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

National Loans Fund Account 2005-2006

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Foreword

The Consolidated Fund (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'.

In order to separate government revenue and expenditure on the one hand and government borrowing and lending on the other, 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 on the CF. 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 the central government's current account, whereas the NLF can be regarded as the 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 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. They are issued from the NLF, sold initially to the DMA and then sold by the DMO to the market. In addition, the DMO issues treasury bills on its own account and undertakes other money market operations to meet the government's daily cash requirements.

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 'official 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 Treasury's agent for foreign currency liability management, including the issuance of foreign currency debt to finance some of the reserves. This debt is issued by, and is an obligation of, the NLF under the National Loans Act 1968, since it is that Act (rather than the Exchange Equalisation 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.

Scope of the National Loans Fund Account

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. However, if the NLF's interest income is less than the interest it pays on its borrowings (which it invariably is), the shortfall is met by a transfer from the CF.

The NLF provides finance for both the DMA and the EEA. 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 Local Authorities. The profits of the Issue Department of the Bank of England are paid to the NLF. NS&I's savings products, other than the Ordinary Account, are liabilities of the NLF. Retained surpluses and deficits of the DMA are NLF assets or liabilities, respectively. As explained below, the EEA's total assets, less its financial liabilities, are now treated as an asset of the NLF.

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

Summary of outturn for 2005-2006

The Account shows the NLF's income and expenditure, assets and liabilities and net cashflow. As a result of an accounting policy change, the NLF's assets now include a claim of some £20 billion on the EEA, in respect of an asset previously described in the EEA's Account as its retained reserves, but now treated as a liability to the NLF. The previous year's account figures have been re-stated, where necessary, to reflect this change. On this basis, the net operating cost on the Fund was £19.6 billion in 2005-2006, broadly the same as in the previous year (£20.2 billion). This was almost wholly attributable to the cost of servicing government debt, offset by income from lending operations and other income. Without this change the Fund's operating costs would have increased from £20.5 billion to £21.8 billion in 2005-2006.

Total gross liabilities increased by £36.5 billion from £530.6 billion to £567.1 billion. The main factor behind this rise was an increase of £65.8 billion in the Fund's liability in respect of gilt-edged stock, but there was also a significant increase of £4.7 billion in NS&I liabilities. At the same time the NLF's liability to the DMA declined by £41.3 billion. There were two factors behind this reduction. The first was that the NLF's cash inflows exceeded its outgoings, so that it was able to repay £21.3 billion of the deposits previously accumulated from the DMA. Secondly, even after these repayments, the DMA still had sufficient funds available to repay its outstanding advance of £20 billion from the Fund. This receipt enabled the NLF to repay a further £20 billion of the DMA's deposits, and so this transaction, agreed shortly before the year end, had the effect of reducing both parties' gross assets and liabilities by the same amount.

The NLF's total gross assets fell by £11 billion to £83.2 billion, mainly due to the DMA's repayment of its advances of £20 billion mentioned above. This was partly offset by an increase of £5 billion in advances made to the PWLB for its loans to Local Authorities. Without the re-statement the Fund's assets would have fallen from £76.1 billion to £63.0 billion.

As a result of these changes, the net liabilities of the Fund increased from £436.3 billion to £483.8 billion. As explained above, this is matched by a corresponding claim on the CF. Without the re-statement the Fund's net liabilities would have increased from £454.5 billion to £504.0 billion.

Forward look

The Debt Management Remit for 2006-2007 was published by the Treasury with the Budget on 22 March 2006. On the basis of a Central Government Net Cash Requirement forecast of £41.2 billion for 2006-2007, the published financing requirement was £68.0 billion (after taking account of gilt redemptions of £29.9 billion and a short-term financing adjustment of -£3.1 billion). NS&I were forecast to contribute £3.0 billion to financing, leaving a forecast net financing requirement for the DMO of £65.0 billion. This was to be met by total gilt sales of £63.0 billion and Treasury bill sales of £2.0 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.

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

Nicholas Macpherson 27 September 2006
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 Department 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 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.

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 'Government Accounting'.

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 that supports the achievement of departmental policies, aims and objectives, set by the Treasury's Ministers, whilst safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in 'Government Accounting'. The National Loans Fund is managed generally within the framework of the Treasury's system of internal control. This framework includes resource allocation and utilisation 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 purpose of the system of internal control

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on a process designed to identify and prioritise the risks to the achievement of departmental policies, aims and objectives, to evaluate the likelihood of those risks being realised and their impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control has been in place for the year ending 31 March 2006 and up to the date of the approval of the annual account, and accords with Treasury guidance. Within this overall departmental framework, the additional controls in place for the management of the National Loans Fund are set out below.

Capacity to handle risk

The management of the National Loans Fund and the supporting processes is based on a risk management strategy and clear segregation of duties within the Treasury.

Staff in Exchequer Funds and Accounts with responsibilities relating to the National Loans Fund are trained in a way appropriate to their responsibilities. Those involved in managing financial and other risks have their objectives set accordingly, including responsibility for relevant aspects of the control framework. Policy and procedures manuals as well as job instructions are maintained to ensure these staff carry out their work in a manner consistent with their responsibilities.

The risk and control framework

The key risks in managing the National Loans Fund are

- incorrect accounting and irregularity of transactions;
- failure of IT systems;
- failure to provide an effective service in adverse circumstances, including disaster situations; and
- failure of principal counter-parties to provide agreed services.

Controls in 2005-2006

Existing internal controls to mitigate risks to the National Loans Fund include

- separation of duties among staff involved in the payments process to reduce the risk of fraudulent payments;
- authorisation processes that require dual approval of payment instructions issued to the Bank of England;
- computer-generated payment instructions derived from underlying transaction records, to minimise the risk of keying errors;

- the authorisation of all payments from the National Loans Fund by the National Audit Office, as required by statute;
- the training of staff to do a range of jobs and periodically swap jobs to keep their knowledge up to date, to improve resilience in key areas;
- well developed Service Level Agreements (or similar understandings) with all principal counter-parties, covering financial relationships and requirements and standards for the interchange of information. These are reviewed regularly;
- an internal audit programme that includes reviews of the operations of the National Loans Fund;
- the implementation of a new computer system that incorporates more robust security features, with processes that improve resilience;
- a review by Treasury Internal Audit, supported by external consultants, of the application controls relating to the new computer system;
- reviews of key risks and assessment of their business impact;
- the maintenance of a Risk Register for operations relating to the National Loans Fund;
- business continuity plans, involving fully operational off-site back-up facilities, that are reviewed and tested periodically;
- the establishment, with the NAO, of other measures that would allow essential payments business to continue in the event of the normal arrangements for granting credit being disrupted, including a joint test at the Treasury's back-up site;
- the consolidation of the separate business continuity plans of each branch of the Exchequer Funds and Accounts Team into a single Team Plan and the development of further business continuity arrangements within the framework of the Treasury's corporate Business Continuity Plan facilities; and
- the conduct of a risk awareness workshop for staff working on the National Loans Fund.

Plans for 2006-2007

In addition to the controls mentioned above, in the coming year I have plans for

- incorporating the improvements recommended by Treasury Internal Audit following their review of the application controls relating to the new computer system;
- further development of business continuity plans, including reviewing inter-connections between principal business counter-parties;
- further focus on enhancing risk awareness within the team through risk workshops, seminars and training; and
- a joint test with the NAO at the back-up site simulating a complete loss of all computer systems.

A member of EFA staff has already attended the second annual Business Continuity in the Public Sector event in April 2006 (to build on the certificate awarded to him in 2005 by APM Group (OGC) for demonstrating knowledge of the Management of Risk at Practitioner level.

Review of effectiveness

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within the Department who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letters and other reports. I have been advised on the implications of the system of internal control by Exchequer Funds and Accounts officials and a plan to address continuous improvement of the system is in place.

Nicholas Macpherson
Accounting Officer
HM Treasury

27 September 2006

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 Account for the year ended 31 March 2006 under the National Loans Act 1968. These comprise the Operating Cost Statement, the Balance Sheet, the Cash Flow Statement 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 the Auditor

As described in the Foreword on pages 2 to 4, the Accounting Officer is responsible for the preparation of financial statements in accordance with Section 21 (1) of the National Loans Act 1968 and in the form prescribed by HM Treasury, and for ensuring the regularity of financial transactions. The Accounting Officer is also responsible for the preparation of the Foreword. These responsibilities are set out in the Statement of Accounting Officer's responsibilities.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, and with International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the National Loans Act 1968 and in the form prescribed by HM Treasury. I also report whether in all material respects the financial transactions of the National Loans Fund Account conform to the authorities which govern them.

I also report to you, if in my opinion, the Foreword is not consistent with the financial statements, if proper accounting records have not been kept or if I have not received all the information and explanations I require for my audit, or if information specified by relevant authorities is not disclosed.

I review whether the statement on pages 6 to 8 reflects the National Loans Fund's compliance with HM Treasury's guidance on the Statement on Internal Control, and I report if it does not. I am not required to consider whether the Accounting Officer's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the HM Treasury's corporate governance procedures or its risk and control procedures.

I read the information contained in the Foreword and consider whether it is consistent with the audited financial statements. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinion

I conducted my audit in accordance with International Standards of Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Accounting Officer in the preparation of the financial statements, and of whether the accounting policies are appropriate to the National Loans Fund's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error and that in all material respects the financial transactions conform with the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In my opinion

- the financial statements give a true and fair view, in accordance with the National Loans Act 1968 and in the form prescribed by HM Treasury, of the state of the National Loans Fund's affairs as at 31 March 2006 and of the net operating cost and cash flows for the year ended 31 March 2006;
- the financial statements have been properly prepared in accordance with the National Loans Act 1968 and in the form prescribed by HM Treasury; and
- in all material respects, the financial transactions of the National Loans Fund Account conform to the authorities which govern them.

I have no observations to make on these financial statements.

John Bourn
Comptroller and Auditor General
3 October 2006

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Operating Cost Statement for the year ended 31 March 2006

	Notes	**2005-2006 £m**	2004-2005 £m
Finance costs of borrowing	2	**28,070**	27,313
Income from lending operations	3	**(4,166)**	(5,008)
Losses/(gains) on foreign exchange transactions	4	**95**	(20)
Other expenditure	5	**6**	17
Other income	5	**(4,391)**	(2,066)
Net operating cost		**19,614**	20,236

The notes on pages 14 to 25 form part of this account.

Balance Sheet at 31 March 2006

	Notes	**2006 £m**	2005 £m Re-stated
Assets			
Advances	8	**49,129**	63,013
IMF Quota Subscription	7	**8,814**	8,616
Loans	6	**2,964**	2,910
Debtors	9	**1,586**	896
Other assets	10	**20,735**	18,792
Total assets		**83,228**	94,227
Liabilities			
Gilt-edged stock	15	**442,591**	376,795
National Savings and Investments products	14	**71,981**	67,256
Liabilities to the IMF	7	**7,805**	5,856
Creditors	11	**5,439**	5,322
Other debt payable in sterling	12	**37,459**	73,612
Other debt payable in foreign currencies	13	**1,789**	1,731
Total liabilities		**567,064**	530,572
Net liabilities		**483,836**	436,345
Liability of the Consolidated Fund to the National Loans Fund	16	**483,836**	436,345

The notes on pages 14 to 25 form part of this account.

Nicholas Macpherson
Accounting Officer
HM Treasury

27 September 2006

Cash Flow Statement for the year ended 31 March 2006

	Notes	**2005-2006 £m**	2004-2005 £m Re-stated
Net cash inflow/(outflow) from operating activities	17(i)	**0**	347
Net cash inflow/(outflow) from financial investment	17(ii)	**13,830**	14,280
Net cash inflow/(outflow) from financing	17(iii)	**(13,830)**	(14,627)
Net cashflow		**0**	0

The notes on pages 14 to 25 form part of this account.

Notes to the Accounts

1 Accounting policies

i Accounting convention

The National Loans Fund Account has been prepared under the historical cost convention modified by the inclusion of certain investments at valuation and in accordance with applicable accounting standards and generally accepted accounting practice in so far as they are relevant to the National Loans Fund. Accounting policies have been applied consistently throughout the year. 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 most of the time. 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 by tax revenue receipts. For this reason, the Accounting Officer continues to adopt the going concern basis in preparing the Account.

ii Basis of presentation

This Account includes the results and transactions of the National Loans Fund and National Savings and Investments products with the exception of the Ordinary Savings Account, which is not a liability of the National Loans Fund.

iii Loans, advances and other debtors

Loans, advances and other debtors are recorded at the nominal value of the amounts due to the National Loans Fund. 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 on advances to the Debt Management Account.

iv Borrowings

Borrowings are stated at the amount of nominal value adjusted for the unamortised portion of premium or discount where net proceeds of borrowing differ from the nominal value of borrowing. Amounts due at maturity in respect of index-linked gilt-edged securities and fixed interest investment products are capitalised. It is not possible to calculate a weighted time to maturity for zero-rated assets or liabilities as there is no defined term. They are treated as maturing in less than one year in the analysis by maturity band.

v Income recognition

Income is recognised in the period in which it is earned.

vi Finance costs

Finance costs, which include Premium Bond prizes, are recognised in the period to which they relate. Finance costs that are contingent on movements in a particular index are recognised in relation to the change in the relevant index for the period. Note 18 contains a breakdown of finance costs by interest rate type. It also shows weighted average interest rates and the weighted average time for which interest rates were fixed as at the end of the financial year.

vii Foreign currencies

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.

viii 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 both National Savings and Investments and the Treasury and are accounted for through their respective resource accounts.

ix Exchange Equalisation Account

The net assets of the Exchange Equalisation Account (previously referred to as its 'retained reserves') have been reclassified as an asset of the National Loans Fund. It is considered that the new classification better reflects the nature of the balance. As a result of this change, some elements of the 2004-2005 results have been re-stated. The impacts of the change in accounting treatment are as shown below.

	2005-2006 £m	2004-2005 £m
Increase/(decrease) in NLF income	**2,023**	252
Increase/(decrease) in NLF assets	**20,193**	18,170

2 Finance costs of borrowing

	2005-2006 £m	2004-2005 £m
Gilt-edged stock		
Marketable	**21,914**	20,233
Non marketable	**1,026**	999
Total	**22,940**	21,232
National Savings and Investments products	**2,535**	2,358
Other finance costs		
Payable in sterling	**2,552**	3,682
Payable in foreign currencies	**43**	41
Total	**2,595**	3,723
Total finance costs on borrowing	**28,070**	27,313

3 Income from lending operations

	2005-2006 £m	2004-2005 £m
Interest on loans advanced by the National Loans Fund to		
Public Corporations	**91**	215
Central Government bodies	**121**	121
	212	336
Interest on loans by the Public Works Loan Board financed by NLF advances	**3,042**	3,084
Interest on funding advanced to the Debt Management Account	**912**	1,588
Total income from lending operations	**4,166**	5,008

4 Losses and (gains) on foreign exchange transactions

	2005-2006 £m	2004-2005 £m
Losses/(gains)on foreign currency borrowing		
Canadian Dollar	**3**	2
US Dollar	**153**	(52)
	156	(50)
Loss/(gain) on Reserve Tranche Position at the IMF	**(61)**	30
Net loss/(gain) on foreign currency transactions	**95**	(20)

5 Other income and expenditure

	2006 £m	2005 £m Re-stated
Other expenditure		
Debt management administration costs*	**6**	7
Expenditure in respect of depreciation of issue Department assets+	**0**	8
3.5% Conversion Loan sinking fund	**0**	2
Total: Other expenditure	**6**	17
Other income		
Income receivable in respect of appreciation of Issue Department assets+	**0**	(16)
EEA net income	**(2,024)**	(352)
Profits of the Bank of England Issue Department+	**(1,661)**	(1,632)
Surplus on the Debt Management Account	**(699)**	(55)
Written off gilt-edged stock	**(1)**	(3)
Miscellaneous receipts	**(6)**	(8)
Total: Other income	**(4,391)**	(2,066)
Net total	**(4,385)**	(2,049)

* 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 foreign currency borrowing.

\+ 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. However, since February 2005 the Bank has changed the composition of the backing of the Note Issue from Gilts and Bills to cash-based instruments and therefore the revaluations have revealed neither an appreciation nor depreciation. In addition, 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 £1,661 million in respect of these profits was credited to the Operating Cost Statement in 2005-2006.

6 Loans

	2005-2006			2004-2005		
	Public Corporations	**Central Government**	**Total**	Public Corporations	Central Government	Total
	£m	**£m**	**£m**	£m	£m	£m
Outstanding at 1 April	**1,416**	**1,494**	**2,910**	1,537	1,426	2,963
Loans advanced	**244**	**166**	**410**	163	172	335
Loans repaid	**(251)**	**(105)**	**(356)**	(284)	(104)	(388)
Outstanding at 31 March	**1,409**	**1,555**	**2,964**	1,416	1,494	2,910

7 IMF Reserve Tranche Position

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) (£8,814 million at 31 March 2006), 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). A small undrawn sterling cash balance is held in an IMF account at the Bank of England. The IMF's sterling holdings in the UK in the form of its NLF NIBS and its sterling balance at the Bank of England represent an NLF liability 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 table below sets out the composition of the RTP at 31 March 2005 and 31 March 2006, 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. Although 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. The EEA also holds the UK's allocation of SDRs (SDR 1,913 million at 31 March 2006), as a liability to the IMF, and retains an asset in the form of the UK's holdings of SDRs (SDR 219 million at 31 March 2006). In 2005-2006, net interest of SDR 6.5 million (£5 million) was payable by the EEA in respect of the UK's overall SDR position.

NLF Assets and Liabilities: Composition of the Reserve Tranche Position

	Asset	Liabilities				Reserve Tranche Position
	IMF Quota Subscription securities	Non- interest - bearing Bank of England	Sterling balances at	Valuation adjustment	Total liabilities	
	£m	£m	£m	£m	£m	£m
Balances at 31 March 2005	8,616	(5,944)	(22)	110	(5,856)	2,760
Exchange rate gains/(losses) for the year on						
Quota subscription	(198)					(198)
Change in year-end valuation adjustment				(312)	(312)	(312)
Change in loan notes as a result of the valuation settlement		176			176	176
Net (increase) in loan notes		(1,813)			(1,813)	(1,813)
Balances at 31 March 2006	**8,814**	**(7,581)**	**(22)**	**(202)**	**(7,805)**	**1,009**

8 Advances

	PWLB £m		DMA £m		EEA £m		Total £m	
	2005-06	2004-05	**2005-06**	2004-05	**2005-06**	2004-05	**2005-06**	2004-05
Outstanding at 1 April	**42,103**	41,468	**20,000**	35,000	**910**	670	**63,013**	77,138
Advances	**8,952**	5,822	**0**	0	**3,245**	1,990	**12,197**	7,812
Advances repaid	**(3,931)**	(5,187)	**(20,000)**	(15,000)	**(2,150)**	(1,750)	**(26,081)**	(21,937)
Outstanding at 31 March	**47,124**	42,103	**0**	20,000	**2,005**	910	**49,129**	63,013

9 Debtors

	At 31 March 2006 £m	At 31 March 2005 £m
Debt Management Account surplus	**842**	143
Accrued interest on DMA funding advance	**72**	122
Accrued interest on loans made by PWLB	**640**	598
Accrued interest on loans made by NLF	**32**	33
Total debtors	**1,586**	896

10 Other assets

		At 31 March 2006 £m		At 31 March 2005 £m Re-stated
Exchange Equalisation Account (in addition to advances outstanding from NLF – see Note 8)		**20,193**		18,170
National Savings and Investments' cash holdings				
from sale of investment products	**338**		384	
for repayment of principal	**152**		202	
for payment of interest	**30**		14	
NS&I Total		**520**		600
Reserve Tranche sterling balances at Bank of England		**22**		22
		20,735		18,792

11 Creditors

	At 31 March 2006 £m	At 31 March 2005 £m
National Savings and Investments interest and prizes	**121**	114
NS&I accrual of interest to be capitalised	**903**	751
Accrued interest on gilt-edged securities	**4,199**	4,110
Accrued interest on borrowing payable in sterling:		
Debt Management Office	**105**	233
Bank of England	**51**	54
Accrued interest on Certificates of Tax Deposit	**20**	23
Other	**11**	10
Accrued interest on loans payable in foreign currency	**29**	27
Total Creditors	**5,439**	5,322

12 Other debt payable in sterling

	At 31 March 2006 £m	At 31 March 2005 £m
Debt Management Account	**9,609**	50,912
Bank of England Issue Department	**13,370**	13,370
Balances in government accounts at the Bank of England	**13,383**	8,288
Temporary deposits from public sector bodies	**788**	692
Other	**309**	350
	37,459	73,612

13 Other debt payable in foreign currencies

	At 31 March 2006 £m	At 31 March 2005 £m
US Dollar	**1,777**	1,703
Euro	**1**	2
Canadian Dollar	**11**	26
Total foreign currency debt	**1,789**	1,731

14 National Savings and Investments products

	2005-2006 £m	2004-2005 £m
Principal outstanding at 1 April	**67,256**	64,646
Cash repayments from the NLF	**(7,713)**	(9,091)
Principal cash received in the NLF	**11,485**	10,689
Interest and other returns accruing to savers capitalised	**1,049**	1,021
Change in cash holdings for principal	**(96)**	(9)
Principal outstanding at 31 March	**71,981**	67,256

15 Gilt-edged stock

	At 31 March 2005 Conventional stock nominal £m	At 31 March 2005 Index-linked stock: Uplifted nominal £m	At 31 March 2005 Unamortised (Discount) /Premium £m	At 31 March 2005 Outstanding liability £m
Marketable securities up to 5 years	98,679	12,824	80	111,583
Marketable securities from 5 to 15 years	83,877	39,850	(300)	123,427
Marketable securities over 15 years	81,748	35,602	2,090	119,440
Undated marketable securities	2,966	-	-	2,966
Non-marketable securities	18,074	863	442	19,379
Total gilt-edged stock	285,344	89,139	2,312	376,795

	At 31 March 2006 Conventional stock nominal £m	**At 31 March 2006 Index-linked stock: Uplifted nominal £m**	**At 31 March 2006 Unamortised (Discount) /Premium £m**	**At 31 March 2006 Outstanding liability £m**
Marketable securities up to 5 years	114,790	13,897	187	128,874
Marketable securities from 5 to 15 years	83,863	61,602	616	146,081
Marketable securities over 15 years	103,655	30,770	5,040	139,465
Undated marketable securities	2,947	-	-	2,947
Non-marketable securities	23,898	888	438	25,224
Total gilt-edged stock	**329,153**	**107,157**	**6,281**	**442,591**

16 Liability of the Consolidated Fund to the National Loans Fund

	2005-2006 £m	2004-2005 £m Re-stated
Liability of the Consolidated Fund to the NLF at 1 April	**436,346**	395,162
Net cash paid to the Consolidated Fund	**46,199**	37,913
Payment from the Consolidated Fund to the NLF for the cost of debt servicing during the year	**(18,323)**	(16,966)
Other net movements	**19,614**	20,237
Liability of the Consolidated Fund to the NLF at 31 March	**483,836**	436,346

17 Notes to the Cash Flow Statement

	2005-2006 £m	2004-2005 £m
i Net cash flow from operating activities		
Interest received	**4,175**	5,066
Other receipts	**1,662**	1,640
Finance costs on borrowing	**(24,336)**	(23,623)
Other flows	**176**	298
Transfer from the Consolidated Fund for the cost of debt servicing	**18,323**	16,966
Total net cash flow from operating activities	**0**	347
ii Net cash flow from financial investment		
Net change in advance to the Debt Management Account	**20,000**	15,000
Net change in advance to the Public Works Loan Board	**(5,021)**	(634)
Net change in loans	**(54)**	54
Net transfers to/from the EEA	**(1,095)**	(140)
Total net cash flow from investing activities	**13,830**	14,280
iii Financing		
Net issuance of government stock	**63,212**	32,160
Net issuance of National Savings instruments	**3,772**	1,598
Other net sterling borrowing	**(36,153)**	(10,745)
Net foreign currency borrowing	**1,538**	273
Net transfer to the Consolidated Fund	**(46,199)**	(37,913)
Total net cash flow from financing activities	**(13,830)**	(14,627)
Total net cashflow	**(0)**	(0)

18 Contingent liabilities

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 £27,770 million at 31 March 2006 (£23,540 million at 31 March 2005).

The NLF also has a contingent liability in respect of unclaimed dividends. This stood at £45.8 million at 31 March 2006 (£44.1 million at 31 March 2005).

19 Post-balance sheet events

The £20 billion NLF advance to the DMA was fully repaid on 30 March 2006. Since then, the NLF has made two cash advances, £5 billion on 26 April 2006 and £10 billion on 3 August 2006, to the DMA.

20 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 cost 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".*

Issues considered in pursuing this objective include

- pursuing a debt issuance policy that is open, transparent and predictable;
- adjusting the nature and maturity of the Government's debt portfolio, by means of the maturity and composition of debt issuance and other market operations including switch auctions, conversion offers and buy-backs;
- issuing gilts that achieve a benchmark premium and developing a liquid and efficient gilt market; and
- taking account of the Government's own appetite for risk, both nominal and real.

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 one 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 some foreign currency debt and deposits from several other public sector accounts.

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

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

Interest rate and foreign currency risks

The NLF's liabilities have a range of interest rate arrangements. Some borrowing and lending is at variable rate, while other assets and liabilities have fixed, or zero, interest rates. The interest paid (and redemption sums) on index-linked gilts vary in line with changes in the Retail Price Index since the initial issue of each stock. National Savings and Investments product liabilities and the assets represented by Public Works Loan Board lending can be at variable or fixed interest rates.

A small portion of the NLF's assets and liabilities is denominated in foreign currencies.

The following analyses set out the interest rate and foreign currency characteristics of NLF assets and liabilities.

NLF liabilities: Interest rate and foreign currency analysis at 31 March 2005

Currency	Total liabilities	Variable rate	Fixed rate	Zero- rated	Fixed rate borrowing Weighted average interest rate	Fixed rate borrowing Weighted average time for which interest rate is fixed
	£m	£m	£m	£m	%	Years
Sterling debt	517,663	206,628	303,715	7,320	5.9	10.4
Debt in foreign currency						
US$	1,703		1,703		2.2	3.1
€	2		2		7.0	1.7
Canadian $	26		26		2.0	1.1
IMF liabilities+	5,856			5,856		
Total liabilities	**525,250**	**206,628**	**305,446**	**13,176**	**5.9**	**10.4**

NLF liabilities: Interest rate and foreign currency analysis at 31 March 2006

Currency	Total liabilities	Variable rate	Fixed rate	Zero- rated	Fixed rate borrowing Weighted average interest rate	Fixed rate borrowing Weighted average time for which interest rate is fixed
	£m	£m	£m	£m	%	Years
Sterling debt	552,031	191,058	348,576	12,397	5.6	11.3
Debt in foreign currency						
US$	1,777		1,777		2.2	2.2
€	1		1		7.0	0.7
Canadian $	11		11		2.0	0.8
IMF liabilities+	7,805			7,805		
Total liabilities	**561,625**	**191,058**	**350,365**	**20,202**	**5.5**	**11.3**

NLF assets: Interest rate and foreign currency analysis at 31 March 2005

Asset type	Total	Variable liabilities	Fixed rate rate	Zero- rated	Weighted average interest rate	Weighted average time for which interest rate is fixed
	£m	£m	£m	£m	%	Years
Loans	2,910		2,910		7.28	15.58
IMF quota subscription (SDR)	8,616			8,616		
Advances	63,013	20,572	41,498	943	6.62	20.5
Other assets	622			622		
Total assets	**75,161**	**20,572**	**44,408**	**10,181**	**6.66**	**20.18**

NLF assets: Interest rate and foreign currency analysis at 31 March 2006

Asset type	Total assets	Variable rate	Fixed rate rate	Zero- rated	Weighted average interest rate	Weighted average time for which interest rate is fixed
	£m	£m	£m	£m	%	Years
Loans	2,964		2,964		7.02	15.43
IMF quota subscription (SDR)	8,814			8,814		
Advances	49,129	218	46,867	2,044	6.22	22.2
Other assets	20,735			20,735		
Total assets	**81,642**	**218**	**49,831**	**31,593**	**6.27**	**21.80**

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 2006 matures in 2055. A small number of stocks are undated. 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 following table shows an analysis of the maturities of NLF liabilities.

Maturity profile for liabilities

	At 31 March 2006	At 31 March 2005
	£m	£m
Within one year/on demand	**160,687**	165,364
Between one and two years	**38,772**	37,977
Between two and five years	**73,011**	73,882
Over five years	**289,155**	248,027
Total	**561,625**	525,250

Credit risk

In respect of loans financed by the NLF, the financial relationship with the borrower is managed by the responsible department in respect of loans to public corporations. The NLF is not allowed to accept losses on its loans. Any such losses can only be written off by via 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 statute. The PWLB is allowed to lend up to an aggregate amount of £55 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.

Derivatives and hedging

The NLF itself does not use derivatives or 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 risk is negated.

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 liabilities, 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 debt it has issued, in practice these risks are offset through the EEA's programme of asset management and swaps.

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