

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

Consolidated Fund and National Loans Fund Accounts 2003-2004

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Foreword

Scope of the Account

These Accounts are prepared under section 21(1) of the National Loans Act 1968. The Act requires the Treasury to prepare accounts for the Consolidated Fund and NLF for each financial year in such form and containing such information as the Treasury considers appropriate.

Detailed information on the transactions of the Consolidated Fund and NLF was disclosed previously in separately published Supplementary Statements. The Finance Act 2003 provided for the removal of the requirement to produce the Supplementary Statements. The information that they contained will now be disclosed primarily in Resource Accounts, Central Government Accounts and the new accruals-based account for the NLF.

The Consolidated Fund account remains on a cash basis, as an account of payments and receipts. Notes to the accounts provide detail on Standing Service payments and receipts. Certain transactions, borne directly by the Consolidated Fund, cannot be brought to account in other statutory accounts and are disclosed more appropriately in the Consolidated Fund account. These items include pensions paid directly from the Consolidated Fund and the UK's capital subscription to the European Investment Bank. This additional information is disclosed on an accruals basis, to assist consolidation into Central Government Accounts, in Notes 7-10 to the Consolidated Fund account.

There is no direct read-across between Notes 7-10 and the Consolidated Fund receipts and payments account.

Audit

Both Accounts are audited by the Comptroller and Auditor General, under the requirements of the National Loans Act 1968.

Statement of Accounting Officer's responsibilities

The Treasury has appointed an Accounting Officer for the accounts. His relevant responsibilities as Accounting Officer, including his responsibility for the propriety and regularity of the public finances for which he is answerable and for the keeping of proper records, are set out in the Accounting Officer Memorandum issued by the Treasury and published in 'Government Accounting'.

Consolidated Fund Account

The Consolidated Fund receives the proceeds of taxation and certain other government receipts, makes issues to finance Supply Services, meets the Standing Services directly charged by Statute, and reimburses the National Loans Fund (NLF) for net interest costs.

This account shows the transactions for the services described in the paragraph above. Taxation accounted for £282.5 billion of receipts. Supply Services accounted for £313.1 billion of payments and a further £14.5 billion was transferred to the NLF for net interest costs. The deficit of £42.2 billion for the year was met from the NLF.

National Loans Fund Account

National Loans Fund receives the proceeds of, and finances the repayment of, Central Government borrowing. Consolidated Fund net deficits are financed by the NLF. Conversely, net surpluses on the Consolidated fund are passed to the NLF.

The NLF has statutory relationships with other government funds. It provides finance for the Debt Management Account (DMA) and the Exchange Equalisation Account (EEA). It also makes loans to various statutory public sector bodies and provides the finance needed by the Public Works Loan Board (PWL). The UK's Reserve Tranche position with the IMF is an asset of the NLF. The profits of the Issue Department of the Bank of England are paid to the NLF.

National Savings and Investments' savings products, other than the Ordinary Account, are liabilities of the NLF. Accounts for the individual savings products are prepared annually by the Director of Savings.

This account shows the Fund's income and expenditure, assets and liabilities and net cashflow. The net operating costs on the Fund was £17.2 billion, arising primarily from the cost of servicing government debt, offset by income from lending operations and other income. Total liabilities were £503.4 billion, an increase of £48.1 billion over the year. Assets were £90.3 billion, predominantly loans and advances, an increase of £3.2 billion over the previous year. The net liability on the Fund of £413.1 billion is represented by the Consolidated Fund's liability to the NLF.

Projections of future government borrowing levels are set out in the annual Pre-Budget Report and the Financial Statement And Budget Report.

Gus O'Donnell
Accounting Officer
HM Treasury

29 November 2004

Statement on Internal Control

Scope of responsibility

As Accounting Officer for the Consolidated Fund and 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 Consolidated Fund and the National Loans Fund are managed within the framework of the Treasury's system of internal control described in the Statement on Internal Control applicable to the Treasury's Resource Accounts, for which I am also the Accounting Officer. This framework covers 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 Consolidated Fund and 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 an ongoing 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 the 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 ended 31 March 2004 and up to the date of the approval of the annual accounts, and accords with Treasury guidance.

Within this overall departmental framework, the additional controls in place for the management of the Consolidated Fund and the National Loans Fund are set out below.

Capacity to handle risk

There is a risk management strategy and clear segregation of duties within the Treasury for the management of the Consolidated Fund and the National Loans Fund and the supporting processes.

Staff in Exchequer Funds and Accounts with responsibilities relating to the Consolidated Fund and 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 responsibilities in a controlled manner.

The Risk and Control framework

Risk priorities for the Consolidated Fund and National Loans Fund are risks of

- incorrect accounting and irregularity of transactions;
- failure of IT systems;
- failure to continue operations promptly in a disaster situation; and
- failure of principal counterparties to provide agreed services.

Controls in 2003-2004

Existing internal controls to mitigate risks to the Consolidated Fund and 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 signatures on payment instructions issued to the Bank of England;
- computer-generated payment instructions derived from underlying transaction records, to minimise the risk of keying errors;
- to improve resilience in key areas by training staff to do a range of jobs and periodically swapping jobs to keep their knowledge up to date;
- all payments from the Consolidated Fund and the National Loans Fund must be authorised by the National Audit Office, as required by statute;
- reviews of key risks and assessment of their business impact;
- a Risk Register is maintained for operations relating to the Consolidated Fund and the National Loans Fund;
- business continuity plans, involving fully operational off-site back-up facilities, that are reviewed and tested periodically;
- with the NAO, establishing other measures that would allow essential payments business to continue in the event of the normal arrangements for granting credit being disrupted; and
- the creation of a new branch in the Exchequer Funds and Accounts team to co-ordinate the team's work on business continuity planning and to manage and oversee the use of the new IT system when it is implemented in 2004-2005. The responsibilities of this branch include
 - working towards consolidating the separate business continuity plans of each branch of the Exchequer Funds and Accounts Team into a single Team Plan and developing further business continuity arrangements within the framework of the Treasury's corporate Business Continuity Plan facilities;
 - putting in place a process to review and monitor business risks routinely, ensuring that responsibility for their management is clearly identified; and
 - providing a small additional pool of staff familiar with the main operational work of the team;
- an internal audit programme that includes reviews of the operations of the Consolidated Fund and the National Loans Fund; and
- well developed Service Level Agreements (or similar understandings) with all principal counterparties, covering financial relationships and requirements and standards for the interchange of information. These are reviewed regularly.

Plans for 2004-2005

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

- completing the implementation of a new computer system that will incorporate more robust security features and scope to improve resilience; and
- completing the consolidation of the separate business continuity plans of each branch of the Exchequer Funds and Accounts Team into a single Team Plan and keeping this up to date thereafter.

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.

Gus O'Donnell
Accounting Officer
HM Treasury

29 November 2004

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

Consolidated Loans Fund Accounts 2003-2004

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

I certify that I have audited the financial statements on pages 9 to 15 under the National Loans Act 1968. These financial statements have been prepared on a cash basis under the accounting policies set out on page 10 and in the form prescribed by the Treasury.

Respective responsibilities of the Accounting Officer and the Auditor

As described on page 3 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 such form the Treasury may prescribe. The Accounting Officer is also responsible for ensuring the regularity of financial transactions and the preparation of the Foreword and the Statement on Internal Controls. My responsibilities, as independent auditor, are established by statute and I have regard to the standards and guidance issued by the Auditing Practices Board and the ethical guidance applicable to the auditing profession.

I report my opinion as to whether the financial statements properly present the receipts and payments of the Consolidated Fund and associated balances held at the year end, whether they are properly prepared in accordance with Section 21 (1) of the National Loans Act 1968 and in the form prescribed by the Treasury, and whether in all material respects the receipts and payments have been applied to the purposes intended by Parliament and conform to the authorities which govern them. I also report if, in my opinion, the Foreword is not consistent with the financial statements, if the Accounting Officer has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit.

I review whether the statement on pages 4 to 6 reflects compliance with Treasury's guidance on the Statement on Internal Control. I report if it does not meet the requirements specified by the Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered whether the Accounting Officer's Statement on Internal Control covers all risks and controls. I am also not required to form an opinion on the effectiveness of the Treasury's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

I conducted my audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the judgements made by the Accounting Officer in the preparation of the financial statements.

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 error, or by fraud or other irregularity and that, in all material respects, the receipts and payments have been applied to the purposes intended by Parliament and conform to 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 properly present the receipts and payments of the Consolidated Fund for the year ended 31 March 2004 and associated balances held at that date and have been properly prepared in accordance with Section 21 (1) of the National Loans Act 1968 and in the form prescribed by the Treasury; and
- in all material respects the receipts and payments have been applied to the purposes intended by Parliament and conform to the authorities which govern them.

I have no observations to make on these financial statements.

John Bourn
Comptroller and Auditor General

28 February 2005

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Consolidated Fund - Account for Receipts and Payments in the year ended 31 March 2004

| | Notes | 2003-2004 £m | 2002-2003 £m |
|-----------------------------------------------|-------|-----------------|-----------------|
| Receipts | | | |
| Tax revenue | | | |
| Inland revenue | 2 | 145,556 | 145,898 |
| Customs and excise | 2 | 115,661 | 108,720 |
| Vehicle excise duty | 2 | 4,712 | 4,399 |
| National non-domestic rates | 2 | 16,579 | 17,593 |
| | | 282,508 | 276,610 |
| Other receipts | | | |
| Repayments from the Contingencies Fund | | 3,500 | 2,277 |
| Miscellaneous | 3 | 10,544 | 9,425 |
| Deficit met from the NLF | | 42,222 | 25,260 |
| Total receipts | | 338,774 | 313,572 |
| Payments | | | |
| Supply services | 4 | 313,072 | 290,183 |
| Standing services | | | |
| Payments to the NLF for net interest payments | | 14,503 | 14,681 |
| Payments to the european communities | 5 | 7,496 | 6,504 |
| Other standing services | 6 | 203 | 204 |
| | | 335,274 | 311,572 |
| Issues to the Contingencies Fund | | 3,500 | 2,000 |
| Total payments | | 338,774 | 313,572 |

The notes on pages 10 to 15 form part of these financial statements.

Gus O'Donnell
Accounting Officer
HM Treasury

29 November 2004

Notes to the Financial Statements

1 Statement of accounting policies

These accounts are prepared under section 21(1) of the National Loans Act 1968 and are prepared on a cash basis.

In addition, accruals-based disclosures are made at Notes 7-10 to assist consolidation into Central Government Accounts. They are restricted to those items not disclosed in departmental resource accounts or elsewhere. These include pensions for Members of the European Parliament, pensions for Royal Household employees who entered employment before 31 March 2001, pensions for Parliamentary Officers for political and civil services provided, Civil List pensions and the UK's capital subscription to the European Investment Bank. These disclosures have been prepared on an accruals basis under the historical cost convention modified to account for the revaluation of investments. There is no direct read-across between Notes 7-10 and the Consolidated Fund receipts and payments account.

2 Tax revenue

Detailed breakdowns of tax revenues paid into the Consolidated Fund are set out in Trust Statements prepared by the receiving departments.

3 Miscellaneous receipts

| | 2003-2004 | 2002-2003 |
|-----------------------------------------------------------------------------|--------------------------|------------------|
| | £000 | £000 |
| Receipts from Estimates paid to the Consolidated Fund | 8,172,771 | 7,580,320 |
| Additional cash surrendered by departments | 798,120 | 0 |
| Independent television levies | 275,273 | 282,364 |
| United Kingdom coinage | 222,000 | 197,000 |
| Crown Estate surplus revenue | 172,300 | 171,100 |
| Over-issues of supply repaid | 617,333 | 986,759 |
| National Savings Bank Ordinary Account contribution for management expenses | 54,000 | 55,250 |
| Miscellaneous | 232,547 | 152,470 |
| Total | <u>10,544,344</u> | <u>9,425,263</u> |

4 Analysis of supply services

a) Supply Services and repayments

| | 2003-2004 | 2002-2003 |
|--------------------------------------------|---------------------------|--------------------|
| | £000 | £000 |
| Supply issues | | |
| For current year | 312,946,256 | 289,112,709 |
| For previous years | 125,669 | 1,070,337 |
| | <u>313,071,925</u> | <u>290,183,046</u> |
| Prior year over-issues surrendered in cash | (Note 3) (617,333) | (986,759) |
| Net supply services | <u>312,454,592</u> | <u>289,196,287</u> |

b Analysis of supply services

| In respect of financial year | 2003-2004 £000 | 2002-2003 £000 | 2001-2002 £000 |
|--------------------------------------------------------|---------------------------|-------------------|-------------------|
| Cash supply granted by Parliament | 321,844,525 | 298,605,563 | 280,821,847 |
| Total NCR outturns reported by Departments | n.a. | 288,927,330+ | 269,436,979* |
| Surplus not required | n.a. | 9,678,233 | 11,384,868 |
| Financing in year | | | |
| 2001-2002 Issues made in year | 0 | 0 | 270,429,207 |
| Prior year issues applied to a subsequent year | 0 | 0 | 969,043 |
| 2002-2003 Issue made in year | 0 | 289,112,709 | 1,070,337 |
| Prior year issues applied to a subsequent year | 0 | 2,045,478 | (2,045,478) |
| Prior and current year over-issues surrendered in cash | 0 | (629) | (986,130) |
| 2003-2004 Issues made in year | 312,946,256 | 125,669 | 0 |
| Prior year issues applied to a subsequent year | 1,738,564 | (1,738,564) | 0 |
| Prior year over-issues surrendered in cash | n.a. | (617,333) | 0 |
| Total | n.a. | 288,927,330 | 269,436,979 |

+ Excludes £251,000 for machinery of government transfer.

* Includes an adjustment for an Excess Vote partly financed by the cash equivalent of surplus appropriations in aid.

n.a. Figures not available during 2003-2004. Figures will depend on audited resource accounts and the subsequent settlement activities to reconcile departments' positions with the Consolidated Fund.

5 United Kingdom contributions to the Budget of the European Communities

Member States' contributions to the Budget of the European Communities are made on the basis of the financing system set out in the Own Resources Decision which was agreed by all Member States and incorporated in UK law by virtue of the EC (Finance) Act 1995. The contributions relate to calendar years and are formula based using factors that are in many cases subject to periodic revision over a number of years as better information becomes available - for example, Gross National Product (GNP). Revisions to a Member State's contributions for a given year may therefore be made for several years. The amount included in the note as expenditure comprises the amount estimated to be payable for the financial year plus an adjustment for earlier years based on the latest estimate of the contribution for those years.

The Own Resources Decision provides for the Community Budget to be financed by own resources consisting of

- i customs duties, including those on agricultural products;
- ii sugar levies;
- iii VAT, which is the application of a uniform rate, not exceeding 1 per cent to a harmonised expenditure base, which must not exceed 0.5% of GNP of any Member State; and
- iv a 'fourth' resource based on Member States' shares in Community GNP. The rate of this GNP based resource is whatever is required, given all other revenue, to balance the Budget.

The UK's abatement is calculated in accordance with the formula set out in the Own Resources Decision. It is equal to 66% of the difference in the previous year between what the UK would have paid if the Community Budget had been financed entirely by VAT (but excluding the UK's contribution to expenditure outside the Community, mainly aid) and the UK's receipts from the Budget.

Member States' budget contributions are subject to revision over several years, particularly as revised estimates of GNP and VAT become available.

| | Contribution for year ended 31 March 2004 £000 | Adjustment of prior years' contributions £000 | 2003-2004 Total £000 | 2002-2003 Total £000 |
|-------------------------------------|-------------------------------------------------------------------|------------------------------------------------------------------|-------------------------------------|----------------------------|
| Customs duties | 1,459,687 | 0 | 1,459,687 | 1,184,359 |
| Sugar levies | 13,323 | 0 | 13,323 | 18,812 |
| VAT contribution (before abatement) | 2,610,336 | (34,632) | 2,575,704 | 2,518,723 |
| Fourth resource contributions | 7,164,883 | 150,264 | 7,315,147 | 6,009,487 |
| | 11,248,229 | 115,632 | 11,363,861 | 9,731,381 |
| Less: UK abatement | (3,874,383) | 6,783 | (3,867,600) | (3,227,353) |
| | 7,373,846 | 122,415 | 7,496,261 | 6,504,028 |

In addition to annual contributions to the Budget of the European Communities, the Consolidated Fund also bears the cost of capital subscriptions to fund the European Investment Bank. These are detailed at Note 10.

6 Other Consolidated Fund standing services payments

| | Notes | 2003-2004 £000 | 2002-2003 £000 |
|-------------------------------------------|-------|---------------------------|-------------------|
| Civil list, annuities and pensions | | | |
| Civil list payments | | 7,900 | 7,900 |
| Annuities to the Royal Family | | 1,064 | 1,118 |
| Civil list annuities | | 636 | 636 |
| Royal Household Pensions Scheme | 7d | 3,107 | 2,819 |
| Pensions, etc for Judicial Services | | 30,540 | 26,454 |
| Other pensions | 7d, 8 | 1,273 | 1,254 |
| Salaries and allowances | | | |
| Courts of Justice | | 120,106 | 111,447 |
| Members of the European Parliament | | 5,319 | 5,160 |
| Other | | 1,260 | 1,159 |
| Miscellaneous services | | | |
| Election and referendum expenses | | 15,151 | 5,224 |
| Royal Mint | | 11,246 | 6,345 |
| Other | | 5,623 | 35,029 |
| Total | | 203,225 | 204,545 |

7 Unfunded pension arrangements

The Consolidated Fund pays as a Standing Service the pension benefits of those Royal Household (RH) employees who entered employment before 31 March 2001 under the Royal Household Pension Scheme, and the pension benefits of Members of the European Parliament (MEPs) under the European Parliament (UK Representatives) Pension Scheme. Pension benefits are based on final pensionable salary and full provision is made for pension liabilities which are accounted for as unfunded defined benefit arrangements in accordance with FRS 17 - Retirement Benefits. The liabilities are measured on an actuarial basis using the projected unit method and discounted using an assumed long-term real rate of return expected to be earned on long-dated index-linked gilts. The rate is determined by the Government Actuary's Department and is subject to review.

a Actuarial assessment assumptions

A full actuarial assessment was carried out for both schemes as at 31 March 2004 by the Government Actuary's Department. The major assumptions used by the actuary were

| | At 31 March 2004 | At 31 March 2003 |
|--------------------------------------|-----------------------------|---------------------|
| | % | % |
| Rate of increase in salaries | 3.9 | 4.9 |
| Rate of increase in pension payments | 2.4 | 3.4 |
| Discount rate | 6.0 | 7.0 |
| Inflation assumption | 2.4 | 3.4 |

b 2003-2004 Expenditure and income

| | RH | MEPs | 2003-2004 | 2002-2003 |
|-----------------------------------------|---------------------|---------------------|---------------------|--------------|
| | £000 | £000 | Total | Total |
| | | | £000 | £000 |
| Expenditure | | | | |
| Current service costs | 1,200 | 1,100 | 2,300 | 2,270 |
| Past service costs | 0 | 0 | 0 | 70 |
| Interest on scheme liability | 2,700 | 1,160 | 3,860 | 3,890 |
| Total expenditure | <u>3,900</u> | <u>2,260</u> | <u>6,160</u> | <u>6,230</u> |
| Income | | | | |
| <i>Pension contributions receivable</i> | | | | |
| Employers (ASLCs) | 977 | 0 | 977 | 1,077 |
| Employees (WPS contributions) | 160 | 511 | 671 | 547 |
| Total income | <u>1,137</u> | <u>511</u> | <u>1,648</u> | <u>1,624</u> |
| Net expenditure | <u>2,763</u> | <u>1,749</u> | <u>4,512</u> | <u>4,606</u> |

c Movement in liabilities during the year

| | RH | MEPs | 2003-2004 | 2002-2003 |
|----------------------------------------------|------------------------|------------------------|------------------------|-----------------|
| | £000 | £000 | Total | Total |
| | | | £000 | £000 |
| Liability in scheme at beginning of the year | (46,500) | (18,780) | (65,280) | (61,790) |
| Current service cost | (1,200) | (1,100) | (2,300) | (2,270) |
| Benefit payments | 3,100 | 770 | 3,870 | 3,517 |
| Past service cost | 0 | 0 | 0 | (70) |
| Other finance charges - interest | (2,700) | (1,160) | (3,860) | (3,890) |
| Total | <u>(47,300)</u> | <u>(20,270)</u> | <u>(67,570)</u> | <u>(64,503)</u> |
| Actuarial gain/(loss) | (4,500) | (1,670) | (6,170) | (777) |
| Liability at end of year | <u>(51,800)</u> | <u>(21,940)</u> | <u>(73,740)</u> | <u>(65,280)</u> |

The full actuarial assessment for the RH Pensions Scheme showed an increase in the provision for pension liabilities from £46,500,000 to £51,800,000.

The full actuarial assessment for the European Parliament (UK Representatives) Pensions Scheme showed an increase in the provision for pension liabilities from £18,780,000 to £21,940,000.

d Analysis of pension benefits paid by the Consolidated Fund

This table provides details of the cash payments paid by the Consolidated Fund in relation to Royal Household and MEPs' pensions as disclosed above. The pension increase element of MEPs' pensions is borne on the Civil Service Superannuation Resource Account.

| | RH £000 | MEPs £000 | 2003-2004 Total £000 | 2002-2003 Total £000 |
|---------------------------------------------------------------------------------------------|--------------|--------------|----------------------------|----------------------------|
| Total pension payable | 2,484 | 720 | 3,204 | 3,073 |
| Commutation and lump sum benefits | 623 | 151 | 774 | 561 |
| Total pension benefits payable | 3,107 | 871 | 3,978 | 3,634 |
| Less: increase element of MEPs' pensions borne by the Civil Superannuation Resource Account | 0 | (105) | (105) | (98) |
| Total borne by the Consolidated Fund | 3,107 | 766 | 3,873 | 3,536 |

e Analysis of actuarial loss on unfunded pension schemes

| | RH £000 | MEPs £000 | 2003-2004 Total £000 | 2002-2003 Total £000 |
|--------------------------------------------------------------------|------------|--------------|----------------------------|----------------------------|
| (Gains) and losses arising on scheme liabilities | 1,400 | 80 | 1,480 | (423) |
| Changes in assumptions underlying the present value of liabilities | 3,100 | 1,590 | 4,690 | 1,200 |
| Total | 4,500 | 1,670 | 6,170 | 777 |

8 Other pensions

In addition to the pensions described in Note 7, the Consolidated Fund also makes payments in relations to: (i) pensions in respect of higher judicial services; (ii) pensions for Parliamentary Officers for political and civil services provided; and (iii) Civil List pensions. FRS 17 disclosures have not been provided for these payments for the reasons given below.

Pensions in respect of higher judicial services - Liabilities in respect of this scheme are included in the Judicial Pensions Scheme resource account.

Pensions for Parliamentary Officers for political and civil services provided - relate to pensions for former Prime Ministers, Speakers, Comptroller and Auditor Generals and Parliamentary Commissioners. In total, a sum of £388,000 was paid from the Consolidated Fund in 2003-2004 in respect of these pensions (£418,000 in 2002-2003). The actuarial liability falling on the Consolidated Fund, across all these schemes, has been assessed as £6.6 million at 31 March 2004.

Civil List 'pensions' - these are not pensions in the accepted sense. They represent 'awards' for distinguished service to the arts and science and are payable for the life of the recipient. As there is no basis for accruing pension entitlement it is judged that they do not come within the scope of FRS 17 -Retirement Benefits.

In all the cases above, the sums involved are not material in the context of this account.

9 Coinage issued and redeemed

The face value of coins issued by the Royal Mint is payable to the Consolidated Fund and the face value of coins redeemed by the Royal Mint is a charge on the Consolidated Fund. The cost of minting the coinage is charged to the Treasury's Resource Account (£33.029 million in 2003-2004).

| | 2003-2004 | 2002-2003 |
|----------------|-----------------------|----------------|
| | £000 | £000 |
| Coins issued | 222,000 | 197,000 |
| Coins redeemed | (10,657) | (5,190) |
| Net income | <u>211,343</u> | <u>191,810</u> |

10 Fixed asset investments

a *European Investment Bank*

Section 3 of the European Communities Act 1972 provides for payments in respect of the capital or reserves of the European Investment Bank, or in respect of loans to the European Investment Bank, to be made from the Consolidated Fund.

The UK's interest in the European Investment Bank has been treated as a fixed asset investment. The Bank's capital has been provided through subscriptions by EU Member States, broadly in proportion to the GNP of the individual countries. The aim is to further the objectives of the European Union by making long-term finance available for investment projects.

The UK's share of subscribed capital was 17.77% at 31 March 2004 (17.77% at 31 March 2003). The investment is revalued each year at the UK's share (17.77%) of the net assets of the Bank as reported in the Bank's accounts to 31 December of the previous year.

| | 2003-2004 | 2002-2003 |
|--------------------------------------------------------------------------------|-------------------------|------------------|
| | £000 | £000 |
| At 1 April - Euro 4,177,730,000 at 1.450 (Euro 3,947,810,000 at 1.631) | 2,881,193 | 2,420,484 |
| Movements including gain on revaluation | 68,665 | 460,709 |
| At 31 March - Euro 4,430,687,000 at 1.502 (Euro 4,177,730,000 at 1.450) | <u>2,949,858</u> | <u>2,881,193</u> |

b *Land Registry Public Dividend Capital*

| | | |
|-----------------------------------------------------|-------------------------|------------------|
| Balance at 1 April | 61,545 | 61,545 |
| Additions | 0 | 0 |
| Disposals | 0 | 0 |
| Balance at 31 March | <u>61,545</u> | <u>61,545</u> |
| Total fixed asset investments at end of year | <u>3,011,403</u> | <u>2,942,738</u> |

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

National Loans Fund Accounts 2003-2004

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

I certify that I have audited the financial statements on pages 19 to 30 under the National Loans Act 1968. These financial statements have been prepared under the historical cost convention as modified by the revaluation of certain investments and the accounting policies set out on page 22 and in the form prescribed by the Treasury.

Respective responsibilities of the Accounting Officer and the Auditor

As described on page 3 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 such form the Treasury may prescribe. The Accounting Officer is also responsible for ensuring the regularity of financial transactions and the preparation of the Foreword and the Statement on Internal Controls. My responsibilities, as independent auditor, are established by statute and I have regard to the standards and guidance issued by the Auditing Practices Board and the ethical guidance applicable to the auditing profession.

I report my opinion as to whether the financial statements give a true and fair view, whether they are properly prepared in accordance with Section 21 (1) of the National Loans Act 1968 and in the form prescribed by the Treasury, and whether in all material respects the expenditure and income have been applied to the purpose intended by Parliament and conform to the authorities which govern them. I also report, if in my opinion, the Foreword is not consistent with the financial statements, if the Accounting Officer has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit.

I review whether the statement on pages 4 to 6 reflects compliance with Treasury's guidance on the Statement on Internal Control. I report if it does not meet the requirements specified by the Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered whether the Accounting Officer's Statement on Internal Control covers all risks and controls. I am also not required to form an opinion on the effectiveness of the Treasury's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

I conducted my audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of the transactions with investors included 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, 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 error, or by fraud or other irregularity and that, in all material respects, the transactions conform to 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 of the state of affairs of the National Loans Fund as at 31 March 2004 and of the net operating cost and cash flows for the year then ended; and have been properly prepared in accordance with Section 21 (1) of the National Loans Act 1968 and in the form prescribed by the Treasury; and
- in all material respects the expenditure and income have been applied to the purposes intended by Parliament and conform to the authorities which govern them.

I have no observations to make on these financial statements.

John Bourn
Comptroller and Auditor General

28 February 2005

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

Operating Cost Statement for the year ended 31 March 2004

| | Notes | 2003-2004 £m | 2002-2003 £m |
|-------------------------------------------------|-------|----------------------|-----------------|
| Finance costs of borrowing | 2 | 24,836 | 24,714 |
| Income from lending operations | 3 | (5,528) | (5,715) |
| (Gains)/losses on foreign exchange transactions | 4 | 42 | (69) |
| Other expenditure | 5 | 29 | 9 |
| Other income | 5 | (2,188) | (5,816) |
| Net operating cost | | <u>17,192</u> | <u>13,123</u> |

The notes on pages 22 to 30 form part of these financial statements.

Balance Sheet as at 31 March 2004

| | Notes | 2003-2004 £m | 2002-2003 £m |
|------------------------------------------------------|-------|-------------------------|------------------|
| Assets | | | |
| Loans | 6 | 2,963 | 3,079 |
| IMF Quota subscription | 7 | 8,697 | 9,294 |
| Advances | 8 | 77,138 | 72,670 |
| Debtors | 9 | 899 | 1,629 |
| Other assets | 10 | 628 | 501 |
| Total assets | | <u>90,325</u> | <u>87,173</u> |
| Liabilities | | | |
| Creditors | 11 | (5,089) | (5,425) |
| Other debt payable in sterling | 12 | (84,356) | (61,423) |
| Other debt payable in foreign currencies | 13 | (1,870) | (376) |
| National Savings and Investments products | 14 | (64,646) | (60,896) |
| Liabilities to the IMF | 7 | (5,245) | (5,347) |
| Gilt-edged stock | 15 | (342,199) | (321,875) |
| Total liabilities | | <u>(503,405)</u> | <u>(455,341)</u> |
| Net liabilities | | <u>(413,080)</u> | <u>(368,168)</u> |
| Liability of the Consolidated Fund to the NLF | 16 | <u>413,080</u> | <u>368,168</u> |

The notes on pages 22 to 30 form part of these financial statements.

Gus O'Donnell
Accounting Officer
HM Treasury

29 November 2004

Cash Flow Statement for the year ended 31 March 2004

| | Notes | 2003-2004 £ m | 2002-2003 £ m |
|-----------------------------------------|--------|-------------------------|------------------|
| Receipt/(payment) | | | |
| Net cash flow from operating activities | 17 i | 1,031 | 3,973 |
| Net cash flow from financial investment | 17 ii | (4,353) | 10,333 |
| Financing | 17 iii | 3,322 | (14,307) |
| Net cashflow | | 0 | 0 |

The notes on pages 22 to 30 form part of these financial statements.

Notes to the Financial Statements

1 Accounting policies

i Accounting convention

The National Loans Fund financial statements have 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.

ii Basis of consolidation

These financial statements consolidate the results and transactions of the National Loans Fund and National Savings and Investment products with the exception of the Ordinary Savings Account, which is not a charge on 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.

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 and the capital uplift added to the nominal value of the borrowing.

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 with the exception of finance costs that are contingent on movements in the relevant indices, which are recognised when they arise.

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.

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 of foreign currency debt issuance are met by the National Loans Fund. Administration and staffing costs are borne by HM Treasury and are accounted for through HM Treasury's resource accounts.

2 Finance costs on borrowing

| | 2003-2004 | 2002-2003 |
|--------------------------------------------------|------------------|-----------|
| | £m | £m |
| Gilt-edged stock | | |
| Marketable | 19,004 | 18,492 |
| Non marketable | 1,348 | 1,736 |
| | 20,352 | 20,228 |
| National Savings and Investments products | 1,923 | 2,080 |
| Other finance costs | | |
| Payable in sterling | 2,528 | 2,243 |
| Payable in foreign currencies | 33 | 163 |
| | 2,561 | 2,406 |
| Total finance costs on borrowing | 24,836 | 24,714 |

3 Income from lending operations

| | 2003-2004 | 2002-2003 |
|-----------------------------------------------------------------|------------------|-----------|
| | £m | £m |
| Interest on loans advanced by the NLF to Public Corporations | 165 | 125 |
| Central Government bodies | 127 | 135 |
| | 292 | 260 |
| Interest on loans advanced through the Public Works Loan Board | 3,942 | 4,071 |
| Interest on funding advanced to the Debt Management Account | 1,294 | 1,384 |
| Total income from lending operations | 5,528 | 5,715 |

4 (Gains) and losses on foreign exchange transactions

| | 2003-2004 | 2002-2003 |
|---------------------------------------------------------|------------------|-----------|
| | £m | £m |
| (Gains)/Losses on foreign currency borrowing | | |
| Canadian Dollar | (2) | (3) |
| US Dollar | (204) | (241) |
| Euro | (0) | 105 |
| | (206) | (139) |
| (Gain)/loss on Reserve Tranche Position at the IMF | 248 | 70 |
| Net (gain)/loss on foreign currency transactions | 42 | (69) |

5 Other income and expenditure

| | 2003-2004 | 2002-2003 |
|----------------------------------------------------------------------------|------------------|-----------|
| | £m | £m |
| Other expenditure | | |
| Debt management administration costs (Note A) | 7 | 4 |
| Expenditure in respect of depreciation of Issue Department assets (Note B) | 20 | 3 |
| 3.5% Conversion loan sinking fund | 2 | 2 |
| | 29 | 9 |

| | 2003-2004 | 2002-2003 |
|----------------------------------------------------------------------------------|------------------|-----------|
| | £m | £m |
| Other income | | |
| Income receivable in respect of appreciation of Issue Department assets (Note B) | (9) | (9) |
| Surplus sterling from EEA | (970) | (3,819) |
| Profits of the Bank of England Issue Department (Note B) | (1,248) | (1,240) |
| Surplus on the Debt Management Account | 49 | (735) |
| Written off gilt-edged stock | (2) | (3) |
| Miscellaneous receipts | (8) | (10) |
| | (2,188) | (5,817) |
| Net total | (2,159) | (5,808) |

Note A Debt management administration costs comprise amounts paid to the Bank of England and the Bank of Ireland mainly for administering the gilt-edged stock register. They also include the cost of issue of foreign currency borrowing.

Note B 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 NLF 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 NLF. The amount payable by the NLF for the year (£20 million) was charged to the Operating Cost Statement. The amount receivable by the NLF (£9 million) was credited to the operating cost statement. In addition, under section 9 of the National Loans Act 1968, the profits of the Issue Department are paid into the NLF. A sum of £1,248 million in respect of these profits was credited to the Operating Cost Statement in 2003-2004.

The NLF has a contingent liability to the Issue Department in respect of that part of the assets backing the note issue which is not represented by government securities. This contingent liability was £19,160 million at 31 March 2004.

6 Loans

| | Public Corporations 31 March 2004 £m | Central Government £m | Total £000 £m |
|-------------------------------------|-----------------------------------------------|-----------------------------|---------------------|
| Outstanding at 1 April 2003 | 1,641 | 1,438 | 3,079 |
| Loans advanced | 77 | 92 | 169 |
| Loans repaid | (181) | (104) | (285) |
| Outstanding at 31 March 2004 | 1,537 | 1,426 | 2,963 |

7 IMF Reserve Tranche Position

The United Kingdom Quota Subscription to the IMF is 10,738.5 million Special Drawing Rights (SDRs) (£8,697 million at 31 March 2004). Part of the Subscription is deposited in the NLF in return for non-interest bearing securities. A small undrawn sterling cash balance is held at the Bank of England. The difference between the gross quota subscription and the NLF's sterling liability to the IMF is the UK's Reserve Tranche position.

| | Asset | Liabilities | | | | Reserve |
|--------------------------------------------------------------------|---------------------------|---------------------------------------|-----------------------------------------------|-------------------------|----------------------|---------------------|
| | IMF Quota Subscription | Non interest bearing securities | Sterling balances at Bank of England | Valuation adjustment | Total liabilities | Tranche Position |
| | £m | £m | £m | £m | £m | £m |
| Balances at 1 April 2003 | 9,294 | (5,359) | (23) | 35 | (5,347) | 3,947 |
| Exchange rate gains/(losses) for the year on Quota Subscription | (597) | | | | | (597) |
| Change in year-end valuation adjustment | | | | 324 | 324 | 324 |
| Change in Loan notes as a result of the valuation settlement | | 26 | | | 26 | 26 |
| Change in cash on No 1 account | | | 1 | | 1 | 1 |
| Other changes in loan notes | | (249) | | | (249) | (249) |
| Balances at 31 March 2004 | 8,697 | (5,582) | (22) | 359 | (5,245) | 3,452 |

8 Advances

| | PWLB £m | DMA £m | EEA £m | Total £m |
|-------------------------------------|---------------|---------------|------------|---------------|
| Outstanding at 1 April 2003 | 44,640 | 28,000 | 30 | 72,670 |
| Advances | 4,603 | 7,000 | 2,570 | 14,173 |
| Advances repaid | (7,775) | 0 | (1,930) | (9,705) |
| Outstanding at 31 March 2004 | 41,468 | 35,000 | 670 | 77,138 |

Note 9 Debtors

| | 31 March 2004 £m | 31 March 2003 £m |
|-----------------------------------------|------------------------|------------------------|
| DMA surplus | 88 | 787 |
| Accrued interest on DMA funding advance | 119 | 101 |
| Accrued interest on PWLB loans | 652 | 695 |
| Accrued interest on NLF loans | 40 | 46 |
| | 899 | 1,629 |

10 Other assets

| | 31 March 2004 £m | 31 March 2003 £m |
|-------------------------------------------------------------|------------------------|------------------------|
| National Savings and Investments' cash holdings | | |
| From sale of investment products | 389 | 450 |
| For repayment of principal | 206 | 17 |
| For payment of interest | 11 | 11 |
| | 606 | 478 |
| Reserve Tranche sterling balances at Bank of England | 22 | 23 |
| | 628 | 501 |

11 Creditors

| | 31 March 2004 £m | 31 March 2003 £m |
|------------------------------------------------------------------------|---------------------------------|------------------------|
| National Savings and Investments interest and prizes | 84 | 78 |
| National Savings and Investments accrual of interest to be capitalised | 629 | 713 |
| Accrued interest on gilt-edged securities | 4,067 | 4,422 |
| <i>Accrued interest on borrowing payable in sterling</i> | | |
| DMO ways and means | 193 | 120 |
| BoE Ways and means | 45 | 42 |
| Accrued interest on Certificates of Tax Deposit | 32 | 38 |
| Other | 10 | 8 |
| Accrued interest on loans payable in foreign currency | 27 | 3 |
| | 5,089 | 5,424 |

12 Other debt payable in sterling

| | 31 March 2004 £m | 31 March 2003 £m |
|--------------------------------------------------------|---------------------------------|------------------------|
| Debt Management Account | 60,116 | 36,652 |
| Bank of of England Issue Department | 13,370 | 13,370 |
| Balances in government accounts at the Bank of England | 8,844 | 9,608 |
| Temporary Deposit Facility | 1,620 | 1,419 |
| Other | 406 | 374 |
| | 84,356 | 61,423 |

13 Other debt payable in foreign currencies

| | 31 March 2004 £m | 31 March 2003 £m |
|-----------------|---------------------------------|------------------------|
| US Dollar | 1,827 | 315 |
| Euro | 2 | 3 |
| Canadian Dollar | 40 | 58 |
| | 1,870 | 376 |

14 National Savings and Investments Products

| | 2003-2004 £m | 2002-2003 £m |
|-----------------------------------------------------------|-------------------------|-----------------|
| Principal outstanding as at 1 April | 60,896 | 59,963 |
| Cash repayments from the NLF | (9,316) | (10,651) |
| Principal cash received in the NLF | 11,873 | 10,253 |
| Interest and other returns accruing to savers capitalised | 1,065 | 1,281 |
| Change in cash holdings for principal | 128 | 50 |
| Principal outstanding 31 March | 64,646 | 60,896 |

15 Gilt-edged stock¹

| | 31 March 2004 | 31 March 2004 | 31 March 2004 | 31 March 2004 |
|------------------------------------------|-----------------------------------|-----------------------------------------------|---------------------------------------|--------------------------|
| | Conventional stock: nominal | Index-linked stock: Uplifted nominal | Unamortised (Discount)/ Premium | Outstanding Liability |
| | £m | £m | £m | £m |
| Marketable securities up to 5 years | 95,849 | 7,104 | (76) | 102,877 |
| Marketable securities from 5 to 15 years | 73,906 | 43,405 | (339) | 116,972 |
| Marketable securities over 15 years | 67,498 | 30,003 | 1,069 | 98,570 |
| Undated marketable securities | 3,206 | 0 | 0 | 3,206 |
| Non-marketable securities | 19,014 | 838 | 722 | 20,574 |
| Total gilt-edged stock | 259,473 | 81,350 | 1,376 | 342,199 |

1 The NLF has a contingent liability in respect of unclaimed dividends. This stood at £41.7m at 31 March 2004.

16 Liability of the Consolidated Fund to the NLF

| | 2003-2004 £m | 2002-2003 £m |
|----------------------------------------------------------------------------------------------|-----------------|-----------------|
| Liability of the Consolidated Fund to the NLF at 1 April | 368,168 | 344,466 |
| Net cash paid to the Consolidated Fund | 42,222 | 25,260 |
| Payment from the Consolidated Fund to the NLF for the cost of debt servicing during the year | (14,502) | (14,681) |
| Other net movements | 17,192 | 13,123 |
| Liability of the Consolidated Fund to the NLF at 31 March | 413,080 | 368,168 |

17 Notes to the Cash Flow Statement

| | 2003-2004 £m | 2002-2003 £m |
|--------------------------------------------------------------------|-----------------|-----------------|
| <i>i Net cash flow from operating activities</i> | | |
| Interest received | 5,559 | 5,792 |
| Other receipts | 2,206 | 5,065 |
| Finance costs on borrowing | (21,915) | (21,667) |
| Other flows | 678 | 102 |
| Transfer from the Consolidated Fund for the cost of debt servicing | 14,503 | 14,681 |
| Total net cash flow from operating activities | 1,031 | 3,973 |
| <i>ii Net cash flow from financial investment</i> | | |
| Net change in advance to the Debt Management Account | (7,000) | 7,000 |
| Net change in advance to the Public Works Loan Board | 3,172 | 2,453 |
| Net change in loans | 115 | 79 |
| Net change in advance to the EEA | (640) | 801 |
| Total net cash flow from investing activities | (4,353) | 10,333 |

iii Financing

| | 2003-2004 | 2002-2003 |
|--------------------------------------------------------------|------------------|-----------|
| | £m | £m |
| Net issuance of Government stock | 18,134 | 11,959 |
| Net issuance of National Savings and Investments instruments | 2,557 | (397) |
| Other net sterling borrowing | 22,933 | 3,497 |
| Net foreign currency borrowing | 1,920 | (4,105) |
| Net transfer to the Consolidated Fund | (42,222) | (25,260) |
| Total net cash flow from financing activities | 3,322 | (14,306) |
| Total net cashflow | 0 | 0 |

18 Financial risks related to the NLF

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

'to minimise over the long term, the 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 NLF, 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 NLF'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 NLF, and is denominated in Special Drawing Rights (SDRs).

Set out below are certain risk factors which could affect the NLF'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 Investment 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 are 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 as at 31 March 2004

Fixed rate borrowing

| Currency | Total liabilities | Variable rate | Fixed rate | Zero rated ¹ | Weighted average interest rate | Weighted average time for which interest rate is fixed |
|------------------------------|-------------------|----------------|----------------|-------------------------|--------------------------------|--------------------------------------------------------|
| | £m | £m | £m | £m | % | Years |
| Sterling Debt | 491,201 | 203,967 | 279,313 | 7,921 | 6.1 | 9.8 |
| Debt in foreign currency | | | | | | |
| US\$ | 1827 | 0 | 1827 | 0 | 2.2 | 4.0 |
| € | 2 | 0 | 2 | 0 | 7.0 | 2.7 |
| CAD \$ | 40 | 0 | 40 | 0 | 2.0 | 1.6 |
| IMF Liabilities ² | 5,245 | 0 | 0 | 5,245 | 0 | 0 |
| Total liabilities | 498,316 | 203,967 | 281,183 | 13,166 | 6.1 | 9.7 |

1 It is not possible to calculate a weighted time to maturity for zero rated liabilities as there is no defined term. They are treated as maturing in less than the year in the analysis by maturity band.

2 Liabilities to the IMF are denominated in sterling, but are subject to a revaluation adjustment reflecting the SDR/£sterling exchange rate movement.

NLF Assets: Interest rate and foreign currency analysis as at 31 March 2004

Fixed rate borrowing

| | Total liabilities | Variable rate | Fixed rate | Zero rated ¹ | Weighted average interest rate | Weighted average time for which interest rate is fixed |
|------------------------------|-------------------|---------------|---------------|-------------------------|--------------------------------|--------------------------------------------------------|
| | £m | £m | £m | £m | % | Years |
| Loans | 2,963 | 0 | 2,963 | 0 | 7.7 | 16.2 |
| IMF quota subscription (SDR) | 8,697 | 0 | 0 | 8,697 | 0 | 0 |
| Advances | 77,138 | 36,815 | 39,492 | 831 | 6.9 | 20.2 |
| Other assets | 628 | 0 | 0 | 628 | 0 | 0 |
| Total liabilities | 89,426 | 36,815 | 42,455 | 10,156 | 6.9 | 19.9 |

1 It is not possible to calculate a weighted time to maturity for zero rated assets as there is no defined term.

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 currently in existence matures in 2038. 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

| | 31 March 2004 £m | 31 March 2003 £m |
|----------------------------|---------------------------------|------------------------|
| Within one year/on demand | 178,637 | 162,598 |
| Between one and two years | 17,093 | 21,314 |
| Between two and five years | 80,282 | 73,094 |
| Over five years | 222,304 | 192,910 |
| Total | <u>498,316</u> | <u>449,916</u> |

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, and by the Public Works Loan Board for loans to Local Authorities.

In the context of NLF loans issued to trading organisations at market rates, under the commercial lending policy, the terms and interest rates applied take account of a credit assessment of the borrower which is reviewed periodically by the responsible department.

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 does not permit the Exchange Equalisation Account to borrow. Where the 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 transferred to the EEA in return for payment in sterling. The NLF's foreign currency liability to the market is hedged by a foreign currency asset on the EEA.

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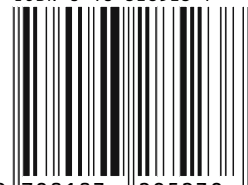
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