Tesco Personal Finance Limited

Directors' Report and Financial Statements

31 December 2006

Registered in Scotland No 173199

Tesco Personal Finance Limited

Directors' Report and Financial Statements
31 December 2006

Directors and Advisers

Directors	Andrew Thomas Higginson – Chairman Norman Cardie McLuskie – Deputy Chairman Timothy Robert Ashdown Robin Bulloch Iain Clink John William Melbourn CBE Christopher Paul Sullivan Laura Katharine Wade Gery Gordon Frances Pell
Secretary	Alan Ewing Mills
Registered Office	24 St Andrew Square Edinburgh EH2 1AF
Telephone	0131 556 8555
Auditors	Deloitte & Touche LLP Edinburgh
Bankers	The Royal Bank of Scotland plc 36 St Andrew Square Edinburgh EH2 2YB

Directors' Report

The directors present their annual report and the audited financial statements for the year ended 31 December 2006

Principal activities

The Company is engaged in the provision of banking and other financial services

Review of the year

Business review

The directors are satisfied with the Company's performance in the year The Company continues to trade successfully within a difficult retail financial services market During the year the Company further expanded its customer base through its principal products personal loans, credit cards, savings accounts, investment products and general insurance

In the forthcoming year the Company intends to grow its existing customer base and introduce additional financial products and services

An interim dividend of £60,000,000 (2005 £nil) was paid on 30 June 2006 and a final dividend of £70,000,000 (2005 £70,000,000) was paid on 21 December 2006

The directors do not anticipate any material change in either the type or level of activities of the Company The directors consider the Company to be in a strong financial position and confirm that the Company has adequate resources to continue in business for the foreseeable future Accordingly they continue to adopt the going concern basis in preparing the financial statements

Financial Performance

The Company's financial performance is presented in the Income Statement on Page 7

Income grew by £26,045,000 and expenses rose by £13,228,000 After impairment provisions of £114,588,000 the profit for the year was £175,139,000, a fall of 7% over 2005, profit before impairment provisions increased by 5%

The Company's cost income ratio for the year was 42 7% (2005 42 3%) The Company's net interest margin for 2006 was 3 3% (2005 3 1%) and the bad debt coverage at the year end was 4 8% (2005 4 1%)

At the year end the Company's financial position showed total assets of £7,486m, a fall of 2% over 2005, including income generating assets comprising investments of £259m and advances of £7,039m The net book value of property, plant and equipment was £15m compared with £17m at the end of the previous year The Company's risk asset ratio was 12 5% at the year end (2005 12 7%)

Other Matters

The Company is funded by facilities from The Royal Bank of Scotland plc It seeks to minimise its exposure to external financial risks other than credit risk, further information on financial risk management policies and exposures is disclosed in Note 25 to the financial statements

Directors' Report (continued)

Directors

The present directors and Secretary who have served throughout the year, except where noted below, are listed on page 1

From 1 January 2006 to date the following changes have taken place

Directors	Appointed	Resigned
B Higgins		5 January 2006
J T Macdonald		18 August 2006
I H Chippendale		25 August 2006
T J R Mason		25 August 2006
Miss A E Court	25 August 2006	8 November 2006
R Bulloch	29 September 2006	
G F Pell	2 February 2007	

No director had an interest in the share capital of the Company

Financial instruments

The major risks associated with the Company's business are market risk, liquidity risk, credit risk and operational risks The Company has established a comprehensive framework for managing these risks, which evolves as the Company's business activities change in response to market, credit, product and other developments The Company's policies for managing each of these risks and its exposure thereto are detailed in note 25 to the financial statements

Directors' responsibilities

The directors are required by the Companies Act 1985 to prepare a directors' report and financial statements for each financial year and have elected to prepare them in accordance with International Financial Reporting Standards They are responsible for preparing financial statements that present fairly the financial position, financial performance, and cash flows of the Company In preparing those financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume the Company will continue in business

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the directors' report and financial statements comply with the Companies Act 1985 They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

Directors' Report (continued)

Directors' statement as to disclosure of information to auditors

Each of the directors at the date of approval of this report confirms that
(1) so far as he/she is aware there is no relevant audit information of which the company's auditors are unaware, and
(2) the director has taken all the steps that he/she ought to have taken to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information
This confirmation is given and shall be interpreted in accordance with the provisions of section 234ZA of the Companies Act 1985

Directors' indemnities

In terms of Section 309C of the Companies Act 1985 Mr NC McLuskie, Mr IH Chippendale, Mr I Clink, Mr B Higgins, Mr JT Macdonald, Miss A E Court, Mr R Bulloch, Mr G F Pell and Mr CP Sullivan have been granted Qualifying Third Party Indemnity Provisions by The Royal Bank of Scotland Group plc

Charitable and political donations

No donations were made by the Company during the year for political purposes (2005 £nil) The following charitable donations were made

Charitable organisation	2006 £	2005 £
National Deaf Children's Society	200	
Save the Children		500
Age Concern		500

Supplier payment policy

In the year ending 31 December 2006, the Company will continue to adhere to the following payment policy in respect of all suppliers The Company is committed to maintaining a sound commercial relationship with its suppliers Consequently, it is the Company's policy to negotiate and agree terms and conditions with its suppliers, which includes the giving of an undertaking to pay suppliers within 30 days of receipt of a correctly prepared invoice submitted in accordance with the terms of the contract or such other payment period as may be agreed

At 31 December 2006, the Company's trade creditors represented 24 days (2005 24 days) of amounts invoiced by suppliers

Auditors

Deloitte & Touche LLP have expressed their willingness to continue in office as auditors and a resolution to re appoint them will be proposed at the forthcoming Annual General Meeting

Approved by the Board of Directors and signed on behalf of the Board

Alan Ewing Mills
Secretary
29 March 2007

Independent auditors' report to the members of Tesco Personal Finance Limited

We have audited the financial statements of Tesco Personal Finance Limited ("the Company") for the year ended 31 December 2006 which comprise the income statement, the balance sheet, the cash flow statement, the statement of changes in equity, the accounting policies and the related Notes 1 to 29 These financial statements have been prepared under the accounting policies set out therein

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985 Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed

Respective responsibilities of directors and auditors

As described in the directors' report, the Company's directors are responsible for the preparation of the director's report and financial statements in accordance with applicable law and International Financial Reporting Standards ("IFRS") as adopted by the European Union Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland)

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985 We also report to you whether, in our opinion, the information given in the directors' report is consistent with the financial statements In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed

We read the directors' report for the above year and consider whether it is consistent with the audited financial statements We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements Our responsibilities do not extend to any information outside the directors' report

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company, consistently applied and adequately disclosed

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements

Independent auditors' report to the members of Tesco Personal Finance Limited (continued)

Opinion

In our opinion

- the financial statements give a true and fair view of the state of the Company's affairs as at 31 December 2006 and of its profit for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the directors' report is consistent with the financial statements

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Edinburgh, United Kingdom
29 March 2007

Income Statement
For the year ended 31 December 2006

	Note	2006 £'000	2005 £'000
Interest receivable and similar income		462,781	455,110
Interest payable	3	(312,730)	(310,414)
Net interest income		150,051	144,696
Fees and commissions receivable		343,880	327,091
Fees and commissions payable		(11,961)	(9,988)
Dividend income from shares in group undertakings		22,370	16,414
Other operating income		1,402	1,484
Non interest income		355,691	335,001
Total income		505,742	479,697
Administrative expenses			
Staff costs	4	11,180	10,781
Premises and equipment		30,689	26,554
Other administrative expenses		167,903	160,011
Depreciation and amortisation		6,243	5,441
Operating expenses		216,015	202,787
Operating profit before provisions for bad and doubtful debts		289,727	276,910
Provisions for bad and doubtful debts	10	114,588	88,716
Operating profit before tax	5	175,139	188,194
Tax on operating profit	7	44,922	49,969
Profit for the year		130,217	138,225
Profit attributable to			
Ordinary shareholders		127,517	135,531
Holders of other equity instruments		2,700	2,694
		130,217	138,225

Statement of Changes in Equity
For the year ended 31 December 2006

	Share capital £'000	Share premium £'000	Equity reserve £'000	Retained earnings £'000	Total £'000
At 1 January 2006	24,790	223,110	45,000	259,093	551,993
Changes in equity for 2006					
Profit for the period			2,700	127,517	130,217
Dividends			(2,700)	(130,000)	(132,700)
At 31 December 2006	24,790	223,110	45,000	256,610	549,510

Statement of Changes in Equity
For the year ended 31 December 2005

	Share capital £'000	Share premium £'000	Equity reserve £'000	Retained earnings £'000	Total £'000
At 1 January 2005 as restated for retrospective adoption of IAS 10	24,790	223,110		213,335	461,235
Implementation of IFRS (IAS32 and IAS 39)			45,000	(19,773)	25,227
At 1 January 2005 as restated	24,790	223,110	45,000	193,562	486,462
Changes in equity for 2005					
Profit for the period			2,694	135,531	138,225
Dividends			(2,694)	(70,000)	(72,694)
At 31 December 2005	24,790	223,110	45,000	259,093	551,993

Balance Sheet
As at 31 December 2006

	Note	2006 £'000	2005 £'000
Assets			
Cash and balances at central banks		3,494	3,542
Loans and advances to banks	9	3,765,599	3,788,993
Loans and advances to customers	10	3,273,419	3,408,370
Equity investments	11	258,500	255,000
Intangible assets	13	3,206	
Property, plant and equipment	14	15,040	16,619
Other assets	15	133,028	131,236
Prepayments and accrued income	17	34,046	28,930
Total assets		7,486,332	7,632,690
Liabilities			
Deposits by banks	18	4,263,405	4,477,040
Customer accounts	19	2,396,959	2,326,023
Other liabilities	20	33,763	40,786
Accruals and deferred income	21	82,695	76,848
Subordinated liabilities	22	160,000	160,000
Total liabilities		6,936,822	7,080,697
Equity			
Called up share capital	23	24,790	24,790
Share premium account		223,110	223,110
Equity reserve		45,000	45,000
Profit and loss account		256,610	259,093
Total equity		549,510	551,993
Total liabilities and equity		7,486,332	7,632,690
Memorandum items			
Other commitments	26	5,546,226	5,961,611

The financial statements were approved by the board of directors on 29 March 2007 and were signed on its behalf by

Andrew Thomas Higginson
Chairman

Robin Bulloch
Director

Cash Flow Statement
For the year ended 31 December 2006

	Note	2006 £'000	2005 £'000
Operating activities			
Operating profit before taxation		175,139	188,194
Adjustments for			
Depreciation		6,243	5,441
Interest on subordinated liabilities		8,689	8,765
Provision for impairment losses		19,401	27,094
Other non cash items		728	(2,751)
Net cash inflow from trading activities	27	210,200	226,743
Changes in operating assets and liabilities	27	(31,056)	310,867
Net cash flows from operating activities before tax		179,144	537,610
Income taxes paid		(49,827)	(52,056)
Cash flow from operating activities		129,317	485,554
Investing activities			
Purchase of fixed assets		(7,870)	(6,249)
Cash flows from investing activities		(7,870)	(6,249)
Financing activities			
Increase in subordinated loan advance		(3,500)	
Decrease / (increase) in balance at central banks		47	(481)
Increase in loans and advances to banks		(48,000)	(66,000)
Dividends paid		(132,700)	(72,694)
Interest on subordinated liabilities		(8,689)	(8,765)
Cash flows from financing activities		(192,842)	(147,940)
Net (decrease) / increase in cash and cash equivalents		(71,395)	331,365
Cash and cash equivalents 1 January		3,397,994	3,066,629
Cash and cash equivalents 31 December	9	3,326,599	3,397,994

Notes to the Financial Statements

1 Principal accounting policies

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB and endorsed by the European Union (EU) The date of transition to IFRS for the Company and the date of its opening IFRS balance sheet was 1 January 2004

Accounting convention

The Company is incorporated in the UK and registered in Scotland The financial statements have been prepared on the historical cost basis

Revenue recognition

Interest income on financial assets that are classified as loans and receivables and interest expense on financial liabilities are determined using the effective interest rate method The effective interest rate method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount Calculation of the effective interest rate takes into account fees receivable, that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs All contractual terms of a financial instrument are considered when estimating future cash flows

Fees in respect of services are recognised as the right to consideration accrues through the provision of the service to the customer The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered The price is usually fixed and always determinable The application of this policy to significant fee types is outlined below

Card related services fees from credit card business include

Interchange received as issuer, the Company receives a fee (interchange) each time a cardholder purchases goods and services The Company also receives interchange fees from other card issuers for providing cash advances through its Automated Teller Machine networks These fees are accrued once the transaction has taken place

Late payment fees as issuer, the Company receives a fee each time a cardholder is late making a scheduled payment These fees are accrued once the transaction has taken place

Balance transfer fees as issuer, the Company receives a fee when a cardholder transfers a balance from another card issuer These fees are accrued once the transaction has taken place

Insurance commission the Company receives commission on the sale of an insurance contract The commission is accrued over the term of the policy

Intangible assets

Intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses Amortisation is charged to profit or loss using methods that best reflect the economic benefits over their estimated useful lives and is included in depreciation and amortisation The estimated useful lives are as follows,

Computer software development	3 years

Notes to the Financial Statements

1 Principal accounting policies (continued)

Plant and equipment

Items of plant and equipment are stated at cost less accumulated deprecation (see below) and impairment losses Where an item of plant and equipment comprises major components having different useful lives, they are accounted for separately

Depreciation is charged through profit or loss on a straight line basis so as to write off the depreciable amount of property, plant and equipment over their estimated useful lives The depreciable amount is the cost of an asset less its residual value Estimated useful lives for plant and equipment are between two and five years

At each reporting date, the Company assesses whether there is any indication that its plant and equipment are impaired If any such indication exists, the Company estimates the recoverable amount of the asset and the impairment loss if any

Foreign currencies

The Company's financial statements are presented in sterling, which is the functional currency of the Company

Transactions in foreign currencies are translated into sterling at the foreign exchange rate ruling at the date of the transaction Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date Foreign exchange differences arising on translation are recognised in profit or loss Non monetary items denominated in foreign currencies that are stated at fair value are translated into sterling at foreign exchange rates ruling at the dates the values were determined

Taxation

Provision is made for taxation at current enacted rates on taxable profits, arising in income or in equity Deferred taxation is accounted for in full for all temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes, except in relation to overseas earnings where remittance is controlled by the Company

Deferred tax assets are recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available in future against which the deductible temporary differences can be utilised

Financial assets and liabilities

Financial assets are classified either as loans and receivables or as available for sale

Loans and receivables – non derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables except those that are classified as held for trading or designated as fair value through profit or loss Loans and receivables are initially recognised at fair value plus directly related transaction costs They are subsequently measured at adjusted cost using the effective interest method (see note above) less any impairment losses

Available for sale – financial assets that are not classified as held for trading, designated at fair value through profit or loss, or loans and receivables are classified as available for sale Financial assets can be designated as available for sale on initial recognition Available for sale financial assets are initially recognised at fair value plus directly related transaction costs They are subsequently measured at fair value except where fair value becomes insufficiently reliable to warrant an unquoted equity instrument to be measured at fair value, then the instrument is measured at cost Exchange differences resulting from retranslating the amortised cost of monetary available for sale financial assets denominated in a foreign currency are recognised in profit or loss Other changes in the fair value of available for sale financial assets are reported in a separate component of shareholders' equity Interest is calculated using the effective interest rate (see note above) is recognised in profit or loss

All financial liabilities have been measured at amortised cost using the effective interest method (see note above)

Notes to the Financial Statements

1 Principal accounting policies (continued)

Impairment of financial assets

The Company assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as available for sale or loans and receivables is impaired A financial asset or portfolio of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset

Financial assets carried at amortised cost if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivable has been incurred, the Company measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition Impairment losses are assessed individually for financial assets that are individually significant and collectively for assets that are not individually significant In making collective assessment of impairment, financial assets are grouped into portfolios on the basis of similar risk characteristics Future cash flows from these portfolios are estimated on the basis of the contractual cash flows and historical loss experience for assets with similar credit risk characteristics Historical loss experience is adjusted, on the basis of current observable data, to reflect the effects of current conditions not affecting the period of historical experience

Impairment losses are recognised in profit or loss and the carrying amount of the financial asset or group of financial assets reduced by establishing an allowance for impairment losses If in a subsequent period the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment

Capital instruments

The Company classifies a financial instrument that it issues as a financial asset, financial liability or an equity instrument in accordance with the substance of the contractual arrangement An instrument is classified as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms An instrument is classified as equity if it evidences a residual interest in the assets of the Company after the deduction of liabilities The components of a compound financial instrument issued by the Company are classified and accounted for separately as financial assets, financial liabilities or equity as appropriate

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits with banks together with short term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of changes in value

Investments in Subsidiaries

The Company's investments in its subsidiaries are stated at cost less any impairment

Notes to the Financial Statements

2 Critical accounting policies and key sources of estimation uncertainty

The reported results of the Company for 2006 are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements The Company's principal accounting policies are set out above United Kingdom company law and IFRS require the directors, in preparing the Company's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent Where accounting standards are not specific and management have to choose a policy, International Accounting Standard ("IAS") 8 'Accounting Policies, Changes in Accounting Estimates and Errors' requires them to adopt policies that will result in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB Framework for the Preparation and Presentation of Financial Statements

The judgements and assumptions involved in the Company's accounting policies that are considered to be the most important to the portrayal of its financial condition are discussed below The use of estimates, assumptions or models that differ from those adopted by the Company would affect its reported results

Loan impairment provisions

The Company's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of loans classified as loans and receivables and carried at amortised cost A loan is impaired when there is objective evidence that events since the loan was granted have affected expected cash flows from the loan The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original effective interest rate

At 31 December 2006, gross loans and receivables totalled £3,440m (2005 £3,555m) and loan impairment provisions amounted to £166m (2005 £147m)

The Company's loan impairment provisions are established on a portfolio basis taking into account the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends The most significant factors in establishing these provisions are the expected loss rates and the related average life These portfolios include credit card receivables and other personal advances including mortgages The future credit quality of these portfolios is subject to certainties that could cause actual credit losses to differ materially from reported loan impairment provisions These uncertainties include the economic environment, notably interest rates and their effect on customer spending, the unemployment level, payment behaviour and bankruptcy trends

Notes to the Financial Statements

3 Interest payable

	2006 £'000	2005 £'000
Loans and advances to customers	99,178	97,062
Subordinated liabilities	8,763	8,765
Other amounts payable The Royal Bank of Scotland Group plc and its subsidiaries	204,789	204,587
	312,730	310,414

4 Staff costs

The Company does not have any direct employees Staff working for Tesco Personal Finance Limited have contracts with Tesco PLC or The Royal Bank of Scotland plc and their remuneration is recharged to the Company as appropriate

The average monthly number of persons (excluding executive directors) seconded to the Company during the year was 161 (2005 172)

Staff costs (including executive directors) recharged for the year are as follows

	2006 £'000	2005 £'000
Wages and salaries	8,394	7,815
Social security costs	775	720
Pension costs	666	775
Other costs including temporary staff	1,345	1,471
	11,180	10,781

Notes to the Financial Statements

5 Operating profit before tax

	2006 £'000	2005 £'000
Operating profit before tax is stated after taking account of the following		
Auditors' remuneration		
Audit services	74	72
Non audit services	21	49
Directors' emoluments (see note 6)	270	375

6 Directors' emoluments

The remuneration of the directors recharged to the Company during the year was as follows

	2006 £'000	2005 £'000
Total emoluments received by directors	270	375
Number of directors to whom retirement benefits are accruing under defined benefit schemes	2	1

Performance related bonuses are awarded on the basis of measuring annual performance against certain specified financial targets, which include both corporate performance objectives and key strategic objectives

The total emoluments of the highest paid director were £226,000 (2005 £361,000) At 31 December 2006, the accrued pension, under a defined benefit scheme, for the highest paid director was £8,000 (2005 £7,000)

7 Tax on operating profit

	2006 £'000	2005 £'000
UK corporation tax charge for the year	43,092	50,623
Tax (over)/under provided on profits for prior years	(455)	44
Total current tax	42,637	50,667
Deferred tax	2,285	(698)
	44,922	49,969

Notes to the Financial Statements

7 Tax on operating profit (continued)

The standard rate of tax for the year, based on the UK standard rate of corporation tax is 30% (2005 30%) The actual tax charge for the current and the previous year differs from the standard rate for the reasons set out in the following reconciliation

	2006 £'000	2005 £'000
Profit on ordinary activities before taxation	175,139	188,194
Tax on profit on ordinary activities at standard rate	52,542	56,458
Factors affecting charge for the year		
Non deductible items		(744)
Non taxable items	(7,521)	(5,730)
Adjustments relating to prior periods	(99)	(15)
Total tax	44,922	49,969

8 Distributions to equity holders

	2006 £'000	2005 £'000
Ordinary dividend paid	130,000	70,000
Interest paid on undated loan capital included within equity	2,700	2,694
	132,700	72,694

On 30 June 2006 an interim dividend of £0 24 (2005 £0 00) per ordinary share was paid

On 21 December 2006 a final dividend of £0 28 (2005 £0 28) per ordinary share was paid, resulting in a total dividend payment of £130,000,000 (2005 £70,000,000)

9 Loans and advances to banks

	2006 £'000	2005 £'000
Loans and receivables to The Royal Bank of Scotland plc		
Remaining maturity		
Three months or less	3,335,599	3,405,993
One year or less but over three months	36,000	24,000
Five years or less but over one year	177,000	162,000
Over five years	217,000	197,000
	3,765,599	3,788,993

Included within cash and cash equivalents is £3,326,599 (2005 £3,397,994) for loans and receivables to banks which had a maturity on original acquisition of less than 3 months

Notes to the Financial Statements

10 Loans and advances to customers

	2006 £'000	2005 £'000
Loans and receivables		
Remaining maturity		
Repayable on demand or at short notice	1,444	1,630
Three months or less	1,985,959	1,982,245
One year or less but over three months	500,975	556,857
Five years or less but over one year	842,954	894,296
Over five years	108,394	120,248
	3,439,726	3,555,276
Impairment provision for loans and advances	(166,307)	(146,906)
	3,273,419	3,408,370

The following table shows impairment provisions for loans and advances classified as loans and receivables

	2006 Total £'000	2005 Total £'000
At 1 January	146,906	108,075
Implementation of IAS 39		11,737
Amounts written off	(95,987)	(63,647)
Recoveries of amounts previously written off	8,712	6,833
Charge to the income statement	114,588	88,716
Unwind of discount	(7,912)	(4,808)
At 31 December	166,307	146,906

11 Equity investments

	2006 £'000	2005 £'000
Available for sale	258,500	255,000

During the year impairment charges of £nil were recognised on available for sale financial assets

The available for sale asset comprises an interest free subordinated loan of £258,500,000 made to Direct Line Group Limited, a wholly owned subsidiary of The Royal Bank of Scotland plc This loans has been classed as an equity investment as there is no interest received and there is no fixed repayment date The loan has been valued at cost as fair value cannot be reliably measured

Notes to the Financial Statements

12 Investments in Group undertakings

Shares in group undertakings in the current and prior year relates to a 100% shareholding in TPF ATM Services Limited which is incorporated in Scotland, amounting to £2

13 Intangible assets

	Computer Software Development £'000
Cost	
At 1 January 2006	
Additions	3,504
At 31 December 2006	3,504
Amortisation	
At 1 January 2006	
Charged during the year	298
At 31 December 2006	298
Net book value	
At 31 December 2006	3,206
At 31 December 2005	

14 Property, plant and equipment

	Plant & Equipment £'000	Fixtures & Fittings £'000	Computer Hardware £'000	Computer Software £'000	Total £'000
Cost					
At 1 January 2006	1,194	3,007	38,393	11,822	54,416
Additions	85		4,281		4,366
At 31 December 2006	1,279	3,007	42,674	11,822	58,782
Depreciation					
At 1 January 2006	1,194	2,936	22,216	11,451	37,797
Charged during the year		29	5,897	19	5,945
At 31 December 2006	1,194	2,965	28,113	11,470	43,742
Net book value					
At 31 December 2006	85	42	14,561	352	15,040
At 31 December 2005		71	16,177	371	16,619

Notes to the Financial Statements

15 Other assets

	2006 £'000	2005 £'000
Amounts payable by The Royal Bank of Scotland plc ("RBS")	95,260	96,717
Amounts payable by other companies within the RBS group	20,453	14,919
Deferred tax (see note 16)	17,315	19,600
	133,028	131,236

16 Deferred taxation

The deferred tax asset can be analysed as follows

	Accelerated capital allowances £'000	Other £'000	Total £'000
At 1 January 2006	2,826	16,774	19,600
Charged to the income statement	(537)	(1,748)	(2,285)
At 31 December 2006	2,289	15,026	17,315

The directors consider that there will be sufficient future profits to support recognition of the deferred tax asset

17 Prepayments and accrued income

	2006 £'000	2005 £'000
Amounts payable by Tesco PLC	135	142
Amounts payable by The Royal Bank of Scotland plc	2,122	7
Other prepayments and accrued income	31,789	28,781
	34,046	28,930

Notes to the Financial Statements

18 Deposits by banks

	2006 £'000	2005 £'000
Amortised cost		
Remaining maturity.		
Three months or less	1,458,039	1,636,083
One year or less but over three months	713,000	708,000
Five years or less but over one year	451,216	355,583
Over five years	1,641,150	1,777,374
	4,263,405	4,477,040

All deposits by banks are repayable to companies within The Royal Bank of Scotland plc group

19 Customer accounts

	2006 £'000	2005 £'000
Repayable on demand		
Amortised cost	2,396,959	2,326,023

20 Other liabilities

	2006 £'000	2005 £'000
Amounts owed to Tesco PLC	1,101	2,857
Amounts owed to The Royal Bank of Scotland plc	5,249	2,366
Corporation tax	19,215	26,405
Other liabilities	8,198	9,158
	33,763	40,786

All amounts owed are repayable within one year

21 Accruals and deferred income

	2006 £'000	2005 £'000
Amounts owed to Tesco PLC	4,837	5,930
Amounts owed to The Royal Bank of Scotland plc	40,195	38,379
Other accruals and deferred income	37,663	32,539
	82,695	76,848

All amounts owed are repayable within one year

Notes to the Financial Statements

22 Subordinated liabilities

	2006 £'000	2005 £'000
Amortised Cost		
Floating rate subordinated loan maturing 2008	20,000	20,000
Floating rate subordinated loan maturing 2009	20,000	20,000
Floating rate subordinated loan maturing 2010	25,000	25,000
Floating rate subordinated loan maturing 2011	30,000	30,000
Floating rate subordinated loan maturing 2017	30,000	30,000
Floating rate subordinated loan maturing 2018	35,000	35,000
	160,000	160,000

Subordinated liabilities comprise loan capital issued in equal proportions by Tesco PLC and The Royal Bank of Scotland plc

The fixed term loan capital is repayable, in whole or in part, at the option of the issuer, prior to maturity, on conditions governing the debt obligation Interest payable is based on three month LIBOR plus a range of 60 to 160 points

23 Called up share capital

	2006 £'000	2005 £'000
Authorised		
500,000,000 Ordinary shares of 10p each	50,000	50,000

	2006 £'000	2005 £'000
Allotted, called up and fully paid		
247,900,000 Ordinary shares of 10p each	24,790	24,790

24 Equity reserve

	2006 £'000	**2005 £'000**
Amortised cost		
Equity reserve	45,000	45,000

The equity reserve comprises an undated floating rate subordinated loan which has no fixed maturity date and may not be repaid except under certain conditions such as the winding up of Tesco Personal Finance Limited

Notes to the Financial Statements

25 Financial instruments

Risk Management

The major risks associated with the Company's businesses are market risk, liquidity risk, credit risk and operational risk The Company has established a comprehensive framework for managing these risks which is continually evolving as the Company's business activities change in response to market, credit, product and other developments

The Company has established clear risk policies, including limits, reporting lines and control procedures This framework is designed to provide tight control and is reviewed regularly by both Executive and Board Committees Responsibility for the control of risk within the Company is vested in the Risk Management Committee (RMC), a sub committee of the Company's Board of Directors, reporting directly to the Board The RMC establishes the strategy, policies and procedures for managing risk within the Company These policies are ratified by the Board of the Company

Market Risk

Market risk is the risk that changes in interest rates, foreign exchange rates, equity prices and other rates, prices, volatilities, correlations or other market conditions, such as liquidity, will have an adverse impact on the Company's financial condition or results

The principal market risk to which the Company is exposed is interest rate risk Mismatches between the repricing dates of the Company's assets and liabilities account for most of the interest rate risk associated with its commercial banking activities

Interest Rate Risk

Structural interest rate risk arises where assets and liabilities in the Company's commercial banking activities have different repricing dates Company policy seeks to minimise the sensitivity of net interest income to changes in interest rates Potential exposures to interest rate movements in the medium to long term are measured and controlled through position and sensitivity limits Short term exposures are measured and controlled in terms of net interest income sensitivity over 12 months to a 1 5% parallel movement in interest rates Risk is managed through arm's length cash transactions

The table below summarises the contractual interest rate sensitivity gap for the Company as at 31 December 2006 It is not necessarily indicative of the positions at other times A liability (or negative) gap position exists when liabilities reprice more quickly or in greater proportion than assets during a given period and tends to benefit net interest income in a declining interest rate environment An asset (or positive) gap position exists when assets reprice more quickly or in greater proportion than liabilities during a given period and tends to benefit net interest income in a rising interest rate environment

Notes to the Financial Statements

25 Financial instruments (continued)

2006	Within 3 months	After 3 months, but within 6 months	After 6 months, but within 1 year	After 1 year, but within 5 years	After 5 years	Non – interest bearing funds	Total
	£m	£m	£m	£m	£m	£m	£m
Assets							
Loans & advances to banks	3,339	12	24	177	217		3,769
Loans & advances to customers	848	762	307	814	107	435	3,273
Other assets						444	444
Total assets	4,187	774	331	991	324	879	7,486
Liabilities and equity							
Customer accounts	2,397						2,397
Deposits by banks	1,664	869	340	1,206	184		4,263
Other liabilities						116	116
Subordinated liabilities	160						160
Shareholders' equity	45					505	550
Total liabilities and equity	4,266	869	340	1,206	184	621	7,486
Interest rate sensitivity gap	(79)	(95)	(9)	(215)	140	258	0

Notes to the Financial Statements

25 Financial instruments (continued)

2005	Within 3 months	After 3 months, but within 6 months	After 6 months, but within 1 year	After 1 year, but within 5 years	After 5 years	Non – interest bearing funds	Total
	£m	£m	£m	£m	£m	£m	£m
Assets							
Loans & advances to banks	3,410	8	16	162	197		3,793
Loans & advances to customers	920	835	345	893	120	295	3,408
Other assets						432	432
Total assets	4,330	843	361	1,055	317	727	7,633
Liabilities and equity							
Customer accounts	2,326						2,326
Deposits by banks	1,852	881	379	1,253	112		4,477
Other liabilities						118	118
Subordinated liabilities	160						160
Shareholders' equity	45					507	552
Total liabilities and equity	4,383	881	379	1,253	112	625	7,633
Interest rate sensitivity gap	(53)	(38)	(18)	(198)	205	102	

Liquidity risk

Liquidity risk is the risk that the Company is unable to meet its payment obligations as they fall due The Company's liquidity risk is managed on a consolidated basis within The Royal Bank of Scotland Group and adheres to the liquidity requirements set by the Financial Services Authority (FSA) from time to time In the UK, the FSA requires the Company to be able to meet its sterling obligations without recourse to the wholesale markets for a period of at least five business days To meet regulatory requirements a diversified portfolio of high quality liquid and marketable assets is maintained Cash flow commitments and marketable asset holdings are measured and managed on a daily basis The Company has credit facilities from The Royal Bank of Scotland plc sufficient to meet all foreseeable outflow requirements as they fall due and its liquidity risk is further mitigated by its well diversified retail deposit base

Credit risk

Credit risk arises where the possibility exists of a counterparty defaulting on its obligations Credit risk arises principally from the Company's lending activities but also from other transactions involving on and off balance sheet instruments Limits have been established for all counterparties based on their respective credit ratings The limits and proposed counterparties are reviewed and approved by the RMC and Board of the Company

The management of individual credit risk is devolved to the operational business unit The RMC ensures that appropriate policies are established and adhered to

Notes to the Financial Statements

25 Financial instruments (continued)

Operational risk

Operational risk is the risk of unexpected losses attributable to human error, systems failures, external events, fraud or inadequate internal control and procedures The Company manages this risk through systems and procedures to monitor transactions and positions, the documentation of transactions and periodic review by internal audit The Company also maintains contingency facilities to support operations in the event of disasters

Fair values

The following table shows the carrying values and where different the fair values of financial instruments on the Company's balance sheet

	2006		2005	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m
Financial assets				
Loans and advances to banks				
Loans and receivables	**3,769**	**3,769**	3,793	3,806
Loans and advances to customers				
Loans and receivables	**3,273**	**3,273**	3,408	3,408
Equity investment				
Available for sale	**259**	**259**	255	255
Financial liabilities				
Deposits by banks				
Amortised cost	**4,263**	**4,251**	4,477	4,483
Deposits by customers				
Amortised cost	**2,397**	**2,397**	2,326	2,326
Subordinated debt				
Amortised cost	**160**	**160**	160	160

Notes to the Financial Statements

26 Commitments

The amounts shown below are intended to provide an indication of the volume of business transacted and not of the underlying credit or other risks

	2006 £'000	2005 £'000
Undrawn formal standby facilities, credit lines and other commitments to lend		
Less than one year	5,546,226	5,961,611

Under a loan commitment the Company agrees to make funds available to a customer in the future Loan commitments, which are usually for a specified term may be unconditionally cancellable or may persist, providing all conditions in the loan facility are satisfied or waived

27 Cash inflow from operating activities

	2006 £'000	2005 £'000
Operating profit before taxation	175,139	188,194
Depreciation	6,243	5,441
Interest on subordinated liabilities	8,689	8,765
Increase in prepayments and accrued income	(5,118)	(2,300)
Increase / (decrease) in accruals and deferred income	5,846	(451)
Provision for bad and doubtful debts	19,401	27,094
Net cash inflow from trading activities	210,200	226,743
Net (Increase) / decrease in deposits with banks	(213,635)	613,866
Net decrease / (increase) in customer accounts	186,486	(269,972)
Net increase in other assets	(4,075)	(36,238)
Net increase in other liabilities	168	3,211
Changes in operating assets and liabilities	(31,056)	310,867

Notes to the Financial Statements

28 Related party transactions

During the year the Company had the following transactions with related parties

(a) Transactions involving directors and other key management personnel

For the purposes of IAS 24 "Related Party Disclosures", key management comprise directors of the company and members of the Group Executive Management Committee The captions in the Group's primary financial statements include the following amounts attributable, in aggregate to key management

	2006 £'000	2005 £'000
Loans and advances to customers	48	57
Customer accounts	12	10

(b) Remuneration of key management personnel

The amount of remuneration recharged to the Company in relation to the directors and other key management personnel is set out below in aggregate Further information about the remuneration of directors is provided in note 6

	2006 £'000	2005 £'000
Short term employee benefits	1,103	1,080
Retirement benefits	134	156
	1,237	1,236

(c) Trading transactions

During the year, group companies entered into the following transactions with related parties who are not members of the Company

	2006 The Royal Bank of Scotland plc £'000	2006 Tesco PLC £'000	2005 The Royal Bank of Scotland plc £'000	2005 Tesco PLC £'000
Interest received and other income	328,864	1,402	326,436	1,484
Interest paid	(204,446)		(203,774)	
Provision of services	(53,790)	(37,736)	(54,801)	(29,557)

The amounts owed by and owed to members of the The Royal Bank of Scotland plc and Tesco PLC groups are disclosed in earlier notes

29 Holding company

The Company's ultimate parent company is Tesco Personal Finance Group Limited which is incorporated in Scotland Financial statements for Tesco Personal Finance Group Limited can be obtained from its registered office at 24 St Andrew Square, Edinburgh, EH2 1AF The smallest and largest group into which the Company is consolidated is Tesco Personal Finance Group Limited