliance with the Ministry's mandate for the management of the Fund. These reports also cover compliance with other external rules and internal limits set by the Board for the management of the Fund and the foreign exchange reserves. Breaches of the guidelines for the management of the Fund are reported to the Ministry of Finance. Significant operational incidents and any breaches of the Ministry's guidelines are mentioned in the public quarterly and annual reports for the Fund.

The Executive Board forwards the quarterly compliance reports to the Supervisory Council. These reports give the Council a good knowledge of any identified breaches of laws and rules, and of the Bank's response.

The Council has been informed of five minor breaches of the Ministry's guidelines in 2010. These are presented in NBIM's compliance reports considered by the Council.

The Office of the Supervisory Council holds regular meetings with NBIM's control and compliance function. At these meetings there is a review of the status of the follow-up of the guidelines from the Ministry and internal guidelines. Control procedures are carried out to assess the response to any breaches of the guidelines. Supplementary documentation is obtained when necessary.

The Supervisory Council received documentation in 2010 that the Executive Board and NBIM systematically assess the governance system for compliance with guidelines in the management of the Government Pension Fund Global. The Council also received documentation and statements that the Executive Board regularly follows up compliance with external and internal rules.

In 2009 the Supervisory Council submitted a consultation response on the Ministry of Finance's proposals for a new mandate for Norges Bank's management of the Government Pension Fund Global. In this response, the Council focused on the rules having to be clear and verifiable. Importance was also attached to the rules clarifying roles and responsibilities at different management levels, and to the rules being stable over time. The Council was kept abreast of the subsequent process and dialogue between the Ministry and the Bank through to the adoption of the regulation on 8 November 2010.

The regulation and new mandate entered into force on 1 January 2011. The Supervisory Council has been informed about the Executive Board's adjustments to the investment mandate and job description for the Chief Executive Officer of NBIM and the principles for risk management in line with the new mandate. The Board's follow-up of the implementation of these rules and compliance with them will be a priority for the Council in 2011.

Performance-based pay

Society generally has shown considerable interest in remuneration systems. In 2010 the Office of the Supervisory Council conducted a review with the aim of assessing the design and implementation of NBIM's system for performance-based pay and the Executive Board's oversight of this area. Assessments were made in relation to the general governance principles in the Norges Bank Act, the Regulation on Risk Management and Internal Control at Norges Bank, and the benchmark that the Bank has chosen to measure itself against.

The Supervisory Council considered the report from this review in March 2011. In relation to the measurement criteria, the report gave a positive assessment of the design and oversight of the system for performance-based pay by the Executive Board and NBIM.

On 21 December 2010 the Ministry of Finance introduced a change to the new mandate for the management of the Government Pension Fund Global, inserting a requirement that the Executive Board is to set guidelines and limits for a remuneration system. The guidelines are to be based on new rules from the Ministry for remuneration schemes in the financial industry. The Supervisory Council has been informed that the Executive Board has initiated a process to formulate new guidelines and limits for the remuneration scheme at NBIM in line with the new rules. This process will be closely monitored by the Council in 2011.

Investments in real estate

In March 2010 Norges Bank was awarded a mandate to gradually invest up to 5 per cent of the Government Pension Fund Global's portfolio in real estate outside Norway through a corresponding reduction in its investments in fixed-income securities. The Supervisory Council has received a written statement from the Executive Board on changes to the mandate for the Chief Executive Officer of NBIM and to the principles for risk management in order to comply with the mandate from the Ministry of Finance.

At meetings in 2010 the Council was updated regularly on the status of the introduction of these activities, including in connection with the consideration of the Bank's budget for 2011. Real estate investments were also one of the topics at the Council's meetings in London in September 2010. In addition the Council was kept abreast of the process of entering into an agreement on investing in The Crown Estate's portfolio of properties on Regent Street in London.

On behalf of the Executive Board, Norges Bank's internal audit unit conducted a review of NBIM's preparation of processes for real estate investments. A summary of the report was considered by the Council.

The Office of the Supervisory Council was given detailed information on the processes for real estate investments during the course of 2010. The focus was mainly on the control system for foreign subsidiaries and corporate structures established in connection with these investments. Deloitte AS has been engaged by the Bank to assess accounting issues.

The Supervisory Council received provisional information on regulatory conditions, general plans and issues relating to real estate investments in 2010. The Council also received documentation and statements confirming that the Bank has made thorough preparations in this area. Real estate investments will be a priority area in the Council's supervision in 2011.

11. WORK ON NORGES BANK'S BUDGET AND ACCOUNTS

THE BUDGETING AND ACCOUNTING PROCESS

In accordance with the Norges Bank Act, each year the Executive Board prepares a proposed budget for Norges Bank for the coming year. This budget is approved by the Supervisory Council and communicated to the Ministry of Finance. The Council may issue special authorisations or additional allocations over and above the budget adopted.

Each year the Executive Board produces an annual report and annual accounts. The annual accounts are adopted by the Supervisory Council. The annual report, the audited annual accounts, the auditor's report and the Council's decision to adopt the accounts are sent to the Ministry of Finance for submission to the King in Council and communication to the Storting.

The Supervisory Council has approved the Bank's budget rules and requirements for internal financial reporting in relation to the budget. The Executive Board has issued supplementary rules. The Council has specified in its rules of procedure that budgetary responsibility also includes supervision of the Board's management and control of the Bank's use of resources, and that the use of resources at the Bank must be responsible and cost-effective.

The Board's proposed budget is supported with risk assessments and action plans. The budget for central banking activities is largely a fixed appropriation budget. Expenditure for ordinary operations and the number of full-time equivalent employees is granted collectively for the Bank's areas. Investments are approved individually.

Operating expenses for investment management are budgeted net as a provisional appropriation. Provisional appropriations are based on forecasts and can, where necessary, be exceeded. The budget reflects the uncertainty associated with these activities, returns and capital inflows into the Government Pension Fund Global. Under the management agreement with the Ministry of Finance, Norges Bank has received an annual fee corresponding to the Bank's direct and

indirect costs for managing the Fund within an upper limit of 0.1 per cent (10 basis points) of average assets under management. Performance-based fees are also covered.

The Supervisory Council monitors the annual use of resources through the Executive Board's presentation of semi-annual accounts and annual management accounts. The Office of the Supervisory Council assists in the Council's consideration, reviewing and gathering supplementary information.

DECISION ON BUDGET FOR 2010 AND BUDGET FOLLOW-UP

The Supervisory Council approved Norges Bank's budget for 2010 in December 2009 without comment.

The use of resources in 2010 has been followed up by the Council by considering the semi-annual report in September and the management accounts for 2010 in March 2011. The management accounts showed that the use of resources was within the approved budget for both central banking and investment management. The Council had no remarks on the management accounts for 2010.

Norges Bank's internal audit unit conducted a review of cost control processes at NBIM in 2010 on behalf of the Executive Board. A summary of the report was considered by the Supervisory Council.

NEW RULES FOR NORGES BANK'S ANNUAL ACCOUNTS

Until 2010 Norges Bank's accounts were prepared in accordance with accounting policies determined by the Supervisory Council. The Council attached importance to these policies complying with the Accounting Act and generally accepted accounting principles. The Bank's financial reporting has undergone significant changes in recent years, particularly when it comes to the reporting on the Government Pension Fund Global as an integral part of the Bank's accounts.

Changes to the Norges Bank Act in 2009 required the Bank to prepare accounts in accordance with the Accounting Act and keep records in accordance with the Bookkeeping Act. In addition, the Ministry of Finance issued a Regulation on the Annual Accounts etc. of Norges Bank (the Annual Accounts Regulation) effective from the 2011 financial year. This provides supplementary rules on the preparation of the annual accounts and annual report in line with the rules in the Accounting Act for large enterprises on the basis of International Financial Reporting Standards. The regulation also governs the established practice of supplementary financial reporting for the Government Pension Fund Global in a note to Norges Bank's annual accounts. This note is reproduced in the annual report on the management of the Government Pension Fund Global.

The Supervisory Council submitted consultation responses on the proposed legislation in 2009 and the proposed regulations in 2010.

Norges Bank began adjusting to the new rules in 2010 with support from Deloitte AS. The Council will oversee this work in 2011.

ANNUAL ACCOUNTS FOR 2010

Norges Bank's annual report and annual accounts for 2010 and the auditor's report from Deloitte AS were considered at the Supervisory Council's meeting of 17 March 2011. The following decision was passed:

- ~ *The Supervisory Council takes note of the annual report of the Executive Board for 2010.*
- ~ *The Supervisory Council takes note of the auditor's report for Norges Bank for 2010.*
- ~ *The Supervisory Council adopts Norges Bank's annual accounts for 2010 with the following transfers and allocations:*
 - ~ *In accordance with a statement from the Ministry of Finance, as a result of the impairment of previously revalued assets, the sum of NOK 37m is to be transferred from "Other capital" to profit for the year.*

~ In accordance with the guidelines, the profit after other allocations of NOK 12 686m is to be transferred to the Adjustment Fund.

Norges Bank's annual accounts for 2010 are the first to have been audited entirely by the appointed external auditor. In previous years the accounts were audited by Central Bank Audit. The audit of the financial reporting for the Government Pension Fund Global for 2007, 2008 and 2009 was performed jointly with Deloitte AS.

Besides its auditor's report on Norges Bank's annual accounts, Deloitte AS issued a separate auditor's report in the annual report on the management of the Government Pension Fund Global. This form of reporting by the external auditor is in response to the Annual Accounts Regulation for Norges Bank and the new mandate for the management of the Government Pension Fund Global. Both reports were unqualified.

There was regular contact between the Office of the Supervisory Council and Deloitte AS during the year. In connection with the consideration of the annual accounts and the auditor's report, the Supervisory Council also receives information from the auditor on significant matters relating to the year's audit. The report from Central Bank Audit and Deloitte AS following the audit of the 2009 accounts was considered by the Council in May 2010. The Council has received confirmation that the Bank has followed up the comments in the report for 2009. The Council will consider the report from Deloitte AS for 2010 at a later date.

INTERIM REPORTING

Norges Bank prepares quarterly accounts for the Government Pension Fund Global and the foreign exchange reserves, which are submitted to the Supervisory Council. The quarterly reports for the Fund are reviewed by Deloitte AS, which issues a statement in accordance with the standard for review engagements. The review reports issued in 2010 were unqualified and were submitted to the Ministry of Finance as agreed. From 2011 the external auditor will submit its reports

to the Supervisory Council in line with the Annual Accounts Regulation.

CONVERSION OF NORGES BANK'S PREMISES

The Executive Board has prepared a final report on the conversion of premises for rental to the financial supervisory authority Finanstilsynet. The report was considered by the Supervisory Council in February 2011. The project has been allocated a total of NOK 460m by the Council, including NOK 68m for the conversion of other premises. The conversion project has resulted in substantially higher overall costs and weaker profitability than originally assumed when the project began.

Norges Bank began assessing the conversion of premises for rental in 2002 in the light of the decision to close the Bank's printing works and free up large areas. The conversion project was originally presented to the Supervisory Council as a marginal financial project with uncertainty as to both expenses and revenue. The Executive Board also attached importance in its assessments to the potential risk to Norges Bank's reputation of leaving large areas unused. The Board presented an investment proposal to the Council of NOK 293m which was approved by the Council in connection with the ordinary budget process for 2006.

The same year Norges Bank signed an agreement with Finanstilsynet on a future lease. One key element in these assessments was that Finanstilsynet was considered an attractive tenant, partly in view of security considerations. At this time the rental market featured a rich supply of premises at low rents. The lease was negotiated on the basis of available calculations and appropriations and with expectations of a modest but positive future return.

Based on an agreement dating from 1990, Norges Bank hired Statsbygg as project manager from 2006. The project was carried out during a period of great pressure on the market and high prices in the construction sector. The Supervisory Council was kept abreast of developments during the project

period and of significant uncertainties, new economic realities and the Executive Board's deliberations. On the basis of a balanced assessment, the Council approved the continuation of the project and approved the Executive Board's proposal for further allocations in 2006 and 2007 totalling NOK 167m.

The actual building work began in September 2007 and was ready for handover in December 2009. The project was presented in the annual accounts during this period. The final construction cost for the rental area in the final report was NOK 392m. Based on new calculations, the value of the rental areas was written down by NOK 80m in the annual accounts for 2009.

The Supervisory Council can confirm that there was a significant increase in construction costs relative to the original budget. With reference to the account above and a review of the Council's previous consideration of this matter, the Council took note of the Executive Board's final report at its meeting on 10 February 2011.

MANAGEMENT OF FUTURE CONVERSION PROJECTS

In connection with the Supervisory Council's consideration of Norges Bank's budget for 2011, and based on experience from the completed conversion project, the Executive Board was asked for a report on the implementation of future conversion projects. The Board presented written information on the management of conversion projects to the Council in February this year. It outlines a model for organisation, project management and reporting to governing bodies. Importance is attached to maintaining the Bank's security standards.

The Supervisory Council took note of the Bank's information on the management of future conversion projects. The Council will consider any future conversion projects on the basis of the Board's management model.



ERICUS AUGUSTANUS
B. 1844
D. 1924

ERICUS AUGUSTANUS
B. 1844
D. 1924

BORGMESTER, ERICUS AUGUSTANUS
B. 1844
D. 1924
REP. SHAPETE COMPANY
1868-1888

12. ASSESSMENT OF THE EXECUTIVE BOARD'S MANAGEMENT AND CONTROL

Norges Bank's operations, organisation and management system are presented in section 5 above.

The Supervisory Council's review of the Executive Board's minutes and its management and control system for Norges Bank are presented in section 8. The supervision of central banking activities is accounted for in section 9, and investment management activities in section 10. The Council's work in relation to the Executive Board's budget and accounting process is described in section 11.

Reference is made to these sections for the Council's assessments of the individual areas for supervision and matters reported on separately.

The Council has received all of the information it has asked for.

On the basis of its supervision and the work of the Office of the Supervisory Council and the external auditor, the Council is of the opinion that the Executive Board exercised satisfactory management and control of Norges Bank's operations in 2010 in accordance with the Norges Bank Act, the guidelines for the management of the Government Pension Fund Global and the Regulations on Risk Management and Internal Control at Norges Bank in 2010.

The Supervisory Council has not identified circumstances in its supervision of Norges Bank's activities and compliance with the rules for its activities that give grounds for any particular remarks under the Norges Bank Act.

Debet		Kredit		1898	
	285000	525000	10000	26	53 Kauf
	60000			27	do
	25000			28	Ved do
	10000				
		10000		11	53 Kauf
		10000		14	do
		12000		15	do
		10000		17	do
		10000		18	do
		10000		22	Ved do
				23	do
				24	do
	5000			27	53 Kauf
	10000				do
		10000			
		20000			
		10000			
		10000			
		415000	615000		
		30000			
		10000	10000		
Kauf		10000			
do		5000	5000		
do		20000	10000		
do		10000			
do		10000			
do		25000	640000		
do		535000			
do		10000			
do		15000	80000		
do		10000	10000		
do			10000		
do			660000		
do		570000			



19
10
19 53

13. PRIORITIES FOR FUTURE SUPERVISORY WORK

The Supervisory Council has approved a supervision plan for 2011 setting out the Council's overall supervision and control tasks. The plan reflects the Council's assessment of risk and materiality, and the results of previous years' supervisory work. It also builds on the strategies and action plans for the Council and the Office of the Supervisory Council for the period 2010-2012 approved by the Council in connection with the establishment of the new audit and supervision system.

The risk assessments are performed in order to be able to prioritise the most important factors or challenges in the Bank's areas of operation that are significant for the Council's supervision.

The Council will prioritise supervision of the Executive Board's processes for establishing, updating and following up compliance with the regulatory framework in significant risk areas. Special focus areas will include operational risk management, compliance with laws and rules, financial management, transparent external reporting and other matters that may be significant for the Bank's operations and reputation.

The Council will closely monitor developments in Norges Bank's organisation, significant activities, results, the threat and risk outlook, and incidents.

The supervision of investment management will continue to have high priority. Special focus areas in 2011 will include the Executive Board's follow-up of the new mandate for the management of the Government Pension Fund Global, the management of counterparty risk and real estate investments. The guidelines for the management and control of Norges Bank's foreign exchange reserves will also be reviewed.

2011 will bring a focus on a comprehensive and balanced control and supervision regime at Norges Bank and appropriate forms of collaboration between the Office of the Supervisory Council, the external auditor and the internal audit unit. In this context, the Supervisory Council will follow up the established principles for collaboration with the Office of the Auditor General in relation to the Government Pension Fund Global.

The Council will continue its work on the development and organisation of its own supervisory activities.

APPENDIX I: MEMBERS AND ALTERNATE MEMBERS OF NORGES BANK'S SUPERVISORY COUNCIL 2010-2011

SUPERVISORY COUNCIL

Reidar Sandal, 2010-2013 (chairman 2010-2011)
Alternate: Ola Røtvei, 2010-2013

Frank Sve, 2010-2013 (deputy chairman 2010-2011)
Alternate: Tone T. Johansen, 2010-2013

Terje Ohnstad, 2008-2011
Alternate: Anne Grethe Kvernød, 2008-2011

Eva Karin Gråberg, 2008-2011
Alternate: Jan Elvheim, 2008-2011

Tom Thoresen, 2008-2011
Alternate: Hans Kolstad, 2008-2011

Runbjørg Bremset Hansen, 2008-2011
Alternate: Camilla Bakken Øvald, 2008-2011

Kåre Harila, 2008-2011
Alternate: Liv Sandven, 2008-2011

Tormod Andreassen, 2008-2011
Alternate: André Støylen, 2010-2011

Gunvor Ulstein, 2008-2011
Alternate: Beate Bø Nilsen, 2008-2011

Morten Lund, 2010-2011
Alternate: Torunn Hovde Kaasa, 2008-2011

Synnøve Søndergaard, 2010-2013
Alternate: Britt Hildeng, 2010-2013

Reidar Åsgård, 2010-2013
Alternate: Kari-Anne Opsal, 2010-2013

Erland Vestli, 2010-2013
Alternate: Jan Blomseth 2010-2013

Marianne Lie, 2010-2013
Alternate: Lars Gjedebo, 2010-2013

Monica Salthella, 2010-2013
Alternate: Lars Haakon Søråas, 2010-2013

PERMANENT COMMITTEE

Reidar Sandal (chairman)
Alternate: Eva Karin Gråberg

Frank Sve (deputy chairman)
Alternate: Erland Vestli

Runbjørg Bremset Hansen
Alternate: Reidar Åsgård

Tom Thoresen
Alternate: Synnøve Søndergaard

Monica Salthella
Alternate: Tormod Andreassen

APPENDIX 2: GUIDELINES FOR THE EXCHANGE OF INFORMATION AND COORDINATION OF AUDITING AND SUPERVISION BETWEEN THE OFFICE OF THE AUDITOR GENERAL AND NORGES BANK'S SUPERVISORY COUNCIL IN RELATION TO THE GOVERNMENT PENSION FUND GLOBAL

1. Background

The Ministry of Finance invests the Government Pension Fund Global as a krone deposit at Norges Bank pursuant to the Government Pension Fund Act and the Storting's decisions and requirements. The Bank is to manage the deposit on the basis of a mandate issued by the Ministry.

The duties of the Office of the Auditor General, the Supervisory Council, the Office of the Supervisory Council and the external auditor (the control bodies) are established by the Auditor General Act, the Norges Bank Act and the Auditors Act and associated instructions and regulations, and the legislation and rules on the management of the Government Pension Fund Global.

2. Aim

The control bodies' duties may result in overlapping activities. These guidelines are to ensure appropriate exchange of information which meets each body's need for information and coordination and contributes to comprehensive and efficient audit, control and supervisory coverage.

3. Key principles

There is to be mutual openness in communication between the control bodies on matters of material importance for audit, control and supervisory work. This includes information on the control bodies' plans, audits performed and the creation of a structure for the exchange of information on ongoing work during the year.

The control bodies are to endeavour to coordinate their schedules and build on one another's work where appropriate. Unnecessary doubling-up should be avoided.

The Office of the Supervisory Council is to help establish appropriate dialogue between the Office of the Auditor General, the external auditor and the Bank, and ensure that the Office of the Auditor General's access rights are upheld.

The exchange of confidential information is to be based on trust and due care in following up and reporting.

The control bodies are to endeavour, within the bounds of applicable laws and rules, to find appropriate procedures for informing one another about matters that may be significant for their respective areas of responsibility prior to external disclosure.

4. Evaluation

The Supervisory Council is to set up an annual meeting between the Office of the Auditor General and the Supervisory Council for the exchange of experience and evaluation of these guidelines.

Oslo, 1 December 2010

Jørgen Kosmo
Auditor General

Reidar Sandal
*Chairman of Norges
Bank's Supervisory
Council*

Chairman of Norges Bank's
Supervisory Council

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