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# Debt Management Account Report and Accounts

**2002 / 2003**

Presented to Parliament in Pursuance of the  
National Loans Act 1968 (as amended by the Finance Act 1998)

Ordered by the House of Commons to be printed 17 July 2003



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**Debt Management Office**  
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This publication is available in electronic form on the DMO web site [www.dmo.gov.uk](http://www.dmo.gov.uk)

All the DMO's publications are available on its web site including:

- annual review covering the main developments for the financial year in which the DMO has been in operation;
- quarterly reviews highlighting more recent developments in the DMO's gilts and cash market activities;
- guides for potential investors in gilts - both wholesale and retail;
- the DMO's annual Report and Accounts for its administrative expenditure and also for the operation of the Debt Management Account;
- Operational Notices covering the DMO's market activities in the gilts and cash markets;
- The DMO's annual business plan;
- The DMO's framework document (which sets out the DMO's relationship with HM Treasury).

Alternatively, hard copies of these publications are available from the DMO by telephoning 020 7862 6501.

# **Debt Management Account Report and Accounts**

**Period from 1 April 2002 to 31 March 2003**

Presented to Parliament in Pursuance of Section 5A of the  
National Loans Act 1968 (as amended by the Finance Act 1998)

Ordered by the House of Commons  
to be printed 17 July 2003



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## Foreword

### Introduction

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2002-03, the fifth year of the UK Debt Management Office's operations, was notable in a number of respects; it saw the first year of positive net gilt issuance since 1997-98 (+£7.8 billion) as the Government's financing requirement rose; it saw the return to issuance in the short maturity sector for the first time since 1999, with the issue of 5% Treasury Stock 2008 and it also saw the issue of the first new index-linked stock for a decade (2% Index-linked Treasury Stock 2035). The impact of geopolitical turbulence in the Middle East also benefited gilts as well as other government bond markets, with gilt yields falling to levels not seen since the 1950s.

In the cash markets, the stock of Treasury bills continued to climb over the financial year from £9.7 billion to £15.0 billion (and peaking at over £22.0 billion) as their importance as a cash management tool grew. We also expanded the range of available maturities and in May 2002 the DMO began issuing six-month Treasury bills alongside the existing one- and three- month maturities. The DMO continued to manage a short-term cash position as an extension of its cash management operations.

On a more personal note 2002-03 saw the departure of my predecessor, Mike Williams who had headed the DMO since its formation in April 1998. Mike's input over the past five years played a major part in establishing and maintaining the reputation of the DMO with both the Treasury and the financial markets more generally and I am most grateful to him for his valuable contribution.

I look forward to building on the solid foundations, which have been laid down. I am convinced that these foundations leave the DMO well placed to respond to the challenge of meeting the significantly increased financing requirement in the current financial year.

### Background

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The UK Debt Management Office (DMO) was established on 1 April 1998. Its aim is "to carry out the Government's debt management policy of minimising financing costs over the longer term, taking account of risk, and to manage the aggregate cash needs of the Exchequer in the most cost effective way".

The DMO assumed responsibility for debt management on 1 April 1998 and for cash management on 3 April 2000.

### The DMO's Objectives

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HM Treasury Ministers set the DMO's strategic objectives, which are published in the DMO's Business Plan and its Framework Document. The objectives for 2002-03 and the DMO's performance against them are summarised in the section below.

- 1. To meet the annual remit set by HM Treasury Ministers for the sale and purchase of gilts, with high regard to long-term cost minimisation, taking account of risk.**
  - this has been successfully achieved.
  - gilt sales targets have been met through the conduct of thirteen outright gilt auctions (eight conventional and five index-linked) and one tender of index-linked stock<sup>1</sup>. Outright gilt sales were £26.3 billion (cash) split between £21.7 billion conventional and £4.6 billion index-linked. Net gilt issuance for the financial year was +£7.8 billion, the first year of positive net issuance since 1997-98.

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<sup>1</sup> The tender, of £74 million nominal of 2% Index-linked Treasury Stock 2035 on 14 November 2002 represented the unsold portion of the uncovered auction on 25 September 2002.

## Background on the DMO

- the final outturn for gilt sales of £26.3 billion was slightly above the annual target of £26.2 billion (as increased in the Pre-Budget Report (PBR)) but within the operational tolerances allowed in the remit.
2. **To offset, through its market operations, the expected outturn cash flow into or out of the National Loans Fund (NLF), on every business day; and in a cost-effective manner, taking account of risk.**
    - this has been successfully achieved.
    - the stock of Treasury bills increased by £5.3 billion, ending the financial year at £15.0 billion. The end-year stock was intentionally £1.0 billion above the target published in the PBR but this was in line with operational tolerances. The Treasury bill stock had peaked at £22.5 billion in late December 2002 to help manage seasonal cash outflows.
  3. **To manage effectively, in accordance with objectives set by HM Treasury Ministers, any assets held on the Debt Management Account.**
    - this has been successfully achieved. The DMO continued to manage a short-term net cash position as an extension of its cash management operations.
  4. **To advise Ministers on setting the remit to meet the Government's objectives under 1-3 above; and to report to Ministers on the DMO's performance against its remit, objectives and targets.**
    - the DMO contributed specific advice in a number of areas of the 2002-03 remit (including the provisional remit published in March 2002 ahead of the Budget forecasts):
      - the range of contingencies to be implemented in the event of changes to the Government's financing requirement (these were implemented twice – in April 2002 when the Budget forecast was published and in November 2002 in the PBR).
      - the extent to which gilt issuance should be split between conventional and index-linked; and within conventionals the split between maturity ranges.
      - the case for new short and medium maturity conventional stocks and a new (ultra-long) index-linked stock.
      - the size and timing of auctions.
      - the split between an increase in the Treasury bill stock and a run-down in the DMO's net cash position as elements of short-term debt financing.
    - the DMO also contributed substantially to preparation of the "Debt & Reserves Management Report 2002-03".
    - the DMO reported performance against its remit to HM Treasury on a monthly basis, and on developments in the gilts portfolio and compliance against its published targets on a quarterly basis. The annual summary of performance against these targets is published in Annex E of the DMO Annual Review.
  5. **To develop policy on, and promote advances in, new instruments, issuance techniques and structural changes to the debt and Treasury bill markets that may help to enhance the efficiency and lower the cost of debt and cash management, liaising as appropriate with the relevant bodies; to keep abreast of**

**developments in debt and cash management policy and practice; and to provide policy advice to HM Treasury Ministers and officials accordingly.**

- on 11 July 2002 the DMO issued the first new index-linked stock for 10 years following the auction of 2% Index-linked Stock 2035 (this was at the time the longest-dated government index-linked stock in issue internationally).
- in May 2002 the DMO issued six month Treasury bills for the first time. Unlike one and three month bills which are offered at weekly tenders, six month bills are usually offered for sale only once a month.
- following a consultation exercise with the market, on 17 July 2002 the DMO announced that it will use Treasury bills as collateral in repo and reverse-repo transactions with its cash management counterparties.
- the DMO has continued to promote the Treasury bill market; it encouraged a secondary market to develop by successfully persuading the market and CRESTCo to include Treasury bills as eligible delivery-by-value (DBV) collateral (following dematerialisation), thereby making Treasury bills a more liquid security.
- on 29 November 2002 the DMO issued a consultation document (jointly with CRESTCo) seeking market views on whether International Securities Identification Numbers (ISINs) should change on redenomination in the event that the UK joined the euro. There was insufficient feedback to lead the DMO to alter its view that ISINs should not change. This outcome was endorsed by the City Euro Group on 3 February 2003. On 4 February 2003 the DMO published its response confirming its intention not to change ISINs on any future redenomination.

**6. To conduct its market operations, liaising as necessary with the relevant bodies, with a view to maintaining or promoting an orderly, efficient and liquid market for gilts.**

- the DMO was able to issue both a new short and medium maturity conventional gilt in 2002-03. The new short (5% Treasury Stock 2008) was the first new such stock since 1999. Its initial auction in June 2002 was followed in August by a conversion offer from 9% Treasury Stock 2008 which increased the amount of the new stock in issue by £5.9 billion, taking it to benchmark size. 5% Treasury Stock 2008 was increased to £14.2 billion in issue by the end of the financial year.
- a second series of conventional gilt strips dates (7 March / 7 September) was introduced – becoming effective on 2 April 2002 (alongside the existing series of 7 June / 7 December). Four stocks (5% Treasury Stock 2008, 5% Treasury Stock 2012, 5% Treasury Stock 2014 and 5% Treasury Stock 2025) had strippable dates on the new series at end-March 2003.
- the DMO operated its standing repo facility only once (in September 2002) compared to 15 times in 2001-02.

**7. To provide, including in liaison with the Bank of England and CRESTCo, a high quality and efficient service to investors in Government debt, and to deal fairly and professionally with market participants in the gilts and money markets, consistent with achieving low cost issuance and an efficient market.**

- the DMO continued to hold its regular quarterly consultation meetings with GEMMs and gilt market investors to discuss their views on gilts issuance in the succeeding quarter. It also began publishing summary minutes of the meetings on its screens and website on the day after the meeting.
- additional meetings were held with the Financial Secretary in January 2003 to discuss views of market participants on the shape of the DMO remit for 2003-04. Representatives of the DMO also visited gilt market investors based in Scotland in February 2003 to canvass their views on the 2003-04 remit.

**8. To contribute to HM Treasury's work on the development of the strategy for managing the Government's financial assets and liabilities.**

- following a review of the arrangements and future requirements for government debt and asset management HM Treasury announced on 25 March 2002 that the activities of the Public Works Loan Board (PWLb) and the Commissioners for the Reduction of the National Debt (CRND) were to be integrated with the DMO. The reorganisation, which was designed to deliver improved management of the central government balance sheet and to offer a more robust, flexible and innovative service to public sector clients, took effect on 1 July 2002. Since the merger, PWLB and CRND business processes and the relationship between them and existing DMO processes have been and continue to be reviewed to optimise internal operating efficiencies.
- following discussions in 2001-02 with HM Treasury, the DMO developed a new version of its simulation model, which can be used to quantify the likely long-term costs against the fiscal risks facing government debt management. This cost-at-risk modeling can be used to enhance the transparency and predictability of the decisions underpinning the debt management remit as well as long-term cost savings. Some preliminary results were published in the Debt and Reserves Management Report 2003-04.

**9. To make information publicly available on the debt and Treasury bill markets and DMO policies where that contributes through openness and predictability to efficient markets and lower costs of issuance.**

- the DMO has continued to expand the content of and resources devoted to its website [www.dmo.gov.uk](http://www.dmo.gov.uk). All the DMO's publications and an increasing amount of data on both the gilts and cash markets appear on the site. PWLB and CRND maintain their own dedicated sites [www.pwlb.gov.uk](http://www.pwlb.gov.uk) and [www.crnd.gov.uk](http://www.crnd.gov.uk) which provide information on their respective activities to their clients.
- minutes of consultation meetings with gilts market participants about forthcoming operations in the gilts market appear on the DMO web site the day after the meetings take place.

**10. To contribute to the Government's wider objectives for financial cost-effectiveness and risk reduction, including by developing partnerships with other parts of the public sector, and by providing advice and expertise to other Government departments (and other governments) as required.**

- the DMO has continued to develop a number of projects with other Government departments utilising the specialist financial market knowledge it has acquired in carrying out its debt and exchequer cash management responsibilities.
- on 19 September 2002 the DMO announced a package of changes to the DMADF through which selected local authorities may deposit cash with the DMO. The initial pilot-scheme, launched in April 2002, was put onto a longer-term footing. The number of local authorities who may use the facility was increased from 50 to 150 and the terms of the fixed deposit product were amended (the maximum maturity was doubled to six months and the minimum transaction size was reduced from £1 million to £250,000).
- the DMO has continued to execute equity index-swaps used as a hedge for the commitment embodied in the Guaranteed Equity Bond (GEB) issued by National Savings & Investments (NS&I). The GEB requires NS&I to pay a return on an equity index over a particular period, where this is positive, with a minimum commitment to repay the capital sum invested.

**11. To resource, staff and manage the DMO to deliver its objectives effectively and efficiently and to ensure value for money in its administrative expenditure.**

- the DMO has continued to grow, reflecting in particular the integration of PWLB and CRND, which took the number of DMO employees to around 80 at the end of the 2002-03 financial year.

- the DMO applied for and was successfully re-accredited with liP status in December 2002. The new accreditation runs for a period of three years.
- as part of its commitment to maintaining liP status the DMO has introduced a rigorous corporate training plan to enhance the skills base of its employees.
- the DMO's annual (administrative) report and audited accounts for 2001-02 were published on 23 July 2002.
- the audited accounts of the DMA for 2001-02 were published on 19 December 2002.
- the DMO published its policy statement on Health and Safety on 7 January 2003.

**12. To develop appropriate management, information and control systems with high regard to risk management; and to ensure full and accurate presentation of accounting and other information.**

- internal reporting arrangements exist and have continued to be developed to help the Chief Executive to meet his internal control responsibilities as required under the Turnbull Guidelines.
- the DMO's internal audit function has completed operational audits and provided controls related advice in accordance with the annual audit programme; it has operated in accordance with the requirements contained in Government Internal Audit Standards.
- the DMO has upgraded its core transaction reporting system in the period which will provide a range of benefits including making it easier to develop and extract data for management information purposes.
- during the year DMO undertook an extensive analysis of its risk IT systems requirements. An implementation project has now started which will be completed during 2003-04 and will allow DMO to adopt good risk management practice across both current and future business streams.
- the DMO has successfully met the requirements of Section 19 of the Freedom of Information Act 2000 by compiling and implementing Publication Schemes for the DMO, the PWLB and the CRND. These are available on the agency's websites and in hardcopy on request.
- the DMO has also successfully re-evaluated its data protection notifications with the Office of the Information Commissioner post-merger to ensure ongoing compliance with the Data Protection Act 1998. Work on bringing together record keeping systems has been progressing and includes integrating the management of records held electronically, part of work towards the 2004 target for full electronic records management.

### Purpose of the Debt Management Account (DMA)

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The Finance Act 1998 provided for the establishment of the Debt Management Account (DMA) and this was created by Order on 15 November 1999. Its purpose is the management and reporting of the debt and cash dealing operations that the DMO undertakes to meet its objectives.

As the Government's debt manager, a key role of the DMO is as an issuer of gilt-edged securities (Gilt-edged securities, or gilts, are UK Government sterling denominated listed securities with longer-term maturities issued), and additionally it supports the secondary market.

These accounts cover the year ending 31 March 2003. Only the DMO's market transactions are accounted for through the DMA. Reported separately from the DMA, the DMO's administrative income and expenditure for the period to 31 March 2003 were published as part of DMO's Annual Report & Accounts 2002-03. This document is available on the DMO's web site at [www.dmo.gov.uk](http://www.dmo.gov.uk).

## Guide to the DMA and Relationship to the National Loans Fund

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The operations of the Consolidated Fund and the National Loans Fund (NLF) - the two key central government funds - are central to an understanding of the accounting arrangements for government debt and cash management, and the role of the DMA. The Consolidated Fund accounts for most central government expenditure and receipts, except for borrowing and financing transactions that are accounted for by the NLF and the DMA. The NLF is the government's main borrowing account. The NLF balances the Consolidated Fund at the end of each business day.

Essentially the DMA's role is to meet the financing needs of the NLF, both in terms of long-term (debt management) and short-term requirements and to meet the NLF's day-to-day cash needs (cash management of both surplus and deficit cash positions). All lending by the DMA to the market when the government has excess cash is an asset of the DMA, while DMA borrowing from the market is a liability. Day-to-day borrowing and lending largely takes the form of the issuance of Treasury bills, and repo and reverse repo transactions with the DMO's commercial counterparties. These latter transactions are collateralised, usually using gilts. For this purpose the DMA holds a large gilt portfolio, a significant proportion of which was bought from the former National Investments and Loans Office (NILO) early in the life of the DMA to underpin the DMO's cash management operations.

The Debt Management Office undertakes gilt issuance operations via the DMA on behalf of the NLF. The NLF creates the gilt that is to be issued and sells it to the DMA from where it is sold on to the market. The responsibility for paying gilt coupons and redeeming debt on maturity falls to the NLF, as gilts remain the liability of the NLF. The DMA also periodically undertakes secondary market gilt transactions in relatively small volumes.

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

To fund the DMO's market operations, the NLF made a cash advance to the DMA at its inception. Further cash advances to the DMA have been to fund the DMA's activities as they have broadened. The advance stood at £28.0 billion on 31 March 2003. At the end of each day, the remaining balance of the advance (less a target Bank of England balance of £200 million) is returned to the NLF as a deposit and this is the means by which the DMA balances the daily financing needs of the NLF. On 31 March this deposit was £36.7 billion. The DMA is charged interest on the advance by the NLF at a rate equal to the Bank of England repo rate. The DMA earns interest at the same rate on any daily deposit made with the NLF.

The need to extend the advance is also driven by a requirement of the Finance Act 1998, which places a cap on the borrowing of the DMA, other than from the NLF. This requires that market borrowing by the DMA (principal outstanding of any money raised, excluding money raised from the NLF) should never exceed its deposits with the Bank of England and the NLF.

Operating surpluses and deficits made annually by the DMA are an asset or liability of the NLF respectively. All or part of any DMA surplus may be paid to the NLF, which will accordingly reduce the liability of the DMA to the NLF. In the case of a deficit this may be recovered from the NLF.

If there was 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.

## Operating and Financial Review

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### Operating Results for the Period

The DMO successfully achieved its objectives for the sale of gilts specified in the annual remit set by Treasury Ministers. It also successfully achieved its objective to offset through its market operations, the expected net cash flow into or out of the NLF, on every business day, and in a cost-effective manner.

Further information on the DMO's achievements against its strategic objectives can be found in the DMO's Business Plan for 2003-2004, all of which can be found on its web site at [www.dmo.gov.uk](http://www.dmo.gov.uk).

The DMA's operations in the year ending 31 March 2003 gave rise to net interest revenue of £102 million (2002: £573 million) and valuation gains on market transactions and assets held of £469million (2002: deficit of £250 million), producing a surplus before financing of £571 million (2002: gain of £323 million). The retained surplus in the year, after financing, produced a surplus of £735 million (2002: deficit of £112 million).

The DMO's operations as both the Government's debt manager and its cash manager take place within a policy framework that underpins the DMO's strategic objectives and an annual remit laid down by the Treasury Ministers. As far as cash management operations are concerned, although the DMO seeks to conduct its market interactions cost effectively, it also has to take into account the primary requirement to smooth the Exchequer's cash flows and to balance the NLF daily. In some circumstances this may reduce the range of available trading strategies that would be open to a commercially driven body.

There are likely to be a range of influences on the DMA's operating results in any accounting period. 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 pattern of Government cash flows, rather than any trading view by the DMO. The DMA's net operating results will therefore be heavily influenced by the interaction between transactions undertaken by the DMO to smooth Government cash flows and market conditions over the course of the year. Similarly any valuation gains or losses are likely in large part to reflect the impact of external interest rate movements on the mark to market value of the DMO's holdings of gilt edged securities which are predominantly, although not exclusively, held as collateral for the DMO's cash management operations.

According to the terms of the Finance Act 1998, the DMA's retained surplus is a liability of the DMA to the National Loans Fund. All or any part of this surplus may be paid from the DMA to the NLF at a time agreed as appropriate. However, there is no requirement for a payment to be made annually and as at the date of publication no such payment had occurred.

The DMO has a statutory requirement to maintain the value of its liabilities in the market at a value lower than its cash and cash equivalents; that is, the sum of its operating bank balance at the Bank of England and its over-night deposit with the National Loans Fund. This has been monitored over the accounting period and successfully achieved. At the balance sheet date, cash and cash equivalents in the DMA exceeded market liabilities by £8.7 billion.

### Structure and policy on operations

The DMO is legally and constitutionally part of HM Treasury, but as an Executive Agency, it operates at arms-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 DMO receives annual remits from HM Treasury covering both its debt and cash management operations. 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.

The gilts remit 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 would also provide the basis for the conduct of any switch, conversion or buy-back operations in a particular year. The cash remit provides information on the planned scale of Treasury bill issuance and by maturity. The remit includes a planned stock of Treasury bills at the end of the financial year.

Within the framework of the remits the DMO decides the size of gilt auctions and Treasury bill tenders and choice of gilts being auctioned.

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 web site at [www.dmo.gov.uk](http://www.dmo.gov.uk)

### **Developments subsequent to 31 March 2003**

During 2002-2003 asset managers continued to manage the DMO net cash position in accordance with the DMO's remit. The balance of funds in the asset book fell to £3.0 billion at the year-end. In view of the size and frequency of outflows from the cash book during the forthcoming financial year, it would be more cost-effective for the Exchequer to incorporate asset book funds into the cash book. As a consequence the asset book was wound up and the funds returned to the cash book during the financial year 2003-04.

The funds are now managed as part of the DMO core cash management operations.

## **Risk Management**

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### **DMO's Approach to Managing Risk**

The DMO attaches a high priority to risk management. It has developed a set of policies to limit 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. In this role he is assisted by functional teams and committees composed of members with the necessary experience and expertise to identify and evaluate the risks in question.

The main committees are:

#### **Credit and Risk Committee**

The committee defines the DMA's approach to the management of risk by setting policies that maintain a balance between risk appetite and business requirements. The remit of the DMO Credit and Risk Committee includes assessment of a broad range of risk areas.

#### **Audit Committee**

Chaired by a non-executive director, this committee meets on a quarterly basis to review the adequacy of the DMO's management of risk and internal controls. It also reviews the internal audit programme and examines completed internal and external audit reports. It considers their major findings and ensures that recommendations are implemented where necessary. The Audit Committee also considers whether management has established adequate arrangements to comply with regulatory and financial reporting requirements, and operational best practices where appropriate. To this end the Audit Committee also examines completed compliance monitoring reports.

### **Managing Committee**

This committee meets weekly to consider strategic and operational issues, taking advice as necessary from an Advisory Board composed of senior managers and non-executive directors. The Committee reviews periodically the DMO's strategic and operational risks, along with the policies for their effective management. Heads of business units report regularly to the Managing Committee on risk management issues in their areas.

Responsibility for day-to-day control is delegated to the business units to ensure that good risk management practices are embedded throughout the business. The business units are supported by a number of functions that ensure that senior managers and the DMO's key operational committees have appropriate information to fully understand the risks concerned; and to demonstrate that they are properly measured and prudently managed.

The main functions in this context are:

### **Risk Management Unit**

This unit provides a capability for the management of market and operational risk, and its reporting; and also for preparation of legal agreements with counterparties.

### **Internal Audit Function**

This function provides a full internal audit service including control systems advice as required, and audit reports on the adequacy and effectiveness of the DMO's internal controls and where applicable recommendations for improvement.

### **Compliance Function**

This function reviews key operations to assess the extent of compliance with plans, policies, procedures and legislation. The compliance reviews in the period have been focussed on scheduled debt and cash management operations, in particular Treasury bill tenders and gilt auctions.

Further details of the DMO's risk management processes are given in the Statement on Internal Control on pages 17 and 18.

## **Objectives and Policies for Holding and Issuing Financial Instruments**

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### **Debt Management Operations**

*"to carry out the Government's debt management policy of minimising financing costs over the longer term, taking account of risk"*

As the Government's debt manager, a key role of the DMO is as an issuer of gilt-edged securities. Gilts are issued on behalf of the Government. Although they are issued by the DMO, thereby passing through the DMA, they remain a liability of the NLF.

In its aim to reduce financing costs over the longer run, the Government seeks to minimise the net present value of its debt rather than the debt interest bill in the current year. The long-term nature of many debt instruments and the importance of an issuer's relationship with the debt markets require the Government to take debt management decisions with a longer-term perspective.

The reference to risk in the Government's debt management policy means that it 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 one is robust against different economic outcomes.

The main way in which the Government influences the composition of its debt portfolio is through the strategy of new issuance that it adopts each year. This sets the proportions of index-linked and conventional gilts and the pattern of issuance across different maturities. Except where there is a clear institutional preference, the Government is rarely in a position to know for certain that issuing one sort of gilt will prove cheaper than another. Therefore, the preferred strategy is to structure new issuance so that the debt portfolio will not expose Government to sharp fluctuations in its financing requirement and debt servicing costs under a range of possible economic outturns. As a consequence the portfolio has a mix of conventional and index-linked debt, as well as a diversity of maturities.

DMO advises HM Treasury to assist in its selection of an appropriate debt issuance strategy in its annual remit.

In addition to issuance, the DMO undertakes gilt transactions in the secondary market with the Gilt Edged Market Makers (GEMMs). Under an agreement with the DMO, the GEMMs provide a secondary market in all gilts and are the primary point of access for investors to the DMO's gilt auctions.

### **Cash Management Operations**

*“to manage the aggregate cash needs of the Exchequer in the most cost effective way”*

The cash management 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 specifies that the DMO is to carry out its cash management objectives primarily by a combination of the following activities:

- Regular weekly Treasury bill tenders;
- Bilateral dealing with DMO counterparties;
- Ad hoc tenders of Treasury bills (and repo or reverse repo transactions).

### **Specific Risks**

*Market Risk:* Management of market risk by the DMO takes account of the underlying objective for acquiring or holding the asset or liability position. The DMO is exposed to fluctuations in the market price of its holdings of securities over the short term. However, the DMO intends to hold to maturity, or over the long term, most of its holdings of securities. Where this is the case the DMO attaches a relatively low priority to containing this risk in the short-term where to do so would incur hedging costs. In other cases, the DMO's risk strategy takes account of the fact that some risk management actions may be inconsistent with the DMO's underlying objective, such as for example the promotion of an efficient and liquid market.

In addition, significant gains or losses will generally not be realised as a result of the DMO's dealing operations. This is because - as required under the statutory terms of its establishment - the DMA operates with a large proportion of its balance sheet assets represented by an over-night deposit with the NLF, thereby greatly reducing liquidity risk. Additionally, the risk of the DMA being unable to meet its liabilities as they fall due is strongly mitigated by the relationship between the DMA and the NLF, which allows at short notice for a further advance from the NLF to be drawn as operational activities require.

The DMO calculates interest rate sensitivity measures across its entire portfolio of financial instruments. In addition it regularly scenario tests relevant parts of the portfolio. At present the DMO does not undertake daily value at risk analysis of its portfolio. The DMO is currently developing its capability to apply a wider range of measures and analysis, and expects to have implemented daily value at risk measurement by early 2004.

The interest rate profile of all DMA assets and liabilities on 31 March 2003 is stated in the table below. (Items are allocated to time bands by reference to the earlier of the next interest rate repricing date and maturity date. Note that, for completeness, accrual items have been included in the analysis by reference to the next cash flow stemming from the asset or liabilities to which they relate).

### Maturity Profile

#### As at 31 March 2003

	0-3 months £m	3-6 months £m	6-9 months £m	9-12 months £m	1-5 years £m	Over 5 years £m	Non rate items £m	Total £m
<b>Assets</b>								
Cash and balances at central bank	319	-	-	-	-	-	-	319
Items in the course of collection	2	-	-	-	-	-	-	2
Loans and advances	6,997	-	-	-	-	-	-	6,997
Debt securities	2,306	107	363	28	3,411	6,744	-	12,959
Prepayment and accrued income	259	39	-	-	-	-	-	298
National Loans Funds - net financing	8,652	-	-	-	-	-	-	8,652
<b>Total Assets</b>	<b>18,535</b>	<b>146</b>	<b>363</b>	<b>28</b>	<b>3,411</b>	<b>6,744</b>	<b>-</b>	<b>29,227</b>
<b>Liabilities</b>								
Items in the course of transmission	(67)	-	-	-	-	-	-	(67)
Deposits	(6,062)	-	-	-	-	-	-	(6,062)
Debt securities in issue	(19,974)	(2,218)	-	-	-	-	-	(22,192)
Accruals and deferred income	(104)	-	-	-	-	-	-	(104)
Other liabilities	-	-	-	-	(15)	-	-	(15)
National Loans Funds - DMA surplus	-	-	-	-	-	-	(787)	(787)
<b>Total Liabilities</b>	<b>(26,207)</b>	<b>(2,218)</b>	<b>-</b>	<b>-</b>	<b>(15)</b>	<b>-</b>	<b>(787)</b>	<b>(29,227)</b>
<b>Maturity Gap</b>	<b>(7,672)</b>	<b>(2,072)</b>	<b>363</b>	<b>28</b>	<b>3,396</b>	<b>6,744</b>	<b>(787)</b>	<b>-</b>
	0-3 months £m	3-6 months £m	6-9 months £m	9-12 months £m	1-5 years £m	Over 5 years £m	All periods £m	
Cumulative Gap	(7,672)	(9,744)	(9,381)	(9,353)	(5,957)	787	-	

Active markets exist for the debt securities in the chart (gilts, Treasury bills, certificates of deposit and commercial paper) except for a small proportion of the DMO's gilt holdings represented by "rump" stocks and intergovernmental bonds. Rumps are specific gilts in which the DMO will be prepared to make a price if requested, but in which, because of the small nominal value outstanding, GEMMs are not required to make a market.

## Derivatives and Hedging

The DMA contains derivatives for hedging equity index risk and foreign currency risk.

*Foreign currency risk:* The DMA held Dollar and Euro commercial paper and certificates of deposit in the period. For each position the foreign currency risk of holding the security was hedged by perfectly matching its foreign currency cash flows with forward foreign exchange contracts agreed in parallel with the security purchase. Both the underlying security and the foreign exchange contract hedges are reported at market amount in the accounts.

Euro denominated government and supranational bonds were used as collateral for a significant proportion of the reverse repo lending to counterparties in the accounting period. The DMO's daily collateral margining operations include management of exposures resulting from changes in Euro-sterling exchange rates.

*Guaranteed Equity Bond:* The DMA held a number of equity derivatives in the period. These hedge an equity index exposure to government but one that is external to the DMA. NS&I began issuing GEB in March 2002 working in association with the DMO who hedged the equity index exposure.

Equity derivatives comprise two simple forward derivatives that address the risk features of the position being hedged – equity index risk and interest rate risk – and are both reported at market value. As at the balance sheet date the derivative represented a net liability with a market value of £15 million.

Because only the derivative is held in the DMA and not the underlying position being hedged, when viewed in isolation the DMA is exposed to equity index risk and interest rate risk over the life of the derivative as though the bond was held speculatively. But in a consolidated government view the exposure to equity index risk is negated.

## Accounting policies

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The accounts of the DMA for the period are drawn up on a UK GAAP basis as far as appropriate, to reflect best accounting practice in reporting on the DMA's activities. The accounts primarily reflect the results of transactions in activities that are carried out in ways and for purposes (though without an overall aim to make a profit) that make them comparable to those of a banking entity.

Accordingly, accounting requirements for banking entities form the basis of the DMA's Accounts Direction on page 32 and are reflected in its accounting policies on page 24 to 25. The effect is that, for example, securities held for trading purposes are marked to market and the related unrealised gains and losses are recognised as income and expenditure in the period.

## Preparation of the Accounts

The accounts have been prepared in accordance with a direction given by HM Treasury in pursuance of Schedule 5A of the National Loans Act 1968 (as amended by the Finance Act 1998). The text of the direction is reproduced on page 32 of this document. The accounts and supporting notes relating to the Debt Management Account for the period from 1 April 2002 to 31 March 2003 have been audited by the Comptroller and Auditor General.

ROBERT STHEEMAN  
Chief Executive and DMA Accounting Officer  
14 July 2003

## Statement of Accounting Officer's Responsibilities

Under Schedule 5A of the National Loans Act 1968 (as amended by the Finance Act 1998) the Treasury has directed the DMO to prepare a statement of the Debt Management Account for each period in the form and on the basis set out in the accounts direction on page 32 of these financial statements. The accounts are prepared on an accrual basis and must give a true and fair view of the operations of the Debt Management Account at the year-end and of its income and expenditure, total recognised gains and losses and cash flows for the financial year.

In preparing accounts the agency is required to:

- *observe the accounts direction issued by the Treasury, including the relevant 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 financial statements;*
- *prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the account will continue in operation.*

The Accounting Officer of HM Treasury has designated the Chief Executive of the Debt Management Office as the Accounting Officer for the Debt Management Account. His relevant responsibilities as Accounting Officer, including his responsibility for the propriety and regularity of the public finances and for the keeping of proper records, are set out in the Accounting Officers' Memorandum, issued by HM Treasury and published in "Government Accounting".

ROBERT STHEEMAN  
Chief Executive and DMA Accounting Officer  
14 July 2003

## Statement on Internal Control

As Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of the UK Debt Management Account's targets, policies and objectives set by Treasury Ministers, whilst safeguarding the public funds for which I am personally responsible, in accordance with the responsibilities assigned to me in "Government Accounting". I also have responsibility for reviewing the effectiveness of the system of internal control.

The system of internal control is designed to manage rather than eliminate the risk of failing to achieve targets, policies and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness.

The system of internal control is under continual review and development. It is designed to identify the principal risks to the achievement of the Office's targets, policies and objectives, to evaluate the nature of and extent of those risks and to manage them efficiently, effectively and economically. This process accords with Treasury guidance and has been operational from October 2000.

The system of internal control includes the following components:

1. The DMO has a robust corporate governance management structure comprising:
  - *An Advisory Board which meets monthly to consider the plans and strategic direction of the DMO ;*
  - *A Managing Committee which meets weekly to consider strategic and operational issues, referring key issues to the Advisory Board where necessary;*
  - *Cash Strategy, Debt Strategy, Investment, and Credit and Risk Committees;*
  - *An Audit Committee chaired by a non-executive director, which meets on a quarterly basis to review the adequacy of the DMO's management of risk and internal controls.*
2. Establishment of business objectives supported by regular review of business priorities and targets. Development and refinement of performance indicators and monitoring capabilities is an on-going process.
3. An internal audit function complying with the Government Internal Audit Standards. Internal audit reports provide an opinion on the adequacy and effectiveness of the DMO's internal control systems and where applicable contain recommendations for improvement. Delivery of audit recommendations is monitored and regularly reported to Managing Committee and Audit Committee.
4. Management in each business function is responsible for ensuring that the operations within their area are compliant with plans, policies, procedures and legislation. Compliance testing is a component of each functional review undertaken by Internal Audit. The frequency and scope of reviews for each functional area is determined by Internal Audit by an annual review of risk priorities across the DMO, and approved by Managing Committee.
5. The DMO's Debt and Cash Management activities are covered by procedure and control manuals. These include requirements for segregation of duties, authorisation and responsibility limits, and checklists for certain set piece activities along with reconciliation and other periodic control checks. Procedure and control manuals are maintained on an ongoing basis and are subject to a full review annually to ensure they remain relevant, comprehensive and up to date.
6. A risk management function 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.
7. Presentations have been held with all staff on the DMO's risk management framework. All members of staff have job descriptions, including specific key risks to be addressed.

8. A high level risk and controls register has been produced by senior management. Risk workshops have been held with all business units to ensure that key operational risks have been identified, together with an assessment of the adequacy of controls in place to manage these risks. Heads of business units assess regularly whether risks to their operations are being managed effectively. New risks, and risks where there is an increased likelihood of occurrence, are highlighted and actions identified to ensure all risks will be effectively managed. This process is supported by the maintenance of exception logs, which identify control weaknesses and resultant actions to improve controls. Key risks and exceptions are documented in a regular report produced by the Risk Management Unit for Managing Committee.
9. A mechanism for approving and prioritising the DMO's programme of projects has been established. This enables tracking and regular review of the progress of projects by Managing Committee. Improved controls are being introduced progressively in the DMO's management of its project programme. Further enhancements will shortly be established, including highlighted tracking of the projects essential for business plan delivery, amplified management accountability for delivery and, on a frequent basis, exception reporting against project plan to highlight project slippage to Managing Committee.
10. The DMO's Business Continuity Plan (BCP), including disaster recovery site and other arrangements, is subject to continual review and update. Testing of some elements of the BCP was undertaken in the year.
11. The DMO is currently developing its portfolio risk management capability to apply a wider range of analysis and measures. Implementation of a system to deliver daily value at risk measurement is expected to be one of these.
12. The DMO has policies on anti-fraud and whistle blowing. Seminars have been held to raise staff awareness of these issues.
13. In establishing controls to deter money laundering the DMO has followed best practice, guidance in the Financial Services Authorities handbook and the joint money laundering steering group.

My review of the effectiveness of the system of internal control is informed by the development and maintenance of the internal control framework by management within the DMO, the work of the DMO's internal audit team, and comments made by the external auditors in their management letter and other reports.

ROBERT STHEEMAN  
Chief Executive and DMA Accounting Officer  
14 July 2003

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

I certify that I have audited the financial statements on pages 21-31 under Schedule 5A of the National Loans Act 1968 (as amended by the Finance Act 1998). These financial statements have been prepared under the historical cost convention as modified by the revaluation of certain investments and the accounting policies set out on pages 24 to 25.

### Respective responsibilities of Accounting Officer and Auditor

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As described on page 16, the Accounting Officer is responsible for the preparation of the financial statements in accordance with Schedule 5A of the National Loans Act 1968 (as amended by the Finance Act 1998) and Treasury directions made thereunder and for ensuring the regularity of financial transactions. The Accounting Officer is also responsible for the preparation of the other contents of the Report. My responsibilities, as independent auditor, are established by statute and guided by the Auditing Practices Board and the auditing profession's ethical guidance.

I report my opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with Schedule 5A of the National Loans Act 1968 (as amended by the Finance Act 1998) and Treasury directions made thereunder, and 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. I also report if, in my opinion, the Foreword is not consistent with the financial statements, if the Debt Management Office has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit.

I read the other information contained in the report and consider whether it is consistent with the audited financial statements. I consider the implications for my certificate if I become aware of any apparent misstatements or material inconsistencies with the financial statements.

I review whether the statement on pages 17 to 18 reflects the Debt Management Office's compliance with Treasury's guidance 'Corporate governance: statement on internal control'. I report if it does not meet the requirements specified by Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements.

### Basis of audit opinion

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I conducted my audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Debt Management Office in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Debt Management Office'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 error, or by fraud or other irregularity 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 have also evaluated the overall adequacy of the presentation of information in the financial statements.

## Opinion

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In my opinion:

- the financial statements give a true and fair view of the state of affairs of the Debt Management Account as at 31 March 2003 and of the surplus and cash flows for the year then ended and have been properly prepared in accordance with Schedule 5A of the National Loans Act 1968 (as amended by the Finance Act 1998) and directions made thereunder by Treasury; and
- 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.

I have no observations to make on these financial statements.

JOHN BOURN  
Comptroller and Auditor General  
15th July 2003

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

## Income and Expenditure Account

### For the year to the 31 March 2003

		2002-2003	2001-2002
	Note	£m	£m
Interest Receivable	2	1,034	1,052
Interest Payable	3	(932)	(479)
<b>Net interest revenue</b>	5	<b>102</b>	<b>573</b>
Dealing profits	4	469	(250)
<b>Operating surplus/(deficit)</b>		<b>571</b>	<b>323</b>
Net NLF interest receivable/(payable)	15b	164	(435)
<b>Retained Surplus/(Deficit)</b>		<b>735</b>	<b>(112)</b>

All income and expenditure arose from continuing operations.

No separate statement of total recognised gains or losses has been prepared, as there are no recognised gains or losses other than those included in the statement above.

The notes on pages 24 to 31 form part of these accounts.

## Balance Sheet

### As at 31 March 2003

	Note	2003 £m	2002 £m
<b>Assets</b>			
Cash and balances at the Bank of England	15d	319	142
Items in the course of collection		2	1,722
Loans and advances	8	6,997	7,193
Debt securities	9	12,959	10,848
Prepayments and accrued income	6	298	256
National Loans Funds - net financing	14	8,652	(3,959)
<b>Total Assets</b>		<b>29,227</b>	<b>16,202</b>
<b>Liabilities</b>			
Items in the course of transmission		(67)	(79)
Deposits	10	(6,062)	(2,284)
Debt securities in issue	11	(22,192)	(13,666)
Accruals and deferred income	7	(104)	(121)
Other liabilities	12	(15)	-
National Loan Funds - DMA surplus	13	(787)	(52)
<b>Total Liabilities</b>		<b>(29,227)</b>	<b>(16,202)</b>

The notes on pages 24 to 31 form part of these accounts.

**Robert Stheeman**  
**Chief Executive and Agency Accounting Officer**  
**14 July 2003**

## Cash Flow Statement

### For the year to the 31 March 2003

	<b>Note</b>	<b>2003 £m</b>	<b>2002 £m</b>
Net cash flow from operating activities	15a	12,624	8,613
Returns on investments and servicing of finance	15b	164	(435)
<b>Net cash flow before financing</b>		<b>12,788</b>	<b>8,178</b>
Financing	15c	(12,611)	(8,482)
<b>Increase/(Decrease) in cash</b>		<b>177</b>	<b>(304)</b>

The notes on pages 24 to 31 form part of these accounts.

## Notes to the Accounts for Year Ended 31 March 2003

### 1. Accounting Policies

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#### **(i) Accounting convention**

The accounts have been prepared under the historical cost convention modified by the inclusion of certain investments at valuation. The DMA's financial statements have been prepared in accordance with the Accounts Direction given by HM Treasury. Although the DMA's financial statements are not subject to the requirements of the Companies Acts, and are not technically those of a bank, they have also been prepared in accordance with the provisions of Schedule 9 of the Companies Act 1985 where relevant, and in accordance with applicable Accounting Standards and Statements of Recommended Practice in so far as they are appropriate to the DMA.

#### **(ii) Valuation of securities (bills, gilts and other debt securities)**

All securities, except bills held by the DMA are included in the balance sheet at their market value.

Bills issued by the DMA are included in the balance sheet at their issue price as adjusted to take account of the amount of discount amortised on these securities as at the balance sheet date.

In accordance with the practice agreed with the NLF any stock which remains uncovered at gilt auction is purchased by the DMA. For conventional gilts, the DMA purchases the uncovered stock at the lowest price accepted at the auction. For index-linked gilts the DMA purchases the uncovered stock at the average price achieved at the auction.

#### **(iii) Sale and repurchase transactions (repos and reverse repos)**

Securities, which have been sold with an agreement to repurchase (repo), continue to be shown on the balance sheet and the sale proceeds recorded as a deposit. Securities acquired in reverse sale and repurchase transactions are not recognised in the balance sheet and their 'purchase' price is treated as a loan receivable. The difference between the sale price and repurchase price is accrued evenly over the life of the transaction and charged or credited to the operating statement as interest payable or receivable.

#### **(iv) Gains and losses on trading operations**

Gains and losses on trading activities are calculated as the difference between sale proceeds (net of interest) being applied against the cost of each stock. Transaction related costs are not applied to recognised gains and losses on trading as these are accounted for separately through the DMO's agency accounts.

Any gains or losses realised in the subsequent sale of stock purchased from the uncovered gilt auctions are recognised within the DMA.

#### **(v) Income recognition**

Income is recognised within the accounts on the following basis:

- Realised gains and losses on trading activities are taken to the operating statement in the period in which they arise.
- Gains and losses arising on the repurchase or early settlement of DMA issued Treasury bills are recognised in the operating statement in the period during which the repurchase or early settlement is made.
- Valuation gains and losses on dealing securities are treated on par with realised gains and losses arising and are recognised through the operating statement as part of dealing profits (losses) and included within the carrying value of those securities.

The proceeds received from the auction of gilts are on behalf of the NLF, and as such are not recognised within the DMA.

**(vi) Administration expenditure**

The accounts reflect the activity through, and the financial position of, the DMA. The DMA primarily represents a fund through which the DMO's cash and debt management operational trading activities pass. Administration and staffing costs together with direct trading related costs such as auction costs and stock exchange listing fees are not accounted for through the accounts of the DMA, but instead are shown in the DMO's agency accounts which are audited and published separately. On this basis the DMA's operating statement only shows stock related gains, deficits and other movements, and associated costs of financing.

**(vii) Funding related costs**

Funding provided by the National Loans Fund (NLF 'advance') to the DMA is subject to a cost of capital charge. The interest rate applied on the outstanding advance from the NLF is based on the Bank of England's repo rate. The interest rate applied to the DMA's deposit with the NLF is also based on this repo rate.

**2. Interest Receivable**

	<b>2002-2003</b>	<b>2001-2002</b>
	<b>£m</b>	<b>£m</b>
Debt securities		
- Gilt-edged securities	653	483
- Other securities	117	146
	<b>770</b>	<b>629</b>
Reverse sale and repurchase transactions	248	408
Interest received on deposits	16	15
	<b>1,034</b>	<b>1,052</b>

**3. Interest Payable**

	<b>2002-2003</b>	<b>2001-2002</b>
	<b>£m</b>	<b>£m</b>
Discounts on issue of bills	(757)	(359)
Interest and similar charges on sale and repurchase transactions (repos)	(163)	(112)
Interest payable on deposits by banks	(12)	(8)
	<b>(932)</b>	<b>(479)</b>

#### 4. Dealing Profits

	<b>2003 £m</b>	<b>2002 £m</b>
British government securities	482	(237)
Other securities	2	(13)
Equity derivatives	(15)	-
	<b>469</b>	<b>(250)</b>

#### 5. Segmental Analysis of Net Interest Revenue

##### For the year to the 31 March 2003

	<b>Total £m</b>	<b>Asset Management £m</b>	<b>Cash Management £m</b>	<b>Debt Management £m</b>	<b>Interbook Trading £m</b>
Debt securities	770	87	680	3	-
Reverse sale and repurchase transactions	248	125	123	-	-
Interest received on deposits	16	2	9	-	5
<b>Total Interest Receivable</b>	<b>1,034</b>	<b>214</b>	<b>812</b>	<b>3</b>	<b>5</b>
Discounts in issue of bills	(757)	-	(757)	-	-
Sale and repurchase transactions (repo)	(163)	-	(163)	-	-
Interest payable on deposits	(12)	-	(7)	-	(5)
<b>Total Interest Payable</b>	<b>(932)</b>	<b>-</b>	<b>(927)</b>	<b>-</b>	<b>(5)</b>
<b>Net Interest Revenue</b>	<b>102</b>	<b>214</b>	<b>(115)</b>	<b>3</b>	<b>-</b>

#### 6. Prepayments and accrued income

	<b>2003 £m</b>	<b>2002 £m</b>
Accrued coupon interest	168	137
Accrued interest on NLF deposit	120	102
Accrued interest on reverse repo	9	16
Accrued interest on bank deposit	1	1
	<b>298</b>	<b>256</b>

## 7. Accruals and Deferred Income

	<b>2003</b> <b>£m</b>	<b>2002</b> <b>£m</b>
Accrued interest - repos	(2)	(2)
Accrued interest - NLF advance	(102)	(119)
Accrued interest - deposits	-	-
	<b>(104)</b>	<b>(121)</b>

## 8. Loans and Advances

<b>Loans and advances - remaining maturity</b>	<b>2003</b> <b>£m</b>	<b>2002</b> <b>£m</b>
3 months or less	6,997	7,193

All loans are secured with government or supranational securities under sale and repurchase agreements.

## 9. Analysis of Debt Securities

<b>9a. Debt securities (at market value)</b>	<b>2003</b> <b>£m</b>	<b>2002</b> <b>£m</b>
British government securities	11,845	7,877
Other securities	1,114	2,971
	<b>12,959</b>	<b>10,848</b>

Other securities also include foreign denominated commercial paper. Foreign currency risk associated with the holding of foreign denominated securities is fully hedged through forward foreign exchange contracts. These forward contracts are included in the market values disclosed above.

<b>9b. Debt securities (maturity analysis)</b>	<b>Nominal</b> <b>£m</b>	<b>Market Value</b> <b>£m</b>
In not more than 3 months	2,299	2,307
In more than 3 months but not more than 1 year	483	497
In more than 1 year but not more than 5 years	3,110	3,411
Over 5 years	5,743	6,744
	<b>11,635</b>	<b>12,959</b>

## 10. Deposits

	<b>2003 £m</b>	<b>2002 £m</b>
Repo	(5,927)	(2,284)
Cash deposits	(135)	-
	<b>(6,062)</b>	<b>(2,284)</b>

Deposits largely relate to repo transactions secured by marketable securities. All deposits had a maturity of 3 months or less, but none were repayable on demand.

Securities that have been 'sold' with an agreement to repurchase (repo) continue to be shown within stock totals.

The market value of securities used to secure the deposits was £5,932m (nominal value £5,120m) at the balance sheet date.

## 11. Debt Securities in Issue

	<b>2003 £m</b>	<b>2002 £m</b>
Bills	(22,192)	(13,666)

The market value of bills held was £22,193m (£13,662m in 2001-2002). All Treasury bills in issue had a remaining maturity of 6 months or less.

## 12. Other Liabilities

	<b>2003 £m</b>	<b>2002 £m</b>
Equity derivatives	(15)	-

The Equity derivatives hedge the Exchequer's exposure to equity index and interest rate risk resulting from GEB issued by National Savings & Investments.

### 13. National Loans Fund - DMA Surplus

	<b>2003</b>	<b>2002</b>
	<b>£m</b>	<b>£m</b>
As at 31 March 2002	(52)	(164)
Retained surplus/deficit in period	(735)	112
Amount paid to NLF	-	-
<b>As at 31 March 2003</b>	<b>(787)</b>	<b>(52)</b>

DMA operating surpluses and deficits are an asset or liability of the NLF respectively. All or part of any DMA surplus created may be paid to the NLF, which accordingly reduces the liability of the DMA to the NLF.

### 14. NLF Advance and Deposit

	<b>NLF Deposit</b>	<b>NLF Advance</b>	<b>Net NLF</b>
	<b>£m</b>	<b>£m</b>	<b>Financing</b>
			<b>£m</b>
Net position as at 31 March 2002	31,041	(35,000)	(3,959)
Advance from NLF to DMA	-	-	-
Repayments of NLF advance by DMA	-	7,000	7,000
Net Change in DMA Deposit with NLF	5,611	-	5,611
<b>Balance c/f at 31 March 2003</b>	<b>36,652</b>	<b>(28,000)</b>	<b>8,652</b>

### 15. Analysis of Cash Flow

#### 15a Reconciliation of Operating Profit to Net Cash Flow from Operating Activities

	<b>2002-2003</b>	<b>2001-2002</b>
	<b>£m</b>	<b>£m</b>
Operating surplus	571	323
(Increase)/Decrease in items in the course of collection	1,720	(1,125)
(Increase)/Decrease in loans and advances	196	5,396
(Increase)/Decrease in debt securities	(2,111)	(882)
(Increase)/Decrease in prepayments and accrued income	(42)	204
Increase/(Decrease) in items in the course of transmission	(12)	(41)
Increase/(Decrease) in deposits	3,778	(729)
Increase/(Decrease) in debt securities in issue	8,526	5,570
Increase/(Decrease) in accrual and deferred income	(17)	(103)
Increase/(Decrease) in other liabilities	15	-
<b>Net cash flow from operating activities</b>	<b>12,624</b>	<b>8,613</b>

**15b. Return on investments and servicing of finance**

	<b>2002-2003</b> <b>£m</b>	<b>2001-2002</b> <b>£m</b>
Interest on NLF advance	(1,384)	(1,631)
Interest on NLF deposit	1,548	1,196
	<b>164</b>	<b>(435)</b>

**15c. Financing**

	<b>2002-2003</b> <b>£m</b>	<b>2001-2002</b> <b>£m</b>
Net increase/(decrease) in advance from NLF	(7,000)	-
Net increase/(decrease) in deposit with NLF	(5,611)	(8,482)
	<b>(12,611)</b>	<b>(8,482)</b>

**15d. Analysis of cash balances**

	<b>2003</b> <b>£m</b>	<b>Movement</b> <b>£m</b>	<b>2002</b> <b>£m</b>
Cash and balances at the Bank of England	319	177	142

**16. Gilt Issuance**

	<b>2003</b> <b>£m</b>	<b>2002</b> <b>£m</b>
Nominal value of gilts on behalf of the NLF	24,650	11,825
Proceeds paid to the NLF	26,275	13,656
Nominal value of uncovered stock purchased from the NLF	74	-

The uncovered stock purchased from the NLF was from the auction of 2% Index-Linked 2035 held on the 25 September 2002. This stock was sold through a mini-tender on 14 November 2002.

## 17. Related party transactions

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### **(i) HM Treasury**

The DMO is an Executive Agency of HM Treasury; activities through the DMA therefore are undertaken on behalf of HM Treasury. HM Treasury and the DMO are therefore related parties.

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 DMO, which have been funded through the HM Treasury vote relating to DMO administration expenditure, and accounted through the DMO Agency accounts:

- Payroll, purchasing and various administrative services.

### **(ii) National Savings & Investments**

National Savings & Investments began issuing GEB in March 2002 in association with the DMO who hedged the equity index and interest rate exposure.

### **(iii) DMO Managing Committee and Senior Managers**

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

## 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 period ending 31 March 2001 and each subsequent financial year comprising:
  - (a) A foreword
  - (b) A statement of Accounting Officer's responsibilities
  - (c) A statement on the system of internal control
  - (d) An income and expenditure account
  - (e) A statement of total recognised gains and losses
  - (f) A balance sheet
  - (g) A cash flow statement
  - (h) Notes to the accounts
2. The accounts shall 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 and the Statements of Recommended Practice issued by the British Bankers' Association and the Irish Bankers' Federation.
3. The accounts shall also be consistent with relevant requirements of the Resource Accounting Manual, except to the extent set out in Appendix A and shall meet the extra information requirements set out in Appendix B.
4. This Accounts Direction shall be reproduced as an Appendix to the Accounts.

David Loweth  
Head of Central Accountancy Team  
HM Treasury  
11 December 2001

## Appendix A

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### APPLICATION OF THE RESOURCE ACCOUNTING MANUAL

#### Background

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1. The Debt Management Account reflects activity that more closely resembles that of a bank than that of an entity covered by the Resource Accounting Manual (RAM). Accordingly, 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 – Summary of Resource Outturn, and Schedule 5 – Resources by Departmental Aim and Objective, are also not relevant.
2. In other respects, the accounts shall be consistent with relevant requirements of the RAM except in so far as is necessary to reflect the special requirements stated below.

#### Income and expenditure account

3. Segmental information shall be given where appropriate, inclusive of separate classes of business.

#### Balance sheet

4. Subject to paragraphs 6 to 8 below, investments shall be valued at market price or at an appropriate estimate of market or fair value.
5. Interests in securities maintained for the purposes of hedging shall be carried at a value that properly reflects the hedge.
6. Investment securities, being securities held for use on a continuing basis in the activities in the Account, shall be carried at cost as adjusted for:
  - a. the amortisation of the premium or discount representing the premium or discount between cost and the redemption proceeds, for redeemable securities;
  - b. any diminution in their value that is expected to be other than temporary;
  - c. translation differences where the investment securities are denominated in foreign currencies.
7. Advances and loans shall be carried at cost less appropriate provision for doubtful debts.
8. All movements in values of investments shall be reflected in the income and expenditure account, including translation differences arising in relation to investment securities denominated in foreign currencies.

#### Cash Flow Statement

9. The return on investments and servicing of finance will form a separate line in the cash flow statement.

## Appendix B

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### EXTRA INFORMATION REQUIRED TO BE DISCLOSED

1. In addition to meeting appropriate requirements of the Companies Act, the banking SORPs and the Resource Accounting Manual, the following extra information shall be disclosed, including an order to facilitate the preparation and consistency of Whole of Government Accounts.

### Foreword

2. The foreword 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) An operating and financial review:
    - i) meeting relevant requirements of the Accounting Standards Board's Statement and the narrative disclosure requirements of FRS 13, "Derivatives and other financial instruments - disclosures" for banks and similar institutions; 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
    - iv) Operating costs
  - (d) Disclosure of income and expenditure, and assets and liabilities, relating to other central government funds, including the National Loans Fund, including analyses by funding purpose;
  - (e) Disclosures meeting the requirements of FRS 13, "Derivatives and other financial instruments – disclosures" as applying to banks and similar institutions, including numerical disclosures about interest risk, currency risk, fair values, and financial instruments used for trading (including information on the market price risk of the trading book).







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