United Kingdom
Debt
Management
Office

Annual Report and Accounts

1998 | 1999

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The *United Kingdom*
Debt Management Office
is an Executive Agency of
HM Treasury

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Cheapside House
138 Cheapside
London EC2V 6BB

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Presented to Parliament in Pursuance of the Exchequer and Audit Departments Act 1921
Ordered by the House of Commons to be printed 29 October 1999

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HC 805

London: The Stationery Office

£9.65

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Chief Executive's Foreword

1998-99 was a year of substantial achievement by the DMO.

The office was formally established on 1 April 1998 when it took over its debt management responsibilities from the Bank of England. This target date was met only with a major effort both from staff in the DMO and from colleagues in HM Treasury, the Bank of England and elsewhere.

The formation of the DMO did not of itself signal a change in the debt management policy framework that had applied to the Bank of England. We have maintained the momentum of the reforms flowing from the Debt Management Review of 1995. But we have benefited from our status as an executive agency, which has allowed us both to establish our own presence in the gilts market and to respond to market pressures and developments. Although legally and constitutionally part of HM Treasury, executive agency status gives the DMO day-to-day operational independence within the parameters laid down by the Chancellor of the Exchequer in our annual remit.

The DMO's key achievements are highlighted on the pages that follow. We met the Chancellor's remit; conducted all auctions successfully; introduced auctions for index-linked gilts; developed a new relationship with the gilt-edged market makers, infrastructure providers and regulators; completed three conversion offers; followed through convention changes; and published a wide range of material, both statistical and operational.

As well as responsibility for debt management, the DMO is to take over responsibility for cash management – the management of the market impact of the Exchequer's daily cash flow. The development of our policy, and designing and procuring the internal processes and systems, was a major task throughout 1998-99, and continues so to be. The launch of the new Debt Management Account (DMA), through which all our transactions will pass, and which marks the start of the transition to cash management, is planned for November 1999, with the DMO taking full responsibility at the end of the financial year.

Among the DMO's key values have been the importance of looking outward: to consult and listen; to respond to criticism and ideas; and to be willing to explain. I have been encouraged by the positive and business-like reception given to the DMO by many firms in the market and their representative bodies. We will build on this; and it will play an important role in meeting the challenges of 1999-2000 and beyond. Of these I would highlight two: the successful introduction of cash management; and responding to the pressures on liquidity in the market occasioned by low issuance.

Equally important to me has been the response from the DMO's own staff. At its start the DMO only had 25 people, rising now to 35 or more. We had little time to pull together a team with very different backgrounds. Management, personnel and finance policies and systems have had to be put in place as the year progressed; and there remains much to be done. Systems development work has added to out of hours commitments. But no one has let that get in the way of meeting our targets and our responsibilities to the market. I am enormously grateful to other members of the DMO's executive team and to the staff as a whole for their professional and personal response to the DMO's first year of operation.

Mike Williams
29 October 1999

Open for business

Achievements and Highlights of the Year

- DMO established on 1 April 1998.
- Successful adherence to our 1998-99 remit from Chancellor of the Exchequer.
- Auction targets met; three conversions completed.
- Index-linked gilts (IG) auctions established; and introduction of IG market makers.
- New Operational Market Notice.
- Review (with Stock Exchange) of the role of inter-dealer brokers.
- Successful transition to decimalisation and actual/actual accrued and yield calculations conventions.
- Publication of annual and quarterly review; and retail gilts brochure (with Bank of England); website established.
- Policy documents published on cash management and conversions.
- All published targets met, except those relevant to cash management which will not be in full operation until around the end of 1999-2000.

6 May 1998

The DMO is officially opened by the then Economic Secretary to the Treasury Helen Liddell, pictured here with Eddie George, (Governor of the Bank of England), Mike Williams (Chief Executive of the DMO), and Sir Terry Burns (then Permanent Secretary to the Treasury)

Performance against targets

Performance Against Targets

The DMO had a successful first year. The work done to set up the DMO, in close liaison with the Bank, facilitated a close to “seamless” transition of gilt market responsibilities from the Bank to the DMO on 1 April 1998. The DMO’s first auction was later that month, and a successful tap issue was made on 3 April 1998. As set out in detail below, the DMO achieved its remit, and met its published targets (except those related to cash management which has proven to be a much more substantial project than expected). In addition the DMO successfully continued the conversions programme, and took forward the programme of reforms already initiated by the Bank and Treasury.

Target 1

To ensure full compliance with the Government’s remit for the issuance of debt to finance the Central Government Net Cash Requirement as set out in the Debt Management Report within the tolerances and subject to the review triggers notified separately to the office.

This was achieved throughout the year.
Account was taken of revisions to the remit, following publication of lower than originally predicted gilt financing requirements in both the Economic and Fiscal Strategy Report in June 1998 and the Pre-Budget Report in November 1998. This resulted in a reduction in the number of scheduled gilt auctions from six to four. The transition to issuance of index-linked gilts by auction as opposed to “tap” issues was successfully achieved. Benchmark stocks were built up by means of three conversion offers. The amount in issue of 6½% 2003 was increased by £6 billion and 5¾% 2009 by £3½ billion. Regular monthly reports on progress throughout the year in meeting the remit have been delivered to HM Treasury.

Target 2

To reduce the maximum time taken to issue the results of conventional gilt auctions from 45 minutes to 40 minutes whilst achieving complete accuracy.

This was achieved for all four gilt auctions held in 1998-99.
The reporting times have been:

May 1998	37 minutes
July 1998	38 minutes
November 1998	33 minutes
January 1999	37 minutes

Target 3

To establish the system for managing the Exchequer's aggregate cash position which achieves cost-effective financing and is error free, properly conducted, legally sound and subject to minimal credit risk (to the satisfaction of an external assessor) by January 1999.

Achievement of this target was agreed to be unrealistic in the course of the year.
An appropriate alternative target has been agreed for 1999-2000.

Target 4

To achieve complete accuracy, within agreed accounting tolerances, in the recording of transactions, delivering money to the NLF and the reports of the Debt Management Account.

This target will not come into play until the DMA is up and running.

Target 5

To acknowledge all letters from the public within two weeks and for at least 95 per cent to be sent a substantive reply within four weeks.

This target was achieved,
with the number of letters received rising noticeably in the second half of the year as the DMO's profile was raised, particularly as a result of conversion offers. Thirteen letters were received in the first half of the year and 73 in the second. Only two letters required holding responses (pending further research) with substantive replies subsequently being sent within the above timeframe.

Target 6

To achieve less than 12 breaches of the operational market notice (excluding any breaches which the Treasury accept were beyond the control of the office).

There was no breach of the operational market notice in 1998-99.

Target 7

To ensure that the qualifications that the NAO have made in respect of the Gilt-edged Official Operations Account are satisfactorily addressed in the running and presentation of the Debt Management Account.

This target will not come into play until the DMA is up and running.

The DMO in 1998-99

Background

The DMO was established on 1 April 1998, with the aim "…. to carry out the Government's debt management policy of minimising financing costs over the longer term, taking account of risk, and to manage the aggregate cash needs of the Exchequer in the most cost-effective way."

In institutional terms, 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 financial 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 separate responsibilities of the Chancellor and other Treasury Ministers, the Permanent Secretary to the Treasury, and the DMO's Chief Executive are set out in a "Framework Document" that was published at the end of March 1998 just before the DMO was formally established. The Framework Document also sets out the DMO's objectives and its Chief Executive's lines of accountability. The Chief Executive is accountable to Parliament for the DMO's performance and operations, in respect of both the office's administrative costs and the Debt Management Account - the warehousing and trading account being established to handle both debt and cash management operations. The DMO's annual remit is set out in the Debt Management Report; the most recent was published in March 1999. More information on the DMO's objectives and activities, as well as its latest published targets, is in the DMO's Corporate Overview and Business Plan, 1999-2000.

The DMO took over responsibility from the Bank of England for debt management - issuance of gilts and management of the gilts market - on its establishment in April 1998. It will take over cash management - management of the market impact of the Exchequer's daily cash flow - at around the end of 1999-2000. During the DMO's first year of operation it comprised some 25 staff, with administrative expenditure of around £3 million; both figures will increase somewhat in the course of 1999-2000. The Bank of England continues to supply settlement and gilt registration services. The DMO is located in Cheapside in the City of London.

Strategic Objectives

The DMO's strategic objectives for 1998-99 were:

- To meet the remit set annually by Treasury Ministers for the sale of gilts, with high regard to long term cost minimisation.
- To provide a high quality efficient service to primary dealers and investors in gilts, consistent with achieving low cost issuance.
- Once the office takes over responsibility for cash management, to provide for the daily aggregate cash needs of the Exchequer in an efficient and cost effective manner.
- To promote a liquid market for gilts and conduct operations in a predictable transparent way with a view to reducing the overall cost of financing.
- To act as sponsor of the gilts market, liaising with the Bank of England, Financial Services Authority, London Stock Exchange and LIFFE, so that the market is healthy, orderly and well-regulated, to meet the issuer's needs.
- To advise Treasury Ministers on setting the remit to meet the Government's debt management objectives.
- To provide policy advice to Treasury Ministers and senior officials on new instruments and structural changes to the gilt market that will help to lower the cost of debt management.

The office will be resourced, staffed and managed to deliver its objectives effectively and efficiently, and it will operate in accordance with the principles of the Citizen's Charter.

Review of activities

DMO Executive Board
From left to right:
Jo Whelan (Head of Markets), Mike Ness (Cash Management Policy Adviser), Dave Curtis (Head of Business Services), Paul Mills (Head of Policy and Analysis) and Hamish Watson (Chief Gilts Dealer) David Courts (Finance and Systems), joined the board in 1999-2000.

1. Market Background

Nominal and real gilt yields fell markedly over the 1998-99 financial year, as global interest rates fell.

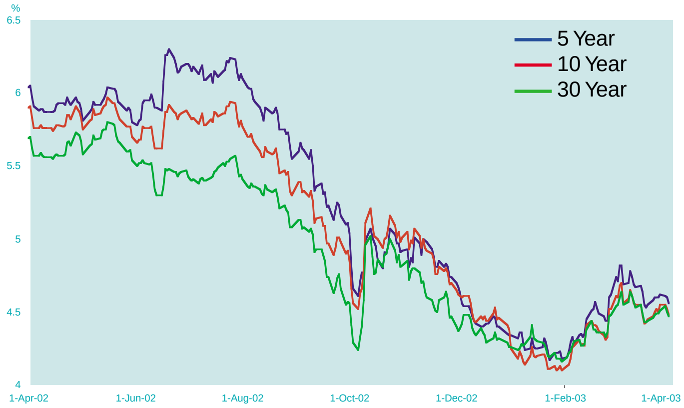


Chart 1
UK conventional benchmark gilt yields 1998-99

Source: DMO

The year began with gilt yields broadly stable, albeit with an upward spike in June as the Bank of England's Monetary Policy Committee (MPC) increased interest rates to 7.5%. The increase was in response to stronger than expected labour market data and perceived inflationary pressures (the RPIX rate announced in June was 3.2% against the MPC target of 2.5%). This was, however, the last increase in that interest rate cycle.

The flight of capital from East Asia and Russia gathered momentum in June and by July major government bond yields had started a decline. This fall was accelerated after the Russian devaluation of the rouble and the imposition of a 90-day debt moratorium.

Gilt yields continued to fall through the summer, although until September there was some market nervousness that MPC might have to increase UK rates again in response to continuing robust labour market data. But other data increasingly indicated a domestic and international economic slowdown. Japanese interest rates were cut in early September and US rates fell by 0.25% to 5.25% on 29 September. On 8 October MPC cut UK rates by 0.25% to 7.25%.

A sudden reversal of yields in the second half of October was caused by the liquidation of holdings in response to global economic difficulties. Governments and central banks around the world responded by reducing interest rates. MPC reduced UK rates in five successive meetings from October 1998 to February 1999 by 2.0% to 5.5% and gilt yields fell accordingly. By January 1999 gilt yields had reached their lowest levels since the 1950s.

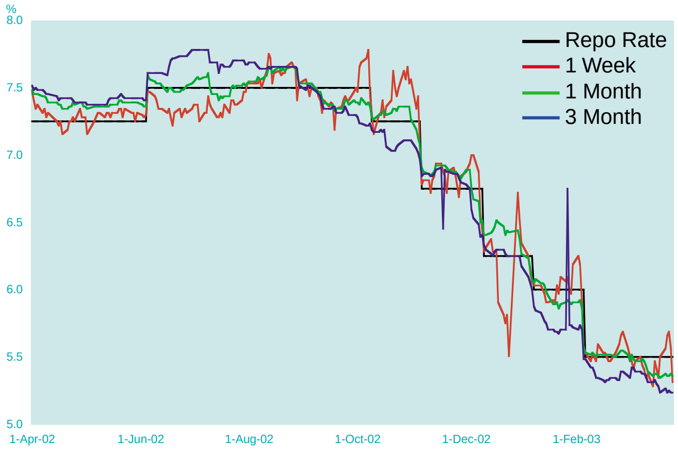


Chart 2
UK Interest rates 1998-99

Source: Bank of England

The close of the financial year saw yields increase slightly from their year lows as signs of economic recovery especially in the UK and the US emerged. The international community also began to focus its attention on the continued appreciation of the US equity market with growing concern that US interest rates might rise.

This expectation was reflected in the sharp under-performance of US Treasuries against gilts and German bunds in the last quarter of the year. Ten-year gilt yields were some 50 basis point above US Treasuries in Q3, but were some 60 basis points *below* by the end of the financial year.

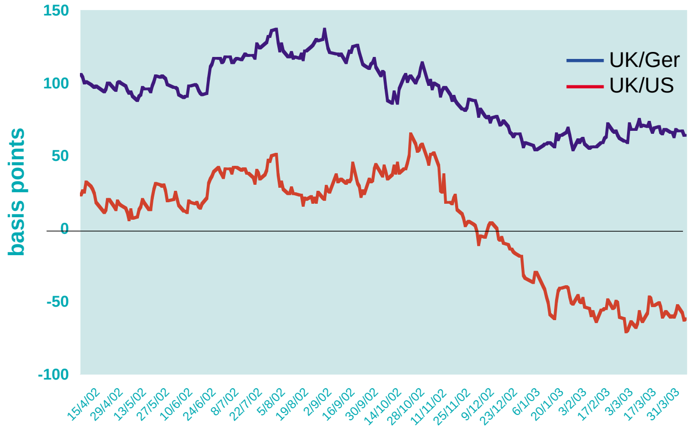


Chart 3
International 10 year bond spreads

Source: DMO

Financing Remit 1998-99

The DMO’s annual remit, contained in The Debt Management Report, published by the Treasury each March, contains a projection of the required gilt sales for the coming financial year. The volume of planned gilt sales is set in the context of the Government’s need to finance the Central Government Net Cash Requirement (CGNCR) plus maturing debt and any net finance required for the foreign exchange reserves. The remit details the overall amount of gilt sales required and the intended split between conventional and index-linked financing, including the maturity mix of conventional sales.

The main feature of 1998-99 was a sharply declining financing requirement, reflecting the continuing health of the public finances. As a consequence the 1998-99 remit was revised twice (in June on publication of the Economic and Fiscal Strategy Report and in November on publication of the Pre-Budget Report). Each revision included the cancellation of a conventional gilt auction, reducing the number from four planned in the original remit to two. Despite this, the Government delivered its commitment to supply a minimum of £2.5 billion (cash) of index-linked gilts (including holding the two planned auctions). As a result, the Government ended 1998-99 overshooting its requirement for gilt sales. The changing gilt financing requirement over the year is shown in the table below.

Table 1: **The 1998-99 Gilt Financing Requirement***

£ billion	**Budget**	**EFSR**	**Pre-Budget Report**	**Budget**	**1998-99 Outturn**
	March 1998	**June 1998**	**November 1998**	**March 1999**	**April 1999**
CGNCR forecast	3.7	3.5	- 2.1	- 2.7	-4.5
Net change in official reserves	0.0	0.0	0.0	0.0	0.1
Gilt redemptions	16.7	16.8	16.8	16.9**	17.0
Overfund from 1997-98	-5.1	-8.2	- 8.2	-8.2	-8.2
Financing Requirement	**15.2**	**12.1**	**6.5**	**6.1**	**4.4**
Financed by:					
National Savings	1.0	0.5	0.1	0.2	0.4
Sales of other public debt	0.0	0.0	0.0	0.0	0.0
Gilt Financing Requirement	**14.2**	**11.6**	**6.4**	**5.9**	**4.0**
Assumed gilt sales 1998-99	-	-	8.1- 8.6	8.2-8.1	
Implied overshoot 1998-99	-	-	1.7- 2.2	2.3	4.1

* Figures may not sum due to rounding.

** Includes ESA 95 reclassification of Bank of England holdings.

The breakdown of planned gilt sales by type across the three published remits, compared to the outturn, was as shown below*.

Gilt Type	**Remit 1 (£bn)**	**Remit 2 (£bn)**	**Remit 3 (£bn)**	**Outturn (£bn)**
Short Conventional	2.7	2.5	0	0
Medium Conventional	2.7	2.5	2.5	2.5
Long Conventional	5.3	3.1	3.1	3.1
Index-linked	3.6	3.5	2.5 - 3.0	2.6
Total	**14.2**	**11.6**	**8.1 - 8.6**	**8.1**

*figures may not sum due to rounding.

The results of the two conventional gilt auctions are summarised below:

Date	Gilt	Nominal Issued (£bn)	Cover	Tail (bp)	Lowest Accepted Price (LAP)[1]	Yield at LAP
20 May 1998	6% 2028	£3.0	2.26	0	£102-30	5.79%
29 July 1998	5% 2009	£2.5	2.93	0	£100-05	5.73%

[1] LAP = Lowest Accepted Price. Prices in £/32nds

The major innovation provided for in the 1998-99 remit was the move to issuing index-linked gilts predominantly by auction (as opposed to smaller issues by “tap”). Two auctions were planned (and successfully held) in the second half of the financial year. In advance of the start of index-linked auctions four index-linked taps were held, together raising £940 million (cash).

The results of the index-linked taps and auctions are summarised below.

Results of index-linked taps (1998-99).

Date	**Gilt**	**Nominal Issued**	**Price at issue[2]**	**Price when exhausted[2]**	**Yield when exhausted[3]**
3 April 1998	$2\frac{1}{2}$% IL 2024	£150m	£151-12	£151-12	2.84%
21 May 1998	$2\frac{1}{2}$% IL 2016	£150m	£185-08	£185-08	2.88%
12 June 1998	$4\frac{1}{8}$% IL 2030	£150m	£160-24	£160-24	2.53%
7 August 1998	$4\frac{3}{8}$% IL 2004	£150m	£128-10	£128-10	2.92%

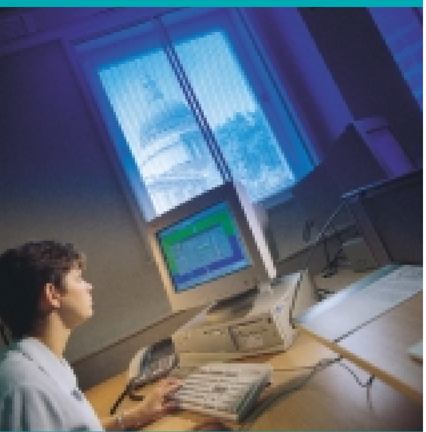
[2] Prices in £/32nds
[3] Assuming 3% inflation

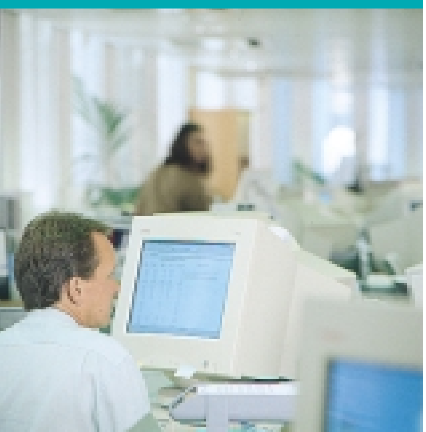
Results of index-linked auctions 1998-99.

Date	Gilt	Nominal Issued	Cover	Clearing Price (CP)[4]	Yield at CP[5]
25 November 1998	$2\frac{1}{2}$% IL 2013	£450m	2.29	£160.24	2.42%
27 January 1999	$2\frac{1}{2}$% IL 2024	£450m	1.83	£181.60	2.01%

[4] Prices in multiples of £0.01
[5] Assuming 3% inflation

DMO Resources





Staff and Recruitment

During its first year of operation the DMO comprised around 25 people. Many of these came on loan or secondment from HM Treasury (and other government departments) and the Bank of England, but some were recruited directly. New staff are increasingly being recruited from the private sector.

There were two external recruitment campaigns to help meet the initial staffing needs of the office, with further external recruitment during 1998-99. Six staff were appointed following these campaigns, initially on a fixed-term basis, although some have now converted to permanent terms. All recruitment exercises were carried out on the basis of fair and open competition and selection on merit in accordance with the guidance laid down by the Civil Service Commissioners. All candidates were selected solely on merit and in accordance with the DMO's equal opportunities policies (see below).

Executive Board

The DMO was reorganised in the course of 1998-99 into three main teams: policy and analysis; markets; and business services. In practice, most staff work flexibly across these areas as necessary. The heads of the main functional teams and other senior staff with relevant experience and responsibilities comprise the DMO's Executive Board. All managerial and operational policy decisions of the DMO are subject to consideration and approval by the Executive Board.

Improving good practice and Investors in People

The DMO has established a continuing programme to improve management good practice and is working towards the Government's target for Investors in People accreditation by the end of December 1999.

Equal Opportunities

The DMO is an equal opportunities employer. Policies are in place to ensure that no job applicant or member of staff receives less favourable treatment on grounds of sex, marital status, colour, racial origin, sexual orientation, age (except in relation to the retirement policy), religion or disability. The DMO attaches great importance to its equal opportunities policy, which it believes to be of benefit to itself and its employees.

Service Quality

The DMO does not provide services direct to the public, and so is not covered by existing arrangements for reporting service quality. However, as part of its sponsorship role HM Treasury sought views from the gilts market as to the standard of service provided by the DMO. Responses from market participants were very positive.

Financial Performance

The DMO's net expenditure in 1998-99 was £2.9 million, slightly less than that projected in its budget. Expenditure on running costs was £2.2 million. Within the total, expenditure on consultants was greater than planned – both on the cash management project (including IT support) and on pay and accounting systems. This was financed by underspends on other services, including those from the Treasury and (for settlement services) from the Bank of England. Pay-related costs were broadly in line with provision. Auction-related costs were much less than expected, but that benefit flows directly through to the NLF.

The DMO's work is distributed broadly across all strategic objectives; non-pay expenditure tends to support either office-wide infrastructure or market operations. Overall, cash management absorbed a slightly higher proportion of budget than anticipated.

Manpower/employee relations

Trades unions are not represented within the DMO, although all staff are encouraged to join an appropriate union and to play an active part in it. Because of its size, it is possible to discuss all matters affecting staff directly with the whole office, and this is done on a regular basis, with all staff being actively encouraged to contribute both formally and informally. For this and other reasons, the office has been able to establish good internal relations and involve all staff in key decisions.

HMT Services

In view of the DMO's size, on-vote agency status and the diseconomies of scale inherent in setting up a wide range of internal support systems, several key support services are provided by HM Treasury; for example, procurement, invoice processing and payment, payroll, library, security and health and safety.

Auditors' Details

As specified by the Exchequer and Audit Department Act 1921, the National Audit Office is responsible for auditing the DMO's annual accounts.

Forward Look

Operational Activities

Markets project

The development of the DMO’s cash management capability, and its integration with the gilts operation, is the single most important activity affecting the DMO throughout 1999-2000. The project will occupy more than half the time of about half the DMO’s current staff, and will be full time for some of these. Some reallocation of internal responsibilities has made it possible to allow some staff to spend more time on the project, particularly those who will be responsible for operational activities within the markets team when it is complete.

The project is being managed as an integrated exercise under a full time project executive who will deliver to the project sponsor - the head of the markets team. A detailed project plan identifies tasks, responsibilities, priorities and risks for the staff most heavily involved. That also brings together the key consultancy resources involved – on systems implementation, accounting, risk management and business continuity.

The impact of the project on the way that the DMO will organise and run itself will be considerable. The existing gilt dealing team will be integrated with the cash dealing team, and they will share a common middle and back office with common system support. Business processes will need to be redesigned accordingly and controls established and risks managed. There will be a much greater number of transactions with a much wide range of counterparties than is the case for gilts. All transactions will flow through the new trading and warehousing account, the Debt Management Account (DMA), that will be set up before the DMO takes over cash management responsibility. An intensive effort in training and trialling will be needed to ensure a high standard of operation. High level operational objectives will need to be cascaded to individuals in such a way as to encourage efficiency but fully meeting the DMO’s public sector obligations.

In 1999-2000 the central managerial task will be to push forward work on the cash management project, with the aim of ensuring that capability is fully established before the end of the financial year, while at the same time meeting existing objectives professionally, effectively and responsively to customer needs.

Market developments

The basic trading structure of the gilts market has now been in place for over a decade. In that time trading technology has changed radically and investors now have a range of different systems available to them to trade securities. Alternative trading mechanisms, such as automatic order matching services or crossing systems, are prevalent in equity markets and a number of service providers intend to extend such services to fixed income markets. Accordingly, the DMO believes that it is appropriate now to consider whether the current structure is still best suited to meet the challenges of a new trading environment. The DMO will be consulting with market participants in due course on what, if any, changes are required.

One feature of this new environment is the trading platform for LIFFE’s gilt futures contracts. 1999 saw these contracts move from an open outcry trading environment onto LIFFE’s new electronic order book, LIFFE Connect. Market participants have commented favourably on this development. LIFFE also began trading the short sterling contract on this platform in September 1999.

Financing Remit for 1999-2000

The DMO’s remit for 1999-2000 was published on 9 March 1999 following the Chancellor’s Budget statement. On the basis of a forecast CGNCR of £6.2 billion, gilt sales of £17.3 billion are planned.

An innovation that was welcomed in the market was the provision in the remit of an indication of how gilt issuance would be affected by changes to the financing requirement. In particular:

- Any increases or reductions to the financing requirement are to be met first by an adjustment to the level of planned Treasury bill issuance of up to £3 billion.
- Above £3 billion, changes to the financing requirement are to be met by a combination of adjustments to the size and number of gilt auctions and the amount of Treasury bill issuance.
- An additional long gilt auction would be added if the financing requirement increased sufficiently and a short gilt auction would be cut if it fell sufficiently.

The financing arithmetic was restated on 20 April, following the publication of the outturn CGNCR for 1998-99, which showed a higher surplus than expected at the time of the Budget and consequently a lower financing requirement. The volume of planned gilt sales, however, remained unchanged at £17.3 billion, the change in the financing arithmetic being absorbed through a reduction in planned Treasury bill sales.

The table below shows the financing arithmetic as presented in the Budget and updated on 20 April 1999:

	Budget	20 April
CGNCR forecast	6.2	6.2
Net financing for official reserves*	2.4	2.3
Gilt redemptions	14.8	14.9
Gilt sales residual from 1998-99	-2.3	-4.1
Financing requirement	21.0	19.3
Financed by:		
National Savings	0.1	0.1
Treasury Bills & other short term debt	3.6	1.9
Gilts Financing Requirement	**17.3**	**17.3**

** estimated at prevailing exchange rates*

** figures may not sum due to rounding*

The table below shows the planned mix of gilt sales under the 1999-2000 remit and the progress of sales to the end of September 1999:

Gilt Type	Remit (£bn)	Sales*(cash) to end September (£bn)
Short Conventional	5.0	2.4
Medium Conventional	3.0	2.7
Long Conventional	5.8	3.5
Index-linked	3.5	1.7

** figures may not sum due to rounding*

The gilt auction calendar for 1999-2000 is below.

Date	Gilt	Amount (nominal)
Wednesday 28 April 1999	4⅛% IL 2030	£500m
Wednesday 26 May 1999	6% 2028	£2,500m
Tuesday 22 June 1999*	5% 2004	£2,500m
Wednesday 28 July	2½% IL 2011	£375m
Tuesday 28 September 1999	5¾% 2009	£2,750m
Wednesday 27 October 1999	2½% IL 2016	£350m
Wednesday 24 November 1999	6% 2028	tba
Wednesday 26 January 2000	Index-linked	tba
Wednesday 29 March 2000	Conventional	tba

** brought forward from originally scheduled date of 23 June.*

In addition, £400 million (nominal) of 6% 2028 was sold by tap for market management reasons on 6 August 1999.

As foreshadowed in the remit, the DMO issued a consultation document on the conduct of switch auctions on 7 July 1999. A number of comments were received from market participants and the DMO took account of these in finalising its proposals, published on 13th September. The first switch auction was held on 21st October 1999 out of 8% 2003 into 5% 2004. It is envisaged that the conduct of such auctions, and the identity of candidate stocks, will be discussed at the regular end-quarter consultation meetings with market participants.

Resources

The DMO's Corporate Overview and Business Plan for 1999-2000[6] identified a number of broad planning conclusions which will underlie the DMO's future resource requirements. They centre on the need for flexibility, an open, innovative and professional culture, wide external contacts, a close operational relationship with HM Treasury and the support of sophisticated systems and good supplier relationships.

To take account of the requirements of cash management, the DMO has been reorganised internally into three broad business areas: policy & analysis, markets and business services. The DMO will continue to attach importance to training and development (it will seek Investors in People accreditation during the year) and to promoting internally its core values: to be professional, goal-orientated, responsive and outward-looking, scrupulously fair in dealing with others, and a good place to work.

The set up of cash management requires both additional people and expenditure in 1999-2000. At the end of that year staff will number about 35. The uncertainties ahead mean that it is difficult to be precise about future resource needs. However, the DMO will be careful to ensure that administrative efficiency is not achieved at the expense of selling debt on less fine terms, or of providing a less efficient service to the market.

[6] Available from the DMO or on its website

Annual Accounts

Year ended 31 March 1999

Presented to Parliament 22 July 1999

The *United Kingdom*
Debt Management Office
is an Executive Agency of
HM Treasury

Foreword to the Accounts

1. Preparation of accounts

The accounts have been prepared in accordance with a direction given by HM Treasury in pursuance of section 5 (1) of the Exchequer and Audit Departments Act 1921. The text of the direction is reproduced on page 45 of this document. The accounts and supporting notes relating to the UK Debt Management Office's activities for the year ended 31st March have been audited by the Comptroller and Auditor General.

2. History and statutory background

The United Kingdom Debt Management Office (DMO) was established on 1 April 1998 as an on-vote agency of HM Treasury. These accounts therefore cover its first year of operation. The agency is financed through the Treasury (Class 16, Vote 1, subhead B) and operates under gross running cost arrangements. Ministerial responsibility for the DMO is vested in the Chancellor of the Exchequer, who is supported by the Economic Secretary. The DMO's Chief Executive is also its Accounting Officer and is responsible to Treasury Ministers for the overall operation of the agency in accordance with its Framework Document.

3. Principal activities

The DMO's 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.

4. Review of activities

The DMO's first year of operation has seen the successful transfer of debt management from the Bank of England, achievement of the remit set for it by Treasury Ministers, the meeting of its debt management targets, the successful continuation of the conversions programme and the taking forward of the programme of reforms already initiated by the Bank and the Treasury. Plans for taking on responsibility for cash management during 1999-2000 have also been put in place.

5. Management of the DMO

The Chief Executive has been appointed by HM Treasury for a three year fixed term to set the agency up and ensure its efficient and effective operation. The agency is managed on a day-to-day basis by an Executive Board, which at 31 March 1999, and in addition to the Chief Executive, comprised:

Paul Mills	– policy and analysis
Hamish Watson	– dealing operations
Jo Whelan	– markets
Mike Ness	– cash management
Dave Curtis	– business services

6. Supplier payment policy

All the DMO's invoices are processed for payment by HM Treasury, which is committed to the CBI code on prompt payment and aims to pay all valid invoices within 30 days of receipt. HM Treasury's payment performance for 1998-99 showed that this target was achieved in respect of 93% of invoices paid.

7. Year 2000 compliance

The DMO is reviewing its embedded and internal IT systems to ensure they are Year 2000 compliant. It is estimated that this might cost in the region of £50,000, reflecting mainly the cost of upgrades to existing software. Assurances on Year 2000 compliance are being sought from all IT suppliers. The DMO will also be establishing contingency arrangements to ensure that essential services can be maintained in the event of Year 2000 or other potential disruptions.

8. Key performance targets

The DMO's key performance targets for 1998-99 and its performance against them can be found in annex E of its 1999-2000 business plan, which can be obtained from the DMO or accessed via DMO's website at ***www.dmo.gov.uk***.

Mike Williams
Chief Executive
22 July 1999

Statement of Accounting Officer's Responsibilities

Under section 5 of the Audit and Exchequer Departments Act 1921 the Treasury has directed the DMO to prepare a statement of accounts for each financial year in the form and on the basis set out in the accounts direction on page 45 of these financial statements. The accounts are prepared on an accruals basis and must give a true and fair view of the agency's affairs 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 agency 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 agency. 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 the Treasury and published in "Government Accounting".

Mike Williams
Chief Executive and Agency Accounting Officer
22 July 1999

Statement on the System of Internal Financial Control

As Accounting Officer, I acknowledge my responsibility for ensuring that an effective system of internal financial control is maintained and operated by the UK Debt Management Office.

The system can provide only reasonable and not absolute assurance that assets are safeguarded, transactions authorised and properly recorded, and that material errors or irregularities are either prevented or would be detected within a timely period.

The system of internal financial control is based on a framework of regular management information, administrative procedures including the segregation of duties, and a system of delegation and accountability. In particular, it includes:

- comprehensive budgeting systems with an annual budget which is reviewed and agreed by the Executive Board;
- regular reviews by the Executive Board of periodic and annual financial reports which indicate financial performance against the forecasts;
- setting targets to measure financial and other performance;
- clearly defined capital investment control guidelines;
- as appropriate, formal project management disciplines.

The UK Debt Management Office secures internal audit services from the Treasury Internal Audit team, which operates to the minimum standards defined in the Government Internal Audit Manual and the Government Information Systems Audit Manual. Their work is informed by an analysis of the risk to which the body is exposed, and annual internal audit plans are based on this analysis. The analysis of risk and the internal audit plans are endorsed by the Executive Board (acting as its Audit Committee) and approved by me. At least annually, the Head of Treasury Internal Audit (HTIA) provides me with reports on internal audit activity in the body. Such reports include the HTIA's independent opinion on the adequacy and effectiveness of systems of internal financial control.

My review of the effectiveness of the system of internal financial control is informed by the work of the internal auditors, the Executive Board, which oversees the work of the internal auditor, the executive managers within the body who have responsibility for the development and maintenance of the financial control framework, and comments made by the external auditors in their management letter and other reports.

Mike Williams
Chief Executive and Agency Accounting Officer
22 July 1999

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

I certify that I have audited the financial statements on pages 34 to 44 under the Exchequer and Audit Departments Act 1921. These financial statements have been prepared under the historical cost convention as modified by the revaluation of certain fixed assets and the accounting policies set out on pages 37 to 38.

Respective responsibilities of the Agency, Chief Executive and Auditor

As described on page 30 the Agency and Chief Executive are responsible for the preparation of the financial statements and for ensuring the regularity of financial transactions. Normally the financial statements of the Agency are produced within the Annual Report, and the Agency and Chief Executive are responsible for the preparation of the other contents of this. The Treasury Officer of Accounts has exceptionally allowed the Annual Report of the Agency to be published at a later date, as this is the first annual set of accounts produced by the Agency. 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 presented in accordance with the Exchequer and Audit Departments Act 1921 and Treasury directions made thereunder, and whether in all material respects the expenditure and income have been applied to the purpose 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 Agency has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit. As the Annual Report is to be published separately I have not reviewed the contents of this.

I review whether the statement on page 31 reflects the Agency's compliance with Treasury's guidance "Corporate Governance: statement on the system of internal financial control". I report if it does not meet the requirements specified by the Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements.

Basis of Opinion

I conducted my audit in accordance with 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 Agency and Chief Executive in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Agency's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements 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

In my opinion:

- The financial statements give a true and fair view of the state of affairs of the Debt Management Office at 31 March 1999 and of the net operating cost, recognised gains and losses and cash flows for the year then ended and have been properly prepared in accordance with the Exchequer and Audit Departments Act 1921 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
23 July 1999
National Audit Office
Comptroller and Auditor General
157-197 Buckingham Palace Road
LONDON
SW1W 9SP

Operating cost statement year ended 31 March 1999

	Note	£'000
Administration Costs		
Staff costs	2	1,102
Other administration costs	3	1,271
Depreciation	6	167
Gross Administration Costs		**2,540**
Operations related costs	4a	334
Gross Administration and Operations-Related Costs		**2,874**
Operating income	5	(387)
Net Administration and Operations-Related Costs before Notional Interest on Capital		**2,487**
Notional Interest on Capital	4b	32
Net Operating Cost		**2,519**

Statement of recognised gains and losses year ended 31 March 1999

	Note	£'000
Unrealised surplus on the revaluation of tangible fixed assets	11	3

All activities arise from continuing operations

The notes on pages 37 to 44 form part of these accounts

Balance sheet as at 31 March 1999

	Note	31/3/1999 £'000	£'000
Fixed assets			
Tangible fixed assets	6		665
Current assets			
Debtors	7	223	
Cash at Bank and in Hand	8	73	
		296	
Creditors (amounts falling due within one year)	9	**(206)**	
Net current assets/(liabilities)			**90**
Total Net Assets			**755**
Represented by:			
Taxpayers' Equity			
General fund	10		752
Revaluation reserve	11		3
			755

Mike Williams
Chief Executive
22 July 1999

The notes on pages 37 to 44 form part of these accounts

Cash flow statement year ended 31 March 1999

	Notes	£'000
Net cash outflow from operating activities	12	(2,319)
Capital expenditure and financial investment	13	(614)
Net cash outflow before financing		**(2,933)**
Financing		
Vote Financing	14	2,936
HM Treasury funding of Bank of England cash float		70
		3,006
Increase in cash in the period		**73**

The notes on pages 37 to 44 form part of these accounts

Notes to the Accounts

1. Statement of Accounting Policies

1.1 Basis of preparation

These financial statements have been prepared in accordance with the Resource Accounting Manual issued by HM Treasury. The particular accounting policies adopted by the DMO are described below. They have been applied consistently in dealing with items considered material in relation to the accounts.

1.2 Accounting Convention

The financial statements have been prepared under the historical cost convention, as modified to account for the revaluation of tangible fixed assets at their value to the business by reference to their current cost.

No comparatives have been presented, as the year to 31 March 1999 is the agency's first year of existence.

1.3 Tangible fixed assets

Individual tangible fixed assets with a purchase cost in excess of £500 are capitalised and are revalued each year using appropriate indices to the net current replacement cost. All assets acquired on an individual or grouped basis (for similar items or those used together) for ongoing use falling above this threshold will be shown as tangible fixed assets.

Revaluation surpluses and deficits arising from temporary changes in value are credited or charged to the revaluation reserve. Permanent diminutions in value are charged to the operating cost statement except to the extent that a revaluation surplus exists in respect of the same asset.

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

1.4 Depreciation

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

Computer equipment	4 years
Office and other non IT equipment	5 years
Furniture, fixtures and fittings	10 years
Leasehold improvements	Over lease term

1.5 Operating leases

Rental payable under operating leases is charged to the operating cost statement on a straight-line basis over the term of the lease. Operating leases are accounted for in accordance with SSAP 21. The DMO's commitments are disclosed in note 19.

1.6 Notional charges

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

1.7 Value added tax

Value added tax (VAT) on purchases, to the extent that it is irrecoverable, is charged to the operating cost statement included under the heading relevant to the type of expenditure. Where VAT is recoverable in respect of DMO expenditure, it is recovered by HM Treasury and is not refunded to the DMO.

1.8 Operating Income

Operating income for the DMO relates to cost recoveries on a full cost basis for services provided primarily to gilt-edged market makers and the National Loans Fund. As the agency is subject to gross running control provisions, for funding purposes, operating income amounts are treated as Appropriations-in-Aid to HM Treasury.

1.9 Pensions Costs

Pension contributions paid or payable are included within the Operating Cost Statement. DMO staff and staff on loan from HM Treasury and other government departments, but not those on short-term contracts, are members of the Principal Civil Service Pension Scheme (PCSPS).

The PCSPS is non-contributory and unfunded. Although it is a defined benefits scheme, liability for the payment of future benefits is a charge to the PCSPS. Agencies covered by the PCSPS meet the cost of pension cover provided for the staff they employ by payment of charges calculated on an accruing basis.

Staff on loan from the Bank of England are members of the Bank's pension scheme. For them, contributions to the relevant pension scheme are recharged to the DMO.

2. Staff Numbers and Costs

2.1 The average number of DMO employees during the year was as follows:

	Number
	24

2.2 Aggregate staff payroll costs were:

	£'000
Wages and salaries	967
Social security costs	51
Other pension costs	84
	1,102

2.3 The Chief Executive's remuneration for the year, excluding employers pension contributions, was £73,829.

The Chief Executive is an ordinary member of the Principal Civil Service Pension Scheme. Contributions in respect of the Chief Executive are paid by the DMO to this scheme at the rate of 18.5% of his gross salary.

2.4 The remuneration (excluding pension contributions but including bonuses) of the other members of the Executive Board for the period fell within the following ranges:

	Number
£30,000 to £34,999	1
£40,000 to £44,999	1
£55,000 to £59,999	1
£60,000 to £64,999	1
£65,000 to £69,999	1

2.5 The remuneration (excluding pension contributions but including bonuses) of higher paid employees (excluding members of the Executive Board) fell within the following range:

	Number
£40,000 to £49,999	3

3. Other Administration Costs

Other administration costs include the following:

	£'000
Rents and Rates	180
Consultants & Professionals	409
IT Current	185
HM Treasury Notional Costs	31
Auditors Fee	16
Travel, Subsistence & Hospitality	12
Legal Services	70
Training	33
Printing & Stationery	80
Other Costs	255
	1,271

4. Operations-related Costs and Notional Interest on Capital

4a Operations-Related Costs

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

4b Notional Interest on Capital

A charge reflecting the cost of capital utilised by the agency is included within the Operating Cost Statement. The charge is calculated at the government's standard rate of 6% in real terms on all assets less liabilities.

5. Operating Income

Operating income amounts relate to cost recoveries made, on a full cost basis, for services provided. All operating income is treated as Appropriations-in-Aid. Operating income for the period was generated from the following sources:

	£'000
Recharges to the National Loans Fund (stock listing and other fees)	334
Recharges to GEMMs (regarding trading system costs)	40
Interest on Bank of England Current Account	3
Other income	10
	387

6. Tangible Fixed Assets

Cost or valuation	IT £'000	Telecoms £'000	Furniture & Fittings £'000	Other £'000	Leasehold Improvements £'000	Total £'000
Transferred on 1 April 1998	-	-	22	-	224	246
Additions	398	134	59	8	20	619
Revaluation	(42)	(13)	-	-	3	(52)
At 31 March 1999	**356**	**121**	**81**	**8**	**247**	**813**
Accumulated depreciation						
Transferred on 1 April 1998						
Charge for the year	99	34	8	2	24	167
Revaluation	(10)	(9)	-	-	-	(19)
At 31 March 1999	**89**	**25**	**8**	**2**	**24**	**148**
Net book value						
At 31 March 1999	**267**	**96**	**73**	**6**	**223**	**665**

7. Debtors: Amounts Falling Due Within One Year

	£'000
Amounts receivable from NLF	132
Prepayments and accrued income	81
Other Debtors	10
	223

8. Cash at Bank and in Hand

	£'000
Balances with the Bank of England	73
	73

9. Creditors: Amounts Falling Due Within One Year

	£'000
Trade creditors	20
HM Treasury and Departmental creditors	78
Accruals and deferred income	108
	206

10. Taxpayer's Equity

Reconciliation of Net Operating Cost to Changes in General Fund

			£'000
Net operating cost			(2,519)
Net Vote funding			**2,936**
Add:	Movement in deposit funded by vote		10
	Assets transferred at 1 April 1998		246
Add:	Non-Cash Charges:		
	Notional Interest on Capital	32	
	Auditors Fee	16	
	HM Treasury Notional Costs	31	
			79
Net increase in General Fund			752
General Fund at 1 April 1998			0
General Fund at 31 March 1999			752

11. Revaluation Reserve

	£'000
Opening Balance at 1 April 1998	0
Movement on revaluation during the year	3
	3

12. Reconciliation of Operating Costs to Operating Cash Flows

	£'000	£'000
Net operating cost		2,519
Adjust for non-cash transactions:		
Depreciation	167	
Notional Interest on Capital	32	
Notional Support Costs	31	
Auditors Remuneration	16	
Deficit on Revaluation	36	
		(282)
Adjust for movements in working capital other than cash :		
Increase in debtors	213	
Increase in creditors	(131)	
		82
Net Cash outflow from operating activities		**2,319**

13. Analysis of Capital Expenditure and Financial Investment

	£'000
Purchases of tangible fixed assets	614
Net cash outflow from investing activities	**614**

Assets valued at £246,000 have been transferred from HM Treasury to Debt Management Office at nil cost on 1 April 1998.

14. Analysis of Financing

	£'000
Vote Financing	2,936
HM Treasury Funding of Bank of England Cash Float	70
Net cash requirement	**3,006**

15. Reconciliation of Cashflow to Appropriation Account

	£'000
Net Cash outflow from operating activities	2,319
Net Capital Expenditure	614
Less : VAT on GEMMS receipts paid over to HM Treasury	(7)
Add : Movement in Deposit Funded by Vote	10
Net Vote Expenditure	**2,936**

16. Appropriation Account Class XVI Vote 1 1998-99

The DMO operates in accordance with Government Accounting on a Treasury Vote (Class 16, Vote1, Subhead B).

HM Treasury reported to Parliament the receipts and payments of the DMO as follows:

		£'000
Gross Expenditure		
Current:	Running Costs	2,236
	Other	334
Capital		614
		3,184
Appropriations-in-Aid		(248)
Net Vote Expenditure		**2,936**

17. Operating Leases

At 31 March 1999 commitments under operating leases were as follows:

	Land and Buildings £'000
Operating leases which expire beyond five years: premises lease	190

18. Pension Arrangements

The majority of the DMO's employees are civil servants to whom the conditions of the Superannuation Acts 1965 and 1972 and subsequent amendments apply. (Those on secondment from the Bank of England are subject to the Bank's pension arrangements; where appropriate, those on short-term contracts make their own arrangements.)

For 1998-99, contributions of £88,000 were paid to the Paymaster General at rates determined from time to time by the Government Actuary and advised by the Treasury. For 1998-99, these rates, by salary band, were:

£14,000 and under	12%
£14,001 to £28,000	13.5%
£28,001 to £50,000	16.5%
£50,001 and over	18.5%

19. Capital Commitments

The DMO has capital commitments contracted but not provided for, the year 1999-2000 of £1,110,000.

20. Contingent Liabilities

The DMO had no contingent liabilities at 31 March 1999.

21. Related Party Transactions

The DMO is an executive agency of HM Treasury, which is therefore regarded as a related party. During the year the DMO has had various transactions with HM Treasury for which notional charges of £31,000 are made.

Other related parties with whom DMO has undertaken various transactions are NILO and the Bank of England.

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

22. Key Financial Performance Targets

There are no key financial targets; the DMO has a number of key targets, but these are intentionally not focused on financial accounting indicators in order to avoid undue risk to its longer-term objectives.

ACCOUNTS DIRECTION GIVEN BY THE TREASURY IN ACCORDANCE WITH SECTION 5(1) OF THE EXCHEQUER AND AUDIT DEPARTMENTS ACT 1921

1. When preparing its accounts for the financial year ended 31 March 1999 and subsequent financial years the UK Debt Management Office shall comply with the accounting principles and disclosure requirements of the edition of the *Resource Accounting Manual* which is in force for the financial year for which the accounts are prepared.

2. In addition to the requirements of the Manual, the *Foreword* shall include a brief history of the UK Debt Management Office and its statutory background.

……………………………………..

Treasury Officer of Accounts

22 July 1999

Printed in the UK for The Stationery Office Limited
on behalf of the Controller of Her Majesty's Stationery Office
Dd 29/10/99 Job No. J10342

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