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United Kingdom Debt Management Office Report and Accounts 2006-2007

and

Debt Management Account Report and Accounts 2006-2007

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United Kingdom Debt Management Office

Report and Accounts 2006-2007

and

Debt Management Account

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and Accounts Act 2000
and
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Contents

Foreword

Scope of the report

This report presents both the Annual Report and Accounts of the UK Debt Management Office (DMO) and the Annual Report and Accounts of the Debt Management Account (DMA). In previous years these documents were published separately.

Chief Executive's statement

2006-07, our ninth year of operations, was a year of significant achievement for the DMO.

The DMO successfully delivered £62.5 billion of gilt sales through a record programme of 36 auctions. This was a significant operational challenge for the staff of the DMO and I am proud of their achievements in implementing the Government's financing remit.

We sold record amounts of long-dated conventional gilts and index-linked gilts (£25.2 billion and £17.2 billion respectively). This reflected both strong underlying investor demand for these securities, in particular from the UK pensions industry, and also the UK Government's own supply preferences in delivering the Government's debt management objective of minimising long-term costs subject to risk. HM Treasury has said that it considers it likely that strong demand for long-dated and index-linked gilts will persist in the medium term and, should that be the case, our policy of skewing issuance towards long-dated maturities would continue.

New lending by the Public Works Loan Board (PWLB) to local authorities also reached a new record of £12.4 billion.

The DMO continued to successfully deliver the Government's cash management objectives under the new banking arrangements and changes to market conditions that resulted from the Bank of England's reforms to the sterling money markets. In addition, through its fund management operation, the DMO continued to provide a cost-effective service to client funds that are the responsibility of the Commissioners for the Reduction of the National Debt (CRND) and via the PWLB continued to provide loans for capital purposes to local authorities.

That the DMO was able to successfully meet these challenging requirements across its range of operations has been dependent, once again, on the commitment and professionalism of its staff and I remain very appreciative of their contribution throughout the year.

Principal activities and history of the DMO

The DMO was established on 1 April 1998, with the aim '… *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*'.

The DMO specialises in the delivery of treasury management services and related policy advice to central government. The DMO performs these functions with a view to contributing to the Government's objective of achieving sound and sustainable public finances and improving the cost effectiveness of public services.

The DMO is legally and constitutionally part of HM Treasury, but as an executive agency, it operates at arm's length from Ministers. The Chancellor of the Exchequer determines the policy and operational framework within which the DMO operates, but delegates to the Chief Executive operational decisions on debt and cash management, and day-to-day management of the office.

The responsibilities of the Chancellor and other HM Treasury Ministers, the Permanent Secretary to the Treasury and the DMO's Chief Executive are set out in a published Framework Document, available on the DMO website at www.dmo.gov.uk, which also sets out the DMO's objectives and its Chief Executive's lines of accountability. The Chief Executive is accountable to Parliament for the DMO's performance and operations, both in respect of its administrative expenditure and the Debt Management Account.

HM Treasury has specific objectives for debt management and cash management. HM Treasury gives the DMO annual remits on debt and cash management. The remits are published in the Debt and Reserves Management Report, usually issued as part of the Budget announcements each spring. The DMO conducts its operations for the forthcoming financial year within the scope of these remits, and to meet its specified objectives and targets.

Debt Management

HM Treasury's debt management objective is *"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"*.

The DMO's main debt management activity is to issue gilt-edged securities (gilts) on behalf of the National Loans Fund (NLF).

The remit set by HM Treasury specifies the planned annual total of gilt sales in cash terms, the split between conventional and index-linked gilt sales and within conventional gilts the split by maturity band. The dates of scheduled outright auctions are also announced. The remit also provides the basis for the conduct of any switch, conversion or buy-back operations in a particular year.

Within the framework of the remit, the DMO decides the size of gilt auctions and the choice of gilts to be auctioned, and the size and maturity breakdown of Treasury bill tenders.

The DMO publishes Operational Notices describing how it will act in the gilts and sterling money markets – copies of these documents are available on the DMO website at www.dmo.gov.uk.

The Government seeks to minimise the costs of servicing its debt over the long-term, rather than the debt interest bill in a single year. The Government tries not only to choose a strategy that minimises the expected average debt cost over the longer term, but tries also to ensure that the chosen policy is robust against different economic outturns and can be delivered in a wide range of economic conditions.

The composition of debt issuance is the primary means by which the Government adjusts the nature and maturity of its debt portfolio. In order to determine the composition, the Government takes into account, among other things, investors' demand for gilts, its own appetite for risk, the shape of the yield curve, and the expected effects of issuance.

The DMO advises HM Treasury in its selection of an appropriate debt issuance strategy.

In addition to gilt issuance (the primary market), the DMO contributes to the development of an efficient and liquid secondary market for gilts, by means including the stewardship of the Gilt Edged Market Makers (GEMMs) system. Under an agreement with the DMO, GEMMs provide a secondary market in all gilts, and are the point of access for institutional investors who wish to take part in the DMO's gilt auctions.

The DMO may redeem gilts prior to maturity in any portfolio by selling them back to the NLF at the then current market rates. This reduces the amount of that gilt in issue and is usually done for market management reasons.

Cash Management

The DMO's cash management objective is *"to offset, through its market operations, the expected cash flow into or out of the National Loans Fund (NLF) on every business day, in a cost effective manner with due regard to risk management"*.

The remit set by HM Treasury specifies that the DMO's main objective in cash management is to offset, through its market operations, the expected cash flow into or out of the NLF on every business day. It is to do this in a cost-effective way, balancing cost and risk in its strategies, and without influencing the level of short-term interest rates.

The remit includes information on the planned approach to Treasury bill issuance and the planned stock of Treasury bills at the end of the financial year.

Gilt purchase and sale service

On 20 December 2004, the DMO introduced a gilt purchase and sale service for retail investors that replaced the Bank of England's brokerage service. This service is only available to those registered on the approved group of investors database, which members of the public are able to apply to join and is operated by Computershare Investors Services PLC, as an agent of the DMO. This service enables members of the public to undertake secondary market transactions in gilts, on an execution only basis, cheaply and quickly within the framework provided by the approved group process, which was introduced as an anti-money laundering measure. This additional service provided by the DMO coincided with the administration of the gilt register being transferred from the Bank of England to Computershare. The contract with Computershare is managed by DMO on behalf of HM Treasury.

PWLB and CRND

On 1 July 2002, the operations of the PWLB and the CRND (two constituent parts of the National Investment and Loans Office (NILO)) were integrated with the DMO, and the relevant PWLB and CRND staff relocated to the DMO's premises.

The PWLB lends principally to local authorities for capital purposes and collects the repayments. Its responsibilities include ensuring these loans are made correctly and that there is no loss to the Exchequer.

The CRND's principal function is managing the investment portfolios of certain public funds. PWLB and CRND continue to carry out their longstanding statutory functions within the DMO.

Relationship of the Debt Management Account to the National Loans Fund

The operations of the Consolidated Fund and the NLF – the main central government funds – are central to an understanding of the role of the DMA in Government debt and cash management. HM Treasury manages both funds. The Consolidated Fund accounts for most central government expenditure and receipts, while the NLF mainly undertakes borrowing and financing transactions. As the Government's main borrowing account the principal role of the NLF is to balance the Consolidated Fund at the end of each day.

The DMA's principal role is to meet the financing needs of the NLF. These include long-term requirements (debt management), short-term requirements, and day-to-day cash needs (cash management). Lending by the DMA to the market (when the Government has excess cash) is an asset of the DMA, while borrowing by the DMA from the market is a liability. Day-to-day borrowing and lending largely takes the form of the issuance of Treasury bills, sale and repurchase transactions (repos), and reverse sale and repurchase transactions (reverse repos) with the market. The repos and reverse repos are collateralised, usually using gilts. For this purpose the DMA holds a large gilt portfolio comprising gilts bought from the NLF and from the former National Investments and Loans Office (NILO) early in the life of the DMA.

Gilts are issued by the DMO and pass through the DMA, but, as they are issued on behalf of HM Treasury, they remain a liability of the NLF. The NLF creates the gilt that is to be issued and sells it to the DMA. The DMA then sells the gilt to the market. The responsibility for paying gilt coupons and redeeming the debt on maturity lies with the NLF. The DMA regularly undertakes secondary market gilt transactions in small volumes. The DMO also offers a buying and selling service to retail customers.

Sterling Treasury bills are issued by the DMO, as part of its cash management operations. These are liabilities of the DMA.

At the end of each day, any surplus balance on the DMA (less a varying target float, typically of around £500 million) is returned to the NLF as a deposit. This is the means by which the DMA balances the daily financing needs of the NLF. The deposit was £35,339 million at 31 March 2007. The DMA pays interest, at the Bank of England repo rate, on the advance to the NLF. The DMA receives interest on any daily deposit made with the NLF at the same rate. This rate has been agreed with HM Treasury.

Under the terms of the Finance Act 1998, the NLF made a cash advance of £6 billion to the DMA at inception in order to establish the account. Subsequent cash advances have been made from time to time. At the start of year the NLF advance to the DMA was nil. In April 2006 the NLF advanced £5 billion to the DMA and advanced a further £10 billion in August 2006. The DMA repaid this advance to the NLF in a single payment of £15 billion in January 2007 when it became clear that the DMA had no further need of the advance in the short-term.

Retained surpluses and deficits of the DMA are assets or liabilities of the NLF respectively. In the case of a retained surplus, HM Treasury may pay all or part of the surplus from the DMA to the NLF thereby reducing the liability of the DMA. The only such payment to date was made in March 2004, which reduced the liability of the DMA to the NLF by £650 million. In the case of a retained deficit, HM Treasury may pay all or part of the deficit to the DMA from the NLF. If there were to be a cessation of the DMA, with a corresponding liquidation of all balances, the NLF is entitled to the net amount realised. In such a situation the NLF will have a responsibility to meet outstanding liabilities including those relating to Treasury bills issued by the DMA.

Relationship of the Debt Management Account to the Commissioners for the Reduction of the National Debt

Commissioners for the Reduction of the National Debt (CRND) is a separate entity within the DMO that performs a fund management service for a small number of public sector clients. The Comptroller General of CRND is also the Deputy Chief Executive of the DMO. CRND client mandates require the bulk of the funds to be invested in gilts or with the DMA Deposit Facility (DMADF). Surplus cash in CRND client accounts is regularly deposited with the DMADF. From time to time, the DMA transacts marketable gilts with CRND and trades these back-to-back with market counterparties. The DMA also transacts non-marketable gilts on behalf of CRND and trades these back-to-back with the NLF. These transactions are carried out on an arms length basis and in line with a Memorandum of Understanding between the DMO and CRND.

The value of deposits outstanding at 31 March 2007 was £48.8 billion (31 March 2006: £19.9 billion).

Corporate governance

Throughout 2006-07, ministerial responsibility for the DMO was vested in the Economic Secretary to the Treasury. At the beginning of the year the post of Economic Secretary was held by Ivan Lewis MP. From 5 May 2006 the post of Economic Secretary was held by Ed Balls MP. From 29 June 2007 the post of Economic Secretary was held by Kitty Ussher MP.

Robert Stheeman, the Agency's Chief Executive, is the Accounting Officer for the Agency and is responsible to HM Treasury Ministers for the overall operation of the Agency in accordance with its Framework Document. The Chief Executive's appointment was through open competition by HM Treasury and he commenced his role as head of the DMO on 6 January 2003.

The Chief Executive is assisted by a Managing Board that, in addition to the Chief Executive, comprised:

Jo Whelan	– Deputy Chief Executive
Jim Juffs	– Chief Operating Officer
Tamara Finkelstein	– non-executive HM Treasury representative (from June 2006)
Colin Price	– non-executive Director
Brian Larkman	– non-executive Director
Sue Owen	– non-executive HM Treasury representative (until April 2006)

The Managing Board supports the Chief Executive in delivering the DMO's objectives. This is supported by the following operational committees:

- Sub-committee of the Managing Board
- Debt Management Committee
- Cash Management Committee
- Fund Management Committee
- Risk Committee.

Colin Price, who was appointed by the Chief Executive, was Finance Director of Shell Pensions Management Services Ltd between 1991 and 2001, a member of the Board of IMRO from 1996 to 2000 and Chairman of The Lord Chancellor's Strategic Investment Board from 2000 to 2006. This position is subject to regular review. Brian Larkman was Global Head of Money Markets at the Royal Bank of Scotland PLC from 2000 to 2001 and previously Managing Director, Global Money Markets at National Westminster Bank PLC from 1991 to 2000 and a member of the Regulatory Decisions Committee of the FSA until 2006. His appointment was made on the basis of open competition.

The DMO established an Audit Committee in 1999 as part of its development of internal risk management and control arrangements in line with best private sector practice. In January 2007, the Audit Committee arrangements were modified as part of the audit committee arrangements for HM Treasury group. Details of this change are set out in the statement on internal control on page 31 to 35.

Risk management

The DMO attaches a high priority to risk management. It has developed a set of policies to manage its exposure to risk in the achievement of its objectives. The DMO's position differs from that of a commercial organisation in that it must always be in a position to transact the underlying business required to meet its remit, although it will seek to minimise risk in doing so. Implementation of these policies is the responsibility of the Chief Executive as the Accounting Officer of the DMA. Functional teams and committees comprising appropriately qualified staff assist the Chief Executive in this role.

Further details of the DMO's risk management processes are given in the section on objectives and policies for holding and issuing financial instruments below, and in the statement on internal control on page 31 to 35.

Disclosures regarding risk management required under FRS 29 are included in the notes to the DMA accounts on page 79 to 94.

Resources

Sustainable development

As an executive agency of HM Treasury, the DMO is a party to the Joint Sustainable Development Statement, signed by the then 'Green Minister' for the Chancellor of the Exchequer's Departments and Agencies, John Healey MP and published on the DMO website.

The DMO is committed to contributing to the Government's objectives on Sustainable Development as contained in the Framework for Sustainable Development in the Government Estate.

Service quality

The DMO does not provide services direct to the public, and so is not covered by existing arrangements for reporting service quality. However, the DMO has strong partnerships with parts of the public sector and provides advice and expertise to other Government departments (and other governments), in developing solutions for financial cost-effectiveness and risk reduction when managing the Government's balance sheet.

Website

In September 2006 the DMO launched its new website at www.dmo.gov.uk consolidating its three websites (DMO, PWLB and CRND) into one. The new website provides users with an interactive database and reporting service and allows access to all of the DMO's publications. Data available includes current and historical gilt prices and yields, detailed gilt auction and Treasury bill tender results and a catalogue of all press releases. Many of the website reports give users the option for automatic downloads of data. The website also provides users with new analytical tools and calculators, enabling them to estimate the redemption payment on an index-linked gilt or the repayment cost of a fixed interest loan from the PWLB. Data accuracy and the speed of updates have been greatly improved by introducing automatic updates of data from DMO systems.

HM Treasury services

HM Treasury continues to provide several support services to the DMO, including purchase order processing, invoice processing and payment, payroll processing and some financial accounting services.

Supplier payment policy

All the DMO's invoices are processed for payment by HM Treasury, which is committed to the CBI code on prompt payment and aims to pay all valid invoices within 30 days or less after acceptance of the relevant goods and services, or the receipt of a legitimate invoice if that is later. For 2006-07, HM Treasury achieved this payment target for 94% of invoices across the department.

Auditors

The Comptroller and Auditor General is responsible for auditing both the DMO and DMA annual accounts, as specified by the Government Resource Accounts Act 2000 and the National Loans Act 1968 respectively.

Other organisational arrangements

Preparation of accounts

The financial accounts for the DMO and the DMA have been prepared in accordance with directions given by HM Treasury. The accounts direction for the DMO is issued in pursuance of section 7 (2) of the Government Resources and Accounts Act 2000. The accounts direction for the DMA is issued in pursuance of section 5A of the National Loans Fund Act 1968. The text of the accounts directions for the DMO and the DMA are reproduced on page 58 and on page 95 to 96 respectively.

The DMO accounts are prepared in accordance with the 2006-07 *Government Financial Reporting Manual (FReM)* issued by HM Treasury. The DMA account is consistent with relevant requirements of *FReM*, but additionally applies the following Financial Reporting Standards: FRS 23 (IAS 21) *The Effects of Changes in Foreign Exchange Rates* (instead of SSAP 13, *Foreign Currency Translation*); FRS 25 (IAS 32) *Financial Instruments: Presentation*; FRS 26 (IAS 39) *Financial Instruments: Recognition and Measurement*; and FRS 29 (IFRS 7) *Financial Instruments: Disclosures* (instead of FRS 13 *Derivatives and other financial instruments: disclosures*) other than Appendix E, *Capital Disclosures*.

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

Pension liabilities

Past and present employees are covered by the provisions of the Principal Civil Service Pension Schemes (PCSPS) which are described in the Remuneration Report on page 26 to 29. The defined benefit schemes are unfunded and are non-contributory except in respect of dependants' benefits. The Agency recognises the expected cost of these elements on a systematic and rational basis over the period during which it benefits from employees' services by payment to the PCSPS of amounts calculated on an accruing basis. Liability for payment of future benefits is a charge on the PCSPS. In respect of the defined contribution schemes, the Agency recognises the contributions payable for the year.

Equal opportunities

The DMO is an equal opportunities employer. Policies are in place to ensure that no job applicant or member of staff receives less favourable treatment on grounds of gender, gender re-assignment, marital or family status, colour, racial origin, sexual orientation, age, background, religion, disability, trade union membership or by any other condition or requirement which cannot be shown to be justifiable.

Disability

The DMO is committed to the promotion of opportunity in all fields and the above policy statement affirms its commitment to equality of opportunities in employment and to the development of management and staff who demonstrate clear awareness of equality issues. The DMO has a culture of inclusiveness and is working towards removing barriers to achieve full diversity.

Employee relations

The DMO continues to maintain effective employee relations and to involve staff in decision-making.

A Staff Council has met regularly throughout the year and enabled an open exchange of ideas and views between management and staff representatives and has been effective as a conduit for wider communication and consultation with all staff.

Union arrangements also continue for staff transferred to the DMO in 2002 under TUPE principles. Staff may choose to join a trade union of their choice.

Improving good practice and investment in people

The DMO was re-accredited as an Investor in People in September 2005 and continues to work towards maintaining this status with the next formal review due by September 2008.The DMO's training and development policy is central to ensuring that the right people with the right skills are in the right job at the right time. The DMO's corporate training programme, complemented by additional specialist and individual training as well as support for ongoing professional studies, continues to enhance the skills base of its employees.

ROBERT STHEEMAN
Chief Executive and Agency Accounting Officer
16 July 2007

Management Commentary

Review of activities in 2006-07

2006-07 was another successful year for the DMO. In its busiest year to date, it successfully met its debt and cash management remits, its strategic objectives and published targets. A full account of these is given on page 14 to 20.

Debt Management

2006-07 saw a record amount of gilt sales, £62.5 billion (cash), delivered through a record number of 36 gilt auctions. The successful delivery of this programme represented a significant operational challenge for the DMO.

The focus of the debt management remit was weighted towards the sale of long-dated conventional and index-linked gilts, which together accounted for over two thirds of total gilt sales. This represented an extension of the strong skew towards sales of long-dated gilts begun in 2005-06 which had seen the launch of ultra-long (50-year) maturity conventional and index-linked gilts. In 2006-07 these gilts were built up further and a 40-year conventional gilt was also launched. Sales of these instruments were supported by ongoing structural demand from the UK pension industry.

The particular maturities of most, but not all, of the planned gilt issuance for 2006-07 were pre-committed at the beginning of the year. £9.5 billion of gilt sales were allocated on a quarterly basis throughout the financial year – all either to long conventional (£8.25 billion) or to indexlinked (£1.25 billion) gilts.

In addition to delivering its own remit, the DMO also sold, on an execution only basis, the existing index-linked gilts in the Nuclear Liabilities Investment Portfolio (NLIP) held by British Nuclear Fuels Limited (BNFL).

In addition to holding gilts to use as collateral in its cash management operations, the DMA continues to hold relatively small portfolios of gilts for other purposes:

Purchase and sale service. This portfolio of gilts (fair value of £18 million at 31 March 2007) is used for purchase and sale transactions with retail investors. This service was introduced in December 2004, when gilt registration services were transferred from the Bank of England to Computershare Investor Services PLC.

Rump stocks. This portfolio (fair value of £18 million at 31 March 2007) contains 'rump stock' gilts. These are gilts in which the DMO will make a bid price upon request from a GEMM. GEMMs are not required to make a market in such gilts, due to the small nominal values outstanding.

Other tradable gilts. This portfolio (fair value of £102 million at 31 March 2007) is comprised of a residual from each gilt auction. A small amount of each gilt auction may be retained due to rounding of the allotment to the successful bidders of the gilts in the auction. The portfolio may also include any gilts bought by the DMO in the secondary market for other reasons.

Cash Management

The cash management remit for 2006-07 was successfully delivered under the new banking arrangements and changes to market conditions that resulted from the Bank of England's reforms to the sterling money markets.

During the year, the DMO carried out its cash management objectives through a combination of regular weekly Treasury bill tenders and dealing with market counterparties. The latter involved sale and repurchase agreements (repos), reverse sale and repurchase agreements (reverse repos), taking unsecured deposits, and the purchase of certificates of deposit and commercial paper maturing within six months. These positions are taken in order to anticipate the net Government cash flow, and the DMO did not seek to hedge exposure to interest rate risk on these positions.

Throughout 2006-07, the DMO held gilts for use as collateral in repo borrowing. At 31 March 2007, gilts held specifically for collateral purposes had a fair value of £25.2 billion.

On 29 March 2007 the DMO joined LCH Clearnet using the RepoClear gilts cash and repo service to help enhance the delivery of its core cash management responsibilities. In addition, the DMO has broadened its bilateral trading relationships through further use of electronic and voice brokers.

DMO hedging of NS&I's Guaranteed Equity Bond

The DMA held a number of equity derivatives in the year (aggregate nominal value of £984 million at 31 March 2007). These are used to hedge an equity index exposure of the Government that is external to the DMA. In March 2002, National Savings & Investments began to issue Guaranteed Equity Bonds in partnership with the DMO. The DMO hedges the equity index exposure resulting from the sale of these products to investors. Each equity derivative comprises two forward derivatives that address the risk features of the positions being hedged: equity index risk and interest rate risk. Both transactions are reported at fair value on the balance sheet. The fair value of the derivatives was a net asset of £212 million at 31 March 2007 (31 March 2006: net asset of £177 million).

The DMA contracts the hedging derivatives, but does not hold the underlying position being hedged. As a result, the DMA is exposed to equity index risk and interest rate risk over the life of the derivatives. However, taking account of the position of both the DMA and National Savings & Investments, the Government has no exposure to equity index risk.

PWLB

PWLB advanced loans amounting to £12.4 billion in 2006-07, 38% more than in 2005-06, which was itself a record year. However, the overall outstanding debt to the Board increased only slightly, because gross advances were largely offset by repayments of principal. The year was, therefore, one of significant debt-rescheduling by the Board's customers.

CRND

During the year CRND continued to provide an efficient, value for money service, with the main investment objectives being to maintain sufficient liquidity to meet withdrawals and to protect the capital value of the funds under management.

Achievements against objectives

HM Treasury Ministers set the DMO's objectives, which are published in the DMO's business plan and its Framework Document. The objectives for 2006-07 and the DMO's performance against them is summarised below.

Objectives 1 and 2 related specifically to the DMA. Objectives 3 to 7 related to the DMO as a whole, including the DMA.

1. **To develop, provide advice on and implement HM Government's debt management strategy.**

   The DMO provided analysis and advice to HM Treasury in connection with the preparation of its financing remit for 2006-07, against a backdrop of challenging market conditions, in particular low and volatile yields at long maturities in early 2006, and a forecast record financing requirement.

   Against this backdrop and a recommended issuance strategy which was heavily biased toward long-dated maturities, the DMO agreed with HM Treasury temporary changes to the remit for 2006-07 designed to provide for greater responsiveness in the event that there were substantial changes in market conditions and the pattern of demand for gilts through the year.

   The remit was delivered in line with initial expectations. Gilt sales (of £62.5 billion) were exactly in line with the remit, as revised at the Pre-Budget Report. This was a record amount – as were the amounts of long-dated conventional and index-linked gilt sales (£25.2 billion and £17.2 billion respectively).

2. **To develop, provide advice on and implement HM Government's cash management requirements.**

   The DMO's cash management objectives were successfully delivered under the new banking arrangements and changes to market conditions that resulted from the Bank of England's reforms to the sterling money markets.

   The DMO continues to monitor and assess the overall performance of Exchequer active cash management in meeting the Government objectives, against a series of agreed key performance indicators and controls. These indicators reflect the principles and objectives of the Government for cash management and are quantitative and qualitative in nature. They include a measure of the cost of active cash management compared with a notional passive benchmark strategy, in the context of market and credit risk limits that reflect a risk appetite approved by Ministers.

   Formal reporting of the performance of active cash management against the key performance indicators will begin for the 2007-08 outturn, the first full year since the sterling market reforms.

3. **To advise HM Treasury on the development and implementation of strategies for managing HM Government's balance sheet to secure sound public finances.**

   The DMO has continued to provide analysis and advice to HM Treasury on the broader implications for HM Government's balance sheet of the management of the Government liabilities and assets entrusted to the DMO, with a view in particular to manage mismatches in the nature of assets and liabilities.

   At an operational level, the DMO has also continued to hedge HM Government's exposure to the equity market through the sale of National Savings and Investments' (NS&I) Guaranteed Equity Bond (GEB) product by implementing swap (equity index and interest rate) transactions with market counterparties.

4. **To develop and deliver its fund management responsibilities and, in particular, to provide a cost-effective service for stakeholders.**

   The DMO, through its Fund Management operation, continued to provide a cost-effective service to client funds that are the responsibility of the Commissioners for the Reduction of the National Debt (CRND).

The DMO continued to manage the gilt registration contract with Computershare Investor Services PLC ("Computershare") on behalf of HM Treasury. It also continued to offer the Gilt Purchase and Sale Service for retail investors, which is carried out in association with Computershare as the DMO's agent.

5. **To provide a cost-effective lending service to local authorities through the Public Works Loan Board.**

   The Public Works Loan Board (PWLB) continued to provide loans for capital purposes to local authorities and other prescribed borrowers, at record levels. Loans totalling £12.4 billion were advanced in 2006-07 an increase of 38% over 2005-06, which had itself been a record year.

   At end-March 2007 loan principal outstanding to the Board totalled £47.9 billion, compared with £47.1 billion at end March 2006, a relatively small rise reflecting significant in-year repayments of principal.

6. **To resource, staff and manage the DMO efficiently and cost-effectively to ensure key responsibilities are achieved.**

   The DMO was reaccredited as an "Investor in People" in September 2005 and continues to work towards maintaining this status. The DMO's training and development policy is central to ensuring that the right people with the right skills are in the right job at the right time. The DMO's corporate training programme complemented by additional specialist and individual training, together with as support for ongoing professional studies, continues to enhance the skills base of its employees.

7. **To manage, operate and develop an appropriate risk and control framework.**

   The DMO continued to operate an effective risk and control framework throughout the year as detailed in the statement of internal control on page 31 to 35. Following an independent review of the risk reporting processes a number of recommendations have been implemented to improve the focus on key risks and controls and the usefulness of the information produced.

Performance against targets

1. **To ensure full compliance with HM Government's remit for the DMO (which is primarily set out in the Debt and Reserves Management Report 2006-07, but, in some areas, is subject to confidential parameters notified separately to the DMO).**

   The gilt sales target of £62.5 billion (cash) was met through the conduct of 36 conventional gilt auctions (19 conventional and 17 index-linked). Outright sales of £63.0 billion were planned in the remit for 2006-07 announced on 22 March 2006; £53.0 billion in a core programme plus a supplementary amount of £10.0 billion of sales to be allocated to a particular type of gilt on a quarterly basis throughout the financial year. The sales target was reduced to £62.5 billion (with the supplementary amount being reduced to £9.5 billion) at PBR on 6 December 2006. The composition of cash proceeds from gilt issuance was £45.3 billion from conventional gilts and £17.2 billion from index-linked gilts. There were no uncovered auctions.

The 36 outright gilt auctions held were as follows:

- 4 April: £2,000 million (nominal) of 4¼% Treasury Gilt 2055
- 11 April £1,200 million (nominal) of 1¼% Index-linked Treasury Gilt 2017
- 25 April: £1,100 million (nominal) of 1¼% Index-linked Treasury Gilt 2027
- 11 May: £2,250 million (nominal) of 4¼% Treasury Gilt 2046
- 23 May: £700 million (nominal) of 1¼% Index-linked Treasury Gilt 2055
- 25 May: £2,750 million (nominal) of 4% Treasury Gilt 2016
- 7 June: £2,750 million (nominal) of 4¼% Treasury Gilt 2046
- 22 June: £2,500 million (nominal) of 4¼% Treasury Gilt 2011
- 27 June: £900 million (nominal) of 1¼% Index-linked Treasury Gilt 2027
- 4 July: £2,250 million (nominal) of 4¼% Treasury Gilt 2046
- 11 July: £1,200 million (nominal) of 1¼% Index-linked Treasury Gilt 2017
- 25 July: £450 million (nominal) of 2½% Index-linked Treasury Stock 2024
- 1 August: £2,500 million (nominal) of 4% Treasury Gilt 2016
- 23 August: £1,000 million (nominal) of 1¼% Index-linked Treasury Gilt 2027
- 5 September: £2,250 million (nominal) of 4¼% Treasury Gilt 2027
- 19 September: £1,200 million (nominal) of 1¼% Index-linked Treasury Gilt 2017
- 21 September: £2,500 million (nominal) of 4¼% Treasury Gilt 2011
- 27 September: £675 million (nominal) of 2% Index-linked Treasury Stock 2035
- 3 October: £2,250 million (nominal) of 4¼% Treasury Gilt 2027
- 12 October: £1,200 million (nominal) of 1¼% Index-linked Treasury Gilt 2017
- 24 October: £650 million (nominal) of 1¼% Index-linked Treasury Gilt 2055
- 7 November: £2,250 million (nominal) of 4¼% Treasury Gilt 2046
- 23 November: £2,500 million (nominal) of 4% Treasury Gilt 2016
- 28 November: £1,000 million (nominal) of 1¼% Index-linked Treasury Gilt 2027
- 29 November: £2,500 million (nominal) of 4¼% Treasury Gilt 2011
- 5 December: £2,250 million (nominal) of 4¼% Treasury Gilt 2027
- 14 December: £650 million (nominal) of 2% Index-linked Treasury Stock 2035
- 9 January: £2,250 million (nominal) of 4¼% Treasury Gilt 2027
- 18 January: £1,200 million (nominal) of 1¼% Index-linked Treasury Gilt 2017
- 25 January: £625 million (nominal) of 1¼% Index-linked Treasury Gilt 2055
- 6 February: £2,250 million (nominal) of 4¼% Treasury Gilt 2046
- 20 February: £1,000 million (nominal) of 1⅛% Index-linked Treasury Gilt 2037
- 22 February: £2,750 million (nominal) of 4% Treasury Gilt 2016
- 6 March: £2,250 million (nominal) of 4¼% Treasury Gilt 2027
- 15 March: £2,750 million (nominal) of 5¼% Treasury Gilt 2012
- 27 March: £950 million (nominal) of 1¼% Index-linked Treasury Gilt 2027

2. To ensure that the maximum time taken to issue the results of gilt auctions does not exceed 40 minutes, that for weekly Treasury bill tenders does not exceed 30 minutes, and that for ad hoc Treasury bill or other tenders does not exceed 15 minutes, whilst achieving complete accuracy.

Achieved; the gilt auction release times during the year were all within the 40 minute target:

- 4 April: 4¼% Treasury Gilt 2055 — 23 minutes
- 11 April: 1¼% Index-linked Treasury Gilt 2017 — 16 minutes
- 25 April: 1¼% Index-linked Treasury Gilt 2027 — 23 minutes
- 11 May: 4¼% Treasury Gilt 2046 — 21 minutes
- 23 May:1¼% Index-linked Treasury Gilt 2055 — 24 minutes
- 25 May: 4% Treasury Gilt 2016 — 22 minutes
- 7 June: 4¼% Treasury Gilt 2046 — 29 minutes
- 22 June: 4¼% Treasury Gilt 2011 — 21 minutes
- 27 June:1¼% Index-linked Treasury Gilt 2027 — 18 minutes
- 4 July: 4¼% Treasury Gilt 2046 — 22 minutes
- 11 July: 1¼% Index-linked Treasury Gilt 2017 — 18 minutes
- 25 July: 2½% Index-linked Treasury Stock 2024 — 18 minutes
- 1 August: 4% Treasury Gilt 2016 — 13 minutes
- 23 August: 1¼% Index-linked Treasury Gilt 2027 — 21 minutes
- 5 September: 4¼% Treasury Gilt 2027 — 25 minutes
- 19 September: 1¼% Index-linked Treasury Gilt 2017 — 16 minutes
- 21 September: 4¼% Treasury Gilt 2011 — 18 minutes
- 27 September: 2% Index-linked Treasury Stock 2035 — 15 minutes
- 3 October: 4¼% Treasury Gilt 2027 — 21 minutes
- 12 October: 1¼% Index-linked Treasury Gilt 2017 — 20 minutes
- 24 October: 1¼% Index-linked Treasury Gilt 2055 — 19 minutes
- 7 November: 4¼% Treasury Gilt 2046 — 17 minutes
- 23 November: 4% Treasury Gilt 2016 — 26 minutes
- 28 November: 1¼% Index-linked Treasury Gilt 2027 — 17 minutes
- 29 November: 4¼% Treasury Gilt 2011 — 19 minutes
- 5 December: 4¼% Treasury Gilt 2027 — 22 minutes
- 14 December: 2% Index-linked Treasury Stock 2035 — 17 minutes
- 9 January: 4¼% Treasury Gilt 2027 — 29 minutes
- 18 January: 1¼% Index-linked Treasury Gilt 2017 — 17 minutes
- 25 January: 1¼% Index-linked Treasury Gilt 2055 — 20 minutes
- 6 February: 4¼% Treasury Gilt 2046 — 18 minutes
- 20 February: 1⅛% Index-linked Treasury Gilt 2037 — 18 minutes
- 22 February: 4% Treasury Gilt 2016 — 17 minutes
- 6 March: 4¼% Treasury Gilt 2027 — 22 minutes
- 15 March: 5¼% Treasury Gilt 2012 — 20 minutes
- 27 March: 1¼% Index-linked Treasury Gilt 2027 — 24 minutes

The average release time for these auctions was 20 minutes.

The release time for the results of the 50 weekly bill tenders held during the financial year ranged from 6 to 25 minutes and averaged 10 minutes. There were no ad hoc or other tenders.

3. **To achieve complete accuracy, within agreed accounting tolerances, in the recording and reporting of transactions through the DMA, and in delivering money (and reconciling payments) to the NLF and to meet the required deadlines for the publication or submission for audit of the annual reports of the DMO and DMA.**

   Achieved. The Comptroller and Auditor General has certified that the accounts gave a true and fair view.

4. **To acknowledge all letters and e-mail enquiries from the public within 4 working days and for at least 95 per cent to be sent a substantive reply within 2 weeks. Furthermore, the DMO will respond to enquiries under the Freedom of Information Act within the statutory timeframe.**

   Achieved. 306 enquiries were received from the public, predominantly by e-mail (17 by letter) in 2006-07. The average response time was 2 working days.

5. **To achieve less than 5 breaches of Operational market notices (excluding any breaches which HM Treasury accept were beyond the control of the DMO).**

   Achieved. There were no breaches of the operational market notices in 2006-07.

6. **To ensure that, where there is a late change in the cash management forecast, any necessary use of end of day borrowing or lending facilities is notified by the due time, where applicable; and to ensure that target weekly balances and expected daily variations are notified according to the agreed schedule.**

   Achieved. All relevant weekly targets were notified to the Bank of England according to the agreed schedule.

7. **To ensure that instructions to counterparties, agents and external systems are complete, accurate and timely, and that monitoring of the progress of transactions through settlement is effective, so that the DMO achieves at least 99% (by value) successful settlement of agreed trades on the due date.**

   Achieved. During the year trades with a value of £1,913 million failed as a result of circumstances outside the DMO's control. No trades failed within the DMO's control. Failed trades represented 0.15% of turnover.

8. **To release all market sensitive data and announcements in a timely manner and to aim to achieve no factual errors in material published by the DMO on its wire service pages, its web sites or its printed documents (insofar as the material is under the control of the DMO and not third parties).**

   Achieved on timeliness; all releases were announced in a timely manner.

   Not achieved on accuracy; over the financial year there were seventeen errors discovered on the DMO website and rectified quickly. Twelve of the errors related to the old DMO website which was replaced in September 2006.

9. **To process all loan or early settlement applications from local authorities within two working days (between date of agreement and completion of transaction).**

   Achieved. All loans and early settlement applications from local authorities were made within two working days (between date of agreement and completion of transaction).

10. To ensure that the gilts purchase and sales service is operated according to its published terms and conditions.

The gilt sale and purchase scheme was conducted fully in line with its terms and conditions in 2006-07. The pattern of sales and purchases through the financial year as a whole is shown in the table below.

	Sales (transactions)	Purchases (transactions)	Aggregate retail sales £m	Aggregate retail purchases £m
April – June 2006	1,641	383	13.7	5.4
July – September 2006	1,548	1,664	9.7	39.4
October – December 2006	1,384	1,016	10.7	18.8
January – March 2007	1,544	694	12.3	11.2
	6,117	**3,757**	**46.4**	**74.8**

Financial performance of the UK Debt Management Office

The DMO is financed through HM Treasury and operated under net cost arrangements, meaning that the control total for the DMO's annual expenditure agreed by Parliament comprises an aggregate of target expenditure and income.

The DMO's net operating cost for 2006-07 was £7.4 million. This represents a decrease of £0.1 million from the previous year, and remained within the DMO's voted expenditure limit.

During the reporting period, the DMO's gross administrative expenditure was £12.1 million, an increase of £0.6 million compared to the previous year. Gross programme expenditure was £2.2 million, a decrease of £1.6 million on 2005-06 programme expenditure which had been higher than normal owing to fees associated with a syndicated gilt issue in September 2005.

In total, the DMO received operating income of £6.8 million (2005-06: £7.8 million), a decrease of £1.0 million. Administration income was higher than 2005-06 due to increased levels of PWLB lending, while programme income was lower because the previous year's income included recovery of the gilt syndication costs.

The DMO shows a balance sheet deficit as at 31 March 2007. This is a product of the relationship between the DMO and HM Treasury as its parent department. The DMO is an executive agency operating at arm's length from ministers but its funding is an allocation of the total voted by Parliament to HM Treasury. The DMO has no operating capital or cash of its own (apart from a deposit held for a sub-tenant); its liabilities are paid by HM Treasury. The cash funding thus provided by HM Treasury to the DMO does not equate to the net operating cost recorded by the DMO on an accrual basis. As required by the Government Financial Reporting Manual, funding is recorded in the General Fund within Taxpayers' Equity, along with net operating cost. The balance of Taxpayers' Equity can therefore be particularly affected by:

- Unpaid and accrued liabilities recognised as an expense by the DMO but not yet funded by HM Treasury
- Outstanding receivables
- Income recognised in the operating cost statement in excess of what can be appropriated in aid which must be paid over to the Consolidated Fund.

A balance sheet deficit therefore reflects the DMO's net operating funding requirement at that date rather than operating performance or solvency.

Financial performance of the Debt Management Account

The DMA's operations for the financial year 2006-07 gave rise to net interest expense of £23 million (2006 net interest income: £40 million restated), net trading income of £35 million (2006: £163 million), and gains from investment securities of £15 million (2006: £19 million). This resulted in a surplus for the year of £27 million (2006: £222 million).

For 2006-07, Financial Reporting Standards 26 and 29 have been applied to the DMA report and accounts resulting in certain changes to its accounting policies. The most significant change relates to the DMO's holding of gilts for use as collateral for its cash management operations and other gilts held that the DMO does not have an intention to trade. These are classified as investment securities available for sale, and at 31 March 2007 had a fair value of £25,352 million (31 March 2006: £28,423 million) inclusive of accrued interest, which was disclosed separately in previous years. Changes in the fair value of the investment securities available for sale are not reflected by gains and losses on the income and expenditure account. This has significantly reduced volatility in the DMA income and expenditure account. (As previously reported, movements in the valuation of these holdings resulted in £530 million of net trading income in 2006.)

The DMA holds derivatives for risk management purposes. Some are used to hedge foreign exchange risk of positions on the DMA, but the largest proportion by value are used to hedge the Government's exposure to equity index risk relating to Guaranteed Equity Bonds issued by National Savings & Investments. (The DMO has no corresponding agreement with National Savings & Investments because the exposure is within Government, and is offset in a consolidated view of the central government accounts.) Valuation changes on these derivatives resulted in trading income in 2006-07 of £35 million (2006: £163 million).

During 2006-07, the DMO issued Treasury bills with a total nominal value of £80.4 billion, which had maturities of one month (£25.35 billion), three months (£44.6 billion), and six months (£10.45 billion). In 2006-07, the DMO issued no Treasury bills to itself for use as collateral. At 31 March 2007, the total nominal value of Treasury bills in issue (excluding unsettled trades) was £15.6 billion, with maturities of one month (£1.6 billion), three months (£8.65 billion), and six months (£5.35 billion). By comparison in 2005-06, the DMO issued Treasury bills with a total nominal value of £87.95 billion (excluding issuance to itself to provide extra collateral), which had maturities of one month (£28.2 billion), three months (£49.8 billion), and six months £9.95 billion). At 31 March 2006, the total nominal value of Treasury bills in issue (excluding unsettled trades) was £19.1 billion, with maturities of one month £2.05 billion), three months (£11.7 billion), and six months £5.35 billion).

With regard to cash management operations, although the DMO seeks to conduct its market interactions cost effectively, it also has to take into account that the primary requirement is to respond to the Exchequer's cash flows and to balance the NLF daily. In some circumstances, this may reduce the range of available trading strategies.

The DMA's net operating results are heavily influenced by the interaction between transactions undertaken by the DMO to smooth Government daily cash flows, and market conditions over the course of the year. The size and composition of the DMA's balance sheet during the year, and the maturity of the DMO's money market transactions, will largely reflect the seasonal pattern of Government cash flows, rather than any trading view by the DMO. The seasonal pattern of the Government's cash flows generally requires borrowing to fund net Government expenditure in the early months of each financial year, prior to receipt of the main tax revenues in the later part of the financial year.

Forward look

The DMO's strategic objectives for 2007-08

The DMO's strategic objectives for 2007-08 are set out in our published business plan which is available on the DMO website at www.dmo.gov.uk.

1. To develop, provide advice on and implement HM Government's debt management strategy.

2. To develop, provide advice on and implement HM Government's cash management requirements.

3. To advise HM Treasury on the development and implementation of strategies for managing HM Government's balance sheet, to secure sound public finances.

4. To develop and deliver its fund management responsibilities and, in particular, to provide a cost-effective service for stakeholders.

5. To provide a cost-effective lending service to local authorities through the Public Works Loan Board.

6. To resource, staff and manage the DMO efficiently and cost-effectively to ensure key responsibilities are achieved.

7. To manage, operate and develop an appropriate risk and control framework.

In the delivery of these objectives, the DMO seeks to support primarily HM Treasury's Objective I: "Maintain a stable macroeconomic environment with low inflation and sound public finances in accordance with the Code for Fiscal Stability". It also seeks to support Objective III "Promote efficient, stable and fair financial markets, for their users and the economy"; Objective VI: "Improve the quality and the cost-effectiveness of public services"; and Objective VII: "Achieve world-class standards of financial management in government".

The DMO's operational targets for 2007-08

1. To ensure full compliance with HM Government's remit for the DMO (which is primarily set out in the Debt and Reserves Management Report 2007-08 but, in some areas, is subject to confidential parameters notified separately to the DMO).

2. To ensure that the maximum time taken to issue the results of gilt auctions does not exceed 40 minutes (and to reduce the average time for publishing gilt auction results following the introduction of automated bid capture), that for weekly Treasury bill tenders does not exceed 30 minutes, and that for ad hoc Treasury bill or other tenders does not exceed 15 minutes, whilst achieving complete accuracy.

3. To achieve complete accuracy, within agreed accounting tolerances, in the recording and reporting of transactions through the DMA, and in delivering money (and reconciling payments) to the NLF and to meet the required deadlines for the publication or submission for audit of the annual reports of the DMO, DMA, the Public Works Loan Board and the Commissioners for the Reduction of the National Debt.

4. To acknowledge all letters and e-mail enquiries from the public within 4 working days and for at least 95 per cent to be sent a substantive reply within 2 weeks. Furthermore, the DMO will respond to enquiries under the Freedom of Information Act within the statutory timeframe.

5. To achieve less than 5 breaches of operational market notices (excluding any breaches which HM Treasury accept were beyond the control of the DMO).

6. To ensure that, for cash management purposes, target weekly balances and expected daily variations are notified according to the agreed schedule.

7. To ensure that instructions to counterparties, agents and external systems are complete, accurate and timely, and that monitoring of the progress of transactions through settlement is effective, so that the DMO successfully settles at least 99% (by value) of agreed trades on the due date.

8. To release all market sensitive data and announcements in a timely manner and to aim to achieve no factual errors in material published by the DMO on its wire service pages, its website or its printed documents (insofar as the material is under the control of the DMO and not third parties).

9. To process all loan or early settlement applications from local authorities within two working days (between date of agreement and completion of transaction).

10. To ensure that the gilts purchase and sales service is operated according to its published terms and conditions.

The DMO's key planning themes for the period to 2010-11

The key planning themes reflect the need for the DMO to continue to deliver its core operational objectives to the highest standards; to develop further initiatives that advance its effectiveness and reduce cost and risk; and to continue to be efficient in the stewardship of the agency.

The objectives within each key planning theme are set out below.

To continue to deliver the DMO's core operations and activities to the excellent standard required.

This will include the following:

- Managing the debt and cash management operations successfully to deliver the financing programmes incorporated within the 2007-08 remit;
- Developing in due course the debt and cash management remits for 2008-09;
- Delivering the Public Works Loan Board's ("PWLB") lending objectives for local authorities; developing where appropriate efficiencies and enhancements to the service; and, where feasible, and desirable, reducing cost and risk to the Exchequer;

- Managing the funds of the Commissioners for the Reduction of the National Debt ("CRND") in accordance with the mandates from clients;
- Delivering the gilt purchase and sale service for retail investors efficiently and effectively;
- Managing the registration contract with Computershare, on behalf of HM Treasury, in an effective and efficient way;
- Continuing to manage hedging transactions to meet NS&I's requirements in respect of its financing programme;
- Producing the report and accounts for the DMO as an agency, the Debt Management Account, the PWLB and CRND funds to the highest standards of quality and timeliness; and
- Ensuring that the DMO's website, publications and information are managed effectively and are available to stakeholders when required.

To further the development of debt and cash management strategy in particular where this identifies initiatives that may provide cost and risk minimisation benefits for HM Government.

This will include the following:

- Developing where appropriate the operational capability to manage market-related risks arising from the DMO's core operations;
- Developing further analytical tools and techniques that help inform debt and cash management strategy;
- Developing further our understanding of the composition of, drivers for and issues relating to the investor base for gilts and Treasury bills;
- Assisting HM Treasury understand the key issues and risks associated with HM Government's treasury management activities; and
- Developing enhancements to the delivery and measurement of the effectiveness of cash management operations.

To improve efficiency and to reduce operational risk where possible

This will include the following:

- Implementing the automated bid capture facility for gilt auctions;
- Delivering a programme of savings to meet the DMO's budget "envelope" resulting from HM Treasury's Comprehensive Spending Review settlement;
- Reviewing further the DMO's banking and settlement arrangements with the intention of identifying efficiencies and where possible advances in operational effectiveness;
- Developing and enhancing the DMO's business delivery capability to improve the operational efficiency of the agency;
- Enhancing the DMO's risk management analytical and reporting framework and capability;
- Continuing to enhance business continuity arrangements to develop further the DMO's operational resilience;

- Implementing a programme of strategic IT work to enhance the DMO's core infrastructure and applications;
- Developing further the management information produced to support the DMO's business and agency functions; and
- Implementing efficiencies in the management of information taking due account of the Freedom of Information Act requirements.

To ensure the core values of the DMO continue to make it an excellent place to work.

This will include the following:

- Continuing to integrate and embed the DMO's core values into all aspects of the DMO's operations ensuring these activities are consistent with and build upon its "Investor in People" status;
- Developing further the use of the DMO's Staff Council as a means of enhancing communication with DMO staff; and
- Identifying and implementing where appropriate more effective ways of working.

Remuneration Report

The DMO has a Pay Committee, which during 2006-07 comprised:

Robert Stheeman	– Chief Executive (Chair)
Jo Whelan	– Deputy Chief Executive
Jim Juffs	– Chief Operating Officer
Colin Price	– non-Executive Director
Brian Larkman	– non-Executive Director

The Pay Committee is responsible for overseeing the DMO's delegated pay arrangements and ratifying the DMO's Pay Remit submission to HM Treasury and its subsequent implementation. Pay progression takes into account individual performance (as assessed through the DMO's appraisal arrangements), job size (as assessed by job evaluation) and, where appropriate, external market comparators as well as public pay policy and affordability.

Remuneration policy

Senior DMO staff

The Chief Executive is a member of the Senior Civil Service, employed by HM Treasury and included in HM Treasury's appraisal arrangements. Increases in salary are made by HM Treasury in accordance with the Senior Salaries Review Body's Report.

Further information about the work of the Review Body can be found at www.ome.uk.com.

Salaries of the Deputy Chief Executive and Chief Operating Officer are set internally in accordance with DMO's delegated pay arrangements by the Chief Executive and the non-executive Directors.

Non-Executive Directors

The Chief Executive, in discussion with the Deputy Chief Executive and Chief Operating Officer, determines the remuneration of the non-Executive Directors. Remuneration is reviewed annually taking account of external market comparators as well as public sector pay policy and affordability, but the DMO reserves the right not to make adjustments.

The non-executives are appointed as "office holders".

Contracts

Senior DMO staff

The Chief Executive's appointment was for an initial 3-year fixed term period. This has been extended twice for a further fixed term period, currently until 31 December 2008. The contract is subject to a

3-month notice requirement. Compensation for early termination would be paid in accordance with the relevant provisions of the Civil Service Compensation Scheme.

The appointments of the Deputy Chief Executive and Chief Operating Officer have been made in accordance with the provisions of the Civil Service Commissioners' Recruitment Code.

Further information about the work of the Civil Service Commissioners can be found at www.civilservicecommissioners.gov.uk

Non-Executive Directors

Colin Price was originally contracted for an initial 2-year period from 21 February 2001. Upon completion, his contract was extended to 20 February 2007 and has been further extended for an additional 3-year term to February 2010.

Brian Larkman's contract is for a period of 3 years from 1 January 2005 until 31 December 2007.

Both contracts are subject to a one-month notice requirement. Contracts will automatically terminate on the date stated unless a further extension has been agreed. As office holders there is no provision for compensation for early termination.

Remuneration received

	2006-07 Salary £000	2005-06 Salary £000
Senior DMO Staff		
Robert Stheeman – Chief Executive	125 – 130	120 – 125
Jo Whelan – Deputy Chief Executive *	80 – 85	100 – 105
Jim Juffs – Chief Operating Officer	125 – 130	120 – 125
Non-Executive Directors		
Colin Price	15 – 20	15 – 20
Brian Larkman	15 – 20	15 – 20

(This information has been audited.)

* The salary disclosed reflects part time hours and is calculated on a pro rata basis from a full time equivalent (FTE) of 0.78 in 2006-07 (0.78 in 2005-06). The 2006-07 total also accommodates a period of unpaid leave.

'Salary' includes gross salary, performance pay or bonuses, overtime, reserved rights to London weighting or London allowances, recruitment and retention allowances, private office allowances and any other allowances to the extent that it is subject to UK taxation.

This report is based on payments made by the Agency and thus recorded in these accounts.

The DMO is not responsible for the remuneration of any Ministers or Tamara Finkelstein, who is an employee of HM Treasury.

Pension benefits

	Accrued pension at age 60 at 31 March 2007 and related lump sum £000	Real increase in pension and related lump sum at age 60 £000	CETV at 31 March 2006 Restated £000	CETV at 31 March 2007 £000	Real increase in CETV £000
Robert Stheeman – Chief Executive	5 – 10	0 – 2.5	79	104	20
Jo Whelan – Deputy Chief Executive	0 – 5	0 – 2.5	38	56	13
Jim Juffs – Chief Operating Officer	35 – 40	5 – 7.5	124	147	19

(This information has been audited.)

The non-Executive Directors are not entitled to any pension benefits.

Civil Service Pensions

Pension benefits are provided through the Civil Service pension arrangements. From 1 October 2002, civil servants may be in one of three statutory based 'final salary' defined benefit schemes (Classic, Premium and Classic Plus). The schemes are unfunded with the cost of benefits met by monies voted by Parliament each year. Pensions payable under Classic, Premium and Classic Plus are increased annually in line with changes in the Retail Prices Index. New entrants after 1 October 2002 may choose between membership of premium or joining a 'money purchase' stakeholder based arrangement with a significant employer contribution (partnership pension account).

Employee contributions are set at a rate of 1.5% of pensionable earnings for Classic and 3.5% for Premium and Classic Plus. Benefits in Classic accrue at the rate of 1/80th of pensionable salary for each year of service. In addition, a lump sum equivalent to three years' pension is payable on retirement. For premium, benefits accrue at the rate of 1/60th of final pensionable earnings for each year of service. Unlike Classic, there is no automatic lump sum (but members may give up (commute) some of their pension to provide a lump sum). Classic Plus is essentially a variation of premium, but with benefits in respect of service before 1 October 2002 calculated broadly in the same way as in classic.

The partnership pension account is a stakeholder pension arrangement. The employer makes a basic contribution of between 3% and 12.5% (depending on the age of the member) into a stakeholder pension product chosen by the employee from a selection of approved products. The employee does not have to contribute but where they do make contributions, the employer will match these up to a limit of 3% of pensionable salary (in addition to the employer's basic contribution). Employers also contribute a further 0.8% of pensionable salary to cover the cost of centrally-provided risk benefit cover (death in service and ill health retirement).

The accrued pension quoted is the pension the member is entitled to receive when they reach 60, or immediately on ceasing to be an active member of the scheme if they are already 60.

Further details about the Civil Service pension arrangements can be found at the website ww.civilservice-pensions.gov.uk.

The cash equivalent transfer value (CETV)

A Cash Equivalent Transfer Value (CETV) is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme.

A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme.

The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies.

The CETV figures, and from 2003–04 the other pension details, include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the Civil Service pension arrangements and for which the Cabinet Office's Civil Superannuation Vote has received a transfer payment commensurate to the additional pension liabilities being assumed. They also include any additional pension benefit accrued to the member as a result of their purchasing additional years of pension service in the scheme at their own cost.

CETVs are calculated within the guidelines and framework prescribed by the Institute and Faculty of Actuaries.

Real increase in CETV

This reflects the increase in CETV effectively funded by the employer. It does not include the increase in accrued pension due to inflation, contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement) and uses common market valuation factors for the start and end of the period.

ROBERT STHEEMAN
Chief Executive and Agency Accounting Officer
16 July 2007

Statement of Accounting Officer's responsibilities

Under the Government Resources and Accounts Act 2000, the DMO is required to prepare agency accounts for each financial year, in the form and on the basis set out in the Accounts Direction issued by HM Treasury on page 58.

Under Schedule 5A of the National Loans Act 1968, HM Treasury has directed the DMO to prepare a statement of the Debt Management Account in the form and on the basis set out in the Accounts Direction on page 95 to 96.

Both accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of the DMO and of the operations of the Debt Management Account respectively and of the related net resource outturn, income and expenditure, recognised gains and losses and cash flows for the financial year.

In preparing both accounts, the DMO is required to:

- observe the relevant Accounts Direction issued by HM Treasury, including accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards, have been followed, and disclose and explain any material departures in the accounts;
- prepare the accounts on a going-concern basis.

In addition, in preparing the agency accounts of the DMO, the Accounting Officer is required to comply with the accounting and other requirements of the Government Financial Reporting Manual.

HM Treasury has appointed the Chief Executive as Accounting Officer for the Debt Management Office and the Debt Management Account.

The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding the DMO's assets, are set out in the Accounting Officers' Memorandum issued by HM Treasury and published in Government Accounting.

Statement on internal control

1. Scope of responsibility

As Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of the Debt Management Office's policies, aims and objectives, 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.

I am Accounting Officer for both the Debt Management Account (DMA) and the Debt Management Office (DMO), an executive agency of HM Treasury. My accountability is subject to the overall responsibility of the Permanent Secretary of HM Treasury (in his capacity as Accounting Officer) for the organisation and management of the Department. In exercising my responsibilities for the DMA, I pay regard to the consequences for the National Loans Fund (NLF) and consult the Permanent Secretary if I consider that my actions could have implications for him in his role as NLF Accounting Officer.

CRND and PWLB are separate business entities within the DMO. Each has its own accounting officer who is responsible for maintaining a sound system of internal control that supports the delivery of the entity's agreed policies, objectives and targets. However, I am responsible for the wider DMO control framework within which both CRND and PWLB are managed, and both accounting officers take assurance from me for the continued sound maintenance of this in relation to their own control responsibilities.

In exercising my specific responsibilities for debt and cash management I take regard of the objectives set by HM Treasury Ministers for the Government's debt and cash management. It is my responsibility to ensure that all activities brought to account on the DMA are conducted with due regard to value for money. I have put arrangements in place to ensure that there is a proper evaluation of the balance of cost and risk in our operations, taking account where appropriate of any cost, risk or other strategic objectives, parameters or guidelines agreed with HM Treasury.

As Agency Accounting Officer I am responsible to the Chancellor and accountable to Parliament for the Agency's use of resources in carrying out its functions as set out in the Framework Document.

2. The purpose of the system of internal control

The system of internal control is designed to manage risk to an acceptable level, balancing the impact of potential risks with the resources required to manage them, rather than to eliminate all risk. 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 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 in the Debt Management Office for the year ended 31 March 2007 and up to the date of approval of the annual report and accounts, and accords with HM Treasury guidance. The DMO has made additions to the system of internal control over the course of the year.

3. Capacity to handle risk

The DMO has a formal risk management strategy and policy set by the Managing Board. This includes an outline of the DMO's capacity to handle risk. The DMO has a Risk Management Assurance Strategy documenting its risk management processes.

The DMO Managing Board is responsible for setting strategic direction and considering high-level operational issues. An executive sub-committee of the Managing Board meets weekly. During the year attendance at these weekly meetings has been expanded to include certain senior managers in order to support the executive members of the Managing Board. The terms of reference of these management committees and those of the Cash Management, Debt Management, Fund Management and Risk Committees clearly set out their roles and responsibilities for providing the organisational capability to consider issues and make relevant decisions at the appropriate level.

Staff have attended presentations on relevant elements of the DMO's risk management framework. These have covered specific issues such as anti-money laundering, whistleblowing, fraud and personal dealing in order to ensure a good level of awareness of DMO's risk policies and controls. In addition, new staff are given an overview of the key aspects of these policies by a member of the Risk Management Team. All members of staff have job descriptions, including specific key risks they are expected to manage.

Management in each business function is responsible for ensuring that the operations within their area are compliant with plans, policies, procedures and legislation. Functional managers are responsible for maintaining compliance arrangements across the DMO in their area of specialism. Risk Management Unit has issued guidance on those sections of the Financial Services Authority handbook that are most pertinent to the DMO's business to all relevant business areas to support managers in meeting this responsibility.

4. The risk and control framework

The DMO has various formal mechanisms for managing the DMO's risks but it is recognised that the most important aspect is that a strong risk management culture pervades the organisation at all levels. This is embedded in both regular operations and the approach taken to new business initiatives. The DMO includes risk management considerations as part of normal business management. The DMO is making on-going efforts to embed a strong risk management culture in every part of the organisation. In support of this Internal Audit and an external risk consultancy firm have carried out reviews of operational risk management during the year. Work is in hand to implement recommendations from these reviews.

The DMO's risk management strategy seeks to achieve a strong risk management culture by linking organisational objectives to the business planning process. Organisational objectives cascade down to individual objectives and job descriptions. Progress has been made during the year on documenting main team objectives with comprehensive coverage planned during 2007-08. This is intended to promote a clear understanding of the ownership of each risk within the organisation. The DMO's business planning and project management processes incorporate assessment of business priorities, budgeting, approval, cost monitoring and delivery.

Heads of business units and functional teams assess regularly whether risks to their operations are being managed effectively. New risks, and risks with an increased likelihood of occurrence, are highlighted and actions identified to ensure all risks will be effectively managed. The DMO has Senior Risk Owners who undertake a cross-functional moderation process to promote better prioritisation of operational risks across the organisation. Project teams use risk registers to monitor and manage identified risks for DMO projects. Managing Board have reviewed during the year the high level risks that the organisation faces, and the adequacy of the relevant controls. This process is supported by the maintenance of exception logs, which identify control weaknesses and resultant actions to improve controls. Key risks, progress on treatment actions, and exceptions are documented in a quarterly report produced by the Risk Management Unit for the Senior Risk Owners and the Managing Board.

A key component of the DMO's control framework is the segregation of duties to promote independent checking and reconciliation, and to avoid concentration of key activities or related controls in individuals or small groups of staff. In particular segregation of duties takes place between front and back office activities. All teams have documented procedures for their main activities and there are clearly defined authorisation levels for committing the DMO externally.

The DMO has policies on anti-fraud measures, money laundering and whistle blowing. An independent review of DMO's money laundering controls was undertaken in 2006-07. Recommendations to move to a risk-based approach in line with market practice will be implemented in 2007-08. The DMO has its own anti-money laundering handbook. DMO staff report on anti-money laundering developments and processes to the Managing Board.

The DMO's Business Continuity Plan (BCP), including disaster recovery site and other arrangements, is subject to continual review and update with the Senior Risk Owners taking a more active role during the year in progressing BCP improvements. The DMO tested the main elements of the BCP during the year by use of both internal and market-wide test exercises with external stakeholders. Assessment of business continuity requirements is a specific requirement for new projects and major business initiatives.

The DMO has established effective communication channels with its main stakeholders to help highlight issues that may affect either party's risks. In addition to maintaining bilateral contacts with market counterparties, the DMO also holds quarterly consultation meetings with Gilt-edged Market Makers (GEMMs) and issues ad hoc public consultation documents on specific issues.

During the year, responsibility for supporting me as Accounting Officer in matters relating to oversight of the governance, internal control and risk management processes was brought under the supervision of the Exchequer Funds Audit Committee and the Group Resource Audit Committee. The Exchequer Funds Audit Committee performs this role for the Accounting Officers of each of the Exchequer Funds which are the Debt Management Account, Public Works Loan Board, Commissioners for the Reduction of the National Debt, Exchange Equalisation Account, National Loans Fund, Consolidated Fund and the Contingencies Fund. The Chair of the Committee reports to me on matters relating to the Debt Management Account, Public Works Loan Board and Commissioners for the Reduction of the National Debt. Members of the Committee are appointed for periods of up to three years, extendable by no more than one additional three-year period. The current membership of the Committee is:

- Colin Price, Chair, non-executive member of the DMO's Managing Board, until December 2006 Chair of the Lord Chancellor's Strategic Investment Board and formerly Global Pension Fund Adviser/Finance Director at Shell Pensions Management Services Limited;
- Brian Larkman, non-executive member of the DMO's Managing Board and formerly Global Head of Money Markets at the Royal Bank of Scotland PLC; and
- Mark Clarke, Director General Finance and Strategy at the Department for Business, Enterprise and Regulatory Reform.

The Exchequer Funds Audit Committee met for the first time on 23 January 2007 and again on 29 March and 26 June, and intends to meet four times a year.

The Group Resource Audit Committee supports the Treasury Permanent Secretary and the Additional Accounting Officers in their responsibilities on HM Treasury group's processes for risk, control and governance related to the Group's Resource Account. The Chair of the Committee reports to me on matters relating to the DMO Agency account. Members of the Committee are appointed for periods of up to three years, extendable by no more than two additional three-year periods. The current membership of the Committee is:

- William Sargent, Chair and non-executive member of HM Treasury Board;
- Stella Manzie, non-executive member of HM Treasury Board; and
- Colin Thwaite, non-executive member of the OGC Board and former Finance Director and Chief Executive of Littlewoods Organisation plc, Leisure Division.

The Group Resource Audit Committee met for the first time on 8 December 2006 and again on 22 March and 22 May 2007, and intends to meet four times a year.

The Chair of each Committee is entitled to attend the meetings of the other Committee.

5. Review of effectiveness

As Accounting Officer, my review of the effectiveness of the system of internal control is informed by the work of executive managers in the DMO who have been delegated responsibility for the development and maintenance of the internal control framework, and by the reports and comments made by the internal and external auditors. I have been supported by the Audit Committees and risk owners in addressing weaknesses and ensuring continuous improvement of the system is in place. The Exchequer Funds Audit Committee considered the 2006-07 DMA accounts in draft and provided me with its views before I formally signed the accounts. The Group Resource Audit Committee considered the DMO Agency accounts as part of its consideration of the HM Treasury Group Resource Account. There are a number of activities that form the basis of my review. Annually I formally review the key outcomes and findings of each activity in order to make my assessment.

- A controls team met periodically to review issues affecting the DMO's system of internal control, recommend actions to management and to implement changes where appropriate. The controls team comprises senior representatives of the DMO teams responsible for finance, risk, control, compliance and internal audit. The controls team reports periodically to the Exchequer Funds Audit Committee on progress to improve the internal control system during the year.

- The Managing Board met approximately every six weeks and considered risk management and operational control issues throughout the year. To support this, members of the Managing Board received the reports produced for quarterly meetings of Senior Risk Owners and details of any agreed actions to improve the DMO's risk profile. The executive sub-committee of the Managing Board usually met weekly and considered risk and control issues on a regular basis.
- The DMO's Risk Management Unit provides control advice on risks throughout the DMO. In the DMO's management reporting structure the Risk Management Unit is separate and independent of the DMO's trading operations. The risk management function also conducts risk analysis and provides an operational, market and credit risk capability for the DMO.
- The DMO's Risk Management Unit conducts monthly controls and compliance testing providing the executive sub-committee of Managing Board with independent assurance on the effectiveness of operational controls and compliance with relevant FSA rules in the dealing and settlements areas.
- During the period of this Statement on Internal Control, Internal Audit has provided reports on the effectiveness of the risk management, control and governance processes for the DMO, to the Audit Committees throughout the period. The audits make a series of recommendations that are addressed as part of our focus on continuous improvement in this area. The Internal Audit work programme is approved by the Audit Committees at the start of the year.
- Internal Audit attended each meeting of the Audit Committees to report the results of audit work and the results of follow-up work on management action to address audit recommendations.
- Internal Audit's view was that assurance could be given over the risk management, control and governance arrangements relevant to the accounts. There are no matters arising from the work of Internal Audit in the period that would give rise to a separate comment in the Statement on Internal Control.

6. Significant internal control issues

On 8th May 2006, an error in the operation of the two-stage payment checking procedures led to a significant overpayment being made to one of the DMO's commercial banking counterparties resulting in the Debt Management Account being debited incorrectly for a short period. The error was identified by established reconciliation procedures and the payment was recovered after approximately thirty minutes with no resultant financial loss. To reduce the risk of recurrence a further system control has been introduced which stops the release of payments that are larger than those normally expected in the course of the DMO's business until an additional check has been performed.

ROBERT STHEEMAN
DMO Chief Executive and DMA Accounting Officer
16 July 2007

United Kingdom Debt Management Office Accounts 2006-2007

and

Debt Management Account Accounts 2006-2007

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United Kingdom Debt Management Office Accounts 2006-2007

Year ended 31 March 2007

Presented to Parliament 20 July 2007

Certificate and Report of the Comptroller and Auditor General to the House of Commons

I certify that I have audited the financial statements of the Debt Management Office for the year ended 31 March 2007 under the Government Resources and Accounts Act 2000. These comprise the Operating Cost Statement and Statement of Recognised Gains and Losses, the Balance Sheet, the Cashflow Statement and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

Respective responsibilities of the Agency, Chief Executive and Auditor

The Agency and Chief Executive, as Accounting Officer, are responsible for preparing the Annual Report, which includes the Remuneration Report, and the financial statements in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions made thereunder and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of Accounting Officer's Responsibilities.

My responsibility is to audit the financial statements and the part of the Remuneration Report to be audited 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 and the part of the Remuneration Report to be audited have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000. I report to you whether, in my opinion, certain information given in the Annual Report, which comprises the Foreword, the Management Commentary and the unaudited part of the Remuneration Report, is consistent with the financial statements. I also report whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

In addition, I report to you if the Agency has not kept proper accounting records, if I have not received all the information and explanations I require for my audit, or if information specified by HM Treasury regarding remuneration and other transactions is not disclosed.

I review whether the Statement on Internal Control reflects the Agency's compliance with HM Treasury's guidance, and I report if it does not. I am not required to consider whether this statement covers all risks and controls, or to form an opinion on the effectiveness of the Agency's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Annual Report 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 on 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 included in the financial statements and the part of the Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the Agency and Chief Executive in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Agency'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 and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by fraud or error, and that in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report to be audited.

Opinions

Audit Opinion

In my opinion:

- the financial statements give a true and fair view, in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by HM Treasury, of the state of the Agency's affairs as at 31 March 2007, and of the net operating cost, recognised gains and losses and cashflows for the year then ended;
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000; and
- The information given within the Annual Report, which comprises the Foreword, the Management Commentary and the unaudited part of the Remuneration Report, is consistent with the financial statements.

Audit Opinion on Regularity

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

Report

I have no observations to make on these financial statements.

JOHN BOURN
Comptroller and Auditor General

National Audit Office
157-197 Buckingham Palace Road
Victoria, London SW1W 9SP
18 July 2007

UK Debt Management Office
Operating cost statement

For the year ended 31 March 2007

	Note	2006-2007 £000	2005-2006 £000
Administration costs			
Staff costs	2	6,450	5,854
Other administration costs	3	5,644	5,652
Gross administration costs		**12,094**	**11,506**
Administration income	5	(5,493)	(4,336)
Net administration costs		**6,601**	**7,170**
Gross programme costs	4	2,192	3,822
Programme income	5	(1,350)	(3,460)
Net programme costs		**842**	**362**
Net Operating Cost		**7,443**	**7,532**

All income and expenditure are derived from continuing operations.

UK Debt Management Office
Statement of recognised gains and losses

For the year ended 31 March 2007

	2006-2007 £000	2005-2006 £000
Net gain on revaluation of tangible fixed assets	–	80
Total recognised gains for the financial year	**–**	**80**

The notes on pages 44 to 57 form part of these accounts.

UK Debt Management Office
Balance sheet

As at 31 March 2007

	Note	2007 £000	2006 £000
Fixed assets			
Tangible assets	6.1	576	737
Intangible assets	6.2	733	861
		1,309	1,598
Current assets			
Debtors	7	1,508	1,122
Cash at bank and in hand	8	172	310
		1,680	1,432
Current Liabilities			
Creditors (amounts falling due within one year)	9	(4,834)	(4,447)
Net current liabilities		**(3,154)**	**(3,015)**
Total assets less current liabilities		**(1,845)**	**(1,417)**
Creditors (amounts falling due after more than one year)	9	(167)	–
Provisions for liabilities and charges	10	(213)	(249)
Total net liabilities		**(2,225)**	**(1,666)**
Represented by:			
Taxpayers' equity / (deficit)			
General Fund	11	(2,312)	(1,753)
Revaluation Reserve	12	87	87
Total net taxpayers' deficit		**(2,225)**	**(1,666)**

ROBERT STHEEMAN
Chief Executive and Agency Accounting Officer
16 July 2007

The notes on pages 44 to 57 form part of these accounts.

UK Debt Management Office
Cash flow statement

For the year ended 31 March 2007

	Note	2006-2007 £000	2005-2006 £000
Net cash outflow from operating activities	13.1	(6,401)	(6,134)
Capital expenditure and financial investment	13.2	(372)	(500)
Net cash outflow before financing		**(6,773)**	**(6,634)**
Payment of amounts due to the Consolidated Fund		(2,359)	(3,466)
Financing	13.3	8,994	10,039
Decrease in cash in the period		**(138)**	**(61)**

The notes on pages 44 to 57 form part of these accounts.

Notes to the accounts
For the year ended 31 March 2007

1 STATEMENT OF ACCOUNTING POLICIES

1.1 Basis of preparation

These financial statements have been prepared in accordance with the 2006-07 *Government Financial Reporting Manual (FReM)* issued by HM Treasury. The accounting policies contained in the *FReM* follow UK generally accepted accounting practice for companies (UK GAAP) to the extent that it is meaningful and appropriate to the public sector.

Where the *FReM* permits a choice of accounting policy, the accounting policy which has been judged to be most appropriate to the particular circumstances of the Agency for the purpose of giving a true and fair view has been selected. The Agency's accounting policies have been applied consistently in dealing with items considered material in relation to the accounts.

1.2 Accounting convention

These accounts have been prepared under the historical cost convention.

1.3 Administration and Programme Expenditure

The Operating Cost Statement is analysed between administration and programme income and expenditure. Administration costs reflect the cost of running the Agency. These include both administrative costs and associated operating income. Income is analysed in the notes between that which, under the administrative cost-control regime, is allowed to be offset against gross administrative costs in determining the outturn against the administration cost limit, and that operating income which is not. Programme costs reflect non-administration costs, including external settlement charges and gilt issuance costs.

1.4 Operating income

Operating income for the DMO relates to cost recoveries on a full cost basis for services provided to external clients and the direct costs when acting as an agent for the National Loans Fund. Fees received from PWLB customers and the management of the Gilt Purchase and Sale Service are set by statute.

As the Agency is subject to net administration cost control provisions, for funding purposes, HM Treasury treats operating income amounts as Appropriations-in-Aid. The operating income is principally:

- Recoveries of costs associated with the DMO acting as an agent for the National Loans Fund regarding stock listing, settlement and gilt auction advertising.
- Charges, where statute permits, for the investment management and administration of public funds by the Commissioners for the Reduction of the National Debt.
- Fees for loans advanced to local authorities from the Public Works Loan Board.
- Fees for secondary market purchase and sale transactions in gilts conducted by members of the public, under a DMO managed contract with Computershare.

1.5 Fixed Assets

Assets acquired for on-going use with a purchase cost in excess of £5,000 are capitalised.

The DMO has adopted the provisions of the 2007-08 FReM in its 2006-07 resource accounts. Furniture, office equipment, IT equipment and software licences for which the value is low and/or the useful economic life is short are stated at the depreciated current cost brought forward at 1 April 2006 for assets acquired before that date, and at depreciated historical cost for assets acquired subsequently.

Profits or losses arising on the disposal of fixed assets are calculated by reference to the carrying value of the asset.

Internal staff costs for IT development work are capitalised as tangible assets when a distinct asset for on-going use is created or significantly developed.

Software purchases that meet the capitalisation criteria are classified as intangible assets.

1.6 Depreciation

Depreciation is provided on a straight-line basis, calculated on revalued amounts to write off assets over their estimated useful lives. The useful lives of fixed assets have been estimated as follows:

■ IT equipment and software	3 years
■ Development costs	3 years
■ Office and other non IT equipment	5 years
■ Furniture, fixtures and fittings	10 years
■ Licence software	license duration up to 10 years
■ Leasehold improvements	lesser of 10 years or outstanding lease term

1.7 Operating leases

Amounts paid and received under the terms of operating leases are charged to the Operating Cost Statement on a straight-line basis over the term of the lease. Operating leases are accounted for in accordance with SSAP 21. The DMO's operating lease commitments are disclosed in Note 14.

1.8 Notional charges

Central HM Treasury costs and other overheads are charged on a notional basis and included in the accounts. These charges include auditors' remuneration and centrally provided support services for payroll, procurement, finance, security, health and safety and legal services. Notional costs are charged to the Operating Cost Statement and credited as a movement on the general fund.

1.9 Value added tax

Value added tax (VAT) on purchases, to the extent that it is irrecoverable, is charged to the Operating Cost Statement and included under the heading relevant to the type of expenditure. Where VAT is recoverable in respect of DMO expenditure, it is recovered by HM Treasury. Where output tax is charged or input tax is recoverable, the amounts are stated net of VAT.

1.10 Capital charge

A charge reflecting the cost of capital utilised by the Agency is included within the Operating Cost Statement. The charge is calculated at the real rate set by HM Treasury, currently 3.5 per cent (2005-06: 3.5 per cent) on the average carrying amount of all assets less liabilities except for assets and liabilities in respect of amounts due from, or due to be surrendered to, the Consolidated Fund, where the charge is nil.

1.11 Pensions

Past and present employees are covered by the provisions of the Principal Civil Service Pension Schemes (PCSPS) which are described in Note 2. The defined benefit schemes are unfunded and are non-contributory except in respect of dependants' benefits. The Agency recognises the expected cost of these elements on a systematic and rational basis over the period during which it benefits from employees' services by payment to the PCSPS of amounts calculated on an accruing basis. Liability for payment of future benefits is a charge on the PCSPS. In respect of the defined contribution schemes, the Agency recognises the contributions payable for the year.

1.12 Provisions

The Agency provides for legal or constructive obligations, which are of uncertain timing or amount at the balance sheet date on the basis of the best estimate of the expenditure required to settle the obligation. Where the effect of the time value of money is significant the estimated risk-adjusted cash flows are discounted using the HM Treasury discount rate of 2.2 per cent (2005-06: 2.2 per cent) in real terms.

2 STAFF NUMBERS AND RELATED COSTS

2.1 Aggregate staff costs comprise:

			2006-2007	2005-2006
	Permanent Staff £000	Others £000	Total £000	Total £000
Wages and salaries	4,014	1,239	5,253	4,768
Social security costs	397	-	397	375
Other pension costs	837	-	837	771
Sub Total	**5,248**	**1,239**	**6,487**	**5,914**
Inward secondees	-	-	-	24
Total Costs	**5,248**	**1,239**	**6,487**	**5,938**
Amounts charged to capital	-	(37)	(37)	(84)
Total Operating Staff Costs	**5,248**	**1,202**	**6,450**	**5,854**

The Principal Civil Service Pension Schemes (PCSPS) to which all of the Agency's employees are members is an unfunded multi-employer defined benefit scheme, but the DMO is unable to identify its share of the underlying assets and liabilities. The scheme Actuary valued the scheme as at 31 March 2003 and details can be found in the resource accounts of the Cabinet Office: Civil Superannuation (www.civilservice-pensions.gov.uk).

For 2006-07, employer contributions of £799,883 were payable to the PCSPS (2005–06: £737,913) at one of four rates in the range 17.1% to 25.5% per cent (2005-06: 16.2 to 24.6 per cent) of pensionable pay, based on salary bands. The scheme's Actuary reviews employer contributions every four years following a full scheme valuation. From 2007-08, the salary bands will be revised but the rates will remain unchanged.

The contribution rates are set to meet the costs of the benefits accuring during 2006-07 to be paid when the member retires, and not the benefits paid during this period to existing pensioners.

Employees can opt to open a **partnership** pension account, a stakeholder pension with an employer contribution. Employer's contributions of £37,407 (2005-06: £33,110) were paid to one or more of the panel of three appointed **stakeholder** pension providers. Employer contributions are age-related and range from 10 to 12.5 per cent (2005-06: 8 to 11.5 per cent) of pensionable pay. Employers also match employee contributions up to 3 per cent of pensionable pay. In addition, employer contributions of £2,252, 0.8 per cent of pensionable pay (2005-06: £1,803, 0.8 per cent), were payable to the PCSPS to cover the cost of the future provision of lump sum benefits on death in service and ill health retirement of these employees.

Contributions due to the **partnership** pension providers at the balance sheet date were £3,888 (2005-06: £4,784). Contributions prepaid at that date were nil.

2.2 The average number of whole-time equivalent persons employed by the DMO during the year was as follows:

	2006-2007				2005-2006
	Senior Management	Officials	Agency temporary and contract staff	Total	Total
Maintaining sound public finances in accordance with the Code for Fiscal Stability	3	70	11	**84**	**79**
Staff engaged on capital projects	-	-	1	**1**	**1**
Total	**3**	**70**	**12**	**85**	**80**

3 OTHER ADMINISTRATION COSTS

	2006-2007 £000	2005-2006 £000
Rentals under operating leases:		
Other operating leases	**1,167**	**1,164**
Non-cash items		
Depreciation and amortisation of fixed assets	917	594
Deficit on revaluation		344
Cost of capital charge	11	25
Auditor's fee	22	21
Provision for early-departure costs:		
Provided in year	4	8
Unwinding of discount on provisions	5	15
	959	**1,007**
Other expenditure		
IT & telecommunications	1,380	1,366
Accommodation related costs	743	584
Legal services	93	78
Consultants & other professional services	887	903
Training	76	104
Printing & stationery	56	56
Travel, subsistence & hospitality	52	88
Other costs	231	302
	3,518	**3,481**
	5,644	**5,652**

Rentals under operating leases include £1,129,542 for rent on building.

The auditor's fee relates entirely to audit work.

4. PROGRAMME RELATED COSTS

	2006-2007 £000	2005-2006 £000
Settlement and custodial charges	934	580
Stock Exchange listing fees	592	598
Auction advertising costs	203	178
Gilt Syndication fees	-	2,187
DMO Gilt Purchase & Sale Service costs	178	188
Brokerage costs	285	91
	2,192	**3,822**

Programme related costs are costs that the DMO must incur as a result of trading and other dealing activities and are not directly controllable. They relate primarily to stock listing, settlement, auction advertising and other trading fees. Where the DMO is acting as agent for the NLF regarding these transactions, these costs are reimbursable.

5 OPERATING INCOME

	2006-2007 £000	2005-2006 £000
Administration income		
Recharges to GEMMs	97	91
Rentals receivable in respect of operating leases	189	226
Other accommodation related income	54	47
Fees and charges to CRND clients	812	852
Fees and charges to PWLB customers	4,320	3,087
Other income	21	33
	5,493	**4,336**
Programme related income		
Recharges to the National Loans Fund	794	2,963
DMO Gilt Purchase & Sale Service commission	556	495
Bank interest	-	2
	1,350	**3,460**
Total income	**6,843**	**7,796**

Recharges to GEMMs relate to trading system costs.

All rentals receivable in respect of operating leases are from external organisations.

Recharges to the National Loans Fund relate to gilt issuance charges.

Income that is surrenderable to the Consolidated Fund in the period comprises Bank of England interest received in the year amounting to £nil (2005-06: £2,173) and excess Appropriations-in-Aid made up from Administration and Programme related income amounting to £2,143,067 (2005-06: £2,485,809).

Analysis of Fees and Charges Income for the year ended 31 March 2007

This analysis of fees and charges is provided as specified by the FReM and not for the disclosure requirements under SSAP 25 – segmental reporting.

Financial objective:

- **CRND**: To invest and manage certain public funds and charge, where statute permits, an administrative cost calculated on a full-cost recovery basis. CRND also carries out other miscellaneous statutory functions for which there is no provision for recovering costs.
- **PWLB**: To advance loans, primarily to local authorities, at a fee rate that is set by statute and designed to cover the cost of examining applications for loans, making advances and maintaining accounts.
- **DMO Gilt Purchase & Sale Service**: To operate a gilt purchase and sale service for retail investors in the secondary market and charge the appropriate transactional cost as defined by statute.

Analysis of Net Operating Cost

	CRND	PWLB	DMO Gilt Purchase & Sale Service
	£000	£000	£000
Full cost	1,025	1,135	859
Income	(812)	(4,320)	(556)
(Surplus) / deficit	**213**	**(3,185)**	**303**

Performance against the financial objective:

- **CRND**: Achieved in full.
- **PWLB**: Achieved in full.
- **DMO Gilt Purchase & Sale Service**: Achieved in full.

6 FIXED ASSETS

6.1 Tangible Fixed Assets

	Leasehold Improvements £000	IT Equipment £000	Telecoms £000	Office Equipment £000	Total £000
Cost or valuation					
At 1 April 2006	846	2,562	146	23	3,577
Additions	16	161	-	-	177
At 31 March 2007	**862**	**2,723**	**146**	**23**	**3,754**
Depreciation					
At 1 April 2006	418	2,262	146	14	2,840
Charged in year	88	246	-	4	338
At 31 March 2007	**506**	**2,508**	**146**	**18**	**3,178**
Net Book Value					
At 31 March 2007	**356**	**215**	**-**	**5**	**576**
At 31 March 2006	**428**	**300**	**-**	**9**	**737**

6.2 Intangible Fixed Assets

	Software £000
Cost or valuation	
At 1 April 2006	2,605
Additions	451
At 31 March 2007	**3,056**
Amortisation	
At 1 April 2006	1,744
Charged in year	579
At 31 March 2007	**2,323**
Net Book Value	
At 31 March 2007	**733**
At 31 March 2006	**861**

7 DEBTORS

7.1 Analysis by Type

	31 March 2007 £000	31 March 2006 £000
Amounts falling due within one year:		
Prepayments and accrued income	947	782
Amounts receivable from the NLF	392	222
Other trade debtors	95	109
	1,434	**1,113**
Amounts falling due after more than one year:		
Prepayments and accrued income	74	9
	1,508	**1,122**

7.2 Analysis by Relationship with HM Government

	Amounts falling due within one year		Amounts falling due after more than one year	
	31 March 2007 £000	31 March 2006 £000	31 March 2007 £000	31 March 2006 £000
Intra-government balances:				
Balances with other central government bodies	412	237	-	-
Balances with bodies external to government	1,022	876	74	9
Total debtors at 31 March	**1,434**	**1,113**	**74**	**9**

8 CASH AT BANK AND IN HAND

	31 March 2007 £000	31 March 2006 £000
Balance at 1 April	310	371
Net change in cash balances	(138)	(61)
Balance at 31 March	**172**	**310**

9 CREDITORS

9.1 Analysis by Type

	31 March 2007 £000	31 March 2006 £000
Amounts falling due within one year:		
Trade creditors	291	657
Taxation and Social Security creditors	210	195
Accruals and deferred income	2,143	926
Deposit advance held as a creditor bond	-	268
Creditor bond interest	3	41
Other creditors	44	-
Payable to the Consolidated Fund:		
Excess appropriations-in-aid	2,143	2,358
Other payments due to be paid to the Consolidated Fund	-	2
	4,834	**4,447**
Amounts falling due after more than one year:		
Deposit advance held as a creditor bond	**167**	**-**

Included within the creditors total for amounts falling due within one year is £0.257 million (2005-06: £0.394 million) of capital expenditure creditors and accruals, which is deducted from the movement in working capital in Note 13.1.

9.2 Analysis by Relationship with HM Government

	Amounts falling due within one year		Amounts falling due after more than one year	
	31 March 2007 £000	31 March 2006 £000	31 March 2007 £000	31 March 2006 £000
Intra-government balances:				
Balances with other central government bodies	2,210	2,584	-	-
Balances with bodies external to government	2,624	1,863	167	-
Total creditors at 31 March	**4,834**	**4,447**	**167**	**-**

10 PROVISIONS FOR LIABILITIES AND CHARGES

	2006-2007 Early departure costs £000	2005-2006 Early departure costs £000
Balance at 1 April 2006	249	284
Provided in the year	4	8
Provisions utilised in the year	(45)	(58)
Unwinding of discount	5	15
Balance at 31 March 2007	**213**	**249**

The Agency meets the additional costs of benefits beyond the normal PCSPS benefits in respect of employees who retire early by paying the required amounts annually to the PCSPS over the period between early departure and normal retirement date. The Agency provides for this in full when the early retirement programme becomes binding by establishing a provision for the estimated payments discounted by the HM Treasury discount rate of 2.2 per cent (2005-06: 2.2 per cent) in real terms.

11 GENERAL FUND

Reconciliation of Net Operating Cost to changes in General Fund

	2006-2007 £000	2005-2006 £000
Balance at 1 April 2006	(1,753)	1,265
Net Parliamentary Funding		
Drawn Down	8,994	6,955
Net transfer from Operating Activities		
Net operating cost	(7,443)	(7,532)
CFERs repayable to the Consolidated Fund	(2,143)	(2,487)
Non-cash charges		
Cost of Capital	11	25
Auditors' Remuneration	22	21
Balance at 31 March 2007	**(2,312)**	**(1,753)**

DMO shows a balance sheet deficit as at 31 March 2007. Where an agency's liabilities are paid by a parent department and the agency's fixed assets are relatively low value, this can give rise to a position where total net liabilities are reported. Under these circumstances, a balance sheet deficit is no reflection on operating performance.

12 REVALUATION RESERVE

	2006-2007 £000	2005-2006 £000
Balance at 1 April 2006	87	7
Movement on revaluation during the year	-	80
Balance at 31 March 2007	**87**	**87**

13 ANALYSIS OF CASH FLOW

13.1 Reconciliation of Operating Costs to Operating Cash Flows:

	2006-2007 £000	2005-2006 £000
Net operating cost	(7,443)	(7,532)
Adjust for non-cash transactions:		
Depreciation	917	594
Notional interest on capital	11	25
Auditor's fee	22	21
Other	-	344
Provision for early-departure costs	9	23
	959	1,007
Adjust for movement in working capital other than cash:		
Decrease / (Increase) in debtors	(386)	128
Increase / (Decrease) in current creditors	771	715
Less items not passing through the Operating Cost Statement	(257)	(394)
Use of provisions	(45)	(58)
	83	391
Net cash outflow from operating activities	**(6,401)**	**(6,134)**

13.2 Analysis of capital expenditure:

	2006-2007 £000	2005-2006 £000
Tangible fixed asset additions	59	(46)
Intangible fixed asset additions	(431)	(454)
Net cash outflow from investing activities	**(372)**	**(500)**

The net inflow of cash for tangible fixed assets is due to the movements in working capital related to fixed asset accruals.

13.3 Analysis of financing:

	2006-2007 £000	2005-2006 £000
From Consolidated Fund (Supply) – current year	8,994	6,955
From Consolidated Fund (Supply) – prior year	-	3,084
Net financing	**8,994**	**10,039**

14 OPERATING LEASES

14.1 At 31 March 2007 the commitments under operating leases to pay rentals during the year following the year of these accounts are shown below, analysed according to the period in which the lease expires:

	Land and Buildings £000	Other £000	2006-2007 Total £000	2005-2006 Total £000
Operating leases which expire beyond one year but not more than five years	-	37	37	37
Operating leases which expire beyond five years:				
premises lease	1,130	-	1,130	1,130
	1,130	**37**	**1,167**	**1,167**

14.2 At 31 March 2007 amounts receivable by the DMO under operating leases to pay rentals during the year following the year of these accounts are shown below, analysed according to the period in which the lease expires:

	2006-2007 Land and Buildings £000	2005-2006 Total £000
Operating leases which expire within one year:		
premises lease	-	114
Operating leases which expire beyond one year but not more that five years:		
premises lease	156	-
	156	**114**

15 CAPITAL COMMITMENTS

The DMO has no capital commitments at 31 March 2007.

16 CONTINGENT ASSETS AND LIABILITIES DISCLOSED UNDER FRS 12

The DMO has no contingent assets or liabilities at 31 March 2007.

17 RELATED PARTY TRANSACTIONS

The DMO is an executive agency of HM Treasury. During the year HM Treasury has provided various business services to the DMO as listed in the Resources section of the Annual Report.

The Consolidated Fund and the National Loans Fund are central government borrowing and expenditure accounts under the control of HM Treasury. The DMO has had transactions with both accounts and they are regarded as related parties because they are under common control of HM Treasury.

The DMO has also undertaken various transactions with the Bank of England and National Savings and Investments. They are regarded as related parties because HM Treasury has significant influence over both these entities in addition to the DMO.

CRND is managed as part of the DMO but is a separate legal entity. CRND is a related party of the DMO because Jo Whelan is the Deputy Chief Executive of the DMO and also the Comptroller General of CRND.

PWLB is also operated within the DMO and subjected to the same operational controls as applied to the DMO's operations as a whole, but charges to PWLB clients are set by statute and the Public Works Loan Commissioners retain their statutory role. Therefore, PWLB is not considered a related party to the DMO.

None of the DMO Managing Board members, senior managers or other related parties has undertaken any material transactions with the DMO during the year.

18 FRS 13 DISCLOSURES

Excluding the Debt Management Account, the PWLB lending facility and the CRND Investment Accounts (which are reported separately from their administrative expenditure) the DMO agency account has no material exposure to liquidity risk, interest rate risk or currency risk. The DMO agency account does not have any borrowings, deposits or foreign currency positions. All material assets and liabilities are denominated in sterling.

Accounts Direction given by HM Treasury in accordance with section 7(2) of the Government Resources and Accounts Act 2000

1. This direction applies to the United Kingdom Debt Management Office.

2. This executive agency shall prepare accounts for the year ended 31 March 2007 in compliance with the accounting principles and disclosure requirements of the edition of the *Government Financial Reporting Manual (FReM)* issued by HM Treasury which is in force for 2006-07.

3. The accounts shall be prepared so as to:

   3.1 give a true and fair view of the state of affairs as at 31 March 2007 and of the income and expenditure (or as appropriate, net resource outturn), total recognised gains and losses (or, as appropriate, recognised gains and losses), and cash flows of the agency for the financial year then ended; and

   3.2 provide disclosure of any material expenditure or income that has not been applied to the purposes intended by Parliament or material transactions that have not conformed to the authorities which govern them.

4. Compliance with the requirements of the *FReM* will, in all but exceptional circumstances, be necessary for the accounts to give a true and fair view. If, in these exceptional circumstances, compliance with the requirements of the *FReM* is inconsistent with the requirement to give a true and fair view the requirements of the *FReM* should be departed from only to the extent necessary to give a true and fair view. In such cases, informed and unbiased judgement should be used to devise an appropriate alternative treatment, which should be consistent with both the economic characteristics of the circumstances concerned and the spirit of the *FReM*. Any material departure from the *FReM* should be discussed in the first instance with HM Treasury.

DAVID WATKINS
Head of the Financial Reporting Policy Team, Her Majesty's Treasury
18 December 2006

Debt Management Account Accounts 2006-2007

Year ended 31 March 2007

Presented to Parliament 20 July 2007

Certificate and Report of the Comptroller and Auditor General to the House of Commons

I certify that I have audited the financial statements of the Debt Management Account for the year ended 31 March 2007 under the National Loans Act 1968. These comprise the Income and Expenditure Account, the Balance Sheet, the Statement of Total Recognised Gains and Losses, the Reconciliation of Movements in Total Funding by the National Loans Fund, the Cashflow 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 Auditor

As described on page 30, the Accounting Officer is responsible for the preparation of financial statements in accordance with Section 15(1) of the National Loans Act 1968 and the Treasury directions made thereunder, and for ensuring the regularity of transactions. The Accounting Officer is also responsible for 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 Treasury directions made thereunder. I also report whether in all material respects the financial transactions of the Debt Management Account have been applied to the purposes intended by Parliament and conform to the authorities which govern them.

In addition, I report to you if proper accounting records have not been kept, if I have not received all the information and explanations I require for my audit, or if information specified by the relevant authorities regarding other transactions is not disclosed.

I review whether the Statement on Internal Control reflects the Debt Management Office's compliance with HM Treasury's guidance, and I report if it does not. I am not required to consider whether this statement covers all risks and controls, or form an opinion on the effectiveness of the Debt Management Office's corporate governance procedures or its risk and control procedures.

I read the other 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 on 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 included in the financial statements. It also includes an assessment of the significant estimates and judgments made by the Accounting Officer in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Debt Management Account'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 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.

Opinions

Audit Opinion

In my opinion:

- the financial statements give a true and fair view, in accordance with the National Loans Act 1968 and directions made thereunder by Treasury, of the state of the Debt Management Account's affairs as at 31 March 2007 and of its surplus for the year then ended; and
- the financial statements have been properly prepared in accordance with the National Loans Act 1968 and directions made thereunder.

Audit Opinion on Regularity

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

Report

I have no observations to make on these financial statements.

JOHN BOURN
Comptroller and Auditor General

National Audit Office
157-197 Buckingham Palace Road
Victoria, London SW1W 9SP
18 July 2007

Debt Management Account
Income and expenditure account

For the year ended 31 March 2007

	Note	2007 £m	2006 restated £m
Interest income	2, 15	2,973	3,103
Interest expense	3, 15	(2,996)	(3,063)
Net interest (expense)/income		**(23)**	**40**
Net trading income	4, 15	35	163
Gains from investment securities	10, 15	15	19
Surplus for the year		**27**	**222**

All income and expenditure arose from continuing operations.

Debt Management Account
Statement of recognised gains and losses

For the year ended 31 March 2007

	Note	2007 £m	2006 restated £m
Net unrealised (losses)/gains on investment securities	10	(825)	477
Net (expense)/income recognised directly in total funding by National Loans Fund		**(825)**	**477**
Surplus for the year from the income and expenditure account		27	222
Total recognised (losses)/gains for the year		**(798)**	**699**

The notes on page 66 to 94 are an integral part of these accounts.

Debt Management Account Balance sheet

As at 31 March 2007

	Note	2007 £m	2006 restated £m
Assets			
Cash and balances at the Bank of England		427	125
Loans and advances to banks	5	10,253	3,871
Securities held for trading	6, 15	3,137	3,539
Derivatives	7, 15	212	178
Investment securities available for sale	8, 15	25,352	28,423
Other assets	9, 15	2,796	1,539
Total assets before deposit at National Loans Fund		**42,177**	**37,675**
Deposit at National Loans Fund	10	35,339	9,714
Total assets		**77,516**	**47,389**
Liabilities			
Deposits by banks	11	10,833	5,003
Due to government customers	12	49,900	20,956
Derivatives	7, 15	-	3
Treasury bills in issue	13	16,710	20,510
Other liabilities	14	29	4
Total liabilities before funding by National Loans Fund		**77,472**	**46,476**
Advance from National Loans Fund	10	-	71
Revaluation reserve	10, 15	(39)	786
Income and expenditure account	15	83	56
Total funding by National Loans Fund	10	**44**	**913**
Total liabilities		**77,516**	**47,389**

ROBERT STHEEMAN
Chief Executive and DMA Accounting Officer
16 July 2007

The notes on page 66 to 94 are an integral part of these accounts.

Debt Management Account
Reconciliation of movements in total funding by National Loans Fund

For the year ended 31 March 2007

	Note	2007 £m	2006 restated £m
Total funding by National Loans Fund at 1 April	10	**913**	**20,264**
Surplus for the year		27	222
Other (losses)/gains for the year	10	(825)	477
(Decrease) in advance from National Loans Fund	10	(71)	(20,050)
Net (decrease) in funding by National Loans Fund		(869)	(19,351)
Total funding by National Loans Fund at 31 March	10	**44**	**913**

The notes on page 66 to 94 are an integral part of these accounts.

Debt Management Account
Cash flow statement

For the year ended 31 March 2007

	Note	2007 £m	2006 restated £m
Net cash inflow/(outflow) from operating activities	16	**21,706**	**(3,881)**
Returns on investments and servicing of finance			
Returns on financial investments		1,762	1,253
Returns on deposit with National Loans Fund		1,158	1,922
Payments on advance from National Loans Fund		(485)	(862)
Net cash outflow from returns on investments and servicing of finance		2,435	2,313
Financial investments			
Net cash inflow from sale of investment securities		70,202	55,245
Net cash outflow from purchase of investment securities		(68,445)	(75,140)
Net cash flow from financial investments		1,757	(19,895)
Net cash inflow/(outflow) before financing		**25,898**	**(21,463)**
Financing			
Net cash inflow/(outflow) from movement in net financing from National Loans Fund	10	(25,596)	21,203
Net cash flow from financing		(25,596)	21,203
Increase/(decrease) in cash		**302**	**(260)**

The notes on page 66 to 94 are an integral part of these accounts.

Notes to the accounts
For the year ended 31 March 2007

1 ACCOUNTING POLICIES

(i) Basis of preparation

The financial statements have been prepared under the historical cost convention, except for re-measurement at fair value of available-for-sale financial assets, financial assets held for trading, and all derivative contracts. The DMA's financial statements have been prepared in accordance with the Accounts Direction given by HM Treasury as set out on page 95 to 96.

The DMA has adopted FRS 26 'Financial Instruments: Recognition and Measurement' and early-adopted FRS 29 'Financial Instruments: Disclosures' (with the exception of Appendix E 'Capital Disclosures'). Both standards are applied retrospectively, with restatement of comparatives as required. However, the DMA has elected not to present comparative information for certain disclosures required under FRS 29 'Financial Instruments: Disclosures', as permitted for entities applying the standard for annual periods beginning before 1 January 2007 – note 21 is affected. FRS 29 supersedes FRS 13 'Derivatives and Other Financial Instruments: Disclosures' and the disclosure requirements of FRS 25, 'Financial Instruments: Disclosure and Presentation'.

In addition to the notes to the accounts, disclosures under FRS 29 relating to the nature and extent of risks may be found under 'risk management' on page 9.

The DMA has also adopted FRS 23 'The Effects of Changes In Foreign Exchange Rates'.

(ii) Financial assets

The DMA holds financial assets that have been classified as securities held for trading, and other securities that have been designated as available for sale. DMO management determines the classification or designation on initial recognition of the asset. The DMA also holds financial assets that are loans and receivables. The DMA does not hold any financial investments that it positively intends, and is independently able, to hold until maturity.

All financial assets are recognised initially at fair value.

Financial assets are derecognised when the rights to receive cash flows from them have expired or where the DMA has transferred substantially all the risks and rewards of ownership.

At each balance sheet date, the DMO assesses whether there is any objective evidence that an available-for-sale financial or loan or receivable is impaired and hence whether any reduction in the carrying amount of the asset, or any impairment allowance, is required.

(a) Financial assets at fair value through profit and loss

This category includes certain debt securities and derivatives.

Debt securities held for trading

Debt securities are classified as held for trading if they have been acquired principally for the purpose of selling in the short term, or if they are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking.

These financial assets are recognised on trade date, when the DMA enters into contractual arrangements with counterparties to purchase securities, and are derecognised when the DMA enters into contractual arrangements to sell them or when they are redeemed. Following initial recognition, fair values are subsequently re-measured, and all gains and losses from changes therein are recognised in the Income and Expenditure account in 'net trading income' as they arise.

Derivatives
The treatment of derivatives is described in section (iv).

(b) Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, comprising cash and balances at central banks, and loans and advances to banks. Loans and advances to banks comprise deposits and reverse repos (reverse sale and repurchase agreements). Securities 'purchased' via reverse repos are not included on the balance sheet.

The DMA does not sell such financial assets and so does not designate any loans and receivables as available for sale, nor held for trading.

Loans and receivables are recognised at trade date and are derecognised when borrowers repay their obligations. Following initial recognition, loans and receivables are subsequently measured at amortised cost using the effective interest method.

(c) Available for sale financial assets
Debt securities are treated as available for sale where they are intended to be held for an indefinite period of time and may be sold in response to changes in factors such as collateral requirements, liquidity needs and interest rates.

These financial assets are recognised on trade date, when the DMA enters into contractual arrangements with counterparties (primarily the National Loans Fund) to purchase securities.

Following initial recognition, fair values are subsequently re-measured, and all gains or losses from changes therein are recognised in the revaluation reserve until the securities are derecognised, at which point cumulative gains or losses previously recognised in this reserve are recognised in the Income and expenditure account as 'gains from investment securities'. However, interest income on available for sale securities, calculated over the asset's expected life using the effective interest rate method, is recognised directly in the Income and Expenditure account. Premiums and/or discounts arising on the purchase of dated investment securities are included in the calculation of their effective interest rates.

(ii) Financial liabilities
The DMA classifies its financial liabilities in the following categories: financial liabilities at fair value through profit and loss; and financial liabilities at amortised cost. DMO management determines the classification at initial liability recognition.

All financial liabilities are recognised initially at fair value.

Financial liabilities are derecognised when they are extinguished – that is, when the obligation is discharged, cancelled or expires.

(a) Financial liabilities at fair value through profit and loss
This category comprises derivatives, the treatment of which is described in section (iv) below.

(b) Financial liabilities at amortised cost

Following initial recognition, deposits by banks, amounts due to customers, and Treasury bills in issue are measured at amortised cost using the effective interest rate to amortise the difference between the initial carrying amount of the liability and the redemption amount over the expected life of the debt. Deposits by banks include repos (sale and repurchase agreements). Securities 'sold' via sale and repurchase agreements continue to be included on the balance sheet.

Deposits by banks and amounts due to customers are recognised at trade date and are derecognised when obligations are repaid.

Debt securities are recognised on trade date, when the DMA enters into contractual arrangements with counterparties to sell securities, and are derecognised when redeemed.

(iv) Derivatives

The DMA enters into the following types of derivative contracts: forward foreign exchange contracts, and equity index / interest rate swaps.

Forward foreign exchange contracts are used to hedge the risk arising from movements in foreign exchange rates.

Equity index / interest rate swaps are entered into to hedge an equity index and interest rate exposure of the Government that is external to the DMA.

Derivatives are classified as assets when their fair value is positive, and as liabilities when their fair value is negative.

All derivatives are classified as held for trading. They are initially recognised at fair value when the DMA enters into contractual arrangements with counterparties and are subsequently re-measured at fair value, with all gains and losses from changes in the fair values of derivatives recognised in the Income and expenditure account in 'net trading income' as they arise. The DMA does not apply hedge accounting.

(v) Determination of fair value

The fair value of a financial instrument on initial recognition is normally the transaction price.

Following initial recognition, the fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities. When active market prices are not available (for example, for the equity leg of equity index / interest rate swaps), fair values are determined by using valuation techniques that refer to observable market data.

If the fair value of a financial asset becomes negative, it is recorded as a financial liability until its fair value becomes positive.

(vi) Offsetting financial assets and financial liabilities

Financial assets and liabilities (including derivatives) are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. The DMA does not offset any financial assets or liabilities. However, when the DMA holds Treasury bills, no financial asset or liability is disclosed as no external transaction has occurred, so neither a financial asset nor liability exists.

(vii) Interest income and expense

Interest income and expense for all interest-bearing financial instruments including those classified as held for trading are recognised in interest income and interest expense in the income and expenditure account using the effective interest method of allocating interest over the relevant period. Interest income and expense is recognised from settlement date.

The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the instrument. When calculating the effective interest rate, cash flows are estimated considering all contractual terms of the financial instrument. The calculation includes all amounts paid or received that are an integral part of the effective interest rate, such as premiums or discounts on acquisition or issue.

(viii) Net trading income

Net trading income comprises all gains and losses from changes in the fair value of financial instruments held for trading, excluding interest income and interest expense on securities held for trading.

(ix) Transaction costs

Transaction costs arising from dealing activities are not charged to the DMA but are instead accounted for through the DMO.

2. INTEREST INCOME

	2007 £m	2006 £m
British Government securities held for trading	29	4
British Government investment securities available for sale	1,258	1,050
Other securities held for trading	159	101
Deposit at National Loans Fund	1,187	1,794
Reverse sale and repurchase agreements	246	104
Other deposits	94	50
	2,973	**3,103**

3. INTEREST EXPENSE

	2007 £m	2006 £m
Advance from National Loans Fund	(414)	(912)
Sale and repurchase agreements	(314)	(312)
Discounts on Treasury bills in issue	(883)	(886)
Other deposits	(1,385)	(953)
	(2,996)	**(3,063)**

4. NET TRADING INCOME

	2007 £m	2006 £m
Trading assets		
British Government securities	(0)	1
Other securities	(1)	0
	(1)	1
Derivatives	36	162
	35	**163**

5. LOANS AND ADVANCES TO BANKS

	2007 £m	2006 £m
Reverse sale and repurchase agreements		
Due in not more than 3 months	5,862	2,570
Due in more than 3 months but not more than 1 year	1,637	-
	7,499	2,570
Fixed term deposits		
Due in not more than 3 months	2,754	1,301
	10,253	**3,871**

All reverse repo transactions are under the provisions of a TBMA/ISMA Global Master Repurchase Agreement. The agreement contains provisions that allow the collateral securities to be valued daily. Securities will be returned to the provider of collateral, or additional securities requested from the provider of collateral, depending on whether the value of the collateral has risen or fallen.

Reverse sale and repurchase agreements included Euro denominated transactions as at 31 March 2007. The associated foreign currency risk was fully hedged through forward foreign exchange contracts (see note 7).

The DMA entered forward starting reverse sale and repurchase agreements with a first cashflow after 31 March 2007 (see note 20 (v) (a)).

6. SECURITIES HELD FOR TRADING

	2007 £m	2006 £m
Carrying value		
British Government securities	19	20
Other securities	3,118	3,519
	3,137	**3,539**

The DMA held no foreign currency denominated trading assets as at 31 March 2007. Other securities included US dollar denominated commercial paper as at 31 March 2006. The associated foreign currency risk was fully hedged through forward foreign exchange contracts (see note 7).

	2007 Nominal £m	2007 Fair value £m	2006 Nominal £m	2006 Fair value £m
Maturity analysis				
Due within 1 year				
In not more than 3 months	3,118	3,118	3,500	3,520
In more than 3 months but not more than 1 year	3	3	2	2
	3,121	**3,121**	**3,502**	**3,522**
Due after 1 year				
In more than 1 year but not more than 5 years	6	6	4	4
In more than 5 years	9	10	12	13
	15	16	16	17
	3,136	**3,137**	**3,518**	**3,539**

7. DERIVATIVES

	2007 Assets £m	2007 Liabilities £m	2006 Assets £m	2006 Liabilities £m
Equity index / interest rate derivatives	212	0	178	1
Foreign exchange derivatives	0	0	0	2
	212	**0**	**178**	**3**

Equity index / interest rate derivatives hedged the Government's exposure to the equity index risk and interest rate risk resulting from the Guaranteed Equity Bond products issued by National Savings and Investments. The contracts have maturity of between 17 days and five years.

All equity index / interest rate derivatives are under the provisions of an ISDA Master Agreement with an English Law Credit Support Annex. The Annex contains provisions that allow the contracts to be valued daily. Collateral securities will be requested from the counterparty, or given / returned to the counterparty, depending on whether the value of the contract has risen or fallen.

Collateral securities held are not included on the balance sheet. Collateral securities given continue to be included on the balance sheet. (See note 20 (v) (b).)

8. INVESTMENT SECURITIES AVAILABLE FOR SALE

Investment securities were all British Government securities.

	2007 Nominal £m	2007 Fair value £m	2006 Nominal £m	2006 Fair value £m
Maturity analysis				
Due within 1 year				
In not more than 3 months	0	0	0	0
In more than 3 months but not more than 1 year	2,226	2,267	2,287	2,339
	2,226	2,267	2,287	2,339
Due after 1 year				
In more than 1 year but not more than 5 years	5,945	6,092	5,821	6,078
In more than 5 years	15,060	16,993	17,150	20,006
	21,005	23,085	22,971	26,084
	23,231	**25,352**	**25,258**	**28,423**

During the year, no gilts (2006: nominal value of £15.8 billion) were created by the NLF and sold to the DMA as collateral. The DMO uses gilts as collateral in repo borrowing, and additional collateral is created as necessary in order to maintain sufficient collateral for its money market operations.

9. OTHER ASSETS

	2007 £m	2006 £m
Due from counterparties	**2,796**	**1,539**

10. NATIONAL LOANS FUND – NET FINANCING

	Deposit at National Loans Fund £m	Advance from National Loans Fund £m	Revaluation reserve £m	Income and expenditure account £m	Total funding by National Loans Fund £m	Net Financing £m
At 1 April 2005 (previously reported)	**50,912**	**20,000**	**0**	**143**	**20,143**	**30,769**
Prior period adjustment on adoption of FRS 26	233	121	309	(309)	121	112
At 1 April 2005 (restated)	**51,145**	**20,121**	**309**	**(166)**	**20,264**	**30,881**
Surplus for the year	-	-	-	222	222	(222)
Released to income and expenditure for the year on disposal of investment securities available for sale	-	-	(19)	-	(19)	19
Other gains/(losses) for the year	-	-	496	-	496	(496)
Change in advance from National Loans Fund	-	(20,050)	-	-	(20,050)	20,050
Change in deposit at National Loans Fund	(41,431)	-	-	-	-	(41,431)
At 31 March 2006 (restated)	**9,714**	**71**	**786**	**56**	**913**	**8,801**
Surplus for the year	-	-	-	27	27	(27)
Released to income and expenditure for the year on disposal of investment securities available for sale	-	-	(15)	-	(15)	15
Other gains/(losses) for the year	-	-	(810)	-	(810)	810
Change in advance from National Loans Fund	-	(71)	-	-	(71)	71
Change in deposit at National Loans Fund	25,625	-	-	-	-	25,625
At 31 March 2007	**35,339**	**-**	**(39)**	**83**	**44**	**35,295**

During the year, the National Loans Fund has provided cash advances to the DMA to fund the DMA's operations. The DMA is charged interest on this advance at the Bank of England repo rate. Each day, the DMA deposits any surplus cash with the National Loans Fund. The DMA receives interest on this deposit at the Bank of England repo rate.

The National Loans Fund provided cash advances during the year: £5 billion on 26 April 2006, and £10 billion on 3 August 2006. The outstanding principal of £15 billion was repaid on 26 January 2007. (No advances were provided during the prior year. The outstanding principal of £20 billion was repaid on 30 March 2006.)

A DMA surplus or deficit is an asset or liability respectively of the National Loans Fund. HM Treasury may pay from the DMO to the National Loans Fund all or part of any DMA surplus. In the case of a retained deficit, HM Treasury may pay all or part of the deficit to the DMA from the NLF.

11. DEPOSITS BY BANKS

	2007 £m	2006 £m
Sale and repurchase agreements		
Due in not more than 3 months	8,585	4,865
Due in more than 3 months but not more than 1 year	1,247	-
	9,832	4,865
Fixed term deposits		
Due in not more than 3 months	1,001	138
	10,833	**5,003**

All repo transactions are under the provisions of a TBMA/ISMA Global Master Repurchase Agreement. The agreement contains provisions that allow the collateral securities to be valued daily. Securities will be returned to the provider of collateral, or additional securities requested from the provider of collateral, depending on whether the value of the collateral has risen or fallen.

The DMA entered forward starting sale and repurchase agreements with a first cashflow after 31 March 2007 (see note 20 (v) (a)).

12. DUE TO GOVERNMENT CUSTOMERS

	2007 £m	2006 £m
Counterparty analysis		
Commissioners for the Reduction of the National Debt		
Fixed term deposits	2,053	16,340
Call notice deposits	46,736	3,560
	48,789	19,900
Other government counterparties		
Fixed term deposits	1,111	1,056
	49,900	**20,956**
Maturity analysis		
In not more than 3 months		
Fixed term deposits	2,645	17,088
Call notice deposits	46,736	3,560
	49,381	20,648
In more than 3 months but not more than 1 year		
Fixed term deposits	519	308
	49,900	**20,956**

Call notice deposits are repayable on demand.

13. TREASURY BILLS IN ISSUE

	2007 £m	2006 £m
Carrying value		
Due in not more than 3 months	13,226	16,472
Due in more than 3 months but not more than 1 year	3,484	4,038
	16,710	**20,510**
Fair value	**16,705**	**20,513**

14. OTHER LIABILITIES

	2007 £m	2006 £m
Due to counterparties	**29**	**4**

15. PRIOR PERIOD ADJUSTMENTS

	2006 previously reported £m	Prior period adjustment £m	2006 restated £m
Income and expenditure account			
Interest income	3,065	38	3,103
Interest expense	(3,058)	(5)	(3,063)
Net trading income	692	(529)	163
Gains from investment securities	0	19	19
Surplus for the year	**699**	**(477)**	**222**
Balance sheet			
Assets			
Debt securities	31,675	(31,675)	0
Securities held for trading	0	3,539	3,539
Derivatives	0	178	178
Investment securities available for sale	0	28,423	28,423
Other assets	1,716	(177)	1,539
Liabilities			
Derivatives	0	3	3
Revaluation reserve	0	786	786
Income and expenditure account	842	(786)	56

All prior period adjustments arose on adoption of FRS 26.

16. ANALYSIS OF CASH FLOW

	2007 £m	2006 £m
Reconciliation of operating profit to net cash inflow/(outflow) from operating activities		
Operating surplus	27	222
Interest receivable from NLF financing	(1,187)	(1,794)
Interest payable on NLF financing added back	414	912
Interest on investment securities	(1,258)	(1,050)
Gains on investment securities	(15)	(19)
(Increase) in loans and advances to banks	(6,382)	(1,977)
Decrease/(increase) in non-investment securities	402	(3,318)
(Increase) in derivatives (asset)	(34)	(157)
(Increase) in other assets	(1,257)	(1,539)
Increase in deposits by banks	5,830	2,926
Increase in amounts due to government customers	28,944	1,611
(Decrease) in derivatives (liability)	(3)	(3)
(Decrease)/increase in Treasury bills in issue	(3,800)	302
Increase in other liabilities	25	3
Net cash inflow/(outflow) from operating activities	**21,706**	**(3,881)**

17. GILT ISSUANCE

	2007 £m	2006 £m
Nominal value of gilts issued on behalf of National Loans Fund	61,450	47,925
Proceeds paid to National Loans Fund	62,521	52,361
Nominal value of uncovered stock purchased from National Loans Fund	-	-

There were no uncovered gilt auctions.

During the year, no gilts (2006: nominal value of £15.8 billion) were created by the NLF and sold to the DMA as collateral. The DMO uses gilts as collateral in repo borrowing, and additional collateral is created as necessary in order to maintain sufficient collateral for its money market operations.

18. EVENTS AFTER THE BALANCE SHEET DATE

There were no material events after the balance sheet date.

19. RELATED PARTY TRANSACTIONS

(i) HM Treasury

The DMA and HM Treasury are under common influence. Therefore the scope and the nature of the arrangements between DMA and its related parties are set out below.

The main services provided to HM Treasury during the year were:

- Debt management, including the management of auctions and taps, for the issue of gilt-edged securities on behalf of the National Loans Fund and market making operations;
- Cash management, including responsibility for the issue and redemption of Treasury bills.

In turn HM Treasury has provided the following services to the DMA, which have been funded through the HM Treasury Vote relating to DMO administration expenditure, and accounted through the DMO Agency accounts:

- Daily provision of Central Government cashflow information; and
- Payroll, purchasing, and various administrative services.

(ii) National Savings & Investments

Since March 2002, the DMO has worked in partnership with National Savings & Investments to hedge the Government's equity index and interest rate exposure arising from National Savings & Investments' issuance of Guaranteed Equity Bonds to retail investors.

(iii) Commissioners for the Reduction of the National Debt

Commissioners for the Reduction of the National Debt (CRND) is a separate entity within the DMO that performs a fund management service for a small number of public sector clients. The Comptroller General of CRND is also the Deputy Chief Executive of the DMO. Processes and internal controls exist to ensure CRND investment decisions are carried out in accordance with CRND client mandates and are kept distinct from other DMO business. CRND client mandates require the bulk of the funds to be invested in gilts or with the DMA Deposit Facility (DMADF). Surplus cash in CRND client accounts is regularly deposited with the DMADF. From time to time, the DMA transacts marketable gilts with CRND and trades these back-to-back with market counterparties. The DMA also transacts non-marketable gilts on behalf of CRND and trades these back-to-back with the NLF. These transactions are carried out on an arms length basis and in line with a Memorandum of Understanding between the DMO and CRND.

The value outstanding of cash deposits taken by the DMA from CRND was £48.8 billion at 31 March 2007 (31 March 2006: £19.9 billion). The DMA bought non-marketable gilts of nominal value £20.6 billion from CRND during the year, and sold non-marketable gilts of nominal value £3.4 billion to CRND (2006: purchases £1.1 billion, sales £7.6 billion).

(iv) DMO Managing Board and senior managers

No member of the Managing Board and no senior managers have undertaken any transactions with the DMA during the year.

20. CREDIT RISK

Credit risk is the risk that a counterparty, or security issuer, will fail to discharge a contractual obligation resulting in financial loss to the DMA. Credit risk is monitored daily by the Risk Management Unit.

Exposure is primarily to financial institutions (mainly banks) as intra-HM Government balances are not considered to give rise to exposure.

Activities that give rise to credit risk include:

- placing cash deposits with banks;
- providing collateral for borrowings from banks;
- exchanging cash and stock in buying and selling financial assets; and
- entering into derivative contracts.

Methods used to measure and manage credit risk in the year ended 31 March 2007 were the same as in the prior year.

(i) Credit risk limits and measurement

The DMO has adopted a policy of the DMA dealing only with highly-creditworthy counterparties and issuers. Credit exposure is controlled by counterparty and issuer limits that are approved by the Risk Committee. These limits are absolute limits and are set for both individual entities and groups of related entities. Separate limits are set for different transaction types.

Credit risk measurement takes into account both current fair value and a risk weighting based on an estimate of potential future changes in value; in measuring credit exposure, different risk weightings are applied to different transaction types. The DMO monitors the DMA's exposure against limits on a daily basis and any breaches are reported to the Risk Committee.

The Risk Committee reviews the concentrations of the DMA's credit exposure to individual banking groups and countries on a monthly basis.

The DMO analyses the creditworthiness of potential counterparties and security issuers using the information provided by three external credit assessment institutions: Standard and Poor's, Moody's Investors Service and Fitch Ratings. Information from these and other information sources is monitored continuously for subsequent changes.

The DMA transacts only with counterparties who meet a minimum long-term credit rating requirement, and purchases securities issued only by issuers who meet such a requirement. Each counterparty and issuer must meet this requirement for each of their three external credit ratings at the time the transaction is entered into.

There are limits on total unsecured lending and on holdings of debt securities issued by financial institutions and corporate entities. There are also limits on the maximum maturity of loans made and securities held.

(ii) Other risk mitigation policies

In addition to the use of credit limits, exposure to credit risk is managed through other specific control and mitigation measures, as outlined below.

(a) Netting agreements

The DMO further restricts the DMA's exposure to credit losses by entering into master netting arrangements with counterparties. These arrangements do not result in an offset of balance sheet assets and liabilities, however if a default occurs all amounts with the counterparty are terminated and settled on a net basis.

Netting agreements normally incorporate collateral terms, including provision for additional margin to be called in response to changes in fair values of underlying transactions.

(b) Collateral

For funds advanced under reverse repo contracts, the DMA takes stock collateral as a means of mitigating risk.

Collateral is required to be in the form of securities issued or guaranteed by HM Government or certain other governments in the European Economic Area with a long-term rating of AA- (Standard and Poor's), Aa3 (Moody's) and AA- (Fitch) or above or other highly-rated securities as agreed from time to time. All collateral is held in the CREST, Euroclear and Clearstream systems.

No collateral held was realised to offset credit losses during the year ended 31 March 2007 (or 31 March 2006), or subsequently.

The DMA also receives cash collateral in the form of margin calls under certain derivative contracts.

(c) Settlement processes

Transactions in financial assets (gilts, treasury bills, certificates of deposit and commercial paper) are settled primarily through the CREST, Euroclear and Clearstream systems, making use of settlement and custody accounts operated by the Bank of England on the DMO's behalf.

The CREST and Euroclear systems are owned by Euroclear Bank S.A., which had a Standard and Poor's credit rating of AA+ at 31 March 2007. The Clearstream system is owned by Clearstream Banking S.A., which had a Standard and Poor's credit rating of AA at 31 March 2007.

Wherever possible, trades are settled as Delivery versus Payment, with simultaneous exchange of cash and stock, or settlement whereby the DMA receives cash or stock from the counterparty before delivering stock or cash in return.

Daily settlement limits are also used to control settlement risk.

(iii) Impairment and provisioning policies

Due to the conservative nature of the DMO's credit policy and the DMA's history of no impairment of assets, no provisioning methodology is considered necessary, however counterparties are monitored for downgrading of credit rating and late settlements and any collateral is valued on a daily basis.

Past due and impaired assets

There were no assets considered impaired, nor whose terms had been renegotiated, at 31 March 2007 (or 31 March 2006).

There were no late repayments of loans and advances to banks at 31 March 2007 (or 31 March 2006) and past due (failed) settlements of open trades amounted to under £1 million at 31 March 2007 (£nil at 31 March 2006).

(iv) Gross exposure to credit risk before collateral held or other credit enhancements

Credit risk exposures on non-HM government balance sheet assets are included below:

	Internal to HM Government		External to HM Government				Total	
			Financial institutions		Corporate entities			
	2007	2006	**2007**	2006	**2007**	2006	**2007**	2006
	£m	£m	**£m**	£m	**£m**	£m	**£m**	£m
Cash and balances at the Bank of England	**-**	-	**427**	125	**-**	-	**427**	125
Loans and advances to banks					**-**			
– Reverse repos	**-**	-	**7,499**	2,570	**-**	-	**7,499**	2,570
– Fixed term deposits	**-**	-	**2,754**	1,301	**-**	-	**2,754**	1,301
Trading assets	**19**	20	**3,019**	3,420	**99**	99	**3,137**	3,539
Derivatives held for risk management purposes (see note 7)	**-**	-	**212**	178	**-**	-	**212**	178
Available-for-sale investment securities	**25,352**	28,423	**-**	-	**-**	-	**25,352**	28,423
Other assets	**-**	-	**2,796**	1,539		-	**2,796**	1,539
Deposit at National Loans Fund	**35,339**	9,714	**-**	-	**-**	-	**35,339**	9,714
Total gross exposure	**60,710**	**38,157**	**16,707**	**9,133**	**99**	**99**	**77,516**	**47,389**

The non-HM Government balances above represent credit risk exposure at 31 March 2007 (and 31 March 2006), without taking into account any collateral held or other credit enhancements attached. The exposures set out above are based on carrying amounts as reported in the balance sheet.

The DMA has not issued any financial guarantees and has no off-balance sheet financial commitments.

(v) Collateral

(a) Sale and repurchase agreements

Sale and repurchase agreements ('repos') and purchase and resale agreements ('reverse repos'), with collateral backing, are:

Settled transactions:

	2007 Balance sheet carrying value £m	2007 Fair value of securities collateral £m	2006 Balance sheet carrying value £m	2006 Fair value of securities collateral £m
Reverse repos (within loans and advances to banks)	**7,479**	**7,652**	2,570	2,751
– Securities collateral shortfall		**10**		-
– Securities collateral 'resold' via repo agreements		**-**		-
Repos (within deposits by banks)	**8,274**	**8,289**	4,865	4,859
– Securities collateral surplus		**-**		-

Unsettled transactions:

	2007 Balance sheet carrying value £m	2007 Fair value of securities collateral £m	2007 Weighted average days to settlement	2006 Balance sheet carrying value £m	2006 Fair value of securities collateral £m	2006 Weighted average days to settlement
Reverse repos (within loans and advances to banks)	**20**	**20**	**3**	-	-	-
Repos (within deposits by banks)	**1,558**	**1,550**	**26**	-	-	-

All repo and reverse repo transactions are with bank (or bank subsidiary) counterparties.

Collateral surplus and shortfall have been calculated at the level of individual counterparties.

Collateral to the value of the unsettled cash amounts is not taken until settlement occurs.

(b) Derivatives

Equity index / interest rate derivative assets and liabilities, with collateral backing, are:

	2007 Balance sheet carrying value £m	2007 Market value of securities collateral £m	2006 Balance sheet carrying value £m	2006 Market value of securities collateral £m
Equity index / interest rate derivative assets	**212**	**193**	178	173
– Securities collateral shortfall		**19**		21
– Securities collateral 'resold'		**-**		-
Equity index / interest rate derivative liabilities	**-**	**-**	1	-
– Securities collateral surplus		**-**		-

Collateral surplus and shortfall have been calculated at the level of individual counterparties.

(vi) Sale and repurchase agreements – analysis by credit rating

Repos and reverse repos, by Standard and Poor's long-term designation of the bank (or bank subsidiary) counterparty at 31 March 2007 (and 31 March 2006), based on the rating of the DMA's counterparties (individual contracting entities rather than ultimate parent entities), were:

	Reverse repos 2007 £m	Reverse repos 2006 £m	Repos 2007 £m	Repos 2006 £m
AAA	**468**	-	**21**	500
AA- to AA+	**6,438**	2,570	**7,548**	4,025
A- to A+	**593**	-	**2,263**	340
Total	**7,499**	**2,570**	**9,832**	**4,865**

(vii) Fixed term deposits at banks and trading assets – analysis by credit rating

Non-HM government deposits and debt securities, by Standard and Poor's long-term rating designation of the counterparty or (for trading assets) issuer at 31 March 2007 (and 31 March 2006), were:

	Cash and balances at the Bank of England		Fixed term deposits at banks (unsecured)		Bank debt securities		Other financial institution debt securities		Corporate debt securities	
	2007	2006	**2007**	2006	**2007**	2006	**2007**	2006	**2007**	2006
	£m	£m	**£m**	£m	**£m**	£m	**£m**	£m	**£m**	£m
AAA	**427**	125	**250**	100	**-**	-	**-**	-	**99**	99
AA- to AA+	**-**	-	**2,504**	1,201	**2,351**	2,337	**-**	-	**-**	-
A- to A+	**-**	-	**-**	-	**668**	1,058	**-**	25	**-**	-
Total	**427**	**125**	**2,754**	**1,301**	**3,019**	**3,395**	**-**	**25**	**99**	**99**

(viii) Derivative assets – analysis by credit rating

Derivative assets, by Standard and Poor's long-term rating designation of the bank counterparty at 31 March 2007 (and 31 March 2006), were:

	Interest rate / equity index derivatives	
	2007	2006
	£m	£m
AA- to AA+	**212**	178
Total	**212**	**178**

Further details of derivative contracts are given in note 7.

(ix) Other assets – analysis by credit rating

Other assets (unsettled trades), by Standard and Poor's long-term rating designation of the counterparty at 31 March 2007 (and 31 March 2006), were:

	2007	2006
	£m	£m
AA- to AA+	**1,945**	1,532
A- to A+	**821**	5
Unrated	**30**	2
Total	**2,796**	**1,539**

(x) Concentration of exposures

Credit exposures are spread mainly across different financial institutions, primarily in the United Kingdom and the rest of the European Economic Area.

(a) Geographical sectors – assets (excluding sale and repurchase agreements)

Credit exposures at 31 March 2007 (and 31 March 2006) by geographical region, based on the country of domicile of the ultimate parent entities of the DMA's counterparties or (for trading assets) issuers, were:

	United Kingdom		Rest of European Economic Area and Switzerland		North America		Asia-Pacific		Total	
	2007 £m	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m
Cash and balances at the Bank of England	**427**	125	**-**	-	**-**	-	**-**	-	**427**	125
Loans and advances to banks – Fixed term deposits	**500**	250	**1,703**	1,051	**551**	-	**-**	-	**2,754**	1,301
Trading assets	**1,003**	995	**1,724**	2,131	**99**	99	**292**	294	**3,118**	3,519
Derivatives	**13**	11	**15**	14	**184**	153	**-**	-	**212**	178
Other assets	**816**	1,464	**1,718**	14	**232**	59	**30**	2	**2,796**	1,539
Total	**2,759**	**2,845**	**5,160**	**3,210**	**1,066**	**311**	**322**	**296**	**9,307**	**6,662**

(b) Geographical sectors – sale and repurchase agreements

Credit exposures at 31 March 2007 (and 31 March 2006) by geographical region, based on the country of domicile of the ultimate parent entities of the DMA's counterparties, were:

	United Kingdom		Rest of European Economic Area and Switzerland		North America		Asia-Pacific		Total	
	2007 £m	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m
Reverse repos (within loans and advances to banks)	**4,141**	2,491	**1,546**	79	**1,812**	-	**-**	-	**7,499**	2,570
Repos (within deposits by banks)	**4,094**	2,108	**4,657**	1,466	**932**	1,291	**149**	-	**9,832**	4,865

21. MARKET RISK

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises interest rate risk, currency risk and other price risk.

Exposure is primarily to interest rate risk.

The DMO manages the DMA's exposure to market risk in three main areas:

- interest rate risk from bank loans and advances and from debt securities (comprising the 'Cash Management' portfolio of trading and non-trading assets and liabilities);
- interest rate and other price risk from the derivatives hedging the Guaranteed Equity Bonds issued by National Savings & Investments; and
- interest rate risk from the retail gilts book.

The scope of market risk monitoring excludes interest rate risk arising from cash at the Bank of England, amounts due to the Commissioners for the Reduction of National Debt ('CRND') and all balances with the National Loans Fund ('NLF').

The methods used throughout the year ended 31 March 2007 to measure and manage market risk were introduced during the previous financial year on 27 June 2005. The change in method at this point largely comprised the addition of further interest rate sensitivity and value at risk procedures.

(i) Market risk measurement

The major sensitivity analysis techniques used to measure and monitor market risk are outlined below.

Interest rate risk derives from the DMA's activity of addressing its cash flow profile throughout the year and interest rate risk limits are in place, expressed in Present value of a basis point (rather than Value at risk) terms.

The Risk Committee reviews the DMA's market risk exposure on a monthly basis, with the Cash Management Committee reviewing certain aspects weekly.

(a) Value at risk

'Value at risk' ('VaR') is a method used to estimate the maximum amount to be lost on an asset or portfolio of assets under normal market conditions over a specific time horizon and level of confidence.

VaR summarizes the worst mark to market loss over a target horizon with a given level of confidence. For instance, with a 95 percent confidence level, VaR should be such that it exceeds 5 percent of the total number of observations in the distribution.

The DMO calculates VaR on its positions using a time horizon of one day and a confidence level of 95%. The model reflects interdependencies, and benefits of diversification, between risk factors such as interest rates, currency rates and equity indices. VaR is calculated daily on the basis of exposures outstanding at the close of business and does not anticipate changes in portfolio over the time horizon.

For interest rate risk, DMO uses the variance-covariance VaR methodology which assumes a normal distribution of risk factor returns and a linear dependency between fair value changes and all risk factor returns.

For exposure related to equity index swaps, The DMO uses 'Monte Carlo' VaR and the exposure measured is that of National Savings and Investments ('NS&I') and the DMA taken together.

(b) Present value of a basis point

'Present value of a basis point' ('PV01') is a standard sensitivity measure used to measure sensitivity to a 0.01% change in interest rates when all other factors are held constant. The change in interest rates has been defined as the movement in the relevant zero coupon curve used to estimate fair value.

Interest rate limits set in PV01 terms were in place throughout the year ended 31 March 2007 (and, in the prior year, from 27 June 2005). Limits used operationally are set lower than those agreed with HM Treasury, in order to safeguard against breach of the latter should an operational error arise. Monitoring against these limits is performed daily and any breaches are reported to the Risk Committee.

A cash management benchmark is used to monitor interest rate exposure (and performance) related to the DMA's Cash Management activities.

(ii) VaR summary for 2007

VaR at 31 March 2007 was:

	2007 £m
Interest rate risk and currency risk – Cash Management	**0.11**
Interest rate risk and other price risk – equity index swaps	**0.01**
Interest rate risk – retail gilts	**0.05**

VaR is not aggregated across activities, as different VaR methodologies are used as described in (i) (a) above.

VaR is calculated monthly for retail gilt exposures and daily for other exposures.

VaR on the instruments contributing to Cash Management interest rate and currency risk was:

	2007 £m
Assets and liabilities	
Repos and reverse repos	**0.04**
Unsecured deposits:	**0.02**
- fixed term deposits at banks;	
- fixed term deposits taken from banks; and	
- amounts taken from local authorities	
Certificates of deposit	**0.04**
Commercial paper	**0.06**
Gilts (non-retail)	**0.02**
Foreign exchange contracts	**-**
Treasury bills	**-**
Effect of diversification	**(0.07)**
Total	**0.11**

The ranges of end-of-day VaR in the year ended 31 March 2007 were:

(a) Interest rate risk and currency risk – Cash Management
(based on daily calculations)

	2007 £m
Highest in the year	**0.52**
Average for the year	**0.20**
Lowest in the year	**0.03**

(b) Interest rate risk and other price risk – equity index swaps
(based on daily calculations)

	2007 £m
Highest in the year	**0.01**
Average for the year	**0.01**
Lowest in the year	**0.00**

(c) Interest rate risk – retail gilts
(based on monthly reporting)

	2007 £m
Highest in the year	**0.11**
Average for the year	**0.07**
Lowest in the year	**0.04**

Exposures to risk from trading and non-trading activities are measured together as they arise from economic environments that are not significantly different.

(iii) Interest rate risk
The DMA enters primarily into cash and securities contracts at fixed interest or discount rates.

The exceptions to this are index-linked gilts, the deposit at the National Loans Fund and call notice deposits from customers. The index-linked gilts are linked to the General Index of Retail Prices in the UK (the 'RPI').

(a) Interest rate risk profile

The DMA's interest rate risk profile at 31 March 2007 (and 31 March 2006) was:

	Fixed rate instruments 2007 £m	Fixed rate instruments 2007 £m	Non-interest bearing assets/ liabilities 2007 £m	Total 2007 £m
Currency				
Sterling				
Assets	**30,316**	**44,192**	**3,008**	**77,516**
Liabilities (before funding by National Loans Fund)	**30,707**	**46,736**	**29**	**77,472**
	2006 £m	2006 £m	2006 £m	2006 £m
Currency				
Sterling				
Assets	27,166	18,506	1,717	47,389
Liabilities (before funding by National Loans Fund)	42,909	3,560	7	46,476

The DMA is charged interest on the advance from the National Loans Fund at the Bank of England repo rate. The benchmark rate for determining the interest payments on other floating rate borrowings is LIBOR.

The DMA held undated gilts with a balance sheet carrying value of £30 million as at 31 March 2007 (31 March 2006: £31 million). This lending is included in the above interest rate disclosures except the weighted average period, as these gilts have no maturity date.

(b) Interest rate sensitivity – PV01 summary for 2007 and 2006

PV01 at 31 March 2007 (and 31 March 2006) was:

	2007 £m	2006 £m
Interest rate risk – Cash Management	**(0.04)**	(0.04)
Interest rate risk – retail gilts	**(0.01)**	(0.02)

The ranges of end-of-day PV01 exposure were:

Cash Management
(based on daily calculations)

	Cash Management	
	2007	2006
	£m	£m
Highest positive in the year	**0.10**	0.30
Average for the year	**(0.04)**	0.10
Highest negative in the year	**(0.13)**	(0.06)

Retail gilts
(based on monthly reporting)

	Retail gilts	
	2007	2006
	£m	£m
Highest positive in the year	**0.00**	0.00
Average for the year	**(0.01)**	(0.02)
Highest negative in the year	**(0.02)**	(0.02)

A positive PV01 indicates exposure to a parallel fall in various yield curves while a negative PV01 indicates exposure to a rise in the curves.

(iv) Currency risk

The DMA enters into certain transactions in instruments denominated in Euro and US Dollars, for diversification purposes, with currency exposure hedged via foreign exchange transactions.

A foreign exchange risk limit is in place that is designed to constrain the extent to which the DMO may incur a net exposure to foreign currency movements when it purchases or sells foreign currency assets. The policy in force during the year ended 31 March 2007 (and the year ended 31 March 2006) was to fully hedge all currency cash flows. Monitoring of this hedging is performed daily and any breaches are reported to the Risk Committee.

Forward foreign currency contracts outstanding at 31 March 2007 (and 31 March 2006) are disclosed in note 7 and 22(iii).

The DMA has no foreign operations and hence no structural foreign exchange exposures.

(v) Other price risk

The DMA is exposed to risk arising from derivative transactions (equity index swaps) entered into to hedge the risk arising to National Savings and Investments from Guaranteed Equity Bonds in issue *(see note 7)*. Returns on these Bonds are linked to the performance of the FTSE 100 UK equity index ('FTSE 100').

The net risk exposure of the hedging derivatives comprises exposure to the FTSE 100 market value, dividend yield and implied volatility as well as to LIBOR interest rates.

There is a limit on the amount of National Savings and Investments' exposure from Guaranteed Equity Bonds that may remain unhedged by the DMA. Monitoring against this limit is performed daily and any breaches are reported to the Risk Committee.

22. LIQUIDITY RISK

Liquidity risk is the risk that that the DMA will encounter difficulty in meeting obligations associated with financial liabilities.

The DMO manages the DMA's liquidity primarily by:

- monitoring cash flows to ensure that daily cash requirements are met;
- holding sufficient financial assets for which there is an active market and which can readily be sold or used as collateral against cash borrowings; and
- arranging the issue of financial instruments to raise funds (through treasury bill tenders and gilt auctions).

The risk of demand by customers for repayment of their deposits is passed on to the NLF.

The DMA and the NLF are under common influence. It is not expected that liabilities of the DMA to the NLF would be required to be paid without warning.

Methods used to measure and manage liquidity risk in the year ended 31 March 2007 were the same as in the prior year except as described in (i) below.

(i) Maximum cumulative flow

There is a daily liquidity risk limit in place that constrains the extent to which the DMO may leave an expected cash flow to be dealt with on the day it occurs.

The liquidity risk limit is measured by the Maximum Cumulative Flow ('MCF') over one day, which is the maximum permitted amount of any net expected cash inflow or outflow for the following day, assuming normal operating conditions.

A limit was in place throughout the year ended 31 March 2007 (and from 27 June 2005 for the year ended 31 March 2006) and acted as a liquidity risk trigger. Limits used operationally are set lower than those agreed with HM Treasury, in order to safeguard against breach of the latter should an operational error arise. Monitoring against these limits is performed daily and any breaches are reported to the Risk Committee.

(ii) Non-derivative cash flows

The contractual undiscounted cash flows of the DMA's liabilities, other than the cash flows under derivative contracts, including interest that will accrue to these liabilities, were:

As at 31 March 2007:

	On demand £m	0-6 months £m	Total Flows (not discounted) £m	Adjustment for discount £m	sheet value £m
Deposits by banks	-	10,874	**10,874**	(41)	**10,833**
Due to government customers	46,736	3,184	**49,920**	(20)	**49,900**
Treasury bills in issue	-	17,126	**17,126**	(416)	**16,710**
Other liabilities	-	29	**29**	-	**29**
Total non-derivative liabilities before funding by National Loans Fund	**46,736**	**31,213**	**77,949**	**(477)**	**77,472**

As at 31 March 2006:

	On demand £m	0-6 months £m	Total Flows (not discounted) £m	Adjustment for discount £m	sheet value £m
Deposits by banks	-	5,012	**5,012**	(9)	**5,003**
Due to government customers	3,560	17,461	**21,021**	(65)	**20,956**
Treasury bills in issue	-	20,918	**20,918**	(408)	**20,510**
Other liabilities	-	4	**4**	-	**4**
Total non-derivative liabilities before funding by National Loans Fund	**3,560**	**43,395**	**46,955**	**(482)**	**46,473**

There were no liabilities that the DMA intended to repay before maturity as at 31 March 2007 (31 March 2006: £nil).

Management expects actual undiscounted cash flows in relation to liabilities to be the same as contractual undiscounted cash flows, except in the case of amounts repayable on demand.

The DMA holds deposits at the Bank of England and other financial assets for which there is a liquid market and that are readily saleable to meet liquidity needs.

(iii) Derivative cash flows

The contractual undiscounted cash flows of the DMA's assets and liabilities under derivative contracts were:

(a) Derivatives settled on a gross basis

As at 31 March 2007:

Sterling cash flows	0-6 months £m	Total undiscounted flows £m
Forward foreign exchange contracts		
– Outflow	-	**-**
– Inflow	7	**7**

Euro cash flows	0-6 months €m	Total undiscounted flows €m
Forward foreign exchange contracts		
– Outflow	10	**10**
– Inflow	-	**-**

As at 31 March 2006:

Sterling cash flows	0-6 months £m	Total undiscounted flows £m
Forward foreign exchange contracts		
– Outflow	-	**-**
– Inflow	100	**100**

US Dollar cash flows	0-6 months $m	Total undiscounted flows $m
Forward foreign exchange contracts		
– Outflow	178	**178**
– Inflow	-	**-**

Balance sheet carrying values are shown in note 7.

(b) Derivatives settled on a net basis

As at 31 March 2007:

Sterling cash flows

	0-6 months £m	6-12 months £m	1-5 years £m	Total undiscounted flows £m	Adjustment for discount £m	Balance sheet carrying value £m
Equity index derivatives						
– Outflow	-	-	-	**-**	-	**-**
– Inflow	32	30	170	**232**	(20)	**212**

As at 31 March 2006:

Sterling cash flows

	0-6 months £m	6-12 months £m	1-5 years £m	Total undiscounted flows £m	Adjustment for discount £m	Balance sheet carrying value £m
Equity index derivatives						
– Outflow	-	-	1	**1**	-	**1**
– Inflow	-	-	201	**201**	(23)	**178**

There were no derivative contracts that the DMA intended to terminate before maturity as at 31 March 2007 (or 2006). Management expects actual undiscounted cash flows in relation to derivatives to be the same as contractual undiscounted cash flows.

Accounts Direction given by HM Treasury under the National Loans Act 1968

1. The Treasury shall prepare accounts for the Debt Management Account ("the Account") for the year ending 31 March 2007 and each subsequent financial year that give a true and fair view of the state of affairs of the Account at the balance sheet date and of its income and expenditure, total recognised gains and losses and cash flows for the year then ended. The accounts shall be prepared under the historical cost convention modified to include certain investments at valuation and in accordance with applicable accounting standards and where appropriate, although not subject to the Companies Act and technically not being the accounts of a bank, the special provisions of Schedule 9 of the Companies Act 1985 relating to banking companies.

2. The accounts shall also be consistent with relevant requirements of the Government Financial Reporting Manual, except to the extent set out in sub-paragraphs a. and b. below and shall meet the extra information requirements set out in Appendix A:

   a) An income and expenditure account shall be prepared instead of Schedule 2, the operating cost statement, and both it and the balance sheet shall be prepared in the same format as those required by Schedule 9 of the Companies Act 1985. Schedule 1 (Statement of Parliamentary Supply) and Schedule 5 (Statement of Operating Costs by Departmental Aim and Objectives), are also not relevant;

   b) The accounts shall follow the requirements of FRS 23 (IAS 21) *The Effects of Changes in Foreign Exchange Rates* (instead of SSAP 13, *Foreign Currency Translation*), FRS 25 (IAS 32) *Financial Instruments: Presentation*), FRS 26 (IAS 39) *Financial Instruments: Recognition and Measurement*, and FRS 29 (IFRS 7) *Financial Instruments: Disclosures* (instead of FRS 13 *Derivatives and other financial instruments: disclosures*) other than Appendix E, *Capital Disclosures*;

3. This Accounts Direction shall be reproduced as an Appendix to the Accounts.

4. This Accounts Direction supersedes that issued on 22 June 2006.

DAVID WATKINS
Head of the Financial Reporting Policy Team, Her Majesty's Treasury
12 July 2007

Appendix A

Extra Information required to be disclosed

1. In addition to meeting appropriate requirements of the Companies Act and the Financial Reporting Manual, the following extra information shall be disclosed, including in order to facilitate the preparation and consistency of Whole of Government Accounts.

Annual Report

2. The Annual Report shall include:

   a) A brief history of the Account, and its statutory background;

   b) An outline of the scope of the Account, its status in relation to HM Treasury and other central funds, and its management arrangements;

   c) A Management Commentary:

      i) Taking into consideration the recommendations outlined in the Accounting Standards Board's Reporting Statement 1, *Operating and Financial Review*; and

      ii) Including appropriate information on financial performance and position reflecting the relationship between the Account and other relevant central funds, and information on targets set by HM Treasury and their achievement.

Notes to the accounts

3. The notes to the accounts shall include the following:

   a) Analyses of assets, between fixed and current assets;

   b) Analyses of debtors and creditors, between those falling due within and after one year;

   c) Where not separately disclosed on the face of the income and expenditure accounts, analyses of income and expenditure giving totals for the following:

      i) Interest receivable and similar income

      ii) Interest payable and similar charges

      iii) Other operating income, including income derived from the provision of services

   d) Disclosure of income and expenditure, and assets and liabilities, relating to other central government funds, including the National Loans Fund.

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