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

National Loans Fund Account 2010-2011

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Contents

Foreword

Background to the National Loans Fund

1 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 set up 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.

2 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).

3 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 long term, taking account of risk, and to minimise the cost of offsetting the Government's net cash flows over time, while operating in a risk appetite approved by Ministers in both cases'. 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 Prices 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 2011-12 published by the Treasury in March 2011 (ISBN: 978-1-84532-838-2).

4 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.

National Loans Fund Activities

5 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.

6 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.

7 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 under section 9(1) of the National Loans Act 1968. NS&I's savings products 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.

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

Eurozone Interventions

9 The UK has continued to support the IMF through the NLF in 2010-11, in line with our commitments as a member of the IMF. The UK has provided such support through both our quota shareholding and our bilateral loan to the Fund. The UK's agreed bilateral loan to Ireland of £3.2 billion will be funded by HM Treasury's Vote, which will receive its funding from the Consolidated Fund through the normal Supply procedures. Details can be found in HM Treasury's Departmental Report and Accounts 2010-11. The UK is also a member of the European Financial Stabilisation Mechanism (EFSM), which provides support to all EU Member States. The Consolidated Fund is responsible for the United Kingdom's contribution to the EFSM. Details can be found in the Consolidated Fund Account 2010-11. The NLF is not party to either the bilateral loan to Ireland or the EFSM.

Special Liquidity Scheme (SLS) and Asset Purchase Facility

10 The SLS is the Bank of England's scheme which allows banks to swap, for up to three years, their high quality mortgage-backed and other securities for Treasury Bills. Treasury Bills are issued 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. The scheme is now winding down and as a result there has been a £53.3 billion fall in Treasury Bills. The scheme is scheduled to cease in June 2012, when the last Treasury Bill matures. 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.

11 The Asset Purchase Facility was set up in 2008-09 at the Bank of England in order to improve liquidity in credit markets by purchasing securities (a process known as 'quantitative easing'). As at 31 March 2011, on an amortised cost basis, £184 billion (2009-10: £184 billion) of gilts from the NLF were held by the Bank of England for quantitative easing. More information on the scheme can be found on the Bank of England's website.

Summary of Outturn for 2010-11

12 The total comprehensive net expenditure of the Fund increased by £7.7 billion from £30.0 billion in 2009-10 to £37.7 billion in 2010-11. This was mainly due to higher finance costs of borrowing of £13.6 billion as gilt stock steadily increased and the Retail Prices Index (RPI) increased. The increase in RPI also led to an increase in NS&I costs. The increased cost was partly offset by higher overall profits of other entities; the total comprehensive income of the DMA increased by £5.1 billion and EEA's total comprehensive income has increased by £802 million. These were a result of fair value gains in the DMA's holdings of gilts and Treasury Bills, and fair value gains on gold holdings.

Gilts and Treasury Bills

13 Total gross liabilities increased by £72 billion from £1,271.8 billion to £1,343.8 billion. The main factor behind this rise was an increase of £122.0 billion in the Fund's liability in respect of gilt-edged stock and a small increase in Other Debt of £4.5 billion. These increases are offset by the £53.3 billion fall in Treasury Bills in respect of the Special Liquidity Scheme and a fall of £1.4 billion for liabilities due to the IMF.

Advances and Loans

14 The NLF's total gross assets decreased by £68.6 billion to £282.4 billion. This was mainly due to a repayment of advances made to the DMA.The principal outstanding has fallen by £85 billion since March 2010 as the DMA no longer required the advance 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

15 During 2009-10, the UK agreed to provide a bilateral loan facility to the IMF for an amount up to the equivalent of SDR 9.92 billion. At 31 March 2011 £1.1 billion of loans were outstanding (31 March 2010: £0.3 billion). The drawn loans represent 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

16 As a result of these changes, the net liabilities of the Fund increased from £920.8 billion to £1,061.4 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 Statistical Bulletin", which can be found on the Treasury website.

Forward Look

17 The Debt Management Remit for 2011-12 was published by the Treasury with the budget on 23 March 2011. On the basis of a Central Government Net Cash Requirement forecast of £120.4 billion for 2011-12, the published net financing requirement was £167.4 billion. This difference relates to upwards adjustments of £49.0 billion for gilt redemptions and £6.0 billion additional sterling financing for the official reserves, and downwards adjustments of £6.0 billion for short term financing, and £2.0 billion for NS&I's net financing contribution. The DMO will meet the net financing requirement by gross gilt sales of £169.0 billion (gilts issued by the NLF) and a reduction in the DMA's Treasury Bill stock of £1.6 billion. More information can be found in The Debt and Reserves Management Report 2011-12 http://www.hm-treasury.gov.uk/2011budget_debtreserves.htm

Preparation of the Account

18 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

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

20 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.

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

Nicholas Macpherson 14 July 2011
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 total comprehensive net expenditure 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 2011 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 set out in HMT's Departmental Annual Report and Accounts. The Treasury Accountant has overall responsibility on a day-to-day basis for risk management of those Funds managed by 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 tasks in their area are compliant with operational policies and procedures, and legislation. EFA management now provide me with a quarterly update report on changes to the control environment and changes in risk exposure. I received the first report in January 2011.

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 awareness and management is provided as required, either by management or by attending appropriate courses. Individuals' objectives reflect the need to manage risks. Training is also provided to staff to build the team's capability and to increase its resilience, EFA team members are encouraged to obtain professional qualifications in areas that are relevant to their roles.

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 the risk, is assigned to each risk. The risk register is regularly reviewed by EFA management, and is circulated to me alongside the quarterly risks and controls report.

During the year, there were two significant changes to the control environment:

- **Modernisation of the Treasury's IT infrastructure and services:** During 2009-10 Fujitsu took over the provision of IT services to the Treasury under the 'Fast Forward' programme. This was rolled out during 2010-11. EFA were migrated to Fujitsu laptops in October/November 2010. Testing was carried out to ensure that all applications worked correctly on the laptops. Migration of the NLF's core accounting system to the Fujitsu data centre servers took place in February 2011 after successful User Acceptance Testing and parallel running. The responsibility for maintaining the accounting system remains with EFA's Business Continuity and Systems Support.

- **Migration of Government Banking Service (GBS) bank accounts to Citigroup and Royal Bank of Scotland:** The Government Banking Service has changed its main provider of banking transaction services from the Bank of England to Citigroup and the Royal Bank of Scotland Group (RBSG). This project was completed during 2010-11. The NLF main bank account remains at the Bank of England. However, there are a number of sub-accounts used by EFA in connection with the NLF, to allow easier monitoring and validation of NLF payments and receipts, which were migrated in October 2010. The project was managed carefully to ensure that new bank accounts were set up correctly, that the accounting system was updated correctly with new account details for counterparties where necessary, and that the new payments and receipts processes would function correctly. New controls are now in place and job instructions have been revised.

The key risks in managing the National Loans Fund and their associated controls are:

- **Irregularity of transactions, including fraudulent or erroneous payments:** 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. Separately, the Comptroller and Auditor General, through the National Audit Office Exchequer Section approves National Loans Fund payments in advance and reconciles Fund transactions on a daily basis. 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.

- **Incorrect accounting:** Application controls exist within the IT system used to manage financial transactions and account for receipts and payments on the Fund. Interest and amortisation are generated automatically by the accounting system at month end using pre-defined rules. New general ledger accounts are authorised by the Deputy Treasury Accountant before being set up. Gilts issuances are reported to senior management on the day. EFA reconciles the dividend claims received from the gilts registrar with its own records prior to each interest payment. The Debt Management Office reconciles principal amounts twice a year. Monthly management accounts for the Fund are also produced and reviewed by the Treasury Accountant, and are provided to me.

- **Failure of IT systems:** The Fujitsu data centre offers the highest level of resilience available as prescribed by Telecommunications Industry Standard TIA-942 with availability set to 99.995%. A disaster recovery site is also provided under the terms of Flex.

- **Failure to provide an effective service in adverse circumstances, including disaster situations:** 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 Office Exchequer Section'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.

- **Failure of principal counterparties to provide agreed services:** Well-developed Service Level Agreements (SLAs) 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. Quarterly meetings are held with managers at the Bank of England where service levels are discussed. A monthly report of any failure to meet the service requirements is also sent to the Bank of England by EFA. A monthly meeting is held with GBS management where service levels are discussed.

- **Information risk:** 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. HMT adheres to Cabinet Office guidelines. EFA's own Data Handling Policy identifies risks specific to EFA. This policy is reviewed on a six-monthly basis or as required.

The Treasury Audit Committee is tasked with supporting me, as Principal Accounting Officer, and the Treasury's Additional and other Accounting Officers in their responsibilities for managing risk, internal control and governance related to the:

- Treasury Group's Annual Report and Accounts;
- Consolidated Fund;
- Contingencies Fund;
- National Loans Fund; and,
- Exchange Equalisation Account.

I appoint members of the Committee for periods up to three years, extendable by no more than two additional three-year periods. The Chair of the Committee reports directly to me and presents a regular report to the Treasury Board. The membership of the Committee during 2010-11 was:

- Michael O'Higgins (Chair) – Non Executive Board Member, HM Treasury; Chairman of the Audit Commission; Chairman of the Pensions Regulator; Non Executive Director, Investec-Calculus Venture Capital Trust;
- Mike Ashley – Head of Quality and Risk Management, KPMG Europe LLP; Board Member, KPMG Europe LLP;
- Zenna Atkins – Chief Executive Officer, Wey Education PLC; Managing Director, Zail Enterprises Ltd; Chair, Royal Navy Audit Committee; Non Executive Director, Royal Navy Board;
- Janet Baker – Non Executive Director and Commissioner, Audit Commission; Non Executive Director, Defence Support Group, MoD; Non Executive Director, Rural Payments Agency;
- Bradley Fried – Managing Partner, Grovepoint Capital LLP, Non Executive Director of the Group Board, Investec plc and formerly CEO, Investec Bank plc; and
- Avinash Persaud – Chairman, Intelligence Capital.

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 me 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 Debt Management Office and the Asset Protection Agency, and the Treasury Accountant also attend Committee meetings as required. Members have the opportunity for a pre-committee discussion with the National Audit Office, Group Head of Internal Audit for HM Treasury and Head of Internal Audit for the Exchequer Funds.

The Treasury Audit Committee met five times during 2010-11.

For the National Loans Fund, an annual risk-based internal audit programme is performed by Exchequer Funds Internal Audit. This programme is agreed with the Treasury Accountant in advance of the Audit Committee's approval. 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 auditor is the Comptroller and Auditor General and the National Audit Office attend all Audit Committee meetings on his behalf.

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 2010-11, 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 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 2010-11 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 2010-11.

Nicholas Macpherson 14 July 2011
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 2011 under the National Loans Act 1968. These comprise the Statement of Comprehensive Net Expenditure, the Statement of Financial Position, the Statement of Cash Flows and the related notes. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of the Treasury, Accounting Officer and auditor

As explained more fully in the Statement of Accounting Officer's Responsibilities, the Treasury and Accounting Officer are 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, certify and report on the financial statements in accordance with the National Loans Act 1968. I conducted my audit in accordance with 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 National Loans 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 read all the financial and non-financial information in the Foreword, Statement of Accounting Officer's responsibilities, and the Statement on Internal Control, to identify material inconsistencies with the audited financial statements. If I become aware of an apparent material misstatements or inconsistencies I consider the implications for my certificate.

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 of the state of the National Loans Fund's affairs as at 31 March 2011, and of the total comprehensive net expenditure for the year then ended; and
- the financial statements have been properly prepared in accordance with the National Loans Act 1968 and in the form prescribed by HM Treasury.

Opinion on other matters

In my opinion, the information given 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

15 July 2011

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

Statement of Comprehensive Net Expenditure for the year ended 31 March 2011

	Note	**2010-11** £m	2009-10 £m
Finance costs of borrowing	2	**51,248**	37,688
Income from lending operations	3	**(4,500)**	(4,608)
Losses on foreign exchange transactions	4	**30**	74
Other expenditure	5	**290**	235
Other income	5	**(9,385)**	(3,353)
Total comprehensive net expenditure		**37,683**	30,036

The changes to taxpayers' equity are those included in the Statement of Comprehensive Net Expenditure and in Note 13 Liability of the Consolidated Fund to the National Loans Fund.

The notes on pages 15 to 34 form part of this account.

Statement of Financial Position as at 31 March 2011

	Note	**At 31 March 2011**	At 31 March 2010
		£m	£m
Assets			
Advances	8	**220,005**	297,918
Loans and commitments to lend	6	**3,388**	3,191
Other assets	9	**47,323**	38,892
IMF Quota Subscription & Bilateral Loans	7	**11,690**	11,022
Total assets		**282,406**	351,023
Liabilities			
Gilt-edged stock	12	**1,059,308**	937,263
National Savings and Investments products	11	**98,886**	98,804
Liabilities to the IMF	7	**7,316**	8,702
Other debt payable in sterling:			
Treasury Bills	10	**122,819**	176,076
Other	10	**55,465**	50,972
Total liabilities		**1,343,794**	1,271,817
Liability of the Consolidated Fund to the National Loans Fund	13	**1,061,388**	920,794

Nicholas Macpherson 14 July 2011
Accounting Officer
HM Treasury

The notes on pages 15 to 34 form part of this account.

Statement of Cash Flows for the year ended 31 March 2011

	Note	**2010-11**	2009-10
		£m	£m
Cash flows from operating activities			
Interest received		**4,531**	4,645
Other receipts		**483**	450
Interest paid		**(42,042)**	(38,547)
Other flows		**258**	(1,761)
Transfer from the Consolidated Fund for the cost of debt servicing	13	**36,770**	35,213
Net change in cash from operating activities		**–**	–
Cash flows from investing activities			
Net decrease in advance to the DMA		**85,000**	50,000
Net increase in advance to the PWLB		**(1,918)**	(378)
Net increase in loans		**(1,050)**	(563)
Net increase in advance to the EEA		**(5,200)**	(3,200)
Reduction on the EEA's capital contribution reserve		**–**	55
Net cash inflow from investing activities		**76,832**	45,914
Cash flows from financing activities			
Net issuance of government stock		**114,458**	202,200
Net redemption of SLS Treasury Bills		**(53,100)**	(26,796)
Net (redemption) / issuance of National Savings products		**(1,560)**	363
Increase / (decrease) in other net sterling borrowing		**4,487**	(27,423)
Net transfers of IMF non-interest bearing securities		**(1,436)**	1,342
Net transfers to the Consolidated Fund	13	**(139,681)**	(195,600)
Net cash outflow from financing activities		**(76,832)**	(45,914)
Net change in cash and cash equivalents		**–**	–
Cash and cash equivalents at beginning and end of year		**–**	–

The notes on pages 15 to 34 form part of this account.

Notes to the Account

1 Accounting Policies

1.1 Accounting convention

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 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'.

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 2010-11 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. IFRS 9 is subject to EU endorsement, the timing of which is uncertain, therefore its adoption date for the NLF is currently unknown.

The revision to IAS 24 'Related Party Disclosures' has been adopted early. It has not had an impact on the financial statements on the NLF.

1.2 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 Statement of Financial Position is presented by order of increasing liquidity. 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.

1.3 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.

1.4 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 EEA, therefore all SDR income is accounted for in that Account and not the NLF.

1.5 Financial assets and liabilities

The assets and liabilities of the NLF are all accounted for as financial assets and liabilities except for those arising from the net assets of the EEA and the DMA, which are accounted for as explained in accounting policy (1.9). 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 DMA. The NLF does not charge interest on its advances to PWLB, but interest on loans by the PWLB to local authorities financed by NLF advances is paid to the NLF under section 3(3) of the National Loans Act 1968.

The fair values of the financial assets and liabilities are disclosed in note 15. 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.

1.6 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.

1.7 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 accounts.

1.8 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.

1.9 Exchange Equalisation Account and Debt Management Account

Under section 11 of Schedule 5A to the National Loans Act 1968, any excess of the assets of the DMA over its liabilities shall be a liability of the Account to the National Loans Fund. Over time, the NLF has advanced sterling to the EEA in order to finance the UK's reserves of gold, foreign currency assets and IMF Special Drawing Rights. As a result, the EEA's net assets, having been derived from initial NLF financing, are ultimately due to the NLF. Annual financial statements are prepared for both the DMA and the EEA. Changes in the net assets are reported in Other Assets (Note 9) and recognised in the Statement of Comprehensive Net Expenditure 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.

1.10 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 15. As mentioned in accounting policy (1.3), 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 17 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

	2010-11	2009-10
	£m	£m
Gilt-edged stock:		
Marketable	**47,230**	33,536
Non-marketable	**17**	11
Total	**47,247**	33,547
National Savings and Investments products	**2,581**	1,911
Treasury Bills	**1,067**	1,865
Other finance costs	**353**	365
Total finance costs of borrowing	**51,248**	37,688

3 Income from lending operations

	2010-11	2009-10
	£m	£m
Interest on loans advanced by the National Loans Fund to:		
Public corporations	**93**	86
Central government bodies	**93**	99
	186	185
Interest on loans by the Public Works Loan Board financed by NLF advances	**2,978**	2,891
Interest on funding advanced to the Debt Management Account	**1,336**	1,532
Total income from lending operations	**4,500**	4,608

4 Losses on foreign exchange transactions

	2010-11	2009-10
	£m	£m
Loss on Reserve Tranche Position at the IMF	**26**	81
Loss/(Gain) on Bilateral Loans to the IMF (Note 7)	**4**	(7)
Net Loss on foreign currency transactions	**30**	74

5 Other income and expenditure

	2010-11 £m	2009-10 £m
Other expenditure		
Debt management administration costs [1]	**4**	4
Expenditure in respect of depreciation of Issue Department Assets [2]	**286**	198
Other	**–**	33
Total: Other expenditure	**290**	235
Other income		
EEA total comprehensive income [3]	**(1,764)**	(962)
Profits of the Bank of England Issue Department [2]	**(475)**	(571)
Income in respect of appreciation of Issue Department Assets [2]	**(294)**	(76)
DMA total comprehensive income	**(6,802)**	(1,677)
SLS Fee income from the DMA	**(44)**	(63)
Miscellaneous receipts	**(6)**	(4)
Total: Other income	**(9,385)**	(3,353)
Net total	**(9,095)**	(3,118)

1 Debt management administration costs mainly comprise amounts paid to the Gilts Registrar for administering the gilt-edged stock register. They also include the costs of managing foreign currency relating to the EEA.

2 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 £475 million in respect of these profits was credited to the Statement of Comprehensive Net Expenditure in 2010-11 (£571 million in 2009-10). 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.

3 Of the EEA's profit of £1,764 million (£962 million in 2009-10), £8 million (£4 million in 2009-10) relates to interest receivable on the Reserve Tranche Position and the bilateral loans to the IMF in line with accounting policy (1.4).

6 Loans and commitments to lend

Loans	**2010-11** Public Corporations £m	Central Government £m	Total £m	2009-10 Public Corporations £m	Central Government £m	Total £m
Principal outstanding at 1 April	**1,641**	**1,522**	**3,163**	1,323	1,530	2,853
Loans advanced	**3,552**	**37**	**3,589**	2,664	114	2,778
Loans repaid	**(3,275)**	**(117)**	**(3,392)**	(2,346)	(122)	(2,468)
Principal outstanding at 31 March	**1,918**	**1,442**	**3,360**	1,641	1,522	3,163
Accrued interest	**13**	**15**	**28**	12	16	28
Total asset outstanding	**1,931**	**1,457**	**3,388**	1,653	1,538	3,191

Commitments to lend	**2010-11** Public Corporations £m	Central Government £m	Total £m	2009-10 Public Corporations £m	Central Government £m	Total £m
Undrawn commitments to lend	**381**	**–**	**381**	873	–	873

Commitments to lend are agreements to lend to a customer in the future, subject to certain conditions. Such commitments are either made for a fixed period, or have no specific maturity but are cancellable by the lender. During the year a commitment of £200 million expired. The NLF has not made any loans, and does not have any commitments to lend, in respect of financial institutions classified as 'Financial Sector (public)' following the banking crisis. In addition to the above, the NLF has loans to, and has a commitment to lend to the IMF, which is explained in Note 7.

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 EEA. The UK's Quota Subscription to the IMF, 10,738.5 million Special Drawing Rights (SDRs) equivalent to £10,581 million at 31 March 2011 (£10,762 million at 31 March 2010), 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 £7,303 million at 31 March 2011 (£8,739 million at 31 March 2010). NIBS represent a liability of the NLF to the IMF. There is a remaining small liability of £26 million (£27 million at 31 March 2010) against which an equal amount of sterling cash is made available 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 2011 was £13 million (£64 million at 31 March 2010).

The table below sets out the composition of the RTP at 31 March 2010 and 31 March 2011, and shows the make-up of changes over the year.

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 2011), as a liability to the IMF, and retains an asset in the form of the UK's holdings of SDRs (SDR 9,304 million at 31 March 2011).

During 2010-11 a net payment was made of £1,230 million to the IMF in support of funding programmes (a net payment to the IMF of £446 million in 2009-10).

During 2009-10, the UK agreed to provide a bilateral loan facility to the IMF for an amount up to the equivalent of SDR 9.92 billion (£9.77 billion at the 31 March 2011 exchange rate). The drawn loans represent a claim on the IMF, and therefore an asset of the NLF. The undrawn loans are 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 (1.4).

In November 2010, G20 countries agreed to double the IMF's quota resource limit. As a result, the UK's quota subscription will increase from SDR 10,738.5 million to SDR 20,155.1 million (an increase of £9,278 million at the 31 March 2011 rate). In order to implement this, the IMF requires that three fifths of member countries with a collective voting share of at least 85 percent finalise their domestic legislative requirements. This increase was approved by Parliament in July 2011.

On 1 April 2011, IMF members agreed to the activation of the New Arrangements to Borrow (NAB). The UK's commitment to the NAB is SDR 18.66 billion (£18.39 billion). This is explained further in note 19.

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 31 March 2010	10,762	(8,739)	(27)	64	(8,702)	2,060
Exchange rate losses for the year on the Quota subscription	(181)					(181)
Change in year-end valuation adjustment				(51)	(51)	(51)
Change in loan notes as a result of the valuation settlement		206			206	206
Change in cash on No 1 account			1		1	1
Net decrease in loan notes		1,230			1,230	1,230
Balances at 31 March 2011	**10,581**	**(7,303)**	**(26)**	**13**	**(7,316)**	**3,265**

Bilateral loan to the IMF	£m
Loans outstanding as at 31 March 2010	260
Loans advanced in 2010-11	853
Loss on foreign exchange	(4)
Bilateral loans outstanding at 31 March 2011	**1,109**
IMF Quota Subscription and Bilateral loan	**11,690**

8 Advances

	PWLB		DMA		EEA		Total	
	£m	£m	**£m**	£m	**£m**	£m	**£m**	£m
	2010-11	2009-10	**2010-11**	2009-10	**2010-11**	2009-10	**2010-11**	2009-10
Principal outstanding at 1 April	**51,247**	50,869	**242,000**	292,000	**3,960**	760	**297,207**	343,629
Advances	**5,255**	5,080	**55,000**	50,000	**6,550**	5,600	**66,805**	60,680
Advances repaid	**(3,337)**	(4,702)	**(140,000)**	(100,000)	**(1,350)**	(2,400)	**(144,687)**	(107,102)
Principal outstanding at 31 March	**53,165**	51,247	**157,000**	242,000	**9,160**	3,960	**219,325**	297,207
Accrued interest	**579**	584	**101**	127	**–**	–	**680**	711
Total advances outstanding	**53,744**	51,831	**157,101**	242,127	**9,160**	3,960	**220,005**	297,918

9 Other assets

		At 31 March 2011		At 31 March 2010
		£m		£m
Exchange Equalisation Account net assets		**27,997**		26,233
Debt Management Account net assets		**18,713**		11,912
National Savings and Investments' cash holdings:				
From sale of investment products	**409**		606	
For repayment of principal	**110**		43	
For payment of interest and prizes	**63**		60	
NS&I Total		**582**		709
SLS accrued fee income from the DMA		**5**		11
Sterling balances at Bank of England advanced to IMF		**26**		27
Total other assets		**47,323**		38,892

10 Other debt payable in sterling

	At 31 March 2011	At 31 March 2010
	£m	£m
Treasury Bills	**122,819**	176,076
Other:		
Debt Management Account	**30,546**	28,511
Bank of England Issue Department	**370**	370
Balances from government accounts at the Government Banking Service	**16,037**	13,552
Deposits from public sector bodies	**7,819**	7,703
Other	**693**	836
	55,465	50,972
Total other debt payable in sterling	**178,284**	227,048

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. The scheme is scheduled to cease in June 2012 when the last Treasury Bill matures. The fair value of Treasury Bills issued at 31 March 2011 was £122,832 million (note 15). Further information on the scheme is provided in paragraph 10 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 Government Banking Service. Deposits from public sector bodies represents deposits by public sector bodies which are directly held with the NLF. Other amounts mainly comprise Certificate of Tax deposits held by the NLF.

11 National Savings and Investments products

	2010-11	2009-10
	£m	£m
Principal outstanding at 1 April	**97,842**	96,503
Cash repayments from the NLF	**(15,498)**	(16,383)
Principal cash received in the NLF	**13,938**	16,746
Capitalised interest and other returns to savers	**1,672**	965
Change in cash holdings for principal	**(130)**	11
Principal outstanding at 31 March	**97,824**	97,842
Accrued interest and other returns to savers	**1,062**	962
Total principal and accrued interest outstanding	**98,886**	98,804

12 Gilt-edged stock

	At 31 March 2011 £m	At 31 March 2010 £m
Marketable Securities:		
Conventional	**818,841**	740,875
Index-Linked	**240,148**	195,994
	1,058,989	936,869
Non-Marketable Securities:		
Conventional	**319**	394
Total gilt-edged stock	**1,059,308**	937,263

On an amortised cost basis at 31 March 2011, £119,580 million (£131,873 million at 31 March 2010) of the total gilt-edged stock liability was held by the DMA, and £184,147 million was held by the Bank of England for quantitative easing (£183,770 million at 31 March 2010). The remaining £755,581 million (£621,620 million at 31 March 2010) 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 £49.50 million (2009-10: £68.25 million).

13 Liability of the Consolidated Fund to the National Loans Fund

	2010-11 £m	2009-10 £m
Liability of the Consolidated Fund to the NLF at 1 April	**920,794**	730,371
Net cash paid to the Consolidated Fund	**139,681**	195,600
Payment from the Consolidated Fund to the NLF for the cost of debt servicing during the year	**(36,770)**	(35,213)
Total comprehensive net expenditure	**37,683**	30,036
Liability of the Consolidated Fund to the NLF at 31 March	**1,061,388**	920,794

14 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) Under the National Loans Act 1968 section 9(3), 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 liability would only crystallise if government securities were insufficient to meet demand from holders of notes to exchange them for another instrument. This contingent liability was £47,080 million at 31 March 2011 (£45,571 million at 31 March 2010).

ii) The NLF also has a contingent liability to the Commissioners for the Reduction of National Debt (CRND) in respect of unclaimed dividends received in previous years. This represents old uncleared amounts surrendered by NS&I and the Gilts Registrar to CRND, and then onto the NLF, and stood at £23.6 million at 31 March 2011 (£22.6 million at 31 March 2010). This contingent liability would crystallise if NS&I investors or holders of gilts requested amounts owed to them.

15 Fair Values

Carrying Value and Fair Value of NLF assets and liabilities

	Values at 31 March 2011		Values at 31 March 2010	
	Carrying Value	**Fair Value**	Carrying Value	Fair Value
	£m	**£m**	£m	£m
Assets				
Advances:				
PWLB	**53,165**	**61,113**	51,247	58,154
DMA	**157,000**	**157,000**	242,000	242,000
EEA	**9,160**	**9,160**	3,960	3,960
Accrued interest	**680**	**680**	711	711
Loans:				
Principal	**3,360**	**3,765**	3,163	3,550
Accrued interest	**28**	**28**	28	28
Other assets	**47,323**	**47,323**	38,892	38,892
IMF quota subscription & bilateral Loan	**11,690**	**11,690**	11,022	11,022
Total assets	**282,406**	**290,759**	351,023	358,317
Liabilities				
Gilts:				
Marketable	**1,058,989**	**1,118,431**	936,869	986,877
Non-marketable	**319**	**320**	394	399
National Savings & Investments:				
Principal	**97,824**	**97,915**	97,842	98,555
Accrued interest	**1,062**	**1,062**	962	975
IMF liabilities	**7,316**	**7,316**	8,702	8,702
Other sterling debt:				
Treasury Bills	**122,819**	**122,832**	176,076	176,108
DMA	**30,546**	**30,546**	28,511	28,511
Issue Department of Bank of England	**370**	**370**	370	370
Government balances	**16,037**	**16,037**	13,552	13,552
Deposits from public sector bodies	**7,819**	**7,819**	7,703	7,703
Other	**693**	**693**	836	836
Total liabilities	**1,343,794**	**1,403,341**	1,271,817	1,322,588

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 £235,696 million (2009-10: £312,878 million) and their fair value is £244,049 million (2009-10: £320,172 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 can be replaced on maturity until the last rollover window in September 2011. Thereafter they will remain until maturity. Therefore the difference between fair value and carrying values will not normally be realised in the NLF.

16 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 2011			As at 31 March 2010		
	Current	**Non-current**	**Total**	Current	Non-current	Total
	£m	**£m**	**£m**	£m	£m	£m
Assets						
Advances	**–**	**220,005**	**220,005**	–	297,918	297,918
Loans	**657**	**2,731**	**3,388**	357	2,834	3,191
Other assets	**613**	**46,710**	**47,323**	748	38,144	38,892
IMF quota subscription (SDR) & Bilateral Loan	**–**	**11,690**	**11,690**	–	11,022	11,022
Total assets	**1,270**	**281,136**	**282,406**	1,105	349,918	351,023
Liabilities						
Gilts						
Conventional	**50,873**	**768,287**	**819,160**	52,376	688,893	741,269
Index-linked	**14,432**	**225,716**	**240,148**	–	195,994	195,994
Gilt-edged stock	**65,305**	**994,003**	**1,059,308**	52,376	884,887	937,263
National Savings and Investments	**98,640**	**246**	**98,886**	98,511	293	98,804
IMF liabilities	**–**	**7,316**	**7,316**	–	8,702	8,702
Treasury Bills for SLS	**122,819**	**–**	**122,819**	176,076	–	176,076
Other debt payable in sterling	**55,465**	**–**	**55,465**	50,972	–	50,972
Total liabilities	**342,229**	**1,001,565**	**1,343,794**	377,935	893,882	1,271,817

17 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:

- meeting the principles of openness, transparency and predictability;
- developing a liquid and efficient gilt market;
- 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; and
- offering cost-effective savings instruments to the retail sector through National Savings & Investments.

For cash management, the aggregate balance on government accounts is swept daily to the National Loans Fund, and then to the DMA. The Debt Management Office deals with the financial markets to manage the daily cash surplus or deficit on the DMA 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 2010/11. The NLF's liabilities also include deposits from several other public sector accounts.

NLF assets include advances to the DMA, the PWLB and the EEA. 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 Prices 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 2011

	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									
Advances	157,384	2,121	6,799	43,832	–	9,869	220,005	52,287	157,849
Loans	254	401	210	2,495	–	28	3,388	3,360	–
Other assets	–	–	–	–	–	47,323	47,323	–	–
IMF quota subscription	–	–	–	–	–	10,581	10,581	–	–
IMF loans	–	–	–	–	–	1,109	1,109	–	–
Total	157,638	2,522	7,009	46,327	–	68,910	282,406	55,647	157,849
Liabilities									
Gilts									
Conventional	–	50,473	226,755	532,962	2,694	6,276	819,160	812,884	–
Index-linked	240,148	–	–	–	–	–	240,148	–	240,148
Gilt-edged stock	240,148	50,473	226,755	532,962	2,694	6,276	1,059,308	812,884	240,148
National Savings and Investments	82,888	2,014	12,840	–	–	1,144	98,886	14,581	83,161
IMF liabilities	–	–	–	–	–	7,316	7,316	–	–
Treasury Bills for SLS	17,256	105,563	–	–	–	–	122,819	122,819	–
Other debt payable in sterling	44,106	–	–	–	–	11,359	55,465	7,812	36,294
Total	384,398	158,050	239,595	532,962	2,694	26,095	1,343,794	958,096	359,603
Period gap	226,760	155,528	232,586	486,635	2,694	(42,815)	1,061,388		
Cumulative gap	226,760	382,288	614,874	1,101,509	1,104,203	1,061,388			

Interest rate and inflation risk analysis as at 31 March 2010

	Up to 1 month/ repayable on demand £m	1-12 months £m	1-5 years £m	Over 5 years £m	Undated £m	Zero-rated £m	Total carrying value £m	Fixed rate £m	Floating rate £m
Assets									
Advances	242,130	1,934	6,128	43,026	–	4,700	297,918	50,711	242,507
Loans	191	166	226	2,580	–	28	3,191	3,163	–
Other assets	–	–	–	–	–	38,892	38,892	–	–
IMF quota subscription	–	–	–	–	–	10,762	10,762	–	–
IMF loans	–	–	–	–	–	260	260	–	–
Total	242,321	2,100	6,354	45,606	–	54,642	351,023	53,874	242,507
Liabilities									
Gilts									
Conventional	–	51,840	194,119	486,400	2,821	6,089	741,269	735,180	–
Index-linked	195,994	–	–	–	–	–	195,994	–	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	–	–	1,034	98,804	18,647	79,123
IMF liabilities	–	–	–	–	–	8,702	8,702	–	–
Treasury Bills for SLS	300	175,776	–	–	–	–	176,076	176,076	–
Other debt payable in sterling	41,567	–	–	–	–	9,405	50,972	7,698	33,869
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			

Foreign currency risk

The NLF's only direct 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 liabilities 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 Prices 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 Statement of Comprehensive Net Expenditure 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.
- 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.
- 100 bp and 10% are management's assessment of the reasonably possible change in interest, RPI and FX rates at the balance sheet date. This is not a forecast.

Using the above assumptions, the following table shows the illustrative impact on the Statement of Comprehensive Net Expenditure that would result from an increase in the UK interest rates and the UK Retail Prices Index, and if the SDR to sterling exchange rate were to strengthen.

	2010-11	2009-10
	Statement of Comprehensive Net Expenditure	Statement of Comprehensive Net Expenditure
	£m	£m
UK interest rates + 100bp income	**384**	1,295
UK Retail Prices Index + 100bp (expense)	**(2,402)**	(1,960)
SDR exchange rate + 10%	**(437)**	(232)

An equal, but opposite effect would result if there was a decrease in UK interest rates and the UK Retail Prices 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 2011 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 Prices Index at 31 March 2011. Because of the many coupon payments to be made for longer dated gilts the table below reports coupon cash flows of £549,843 million (£504,522 million at 31 March 2010) whereas the gilts liability in the Statement of Financial Position contains accruals to the statement of financial position date of £26,006 million (£23,406 million at 31 March 2010). Undated gilts do not have a contractual maturity date and so coupon payments on them (currently £91m 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 2011

	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	–	–	50,188	222,181	524,576	2,694	799,639
Coupons	–	7,028	29,134	123,490	332,325	–	491,977
Index-Linked Gilts:							
Principal	–	–	14,405	19,101	200,156	–	233,662
Coupons	221	635	3,169	14,188	39,653	–	57,866
Total Gilts	221	7,663	96,896	378,960	1,096,710	2,694	1,583,144
NS&I	98,496	62	–	262	–	82	98,902
IMF	7,316	–	–	–	–	–	7,316
Treasury Bills for SLS	17,261	24,365	81,556	–	–	–	123,182
Temporary Deposits	7,772	3	48	–	–	–	7,823
Other debt payable in sterling	47,646	–	–	–	–	–	47,646
	178,712	**32,093**	**178,500**	**379,222**	**1,096,710**	**2,776**	**1,868,013**

The maturity of liabilities after five years is:

	5–10 years £m	10–20 years £m	20–30 years £m	30–40 years £m	Over 40 years £m	Total £m
Conventional Gilts:						
Principal	173,416	138,315	120,803	57,920	34,122	524,576
Coupons	99,554	125,750	69,869	28,205	8,947	332,325
Index-Linked Gilts:						
Principal	53,779	56,305	48,648	28,968	12,456	200,156
Coupons	13,627	16,402	6,246	2,600	778	39,653
	340,376	**336,772**	**245,566**	**117,693**	**56,303**	**1,096,710**

At 31 March 2010

	Up to 1 month £m	1–3 months £m	3–12 months £m	1–5 years £m	Over 5 years £m	Undated £m	Total £m
Liabilities							
Conventional Gilts:							
Principal	–	21,335	30,413	190,662	478,016	2,821	723,247
Coupons	–	7,100	26,338	109,639	310,924	–	454,001
Index-Linked Gilts:							
Principal	–	–	–	31,978	158,632	–	190,610
Coupons	211	472	3,004	12,862	33,972	–	50,521
Total Gilts	211	28,907	59,755	345,141	981,544	2,821	1,418,379
NS&I	98,349	90	–	429	–	72	98,940
IMF	8,702	–	–	–	–	–	8,702
Treasury Bills for SLS	300	108,657	67,397	–	–	–	176,354
Temporary Deposits	2,305	5,401	–	–	–	–	7,706
Other debt payable in sterling	43,269	–	–	–	–	–	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 £m	10–20 years £m	20–30 years £m	30–40 years £m	Over 40 years £m	Total £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**

Credit risk

The NLF makes loans to UK public corporations and central government entities, advances to other UK central Exchequer Funds and subscribes to the IMF. The NLF also lends to the IMF via a bilateral loan facility. As a result the NLF is not exposed to significant credit risk. Details of this can be found in notes 6, 7 and 8. Total loans and advances stand at £223,393 million (2009-10: £301,109 million) and IMF exposure stands at £11,690 million (2009-10: £11,022 million).

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 PWLB 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 (2009-10: £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's 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 bilateral 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 DMA and the EEA.

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 EEA Act constrains how the 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. No foreign currency debt has been issued or is outstanding at 31 March 2011.

18 Related Parties

The Treasury is the ultimate controlling party of the NLF. There have been no direct transactions between the Treasury and the NLF in 2010-11.

The main related parties of the NLF are the CF, DMA, EEA, PWLB, Bank of England and NS&I. The relationship between the NLF and CF is explained in the Foreword. The NLF has provided finance to the DMA, the EEA, the PWLB and to various statutory public sector bodies. The NLF has also transacted with the Bank of England and NS&I. Transactions with these bodies are all disclosed in these accounts. The National Loans Fund has also had a significant number of transactions with other government bodies through its temporary borrowing of balances in various government bank accounts.

During the year there have been no transactions between key management personnel at the Treasury and the NLF.

19 Events After the Reporting Period

On 1 April 2011, IMF members agreed to the activation of the expanded New Arrangements to Borrow (NAB). The UK's commitment to the new NAB is SDR 18.66 billion (£18.39 billion). The new NAB, however, can only be used to finance programmes agreed after its activation. Previously agreed programmes will continue to be funded from the quota and bilateral loans. The UK, along with all other major bilateral creditors, has agreed to keep open its bilateral loan facility of SDR 9.92 billion (£9.77 billion) for this purpose, on the condition that combined drawings from the UK's share of the NAB and the UK's bilateral loan do not exceed SDR 18.66 billion. This commitment to the NAB was reported as an Event After the Reporting Period in the NLF's 2009-10 Account.

In November 2010, G20 countries agreed to double the IMF's quota resource limit. As a result, the UK's quota subscription will increase from SDR 10,738.5 million to SDR 20,155.1 million (an increase of £9,278 million at the 31 March 2011 rate). In order to implement this, the IMF requires that three fifths of member countries with a collective voting share of at least 85 percent finalise their domestic legislative requirements. This increase was approved by Parliament in July 2011.

20 Date of Authorisation for Issue of Account

The Account was authorised for issue on 15 July 2011.

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