

**National Savings  
and Investments**  
Product Accounts 2006/07



# **National Savings and Investments**

## Product Accounts 2006/07

Presented to Parliament in pursuance of section 7 of the  
Government Resources and Accounts Act 2000

Ordered by the House of Commons to be printed 19 July 2007

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# Foreword

## Statutory Background

### NS&I

National Savings and Investments (NS&I) became an Executive Agency of the Chancellor of the Exchequer in 1996. Its origins can be traced back to the National Savings Bank in the 1860s. In February 2002 National Savings launched its new name and corporate identity and is now known as 'NS&I'.

NS&I is an integral part of the UK's debt management arrangements. Its sole aim is to help reduce the cost to the taxpayer of Government borrowing now and in the future, through the sale of savings and investment products to the retail market, thus providing retail funding for Government that is cost-effective in relation to funds raised on the wholesale market.

The Director of Savings, who is also NS&I's Chief Executive, is the Accounting Officer responsible for administering NS&I's products. The Chief Executive of NS&I is accountable to Treasury ministers for the performance of the Agency and, as Accounting Officer, to Parliament for the proper, effective and efficient use of public funds. Accountability to Treasury Ministers is achieved via a governance framework, which includes a Framework Document, Corporate Plan, Service Delivery Measures and the annual Financing Remit.

### Siemens

In January 1999, NS&I signed a 10-year contract with Siemens for provision of operational services which came into effect on 1 April 1999. The initial 10-year contract was extended to a 15-year contract ending in March 2014.

### National Loans Fund (NLF)

NLF is central government's main borrowing and lending account. Most of the NLF's borrowing needs are met indirectly through borrowing on its behalf by NS&I and the Debt Management Office. (DMO)

### The Commissioners for the Reduction of National Debt (CRND)

Under the National Savings Bank Act 1971, Ordinary Account investments are passed to the CRND, who invest them under section 18 of that Act. The CRND is part of the DMO.

Under the National Savings Stock Register Regulations 1976, some old uncleared payments are also passed to the CRND for inclusion in the Unclaimed Dividends Account.

## NS&I's Products and Regulation

These accounts cover transactions and balances on all NS&I's products.

The products covered by these accounts and their governing legislation and regulations are as follows:

### Products governed by the National Debt Act 1972

British Savings Bonds	National Savings Stock Register Regulations 1976
Capital Bonds	National Savings Stock Register Regulations 1976
Children's Bonus Bonds	Savings Certificates (Children's Bonus Bonds) Regulations 1991
Deposit Bonds	National Savings Stock Register Regulations 1976
First Option Bonds	National Savings Stock Register Regulations 1976
Fixed Rate Savings Bonds	National Savings Stock Register Regulations 1976
Gift Tokens	
Guaranteed Equity Bonds (GEB)	National Savings Stock Register Regulations 1976
Income Bonds	National Savings Stock Register Regulations 1976
Pensioners' Guaranteed Income Bonds	National Savings Stock Register Regulations 1976
Premium Bonds	Premium Savings Bonds Regulations 1972
Save As You Earn	Savings Contracts Regulations 1969
Savings Certificates	Savings Certificates Regulations 1991
Savings Stamps	National Savings Stamps Regulations 1969
Yearly Plan	Savings Certificates (Yearly Plan) Regulations 1984

### Products governed by the National Savings Bank Act 1971

Easy Access Savings Account	National Savings Bank Regulations 1972
Individual Savings Account	National Savings Bank Regulations 1972
Investment Account	National Savings Bank Regulations 1972
Ordinary Account	National Savings Bank Regulations 1972
Treasurers' Account	National Savings Bank Regulations 1972

British Savings Bonds, Deposit Bonds, First Option Bonds, Gift Tokens, Ordinary Account, Save As You Earn, Savings Stamps and Yearly Plan were not on sale during the year, but some customer funds are still invested within them.

NS&I subscribes to the Banking Code, which provides greater transparency and improved communications with its customers. In October 2004, the Banking Code Compliance Board conducted a review and gave NS&I a 'green' status. The next formal review is in 2007-08 and NS&I conducts annual self-assessments to ensure ongoing compliance.

Although NS&I is not regulated by the Financial Services Authority (FSA), NS&I recognises the relevant legislation and aims to work in the spirit of the overall regulatory framework. Over the past 12 months the focus has been on implementing and embedding relevant work practices and ensuring closer adherence to the relevant standards set out in the FSA handbook, and this focus will remain in place for the next 12 months.

NS&I has been Financial Ombudsman Service (FOS) compliant since September 2005.

NS&I strives to meet both regulatory and best practice standards (that are applicable to NS&I) within the financial services industry.

## Accounts

The accounts have been prepared under a direction issued by the Treasury in accordance with section 7(2) of the Government Resources and Accounts Act 2000. This direction is disclosed in an Annex to these accounts.

## Scope of the Product Accounts

These accounts record the transactions for the year ended 31 March 2007 on retail savings and investment products administered by NS&I and the balances in respect of those products as at that date. They do not include:

- *The investment or use of funds.* Customer funds are not directly invested by NS&I. They are passed to either the NLF, to fund public sector activity or to the CRND where they are invested mainly in Government securities.
- *NS&I's administration costs.* These are funded by Parliamentary Vote and accounted for separately in the 'NS&I Annual Resource Accounts'.
- *Tax foregone.* Some NS&I products are tax-free. The notional cost of tax foregone by the Exchequer is not recognised as a cost in these accounts, but is considered as part of NS&I's overall metric when computing how cost-effective they have been at financing the national debt.

A separate White Paper account (Ordinary Deposits Account) is also published for the Ordinary Account.

## Performance for the year

NS&I's objective is to provide the Government with cost-effective retail finance compared to funds raised on the wholesale market.

In pursuit of this objective, NS&I raised £14.17 billion through sales and deposits. After repayments and interest, total liabilities to customers increased by £5.56 billion during 2006/07 to £78.90 billion.

In 2006-07 NS&I continued its operational change programme, which is aimed at modernising the organisation and providing customers with greater choice in how they transact with NS&I. Additionally, there was a significant improvement in sales through the direct channels (internet and telephone) both in numbers of customers and also percentage of overall sales. A new Direct ISA product was launched successfully on 6 April 2006 to coincide with the new tax season.

NS&I's administration costs are funded by Parliamentary Vote and are shown in the Resource Accounts. However, the interest costs on NS&I products are included in the total cost of servicing the National Debt and these costs are therefore reflected as a charge on the NLF and are reflected in these accounts.

HM Treasury is responsible for the operation of the NLF.

## Looking forward

NS&I launched a new five-year strategy, **NS&I Adding Value** on 1 April 2007. The new strategy will aim to deliver sustainable long-term value to stakeholders by simplifying, modernising and diversifying the business. The new strategy is a shift from growth (under Direction 2007, the previous five-year strategy) to maximise Value Add (i.e. the savings for Government on raising finance through NS&I when compared to funds raised by Government on the wholesale market) within a defined Net Financing range.

## Audit

These accounts have been audited by the Comptroller and Auditor General whose Certificate and Report appear on pages 8 and 9.

## Important events occurring since the year end

There have been no significant events since the end of the year which would affect the income and expenditure for the year or the assets and liabilities at the year end.



**Jane Platt**  
Director of Savings  
NS&I

3 July 2007

# Statement of Accounting Officer's responsibilities

Under the Government Resources and Accounts Act 2000, NS&I is required to prepare accounts covering all its products for each financial year in accordance with a Treasury direction.

The accounts are prepared on an accruals basis and must give a true and fair view of the products' balances at the year end, and of the income and expenditure and cash flows for the financial year.

HM Treasury has appointed the Director of Savings as Accounting Officer for NS&I, with responsibility for preparing the NS&I Product Accounts and for transmitting them to the Comptroller and Auditor General.

In preparing the accounts, the Accounting Officer is required to comply with the Financial Reporting Manual (FReM) prepared by HM Treasury, and in particular to:

- Observe 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, as set out in the Financial Reporting Manual (FReM), have been followed, and disclose and explain any material departures in the accounts; and
- Prepare the accounts on a going concern basis.

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

The Accounting Officer's responsibility for the keeping of information relating to proper records includes the responsibility for the maintenance, integrity and upkeep of the product accounts on the NS&I website.

# Statement on internal control

## 1. Scope of responsibility

As Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of NS&I's policies, aims and objectives, while safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Government Accounting.

Although, as Accounting Officer, I retain sole responsibility for the system of internal control within NS&I, I am assisted in discharging this responsibility by the NS&I Board, which, in addition to me and the other NS&I executive directors, comprises four independent non-executive directors and two representatives of HM Treasury, who provide the key assurance link back to Treasury Ministers.

The Ministers, while maintaining accountability, have delegated day-to-day dealings with NS&I to HM Treasury's Debt and Reserves Management (DRM) team. The NS&I Board has assumed overall responsibility for monitoring the effectiveness of the Agency's risk management processes. I and my senior staff also hold regular briefing meetings with other relevant HM Treasury teams and a monthly performance report is sent to the Economic Secretary to the Treasury.

## 2. The purpose of the system of internal control

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of departmental policies, aims and objectives. It enables management to evaluate the likelihood of those risks being realised and the impact should they be realised; and to manage them efficiently, effectively and economically to an overall level acceptable to NS&I. The system of internal control has been in place in NS&I for the year ended 31 March 2007 and up to the date of approval of the accounts, and accords with HM Treasury guidance.

## 3. Capability to handle risk

The Board, Audit Committee and Executive Management Team (EMT-comprising the Executive Directors and Siemens Account Director) have primary responsibility for identifying and monitoring key risks that face NS&I. At each meeting the EMT considers whether there are any new risks to the business to be registered; and regularly discusses the key risks as part of its quarterly risk review, and the Board formally reviews the key risks at least annually to ensure they remain valid and complete in the light of changing circumstances in the year and business plans for the coming year.

NS&I has a risk management strategy, a risk management policy and agreed risk management reporting protocols, which are approved annually by the Board.

The Audit Committee, chaired by an independent director, is responsible for providing assurance, in conjunction with internal and external auditors, to the Board on the existence and effectiveness of the overall processes for managing risk within NS&I and within the part of Siemens concerned with NS&I's business.

NS&I's business model means that we are critically reliant on our business partner, Siemens, for the delivery of our strategic objectives. Consequently, we have established joint processes with Siemens to manage the partnership as one business. These include reciprocal Siemens representation at the NS&I EMT meetings and NS&I representation at Siemens NS&I Account senior management team meetings; joint working between project offices; joint project teams; and a Joint Audit and Risk Management Committee (JARMC). The JARMC updates the Audit Committee on the management of risks to the joint business. Across the whole business, Directors and operational managers are responsible for embedding risk identification and management within the design, documentation and operation of business processes, in line with agreed risk tolerances.

In recognition of the strategic importance of Compliance, 2006/07 saw the establishment of two formal steering groups: the Compliance Steering Group and the Fraud Steering Group, both of which include Siemens representation.

The risk management process is led by the Executive Management Team, comprising the Executive Directors and the Siemens Account Director responsible for the NS&I account, who are responsible for:

- Implementation of the risk management strategy;
- Developing and overseeing the risk management policy;
- Identifying and evaluating strategic risks; and
- Designing, operating and monitoring a suitable system of internal control.

#### **4. The risk process**

An analysis of key risks and the consequent significant sub-risks has been established through an ongoing programme of individual and collective discussion with the Executive Directors. With very few exceptions where sub-risks have been retained by the Directors, all sub-risks have been allocated to Business Unit Leaders or senior managers. An organisation-wide risk register records all significant risks identified, links lower level risks through to the key risks, records mitigating controls and named risk managers. The Board reviews the key risks annually to ensure they remain valid and complete in the light of business plans for the coming year. For each key and sub-risk identified, the assessment and scoring of the probability and impact both before and after mitigating controls is performed using a consistent methodology on a risk matrix. The results of this are considered against our agreed organisation risk appetite as approved annually by the Board. Reviews of risks and their risk scores are performed regularly, and at least quarterly by executive directors, Business Unit Leaders, and the Executive Management Team.

Where further action is necessary to reduce exposure, the action, and its intended effect on the status of the risk, is logged, responsibility allocated, and a completion date agreed. Progress on the action is tracked and missed completion dates, if any, on residual key risks are reported monthly through to the Executive Management Team and bi-monthly to the Board via the Corporate Balanced Scorecard. Risks where exposure remains unacceptably high despite controls are flagged as red, are reviewed quarterly by Business Unit Leaders, the Executive Management Team and the Audit Committee, and bi-annually by the Board.

As part of the annual planning cycle, Business Unit Leaders are required to identify the significant risks, which could impact on the achievement of each main element of their proposed business plans for the year. These risks are then compared with the existing risk register, which is amended as necessary.

Contingency plans are in place or are being implemented for all sub-risks where exposure is inherently unacceptable.

Our management of risk is embedded in policymaking, planning and delivery by Executive Directors and Business Unit Leaders who are responsible for ensuring the proper management of risks; and cascading implementation of the risk management strategy and policy within their directorates and teams respectively. Business Unit Leaders are responsible for implementation of self-assessment processes. A programme management function ensures that all projects are subject to formal project management disciplines including an assessment of inherent and residual risks. Projects are governed by formal project management disciplines including regular review of project and programme risks overseen by the project board, Executive Management Team and the Board.

Business Unit Leaders provide written sign offs to the relevant Executive Directors that they are satisfied that all their sub-risks are either adequately controlled, or that plans are in place to provide that control. In addition, EMT members provide me with equivalent written sign offs for the key risks for which they have responsibility. Executive Directors also provide written assurance that an adequate system of internal control operates within their directorates, and that, to the best of their knowledge, their staff comply with all relevant legal and regulatory requirements.

These approaches continue to be refined to further embed risk management within NS&I's business, and during 2006-07 training was provided to all key risk and sub-risk owners in the use of new risk management software, which came into use during the year. The new software and associated processes will provide greater ownership of risk and risk management processes.

During 2006-07, considerable progress continued to be made on developing our business continuity plans.

Compliance policies and procedures have been strengthened during 2006-07. This has led to:

- Further review of the evidence of identity policy to enhance anti-money laundering procedures including a risk-based approach to anti-money laundering;
- Strengthening the Compliance resources by recruiting more staff;
- Formalising Compliance governance by the implementation of the Compliance Steering Group with membership from across the business including Siemens;
- The appointment of a Compliance manager by Siemens;
- Implementation of a financial promotions policy development group to provide a consistent approach across media channels;
- Computer-based training for awareness on Data Protection Act, Freedom of Information Act and money laundering in the operational areas;
- Implementing a comprehensive compliance focused audit programme to give assurance to EMT; and
- Working closely on partnership programmes with Post Office including a review of outsourced arrangements and an extensive Post Office audit.

Plans for 2007-08 include recruitment of increased central resources to further strengthen the risk management process, an enhanced overall risk framework and the establishment of more formal compliance reviews to complement the internal audit approach.

## 5. Review of effectiveness

As Accounting Officer, I also have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the Executive Directors and managers within the department and Siemens, who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports.

The Board satisfies itself on the adequacy of the risk management process and reviews the management of each key residually red risk at least annually by examining evidence of performance against objectives and targets, the timely identification and assessment of significant risks, the prioritisation of risks and the allocation of resources to address areas of exposure, the ability of NS&I to learn from its experiences and the commitment and speed with which corrective actions are implemented. The Board also reviews the internal and external risk profile for the coming year and considers if current internal control arrangements are likely to be effective.

The Executive Management Team conducts quarterly reviews of the risk register and reports on residually red risks to the Audit Committee, which in turn reviews residually red risks each quarter, and reviews annually the assurance on the overall system of internal control provided by the Head of Internal Audit, and advises the Board of its assessment of the internal control system.

The Head of Internal Audit provides the Audit Committee with regular reports on internal audit activity, including his independent opinion on the adequacy and effectiveness of the system of internal control, together with recommendations for improvement.

The overall internal audit plan and audit process for the NS&I business, led by Deloitte Touche, is based on management's assessment of risk throughout the business. In my opinion, and that of the Audit Committee, this appreciably enhances the internal audit process, and hence of the value of the internal audit assurance. We will continue our ongoing process for assessing internal controls against best practice across all systems and products. The approach to reviewing effectiveness and plans to ensure the continuous improvement of the systems in place will be further refined in 2007/08.



**Jane Platt**  
Director of Savings  
NS&I

3 July 2007

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

I certify that I have audited the financial statements of the NS&I's Products Accounts for the year ended 31 March 2007 under the Government Resources and Accounts Act 2000. These comprise the Income and Expenditure Account, the Balance Sheet and the Cash Flow Statement and the related notes. These financial statements have been prepared under the accounting policies set out within them.

## **Respective responsibilities of the Accounting Officer and auditor**

The Accounting Officer is responsible for preparing the Foreword and the financial statements in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions made thereunder and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of Accounting Officer's Responsibilities.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, and with International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the financial statements give a true and fair view and whether they have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000. I report to you whether, in my opinion, the Foreword is consistent with the financial statements. I also report whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities that govern them.

In addition, I report to you if NS&I has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit. I also report whether the financial statements give a true and fair view of the balances held in respect of NS&I's products as at 31 March 2007.

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

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

## Basis of audit opinion

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Accounting Officer in the preparation of the financial statements, and of whether the accounting policies are most appropriate to NS&I's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations, which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error and that in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities that govern them. In forming my opinion, I also evaluated the overall adequacy of the presentation of information in the financial statements and the Foreword.

## Opinions

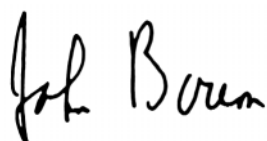
In my opinion:

- the financial statements give a true and fair view, in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by HM Treasury, of the state of NS&I's affairs as at 31 March 2007, of the balances held in respect of NS&I's products as at 31 March 2007 and of the income and expenditure and cash flows for the year then ended;
- the financial statements and the Foreword have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000; and
- information given within the Foreword is consistent with the financial statements.

## Audit Opinion on Regularity

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

I have no observations to make on these financial statements.



### John Bourn

Comptroller and Auditor General  
National Audit Office  
157-197 Buckingham Palace Road  
Victoria  
London SW1W 9SP

6 July 2007

# Income and Expenditure account (I&E)

for year ended 31 March 2007

	Notes	2006/07 £000s	Restated 2005/06 £000s
Interest and prizes earned by investors	2	<u>2,876,933</u>	<u>2,544,142</u>
Financed by the NLF	3	(2,873,362)	(2,540,876)
Financed by the CRND	4	<u>(3,571)</u>	<u>(3,266)</u>
		<u>(2,876,933)</u>	<u>(2,544,142)</u>
<b>Net Cost</b>		<u>0</u>	<u>0</u>

The notes on pages 13 to 24 form part of these accounts.

The effect of restatement is explained in note 14.

# Balance sheet

as at 31 March 2007

	Notes	31/03/07 £000s	Restated 31/03/06 £000s
<b>Assets</b>			
Held by the NLF	3	77,965,989	72,454,795
Held by the CRND	4	340,196	353,335
Cash at bank and in hand		430,962	402,553
Debtors	5	171,540	137,249
	10	<u>78,908,687</u>	<u>73,347,932</u>
<b>Liabilities</b>			
Liability to investors			
Principal		(77,571,565)	(72,230,645)
Accrued interest and prizes		<u>(1,289,572)</u>	<u>(1,072,664)</u>
		(78,861,137)	(73,303,309)
Unclaimed monies		<u>(39,727)</u>	<u>(37,392)</u>
<b>Total Funds Invested</b>	7	<u>(78,900,864)</u>	<u>(73,340,701)</u>
Other creditors	6	(7,823)	(7,231)
	10	<u>(78,908,687)</u>	<u>(73,347,932)</u>
<b>Net Assets</b>		<u>0</u>	<u>0</u>

The notes on pages 13 to 24 form part of these accounts.

The effect of restatement is explained in note 14.

*Jane Platt*

**Jane Platt**  
Director of Savings  
NS&I

3 July 2007

# Cash flow statement

for the year ended 31 March 2007

	Notes	2006/07 £000s	2005/06 £000s
Net cash inflow from transactions with investors	8	2,649,531	2,323,557
Net cash outflow from the NLF and the CRND	9	(2,621,122)	(2,423,930)
Increase/(Decrease) in cash at bank and in hand		<u>28,409</u>	<u>(100,373)</u>

The notes on pages 13 to 24 form part of these accounts.

# Notes to the Accounts

## 1. Accounting policies

**Basis of Preparation:** The accounts are prepared in accordance with an Accounts Direction given by the HM Treasury under the Government Resources and Accounts Act 2000, complying with the extent specified therein and with the HM Treasury's Government Financial Reporting Manual (FRM). The principal accounting policies applied in the preparation of these accounts are set out below.

**Changes in accounting policies:** With effect from 01/04/2006 NS&I has adopted FRS26, 'Financial instruments: Measurement', and FRS29, 'Financial instruments: Disclosures'. The adoption of these standards represents a change in accounting policy. Comparative figures have been restated accordingly (see note 14). The main impact of this change has been on the accounting for the Guaranteed Equity Bonds (GEB) and the associated embedded and hedging derivatives where current and prior year figures for the balance sheet valuation have been restated and additional disclosures regarding valuation provided. In the I&E Account the Interest and Prizes earned by investors and the Financed by the NLF figures have been adjusted by an equal and opposite amount to reflect the change in accounting policy. The impact on the Balance Sheet is that the GEB accrued interest figures on both the asset and liability sides have also been equally adjusted. There is therefore a nil effect on both net cost and net assets. Some of the standards' disclosures are not applicable to NS&I such as the capital disclosures as set out in the Accounts direction (see Annex). No other restatements were required as result of FRS26 adoption.

**Income and Expenditure Statement (I&E):** The I&E Statement has been included in the accounts as required under the revised Accounts Direction. The Transaction with Investors Statement has been removed from the primary statements. However, this information is still included in note 2 to the accounts.

**Interest and prizes earned by investors:** Interest is deemed to capitalise when it starts earning further interest in accordance with the terms and conditions applicable to each product. Capitalised interest is included within interest earned in the I&E account and is included within the principal owed to investors in the Balance Sheet. Interest and index linking, where applicable, are accrued from the date of receipt or most recent capitalisation to the end of the accounting period. Index Linked Savings Certificates are directly linked to increases in the Retail Price Index.

The prize fund for Premium Bonds relating to the first day of the following month is accrued as investments are eligible for this draw if they are still held at the end of the month.

**Financed by the CRND/NLF:** The interest and prizes earned by investors is funded by the CRND (Ordinary account only) and the NLF (all other products). The accounting policy for the CRND/NLF interest is as outlined under 'Interest and prizes earned by investors' and is therefore equal and opposite in total, resulting in a net cost of zero as per the I&E account.

**Liabilities to investors:** A receipt from an investor is recognised as a liability when NS&I or one of its agents receives a payment instrument for a valid investment. Payments are recognised as a reduction in the liability to the investor on the date of the payment instrument. Where payment instruments are not paid within their stipulated time limit the liability to investor is reinstated.

If an investor decides to reinvest funds in the same or another product this is termed a reinvestment and is recognised as a payment and new receipt. An automatic or default rollover of funds within the same product, which requires no action by the investor, is not recognised as a payment or receipt.

The embedded derivative contained within the GEB product is included at fair value within the total liability to investors. See also note 7.

**Measurement bases:** All assets and liabilities, excluding the financial derivative and the hedging derivative embedded within the GEB product, are stated on an amortised cost basis. Embedded derivatives within the GEB product and the related hedge have been separately measured at fair value. The fair value of derivative contracts that hedge the GEB embedded derivative is calculated by an independent specialist and provided to NS&I by the DMO of HM Treasury. The value of the hedging derivative is determined by the use of an Asian clique derivative model, which includes the following standard factors for options: FTSE 100 strike, FTSE dividend yield, time to maturity, implied FTSE volatility, and the risk-free yield.

The fair value of the embedded derivative is set at an equal and opposite value to the hedging derivative with both values being reflected on the liabilities and assets sides of the Balance Sheet respectively.

**Relationships with the NLF and the CRND:**

NS&I is the Government's retail savings agency. All funds from investors are payable to either the NLF or the CRND and all liabilities to investors are discharged from funds payable by the NLF and the CRND, on a statutory basis. Risks relating to liabilities to investors are met wholly by the NLF and the CRND. Further, the Product Accounts present only a part of the Government's overall financing requirement that is managed by the HM Treasury rather than NS&I, including through the NLF and the CRND, (with recourse to the Consolidated Fund) and is financed ultimately from the Government's tax revenues. Due to the nature of these arrangements the risk management and capital disclosure requirements of FRS29 are not applicable for these accounts.

The analysis by principal liability and accrued interest of the total funds Held by/Financed by the NLF (note 3) and the CRND (note 4) does not equal the total funds invested by product (note 7) i.e. liability to investors. This is due to timing differences in the flow of funding and defunding movements between NS&I and its agents and the NLF/CRND via the Bank of England bank accounts. This difference is represented by the net of cash plus debtors minus other creditors. Principal amounts are classified as loans and receivables except for the hedging derivative balance (note 10) and interest earned is as set out in the interest note above.

**GEB:** In March 2002, NS&I began to issue GEB in partnership with the DMO. The DMO hedges the equity index exposure resulting from the sale of these products to investors. Each equity derivative comprises two forward derivatives that address the risk features of the positions being hedged; equity index risk and interest rate risk. Both transactions are reported at market value on the Balance Sheet. The embedded derivative and the hedging derivative are included in the GEB figures as set out in note 7 and 3 respectively. NS&I does not hold the underlying position being hedged. The DMO is exposed to equity index risk and interest rate risk over the life of the derivatives.

## 2. Transactions with investors by product

	Received from investors	Interest and prizes earned	Paid to investors including tax deducted at source	Increase/ (decrease) in investors funds	Restated Invested at 31/03/06	Invested at 31/03/07
	£000s	£000s	£000s	£000s	£000s	£000s
British Savings Bonds	–	–	(11)	(11)	2,684	2,673
Capital Bonds	20,964	51,159	(137,077)	(64,954)	1,197,586	1,132,632
Children's Bonus Bonds	54,283	51,590	(105,882)	(9)	1,309,571	1,309,562
Deposit Bonds	–	–	(609)	(609)	6,465	5,856
Easy Access Savings Account	511,599	39,167	(510,233)	40,533	1,005,581	1,046,114
First Option Bonds	–	7,958	(25,630)	(17,672)	215,681	198,009
Fixed Rate Savings Bonds	91,602	22,830	(94,251)	20,181	549,819	570,000
Gift Tokens	–	–	(4)	(4)	1,539	1,535
GEB	67,173	93,560	(3,720)	157,013	1,196,829	1,353,842
Income Bonds	595,562	325,048	(1,039,474)	(118,864)	7,455,861	7,336,997
Individual Savings Account	1,405,600	102,402	(522,602)	985,400	1,725,481	2,710,881
Investment Account	555,032	202,644	(1,181,818)	(424,142)	6,067,714	5,643,572
Ordinary Account	760	3,571	(20,069)	(15,738)	328,732	312,994
Pensioners' Guaranteed						
Income Bonds	365,508	136,848	(732,985)	(230,629)	3,316,088	3,085,459
Premium Bonds	8,422,391	1,068,736	(5,346,953)	4,144,174	31,104,925	35,249,099
Save As You Earn	–	425	(526)	(101)	11,430	11,329
Savings Certificates	2,063,126	768,005	(1,746,986)	1,084,145	17,754,653	18,838,798
Savings Stamps	–	–	(4)	(4)	5,780	5,776
Treasurers' Account	11,721	2,448	(11,674)	2,495	59,607	62,102
Yearly Plan	–	542	(1,583)	(1,041)	24,675	23,634
<b>Total</b>	<b>14,165,321</b>	<b>2,876,933</b>	<b>(11,482,091)</b>	<b>5,560,163</b>	<b>73,340,701</b>	<b>78,900,864</b>

First Option Bonds and Fixed Rate Savings Bonds are the only products which have tax deducted at source.

As a result of the adoption of FRS26, the 31/03/2006 value of the GEB has been restated to £1,196,829,000 from £1,227,329,000 to include the embedded derivative at fair value. As a result the total invested at 31/03/2006 has been reduced by £30,500,000. See also note 14. Included in the interest and prizes figure at 31/03/2007 is an amount of £68,380,000 (31/03/2006; £177,237,000) which represents the fair value movement on the embedded derivative contained within the GEB products.

Increase in investors' funds is equal to increase in the total funds invested in the Balance Sheet.

### 3. Amounts held by the NLF

	31/03/07	Restated 31/03/06
	£000s	£000s
At 01 April	72,454,795	67,483,610
Interest and Prizes earned by investors Received from the NLF	2,873,362	2,540,876
	(10,374,011)	(9,055,104)
Paid to the NLF	13,011,843	11,485,413
At 31 March	<u>77,965,989</u>	<u>72,454,795</u>

The amounts held by the NLF as at 31 March 2007 relate to the following products:

	Principal liability £000s	Accrued interest £000s	Total £000s
Capital Bonds	1,089,746	31,238	1,120,984
Children's Bonus Bonds	1,252,823	51,933	1,304,756
Easy Access Savings Account	1,019,657	–	1,019,657
First Option Bonds	192,470	4,442	196,912
Fixed Rate Savings Bonds	553,129	8,793	561,922
GEB	926,489	417,339	1,343,828
Income Bonds	7,277,962	26,229	7,304,191
Individual Savings Account	2,542,049	96,658	2,638,707
Investment Account	5,569,055	53,326	5,622,381
Pensioners' Guaranteed Income Bonds	3,062,584	4,750	3,067,334
Premium Bonds	34,853,165	78,687	34,931,852
Save As You Earn	5,631	5,612	11,243
Savings Certificates	18,294,470	462,736	18,757,206
Treasurers' Account	60,787	671	61,458
Yearly Plan	23,191	367	23,558
<b>Total</b>	<u>76,723,208</u>	<u>1,242,781</u>	<u>77,965,989</u>

Due to the adoption of FRS26, prior year interest and prizes earned held by the NLF has been restated from £2,534,739,000 to £2,540,876,000 due to the GEB, which includes the hedging derivative which is measured at fair value. See also note 14.

Included in the Financed by NLF in I&E figure at 31 March 2007 is an amount of £68,380,000 (31 March 2006; £177,237,000) which represents the fair value movement on the hedging derivative contained within the GEB products.

The accrued interest figure at 31 March 2007 of £417,339,000 (31 March 2006; £348,959,000) represents the fair value on the hedging derivative contained within the GEB products.

#### 4. Amounts held by the CRND

	31/03/07	31/03/06
	£000s	£000s
At 01 April	353,335	356,448
Interest payable to investors	3,571	3,266
Received from the CRND	(20,878)	(10,571)
Paid to the CRND	4,168	4,192
At 31 March	<u>340,196</u>	<u>353,335</u>

The amounts held by the CRND as at 31 March 2007 relate to the following products:

	Principal liability £000s	Accrued interest £000s	Unclaimed monies £000s	Total £000s
British Savings Bonds	–	–	2,644	2,644
Gift Tokens	–	–	1,529	1,529
Income Bonds	–	–	2,439	2,439
Ordinary Account	299,357	1,172	–	300,529
Pensioners' Guaranteed Income Bonds	–	–	249	249
Premium Bonds	–	–	27,035	27,035
Savings Stamps	–	–	5,771	5,771
Total	<u>299,357</u>	<u>1,172</u>	<u>39,667</u>	<u>340,196</u>

Unclaimed monies represent old uncleared payments to investors which are transferred to the CRND under National Savings Stock Register Regulations 1976.

#### 5. Debtors

	31/03/07	31/03/06
	£000s	£000s
Agents	171,174	136,538
Other debtors	366	711
	<u>171,540</u>	<u>137,249</u>

NS&I is in partnership with Post Office Limited as its agent. The Post Office provides a face-to-face counter service for customers who can purchase or make repayments for NS&I products.

## 6. Other Creditors

	31/03/07 £000s	31/03/06 £000s
NLF	81	63
HM Revenue	12	1
Agents	7,668	66
Other creditors	62	7,101
	<u>7,823</u>	<u>7,231</u>

## 7. Total funds invested by product

2006/07	Principal liability £000s	Accrued interest and prizes £000s	Unclaimed monies £000s	Total funds invested £000s
British Savings Bonds	–	–	2,673	2,673
Capital Bonds	1,101,394	31,238	–	1,132,632
Children's Bonus Bonds	1,257,629	51,933	–	1,309,562
Deposit Bonds	5,856	–	–	5,856
Easy Access Savings Account	1,046,114	–	–	1,046,114
First Option Bonds	193,567	4,442	–	198,009
Fixed Rate Savings Bonds	561,207	8,793	–	570,000
Gift Tokens	–	–	1,535	1,535
GEB	936,503	417,339	–	1,353,842
Income Bonds	7,300,772	33,702	2,523	7,336,997
Individual Savings Account	2,614,223	96,658	–	2,710,881
Investment Account	5,590,246	53,326	–	5,643,572
Ordinary Account	311,822	1,172	–	312,994
Pensioners' Guaranteed Income Bonds	3,077,659	7,518	282	3,085,459
Premium Bonds	35,108,096	114,065	26,938	35,249,099
Save As You Earn	5,717	5,612	–	11,329
Savings Certificates	18,376,062	462,736	–	18,838,798
Savings Stamps	–	–	5,776	5,776
Treasurers' Account	61,431	671	–	62,102
Yearly Plan	23,267	367	–	23,634
Total	<u>77,571,565</u>	<u>1,289,572</u>	<u>39,727</u>	<u>78,900,864</u>

An analysis of total funds invested by product for the previous year is in note 2.

The accrued interest figure at 31 March 2007 of £417,339,000 (31 March 2006; £348,959,000) represents the fair value on the embedded derivative contained within the GEB products.

**8. Net cash inflow from transactions with investors**

	2006/07 £000s	2006/07 £000s	Restated 2005/06 £000s
Net increase in total funds invested		5,560,163	4,857,016
Adjustments for non-cash items			
Interest and prizes earned by investors		(2,876,933)	(2,544,142)
		<u>2,683,230</u>	<u>2,312,874</u>
Adjustments for movements in working capital other than cash			
(Increase)/Decrease in Debtors	(34,291)		6,114
Increase in Other Creditors	<u>592</u>		<u>4,569</u>
		(33,699)	
Net cash inflow		<u>2,649,531</u>	<u>2,323,557</u>

For 2005/06, the net increase in total funds invested has been reduced (as result of prior year restatement by £6,137,000) while the Interest and prizes earned by investors has increased by the same amount. This restatement is due to the adoption of FRS26, where the embedded derivative and hedge on the GEB are measured at fair value.

Although note 8 figures have been restated, the net cash flow impact is same as in prior year published accounts. See also note 14.

**9. Net cash outflow from the NLF and the CRND**

	2006/07 £000s	2006/07 £000s	2005/06 £000s
<b>NLF</b>			
Received from the NLF	10,374,011		9,055,104
Paid to the NLF	<u>(13,011,843)</u>		(11,485,413)
		(2,637,832)	
<b>CRND</b>			
Received from the CRND	20,878		10,571
Paid to the CRND	<u>(4,168)</u>		(4,192)
		16,710	
Net cash outflow		<u>(2,621,122)</u>	<u>(2,423,930)</u>

Cash received from investors is passed to the NLF for all products apart from Ordinary Account where cash is passed to the CRND. Cash is not invested by NS&I. Cash to make payments to investors is drawn down from the NLF or the CRND as and when required.

## 10. Categorisation of Financial Assets and Liabilities

	2006/07 £000s	2005/06 £000s
<b>Assets</b>		
Financial assets measured at fair value through I&E	417,339	348,959
Loans & receivables	78,060,386	72,596,420
Cash	430,962	402,553
	<u>78,908,687</u>	<u>73,347,932</u>
<b>Liabilities</b>		
Financial liabilities measured at fair value through I&E	(417,339)	(348,959)
Financial liabilities measured at amortised cost	(78,491,348)	(72,998,973)
	<u>(78,908,687)</u>	<u>(73,347,932)</u>

## 11. Market and Credit Risk

NS&I is a Government agency. NS&I's principal activity is financing a part of the Government borrowing by selling savings and investments products to retail savers and investors. The monies received are invested on exactly the same terms as the retail savings and investment products with the NLF or the CRND. NS&I has no specific liquidity reserve as direct access to the NLF cash is available. All assets are held with the UK Government and therefore, against this background, NS&I does not face any material market or credit risk.

NS&I has no liquidity risk in respect of customer sales and repayments as such liquidity is managed through bank accounts held at the Bank of England and linked to the Ways and Means accounts at the NLF to ensure a smooth flow of funds between the NLF, NS&I and our customers. Interest rate risk belongs to UK Government and is managed by the NLF in conjunction with the DMO. Liquidity is also managed by giving customers a fair deal in a highly competitive market. NS&I offer products that suit customer needs, backed by excellent customer service and consistent product pricing. There is no currency exposure as all assets and liabilities are denominated in sterling.

## 12. Maturity Profile

GEB products are repayable at the end of their term. All other products are repayable on demand. The liability maturity profile for the total liability for all products is as follows:

	31/03/07 £000s	Restated 31/03/06 £000s
Maturing in one year or less or repayable on demand	77,907,535	72,151,103
Maturing in more than one year but not more than two years	387,211	328,012
Maturing in more than two years but not more than five years	607,377	868,817
Maturing in more than five years	6,564	–
	<u>78,908,687</u>	<u>73,347,932</u>

Due to the GEB embedded derivative shown at fair value the prior year total has been restated by (£23,269,000) of which (£30,500,000) is due to the GEB product being shown at fair value and £7,231,000 being the Other Creditors balance (see note 6) which is now included in the total liability figure.

This restatement is due to the adoption of FRS26, whereby the embedded derivative on the GEB product is measured at fair value.

### 13. Fair Values of Assets and Liabilities

	31/03/07 Total per Accounts £000s	31/03/07 Fair Values £000s
<b>Assets</b>		
Held by the NLF – all products apart from GEB	76,612,147	75,322,846
Held by the NLF – GEB	1,353,842	1,318,874
Held by the CRND	340,196	340,196
Cash	430,962	430,962
Debtors	171,540	171,540
	<u>78,908,687</u>	<u>77,584,418</u>
<b>Liabilities</b>		
Fixed rate products	13,636,553	12,347,252
GEB	1,353,842	1,318,874
Floating rate products	63,841,654	63,841,654
Non interest bearing products	68,815	68,815
Other creditors	7,823	7,823
	<u>78,908,687</u>	<u>77,584,418</u>

	31/03/06 Total per Accounts £000s	31/03/06 Fair Values £000s
<b>Assets</b>		
Held by the NLF – all products apart from GEB	71,257,966	70,051,005
Held by the NLF – GEB	1,196,829	1,166,022
Held by the CRND	353,335	353,335
Cash	402,553	402,553
Debtors	137,249	137,249
	<u>73,347,932</u>	<u>72,110,164</u>
<b>Liabilities</b>		
Fixed rate products	14,195,839	12,988,878
GEB	1,196,829	1,166,022
Floating rate products	57,879,416	57,879,416
Non interest bearing products	68,617	68,617
Other creditors	7,231	7,231
	<u>73,347,932</u>	<u>72,110,164</u>

As there is no material difference between the carrying value and the fair value of the floating rate products (except GEB), non-interest bearing products, other creditors and debtors are all therefore deemed to be at fair value. The fair value of the fixed rate products is derived by discounting future expected cash flows. Any impact of early repayments is ignored as the impact of these is immaterial. The fair value of the assets held by the NLF is a mirror of the related liabilities which it guarantees subject to timing differences.

The fair value of the GEB product is the total of the fair value of the embedded derivative and the fair value of the related host contract. The fair value of the embedded derivative is calculated by an independent specialist company and provided to NS&I by the DMO. The fair value of the host contract is derived by discounting future expected cashflows at an appropriate zero coupon bond rate. The impact of early repayments on GEB products has proven to be not material and therefore, does not impact upon the fair values shown. For each GEB issue a matched hedge is in place with the DMO.

For Assets held by the CRND the carrying value is equal to fair value and the carrying value of liabilities is equal to fair value.

## 14. Impact of change in accounting policy

As the change in accounting policy only impacts on the GEB, current year and prior year I&E, Balance Sheet and notes 2, 3, 8 and 12 have been restated for the accrued interest on the GEB. The prior year I&E interest figure of £193,450,000 has been revised to £199,587,000. The prior year Balance Sheet (both asset and liability) GEB accrued interest figure of £301,258,000 has been revised to £348,959,000. The current year I&E accrued interest figure of £90,657,000 has been revised to £93,560,000. The current year Balance Sheet (both asset and liability) GEB accrued interest figure of £391,740,000 has been revised to £417,339,000.

FRS26 requires all embedded derivatives that are not closely related to the host contract, and which are embedded in financial instruments which are accounted for other than at fair value through I&E, to be separated from the host contract. The separated embedded derivative must be measured at fair value through the I&E.

The GEB contain embedded equity options. These embedded options expose the investor to FTSE-100 risk. This risk is not closely related to the interest rate risk of the host debt product and the equity options therefore require separation. The separated equity options will be initially and subsequently measured at fair value through the I&E.

FRS26 requires the hybrid contract to be separated into its component parts at initial recognition. The fair value of the hybrid instrument, being the amount of funds invested by the customer, will be assigned between the equity options and host debt contract as follows:

- The equity options will be initially measured at their fair value; and
- The host contract will be initially measured at an amount equal to the difference between the fair value of the hybrid contract and the fair value of the options.

This will result in the host debt contract being initially measured and recognised at an amount other than the funds invested by the client. This amount will be subsequently measured at amortised cost based on the effective interest rate.

The underlying principal liability of £926 million is shown at amortised cost as it is held to maturity. However, the fair value of this is disclosed in note 13 as part of the overall GEB fair value disclosure.

# ANNEX: Accounts Direction

## ACCOUNTS DIRECTION GIVEN BY HM TREASURY IN ACCORDANCE WITH SECTION 7(2) OF THE GOVERNMENT RESOURCES AND ACCOUNTS ACT 2000

1. The Department of National Savings and Investments shall prepare accounts for its Product Accounts for the year ending 31 March 2007 (and each subsequent financial year) that give a true and fair view of the state of affairs of the Product Accounts at the balance sheet date and of their income and expenditure and cash flows for the year then ended. The accounts shall be prepared under the historical cost convention modified to include certain financial instruments at valuation and in accordance with applicable accounting standards.
2. The accounts shall be consistent with relevant requirements of the Government Financial Reporting Manual, except to the extent set out below:
  - a. An income and expenditure account shall be prepared instead of an Operating Cost Statement;
  - b. the Statement of Parliamentary Supply and the Statement of Operating Costs by Departmental Aim and Objectives are not relevant to the Product Accounts; and
  - c. the accounts shall follow the requirements of FRS23 (IAS 21) The Effects of Changes in Foreign Exchange Rates (instead of SSAP 13, Foreign Currency Translation), FRS25 (IAS 32) Financial Instruments: Presentation), FRS26 (IAS 39) Financial Instruments: Measurement, and FRS29 (IFRS 7) Financial Instruments: Disclosures (instead of FRS13 Derivatives and other financial instruments: disclosures) other than Appendix E, Capital disclosures.
3. This Accounts Direction shall be reproduced as an Appendix to the Product Accounts.
4. This Accounts Direction supersedes that issued on 22 May 2002



David Watkins  
Head, Financial Reporting Policy  
HM Treasury  
23 May 2007

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