

**Tesco Personal Finance Limited**

**Directors' Report and Financial Statements**

**31 December 2003**

Registered in Scotland No. 173199



# **Tesco Personal Finance Limited**

## **Directors' Report and Financial Statements 31 December 2003**

	<b>Pages</b>
Directors and advisers	1
Directors' report	2
Independent auditors' report	7
Profit and loss account	9
Balance sheet	10
Notes to the financial statements	11

## Directors and advisers

**Directors:**

Rowley Stuart Ager – Chairman  
Norman Cardie McLuskie – Deputy Chairman  
William Scott Black  
Ian Hugh Chippendale  
Iain Clink  
Bernard Higgins  
Andrew Thomas Higginson  
Timothy John Rolit Mason  
John William Melbourn CBE  
Kenneth Ian Towle

**Secretary:**

Alan Ewing Mills

**Registered Office:**

42 St Andrew Square  
Edinburgh  
EH2 2YE

**Telephone:**

0131 556 8555

**Registered Auditors:**

Deloitte & Touche LLP  
Edinburgh

**Bankers:**

The Royal Bank of Scotland plc  
36 St Andrew Square  
Edinburgh  
EH2 2YB

## **Directors' report 31 December 2003**

The directors present their annual report and the audited financial statements for the year ended 31 December 2003.

### **Principal activities**

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

### **Review of business and future developments**

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 further grow its existing customer base and introduce additional financial products and services as appropriate.

The cost: income ratio for the year was 45.9% (2002: 49.6%).

### **Dividends**

The directors do not recommend the payment of a dividend (2002: nil).

### **Directors**

The present directors are listed on page 1.

Mr Kenneth Ian Towle was appointed as a director of the Company on 14 February 2003. Mr Andrew William Dewhurst and Mr George Anthony Schofield resigned as directors of the Company on 28 November 2003.

### **Directors' interests**

No director had an interest in the shares of the Company.

**Directors' report (continued)**  
**31 December 2003**

**Directors' interests (continued)**

The following directors were beneficially interested in the 25p ordinary shares of The Royal Bank of Scotland Group plc, the ultimate holding company.

	<b>At 31 December 2003</b>	<b>At 1 January 2003</b>
N C McLuskie	154,508	150,037
W S Black	99,198	95,376
I H Chippendale	21,257	19,240
I Clink	10,262	9,722
B Higgins	367	352
J W Melbourn	74,613	76,656

Options to subscribe for ordinary shares of 25p each in The Royal Bank of Scotland Group plc granted to and exercised by directors during the year to 31 December 2003 are included in the table below:-

	<b>At 1 January 2003</b>	<b>Granted during the year</b>		<b>Exercised during the year</b>		<b>As at 31 December 2003</b>
		<b>Options</b>	<b>Price £</b>	<b>Options</b>	<b>Price £</b>	
N C McLuskie	116,430	39,700	12.37	90	9.85	156,040
W S Black	43,932	283	13.07	452	9.85	57,538
		14,100	12.37	325	7.41	
I H Chippendale	54,171	707	13.07	983	9.85	53,895
I Clink	27,515	226	13.07	314	9.85	41,627
		14,200	12.37			
B Higgins	70,525	40,500	12.37	20,486	7.81	87,325
				3,214	9.33	

**Directors' report (continued)**  
**31 December 2003****Directors' interests (continued)**

No director had an interest in any of the preference shares, other than as disclosed below, of The Royal Bank of Scotland Group plc for the year ended 31 December 2003. In addition, other than as disclosed below, during that year none of the directors held a beneficial interest in the loan capital of The Royal Bank of Scotland Group plc or in the share or loan capital of any of the other subsidiaries of The Royal Bank of Scotland Group plc, including the Company.

As at 31 December 2003 the following directors had an interest in the Additional Value Shares (AVS) of £0.01 each in The Royal Bank of Scotland Group plc.

	<b>No of AVS</b>	<b>No of AVS</b>
	<b>At 31 December 2003</b>	<b>At 1 January 2003</b>
N C McLuskie	-	26,584
W S Black	-	47,041
J W Melbourn	-	77,624
I Clink	-	9,319
I H Chippendale	-	5,521
B Higgins	-	52

On 31 December 2003, the Additional Value Shares were de-listed from The London Stock Exchange, converted to Non-Voting Deferred Shares and transferred to RBS NVDS Nominees Limited. None of the directors has an interest in the Non-Voting Deferred Shares.

As at 31 December 2003 J W Melbourn also held interest in 180,644 (2002: 193,464) Floating Rate Unsecured Loan Notes 2005 in The Royal Bank of Scotland Group plc.

**Directors' report (continued)**  
**31 December 2003****Share capital**

No changes were made to the share capital during the year.

**Directors' responsibilities**

United Kingdom company law requires the directors to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the Company and of the profit or loss for that period. 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; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that 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 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.

The directors confirm that these financial statements comply with the aforementioned requirements.

**Charitable and political donations**

No donations were made by the Company during the year for political purposes (2002; nil). The following charitable donations were made by the Company:

<b>Charitable organisation</b>	<b>Year ended 31 December 2003</b>	<b>Year ended 31 December 2002</b>
Barnardos	£165,000	-
Tesco Triathlon	£1,000	-
St Andrews Hospice Appeal	£300	-
Scottish Community Foundation	£100	-
Cystic Fibrosis	-	£112,722
Marie Curie	-	£200
Child Victims of Crime	-	£200

## **Directors' report (continued)** **31 December 2003**

### **Supplier payment policy**

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 by the Company to pay suppliers within 30 days of receipt of a correctly prepared invoice submitted in accordance with the terms of the contract. The average duration of amounts owing to suppliers during the year was 23 days (2002: 28).

### **Auditors**

On 1 August 2003, Deloitte & Touche, the Company's auditors, transferred their business to Deloitte & Touche LLP, a limited liability partnership incorporated under the Limited Liability Partnership Act 2000. The Company's consent has been given to treating the appointment of Deloitte & Touche as extending to Deloitte & Touche LLP with effect from 26 September 2003 under the provisions of Section 26(5) of the Companies Act 1989. A resolution to re-appoint Deloitte & Touche LLP as the Company's auditor 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

6<sup>th</sup> February 2004



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

We have audited the financial statements of Tesco Personal Finance Limited for the year ended 31 December 2003 which comprise the profit and loss account, the balance sheet and the related notes 1 to 33. 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 statement of directors' responsibilities, the Company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report if, in our opinion, the directors' report is not consistent with the financial statements, if 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 transactions with the Company is not disclosed.

We read the directors' report for the above year and consider the implications for our report if we become aware of any apparent misstatements.

### **Basis of audit opinion**

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts 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 2003 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

*Deloitte & Touche LLP*

**Deloitte & Touche LLP**

Chartered Accountants and Registered Auditors

6<sup>th</sup> February 2004

## Profit and loss account for the year ended 31 December 2003

	Note	Year ended 31.12.03 £'000	Year ended 31.12.02 £'000
Interest receivable:-			
Other interest receivable and similar income	4	231,362	198,907
Interest payable	5	(104,454)	(87,043)
<b>Net interest income</b>		<b>126,908</b>	<b>111,864</b>
Fees and commissions receivable		228,717	160,948
Fees and commissions payable		(10,786)	(14,251)
Dividend Income:			
Income from shares in group undertakings	6	12,014	5,504
Other operating income	6	1,793	1,458
<b>Non-interest income</b>		<b>231,738</b>	<b>153,659</b>
<b>Total income</b>		<b>358,646</b>	<b>265,523</b>
Administrative expenses:-			
Staff costs	8	8,869	10,233
Premises and equipment		13,387	10,167
Other administrative expenses	9	138,718	105,722
Depreciation	10	3,594	4,108
<b>Operating expenses</b>		<b>164,568</b>	<b>130,230</b>
<b>Profit before provisions for bad and doubtful debts</b>		<b>194,078</b>	<b>135,293</b>
Provisions for bad and doubtful debts	14	39,212	41,176
<b>Operating profit</b>	10	<b>154,866</b>	<b>94,117</b>
Tax on profit on ordinary activities	11	42,699	26,799
<b>Profit on ordinary activities after tax and retained for the financial year</b>	27	<b>112,167</b>	<b>67,318</b>

All the above amounts relate to continuing operations.

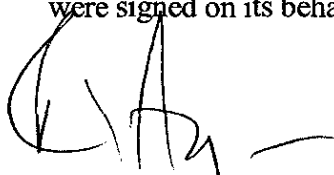
There were no other recognised gains or losses in the year, other than the profit for the year as reported above and therefore no separate statement of total recognised gains and losses has been presented. There is no difference between profit on ordinary activities before taxation and the retained profit for the year stated above, and their historical cost equivalents. Movements on profit and loss account reserves are shown in note 27.


**Balance sheet  
at 31 December 2003**

	Note	31.12.03 £'000	31.12.02 £'000
<b>Assets</b>			
Cash and balances at central banks		3,234	2,124
Loans and advances to banks	13	123	161
Loans and advances to customers	14	2,892,450	2,433,289
Shares in group undertakings	12	-	-
Tangible fixed assets	16	12,774	9,079
Other assets	17	264,156	192,769
Prepayments and accrued income	18	10,519	8,838
<b>Total assets</b>		<b>3,183,256</b>	<b>2,646,260</b>
<b>Liabilities</b>			
Deposits by banks	19	273,128	41,827
Customer accounts	20	2,211,530	2,051,378
Other liabilities	21	33,705	33,784
Accruals and deferred income	22	39,585	41,130
Subordinated liabilities	23	205,000	170,000
Called up share capital	24	24,790	24,790
Share premium account	25	223,110	223,110
Profit and loss account	27	172,408	60,241
Equity shareholders' funds	28	420,308	308,141
<b>Total liabilities</b>		<b>3,183,256</b>	<b>2,646,260</b>
<b>Memorandum items</b>			
Commitments	30	4,617,162	3,015,257

Shares in group undertakings detailed in the prior and current year above relates to a 100% shareholding in TPF ATM Services Limited amounting to £2.

The financial statements were approved by the board of directors on 6<sup>th</sup> February 2004 and were signed on its behalf by:

  
**Rowley Stuart Ager**  
Chairman

  
**Norman Cardie McLuskie**  
Deputy Chairman

**Notes to the financial statements  
for the year ended 31 December 2003****1 Principal accounting policies**

The financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom and the Statements of Recommended Practice issued jointly by the British Bankers' Association and the Irish Bankers' Federation. A summary of the more important accounting policies which have been applied consistently, is set out below. The financial statements are prepared in accordance with Part VII, Chapter II of, and schedule 9 to, the Companies Act 1985. The Company is a wholly owned subsidiary of another company incorporated in Great Britain and is therefore exempt from the requirement to prepare group financial statements by virtue of s228 of the Companies Act 1985. Consolidated financial statements are prepared by Tesco Personal Finance Group Limited. Accordingly, the financial statements present information about the Company as an individual undertaking and not as a group. The Company has taken advantage of the exemption from preparing a cash flow statement conferred by Financial Reporting Statement No. 1 (Revised) on the grounds that it is a wholly owned subsidiary.

**Basis of accounting**

The financial statements have been prepared under the historical cost convention and in compliance with section 226 of, and schedule 9 to, the Companies Act 1985.

**Tangible fixed assets**

The cost of tangible fixed assets is their purchase cost, together with any incidental expenses of acquisition.

Depreciation is calculated so as to write off the cost of tangible fixed assets, less their estimated residual values, over expected lives of the assets, generally between two and five years.

**Taxation**

Certain items of income and expenditure are accounted for in different periods for financial reporting purposes and for taxation purposes. The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. A deferred tax asset is recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable profits from which the future reversal of the underlying timing differences can be deducted.

**Operating leases**

Operating lease rentals are charged to the profit and loss account on a straight line basis over the lease term.

## 1 Principal accounting policies (continued)

### Loans and advances

Loans and advances are valued at cost less specific and general provisions and any amounts written off.

Specific provisions are made against loans and advances held by the Company when, as a result of a detailed appraisal of the portfolio, it is considered that recovery is doubtful. A general provision is made against loans and advances to cover bad and doubtful debts which have not been separately identified but are known from experience to be present in any portfolio of advances.

Loans and advances classified as bad debts are written off in part or in whole when there is no realistic prospect of recovery.

### Derivative transactions

Derivative transactions comprise interest rate swaps for hedging purposes.

Derivative transactions are accounted for in accordance with the item or items being hedged. Consequently, profits or losses on hedges are recognised on a similar accounting basis as the profits or losses on the underlying item or items being hedged. Therefore they are recognised in the financial statements as adjustments to the profit or loss item or items being hedged. To the extent necessary to achieve a common timing of income recognition on the item or items being hedged, deferred realised gains and losses are included in the balance sheet under "Accruals and deferred income" and "Prepayments and accrued income".

### Interest

Interest income is recognised on each loan using the earning rules appropriate to the type of loan agreement. Interest expense is recognised on an accruals basis.

### Fees and commissions

Fees and commissions receivable in relation to services provided by the Group are recognised when earned. Fees and commissions payable are charged to the profit and loss account immediately.

## 2 Holding company

The Company's ultimate parent company is The Royal Bank of Scotland Group plc which is incorporated in Scotland. Financial statements for The Royal Bank of Scotland Group plc can be obtained from The Royal Bank of Scotland Group plc, 42 St Andrew Square, Edinburgh, EH2 2YE. The Company's intermediate holding company is Tesco Personal Finance Group Limited whose financial statements can be obtained at the same address. Tesco Personal Finance Limited is exempt from the obligation to prepare group accounts.

The smallest sub group into which the Company is consolidated is Tesco Personal Finance Group which has as its parent company The Royal Bank of Scotland plc, a company incorporated in Great Britain and registered in Scotland. Copies of the consolidated financial statements for this sub group can be obtained from The Royal Bank of Scotland Group plc, 42 St Andrew Square, Edinburgh EH2 2YE.

## 3 Segmental reporting

The Company's results are generated from the provision of banking and other financial services mainly within the United Kingdom.

## 4 Other interest receivable and similar income

	Year ended 31.12.03 £'000	Year ended 31.12.02 £'000
Loans and advances to banks	-	213
Loans and advances to customers	230,611	196,531
Amounts receivable from group companies	751	2,163
	<u>231,362</u>	<u>198,907</u>

## 5 Interest payable

	Year ended 31.12.03 £'000	Year ended 31.12.02 £'000
Loans and advances to customers	70,162	65,021
Subordinated liabilities	8,794	5,994
Amounts payable to group companies	25,498	16,028
	<u>104,454</u>	<u>87,043</u>

## 6 Other income

	Year ended 31.12.03	Year ended 31.12.02
	£'000	£'000
Income from TPF ATM Services Ltd	12,014	5,504
Other income	<u>1,793</u>	<u>1,458</u>
	<u>13,807</u>	<u>6,962</u>

## 7 Directors' emoluments

The remuneration of the directors paid by or recharged to the Company during the year was as follows:

	Year ended 31.12.03	Year ended 31.12.02
	£'000	£'000
Directors' fees	22	22
Other emoluments	<u>422</u>	<u>359</u>
Total	<u>444</u>	<u>381</u>

## Highest paid director

The highest paid director during 2003 was Iain Clink (2002: Andrew William Dewhurst).

	Year ended 31.12.03	Year ended 31.12.02
	£'000	£'000
Total emoluments	266	211
Defined benefit pension:		
Accrued pension per annum at end of year	42	64



## 8 Staff costs

The Company currently does not have any direct employees. Staff working for the Company 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 135 (2002: 262).

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

	<b>Year ended 31.12.03 £'000</b>	<b>Year ended 31.12.02 £'000</b>
Wages and salaries	6,287	7,646
Social security costs	676	509
Pension costs	563	674
Other costs including temporary staff	1,343	1,404
	<u>8,869</u>	<u>10,233</u>

## 9 Other administrative expenses

An analysis of other administrative expenses incurred by the Company is detailed below:

	<b>Year ended 31.12.03 £'000</b>	<b>Year ended 31.12.02 £'000</b>
Technology, consulting and outsourcing costs	79,360	47,556
Marketing, printing and stationery	49,648	48,959
Postage and other costs	9,710	9,207
	<u>138,718</u>	<u>105,722</u>

**10 Profit on ordinary activities before tax**

	Year ended 31.12.03 £'000	Year ended 31.12.02 £'000
Profit on ordinary activities before taxation is stated after charging:		
Depreciation charge for year	3,594	4,108
Auditors' remuneration:-		
Audit services	63	56
Non-audit services	18	331

**11 Tax on profit on ordinary activities**

	Year ended 31.12.03 £'000	Year ended 31.12.02 £'000
UK corporation tax charge for the year	42,894	30,328
Tax under provided on profits on prior year	1,114	138
Total current tax	44,008	30,466
Deferred taxation – origination and reversal of timing differences	(1,309)	(3,667)
	42,699	26,799

The standard rate of tax for the year, based on the UK standard rate of corporation tax is 30% (2002: 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.

	Year ended 31.12.03 £'000	Year ended 31.12.02 £'000
Profit on ordinary activities before taxation	154,866	94,116
Tax on profit on ordinary activities at standard rate	46,459	28,235
Factors affecting charge for the year:		
Other movements in deferred tax	1,475	4,235
Non-taxable items	(3,604)	(1,651)
Capital allowances in excess of depreciation	(1,436)	(491)
Current taxation adjustments relating to prior periods	1,114	138
Total current tax	44,008	30,466

## 12 Shares in Group undertakings

At 31 December 2003 the Company held shares in the following subsidiary company, which is incorporated in Great Britain, registered in Scotland. The subsidiary has only one class of ordinary share, and has issued share capital of £2.

<b>Name</b>	<b>% Holding</b>	<b>Principal Activity</b>
TPF ATM Services Limited	100	Provision of Automated Teller Services

## 13 Loans and advances to banks

	<b>31.12.03</b>	<b>31.12.02</b>
	<b>£'000</b>	<b>£'000</b>
<b>Repayable on demand:</b>		
Loans and advances to The Royal Bank of Scotland plc	<u>123</u>	<u>161</u>

## 14 Loans and advances to customers

	<b>31.12.03</b>	<b>31.12.02</b>
	<b>£'000</b>	<b>£'000</b>
Repayable on demand or at short notice	1,786	1,853
<b>Remaining maturity:</b>		
Three months or less	1,606,380	1,420,075
One year or less but over three months	495,518	369,196
Five years or less but over one year	792,251	668,948
Over five years	<u>84,252</u>	<u>49,906</u>
	<b>2,980,187</b>	<b>2,509,978</b>
Provision for bad and doubtful debts	<u>(87,737)</u>	<u>(76,689)</u>
	<b>2,892,450</b>	<b>2,433,289</b>

**14 Loans and advances to customers (continued)**
**Provision for bad and doubtful debts**

	<b>31.12.03</b>	<b>31.12.03</b>	<b>31.12.02</b>	<b>31.12.02</b>
	<b>Specific</b>	<b>General</b>	<b>Specific</b>	<b>General</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Opening balance	52,044	24,645	49,457	11,087
Amounts written off	(28,164)	-	(25,031)	-
Charge to profit and loss account	37,929	1,283	27,618	13,558
Closing balance	<u>61,809</u>	<u>25,928</u>	<u>52,044</u>	<u>24,645</u>

**15 Interest in suspense**

In certain cases, interest is not being applied where its recoverability is in doubt.

	<b>31.12.03</b>	<b>31.12.02</b>
	<b>£'000</b>	<b>£'000</b>
Loans and advances on which interest is not being applied:		
- before specific provisions	<u>70,513</u>	<u>58,730</u>
- after specific provisions	<u>39,506</u>	<u>27,316</u>

**16 Tangible fixed assets**

	<u>Plant &amp; Equipment</u> £'000	<u>Fixtures &amp; Fittings</u> £'000	<u>Computer Hardware</u> £'000	<u>Computer Software</u> £'000	<u>Total</u> £'000
<b>Cost</b>					
At 1 January 2003	1,194	2,893	18,055	11,448	33,590
Additions	-	74	7,216	-	7,290
Disposals	-	-	-	-	-
<b>As at 31 December 2003</b>	<b>1,194</b>	<b>2,967</b>	<b>25,271</b>	<b>11,448</b>	<b>40,880</b>
<b>Depreciation</b>					
At 1 January 2003	1,160	2,598	9,325	11,429	24,512
Provided during the year	23	177	3,388	6	3,594
Disposals	-	-	-	-	-
<b>As at 31 December 2003</b>	<b>1,183</b>	<b>2,775</b>	<b>12,713</b>	<b>11,435</b>	<b>28,106</b>
<b>Net book value at 31 December 2003</b>	<b>11</b>	<b>192</b>	<b>12,558</b>	<b>13</b>	<b>12,774</b>
<b>Net book value at 31 December 2002</b>	<b>34</b>	<b>295</b>	<b>8,730</b>	<b>20</b>	<b>9,079</b>

**17 Other assets**

	31.12.03 £'000	31.12.02 £'000
<b>Amounts falling due within one year:</b>		
Amounts payable by The Royal Bank of Scotland plc	29,019	6,531
Amounts payable by other group companies	222,606	175,016
Deferred tax (see note 26)	12,531	11,222
	<b>264,156</b>	<b>192,769</b>

Amounts payable by other group companies includes an interest free subordinated loan of £211,000,000 (2002: £165,000,000) made to Direct Line Group Limited, a wholly owned subsidiary of The Royal Bank of Scotland Group plc.

**18 Prepayments and accrued income**

	31.12.03 £'000	31.12.02 £'000
<b>Amounts falling due within one year:</b>		
Amounts payable by Tesco PLC	162	167
Amounts payable by The Royal Bank of Scotland plc	-	93
Other prepayments and accrued income	<u>10,357</u>	<u>8,578</u>
	<u>10,519</u>	<u>8,838</u>

**19 Deposits by banks**

	31.12.03 £'000	31.12.02 £'000
<b>With agreed maturity dates or periods of notice, by remaining maturity:</b>		
Three months or less	<u>273,128</u>	<u>41,827</u>

All deposits by banks are repayable to another Group undertaking.

**20 Customer accounts**

	31.12.03 £'000	31.12.02 £'000
Repayable on demand	<u>2,211,530</u>	<u>2,051,378</u>

**21 Other liabilities**

	31.12.03 £'000	31.12.02 £'000
Amounts owed to Tesco PLC	2,270	1,918
Amounts owed to The Royal Bank of Scotland plc	1,829	2,845
Other liabilities	<u>29,606</u>	<u>29,021</u>
	<u>33,705</u>	<u>33,784</u>

All amounts owed are repayable within one year.

**22 Accruals and deferred income**

	31.12.03 £'000	31.12.02 £'000
Amounts owed to Tesco PLC	4,510	8,364
Amounts owed to The Royal Bank of Scotland plc	4,385	3,892
Other accruals and deferred income	30,690	28,874
	<u>39,585</u>	<u>41,130</u>

All amounts owed are repayable within one year.

**23 Subordinated liabilities**

	31.12.03 £'000	31.12.02 £'000
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	-
Undated floating rate subordinated loan	45,000	45,000
	<u>205,000</u>	<u>170,000</u>

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 sixty to one hundred and sixty basis points.

The perpetual loan capital has no fixed maturity date and may not be repaid except under certain conditions such as the winding up of Tesco Personal Finance Ltd or, at certain agreed dates.

**24 Called up share capital**

	31.12.03 £'000	31.12.02 £'000
<b>Authorised</b>		
500,000,000 Ordinary shares of 10p each	<u>50,000</u>	<u>50,000</u>
	31.12.03 £'000	31.12.02 £'000
<b>Allotted, called up and fully paid</b>		
247,900,000 Ordinary shares of 10p each	<u>24,790</u>	<u>24,790</u>

## 25 Share premium account

	31.12.03 £'000	31.12.02 £'000
Opening balance	223,110	223,110
Closing balance	<u>223,110</u>	<u>223,110</u>

## 26 Deferred taxation

	31.12.03 £'000	31.12.02 £'000
<b>Provision for deferred taxation consists of the following amounts:</b>		
Capital allowances in excess of depreciation	3,709	3,828
Other timing differences	8,822	7,394
Closing balance	<u>12,531</u>	<u>11,222</u>

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

## 27 Profit and loss account

	31.12.03 £'000	31.12.02 £'000
Opening balance	60,241	(7,077)
Retained profit for the year	112,167	67,318
Closing balance	<u>172,408</u>	<u>60,241</u>



**28 Reconciliation of movements in shareholders' funds**

	31.12.03 £'000	31.12.02 £'000
Profit for the year	112,167	67,318
Opening shareholders' funds	308,141	240,823
Closing shareholders' funds	<u>420,308</u>	<u>308,141</u>

**29 Derivatives and other financial instruments**
**Risk management**

The Company is exposed to a number of risks through its normal operations, the most significant of which are credit risk, interest rate risk and liquidity risk. Responsibility for the control of risk within the Company is vested in the Risk Management Committee (RMC), a sub committee of the 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.

**Objectives, policies and strategies**

The Company's policy is not to undertake any speculative trading activities. Consequently, it is the policy to use derivative instruments only to hedge risk on the Banking Book and not to trade speculatively for financial gain. The RMC reviews regularly the Company's exposure to interest rate risk and the policy is to use derivatives or other financial instruments to maintain this exposure within levels considered prudent. The objective is to reduce the effect of fluctuating interest rates on net interest income.

**Credit risk**

Credit risk arises where the possibility exists of a counterparty defaulting on its obligations. The Company lends surplus funds to the interbank market. 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.

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

**29 Derivatives and other financial instruments (continued)****Interest rate risk**

Interest rate risk arises as a result of timing differences on the re-pricing of assets and liabilities, and unexpected changes in the slope and shape of the yield curves. Exposure to interest rate movements arises when there is a mismatch between interest rate sensitive assets and liabilities. The Company closely monitors interest rate movements, the interest rate and re-pricing maturity structure of its interest bearing assets and liabilities and the level of non-interest bearing assets and liabilities. In order to reduce the effect of fluctuating interest rates on net interest income, interest rate risk is assessed and hedged via interest rate swaps or other derivative transactions.

## 29 Derivatives and other financial instruments (continued)

### Interest rate sensitivity gap

The following table shows the contractual re-pricing terms for each category of asset and liability, together with management's estimate of the interest rate sensitivity gap for the Company as at 31 December 2003. This does not reflect the potential impact of early repayment or withdrawal. Transactions without defined contractual re-pricing terms are shown according to management's expectations. Major changes in position can be, and are, made promptly as market outlooks change. In addition, significant variations in interest rate sensitivity may exist within the re-pricing periods presented.

	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
<b>Assets:</b>							
Loans and advances to banks	3	-	-	-	-	-	3
Loans and advances to customers	693	684	310	793	84	416	2,980
Other assets	-	-	-	-	-	287	287
<b>Total Assets</b>	<b>696</b>	<b>684</b>	<b>310</b>	<b>793</b>	<b>84</b>	<b>703</b>	<b>3,270</b>
<b>Liabilities:</b>							
Customer accounts	2,212	-	-	-	-	-	2,212
Deposits by banks	273	-	-	-	-	-	273
Other liabilities	-	-	-	-	-	160	160
Subordinated liabilities	205	-	-	-	-	-	205
Shareholders' funds	-	-	-	-	-	420	420
<b>Total Liabilities</b>	<b>2,690</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>580</b>	<b>3,270</b>
On balance sheet gap	(1,994)	684	310	793	84	123	-
Off-balance sheet items affecting interest rate sensitivity	1,965	(738)	(294)	(826)	(86)	(21)	-
Interest rate sensitivity gap	(29)	(54)	16	(33)	(2)	102	-
Cumulative interest rate sensitivity gap	(29)	(83)	(67)	(100)	(102)	-	-

**29 Derivatives and other financial instruments (continued)****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 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.

**Non trading derivatives**

The Company has established, during the year, non trading derivative positions internally through transactions with a fellow group company, The Royal Bank of Scotland plc.

At 31 December 2003, the Company had entered into several interest rate swaps, with the total notional principal amount of £5,273,054,000 (2002: £4,724,199,000) to hedge the risk associated with the products offered by the Company. Of these swaps £3,187,450,000 (2002: £3,003,260,000) expire within one year and £393,000,000 (2002: £275,570,000) expire between one and five years and £1,692,604,000 (2002: £1,445,369,000) expire between five and ten years. The net replacement cost of the contracts at 31 December 2003 was £881,566 (2002: £17,817,881) of which £7,540,505 (2002: £6,741,103) relates to contracts expiring within one year and -£3,729,130 (2002: -£68,342) relates to contracts expiring between one and five years and -£2,929,809 (2002: £11,145,121) expire between five and ten years. This is represented by assets with a fair value of £19,295,643 and liabilities of £18,414,077. Fair values represent the current market value of these instruments. The carrying value of these instruments in the balance sheet is £8,515,579 being the accrued interest at the balance sheet date.

The underlying principal amount reflects the value of the business transacted and not the underlying credit or market risks. Under current Bank of England Guidelines the credit equivalent amount for these transactions using the original exposure method is £46,649,703 (2002: £55,857,491).

The risks involved in derivatives include market and credit risk. Market risk is the risk of loss arising from adverse changes in value as a result of movements in market prices.

**Trading derivatives**

The Company had no trading derivatives during the year (2002: nil).

**Fair values of financial assets and liabilities**

Fair values for financial assets and liabilities where there is a liquid and active market are shown above.

### 30 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.

	31.12.03 £'000	31.12.02 £'000
<b>Formal standby facilities, credit lines and other commitments to lend:</b>		
Less than one year	<u>4,617,162</u>	<u>3,014,911</u>
There are annual commitments under non-cancellable operating leases. These are disclosed as follows:		
<b>Land and buildings operating leases which expire:</b>		
Greater than five years	-	346
<b>Total commitments</b>	<u><b>4,617,162</b></u>	<u><b>3,015,257</b></u>

### 31 Arrangements with directors and approved persons

At 31 December 2003, the aggregate amounts outstanding under transactions, arrangements and agreements entered into by the Company in the normal course of business and at normal commercial terms with directors and approved persons of the Company were as follows:

	No. Persons	£'000
Loans to directors and approved persons	<u>14</u>	<u>59</u>

The above information is presented in accordance with the requirements laid down in the Companies Act 1985 and the Financial Services and Markets Act 2000.

## 32 Controlling parties

The Royal Bank of Scotland Group plc and Tesco PLC hold an equal number of shares in the holding company, Tesco Personal Finance Group Limited. One of the shares held by Tesco PLC is non voting and as a consequence The Royal Bank of Scotland Group plc is the ultimate controlling company.

Financial statements for the ultimate parent company can be obtained from The Royal Bank of Scotland Group plc, 42 St Andrew Square, Edinburgh, EH2 2YE.

## 33 Related party transactions

During the year the Company received interest and other income of £750,871 (2002: £2,163,307) from The Royal Bank of Scotland plc. Interest in respect of wholesale borrowing paid to The Royal Bank of Scotland plc amounted to £10,846,786 (2002: £520,944).

In addition, the Company incurred recharges from The Royal Bank of Scotland plc, and its subsidiaries, totalling £46,530,502 (2002: £39,367,137) for the provision of services.

Tesco PLC have recharged the Company an amount totalling £25,090,970 (2002: £21,381,952) for the provision of services.

The Company received fees from Tesco PLC for the managing of certain financial products during the period of £1,793,147 (2002: £1,458,494).

The above transactions are charged in accordance with the Shareholders' Agreement between Tesco PLC and The Royal Bank of Scotland plc and are thus not necessarily charged at arms' length.

The Company received additional subordinated loan capital from The Royal Bank of Scotland plc totalling £17,500,000 (2002: £37,500,000) during the year.

The Company received additional subordinated loan capital from Tesco PLC totalling £17,500,000 (2002: £37,500,000) during the year.

The Company also increased the subordinated loan to Direct Line Group Limited, a fellow group company, to £211,000,000 (2002: £165,000,000) during the year. In addition, fees of £98,768,805 relating to insurance business underwritten by Direct Line Group Limited were received during the year (2002: £67,188,051).

TPF Services Limited Liability Partnership recharged the Company £33,130,003 (2002: £15,612,945) for the management of the ATM network.

The Company charged TPF ATM Services Limited £184,163 (2002: £82,396) for the provision of management services.

The Company received £12,013,932 (2002: £5,504,126) from TPF ATM Services in respect of dividends.