Presented to Parliament pursuant to Section 21(1) of the National Loans Act 1968

National Loans Fund Account 2009-2010

LONDON: The Stationery Office
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Contents

Foreword

Background to the National Loans Fund

The National Loans Fund (NLF) was established on 1 April 1968 by the National Loans Act 1968 to account for government borrowing and lending, which were until then accounted for as part of the Consolidated Fund (CF). The CF was first set up in 1787 as 'one fund into which shall flow every stream of public revenue and from which shall come the supply for every service'. The NLF was setup in order to separate government revenue and expenditure on the one hand and government borrowing and lending on the other. The accounts for the CF and NLF are now published separately.

Both the CF and NLF are administered by the Treasury, with the bank accounts maintained at the Bank of England. The CF can therefore be regarded as central government's current account, whereas the NLF can be regarded as central government's main borrowing and lending account. Most of the NLF's borrowing needs are now met indirectly through borrowing on its behalf by the Debt Management Office (DMO) and National Savings and Investments (NS&I).

The DMO was established as an executive agency of the Treasury on 1 April 1998. Its aim is 'to carry out the Government's debt management policy of minimising financing costs over the longer term, taking account of risk, and to manage the aggregate cash needs of the Exchequer in the most cost-effective way'. Its operations are managed through the Debt Management Account (DMA), which is a bank account at the Bank of England, linked closely with the NLF as described below. As the Government's debt manager, the DMO has a key role in the issue of gilt-edged securities on behalf of the Treasury. Gilt-edged securities, or gilts, are UK Government sterling-denominated listed bonds. There are two main types: conventional (i.e. fixed rate) gilts and index-linked gilts, on which the return is linked to movements in the Retail Price Index. They are issued from the NLF, sold initially to the DMA and then sold from the DMA by the DMO to the market. In addition, the DMO issues Treasury Bills from the DMA and undertakes other money market operations to meet the Government's daily cash requirements. Further details on these operations can be found in the Debt and Reserves Management Report 2010-11 published by the Treasury in April 2010 (ISBN: 978-1-84532-697-5).

The Exchange Equalisation Account (EEA) was established in 1932 to provide a fund that could be used, when necessary, to regulate the exchange value of sterling. It holds the UK's reserves of gold, foreign currency assets and International Monetary Fund (IMF) Special Drawing Rights. Combined with the UK's Reserve Tranche Position (RTP) with the IMF, these assets comprise the UK's official holdings of international reserves ('the reserves'). The RTP is an asset of the NLF. The Bank of England acts as the Treasury's agent in the day-to-day management of the EEA. It 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. If foreign currency debt is issued, it is issued by the NLF under the National Loans Act 1968, since it is that Act (rather than the Exchange Equalisation Act 1979) which provides the powers for the government to issue foreign currency securities. The foreign currency raised by issuing foreign currency debt is transferred from the NLF to the EEA in exchange for sterling. The Bank manages the foreign currency assets and liabilities associated with the official 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 risk exposures therein, to be managed collectively in an efficient way. There were no foreign currency liabilities of the NLF at the year end (31 March 2009; nil).

National Loans Fund activities

The NLF's main role is to meet the finance needs of the Consolidated Fund to the extent that taxation and other receipts are insufficient to meet the CF's outgoings. To this end the NLF undertakes borrowing and uses the proceeds to meet any deficits on the CF; conversely, any net surpluses on the CF are passed to the NLF to reduce the latter's need to borrow or to increase the amount that it can lend. The NLF finishes every day with a nil balance on its bank account because any cash surpluses or deficits are offset by transfers to or from the DMA.

The NLF's borrowing operations include the temporary borrowing of balances in various government bank accounts that are surplus to immediate requirements. Such borrowing minimises the amount that the NLF needs to borrow from other sources. Where the money borrowed in this way already counts as Exchequer money, interest is not paid. For the rest of its borrowing, however, the NLF normally has to pay interest and finance repayments when required. If the NLF's interest income is less than the interest it pays on its borrowings, which it generally is, the shortfall is met by a transfer from the CF.

The NLF provides finance for both the DMA and the EEA as required. It also makes loans to various statutory public sector bodies and provides the finance needed by the Public Works Loan Board (PWLB) for its loans to prescribed bodies, mainly Local Authorities. The profits of the Issue Department of the Bank of England are also paid to the NLF. NS&I's savings products, other than the Ordinary Account, are liabilities of the NLF. In year surpluses and deficits of the DMA and the EEA are income and expenditure of the NLF respectively, and the net assets of the DMA and the EEA are assets of the NLF. The Capital Contribution Reserve of the EEA is periodically reduced, 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.

By virtue of section 19(1) of the National Loans Act 1968, the net liabilities of the NLF are a liability of the CF.

The impact of events in the financial sector

The NLF does not engage in transactions with commercial banks and so has not been directly exposed to events in the financial sector such as increases in credit risk or decreases in the value of financial sector assets. However, the NLF's accounts have been greatly impacted by the Special Liquidity Scheme. This was launched by the Bank of England on 21 April 2008 to allow banks to swap, for up to three years, their high quality mortgage-backed and other securities for Treasury Bills. Treasury Bills for this purpose are issued with a maturity of nine months by the NLF and sold to the DMA which makes them available to be borrowed by the Bank of England. The drawdown period for the Special Liquidity Scheme closed on 30 January 2009. Although the drawdown window has now closed the scheme will remain in place for three years from 21 April 2008, thereby providing participating institutions with continuing liquidity support and certainty. Additional Bills have been created to be held by the DMA to be available to replace the maturing Bills. The Bank of England pays stock lending fees to the DMA for the loan of Treasury Bills under the Special Liquidity Scheme. A portion of these fees is payable to the NLF. More details of the scheme are available from the Bank of England's website. The main impacts on the accounts are described in the Summary of Outturn for 2009-2010 section, below.

In 2008-2009, £47.75 billion of gilts were created by the NLF and sold to the DMA in connection with the Bank of England's Discount Window Facility (DWF). The purpose of the DWF is to provide liquidity insurance to the banking system. More details of this scheme are available on the Bank of England's website. As the DMA had sufficient stock of gilts, no new gilts were sold to it by the NLF in 2009-2010.

HM Treasury's net cash usage for the year was £33.6 billion. This extra funding was due to a number of futher financial sector interventions in 2009-2010, which were provided by the CF using funds from the NLF. Gilts issuance increased as a result of this. The impact on the accounts is described in the Summary of Outturn for 2009-2010. Details of how HM Treasury used the cash issued to it from the CF can be found in HM Treasury's 2009-2010 Annual Report and Resource Accounts.

NS&I's 2009-2010 remit was to broadly maintain the existing level of stock as at the end of 2008-2009. NS&I's net contribution to financing, published in 2009's Budget was set within a range of +/- £2.0 billion. During the year, £1.6 billion was received which falls within this range.

During 2008-2009, the Asset Purchase Facility was set up at the Bank of England in order to improve liquidity in credit markets by purchasing securities (a process known as 'quantative easing'). As at March 2010, on an amortised cost basis, £184 billion of gilts from the NLF were held by the Bank of England for quantative easing, compared to £13 billion at March 2009. More information on the scheme can be found on the Bank of England's website.

The NLF has not been directly impacted by any other government schemes to provide financial assistance directly to the banking sector.

International Financial Reporting Standards

The financial statements for the year ending 31 March 2010 are the first National Loans Fund financial statements to be prepared in accordance with International Financial Reporting Standards (IFRS). Prior financial statements up to 31 March 2009 have been prepared in accordance with UK Generally Accepted Accounting Practice (UK GAAP). The transition to IFRS has not affected the accounting policies, Operating Cost Statement, Statement of Financial Position or Statement of Cash Flows of the National Loans Fund. In accordance with IAS 1, Presentation of Financial Statements, three statements of financial position and related notes have been presented as accounting policies have been applied retrospectively.

Summary of Outturn for 2009-2010

The net operating cost of the Fund increased by £15.4 billion from £14.6 billion in 2008-2009 to £30.0 billion in 2009-2010. This was mainly due to £3.3 billion lower income from NLF's lending operations for the year and considerably lower overall profits of other entities; surplus of the DMA decreased by £7.7 billion and EEA's net income has fallen by £4.4 billion. These were a result of fair value losses in the DMA's holdings of gilts and Treasury Bills, and fair value losses on financial instruments within the EEA coupled with a smaller gain on gold holdings in comparison to 2008-2009.

Gilts and Treasury Bills

Total gross liabilities increased by £146.7 billion from £1,125.1 billion to £1,271.8 billion. The main factor behind this rise was an increase of £201.8 billion in the Fund's liability in respect of gilt-edged stock and a small increase in NS&I products of £1.6 billion. During the year, gilts with a nominal value of £Nil (2008-2009: £55.6 billion) were created by the NLF and sold to the DMA for use as collateral in its Exchequer cash management operations. Additionally, gilts with a nominal value of £Nil (2008-2009: £47.75 billion) were created by the NLF and sold to the DMA in connection with the Bank of England's Discount Window Facility (DWF). These increases are offset by a £28.4 billion fall in Treasury Bills in respect of the Special Liquidity Scheme, a fall in Other Debt of £27.5 bilion and a fall of £0.8 billion for liabilities due to the IMF.

Advances and Loans

The NLF's total gross assets decreased by £43.7 billion to £351.0 billion. This was mainly due to a repayment of advances made to the DMA.The principal outstanding has fallen by £50 billion since March 2009 as the DMA no longer required the deposit to facilitate its operations in the short term. This has been partly offset by an increase in the amount advanced to the EEA and an increase in the net assets of the DMA and the EEA.

International Monetary Fund

During 2009-2010, the UK agreed to provide a bilateral loan facility to the IMF for an amount up to the equivalent of SDR 9.92 billion. As at 31 March 2010, one drawing had been made under the facility and was still outstanding. The drawn loan represents a claim on the IMF, and therefore an asset of the NLF. The undrawn loan is a commitment of the NLF.

Public Sector Net Debt

As a result of these changes, the net liabilities of the Fund increased from £730.4 billion to £920.8 billion. This is matched by a corresponding claim on the CF. The NLF lends to and borrows from other parts of the public sector. For example it makes advances to the PWLB and borrows directly from a range of public sector bodies (as described in note 10). In addition, some of the gilts it has issued are held in the public sector, including by the DMA which retains a portfolio of gilts as collateral for its money market activities. The DMA also has large advances to and from the NLF. Therefore, the NLF's net liabilities do not equate to the Public Sector Net Debt ('PSND'), which is a calculation of the net debt of the whole of the public sector after eliminating intra-public sector balances. Figures for PSND are published jointly by HM Treasury and the Office for National Statistics in the monthly 'Public Sector Finances First Release', which can be found on the Treasury website.

Forward look

Revisions to the Debt Management Office's remit for 2010-2011 were announced in the Budget on 22 June 2010. On the basis of a revised Central Government Net Cash Requirement forecast of £146.1 billion for 2010-2011, the revised net financing requirement is £162.5 billion. The DMO will meet the net financing requirement by gross gilt sales of £165 billion and net Treasury bill purchases of £2.5 billion.

Preparation of the account

The Account is prepared under section 21(1) of the National Loans Act 1968. The Act requires the Treasury to prepare an account for the NLF for each financial year in such form and containing such information as the Treasury considers appropriate.

Audit

The NLF Account is audited by the Comptroller and Auditor General under the requirements of the National Loans Act 1968.

As the Accounting Officer, I have taken all the steps that I ought to have taken to make myself aware of any relevant audit information and to establish that the NLF's auditors are aware of that information. So far as I am aware, there is no relevant audit information of which the NLF's auditors are unaware.

The National Audit Office bears the cost of all external audit work performed on the NLF.

Nicholas Macpherson 16 July 2010
Accounting Officer
HM Treasury

Statement of Accounting Officer's responsibilities

Under section 21(1) of the National Loans Act 1968 HM Treasury is required to prepare an account relating to the National Loans Fund for each financial year in such form and containing such information as the Treasury considers appropriate.

The National Loans Fund Account is prepared on an accruals basis and must give a true and fair view of the state of affairs of the Fund and of the net operating cost and the cash flows for the financial year.

The Treasury has appointed its Permanent Secretary as Accounting Officer for the Fund, with overall responsibility for its operation, for preparing the annual account and for transmitting it to the Comptroller and Auditor General for audit.

In preparing the Account the Accounting Officer is required to observe the applicable accounting standards and generally accepted accounting practice in so far as they are relevant to the Account, and apply suitable accounting policies on a consistent basis.

The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which he is answerable, and for the keeping of proper accounting records, are set out in the Accounting Officers' Memorandum issued by the Treasury and published in 'Managing Public Money'.

Statement on Internal Control

Scope of responsibility

As Accounting Officer for the National Loans Fund, I have responsibility for maintaining a sound system of internal control to support the achievement of the Fund's policies, aims and objectives, 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'. I am also obliged to conduct a review of the effectiveness of the system of internal control. This review covers all controls, including financial, operational and compliance controls and risk management. The National Loans Fund is managed generally within the framework of the Treasury's system of internal control. This framework includes resourcing the administration of the National Loans Fund, security and the management of risks across the Treasury's business. In addition, there are further controls that are specific to the management of the National Loans Fund, as detailed below.

The National Loans Fund is managed by the Treasury Accountant and his managers within the Exchequer Funds and Accounts (EFA) Team of HM Treasury.

The purpose of the system of internal control

The system of internal control is designed to manage risk to an acceptable level, balancing the impact of potential risks with the resources required to manage them, rather than 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 National Loans Fund'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 2010 and up to the date of approval of the financial statements, and accords with Treasury guidance.

Capacity to handle risk

EFA is managed within HMT's risk management framework which is explained in HMT's Annual Report and Accounts. The Treasury Accountant has overall responsibility on a day-to-day basis for risk management within EFA, and for ensuring that my financial, regularity and propriety responsibilities as Accounting Officer of the National Loans Fund are discharged appropriately. He is supported by EFA management who are responsible for ensuring that the operations in their area are compliant with plans, policies, procedures and legislation. EFA management ensure that staff working on the National Loans Fund are trained and equipped to manage risk in a way appropriate to their authority and duties. Training on risk management is provided as required, either by management or by attending appropriate courses. Guidance on risk management is available to all staff on the intranet and individuals' objectives reflect the need to manage risks. Business continuity resilience is regularly tested locally and with business partners, and lessons learned feed into improved business continuity processes.

The risk and control framework

Risk management is key to all processes within EFA, including business continuity resilience planning for those public funds for which EFA is responsible. The risk management strategy includes periodic horizon scanning to identify any changes in risk exposure, to evaluate the change and to identify appropriate mitigating actions. Significant risk issues are recorded in a risk register and are assessed by likelihood and impact. A risk owner, who is responsible for managing risk, is assigned to each risk. The risk register is regularly reviewed by EFA management.

There have been no significant changes in the risk control environment during the year.

The key risks in managing the National Loans Fund are;

- irregularity of transactions, including fraudulent or erroneous payments;
- incorrect accounting;

- failure of IT systems;
- failure to provide an effective service in adverse circumstances, including disaster situations; and
- failure of principal counterparties to provide agreed services.

EFA has various controls in place for managing the risks associated with the National Loans Fund. Clear separation of duties is enforced by appropriate user permissions within the Accounting System and payment approval panels. Up-to-date policy and procedures manuals including job instructions are readily accessible to all operational staff. Payment instructions are computer-generated and are derived from underlying transaction records. This minimises the risk of keying errors. In addition application controls exist within the IT system used to manage financial transactions and account for receipts and payments on the Fund. There is also a clear and comprehensive audit trail in the IT system, to which the National Audit Office Exchequer Section has real-time access. Well-developed Service Level Agreements for the provision of services from all principal counterparties are in place. They cover details of the monitoring and control arrangements that both parties are expected to observe. Data and information risk are managed in accordance with HMT's policies, which involve a range of controls to prevent unauthorised disclosures. These include encryption and physical and IT security. EFA's own Data Handling Policy identifies risks specific to EFA. This policy is reviewed on a six-monthly basis or as required. Gilts issuances are reported to senior management on the day. EFA reconciles the dividend claims received from the gilts registrar with its own records upon each interest payment. The Debt Management Office reconciles principal amounts twice a year. Monthly management accounts for the Fund are produced and are reviewed by the Treasury Accountant, and are provided to me.

Separately, the Comptroller and Auditor General, through the National Audit Office Exchequer Section authorises National Loans Fund payments in advance and reconciles Fund transactions on a daily basis.

A number of controls exist in respect of business continuity. To ensure operational resilience in key areas in the event of a threat to business continuity, staff within EFA are trained to provide cover for times when other staff members are absent. Measures are in place to facilitate the National Audit Offices's normal payments approval process in the event of disruption to enable the essential payments business to continue. The risks that impact upon EFA's key stakeholders are managed by their involvement in business continuity planning and testing. Business continuity arrangements are regularly reviewed and tested within the framework of the Treasury's corporate Business Continuity Plan facilities. The National Loans Fund's operations were not affected by the severe winter weather.

During the year, audit committee arrangements for the HM Treasury group were revised. Responsibility for supporting me as Accounting Officer in matters relating to governance, internal control and risk management processes lay with the Exchequer Funds Audit Committee until 31 December 2009, and with the Treasury Audit Committee from 1 January 2010.

The membership of the Exchequer Funds Audit Committee during the period was;

- Colin Price, Committee Chair, non-executive Director of the UK Debt Management Office Managing Board and formerly Global Pension Fund Adviser/Finance Director at Shell Pensions Management Services Limited;
- Brian Larkman, non-executive Director of the UK Debt Management Office Managing Board and formerly Global Head of Money Markets at the Royal Bank of Scotland plc; and
- Mark Clarke, formerly Director General (Finance and Strategy) at the Department for Business, Enterprise and Regulatory Reform.

The Exchequer Funds Audit Committee met three times during 2009-2010.

From 1 January 2010, the Treasury Audit Committee has been tasked with supporting the Permanent Secretary and the Treasury Additional Accounting Officers in their responsibilities for managing risk, internal control and governance related to the;

- Treasury Group's Resource Account;
- Consolidated Fund;

- Contingencies Fund;
- National Loans Fund; and,
- Exchange Equalisation Account.

The Permanent Secretary appoints members of the Committee for periods up to three years, extendable by no more than one additional three-year period. The Chair of the Committee, Michael O'Higgins, reports directly to the Permanent Secretary.

The membership of the Treasury Audit Committee since 1 January 2010 is;

- Michael O'Higgins, Committee Chair, independent member of the Treasury Board;
- Michael Ashley, Head of Quality and Risk Management for KPMG Europe LLP and member of their Board;
- Zenna Atkins, Chairman of Ofsted; Executive Director of Social Solutions Limited, independent member of the Royal Navy Board and Chair of their Audit Committee, Chairman of Places for People Group Limited and independent member of the South East of England Development Agency;
- Janet Baker; Non-executive Director, Healthcare Purchasing Consortium and formerly a Senior Partner at PA Consulting;
- Brad Fried, Managing Partner, Grovepoint Capital LLP, Non-executive Director of the Group Board of Investec Bank plc and formerly Chief Executive Officer of Investec plc[1]; and
- Avinash Persaud, Emeritus Professor of Gresham College, Chairman, Intelligence Capital Limited, Chairman of the Warwick Commission on Financial Reform and Member of the UN Commission on International Financial Reform

The Treasury Audit 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.

In addition to the independent members, the appropriate Accounting Officers, HM Treasury's Group Director of Finance, the Chief Executives of the Office of Government Commerce and Debt Management Office, and the Treasury Accountant also attend Committee meetings as required. Before each meeting members have the opportunity for a pre-committee discussion with the National Audit Office, Group Head of Internal Audit and Head of Internal Audit for the Exchequer Funds.

The Treasury Audit Committee met twice between 1 January and 31 March.

An annual risk-based internal audit programme is performed by Exchequer Funds Internal Audit. The programme is agreed with the Treasury Accountant in advance. The work programme always includes a review of the receipts and payments process within EFA, due to the perceived level of risk. The Audit Committee reviews the risk-based work programme and is kept informed of progress and amendments.

The external audit function is provided by the National Audit Office, who attend all Audit Committee meetings.

1 Brad Fried stepped down as Chief Executive Officer of Investec plc in February 2010 and became a Non-executive Director of the Group Board of Investec plc in April 2010.

Review of effectiveness

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review is informed by the work of Exchequer Funds Internal Audit who provided positive assurance as to the management and control of the National Loans Fund in 2009-2010, and the executive managers within EFA 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 Exchequer Funds Audit Committee, and latterly the Treasury Audit Committee, and risk owners in addressing weaknesses and ensuring continuous improvement of the system is in place. The Treasury Audit Committee considered the 2009-2010 accounts in draft and provided me with its views before I formally signed the accounts. In my opinion, the system of internal control was effective with no significant control issues identified in 2009-2010.

Nicholas Macpherson 16 July 2010
Accounting Officer
HM Treasury

The Certificate and Report of the Comptroller and Auditor General to the Houses of Parliament

I certify that I have audited the financial statements of the National Loans Fund for the year ended 31 March 2010 under the National Loans Act 1968. These comprise the Operating Cost Statement, the Statement of Financial Position, the Statement of Cashflows and the related notes. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of the Accounting Officer and Auditor

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. My responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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. This includes an assessment of: whether the accounting policies are appropriate to the Fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Accounting Officer; and the overall presentation of the financial statements.

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

Opinion on regularity

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

Opinion on financial statements

In my opinion

- the financial statements give a true and fair view, in accordance with the National Loans Act 1968 and in a form prescribed by HM Treasury, of the state of the National Loans Fund's affairs as at 31 March 2010, and of the net operating cost, and cash flows for the year then ended; and
- the financial statements have been properly prepared in accordance with the National Loans Act 1968 and in a form prescribed by HM Treasury.

Opinion on other matters

In my opinion, the information included in the Foreword, 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
- the financial statements are not in agreement with the accounting records or returns; or
- I have not received all of the information and explanations I require for my audit; or
- the Statement on Internal Control does not reflect compliance with HM Treasury's guidance.

Report

I have no observations to make on these financial statements.

Amyas CE Morse
Comptroller and Auditor General

16 July 2010

National Audit Office
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London SW1W 9SP

Operating Cost Statement for the year ended 31 March 2010

	Note	**2009-2010** £m	2008-2009 £m
Finance costs of borrowing	2	**37,688**	39,663
Income from lending operations	3	**(4,608)**	(7,913)
Losses/(gains) on foreign exchange transactions	4	**74**	(249)
Other expenditure	5	**235**	54
Other income	5	**(3,353)**	(16,980)
Net operating cost		**30,036**	14,575

There are no changes to taxpayers' equity other than those included in the Operating Cost Statement.

The notes on pages 16 to 35 form part of this Account.

Statement of Financial Position as at 31 March 2010

	Note	**At 31 March 2010**	Restated At 31 March 2009	Restated At 1 April 2008
		£m	£m	£m
Assets				
Advances	8	**297,918**	344,375	52,703
Loans	6	**3,191**	2,882	3,001
Other assets	9	**38,892**	36,262	25,180
IMF Quota Subscription and Bilateral Loan	7	**11,022**	11,196	8,881
Total assets		**351,023**	394,715	89,765
Liabilities				
Gilt-edged stock	13	**937,263**	735,504	489,955
National savings and investments products	12	**98,804**	97,195	84,430
Liabilities to the IMF	7	**8,702**	9,501	8,320
Other debt payable in sterling				
Treasury Bills	10	**176,076**	204,459	0
Other	10	**50,972**	78,427	76,754
Other debt payable in foreign currencies	11	**0**	0	1,534
Total liabilities		**1,271,817**	1,125,086	660,993
Liability of the Consolidated Fund to the National Loans Fund	14	**920,794**	730,371	571,228

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Nicholas Macpherson 16 July 2010
Accounting Officer
HM Treasury

The notes on pages 16 to 35 form part of this Account.

Statement of Cash Flows for the year ended 31 March 2010

	Note	**2009-2010**	2008-2009
		£m	£m
Cash flows from operating activities			
Interest received		**4,645**	7,789
Other receipts		**450**	2,131
Interest paid		**(38,547)**	(30,282)
Other flows		**(1,761)**	(589)
Transfer from the Consolidated Fund for the cost of debt servicing	14	**35,213**	20,951
		0	0
Cash flows from investing activities			
Net decrease/(increase) in advance to the DMA		**50,000**	(292,000)
Net increase in advance to the PWLB		**(378)**	(116)
Net (increase)/decrease in loans		**(563)**	118
Net (increase)/decrease in advance to the EEA		**(3,200)**	570
Reduction on the EEA's capital contribution reserve		**55**	3,615
		45,914	(287,813)
Cash flows from financing activities			
Net issuance of government stock		**202,200**	239,001
Net (redemption)/issuance of SLS Treasury Bills		**(26,796)**	202,438
Net issuance of National Savings products		**363**	11,794
(Decrease)/increase in other net sterling borrowing		**(27,423)**	1,883
Net transfers of IMF non-interest bearing securities		**1,342**	(270)
Net transfers of foreign currency borrowing		**0**	(1,514)
Net transfers to the Consolidated Fund	14	**(195,600)**	(165,519)
		(45,914)	287,813
Net change in cash and cash equivalents		**0**	0
Cash and cash equivalents at beginning and end of year		**0**	0

The notes on pages 16 to 35 form part of this Account.

Notes to the Account

1 Accounting policies

i Accounting convention

The National Loans Fund Account has been prepared under the historical cost convention and in accordance with International Financial Reporting Standards (IFRSs) as adapted or interpreted for the public sector context in so far as they are relevant to transactions and balances within the National Loans Fund. These include IFRS 7 'Financial Instruments: Disclosures' and IAS 39 'Financial Instruments: Recognition and Measurement'.

The financial statements for the year ended 31 March 2010 are the first National Loans Fund financial statements to be prepared in accordance with IFRS. Prior financial statements up to 31 March 2009 have been prepared in accordance with UK Generally Accepted Accounting Practice (UK GAAP). IFRS 1, First-time Adoption of International Financial Reporting Standards has been applied in preparing these financial statements. Accounting policies have been applied consistently to all years presented.

The National Loans Fund Account consists mainly of financial instruments. UK GAAP for such instruments is consistent with IFRS. Therefore as the transition to IFRS has not affected the accounting policies, Operating Cost Statement, Statement of Financial Position or Statement of Cash Flows of the National Loans Fund, reconciliations to show the effect of transition to IFRS are not necessary. In accordance with IAS 1, Presentation of Financial Statements, three statements of financial position and related notes have been presented as accounting policies have been applied retrospectively. In addition, an extra disclosure has been added at note 17 to distinguish current from non-current assets and liabilities.

A presentational change has been made to the Statement of Cash Flows. Previously the Statement of Cash Flows showed only headings in respect of operating, investing and financing activities. The detail was provided in the notes. The cash flow note has now been included on the face of the Statement of Cash Flows. This is not related to the IFRS transition, but provides a clearer presentation of the cash flows of the National Loans Fund.

IFRS 9 'Financial Instruments', was issued in November 2009 and is set to replace IAS 39 'Financial Instruments: Recognition and Measurement'. This standard has not been applied for 2009-2010 since the effective date is set for 1 January 2013. It is expected that the application of IFRS 9 should have no significant impact upon the financial statements of the NLF.

ii Basis of presentation

The National Loans Fund Account is stated in millions of pounds sterling (£m). This Account presents the results and transactions of the National Loans Fund. The NLF is the government's main borrowing and lending account. By the nature of government financing, it is expected that the NLF will show a net liability. By virtue of section 19(1) of the National Loans Act 1968, the net liabilities of the NLF are a liability of the Consolidated Fund. The servicing of these liabilities is mainly met by tax revenue receipts. For this reason, the Accounting Officer continues to adopt the going concern basis in preparing the Account.

iii Recognition of finance income and costs

Premium Bond prizes are recognised in the period to which they relate. Other interest income and costs of financing are determined using the effective interest rate method. The effective interest rate method is a method of calculating the amortised cost of a financial asset or financial liability and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. The calculation takes into account premiums or discounts on acquisition or issue of financial assets and liabilities and all the contractual terms of the financial instrument. The majority of the NLF's financial assets and liabilities have a fixed return. For those products that have a variable return, the current rate applicable to that product is used in the calculation of the finance income or cost. Gilts with the same maturity and coupon rate are sometimes issued in separate tranches. Because of market conditions each tranche may be issued with a different premium or discount and therefore a different effective interest rate. However, once issued, gilts with the same maturity and coupon rate are indistinguishable from each other and so are accounted for as one issue using a weighted average effective interest rate.

iv Recognition of finance income – Special Drawing Rights (SDR)

The IMF remunerates the UK in SDRs on its Reserve Tranche Position (RTP) for balances in excess of SDR 700 million and on its bilateral loans. Under section 3(2) of the Exchange Equalisation Act 1979 any SDRs received by the Government must be treated as assets of the Exchange Equalisation Account, therefore all SDR income is accounted for in that Account and not the NLF.

v Financial assets and liabilities

The assets and liabilities of the NLF are all accounted for as financial assets and liabilities except for assets arising from the net assets of the Exchange Equalisation Account and the Debt Management Account, which are accounted for as explained in accounting policy (ix). The NLF's financial assets are all designated as loans and receivables. In accordance with IAS 39, financial assets and liabilities are initially recognised at fair value. They are subsequently measured at amortised cost using the effective interest rate method. There have been no impairment losses during the year. If gilts are issued by a syndication process, the syndication fees are borne by the NLF and are netted off from gross issuance proceeds as part of the calculation of amortised cost. Other directly related issue costs for assets and liabilities are negligible and are written off as incurred.

The distinction between loans and advances derives from the legislation that governs the operation of the NLF. On loans, interest must be charged at a rate that at least covers the cost that the Fund would have to bear if it were to borrow the same sum for the period of the loan, plus the Treasury's own administration costs. There is no such requirement for advances, although interest is charged at base rate on advances to the Debt Management Account.

The fair values of the financial assets and liabilities are disclosed in note 16. They are calculated by reference to market prices where instruments are traded on an active quoted market, or, where this is not the case, as the net present value of future cash flows.

vi Foreign currencies

The financial statements of the National Loans Fund are presented in sterling, which is the Fund's functional currency, being the currency of the primary economic environment in which it operates. Transactions denominated in foreign currencies are recorded at the rate of exchange applicable to the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date. Liabilities to the IMF are denominated in sterling, but are subject to a revaluation adjustment reflecting the SDR/£ sterling exchange rate movement.

vii Administration expenditure

These financial statements reflect the activity through, and the financial position of, the National Loans Fund. The costs of gilts registration, listing fees and foreign currency debt issuance are met by the National Loans Fund. Administration costs, such as departmental staff costs and bank charges, are borne by the appropriate body and are accounted for through their respective resource accounts.

viii Fee income

The Bank of England pays stock lending fees to the DMA for the loan of Treasury Bills under the Special Liquidity Scheme. A portion of these fees is payable to the NLF. Fee income receivable from the DMA is accrued as earned.

ix Exchange Equalisation Account and Debt Management Account

The net assets of the Exchange Equalisation Account (EEA) and the Debt Management Account (DMA) are assets of the NLF. Changes in the net assets are reported in Other Assets (Note 9) and recognised in the Operating Cost Statement as Other Income (Note 5). The NLF's assets and income are the result of the activity in the EEA and DMA during the year and the various accounting policies applied by them to that activity.

x Critical accounting judgements and key sources of estimation uncertainty

There are no areas of the financial statements which are reliant on management's judgement in the process of applying the Fund's accounting policies. Fair values are included for disclosure purposes only. Their calculation is described in note 16. As mentioned in accounting policy (iii), the majority of the NLF's financial assets have a fixed return. For those products that have a variable return, the current rate applicable to that product is used in the calculation of the finance income or cost. Note 18 applies various assumptions to demonstrate the sensitivity of NLF's assets and liabilities to changes in interest rates, inflation and the SDR to sterling exchange rate.

2 Finance costs of borrowing

	2009-2010	2008-2009
	£m	£m
Gilt-edged stock		
Marketable	**33,536**	29,588
Non-marketable	**11**	29
Total	**33,547**	29,617
Treasury Bills	**1,865**	6,114
National Savings and Investments products	**1,911**	2,554
Other finance costs		
Payable in sterling	**365**	1,369
Payable in foreign currencies	**0**	9
Total finance costs on borrowing	**37,688**	39,663

3 Income from lending operations

	2009-2010	2008-2009
	£m	£m
Interest on loans advanced by the National Loans Fund to		
Public corporations	**86**	86
Central government bodies	**99**	106
	185	192
Interest on loans by the Public Works Loan Board financed by NLF advances	**2,891**	3,174
Interest on funding advanced to the Debt Management Account	**1,532**	4,547
Total income from lending operations	**4,608**	7,913

4 Gains on foreign exchange transactions

	2009-2010	2008-2009
	£m	£m
Loss on foreign currency borrowing US dollar	**0**	4
Loss/(gain) on Reserve Tranche Position at the IMF	**81**	(253)
Gain on Bilateral Loan to the IMF (Note 7)	**(7)**	0
Net Loss/(gain) on foreign currency transactions	**74**	(249)

5 Other income and expenditure

	2009-2010	2008-2009
	£m	£m
Other expenditure		
Debt management administration costs*	**4**	3
Expenditure in respect of depreciation of Issue Department Assets+	**198**	51
Other	**33**	0
Total: Other expenditure	**235**	54
Other income		
EEA net income**	**(962)**	(5,414)
Profits of the Bank of England Issue Department+	**(571)**	(1,837)
Income in respect of appreciation of Issue Department Assets+	**(76)**	(344)
Surplus on the DMA	**(1,677)**	(9,345)
SLS Fee income from the DMA	**(63)**	(32)
Miscellaneous receipts	**(4)**	(8)
Total: Other income	**(3,353)**	(16,980)
Net total	**(3,118)**	(16,926)

* Debt management administration costs mainly comprise amounts paid to the Gilts Registrar for administering the gilt-edged stock register. They also include the Bank of England's costs relating to the issue of any foreign currency borrowing.

+ Under section 9 of the National Loans Act 1968, the profits of the Issue Department are paid into the National Loans Fund. A sum of £571 million in respect of these profits was credited to the Operating Cost Statement in 2009-2010 (£1,837 million in 2008-2009). In addition, the Bank of England Issue Department is required by the Currency and Bank Notes Act 1928 to hold investments equal to the value of bank notes in issue. Periodically these investments are revalued to market value. If the market value is less than the value of notes in issue, legislation requires the National Loans Fund to pay an amount equal to the deficiency to the Issue Department to finance the purchase of additional investments. Conversely, if the market value of the assets exceeds the value of the notes in issue, the Issue Department sells investments to the value of the surplus and pays the proceeds to the National Loans Fund.

** Of EEA's profit of £962 million (£5,414 million, 2008-2009), £4 million (£4 million, 2008-2009) relates to interest receivable on the Reserve Tranche Position and the bilateral loan to the IMF in line with accounting policy (iv).

6 Loans and commitments to lend

Loans			**2009-2010**			2008-2009
	Public Corporations	**Central Government**	**Total**	Public Corporations	Central Government	Total
	£m	**£m**	**£m**	£m	£m	£m
Principal outstanding at 1 April	**1,323**	**1,530**	**2,853**	1,334	1,637	2,971
Loans advanced	**2,664**	**114**	**2,778**	278	18	296
Loans repaid	**(2,346)**	**(122)**	**(2,468)**	(289)	(125)	(414)
Principal outstanding at 31 March	**1,641**	**1,522**	**3,163**	1,323	1,530	2,853
Accrued interest	**12**	**16**	**28**	12	17	29
Total asset outstanding	**1,653**	**1,538**	**3,191**	1,335	1,547	2,882

Commitments to lend			**2009-2010**			2008-2009
	Public Corporations	**Central Government**	**Total**	Public Corporations	Central Government	Total
	£m	**£m**	**£m**	£m	£m	£m
Undrawn commitments to lend						
Maturity period						
– less than one year	**573**	**0**	**573**	611	0	611
– one year and over	**300**	**0**	**300**	600	0	600
	873	**0**	**873**	1,211	0	1,211

The NLF has not made any loans, and does not have any commitments to lend, in respect of financial institutions classified as Public Corporations. In addition, to the above, the NLF has made a loan to, and has a commitment to lend to the IMF, which is explained in Note 7.

In addition to the principal balance of £2,971 million at 1st April 2008, there was accrued interest of £30 million, giving a total balance of £3,001 million.

7 IMF Reserve Tranche Position and Bilateral Loan

The United Kingdom's relationship with the International Monetary Fund impacts on the National Loans Fund, the UK's Foreign Exchange Reserves and the Exchange Equalisation Account (EEA). The UK's Quota Subscription to the IMF, 10,738.5 million Special Drawing Rights (SDRs) equivalent to £10,762 million at 31 March 2010 (£11,196 million at 31 March 2009), was paid from the National Loans Fund and is recognised as a NLF asset. Part of the Subscription is deposited by the IMF in the NLF in return for sterling non-interest-bearing securities (NIBS) which totalled £8,739 million at 31 March 2010 (£7,397 million at 31 March 2009). NIBS represent a liability of the NLF to the IMF. There is a remaining small liability of £27 million (£28 million at 31 March 2009) against which an equal amount of sterling cash is made avaliable in an account at the Bank of England as an advance to the IMF.

The difference between the gross quota subscription and the NLF's sterling liability to the IMF is the UK's Reserve Tranche Position (RTP). Under the arrangements for membership of the Fund, valuation adjustments are made between the IMF and NLF annually to reflect any changes in value, in SDR terms, of the NLF's sterling liability to the IMF. An annual settlement payment is made between the NLF and the IMF, normally in May. The cumulative valuation adjustment at 31 March 2010 was £64 million (£2,076 million at 31 March 2009).

The table below sets out the composition of the RTP at 1 April 2008, 31 March 2009 and 31 March 2010, and shows the make-up of changes over the years.

The RTP represents an SDR asset that can be drawn on by the UK if needed. Because the RTP is a net asset of the NLF it is therefore also considered as part of the UK's Foreign Exchange Reserves. Sterling transactions by the IMF impact on the level of NIBS, and hence on the RTP. Under current policy, changes in the RTP lead to adjustments in the composition of other Reserve Assets, in order to keep the portfolio composition of the Reserves in line with plan.

Interest is payable by the IMF on the RTP balance in excess of SDR 700 million. This interest is retained in the EEA. Separately, the EEA also holds the UK's allocation of SDRs (SDR 10,134 million at 31 March 2010), as a liability to the IMF, and retains an asset in the form of the UK's holdings of SDRs (SDR 9,150 million at 31 March 2010).

During 2009-2010 a net payment was made of £446m to the IMF in support of funding programmes (a net payment to the IMF of £887m in 2008-2009).

NLF assets and liabilities: composition of the Reserve Tranche Position and Bilateral Loan

	Asset			Liabilities		Reserve Tranche Position
	IMF Quota Subscription	Non-interest-bearing securities	Other quota liability	Valuation adjustment	Total liabilities	
	£m	£m	£m	£m	£m	£m
Balances at 1 April 2008	8,881	(7,667)	(21)	(632)	(8,320)	561
Exchange rate gains for the year on the Quota subscription	2,315	0	0	0	0	2,315
Change in year-end valuation adjustment	0	0	0	(1,444)	(1,444)	(1,444)
Change in loan notes as a result of the valuation settlement	0	(617)	0	0	(617)	(617)
Change in cash on No 1 account	0	0	(7)	0	(7)	(7)
Net decrease in loan notes	0	887	0	0	887	887
Balances at 31 March 2009	11,196	(7,397)	(28)	(2,076)	(9,501)	1,695
Exchange rate losses for the year on the quota subscription	**(434)**	**0**	**0**	**0**	**0**	**(434)**
Change in year-end valuation adjustment	**0**	**0**	**0**	**2,140**	**2,140**	**2,140**
Change in loan notes as a result of the valuation settlement	**0**	**(1,788)**	**0**	**0**	**(1,788)**	**(1,788)**
Change in cash on No 1 account	**0**		**1**		**1**	**1**
Net decrease in loan notes	**0**	**446**	**0**	**0**	**446**	**446**
Balances at 31 March 2010	**10,762**	**(8,739)**	**(27)**	**64**	**(8,702)**	**2,060**

Bilateral loan to the IMF

	£m
Loans advanced as at 31 March 2009 and 1 April 2008	**0**
Loans advanced 2009-2010	**253**
Gain/(Loss) on foreign exchange	**7**
Loans outstanding 31 March 2010	**260**
IMF quota subscription and bilateral loan	**11,022**

During 2009-2010, the UK agreed to provide a bilateral loan facility to the IMF for an amount up to the equivalent of SDR 9.92 billion (£9.94 billion). As at 31 March 2010, one drawing had been made under the facility and was still outstanding. The drawn loan represents a claim on the IMF, and therefore an asset of the NLF. The undrawn loan is a commitment of the NLF. Interest is payable by the IMF on the loan balance, and is retained in the EEA in line with accounting policy (iv).

8 Advances

		PWLB		**DMA**		**EEA**		**Total**
		£m		**£m**		**£m**		**£m**
	2009-2010	2008-2009	**2009-2010**	2008-2009	**2009-2010**	2008-2009	**2009-2010**	2008-2009
Principal outstanding at 1 April	**50,869**	50,753	**292,000**	0	**760**	1,330	**343,629**	52,083
Advances	**5,080**	6,360	**50,000**	392,000	**5,600**	960	**60,680**	399,320
Advances repaid	**(4,702)**	(6,244)	**(100,000)**	(100,000)	**(2,400)**	(1,530)	**(107,102)**	(107,774)
Principal outstanding at 31 March	**51,247**	50,869	**242,000**	292,000	**3,960**	760	**297,207**	343,629
Accrued interest	**584**	580	**127**	166	**0**	0	**711**	746
Total advances outstanding	**51,831**	51,449	**242,127**	292,166	**3,960**	760	**297,918**	344,375

In addition to the principal balance of £52,083 million at 1st April 2008, there was accrued interest of £620 million, giving a total balance of £52,703 million.

9 Other assets

		At 31 March 2010		At 31 March 2009		At 1 April 2008
		£m		£m		£m
Exchange Equalisation Account net assets		**26,233**		25,327		23,528
Debt Management Account net assets		**11,912**		10,235		890
National Savings and Investments' cash holdings						
From sale of investment products	**606**		493		598	
For repayment of principal	**43**		145		117	
For payment of interest and prizes	**60**		26		26	
NS&I Total		**709**		664		741
SLS accrued fee income from the DMA		**11**		8		0
Sterling balances at Bank of England advanced to IMF		**27**		28		21
Total other assets		**38,892**		36,262		25,180

10 Other debt payable in sterling

	At 31 March 2010 £m	At 31 March 2009 £m	At 1 April 2008 £m
Treasury Bills	**176,076**	204,459	0
Other			
Debt Management Account	**28,511**	48,967	49,140
Bank of England Issue Department	**370**	4,144	7,403
Balances from government accounts at the Bank of England	**13,552**	16,383	16,288
Temporary deposits from public sector bodies	**7,703**	7,792	3,473
Other	**836**	1,141	450
	50,972	78,427	76,754
Total other debt payable in sterling	**227,048**	282,886	76,754

Treasury Bills have been issued by the NLF to the DMA in connection with the Bank of England's Special Liquidity Scheme. When the Scheme closed on 30 January 2009 the face value of Bills lent to financial institutions by the Bank of England was £185.7 billion. Additional bills have been created to be held by the DMA to be available to replace maturing Bills. The fair value of Treasury Bills issued at 31 March 2010 was £176,108 million (note 16). Further information on the scheme is provided in paragraph 9 of the Foreword, and can also be found on the websites of the Bank of England and the Debt Management Office. The next two items reflect deficit funding from the DMA and the Issue Department of the Bank of England. The fourth item reflects the transfer to the NLF of any temporary cash surpluses on other government accounts held at the Bank of England.

11 Other debt payable in foreign currencies

	At 31 March 2010 £m	At 31 March 2009 £m	At 1 April 2008 £m
HMG US $3 billion 2.25% Bond 2008	**0**	0	1,509
Accrued interest	**0**	0	25
Total foreign currency debt	**0**	0	1,534

12 National Savings and Investments products

	2009-2010 £m	2008-2009 £m
Principal outstanding at 1 April	**96,503**	83,177
Cash repayments from the NLF	**(16,383)**	(13,770)
Principal cash received in the NLF	**16,746**	25,564
Capitalised interest and other returns to savers	**965**	1,609
Change in cash holdings for principal	**11**	(77)
Principal outstanding at 31 March	**97,842**	96,503
Accrued interest and other returns to savers	**962**	692
Total principal and accrued interest outstanding	**98,804**	97,195

In addition to the principal balance of £83,177 million at 1 April 2008, there was accrued interest of £1,253 million, giving a total balance of £84,430 million.

13 Gilt-edged stock

	At 31 March 2010	At 31 March 2009	At 1 April 2008
	Outstanding liability (including accrued interest)	Outstanding liability (including accrued interest)	Outstanding liability (including accrued interest)
	£m	£m	£m
Marketable Securities			
Conventional	**740,875**	560,059	344,141
Index-Linked	**195,994**	175,133	145,242
	936,869	735,192	489,383
Non-Marketable Securities			
Conventional	**394**	312	572
Index-Linked	**0**	0	0
	394	312	572
Total gilt-edged stock	**937,263**	735,504	489,955

At 31 March 2010, £131,873 million (£136,623 million at 31 March 2009) of the total gilt-edged stock liability was held by the DMA, and £805,390 million (£598,881 million at 31 March 2009) was held by other investors.

Syndication fees are borne by the NLF and are netted off from gross issuance proceeds as part of the calculation of amortised cost. Other directly related issue costs for assets and liabilities are negligible and are written off as incurred. Total syndication fees for the year were £68.25 million, (2008-2009; Nil).

14 Liability of the Consolidated Fund to the National Loans Fund

	2009-2010	2008-2009
	£m	£m
Liability of the Consolidated Fund to the NLF at 1 April	**730,371**	571,228
Net cash paid to the Consolidated Fund	**195,600**	165,519
Payment from the Consolidated Fund to the NLF for the cost of debt servicing during the year	**(35,213)**	(20,951)
Net operating cost	**30,036**	14,575
Liability of the Consolidated Fund to the NLF at 31 March	**920,794**	730,371

15 Contingent liabilities

The following contingent liabilities fall outside the scope of IAS 37 as the possibility of an outflow of resources is remote. However, disclosure of these liabilities is necessary under Parliamentary reporting requirements. These are as follows;

i) The NLF has a contingent liability to the Bank of England Issue Department in respect of that part of the assets backing the note issue that is not represented by government securities. This contingent liability was £45,571 million at 31 March 2010 (£36,198 million at 31 March 2009).

ii) The NLF also has a contingent liability in respect of unclaimed dividends from the Commissioners for the Reduction of the National Debt (CRND). This represents old-uncleared payments to NS&I investors and stood at £22.6 million at 31 March 2010 (£54.1 million at 31 March 2009). The reduction is mainly due to a transfer of funds to NS&I during 2009-2010. Previously, dividends which had not been claimed by customers have been surrendered by NS&I to CRND, and then surrendered onto the NLF. However, to facilitate revised processes at NS&I, the funds have been transferred to and will continue to be held by NS&I.

16 Fair values

Carrying value and fair value of NLF assets and liabilities as at 31 March 2010

	Values at 31 March 2010	
	Carrying Value	**Fair Value**
Assets	**£m**	**£m**
Loans:		
Principal	**3,163**	**3,550**
accrued interest	**28**	**28**
IMF Quota Subscription and Bilateral Loan	**11,022**	**11,022**
Advances:		
PWLB	**51,247**	**58,154**
DMA	**242,000**	**242,000**
EEA	**3,960**	**3,960**
accrued interest	**711**	**711**
Other assets	**38,892**	**38,892**
Total assets	**351,023**	**358,317**
Liabilities		
Other sterling debt		
Treasury Bills	**176,076**	**176,108**
DMA	**28,511**	**28,511**
Issue Department of Bank of England	**370**	**370**
Government balances	**13,552**	**13,552**
Temporary deposits	**7,703**	**7,703**
Other	**836**	**836**
National Savings & Investments	**97,842**	**98,555**
accrued interest	**962**	**975**
IMF liabilities	**8,702**	**8,702**
Gilts		
Marketable	**936,869**	**986,877**
Non-marketable	**394**	**399**
Total liabilities	**1,271,817**	**1,322,588**

Carrying value and fair value of NLF assets and liabilities as at 31 March 2009

	Values at 31 March 2009	
	Carrying Value	Fair Value
Assets	£m	£m
Loans		
Principal	2,853	3,434
accrued interest	29	29
IMF Quota Subscription and Bilateral Loan	11,196	11,196
Advances:		
PWLB	50,869	60,455
DMA	292,000	292,000
EEA	760	760
accrued interest	746	746
Other assets	36,262	36,262
Total assets	394,715	404,882
Liabilities		
Other sterling debt		
Treasury Bills	204,459	205,147
DMA	48,967	48,967
Issue Department of Bank of England	4,144	4,144
Government balances	16,383	16,383
Temporary deposits	7,792	7,792
Other	1,141	1,141
National Savings & Investments	96,503	96,699
accrued interest	692	694
IMF liabilities	9,501	9,501
Gilts		
Marketable	735,192	791,744
Non-marketable	312	324
Total liabilities	1,125,086	1,182,536

Carrying Value and Fair Value of NLF assets and liabilities as at 1 April 2008

	Values at 1 April 2008	
	Carrying Value	Fair Value
Assets	£m	£m
Loans		
Principal	2,971	3,333
accrued interest	30	30
IMF Quota Subscription and Bilateral Loan	8,881	8,881
Advances		
PWLB	50,753	59,453
EEA	1,330	1,330
accrued interest	620	620
Other assets	25,180	25,180
Total assets	89,765	98,827
Liabilities		
Other sterling debt		
DMA	49,140	49,140
Issue department of Bank of England	7,403	7,403
Government balances	16,288	16,288
Temporary deposits	3,473	3,473
Other	450	450
Foreign debt		
US$ bond	1,509	1,508
accrued interest	25	22
National Savings & Investments:	83,177	82,093
accrued interest	1,253	1,224
IMF liabilities	8,320	8,320
Gilts		
Marketable	489,383	525,936
Non-marketable	572	580
Total liabilities	660,993	696,437

The NLF's assets are classified as financial assets except for the net assets of the EEA and DMA. The carrying value of financial assets (all of which are designated as loans and receivables) is £312,878 million (2009 – £359,153 million) and their fair value is £320,172 million (2009 – £369,320 million). All the NLF's liabilities are financial liabilities. In instances where the fair value differs from the carrying value, the fair value has been calculated by reference to market prices where instruments are traded on an active quoted market, or, where this is not the case, as the net present value of future cash flows.

The fair value of advances to the PWLB are calculated as the net present value of future cash flows. Loans by the PWLB are usually at a fixed rate of interest and so their fair value increases or decreases according to changes in the difference between the fixed rate of interest earned on the loan and current market values. Differences between the fair and book value will not be realised as the PWLB loans are not traded by the NLF.

The fair value of Gilts and Treasury Bills are calculated by reference to their market prices. Gilts are generally left in issue until they are very close to maturity and so the difference between their fair value and book value will normally not be realised in the NLF accounts. Treasury Bills are created for use in the Bank of England's Special Liquidity Scheme. Under the scheme, Treasury Bills are replaced on maturity. Therefore the difference between fair value and carrying values will not normally be realised in the NLF.

17 Maturity of assets and liabilities

The following table shows the split between current and non-current assets and liabilities based on contract date of maturity or expected maturity if there is no contract date.

	As at 31 March 2010			As at 31 March 2009			As at 1 April 2008		
	Less than 12 months	**More than 12 months**	**Total**	Less than 12 months	More than 12 months	Total	Less than 12 months	More than 12 months	Total
	£m	**£m**	**£m**	£m	£m	£m	£m	£m	£m
Assets									
Advances	**0**	**297,918**	**297,918**	0	344,375	344,375	0	52,703	52,703
IMF Quota Subscription (SDR) and Bilateral Loan	**0**	**11,022**	**11,022**	0	11,196	11,196	0	8,881	8,881
Loans	**357**	**2,834**	**3,191**	31	2,851	2,882	18	2,983	3,001
Other assets	**748**	**38,144**	**38,892**	700	35,562	36,262	763	24,417	25,180
Total assets	**1,105**	**349,918**	**351,023**	731	393,984	394,715	781	88,984	89,765
Liabilities									
Gilts									
Conventional	**52,376**	**688,893**	**741,269**	16,380	543,991	560,371	18,493	326,220	344,713
Index-linked	**0**	**195,994**	**195,994**	9,504	165,629	175,133	0	145,242	145,242
Gilt-edged stock	**52,376**	**884,887**	**937,263**	25,884	709,620	735,504	18,493	471,462	489,955
National Savings and Investments	**98,511**	**293**	**98,804**	96,916	279	97,195	83,798	632	84,430
IMF liabilities	**0**	**8,702**	**8,702**	0	9,501	9,501	0	8,320	8,320
Treasury Bills for SLS	**176,076**	**0**	**176,076**	204,459	0	204,459	0	0	0
Other debt payable in sterling	**50,972**	**0**	**50,972**	78,427	0	78,427	76,754	0	76,754
Other debt payable in foreign currencies	**0**	**0**	**0**	0	0	0	1,534	0	1,534
Total liabilities	**377,935**	**893,882**	**1,271,817**	405,686	719,400	1,125,086	180,579	480,414	660,993

18 Financial risks related to the NLF

The Government's debt management policy is set out in the annual Debt and Reserves Management Report. The debt management policy remains

> *"to minimise, over the long term, the costs of meeting the Government's financing needs, taking into account risk, whilst ensuring that debt management policy is consistent with the aims of monetary policy".*

The debt management policy objective is achieved by:

- pursuing an issuance policy that is open, transparent and predictable;
- issuing gilts that achieve a benchmark premium;
- adjusting the maturity and nature of the Government's debt portfolio, primarily by means of the maturity and composition of debt issuance and potentially by other market operations including switch auctions, conversion offers and buy-backs;
- developing a liquid and efficient gilt market; and
- offering cost-effective savings instruments to the retail sector through National Savings & Investments.

Through these means, the Government seeks to choose a strategy that minimises the expected average debt cost over the longer term, and ensures that the chosen strategy is robust against different economic outturns.

For cash management, the aggregate balance on government accounts is swept daily to the National Loans Fund, and then to the Debt Management Account. The Debt Management Office deals with the financial markets to manage the daily cash surplus or deficit on the Debt Management Account relative to its target overnight balance, lending when there is a surplus and borrowing when there is a deficit.

The National Loans Fund's liabilities include conventional and index-linked gilt-edged securities and a wide range of National Savings and Investments products. There is a wide spread of maturities. NLF liabilities also include Treasury Bills in respect of the Bank of England's Special Liquidity Scheme. Treasury Bills for this purpose are issued with a maturity of nine months. No foreign currency debt was issued in 2009-2010. The NLF's liabilities also include deposits from several other public sector accounts.

NLF assets include advances to the Debt Management Account, the Public Works Loan Board, and the Exchange Equalisation Account. The UK's gross Quota Subscription to the IMF is also an asset of the National Loans Fund, and is denominated in Special Drawing Rights (SDRs). NLF assets also include the net assets of the DMA and EEA.

Set out below are certain risk factors that could affect the National Loans Fund's operations.

Interest rate and inflation risk

The NLF is exposed to cash flow interest rate risk on its floating rate borrowing and lending, due to the risk that future interest rates will fluctuate. It is not exposed to fair value interest rate risk as its financial assets and liabilities are measured at amortised cost and not fair value. Some of the NLF's assets and liabilities are zero-rated, and are therefore not exposed to changes in interest rates.

Inflation risk arises because interest and redemption amounts paid on index-linked gilts vary in line with changes in the UK Retail Price Index (RPI) since the initial issue of each stock.

The table below analyses the NLF's interest rate and inflation risk. Assets and liabilities are included at carrying amount and are shown at the earlier of contractual re-pricing or maturity dates.

Interest rate and inflation risk analysis as at 31 March 2010

	Up to 1 month/ repayable on demand	1-12 months	1-5 years	Over 5 years	Undated	Zero-rated	Total carrying value	Fixed rate	Floating rate
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Assets									
Loans	191	166	226	2,580	0	28	3,191	3,163	0
Advances	242,130	1,934	6,128	43,026	0	4,700	297,918	50,711	242,507
Other assets	0	0	0	0	0	38,892	38,892	0	0
IMF Quota Subscription	0	0	0	0	0	10,762	10,762	0	0
IMF loans	0	0	0	0	0	260	260	0	0
Total	242,321	2,100	6,354	45,606	0	54,642	351,023	53,874	242,507
Liabilities									
Gilts									
Conventional	0	51,840	194,119	486,400	2,821	6,089	741,269	735,180	0
Index-linked	195,994	0	0	0	0	0	195,994	0	195,994
Gilt-edged stock	195,994	51,840	194,119	486,400	2,821	6,089	937,263	735,180	195,994
National Savings and Investments	79,123	5,423	13,224	0	0	1,034	98,804	18,647	79,123
Treasury Bills for SLS	300	175,776	0	0	0	0	176,076	176,076	0
Other debt payable in sterling	41,567	0	0	0	0	9,405	50,972	7,698	33,869
IMF liabilities	0	0	0	0	0	8,702	8,702	0	0
Total	316,984	233,039	207,343	486,400	2,821	25,230	1,271,817	937,601	308,986
Period gap	74,663	230,939	200,989	440,794	2,821	(29,412)	920,794		
Cumulative gap	74,663	305,602	506,591	947,385	950,206	920,794			

Interest rate and inflation risk analysis as at 31 March 2009

	Up to 1 month/ repayable on demand	1-12 months	1-5 years	Over 5 years	Undated	Zero-rated	Total carrying value	Fixed rate	Floating rate
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Assets									
Loans	1	30	232	2,590	0	29	2,882	2,853	0
Advances	292,151	1,771	5,279	43,652	0	1,522	344,375	50,694	292,159
Other assets	0	0	0	0	0	36,262	36,262	0	0
IMF Quota Subscription	0	0	0	0	0	11,196	11,196	0	0
IMF loans	0	0	0	0	0	0	0	0	0
Total	292,152	1,801	5,511	46,242	0	49,009	394,715	53,547	292,159
Liabilities									
Gilts									
Conventional	0	16,094	157,318	378,640	2,873	5,446	560,371	554,925	0
Index-linked	175,133	0	0	0	0	0	175,133	0	175,133
Gilt-edged stock	175,133	16,094	157,318	378,640	2,873	5,446	735,504	554,925	175,133
National Savings and Investments	81,172	178	15,060	0	0	785	97,195	15,238	81,172
Treasury Bills for SLS	20,448	184,011	0	0	0	0	204,459	204,459	0
Other debt payable in sterling	66,125	0	0	0	0	12,302	78,427	7,779	58,346
IMF liabilities	0	0	0	0	0	9,501	9,501	0	0
Total	342,878	200,283	172,378	378,640	2,873	28,034	1,125,086	782,401	314,651
Period gap	50,726	198,482	166,867	332,398	2,873	(20,975)	730,371		
Cumulative gap	50,726	249,208	416,075	748,473	751,346	730,371			

Foreign currency risk

The NLF's only exposure to foreign exchange movements is through the UK's transactions with the IMF. These are described in note 7. The quota subscription to the IMF and the bilateral loan to the IMF are both SDR denominated assets and are subject to valuation adjustments by the IMF and also at the year end. Whilst being denominated in sterling, the UK's assets of the IMF are subject to SDR valuation adjustments by the IMF.

Sensitivity analysis

The following analysis, required by IFRS 7, is intended to illustrate the sensitivity of the NLF's financial assets and liabilities to changes in UK interest rates, the UK Retail Price Index and the SDR to sterling exchange rate. The sensitivity analysis has been calculated on the basis that the components of financial assets and liabilities, the amount of instruments held at fixed, floating and zero interest rates and the amount of instruments held in SDRs are all constant and are as at the Statement of Financial Position date.

The following assumptions have been made in calculating sensitivity;

- All sensitivities impact the Operating Cost Statement and thereby the net liability of the CF to the NLF;
- Finance income and costs and the net liability of the CF to the NLF will be affected by changes in interest rates on floating rate instruments;
- Finance income and costs and the net liability of the CF to the NLF will not be affected by changes in interest rates on fixed rate instruments;
- All instruments are held at amortised cost and are therefore not subject to changes in fair value as a result of interest rate changes; and
- No sensitivity is provided for interest accruals where these are based on pre-agreed interest rates and are therefore not susceptible to further rate changes.

Using the above assumptions, the following table shows the illustrative impact on the Operating Cost Statement that would result from an increase in UK interest rates, the UK retail price index, and if the SDR to sterling exchange rate were to strengthen.

	2009-2010	2008-2009	As at 1 April 2008
	Operating Cost Statement	Operating Cost Statement	Operating Cost Statement
	£m	£m	£m
UK interest rates + 100bp income/(expense)	**1,295**	1,526	(1,303)
UK retail price index + 100bp (expense)	**(1,960)**	(1,751)	(1,452)
SDR exchange rate + 10%	**(232)**	(170)	(56)

An equal, but opposite effect would result if there was a decrease in UK interest rates and the UK retail price index, and if the SDR to sterling exchange rate were to weaken.

Liquidity risk

NLF liabilities carry a wide range of maturities, spreading funding requirements for redemption payments across a wide time period into the future. The longest stock in existence at 31 March 2010 matures in 2060. A small number of stocks are undated and can be redeemed by the Treasury at a time of its choosing. Deposits in the NLF have a shorter maturity profile, since they can change on demand. However, in practice, balances change only slowly due to re-investment. The NLF is the government's main borrowing and lending account. By the nature of government financing, it is expected that the NLF will show a net liability. By virtue of section 19(1) of the National Loans Act 1968, the net liabilities of the NLF are a liability of the Consolidated Fund. The servicing of these liabilities is met mainly by tax revenue receipts. For this reason, the Accounting Officer continues to adopt the going concern basis in preparing the Account.

Contractual undiscounted cash flows of financial liabilities

The following table shows the contractual undiscounted cash flows of the NLF's liabilities. The amounts shown are the cash flows arising from the NLF's financial liabilities during the period up to and including maturity. This is in contrast to the basis on which the statement of financial position amounts are calculated. As described in note 1, items on the statement of financial position are valued at fair value upon initial recognition and subsequently held at amortised cost. Therefore totals in the following table will not agree to the statement of financial position.

The treatment of coupon payments is of particular significance. The table includes contractual coupon payments for the period to maturity based on interest rates or, in the case of index-linked gilts, the retail price index at 31 March 2010. Because of the many coupon payments to be made for longer dated gilts the table below reports coupon cash flows of £504,522m whereas the Gilts liability in the statement of financial position contains accruals to the statement of financial position date of £23,406m. Undated Gilts do not have a contractual maturity date and so coupon payments on them (currently £94m per annum) are not included in the table below.

The cash flows reported in the table will be funded by replacement debt issues, the proceeds of assets or by finance from the Consolidated Fund.

At 31 March 2010

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Undated	Total
	£m	£m	£m	£m	£m	£m	£m
Liabilities							
Conventional Gilts:							
Principal	0	21,335	30,413	190,662	478,016	2,821	723,247
Coupons	0	7,100	26,338	109,639	310,924	0	454,001
Index-linked Gilts:							
Principal	0	0	0	31,978	158,632	0	190,610
Coupons	211	472	3,004	12,862	33,972	0	50,521
Total Gilts	211	28,907	59,755	345,141	981,544	2,821	1,418,379
NS&I	98,349	90	0	429	0	72	98,940
IMF	8,702	0	0	0	0	0	8,702
Treasury Bills for SLS	300	108,657	67,397	0	0	0	176,354
Temporary deposits	2,305	5,401	0	0	0	0	7,706
Other debt payable in sterling	43,269	0	0	0	0	0	43,269
	153,136	143,055	127,152	345,570	981,544	2,893	1,753,350

The maturity of liabilities after five years is

	5-10 years	10-20 years	20-30 years	30-40 years	Over 40 years	Total
	£m	£m	£m	£m	£m	£m
Conventional Gilts						
Principal	173,765	105,326	113,971	53,307	31,647	478,016
Coupons	96,356	114,123	62,698	28,010	9,737	310,924
Index-linked Gilts						
Principal	33,056	55,061	45,254	17,966	7,295	158,632
Coupons	12,307	14,356	5,070	1,692	547	33,972
	315,484	288,866	226,993	100,975	49,226	981,544

At 31 March 2009

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Undated	Total
	£m	£m	£m	£m	£m	£m	£m
Liabilities							
Conventional Gilts							
Principal	0	0	15,958	154,365	370,311	2,872	543,506
Coupons	0	6,907	20,290	89,140	255,591	0	371,928
Index-linked Gilts							
Principal	0	9,421	0	32,442	128,153	0	170,016
Coupons	215	465	2,868	12,616	31,000	0	47,164
Total Gilts	215	16,793	39,116	288,563	785,055	2,872	1,132,614
NS&I	96,689	0	136	362	0	94	97,281
IMF	9,501	0	0	0	0	0	9,501
Treasury Bills for SLS	20,503	34,725	150,466	0	0	0	205,694
Temporary deposits	7,467	327	0	0	0	0	7,794
Other debt payable in sterling	70,635	0	0	0	0	0	70,635
	205,010	51,845	189,718	288,925	785,055	2,966	1,523,519

The maturity of liabilities after five years is

	5-10 years	10-20 years	20-30 years	30-40 years	Over 40 years	Total
	£m	£m	£m	£m	£m	£m
Conventional Gilts						
Principal	119,822	98,764	80,644	39,121	31,960	370,311
Coupons	78,314	95,853	51,820	23,108	6,496	255,591
Index-linked Gilts						
Principal	31,626	50,594	34,549	4,348	7,036	128,153
Coupons	11,639	13,185	4,387	1,173	616	31,000
	241,401	258,396	171,400	67,750	46,108	785,055

Credit risk

Credit risk arises when the NLF lends or advances to other bodies. Details of this can be found in notes 6, 7 and 8. Total loans and advances stand at £301,109 million (2008-09; £347,257 million) and IMF exposure stands at £11,022 million (2008-09 £11,196 million).

Due to the nature of its borrowers, the NLF is not exposed to significant credit risk. In respect of loans financed by the NLF, the financial relationship with the borrower is managed by the department responsible for the relevant public corporation. The sponsoring department performs due diligence on the borrower and proposes the loan. The Treasury reviews the proposal and, if the proposal is approved, the NLF will make the loan. The NLF is not allowed to accept losses on its loans. Any such losses can only be written off by primary legislation; however, in 1990 the Treasury gave an undertaking to the Public Accounts Committee that it would not seek Parliament's approval to such a course except as part of a reconstruction of the borrower's finances prior to privatisation. In other cases the Treasury would look to the borrower's sponsor department to cover any losses from its resource account.

In the case of advances to the Public Works Loan Board for loans to Local Authorities, the PWLB manages the financial relationship with the borrower, though the credit risk is borne by the NLF.

In the context of NLF loans issued to trading organisations at market rates, under the Commercial Lending policy, the terms and interest rates are designed to reflect the terms on which a private sector lender, such as a commercial bank, would lend to the borrower if the borrower were a wholly private sector body, rather than a government body.

Ceilings on total lending from the NLF to specific bodies are prescribed in the statutes governing each loan. The PWLB is allowed to lend up to an aggregate amount of £70 billion (2008-2009: £70 billion). For short-term lending to public bodies, the maximum exposure of the NLF is determined by prescribed credit ceilings appropriate for the circumstances of the body.

The IMF maintains a level of resources as prudential cover in order to ensure the continued security and liquidity of its members' claims. Other factors that help safeguard the Fund resources include the conditions associated with Fund lending and the Fund's status as a creditor who has the preferential right to receive payment. This covers the new loan agreement with the IMF as per Note 7.

None of the NLF's financial assets are past due or impaired.

Derivatives and hedging

The NLF itself does not use derivatives or undertake hedging. However, as explained in more detail below, some of the risks on the NLF are offset by hedging and other activities of the Debt Management Account and the Exchange Equalisation Account.

National Savings & Investments have issued a number of Guaranteed Equity Bonds that expose the NLF to equity index risk. The Debt Management Office have hedged this exposure through derivatives that are held on the DMA. For the government overall (and the NLF) this ensures that the equity index risk is negated, and replaced with a LIBOR exposure.

The Exchange Equalisation Account Act constrains how the Exchange Equalisation Account (EEA) may borrow from outside government. Where the EEA's foreign currency reserves are financed by foreign currency borrowing, the debt is issued by and is an obligation of the NLF. The foreign currency raised is sold to the EEA for sterling. While the NLF remains exposed to the interest rate and exchange rate risks from the foreign currency loan it has issued, in practice these risks are offset through the EEA's programme of asset management and swaps.

19 Events After the Reporting Period

G20 countries have committed to expanding the IMF's New Arrangements to Borrow (NAB). As part of this effort, the UK will increase its commitment to the NAB to SDR 18.66 billion (£18.7 billion) (this figure includes the UK's contingent bilateral loan to the IMF of SDR 9.92 billion (£9.94 billion), which came into effect in September 2009. The bilateral loan will be rolled into the expanded NAB once it comes into effect). This increase is subject to Parliamentary approval. If these credit lines are called upon, the amounts provided in sterling will be subject to valuation adjustments at year end.

20 Date of Authorisation for Issue of Account

The Account was authorised for issue by the Accounting Officer on 16 July 2010.

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