

Registered Number 3149607

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
DIRECTORS' REPORT AND FINANCIAL STATEMENTS
YEAR ENDED 31 DECEMBER 2005



**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
DIRECTORS' REPORT AND FINANCIAL STATEMENTS**

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BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
DIRECTORS AND COMPANY INFORMATION

DIRECTORS

C W Haresnape
I G Stewart

SECRETARY

S Mayer

REGISTERED OFFICE

Premier House
City Road
CHESTER
CH88 3AN

AUDITORS

KPMG Audit Plc
1 The Embankment
Neville Street
LEEDS
LS1 4DW

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC DIRECTORS' REPORT

The directors present their report and the audited financial statements for the year ended 31 December 2005.

PRINCIPAL ACTIVITY AND BUSINESS REVIEW

The principal activity of the Company is to finance mortgage lending. In 1997 the Company issued £105.6m floating rate loan notes. The interest payable on the loan notes is set at 60% of the three-month LIBOR rate for Sterling deposits less 0.30% per annum. The loan notes are secured on the mortgage portfolio. The capital appreciation arising on the sale of a mortgage holder's property is shared between the mortgage holder and the Company as set out in the original loan agreement. The Company pays its entire share of the appreciation to loan note holders and the swap provider. No changes in the business of the Company are anticipated.

Movements in the mortgage book are disclosed in the notes to the financial statements.

RESULTS FOR THE YEAR TO 31 DECEMBER 2005

No new mortgages were acquired or generated by the Company in the year and no new loan notes were issued.

The profit after taxation for the year, prepared using International Financial Reporting Standards, amounted to £330,050 (2004: £307,863). An interim dividend of £112,338 was paid (2004: £130,225). The directors do not recommend a final dividend (2004: £162,539).

SUPPLIER PAYMENT POLICY

It is the Company's policy that payments to suppliers are made in accordance with those terms and conditions agreed between the Company and its suppliers. The Company did not, at any time during the year, obtain or seek to obtain credit from any of its suppliers. On this basis no calculation has been made for the average number of days credit taken at the year-end.

FINANCIAL INSTRUMENTS

The Company's main financial instruments, other than derivatives, are mortgage loans, funds on deposit and loan notes. The principal purpose of these financial instruments is to raise finance for the Company's operations. It is, and has been throughout the year under review, the Company's policy that no trading in financial instruments is undertaken.

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at a different time. The Company minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of assets and liabilities are similar. The Company has also entered into an interest rate derivative with an external swap provider to manage the interest rate risk on its operations and sources of finance. The purpose of the interest rate swap is to reduce the interest rate risk on the Company's assets and liabilities by paying over a portion of capital appreciation on the mortgage loans in return for a fixed interest receipt. The loan notes issued by the Company are exposed to cash flow interest rate risk as they carry a floating interest rate that is reset as market rates change.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
DIRECTORS' REPORT (CONT'D)**

FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk arises on the individual loans within the mortgage portfolio which are secured on the underlying residential properties but the credit risk is considered to be low. The mortgage balances are monitored as part of the HBOS Group impairment process but no impairment provision is considered to be necessary at 31 December 2005.

Further discussion of the Company's approach to financial instruments is set out in note 1 (accounting policies) and in note 16.

DIRECTORS AND THEIR INTERESTS

The directors who served during the year were as follows:

I G Stewart
J H Lloyd (resigned 2 December 2005)
C W Haresnape (appointed 2 December 2005)

During the year, no director had any beneficial interest in the share capital of the Company or of any other Group undertaking other than in HBOS plc, the ultimate holding company.

The beneficial interests of the directors and their immediate families in HBOS plc shares are set out below. References to "HBOS plc shares" are to ordinary shares of 25p each in HBOS plc.

	At 31.12.04	At 31.12.05
	HBOS plc shares	HBOS plc shares
I G Stewart	13,390	13,719

**LONG TERM INCENTIVE PLAN
HBOS SCHEME, FORMER BANK OF SCOTLAND SCHEME AND FORMER HALIFAX
SCHEME**

Share options granted between 1995 and 2000 under the Bank of Scotland Executive Stock Option Scheme 1995 are subject to performance pre-conditions which have now been satisfied. Share options granted under the other plans are not subject to a performance precondition. Details of the options outstanding under these plans are set out below.

	Options outstanding at 31.12.04	Granted(G), lapsed (L) or exercised (E) in year	At 31.12.05
I G Stewart	9,043	-	9,043

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
DIRECTORS' REPORT (CONT'D)**

ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRSs")

The financial statements for the year ended 31 December 2005 have been prepared in accordance with International Financial Reporting Standards (IFRSs) and its interpretations as endorsed by the EU and effective at 31 December 2005.

IAS 32 "Financial Instruments: Disclosure and Presentation" and IAS 39 "Financial Instruments: Recognition and Measurement" only became effective from 1 January 2005. Accordingly, the 2004 comparatives do not reflect the provisions of these standards, but have been prepared in accordance with the applicable UK accounting standards in force for that period.

The main effects of IFRSs for the Company are that dividends previously accrued at 31 December 2004 under UK GAAP have not been reflected in the financial statements until they were declared and paid in 2005; the mortgage portfolio, bank accounts and loan notes have been presented on an amortised cost basis; and the Company's share of the capital appreciation arising on the mortgage portfolio and capital appreciation payable to the loan note holders has been reflected as an embedded derivative asset and liability, respectively.

Full disclosures are given in the notes to these financial statements for the year ended 31 December 2005 which explain the financial effect of transition to IFRSs.

RATIFICATION OF PREVIOUS UNAPPROVED DIVIDEND PAYMENTS

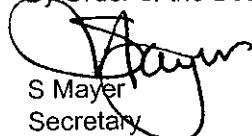
Dividend payments of the Company were made between 1 March 1998 and 31 December 2004 without the payments having been formally approved by the directors and/or shareholders of the Company.

The directors believe that neither the Company's shareholders nor its creditors were prejudiced, given that at the time the payments were made the Company had sufficient distributable reserves to make such payments. The Company has therefore obtained from the Company's shareholders, retrospective ratification of all previous unapproved dividend payments.

AUDITORS AND ANNUAL GENERAL MEETING

KPMG Audit Plc were re-appointed as auditors of the Company on 22 February 2005 for the forthcoming financial period. KPMG Audit Plc have signified their willingness to continue in office and a resolution for their re-appointment will be proposed at the forthcoming Annual General Meeting on 17 March 2006.

By Order of the Board


S Mayer
Secretary

Premier House
City Road
CHESTER
CH88 3AN

17 March 2006

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with IFRSs as adopted by the EU.

The financial statements are required by law to present fairly the financial position and performance of the company; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; 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 that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

**INDEPENDENT AUDITORS' REPORT
TO THE MEMBERS OF BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**

We have audited the company financial statements (the "financial statements") of BOS (Shared Appreciation Mortgages) NO. 2 PLC for the year ended 31 December 2005 which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement, the Statement of Recognised Income and Expense and the related notes. 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 auditor's 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

The directors' responsibilities for preparing the Directors' Report and the Company financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU, are set out in the Statement of Directors' Responsibilities on page 6.

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 and whether, in addition, the financial statements have been properly prepared in accordance with Article 4 of the IAS Regulation. We also report to you 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 other transactions is not disclosed.

We read other information contained in the Directors' Report 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 other information.

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 judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, 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 BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC (CONT'D)**

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Company's affairs as at 31 December 2005 and of its profit for the year then ended; and
- the financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;

KPMG Audit Plc.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
1 The Embankment
Neville Street
LEEDS
LS1 4DW

17 March 2006

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2005

	Notes	2005 £	2004 £
Interest receivable and similar income	2	4,802,337	2,619,185
Interest payable and similar charges	3	(4,145,960)	(2,037,845)
Net interest income		656,377	581,340
Net fair value gains and losses on derivatives	4	(119,501)	-
Other operating income	5	2,775	3,528
Operating expenses	6	(68,151)	(145,064)
Profit before tax for the year		471,500	439,804
Income tax expense	7	(141,450)	(131,941)
Profit for the year		330,050	307,863
Profit attributable to equity holders		330,050	307,863

The profit shown above is derived from continuing operations.

The notes on pages 13 to 35 form part of these financial statements.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
STATEMENT OF RECOGNISED INCOME AND EXPENSE
FOR THE YEAR ENDED 31 DECEMBER 2005

	Notes	2005 £	2004 £
Change in accounting policy on adoption of IAS 39		714,682	-
Tax on items taken directly to equity		(214,405)	-
Net income recognised directly in equity	19 (d)	500,277	-
Profit for the year		330,050	307,863
Total recognised income and expense for the year attributable to equity holders		830,327	307,863

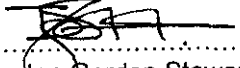
The notes on pages 13 to 35 form part of these financial statements.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
BALANCE SHEET AS AT 31 DECEMBER 2005

	Notes	2005 £	2004 £
Assets			
Mortgage portfolio	8	15,832,207	32,413,391
Shared appreciation rights receivable	9	141,344,192	-
Total non-current assets		157,176,399	32,413,391
Other receivables	10	-	130,650
Cash and cash equivalents	11	41,839,392	50,538,994
Derivative asset		-	40,237
Total current assets		41,839,392	50,709,881
Total assets		199,015,791	83,123,272
Equity			
Called up share capital		50,001	50,001
Retained earnings		1,512,830	957,380
Total equity	12	1,562,831	1,007,381
Liabilities			
Interest-bearing loans and borrowings	13	56,839,438	81,427,066
Shared appreciation rights payable	14	116,342,703	-
Deferred tax liability		214,405	-
Total non-current liabilities		173,396,546	81,427,066
Other payables	15	1,201,210	553,682
Derivative liability		22,713,716	-
Bank overdraft	11	38	3,202
Current tax liability	7	141,450	131,941
Total current liabilities		24,056,414	688,825
Total liabilities		197,452,960	82,115,891
Total equity and liabilities		199,015,791	83,123,272

The notes on pages 13 to 35 form part of these financial statements.

These financial statements were approved by the Board of Directors on 17 March 2006

and were signed on its behalf by:  Director
Ian Gordon Stewart

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2005

Indirect Method		2005	2004
	Notes	£	£
Cash flows from operating activities			
Profit before tax for the year		471,500	439,804
<i>Adjustments for:</i>			
Interest income	2	(4,802,337)	(2,619,185)
Interest expense	3	4,098,696	2,037,845
Amortisation of issue costs	3 / 6	47,264	75,120
Shared appreciation income	5	(3,029,808)	(4,748,513)
Shared appreciation expense	5	3,029,808	4,748,513
Net fair value gains and losses on derivatives	4	119,501	-
Operating profit before changes in working capital and provisions		(65,376)	(66,416)
Increase/(decrease) in other payables		116,540	(1,932)
Cash generated from the operations		51,164	(68,348)
Income taxes paid		(131,941)	(138,115)
Net cash from operating activities		(80,777)	(206,463)
Cash flows from investing activities			
Bank interest received		2,163,777	2,150,945
Premium interest received		448,079	470,141
Repayment of mortgages	8	802,379	1,631,578
Shared appreciation received		3,029,808	4,748,513
Net cash flows from investing activities		6,444,043	9,001,177
Cash flows from financing activities			
Interest paid on borrowings		(2,093,340)	(1,999,377)
Repayment of borrowings	13	(1,850,533)	(3,847,738)
Dividends paid	12	(274,877)	(280,402)
Shared appreciation paid		(2,498,819)	(4,506,713)
Net cash flows from financing activities		(6,717,569)	(10,634,230)
Net increase in cash and cash equivalents		(354,303)	(1,839,516)
Cash and cash equivalents at 1 January		50,535,792	52,375,308
Cash and cash equivalents at 31 December	11	50,181,489	50,535,792

As explained in the accounting policies on page 13, cash is distributed in accordance with the securitisation transaction agreements.

The notes on pages 13 to 35 form part of these financial statements.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005

1. SIGNIFICANT ACCOUNTING POLICIES

BOS (Shared Appreciation Mortgages) NO. 2 PLC is a company domiciled in the United Kingdom.

The financial statements were authorised for issue by the directors on 17 March 2006.

(a) Statement of compliance

The financial statements for the year ended 31 December 2005 have been prepared in accordance with International Financial Reporting Standards (IFRSs) and its interpretations as endorsed by the EU and effective at 31 December 2005.

The accounting policies set out below have been applied in respect of the financial year ended 31 December 2005. IAS 32 "Financial Instruments: Disclosure and Presentation" and IAS 39 "Financial Instruments: Recognition and Measurement" only became effective from 1 January 2005. Accordingly, the 2004 comparatives do not reflect the provisions of these standards, but have been prepared in accordance with the applicable UK accounting standards in force for that period. Where the implementation of these standards resulted in a change in accounting policy from 1 January 2005, the policy applied in respect of the 2004 comparative information has been set out at the end of each accounting policy. The related 2005 policy has been annotated with an asterisk in the heading to indicate the change in policy. Where there is no asterisk, the policy has been applied consistently in both periods presented in the financial statements.

IFRS 1 "First-time Adoption of IFRSs" has been applied to these financial statements. An explanation of how the transition to IFRSs has affected the reported financial position, financial performance and cash flows of the Company is provided in note 19. There has been no material effect on the reported profit for the year ended 31 December 2004, the changes are confined to changes in presentation.

(b) Basis of preparation

The financial statements are presented in sterling.

The financial statements have been prepared on the historical cost basis (except that derivative financial instruments are stated at their fair value), and on a going concern basis.

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates used in the financial statements.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods. Further information on the assumptions used is given in note 16.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c) Financial instruments*

The Company's financial instruments comprise a mortgage portfolio, cash and cash equivalents, derivatives, interest-bearing borrowings and various receivables and payables that arise directly from its operations. The main purpose of these financial instruments is to raise finance for the Company's operations. These financial instruments are classified in accordance with the principles of IAS 39 as described below.

(c)(i) Mortgage portfolio*

The Company's mortgage portfolio comprises mortgage loans with no fixed maturity date. The individual mortgage loans terminate on the earlier of, the sale of the property or the death of the mortgage account holder.

Under IAS 39, the mortgage portfolio is classified within "loans and receivables". The initial measurement is at fair value (excluding amounts for the shared appreciation referred to in (c)(iv) below). Subsequent measurement is at amortised cost with revenue being recognised using the effective interest method. The discount arising on initial recognition is being amortised over the expected life of the mortgages.

At each reporting period end, the Company assesses whether there is any objective evidence that mortgage loans within the portfolio are impaired. The directors do not consider that a provision for impaired assets is currently required.

For the 2004 financial statements that were prepared under UK GAAP, interest receivable was calculated on an accruals basis using the contractual interest payment terms of the mortgages. No interest payments are required from customers during the life of the mortgages and no mortgage income was therefore recognised.

(c)(ii) Cash and cash equivalents*

The Company holds bank accounts with an external provider and a group undertaking. These accounts are held in the Company's name and meet the definition of cash and cash equivalents. The use of certain accounts is restricted by a detailed priority of payments set out in the securitisation transaction agreements. The cash can only be used to meet certain specific liabilities and is not available to be used with discretion.

These bank accounts are classified within "loans and receivables" in accordance with IAS 39. The initial measurement is at fair value. Subsequent measurement is at amortised cost with revenue being recognised using the effective interest method. The discount arising on initial recognition is being amortised over the expected life of the mortgages and loan notes.

The Statement of Cash Flows has been presented using the indirect method of preparation.

For the 2004 financial statements the interest arising on the bank accounts was recognised on an accruals basis under UK GAAP.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c)(iii) Interest-bearing borrowings*

The Company's interest-bearing borrowings comprise mortgage-backed floating rate loan notes that have been issued in the capital market.

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

For the 2004 financial statements, the issue costs, in respect of the floating rate loan notes, were deferred and were charged to operating expenses over a ten-year period, being the estimated life of the mortgages. Interest payable was calculated on an accruals basis using the contractual interest payment terms of the loan notes.

(c)(iv) Embedded derivatives*

Certain derivatives are embedded within other non-derivative host financial instruments to create a hybrid instrument. Where the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risks of the host instrument, and where the hybrid instrument is not measured at fair value, the embedded derivative is separated from the host instrument with changes in fair value of the embedded derivative recognised in the income statement. Depending on the classification of the host instrument, the host is then measured in accordance with IAS 39.

The capital appreciation arising on the sale of a mortgage holder's property is shared between the mortgage holder and the Company as set out in the original loan agreement. The Company pays its entire share of the appreciation to the loan note holders and the swap provider.

The economic characteristics and risks of the shared appreciations rights receivable and payable are not viewed as being closely related to those arising on the mortgages and loan notes, respectively. The shared appreciation rights receivable and payable have therefore been valued separately from the mortgages and loan notes using discounted cash flow techniques and taking account of current House Price Inflation ("HPI"). There is uncertainty regarding the timing of any future shared appreciation receipts and the directors do not consider that it is practical to include an estimate of future HPI in these valuations. The resulting fair value movements of these embedded derivatives are recorded in net fair value gains and losses on derivatives in the income statement and the embedded derivatives are shown separately on the face of the balance sheet. The host instruments are valued at amortised cost, as noted above in (c)(i) and (c)(iii).

In the 2004 financial statements that were prepared under UK GAAP, the shared appreciation was accounted for at the point when cash was received from the mortgage customer, with an equal liability recognised at this point.

(c)(v) Derivatives*

The Company uses a derivative financial instrument to hedge its exposure to interest rate risk arising from operational, financing and investment activities. In accordance with its treasury policy, the Company does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c)(v) Derivatives* (continued)

IAS 39 requires all derivative financial instruments to be recognised initially at cost on the balance sheet. Subsequent to initial recognition, derivatives are remeasured to fair value. The gain or loss on remeasurement to fair value is recognised immediately in profit or loss. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged. The fair value of interest rate swaps is the estimated amount that the Company would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties.

On adoption of IAS 39 at 1 January 2005, the fair value of the Company's interest rate swap has been recognised as a derivative liability in the balance sheet. The subsequent gain or loss on remeasurement of the interest rate swap to fair value has been recognised immediately in net fair value gains and losses on derivatives in the income statement.

Amounts receivable on the interest rate swap are accounted for on an accruals basis within interest receivable in the income statement. The shared appreciation payable is recorded in other operating income.

For the year ended 31 December 2004, the interest rate swap was deemed to be an effective economic hedge under UK GAAP. The underlying assets and liabilities were recorded in the balance sheet at cost (or net realisable value if lower). The interest on the derivative was recognised on an accruals basis, consistent with the underlying instrument being hedged. Changes in the fair value of instruments used as hedges were not recognised in the financial statements until maturity of the hedged position.

(c)(vi) Other receivables

Other receivables are stated at their cost less impairment losses.

(c)(vii) Other payables

Other payables are stated at cost.

(d) Fees and commissions

Fees and commissions receivable for the continuing service of loans and advances are recognised on the basis of work done. Other fees are recognised when receivable.

(e) Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided: the initial recognition of assets and liabilities that affects neither accounting nor taxable profit; and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates at the balance sheet date.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(e) Income tax (continued)

Deferred tax has been charged or credited to equity for the adjustments to retained earnings that have been recognised on the adoption of IAS 39 at 1 January 2005.

(f) VAT

Value Added Tax is not recoverable by the Company and is included with its related costs.

(g) Dividends

Dividends on the equity shares of the Company are recognised as a liability in the period in which they are declared.

(h) Related parties

In accordance with the provisions of IAS 24, "Related Party Disclosures", the Company has disclosed details of transactions with its related parties, including those with fellow HBOS group companies.

(i) Standards in issue but not yet adopted

The directors are considering the following standards which are currently in issue but are not mandatory. The directors do not intend to adopt these standards and amendments to standards in the current year financial statements:

IAS 39: Financial Instruments: Recognition and Measurement – amendment to financial guarantee contracts and amendment to the fair value option;

IAS 1: Presentation of Financial Statements – amendment on Capital Management;

IFRS 7: Financial Instruments: Disclosures.

The directors do not consider the financial effect or disclosure of these standards to be material to the financial statements.

2. INTEREST RECEIVABLE AND SIMILAR INCOME

	2005 £	2004 £
Mortgage interest from customers	1,434,437	-
Bank interest from group undertakings	39,600	38,283
Bank interest	3,328,300	2,580,902
	4,802,337	2,619,185

Interest on impaired assets is £nil for the year ended 31 December 2005.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

3. INTEREST PAYABLE AND SIMILAR CHARGES

	2005 £	2004 £
Interest payable on loan notes	4,098,696	2,037,845
Amortisation of issue costs	47,264	-
	<u>4,145,960</u>	<u>2,037,845</u>

Interest payable comprises amounts arising on the loan notes, calculated on an effective yield basis for the year ended 31 December 2005. For the year ended 31 December 2004, amortisation of issue costs has been included in operating expenses.

4. NET FAIR VALUE GAINS AND LOSSES ON DERIVATIVES

	2005 £	2004 £
Fair value movement on shared appreciation rights receivable	(448,996)	-
Fair value movement on shared appreciation rights payable	217,030	-
Fair value movement on interest rate derivative	112,465	-
	<u>(119,501)</u>	<u>-</u>

5. OTHER OPERATING INCOME

	2005 £	2004 £
Fees and commissions receivable	2,675	3,510
Shared appreciation receivable	3,029,808	4,748,513
Shared appreciation payable	(3,029,808)	(4,748,513)
Other income	100	18
	<u>2,775</u>	<u>3,528</u>

6. OPERATING EXPENSES

	2005 £	2004 £
Amortisation of issue costs	-	75,120
Bank administration fees	56,716	58,976
Rating agency fees	9,000	9,000
Audit fees	2,352	2,291
Other fees	83	(323)
	<u>68,151</u>	<u>145,064</u>

In accordance with IAS 39, the amortisation of issue costs is included in interest payable for the year ended 31 December 2005. The Company has no employees and none of the directors receive any emoluments from the Company.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

7. INCOME TAX EXPENSE

	2005 £	2004 £
Current Tax		
Corporation tax charge for the year at a rate of 30% (2004:30%)	141,450	131,941
	<u>141,450</u>	<u>131,941</u>
Deferred Tax		
Deferred tax charge for the year at a rate of 30% (2004:30%)	-	-
	<u>-</u>	<u>-</u>
Total income tax expense in income statement	<u>141,450</u>	<u>131,941</u>

	2005 £	2004 £
Reconciliation of effective tax rate		
The tax for the year is equal to the standard rate of corporation tax in the UK of 30%.		
Profit before tax	471,500	439,804
	<u>471,500</u>	<u>439,804</u>
Profit multiplied by the standard rate of corporation tax in the UK	141,450	131,941
	<u>141,450</u>	<u>131,941</u>
Deferred tax recognised directly in equity		
Relating to effective yield and fair value adjustments on adoption of IAS 39	214,405	-
	<u>214,405</u>	<u>-</u>
Deferred tax balance		
Deferred tax liabilities – fair value adjustments on derivatives	(710,811)	-
	<u>(710,811)</u>	<u>-</u>
Deferred tax assets - effective yield adjustments	496,406	-
	<u>496,406</u>	<u>-</u>
	<u>(214,405)</u>	<u>-</u>
The movement for the year was as follows:		
At 1 January	-	-
Change in accounting policy	214,405	-
	<u>214,405</u>	<u>-</u>
Opening balance restated	214,405	-
Charge for year	-	-
	<u>-</u>	<u>-</u>
At 31 December	<u>214,405</u>	<u>-</u>

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

8. MORTGAGE PORTFOLIO

	2004
	£
At 31 December 2003	34,044,969
Capitalised fees	4,265
Mortgage redemptions in the year	(1,635,843)
At 31 December 2004	32,413,391
	2005
	£
At 31 December 2004	32,413,391
Adjustment on adoption of IAS 39	(17,213,242)
Capitalised fees	10,865
Mortgage redemptions in the year	(813,244)
Amortisation of discount	1,434,437
At 31 December 2005	15,832,207

The mortgage loans advanced by the Company have no fixed maturity date but would terminate on the earlier of, the sale of the property, or the death of the mortgage account holder.

9. SHARED APPRECIATION RIGHTS RECEIVABLE

The right for the Company to receive a share of the capital appreciation arising on the individual mortgages, as set out in the original loan agreements, is classified as an embedded derivative, in accordance with the principles of IAS 39. The embedded derivative has been valued separately from the host contract using discounted cash flow techniques. No estimate has been made of the effect of future HPI as the directors consider that this is impractical.

The Company is contractually obliged to pay to the loan note holders or the swap provider any amounts received from mortgage customers for the shared appreciation. A corresponding derivative liability has therefore been recognised in the balance sheet for the same value as the derivative asset (note 14).

10. OTHER RECEIVABLES

	2005	2004
	£	£
Deferred expenditure	-	130,650
	-	130,650

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

11. CASH AND CASH EQUIVALENTS

	2005 £	2004 £
Guaranteed investment contract account (GIC)	47,743,222	48,793,551
Other bank accounts	2,268,810	1,539,542
Bank overdraft	(38)	(3,202)
Accrued interest on GIC account	169,495	205,901
Cash and cash equivalents in the statement of cash flows	<u>50,181,489</u>	<u>50,535,792</u>
Unamortised discount on GIC account	(8,342,135)	-
Total cash and cash equivalents	<u><u>41,839,354</u></u>	<u><u>50,535,792</u></u>

The Company holds the GIC bank account with an external provider. The Company is contractually entitled to a LIBOR related return on this account and the income is accounted for on an effective yield basis. The use of the account is restricted by a detailed priority of payments set out in the securitisation transaction agreements. The cash can only be used to meet certain specific liabilities and is not available to be used with discretion.

All the accounts are held in the Company's name and meet the definition of cash and cash equivalents.

12. TOTAL EQUITY

Reconciliation of movement in capital and reserves

	Share Capital £	Retained Earnings £	Total Equity £
Balance at 1 January 2004 (restated)	50,001	929,919	979,920
Total recognised income and expense (restated)	-	307,863	307,863
Dividends to shareholders	-	(280,402)	(280,402)
	<u>50,001</u>	<u>957,380</u>	<u>1,007,381</u>
Balance at 31 December 2004	<u>50,001</u>	<u>957,380</u>	<u>1,007,381</u>
Balance at 1 January 2005	50,001	957,380	1,007,381
Total recognised income and expense (includes accounting policy changes)	-	830,327	830,327
Dividends to shareholders	-	(274,877)	(274,877)
	<u>50,001</u>	<u>1,512,830</u>	<u>1,562,831</u>
Balance at 31 December 2005	<u>50,001</u>	<u>1,512,830</u>	<u>1,562,831</u>

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

12. TOTAL EQUITY (CONTINUED)

Share capital

	2005 £	2004 £
Authorised		
50,000 ordinary shares of £1 each	50,000	50,000
	<u> </u>	<u> </u>
1 deferred share of £1	1	1
	<u> </u>	<u> </u>
Allotted, called up and fully paid		
50,000 ordinary shares of £1 each	50,000	50,000
	<u> </u>	<u> </u>
1 deferred share of £1	1	1
	<u> </u>	<u> </u>

The deferred share carries no entitlement to any dividend or to any share in any surplus assets of the Company on a winding-up, other than the right to be repaid the amount of any paid up share capital thereon. The right to be repaid any paid up share capital in the deferred share shall be deferred until after all paid up share capital has been first repaid on all other classes of issued share capital in the Company.

The deferred share carries the right to receive notice of all general meetings of the Company but does not carry the right to attend, speak or vote at a general meeting unless a resolution is to be proposed abrogating, varying or modifying any of the rights or privileges of the holder of the deferred share, or for the winding up or administration of the Company under the Insolvency Act 1986, or for the entry by the Company with any other party into a merger, reconstruction, scheme of arrangement or amalgamation of or affecting the Company, in any of which cases such holder shall have the right to attend such general meeting and shall be entitled to speak and vote. Whenever the holder of the deferred share is entitled to vote at a general meeting, such holder shall have one vote and on a poll such number of votes as is equal to 34% of the number of votes attached to all other issued shares of the Company.

Dividends

After the balance sheet date the following dividends were proposed by the directors. The dividends have not been provided for in these financial statements and there are no income taxes consequences.

	2005 £	2004 £
2005 Final dividend	-	-
2004 Final dividend	-	162,539
	<u> </u>	<u> </u>
	-	162,539
	<u> </u>	<u> </u>

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

13. INTEREST-BEARING LOANS AND BORROWINGS

This note provides information about the contractual terms of the Company's interest-bearing loans and borrowings. For more information about the Company's exposure to interest rate risk and the fair value of its financial instruments, see note 16.

	2004 £
At 31 December 2003	85,094,653
Loan note redemptions	(3,847,738)
	81,246,915
Accrued interest	180,151
At 31 December 2004	81,427,066
	2005 £
At 31 December 2004	81,246,915
Adjustment on adoption of IAS 39	(24,222,547)
Loan note redemptions	(1,850,533)
Amortisation of discount	2,018,546
	57,192,381
Accrued interest	166,961
Deferred issue costs	(519,904)
At 31 December 2005	56,839,438

The asset backed floating rate loan notes are due in 2072. The interest rate applicable on the loan notes up to and including the interest period ending in the quarter to 31 August 2027 is 60 per cent of LIBOR for three-month sterling deposits less 0.30% per annum. Thereafter, the interest rate applicable to the loan notes will be 60 per cent of LIBOR for three-month sterling deposits plus 0.10% per annum. The loan notes carry, in addition to interest, rights to receive certain amounts calculated by reference to the value of shared appreciation proceeds received from redeemed mortgages. The loan notes are subject to mandatory part redemption from time to time based on the level of redeemed mortgages and can be redeemed in full, in certain circumstances, at the option of the Company. The loan notes are secured on the mortgage portfolio, the guaranteed investment contract and certain other assets of the Company.

14. SHARED APPRECIATION RIGHTS PAYABLE

The Company is contractually obliged to pay to the loan note holders and swap provider any amounts received from mortgage customers for the shared appreciation arising on the sale of the property. A derivative liability has therefore been recognised in the balance sheet for the same value as the derivative asset (note 9).

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

15. OTHER PAYABLES

	2005 £	2004 £
Accruals and deferred income	1,201,210	553,682
	1,201,210	553,682

16. FINANCIAL INSTRUMENTS

The Company's financial instruments comprise a mortgage portfolio, cash and cash equivalents, derivatives, interest-bearing borrowings and various receivables and payables that arise directly from its operations. Exposure to credit and interest rate risk arises in the normal course of the Company's business.

16(a) Credit risk

Credit risk arises on the individual loans within the mortgage portfolio which are secured on the underlying residential properties. Mortgage loans are no longer offered by the Company. The maximum loan-to-value of the original advances was 25% and the credit risk is considered to be low. The mortgage balances are monitored as part of the HBOS Group impairment process but no impairment provision is considered to be necessary at 31 December 2005. The maximum exposure to credit risk is represented by the carrying amount of the mortgages.

The Company has no exposure to credit risk on the shared appreciation. In accordance with the legal documents, only amounts actually received by the Company from the borrower are required to be paid over to the loan note holders and swap provider.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

16. FINANCIAL INSTRUMENTS (CONTINUED)

16(b) Interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at a different time. The Company minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of assets and liabilities are similar. The loan notes issued by the Company are exposed to cash flow interest rate risk as they carry a floating interest rate that is reset as market rates change.

Effective interest rates and repricing analysis

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and the periods in which they reprice, if this is earlier than the maturity date.

2005

	Effective interest Rate %	Total £	6 months or less £	6 – 12 months £	1 – 2 years £	2 – 5 years £	More than 5 years £
Mortgage portfolio*	7.10	15,832,207	-	-	-	-	15,832,207
Cash and cash equivalents (note 11)	8.11	41,839,392	41,839,392	-	-	-	-
Loan notes	6.04	(56,839,438)	(56,839,438)	-	-	-	-
Bank overdraft (note 11)	0.0	(38)	(38)	-	-	-	-

2004

	Effective interest Rate %	Total £	6 months or less £	6 – 12 months £	1 – 2 years £	2 – 5 years £	More than 5 years £
Mortgage portfolio*	0.00	32,413,391	-	-	-	-	32,413,391
Cash and cash equivalents (note 11)	5.05	50,538,994	50,538,994	-	-	-	-
Loan notes	2.45	(81,427,066)	(81,427,066)	-	-	-	-
Bank overdraft (note 11)	0.0	(3,202)	(3,202)	-	-	-	-

* These assets bear interest at a fixed contractual rate of 0% but are subject to an effective yield adjustment under IAS 39.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

16. FINANCIAL INSTRUMENTS (CONT'D)

16(c) Fair values

The fair values of the Company's financial instruments, together with the carrying amounts shown in the balance sheet are as follows

	Note	Fair Value 2005 £	Carrying Amount 2005 £	Fair Value 2004 £	Carrying Amount 2004 £
Mortgage portfolio	8	4,465,337	15,832,207	175,898,986	32,413,391
Shared appreciation rights receivable	9	141,344,192	141,344,192	-	-
Other receivables	10	-	-	130,650	130,650
Cash and cash equivalents	11	41,839,392	41,839,392	50,538,994	50,538,994
Interest-bearing loans and borrowings	13	(56,839,438)	(56,839,438)	(175,898,986)	(81,427,066)
Shared appreciation rights payable	14	(116,342,703)	(116,342,703)	-	-
Derivative liability		(22,713,716)	(22,713,716)	-	-
Other payables	15	(1,201,210)	(1,201,210)	(553,682)	(553,682)
Bank overdraft	11	(38)	(38)	(3,202)	(3,202)

Estimation of fair values

The following comments summarise the main methods and assumptions used in estimating the fair value of financial instruments that are reflected in the table above.

Cash and cash equivalents, interest bearing loans and bank overdrafts are recognised on an amortised cost basis that is considered to be a close approximation to fair value. Other receivables and other payables have a carrying value that closely approximates to the fair value of the instrument.

The fair value of the mortgage portfolio, shared appreciation rights receivable, shared appreciation rights payable and derivative liability has been calculated by discounting future cash flows at an appropriate market rate. The valuation method is consistent with commonly used market techniques. All inputs into the valuation models are obtained from observable market data.

The fair value of the mortgages as at 31 December 2004 includes the value of house price inflation that would be receivable from borrowers if the loans were terminated at the period end. Similarly, the fair value of the interest-bearing loans as at 31 December 2004 includes the value of house price inflation that would be payable to loan note holders on redemption of the mortgage loans. The current value of house price inflation has been included in the embedded derivative for shared appreciation rights receivable and payable as at 31 December 2005, following the adoption of IAS 39.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

17. RELATED PARTIES

The Company is a subsidiary undertaking of HBOS plc group. The Company receives interest from Bank of Scotland, a fellow subsidiary. Bank of Scotland administers the mortgage portfolio on behalf of the Company, for which quarterly service fees are paid. Dividends were paid to Uberior Investments PLC, the immediate parent undertaking of the Company. The Company's transactions with related parties are summarised below.

	HBOS plc and subsidiaries 2005 £	HBOS plc and subsidiaries 2004 £
Income Statement		
Interest receivable and similar income	39,600	38,283
Operating expenses	56,716	58,976
Dividends paid	274,877	280,402
Balance Sheet		
Assets		
Cash and cash equivalents	2,268,772	1,123,090
Liabilities		
Other payables	(4,772)	(4,863)
Bank overdraft	(38)	(3,202)

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)**

18. PARENT UNDERTAKINGS

HBOS plc is the ultimate parent undertaking of BOS (Shared Appreciation Mortgages) NO. 2 PLC and heads the largest group into which the accounts of the Company are consolidated. The consolidated accounts of HBOS plc may be obtained from its head office at The Mound, Edinburgh, EH1 1YZ.

The Governor and Company of the Bank of Scotland heads the smallest group into which the accounts of the Company are consolidated. The accounts of The Governor and Company of the Bank of Scotland may be obtained from its head office at The Mound, Edinburgh, EH1 1YZ.

19. EXPLANATION OF TRANSITION TO IFRS

As stated in note 1(a), these are the Company's first financial statements prepared in accordance with IFRSs.

The accounting policies applied in preparing the financial statements are set out in note 1.

In preparing its opening IFRS balance sheet, the Company has reclassified and adjusted amounts reported in previous financial statements prepared in accordance with its old basis of accounting (UK GAAP). An explanation of how the transition process from UK GAAP to IFRSs has affected the Company's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

19. EXPLANATION OF TRANSITION TO IFRS

19(a) Balance Sheet as at 1 January 2004 (IFRS GAAP)

	Notes	31.12.2003 UK GAAP £	Transition to IFRS £	1.1.2004 IFRS GAAP £
Assets				
Mortgage portfolio		34,044,969	-	34,044,969
Shared appreciation rights receivable		-	-	-
Total non-current assets		<u>34,044,969</u>	<u>-</u>	<u>34,044,969</u>
Other receivables	1	205,769	-	205,769
Cash and cash equivalents	2	52,375,403	-	52,375,403
Derivative asset		42,138	-	42,138
Total current assets		<u>52,623,310</u>	<u>-</u>	<u>52,623,310</u>
Total assets		<u>86,668,279</u>	<u>-</u>	<u>86,668,279</u>
Equity				
Called up share capital		50,001	-	50,001
Retained earnings	3	779,742	150,177	929,919
Total equity		<u>829,743</u>	<u>150,177</u>	<u>979,920</u>
Liabilities				
Interest-bearing loans and borrowings		85,236,336	-	85,236,336
Shared appreciation rights payable		-	-	-
Deferred tax liability		-	-	-
Total non-current liabilities		<u>85,236,336</u>	<u>-</u>	<u>85,236,336</u>
Other payables	1	313,813	-	313,813
Current tax liability		138,115	-	138,115
Bank overdraft	2	95	-	95
Proposed dividend	3	150,177	(150,177)	-
Total current liabilities		<u>602,200</u>	<u>(150,177)</u>	<u>452,023</u>
Total liabilities		<u>85,838,536</u>	<u>(150,177)</u>	<u>85,688,359</u>
Total equity and liabilities		<u>86,668,279</u>	<u>-</u>	<u>86,668,279</u>

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

19. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

19(a) Balance Sheet as at 1 January 2004 (IFRS GAAP) (Continued)

Notes

1. Other receivables and other payables comprise certain amounts that were previously recognised separately on the face of the balance sheet. Other receivables comprise deferred expenditure. Other payables comprise accruals and deferred income.

2. Cash and cash equivalents include certain amounts that were previously recognised separately on the face of the balance sheet as amounts due from group undertakings.

3. Under IFRS, dividends on the Company's equity shares are recognised as a liability in the period in which they are declared. The proposed dividend at 31 December 2003 of £150,177 has therefore been reversed from current liabilities and retained earnings have been increased by the same amount. This is the only change to amounts previously recognised under UK GAAP.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

19. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

19(b) Balance Sheet as at 31 December 2004 (IFRS GAAP)

	Notes	31.12.2004 UK GAAP £	Transition to IFRS £	31.12.2004 IFRS GAAP £
Assets				
Mortgage portfolio		32,413,391	-	32,413,391
Shared appreciation rights receivable		-	-	-
Total non-current assets		32,413,391	-	32,413,391
Other receivables	1	130,650	-	130,650
Cash and cash equivalents	2	50,538,994	-	50,538,994
Derivative asset		40,237	-	40,237
Total current assets		50,709,881	-	50,709,881
Total assets		83,123,272	-	83,123,272
Equity				
Called up share capital		50,001	-	50,001
Retained earnings	3	794,841	162,539	957,380
Total equity		844,842	162,539	1,007,381
Liabilities				
Interest-bearing loans and borrowings		81,427,066	-	81,427,066
Shared appreciation rights payable		-	-	-
Deferred tax liability		-	-	-
Total non-current liabilities		81,427,066	-	81,427,066
Other payables	1	553,682	-	553,682
Current tax liability		131,941	-	131,941
Proposed dividend	3	162,539	(162,539)	-
Bank overdraft	2	3,202	-	3,202
Total current liabilities		851,364	(162,539)	688,825
Total liabilities		82,278,430	(162,539)	82,115,891
Total equity and liabilities		83,123,272	-	83,123,272

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

19. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

19(b) Balance Sheet as at 31 December 2004 (IFRS GAAP) (Continued)

Notes

1. Other receivables and other payables comprise certain amounts that were previously recognised separately on the face of the balance sheet. Other receivables comprise deferred expenditure. Other payables comprise accruals and deferred income.

2. Cash and cash equivalents include certain amounts that were previously recognised separately on the face of the balance sheet as amounts due from group undertakings.

3. Under IFRS, dividends on the Company's equity shares are recognised as a liability in the period in which they are declared. The proposed dividend at 31 December 2003 of £150,177 has therefore been reversed from current liabilities and retained earnings have been increased by the same amount. This is the only change to amounts previously recognised under UK GAAP.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

19. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

19(c) Balance Sheet as at 1 January 2005 (IFRS GAAP)

	Notes	31.12.2004 IFRS GAAP £	IAS 39 Adoption £	1.1.2005 IFRS GAAP £
Assets				
Mortgage portfolio	1	32,413,391	(17,213,242)	15,200,149
Shared appreciation rights receivable	2	-	141,793,188	141,793,188
Total non-current assets		<u>32,413,391</u>	<u>124,579,946</u>	<u>156,993,337</u>
Other receivables	3	130,650	(130,650)	-
Cash and cash equivalents	4	50,538,994	(9,100,511)	41,438,483
Derivative asset	8	40,237	(40,237)	-
Total current assets		<u>50,709,881</u>	<u>(9,271,398)</u>	<u>41,438,483</u>
Total assets		<u>83,123,272</u>	<u>115,308,548</u>	<u>198,431,820</u>
Equity				
Called up share capital		50,001	-	50,001
Retained earnings	5	957,380	500,277	1,507,657
Total equity		<u>1,007,381</u>	<u>500,277</u>	<u>1,507,658</u>
Liabilities				
Interest-bearing loans and borrowings	3, 6	81,427,066	(24,789,715)	56,637,351
Shared appreciation rights payable	7	-	116,559,733	116,559,733
Deferred tax liability		-	214,405	214,405
Total non-current liabilities		<u>81,427,066</u>	<u>91,984,423</u>	<u>173,411,489</u>
Other payables		553,682	-	553,682
Derivative liability	8	-	22,823,848	22,823,848
Current tax liability		131,941	-	131,941
Bank overdraft		3,202	-	3,202
Total current liabilities		<u>688,825</u>	<u>22,823,848</u>	<u>23,512,673</u>
Total liabilities		<u>82,115,891</u>	<u>114,808,271</u>	<u>196,924,162</u>
Total equity and liabilities		<u>83,123,272</u>	<u>115,308,548</u>	<u>198,431,820</u>

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

19. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

19(c) Balance Sheet as at 1 January 2005 (IFRS GAAP) (Continued)

Notes

The comments below explain the adjustments required at 1 January 2005 on adoption of IAS 39 and IAS 32 and noted in the table above. These notes should be read in conjunction with the accounting policies set out in note 1 to the financial statements.

1. The adjustment to the mortgage portfolio represents the adjustment required to recognise the portfolio at its initial fair value, excluding the embedded derivative for shared appreciation. The discount arising is being amortised over the expected life of the mortgages.
2. The right to receive shared appreciation is being accounted for as an embedded derivative that is not closely related to the host contract, being the mortgage loans, and is included in the balance sheet at its fair value at 1 January 2005.
3. Deferred issue costs incurred in raising the loan notes have previously been included in current assets under UK GAAP. On adoption of IAS 39, the balance of attributable transaction costs has been netted against the loan notes included in interest-bearing loans and borrowings.
4. Cash and cash equivalents have been adjusted to recognise them at their initial fair value. The discount arising is being amortised over the expected life of the mortgages and loan notes.
5. The effect on retained earnings of the IAS 39 adjustments is set out in the table below.
6. The loan notes have been adjusted to recognise them at their initial fair value, excluding the embedded derivative for shared appreciation. The discount arising is being amortised over the expected life of the loan notes. The expected life of the loan notes has been revised under IAS 39 and this has necessitated an adjustment to the amortisation charged to date on the issue costs.
7. The obligation to pay shared appreciation is being accounted for as an embedded derivative that is not closely related to the host contract, being the loan notes, and is included in the balance sheet at its fair value at 1 January 2005.
8. The fair value of the interest rate swap has been included in the balance sheet on adoption of IAS 39.

19(d) Effect on Retained Earnings

The effect of the above adjustments on retained earnings is as follows:

	1 January 2004	31 December 2004	1 January 2005
	£	£	£
Amortisation of deferred issue costs	-	-	436,518
Fair value adjustment on mortgages	-	-	(17,213,242)
Fair value adjustment on loan notes	-	-	24,222,547
Fair value adjustment on GIC account	-	-	(9,100,511)
Shared appreciation rights receivable	-	-	141,793,188
Shared appreciation rights payable	-	-	(116,559,733)
Fair value of interest rate swap	-	-	(22,864,085)
Tax effect of adjustments	-	-	(214,405)
Dividends proposed	150,177	162,539	-
Total adjustment to equity attributable to equity holders of the parent	150,177	162,539	500,277

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NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (CONT'D)

19. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

19(e) For the year ended 31 December 2004

	Notes	UK GAAP £	Effect of transition to IFRSs £	IFRS GAAP £
Interest receivable and similar income		2,619,185	-	2,619,185
Interest payable and similar charges		(2,037,845)	-	(2,037,845)
Net interest income		581,340	-	581,340
Net fair value gains and losses on derivatives		-	-	-
Fees and commissions receivable		3,510	(3,510)	-
Shared appreciation receivable		4,748,513	(4,748,513)	-
Shared appreciation payable		(4,748,513)	4,748,513	-
Other income		18	(18)	-
Other operating income	1	-	3,528	3,528
Operating expenses		(145,064)	-	(145,064)
Profit before tax for the year		439,804	-	439,804
Income tax expense		(131,941)	-	(131,941)
Profit for the year		307,863	-	307,863
Dividend on equity shares - paid	2	(130,225)	130,225	-
Dividend on equity shares - proposed	2	(162,539)	162,539	-
Retained profit for the year		15,099	292,764	307,863

Notes

1. Other operating income includes £4,748,513 payable and receivable for shared appreciation. These amounts were previously disclosed separately on the face of the profit and loss account.

2. Proposed dividends of £162,539 are not reflected as an obligation under IFRS until they are declared. The distribution has therefore been reversed from the profit and loss account. Paid dividends of £130,225 are now shown as a deduction from retained earnings.

19(f) Cash Flows

Under UK GAAP the Company was exempt from preparing a Cash Flow Statement under paragraph 5(a) of FRS 1(revised 1996) "Cash Flow Statements", as it is a wholly-owned subsidiary and its results are consolidated within the financial statements of HBOS plc which are publicly available. No such exemption exists under IAS 7 and a statement of cash flows has therefore been presented for the first time for the year ended 31 December 2005 and the comparative period.