

NATIONAL LOANS ACT 1968

Accounts prepared under Section 3 (6) of the National Loans Act 1968 together with the Certificate and Report of the Comptroller and Auditor General thereon.

Presented pursuant to Section 3 (6) of the National Loans Act 1968.

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**Public Works Loan Board Accounts  
2007-08**

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# Foreword

## Introduction

These accounts have been prepared by the Public Works Loans Board (PWLB) under a direction issued by HM Treasury in accordance with Section 3 (6) of the National Loans Act 1968. The accounts show amounts advanced by the Board and the repayments received from borrowers to service their loans. The accounts do not demonstrate the resources that have been used to deliver the PWLB's objectives, which are reported in the DMO Report and Accounts 2007-08.

## Brief history and background of the Public Works Loans Board

The PWLB is an independent statutory body that originated in 1793 and became permanently established in 1817. Since 1946 it has consisted of a maximum of twelve Commissioners appointed by the Crown to hold office for four years; three Commissioners retire each year on 1 April but are eligible for re-appointment.

In July 2002 responsibility for the administration of the PWLB's operations was transferred from National Investments and Loans Office (NILO) to the UK Debt Management Office (DMO), NILO then being abolished. Since then, the PWLB has retained its statutory identity but otherwise operated as a business unit of the DMO.

Monies are provided by Act of Parliament and drawn from the National Loans Fund (NLF). The NLF is the government's main borrowing account and is administered by HM Treasury, which determines the rates of interest.

The PWLB's lending policy and operational arrangements are set out in Circulars issued with the Commissioners' approval and displayed on the PWLB's website, [www.pwlb.gov.uk](http://www.pwlb.gov.uk).

## Current Commissioners of the PWLB

|                                     |   |
|-------------------------------------|---|
| Mr John Parkes, CBE DL<br>Chairman  | Treasurer and Pro-Chancellor, University of Hull;<br>Director, EMIH Ltd; Former Chief Executive,<br>Humberside County Council |
| Mrs Rachel Terry<br>Deputy Chairman | Former Associate, Tribal Treasury Services Limited;<br>Former Partner, Touche Ross & Company                                  |
| Mr Brian Tanner, CBE DL             | Chairman, Taunton & Somerset NHS Trust; Former<br>Chief Executive, Somerset County Council                                    |
| Mr Lawrence Nippers, MBE            | Former Director of Finance and Central Services,<br>Newport City Council  |
| Mrs Sarah Wood                      | Former Director of Economic and Environmental Policy,<br>Local Government Association   |
| Miss Mei Sim Lai, OBE               | Principal, LaiPeters  |
| Mr Gordon Edwards                   | Corporate Director for Resources Management,<br>Aberdeen City Council   |
| Mrs Philippa Foster Back, OBE       | Director, Institute of Business Ethics  |
| Mr Tony Caplin                      | Chairman, Ealing Hospital NHS Trust, Disenco plc;<br>Non-Executive Director, Panmure Gordon plc, Hand<br>Picked Hotels Ltd    |

### **The role of the Commissioners**

The functions of the Commissioners, derived chiefly from the Public Works Loans Act 1875 ('the 1875 Act') and the National Loans Act 1968 ('the 1968 Act'), are to consider loan applications from local authorities and other prescribed bodies and, where loans are made, to collect the repayments. At present nearly all borrowers are local authorities requiring loans for capital purposes. The Commissioners are legally required, before making a loan, to satisfy themselves that there is sufficient security for its repayment.

Management of credit risk is described in Note 9 to the accounts.

In practice the Commissioners' main role is to determine the general lending policy of the PWLB and to deal with related matters. The Board has delegated to the Secretary day-to-day responsibilities for authorising loans and ensuring the collection of payments due. The Secretary acts as the Accounting Officer of the PWLB and attends meetings of the Board.

The Commissioners act as a Board to discharge their duties. The Commissioners are not paid for their services.

### **The loans**

Section 3 (11) and Schedule 4 of the 1968 Act authorise the Commissioners to make loans to any local authority in Great Britain for any purpose for which the authority has power to borrow and to certain other authorities and persons for limited purposes. The Commissioners also have the powers to lend to harbours.

The amount which the Commissioners may lend, or undertake to lend, is provided by Section 4 of the 1968 Act, which permits the Commissioners to make loans up to a limit of the aggregate of:

- any commitments of the Commissioners outstanding in respect of undertakings entered into by them to grant local loans; and
- any amount outstanding in respect of the principal of any loans.

The current limit of the aggregate, set by the Finance Act 1990, is £55 billion.

All loans are drawn from, and repayments are paid back to, the NLF. All interest and premiums on early redemption paid to PWLB by borrowers is paid back to the NLF. Discounts payable on early redemptions are drawn from the NLF.

In accordance with Sections 3(2) and 5 of the 1968 Act, interest on loans made by the Commissioners is payable at rates that are set on a day to day basis by the DMO, using a methodology agreed with HM Treasury.

Loans are repayable within a period not exceeding that authorised by the Act empowering the local authority to borrow. If no period is so authorised, loans are repayable within 50 years (Section 11 of the 1875 and Section 2(2) of the Local Authorities Loans Act 1945). In practice, the maximum period for which the Commissioners may advance new loans is the same as the longest period for which HM Treasury has set a rate, currently 50 years. Prior to February 2000, PWLB issued loans for up to 60 years.

The Commissioners are normally prepared to lend to an authority up to the available capacity in its legal borrowing limit as determined under Part 1, Chapter 1 of the Local Government Act 2003. The Commissioners require a verbal statement of confirmation from the borrowing authority that it is complying with the appropriate requirements of the Board's Circulars and the relevant legislation with regard to the council's borrowing powers.

Section 5(3) of the 1875 Act requires the Commissioners to prepare for each financial year a report of their transactions during the year, including a statement of loans approved and advanced. These reports are presented to Parliament and subsequently published.

### **Audit arrangements**

The accounts are audited by the Comptroller and Auditor General in accordance with Section 3 (6) of the 1968 Act.

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

## **Management Commentary**

### **Factors influencing financial performance**

Movements in the PWLB balance sheet and its corresponding pattern of income are driven by borrower demand for new loans and the repayment (early or otherwise) of existing loans. All interest receivable by PWLB from borrowers is payable to the NLF. The demand for new loans is influenced by their need for capital finance, changes in market borrowing rates and borrowers' expectation of future interest rate changes. These factors, considered alongside any premium or discount payable for early redemption, also influence the pattern of demand for early redemption of existing loans by borrowers for refinancing purposes. Borrowers can request to repay loans before their due date. Acceptance of requests for early repayment is at the discretion of PWLB.

### **Results for 2007-08**

In 2007-08, PWLB agreed new loans to borrowers of £10,000 million compared to £12,354 million the previous year.

With effect from 1 November 2007, PWLB implemented changes to the interest rate structure of its loans incorporating a separate set of rates for early repayments. The purpose of this change was to better reflect the impact on the Exchequer of the borrower's option to refinance. This has had the effect of reducing the total value of loans redeemed early for refinancing purposes.

Overall, as at March 2008, there was an increase in the average period to maturity of fixed rate loans to 29.5 years (2007: 27.5 years). There was also a reduction in the weighted average interest rate of PWLB loans outstanding at the balance sheet date to 5.72% (2007: 5.97%).

PWLB borrowers redeemed early loans of value £6,434 million in 2007-08 (2006-07: £10,698 million). Premiums paid by PWLB customers for early redemption of loans were £337 million in 2007-08 (2006-07: £354 million). Discounts paid to PWLB customers for early redemption of loans were £244 million in 2007-08 (2006-07: £169 million).

At 31 March 2008, PWLB held loan assets outstanding to borrowers of £51,344 million (2007: £48,671 million), inclusive of accrued interest receivable of £598 million (2007: £762 million). PWLB also held a cash balance at the Bank of England of £29 million (2007: £211 million) comprising monies in transition between the NLF and PWLB borrowers.

In 2007-08 PWLB's income from interest receivable on loans was £2,841 million (2006-07: £2,895 million). The slight decrease in interest income on the previous year was due to a fall in the rates applied to variable rate loans and new loans due to refinancing in 2007-08.

The corresponding liability of the Board to the NLF comprised loan principal of £50,753 million (2007: £48,110 million) and loan interest of £620 million (2007: £772 million) outstanding.

PWLB's fee income and administrative expenditure are accounted for within the DMO's overall budget agreed with HM Treasury. In 2007-08, the DMO received fees and charges of £3.5 million (2006-07: £4.3 million) from PWLB customers in respect of new loans issued.

**Date of authorisation for issue**

The accounts were authorised for issue on 25 June 2008.

**Mark Frankel**  
**Secretary, Public Works Loans Board**  
**23 June 2008**

## Statement of Secretary's Responsibilities

1. Under Section 3 (6) of the National Loans Act 1968 the Commissioners are required to prepare an account for each financial year in the form and on the basis determined by HM Treasury.
2. The Public Works Loan Board Accounts are prepared on an accruals basis, as directed by HM Treasury, and must give a true and fair view of the state of affairs of the Board and the cash flows for the financial year.
3. The Commissioners have appointed the Secretary to discharge their residual statutory responsibilities, a role that is analogous to acting as an Accounting Officer. Therefore the Secretary has responsibility for preparing the annual accounts and for transmitting these to the Comptroller and Auditor General.
4. In preparing the accounts the Secretary is required to observe the applicable accounting standards and generally accepted accounting practice in so far as they are relevant to the Accounts, and apply suitable accounting policies on a consistent basis.
5. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, and for the keeping of proper accounting records, are set out in the Accounting Officers' Memorandum issued by HM Treasury and published in 'Managing Public Money'.

# Statement on Internal Control

## **1 Scope of responsibility**

The Public Works Loan Board Commissioners have appointed me as Secretary to the Board. I am responsible for ensuring that appropriate advice is given to the Commissioners on all matters relating to financial propriety and regularity, for keeping accounts and submitting them for external audit by the Comptroller and Auditor General and for the efficient and effective use of resources and ensuring that the business is managed within the appropriate control framework.

PWLB is a separate statutory entity managed within the control framework of the DMO. While I am responsible for PWLB's system of internal control, the Accounting Officer of the DMO is responsible for the wider control framework within which PWLB is managed. In discharging my own controls responsibilities I place assurance on the continued sound maintenance of the wider control framework from the Statement on Internal Control for the DMO, although I understand that only reasonable and not absolute assurance can be given that the risks have been controlled.

## **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 an ongoing 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.

Since July 2002 certain elements of the DMO's system of internal control have been incorporated into PWLB processes including loans being confirmed by a separate team and payments also being verified and released by non-PWLB staff. In addition the DMO's Business Continuity Plan takes full account of PWLB's needs and is subject to continual review and update.

Relevant elements of the DMO system of internal control have been implemented for PWLB. The system of internal control has been in place for the year ended 31 March 2008 and up to the date of approval of this account, and accords with Treasury guidance.

## **3 Capacity to handle risk**

The DMO has a formal risk management strategy and policy, which includes PWLB activities, set by the DMO Managing Board. The DMO has risk management policies documenting its risk management processes.

The DMO's Managing Board is responsible for setting strategic direction and considering high-level operational issues. An executive sub committee of the Managing Board generally meets weekly. The terms of reference of this committee and those of the Risk Committee 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 the DMO's risk policies and controls. 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. Most functional managers are responsible for maintaining compliance arrangements across the DMO in their area of specialism.

#### **4 The risk and control framework**

The DMO has various formal mechanisms for managing risk, including operational and other risk relating to PWLB, that are incorporated into its approach to both regular operations and new business initiatives. A key component is a Risk Committee that meets every month. Processes are in place for regular measurement and monitoring of key business risks.

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.

Heads of business units and functional teams assess regularly whether risks to their operations are being managed effectively. 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 each DMO project. Managing Board has 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.

During the year the DMO has reviewed information risk for sensitive data in the light of Cabinet Office guidance. No significant weaknesses were found. The DMO has nominated a Senior Information Risk Owner and work is in hand to ensure compliance with the latest Cabinet Office requirements.

All teams have documented procedures for their main activities. The DMO has policies on anti-fraud and whistleblowing that cover PWLB activities. 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 have been implemented in 2007-8. The DMO has its own anti-money laundering handbook. DMO staff report on anti-money laundering developments and processes to the Managing Board. The Commissioners have regard for the relevant principles of the 'Code of Best Practice for Board Members of Public Bodies' issued by HM Treasury.

The PWLB team meet regularly to review risk management issues, including emerging risks, and to agree control improvements and other relevant measures as necessary.

A controls team met periodically to review issues affecting the DMO's system of internal control, including PWLB, recommend actions to management and 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.

Responsibility for supporting me as Secretary in matters relating to governance, internal control and risk management processes rests with the Exchequer Funds 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, Exchange Equalisation Account, National Loans Fund, Consolidated Fund, the Contingencies Fund and the funds managed by the 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 Chair of the Committee reports to me on matters relating to the PWLB. The current membership of the Committee is:

- Colin Price, Chair, non-executive member of the DMO's Managing 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 (appointed June 2007), Director General Finance and Strategy at the Department for Business, Enterprise and Regulatory Reform.

## **5 Review of Effectiveness**

As Secretary, I have responsibility for reviewing the effectiveness of the system of internal control relating to PWLB within the context of the wider DMO system of internal control on which the Chief Executive of the DMO has given me assurances. My review of the effectiveness of the system of internal control for PWLB is a continuous process. It is informed by the work of the managers who have responsibility for the development and maintenance of the internal control framework, work of the internal auditors and comments made by the external auditors in their management letter and other reports. A process to address weaknesses and ensure continuous improvement of the system is in place. I inform the Commissioners of details of Internal Audit reports and my response to any recommendations.

The DMO's Risk Management Unit conducts monthly controls and compliance testing providing the executive sub-committee of the Managing Board with independent assurance on the effectiveness of operational controls. No significant internal control failures were identified during the period.

Internal Audit attended each meeting of the Exchequer Funds Audit Committee 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.

In my opinion, the system of internal control relating to PWLB was effective throughout the financial year 2007-08 and remains so on the date I sign this statement.

**Mark Frankel**  
**Secretary, Public Works Loan Board**  
**23 June 2008**

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

I certify that I have audited the financial statements of the Public Works Loan Board for the year ended 31 March 2008 under the National Loans Act 1968. These comprise the Income and Expenditure Account, the Balance Sheet, 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 Loan Commissioners, Secretary to the Public Works Loan Board and Auditor**

As described in the Foreword, the Loan Commissioners have a statutory duty to prepare accounts in respect of their transactions. They have appointed the Secretary to the Public Works Loan Board to discharge their responsibilities for the preparation of financial statements in accordance with Section 3 (6) of the National Loans Act 1968 and Treasury directions made thereunder and for ensuring the regularity of financial transactions. The Secretary is also responsible for preparation of the Foreword. These responsibilities are set out in the Statement of Secretary'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 Public Works Loan Board have been applied to the purposes intended by Parliament and conform to the authorities which govern them.

In addition, I report to you if the Public Works Loan Board 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 other transactions is not disclosed.

I review whether the Statement on Internal Control reflects the Public Work Loans Board'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 Public Works Loan Board's corporate governance procedures or its risk and control procedures.

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

### **Basis of audit opinion**

I conducted my audit in accordance with International Standards 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 judgements made by the Secretary to the Public Works Loan Board in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Public Works Loan Board'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 Treasury directions made thereunder, of the state of the Public Works Loan Board's affairs as at 31 March;
- the financial statements have been properly prepared in accordance with the National Loans Act 1968 and Treasury directions made thereunder; and
- information contained in the Foreword is consistent with the financial statements.

### **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.

**T J Burr  
Comptroller and Auditor General  
National Audit Office  
151 Buckingham Palace Road  
Victoria  
London SW1W 9SS**

**24 June 2008**

## Income and Expenditure Account

For the year ended 31 March 2008

|  | <b>Note</b> | <b>2007-08<br/>£m</b> | <b>2006-07<br/>£m</b> |
|--|-------------|-----------------------|-----------------------|
| Interest income                                      | 2           | 2,934                 | 3,080                 |
| <b>Operating income</b>                              |             | <b>2,934</b>          | <b>3,080</b>          |
| Interest and premiums payable to National Loans Fund |             | (2,934)               | (3,080)               |
| <b>Operating surplus retained</b>                    |             | <b>-</b>              | <b>-</b>              |

There were no gains or losses during the year other than those disclosed in the Income and Expenditure Account.

The notes on pages 14 to 20 form part of these accounts.

## Balance Sheet

As at 31 March 2008

|  | Note | 2008<br>£m    | 2007<br>£m    |
|--|------|---------------|---------------|
| <b>Assets</b>                              |      |               |               |
| Cash balance at Bank of England            | 8d   | 29            | 211           |
| Loans outstanding to customers             | 4    | 51,344        | 48,671        |
| <b>Total Assets</b>                        |      | <b>51,373</b> | <b>48,882</b> |
| <b>Liabilities</b>                         |      |               |               |
| Amounts owed to the National Loans Fund    |      |               |               |
| Loan principal                             | 7    | 50,753        | 48,110        |
| Loan Interest including discounts/premiums | 7    | 620           | 772           |
| Total amounts due to the NLF               |      | <b>51,373</b> | <b>48,882</b> |
| <b>Total Liabilities</b>                   |      | <b>51,373</b> | <b>48,882</b> |

The notes on pages 14 to 20 form part of these accounts.

**Mark Frankel**  
**Secretary, Public Works Loan Board**  
**23 June 2008**

## Cash Flow Statement

For the year ended 31 March 2008

|   | <b>Note</b> | <b>2008<br/>£m</b> | <b>2007<br/>£m</b> |
|---|-------------|--------------------|--------------------|
| Net cash flow from operating activities         | 8a          | 263                | 2,111              |
| Returns on investments and servicing of finance | 8b          | (3,087)            | (2,947)            |
| <b>Net cash flow before financing</b>           |             | <b>(2,824)</b>     | <b>(836)</b>       |
| Financing                                       | 8c          | 2,642              | 987                |
| <b>Increase/(Decrease) in cash</b>              |             | <b>(182)</b>       | <b>151</b>         |

The notes on pages 14 to 20 form part of these accounts.

## Notes to the Accounts for the Year Ended 31 March 2008

### 1 Accounting policies

#### (i) Basis of preparation

The accounts have been prepared in accordance with a direction given by HM Treasury and in accordance with UK GAAP in so far as they are appropriate to PWLB, under the historical cost convention.

#### (ii) Financial assets

PWLB classifies its financial assets as loans and receivables under FRS 26 (Financial Instruments: Recognition and Measurement), which are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. PWLB does not sell financial assets and so does not designate any loans and receivables as available-for-sale or held for trading.

All loans are recognised initially at fair value, normally the amount advanced to the borrower. Loans and receivables are subsequently measured at amortised cost using the effective interest method.

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 based on the contractual terms of the loan. Owing principally to the long maturities of most loans and the volatile pattern of early repayments, the actual cash flows and the expected lives of the loans cannot be estimated reliably.

The market value of loans outstanding, disclosed in Note 5 to the accounts, is calculated as the aggregate net present value of future cash flows on each individual loan.

#### (iii) Liabilities

All PWLB liabilities relate to monies drawn from the National Loans Fund for the purpose of issuing loans to PWLB borrowers. All principal and interest repayments receivable by PWLB, along with any premiums for early redemption, are repayable to the NLF and are valued in the same way as the corresponding asset.

#### (iv) Recognition of assets and liabilities

Loans and receivables are recognised when cash is advanced to borrowers and are derecognised when borrowers settle their obligations. Liabilities are recognised when cash is advanced to PWLB from the National Loans Fund and derecognised when cash is paid back to the National Loans Fund.

#### (v) Income recognition

Contractual interest income is recognised using the effective interest method. Premiums and discounts on early repayments are recognised when received and paid.



**2 Interest income**

|   | <b>2008</b>  | <b>2007</b>  |
|---|--------------|--------------|
|   | <b>£m</b>    | <b>£m</b>    |
| Contractual interest income for fixed rate loans    | 2,834        | 2,885        |
| Contractual interest income for variable rate loans | 7            | 10           |
| Premiums received                                   | 337          | 354          |
| Discounts paid                                      | (244)        | (169)        |
|   | <b>2,934</b> | <b>3,080</b> |

**3 Segmental analysis of interest income by country****Analysis for 2008**

|                     | <b>England</b> | <b>Wales</b> | <b>Scotland</b> | <b>Total</b> |
|---------------------|----------------|--------------|-----------------|--------------|
|                     | <b>£m</b>      | <b>£m</b>    | <b>£m</b>       | <b>£m</b>    |
| Fixed rate loans    | 2,210          | 185          | 439             | 2,834        |
| Variable rate loans | 7              | -            | -               | 7            |
|                     | <b>2,217</b>   | <b>185</b>   | <b>439</b>      | <b>2,841</b> |

**Analysis for 2007**

|                     | <b>England</b> | <b>Wales</b> | <b>Scotland</b> | <b>Total</b> |
|---------------------|----------------|--------------|-----------------|--------------|
|                     | <b>£m</b>      | <b>£m</b>    | <b>£m</b>       | <b>£m</b>    |
| Fixed rate loans    | 2,228          | 194          | 463             | 2,885        |
| Variable rate loans | 10             | -            | -               | 10           |
|                     | <b>2,238</b>   | <b>194</b>   | <b>463</b>      | <b>2,895</b> |

**4 Loans outstanding to customers**

|   | <b>2008</b>   | <b>2007</b>   |
|---|---------------|---------------|
|   | <b>£m</b>     | <b>£m</b>     |
| Fixed rate loans principal              | 50,671        | 47,734        |
| Variable rate loans principal           | 75            | 175           |
| <b>Total – Loans outstanding</b>        | <b>50,746</b> | <b>47,909</b> |
| Accrued interest on fixed rate loans    | 597           | 761           |
| Accrued interest on variable rate loans | 1             | 1             |
| <b>Total - Accrued interest</b>         | <b>598</b>    | <b>762</b>    |
| <b>Total – Loans outstanding</b>        | <b>51,344</b> | <b>48,671</b> |

**5 Loans and advances to customers****5a Loans outstanding - market valuation and weighted average interest rate**

|                     | <b>2008<br/>Principal</b> | <b>2008<br/>Market Value</b> | <b>2008<br/>Weighted<br/>Average Interest<br/>Rate</b> |
|---------------------|---------------------------|------------------------------|--|
|                     | <b>£m</b>                 | <b>£m</b>                    | <b>%</b>   |
| Fixed rate loans    | 50,671                    | 59,371                       | 5.72   |
| Variable rate loans | 75                        | 75                           | 5.35   |
|                     | <b>50,746</b>             | <b>59,446</b>                | <b>5.72</b>  |

|                     | <b>2007<br/>Principal</b> | <b>2007<br/>Market Value</b> | <b>2007<br/>Weighted<br/>Average Interest<br/>Rate</b> |
|---------------------|---------------------------|------------------------------|--|
|                     | <b>£m</b>                 | <b>£m</b>                    | <b>%</b>   |
| Fixed rate loans    | 47,734                    | 53,013                       | 5.97   |
| Variable rate loans | 175                       | 176                          | 5.51   |
|                     | <b>47,909</b>             | <b>53,189</b>                | <b>5.97</b>  |

The weighted average period for which rates are fixed is 29.5 years (2006-07: 27.5 years) for fixed rate loans.

At 31 March 2008, £1 million of loans (31 March 2007: £1 million) had been confirmed but not yet advanced. These loans are not included in the balance sheet.

The balance of outstanding loans includes £11 million of loans (31 March 2007: £5 million) which borrowers had confirmed their intention to repay but as at the balance sheet date had not yet been received.

**5b Loans outstanding – maturity analysis**

|  | <b>2008<br/>Principal<br/>Outstanding<br/>£m</b> | <b>2007<br/>Principal<br/>Outstanding<br/>£m</b> |
|--|--|--|
| Up to 1 month / repayable on demand              | 16   | 80   |
| In more than 1 months but not more than 3 months | 97   | 145  |
| In more than 3 months but not more than 1 year   | 537  | 519  |
| In more than 1 year but not more than 5 years    | 3,275  | 3,116  |
| In more than 5 years but not more than 10 years  | 5,328  | 5,280  |
| In more than 10 years but not more than 20 years | 8,671  | 10,063   |
| In more than 20 years but not more than 30 years | 8,471  | 10,181   |
| In more than 30 years but not more than 40 years | 4,325  | 2,841  |
| More than 40 years                               | 20,026   | 15,684   |
| <b>Total Assets</b>                              | <b>50,746</b>                                    | <b>47,909</b>                                    |

**5c Loans outstanding – interest rate profile**

This note indicates the period of the next re-pricing date for variable rate loans and the maturity date for fixed rate loans.

|  | <b>2008<br/>Principal<br/>Outstanding<br/>£m</b> | <b>2007<br/>Principal<br/>Outstanding<br/>£m</b> |
|--|--|--|
| Up to 1 month / repayable on demand              | 51   | 139  |
| In more than 1 months but not more than 3 months | 115  | 180  |
| In more than 3 months but not more than 1 year   | 551  | 523  |
| In more than 1 year but not more than 5 years    | 3,223  | 3,073  |
| In more than 5 years but not more than 10 years  | 5,313  | 5,225  |
| In more than 10 years but not more than 20 years | 8,671  | 10,063   |
| In more than 20 years but not more than 30 years | 8,471  | 10,181   |
| In more than 30 years but not more than 40 years | 4,325  | 2,841  |
| More than 40 years                               | 20,026   | 15,684   |
| <b>Total Assets</b>                              | <b><u>50,746</u></b>                             | <b><u>47,909</u></b>                             |

**5d Loans outstanding - country analysis**

|          | <b>2008<br/>£m</b>   | <b>2007<br/>£m</b>   |
|----------|----------------------|----------------------|
| England  | 40,383               | 37,668               |
| Wales    | 3,223                | 3,151                |
| Scotland | 7,140                | 7,090                |
| Total    | <b><u>50,746</u></b> | <b><u>47,909</u></b> |

**6 New issue, maturity and early redemption of loan principal**

|                               | <b>2008<br/>£m</b>  | <b>2007<br/>£m</b> |
|-------------------------------|---------------------|--------------------|
| New agreed loans to customers | 10,000              | 12,354             |
| Loans maturing                | (729)               | (831)              |
| Loans redeemed early          | (6,434)             | (10,698)           |
| Net increase in loans         | <b><u>2,837</u></b> | <b><u>825</u></b>  |

**7 Loan principal and interest owed to National Loans Fund**

|   | <b>2008<br/>£m</b>   | <b>2007<br/>£m</b>   |
|---|----------------------|----------------------|
| Loan principal outstanding to customers                 | 50,746               | 47,909               |
| Loan principal repaid but not yet surrendered to NLF    | 7                    | 201                  |
| <b>Total loan principal owed to National Loans Fund</b> | <b><u>50,753</u></b> | <b><u>48,110</u></b> |

Loan interest owed to the National Loans Fund of £620m at 31 March 2008 (2007: £773m) included £1m premium (2007: £1m discount) for loans redeemed early.

**8 Analysis of cash flow**

|   | <b>2007-08<br/>£m</b> | <b>2006-07<br/>£m</b> |
|---|-----------------------|-----------------------|
| <b>8a Reconciliation of operating income to net cash flow from operating activities</b> |                       |                       |
| Operating income  | 2,934                 | 3,080                 |
| Increase in loans and advances to customers   | (2,837)               | (824)                 |
| Increase/(Decrease) in accrued income   | 164                   | (143)                 |
| Increase/(Decrease) in net early redemption discounts and premiums due to NLF           | 2                     | (2)                   |
| <b>Net cash flow from operating activities</b>  | <b><u>263</u></b>     | <b><u>2,111</u></b>   |

**8b Return on investments and servicing of finance**

|  |                       |                       |
|--|-----------------------|-----------------------|
| Interest and premiums paid to National Loans Fund            | (3,087)               | (2,947)               |
| <b>Total returns on investments and servicing of finance</b> | <b><u>(3,087)</u></b> | <b><u>(2,947)</u></b> |

**8c Financing**

|   |                     |                   |
|---|---------------------|-------------------|
| Increase/(Decrease) in loans principal outstanding to NLF | 2,642               | 987               |
| <b>Total financing</b>                                    | <b><u>2,642</u></b> | <b><u>987</u></b> |

**8d Analysis of cash balances**

|                                      | <b>2008<br/>£m</b> | <b>Movement<br/>£m</b> | <b>2007<br/>£m</b> |
|--------------------------------------|--------------------|------------------------|--------------------|
| Cash and balances at Bank of England | 29                 | (182)                  | 211                |

## 9 Risk management

Measurement and management of certain specific financial risks is described below.

**Credit risk:** credit risk is the risk that a counterparty will fail to discharge a contractual obligation, resulting in financial loss to the PWLB. Any such loss would be borne by the NLF.

### *Risk measurement*

Credit risk exposures (before collateral held or other credit enhancements) are shown below:

|                                      | Wholly-owned by UK central government | Major local authorities | Parish councils and drainage boards | Harbour boards | Total         |
|--------------------------------------|---------------------------------------|-------------------------|-------------------------------------|----------------|---------------|
|                                      | £m                                    | £m                      | £m                                  | £m             | £m            |
| <b>2008</b>                          |                                       |                         |                                     |                |               |
| Cash and balances at Bank of England | 29                                    | -                       | -                                   | -              | 29            |
| Loans outstanding to customers       | -                                     | 51,240                  | 100                                 | 4              | 51,344        |
| <b>Total gross amount</b>            | <b>29</b>                             | <b>51,240</b>           | <b>100</b>                          | <b>4</b>       | <b>51,373</b> |
| Loans confirmed but not advanced     | -                                     | 1                       | -                                   | -              | 1             |
| <b>2007</b>                          |                                       |                         |                                     |                |               |
| Cash and balances at Bank of England | 211                                   | -                       | -                                   | -              | 211           |
| Loans outstanding to customers       | -                                     | 48,572                  | 93                                  | 6              | 48,671        |
| <b>Total gross amount</b>            | <b>211</b>                            | <b>48,572</b>           | <b>93</b>                           | <b>6</b>       | <b>48,882</b> |
| Loans confirmed but not advanced     | -                                     | 1                       | -                                   | -              | 1             |

The components of 'Total gross amount' set out above are based on carrying amounts as reported in the balance sheet.

There were no overdue loan repayments, renegotiated loans or assets considered impaired at 31 March 2008 (31 March 2007: nil).

Loans for which payment schedules had been amended in order to facilitate more efficient administration by local authorities are not considered to constitute renegotiated loans in credit risk terms and there were no such amendments for harbour boards.

PWLB does not issue any financial guarantees.

### *Risk management*

As stated on page 2, the PWLB Commissioners are legally required before making a loan to satisfy themselves that there is sufficient security for its repayment. The vires of all new borrowers are checked.

The PWLB lends only to local authorities and other prescribed bodies.

Loans to local authorities, together with related interest, are automatically secured by statute on all revenue streams of the borrower.

Loans to harbour boards are secured on property and are made only with the provision of a guarantee from the local authority. In addition, the business plan is reviewed. No new loans were made to harbour boards in the year ended 31 March 2008 (31 March 2007: nil).

PWLB does not differentiate borrowers by credit rating.

PWLB continuously monitors its total lending against a limit set by statute.

**Market risk:** market risk is the risk that the fair value of a financial instrument will fluctuate because of changes in market prices.

Market risk comprises interest rate risk, currency risk and other price risk. PWLB activities are not considered to give rise to interest rate risk for the PWLB itself, but rather form part of the interest rate risk profile of the NLF. Interest rates on PWLB lending are set on a day to day basis by the DMO, using a methodology agreed with HM Treasury.

There is no exposure to currency risk or other price risk.

**Liquidity risk:** liquidity risk is the risk that the PWLB will encounter difficulty in meeting obligations associated with financial liabilities.

PWLB activities are not considered to give rise to liquidity risk for the PWLB itself, but rather form part of the liquidity risk profile of the NLF. PWLB cash flow requirements are forecast and monitored daily.

## ANNEX

### **ACCOUNTS DIRECTION GIVEN BY THE TREASURY IN ACCORDANCE WITH SECTION 3 (6) OF NATIONAL LOANS ACT 1968**

1. The Public Works Loans Board shall prepare accounts for the financial year ended 31 March 2004 and subsequent financial years comprising:

- (a) a Foreword
- (b) a Statement of Internal Control
- (c) an Income and Expenditure Account
- (d) a Balance Sheet; and
- (e) a Cash Flow Statement

including such notes as may be necessary for the purposes referred to in the following paragraphs.

2. The accounts shall give a true and fair view of the income and expenditure, and cash flows for the financial year, and the state of affairs as at the end of the financial year.

3. Subject to this requirement, the accounts shall be prepared in accordance with:

- (a) Generally Accepted Accounting Practice in the United Kingdom (UK GAAP) to the extent that it is relevant. Any departure from UK GAAP is only permissible in the context of providing a true and fair view for this public sector account.
- (b) any other relevant guidance that the Treasury may issue from time to time in respect of accounts which are required to give a true and fair view.

4. This direction shall be reproduced as an appendix to the accounts.

**DAVID A CRUDEN, FCA**

**HEAD OF CENTRAL ACCOUNTANCY TEAM, HER MAJESTY'S TREASURY**

25 February 2005