

Registered Number 3149607

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**

**ANNUAL REPORT AND ACCOUNTS**

**YEAR ENDED 31 December 2010**

THURSDAY



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

**DIRECTORS**

Ian Gordon Stewart  
Tracey Anne Hill

**COMPANY SECRETARY**

Angela Lockwood

**REGISTERED OFFICE**

Trinity Road  
HALIFAX  
West Yorkshire  
HX1 2RG

**INDEPENDENT AUDITORS**

PricewaterhouseCoopers LLP  
Benson House  
33 Wellington Street  
Leeds  
LS1 4JP

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC  
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2010**

The directors present their report and the audited financial statements for BOS (Shared Appreciation Mortgages) NO 2 PLC (the "Company") for the year ended 31 December 2010

**PRINCIPAL ACTIVITY**

The principal activity of the Company is to finance mortgage lending. In 1997 the Company issued £105.6m floating rate notes (the "Notes"). The interest payable on the Notes is set at 60% of the three-month LIBOR rate for Sterling deposits less 0.30% per annum until August 2027. Thereafter, the interest rate applicable to the Notes will be 60% of the three-month LIBOR rate for Sterling deposits plus 0.10% per annum until 2072 when the Notes become due. The 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 Note holders and the swap provider.

The activities of the Company are conducted primarily by reference to a series of transaction documents (the "Programme Documentation").

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

**Business structure**

The Company is a subsidiary undertaking of Bank of Scotland plc ("BOS") and ultimately Lloyds Banking Group plc ("LBG").

**RESULTS AND DIVIDENDS**

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

The profit after taxation for the year amounted to £2,037,737 (2009: £1,369,181 profit). A dividend of £2,000,000 was paid in the year (2009: £171,000).

**BUSINESS REVIEW AND FUTURE DEVELOPMENTS**

The Company's business will continue to unwind over the life of the mortgages issued as no further advances will be made. Cash is continuing to be collected.

The principal asset in the Company is a mortgage portfolio which is subject to an annual impairment review. The mortgage portfolio is subject to the economic factors relating to the housing market (see "Credit Risk" below). In 2009 the UK experienced a significant reduction in activity in the housing market, together with a growth in mortgage arrears, as the effects of the recession became more widespread. During 2010, the UK housing market stabilised with some small indications of a recovery, but overall activity remained static for most of 2010. However, these trends did not affect the Company's results as the mortgage loans bear a zero rate of interest. No impairment provision was deemed necessary as at 31 December 2010 or 31 December 2009.

UK interest rates have remained relatively stable and at historically low levels for both 2009 and 2010, which has impacted on the Company's results for both years due to correspondingly low LIBOR rates. The underlying profits are determined by a margin earned between the interest received on the bank accounts including a Guaranteed Investment Contract account (the "GIC"), income on the swap and the interest paid to the Note holders. This is fixed by the Programme Documentation. The sensitivity of the Company's results to changes in interest rates is assessed in note 16.

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**BUSINESS REVIEW AND FUTURE DEVELOPMENTS (CONTINUED)**

Under International Financial Reporting Standards ("IFRSs") an effective yield adjustment is made on interest receivable and interest payable, reflecting the discount at which the mortgages and Notes were originally issued. The net difference passed through the Statement of Comprehensive Income for the year ended 31 December 2010 was £82,548 profit (31 December 2009 £82,548 profit).

Standard and Poor's, the Rating Agency rating the Notes, has issued updated criteria for counterparties to a structured finance transaction. The potential impact of these changes to the Programme Documentation and, therefore, the Company is currently being assessed.

The key performance indicator used by management in assessing the performance of the Company is the monitoring of actual cash flows against planned cash flows on the Notes. The Company's performance is addressed in the quarterly management accounts provided to the directors.

**POST BALANCE SHEET EVENTS**

During 2009, the balance in the external GIC account was transferred to BOS, in accordance with the terms of the Programme Documentation, as a result of the downgrade in the external GIC provider's credit rating. However following BOS's subsequent downgrade other alternative measures have been considered by the directors, in discussion with the Trustee and Note holders' legal representatives, to remove the GIC balance and make the remaining Notes zero-coupon.

As a result, in January 2011 notices were issued for a Note holder meeting to be held on 23 February 2011, and at this meeting the proposals were approved, with the repayment of the GIC account and reduction in Notes outstanding made on 28 February 2011. Further information can be found in Note 21 to the financial statements.

**POLICY AND PRACTICE ON PAYMENT OF CREDITORS**

The Company follows "The Better Payment Practice Code", published by the Department of Trade and Industry, regarding payments to suppliers. A copy of the code and information about it may be obtained from the Department of Trade and Industry, No. 1 Victoria Street, London, SW1H 0ET.

The Company's policy is to agree terms of payment with suppliers and these normally provide for settlement within 30 days after the date of the invoice, except where other arrangements have been negotiated. It is the policy of the Company to abide by the agreed terms of payment, provided the supplier performed according to the terms of the contract.

The Company owed no money to trade creditors at 31 December 2010 or at 31 December 2009.

**DIRECTORS**

The directors who served during the year and up to the date of signing the financial statements were as follows:

Ian Gordon Stewart  
Tracey Anne Hill

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**RISK MANAGEMENT**

The majority of the Company's assets and liabilities have been classified as financial instruments in accordance with IAS 32 "Financial Instruments Presentation"

The Company's financial instruments comprise a mortgage portfolio, cash and liquid resources, a derivative contract ("swap"), an embedded derivative, interest-bearing loans and borrowings and various other payables that arise directly from its operations. 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.

The principal risks arising from the Company's financial instruments are credit risk and interest rate risk. These and other risks which may affect the Company's performance are detailed below. Further analysis of the risks facing the Company on its financial instruments is provided in note 16.

**Credit Risk**

Credit risk arises on the individual loans within the mortgage loan portfolio which are in turn secured on the underlying UK residential properties. The performance of these loans is therefore influenced by the economic background and the UK housing market. However, the maximum loan-to-value of the original advances was 25% and the credit risk is considered to be low.

The extent to which the Company can meet its obligations to pay interest and ultimately repay the Notes will be dependent upon the receipt of funds earned on its bank deposits, the swap agreement with the external provider, principal receipts on the mortgages and the Letter of Credit issued by BOS (see "Liquidity Risk"). To the extent that this income does not provide sufficient funds to cover the interest due on the Notes or the repayment of the Notes the Company has no claim on the assets of BOS.

The terms of the Mortgage Portfolio Agreement given by BOS in respect of the mortgages require BOS to repurchase any mortgage which is found to be in breach of warranty. BOS will repurchase any mortgages that are found or held not to be valid, binding and enforceable.

Although in such an event the total value of the outstanding loan and any accrued interest will be covered by BOS, the Note holder will not receive the benefit of any future payments of appreciation amounts or partial repayment of appreciation amounts in respect of the mortgages repurchased.

Shared appreciation is subject to the movement in the market value of the property which is dependent upon house price inflation ("HPI"). This may provide a return on the Notes below initial expectations. Any expected increase in value cannot be guaranteed.

**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 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 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 FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**RISK MANAGEMENT (CONTINUED)**

**Liquidity risk**

The Company has an unconditional and irrevocable 364-day revolving Letter of Credit provided by BOS. The Letter of Credit is for a maximum aggregate principal amount of £1,165,000 to assist the Company should it not be able to meet its obligations under the Notes. The reliance on this facility is therefore dependent upon the creditworthiness of BOS. The Company has not drawn on the Letter of Credit since inception.

**Operational risk**

In accordance with the Programme Documentation the Company is bound to make payments to meet third party expenses.

The Company's operations are subject to periodic review by the Internal Audit function of LBG.

**STATEMENT OF DIRECTORS' RESPONSIBILITIES**

The directors are responsible for preparing the Directors' Report and 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 the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent,
- state whether applicable International Financial Reporting Standards (IFRSs) as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. 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.

**Statement of disclosure of information to auditors**

So far as the directors are aware, there is no relevant audit information of which the Company's auditors are unaware, and the directors have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information. This confirmation is given, and should be interpreted, in accordance with the provisions of section 418 of the Companies Act 2006.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**EMPLOYEES**

The Company has employed no staff during the year ended 31 December 2010 or the previous year

**INDEPENDENT AUDITORS**

PricewaterhouseCoopers LLP have indicated their willingness to continue in office

**STATEMENT OF GOING CONCERN**

The directors are satisfied that the Company has adequate resources to continue to operate for the foreseeable future and is financially sound. For this reason, they continue to adopt the going concern basis in preparing the accounts

By Order of the Board



Angela Lockwood  
Secretary

Trinity Road  
HALIFAX  
West Yorkshire  
HX1 2RG

DATE 25 March 2011

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

We have audited the financial statements of BOS (Shared Appreciation Mortgages) NO 2 PLC for the year ended 31 December 2010 which comprise the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

**Respective responsibilities of directors and auditors**

As explained more fully in the Directors' Responsibilities Statement set out on page 5, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

**Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements.

**Opinion on financial statements**

In our opinion the financial statements

- give a true and fair view of the state of the company's affairs as at 31 December 2010 and of its profit and cash flows for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

**Opinion on other matter prescribed by the Companies Act 2006**

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.



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

**Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit



Mark Hannam (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Leeds

Date 25 March 2011

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**STATEMENT OF COMPREHENSIVE INCOME**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

	Notes	2010 £	2009 £ Restated
Interest receivable and similar income	2	3,617,230	3,434,817
Interest payable and similar charges	3	(1,044,522)	(1,468,930)
<b>Net interest income</b>		<u>2,572,708</u>	<u>1,965,887</u>
Net fair value gains and losses on derivatives	4	303,841	582
Other operating income	5	5,025	3,900
Operating expenses	6	(57,948)	(68,728)
<b>Profit before tax</b>		<u>2,823,626</u>	<u>1,901,641</u>
Taxation	7	(785,889)	(532,460)
<b>Profit / total comprehensive income attributable to equity holders</b>		<u><u>2,037,737</u></u>	<u><u>1,369,181</u></u>

The profit shown above is derived from continuing operations. The Company operates in a single business segment and all of the Company's activities are in the UK.

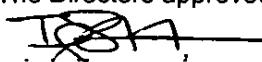
The accompanying notes on pages 13 to 36 form an integral part of the financial statements.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**BALANCE SHEET AS AT 31 DECEMBER 2010**

	Notes	2010 £	2009 £ Restated	1 Jan 2009 £ Restated
<b>Assets</b>				
Mortgage portfolio	8	13,362,551	14,129,109	15,082,385
Shared appreciation rights receivable	9	113,583,458	112,110,507	131,769,549
<b>Total non-current assets</b>		<b>126,946,009</b>	<b>126,239,616</b>	<b>146,851,934</b>
Cash and cash equivalents	10	34,639,306	36,387,162	36,251,308
<b>Total current assets</b>		<b>34,639,306</b>	<b>36,387,162</b>	<b>36,251,308</b>
<b>Total assets</b>		<b>161,585,315</b>	<b>162,626,778</b>	<b>183,103,242</b>
<b>Equity</b>				
Share capital	11	50,001	50,001	50,001
Retained profits		3,084,655	3,046,918	1,848,737
<b>Shareholders' equity</b>		<b>3,134,656</b>	<b>3,096,919</b>	<b>1,898,738</b>
<b>Liabilities</b>				
Interest-bearing loans and borrowings	12	44,940,628	47,635,242	50,618,797
Shared appreciation rights payable	13	94,024,742	92,592,997	108,651,577
Deferred tax liability	14	127,560	151,183	170,080
<b>Total non-current liabilities</b>		<b>139,092,930</b>	<b>140,379,422</b>	<b>159,440,454</b>
Interest-bearing loans and borrowings	12	(15,352)	(16,020)	96,219
Trade and other payables	15	491,954	631,341	277,748
Derivative liability		18,071,554	17,982,293	21,209,659
Bank overdraft	10	61	1,466	2,506
Current tax liability	7	809,512	551,357	177,918
<b>Total current liabilities</b>		<b>19,357,729</b>	<b>19,150,437</b>	<b>21,764,050</b>
<b>Total liabilities</b>		<b>158,450,659</b>	<b>159,529,859</b>	<b>181,204,504</b>
<b>Total equity and liabilities</b>		<b>161,585,315</b>	<b>162,626,778</b>	<b>183,103,242</b>

The Directors approved the financial statements on

25 March 2011

  
 Ian Gordon Stewart  
 Director

The accompanying notes on pages 13 to 36 form an integral part of the financial statements

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**STATEMENT OF CHANGES IN EQUITY**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

	<b>Share Capital £</b>	<b>Retained Profits £</b>	<b>Total £</b>
Balance at 1 Jan 2010	50,001	3,046,918	3,096,919
Profit for the year	-	2,037,737	2,037,737
Dividends paid in the year	-	(2,000,000)	(2,000,000)
	<hr/>	<hr/>	<hr/>
Balance at 31 Dec 2010	50,001	3,084,655	3,134,656
	<hr/>	<hr/>	<hr/>
	<b>Share Capital £</b>	<b>Retained Profits £</b>	<b>Total £</b>
Balance at 1 Jan 2009	50,001	1,848,737	1,898,738
Profit for the year	-	1,369,181	1,369,181
Dividends paid in the year	-	(171,000)	(171,000)
	<hr/>	<hr/>	<hr/>
Balance at 31 Dec 2009	50,001	3,046,918	3,096,919
	<hr/>	<hr/>	<hr/>

The accompanying notes on pages 13 to 36 form an integral part of the financial statements

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2010**

	Notes	2010 £	2009 £ Restated
<b>Operating Activities</b>			
Inter-company fees paid		(44,187)	(46,296)
External audit fees paid		(3,290)	(3,220)
Administration expenses		(5,552)	(15,378)
Tax paid		(551,357)	(177,918)
		<hr/>	<hr/>
<b>Net cash from operating activities</b>		(604,386)	(242,812)
		<hr/>	<hr/>
<b>Investing Activities</b>			
Repayments on mortgage portfolio		1,450,125	1,637,269
Shared appreciation rights received		7,143,455	5,732,168
		<hr/>	<hr/>
<b>Net cash flows from investing activities</b>		8,593,580	7,369,437
		<hr/>	<hr/>
<b>Financing Activities</b>			
Bank interest received		2,578,529	2,396,116
Swap interest received		351,896	373,679
Repayment of borrowings		(3,702,906)	(3,893,844)
Interest paid on borrowings		(65,313)	(602,628)
Shared appreciation rights paid		(7,257,082)	(5,451,285)
Dividends paid		(2,000,000)	(171,000)
		<hr/>	<hr/>
<b>Net cash from financing activities</b>		(10,094,876)	(7,348,962)
		<hr/>	<hr/>
Net decrease in cash and cash equivalents		(2,105,682)	(222,337)
Cash and cash equivalents at start of year		42,492,618	42,714,955
		<hr/>	<hr/>
<b>Cash and cash equivalents at end of year</b>	10	40,386,936	42,492,618
		<hr/>	<hr/>

The Cash Flow Statement is presented using the direct method to improve the transparency of the financial statements

The accompanying notes on pages 13 to 36 form an integral part of the financial statements

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

**1 SIGNIFICANT ACCOUNTING POLICIES**

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

**(a) Statement of compliance**

The financial statements for the year ended 31 December 2010 have been prepared in accordance with International Financial Reporting Standards (IFRSs) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) as adopted by the European Union. The standards applied by the Company are those endorsed by the European Union and effective at the date the financial statements are approved by the Board. However the Company has not utilised the "carve-out" provisions in respect of full fair value and portfolio hedging of core deposits in IAS39 'Financial Instruments Recognition and Measurement' as adopted by the European Union. Consequently, the financial statements comply with IFRSs.

The following new IFRS pronouncements, relevant to the Company, became effective for financial years beginning on or after 1 January 2010 and have been adopted in these financial statements. None of these standards or amendments had a material impact on the financial statements.

- Amendment to IAS 39 "Financial Instruments Recognition and Measurement" – 'Eligible Hedged Items'. This clarifies how the principles underlying hedge accounting should be applied in particular situations,
- Improvements to IFRSs (issued April 2009). Sets out minor amendments to IFRS standards as part of the annual improvements process.

The financial statements also comply with the relevant provisions of Part XV of the Companies Act 2006.

The Company is a subsidiary undertaking of BOS and ultimately LBG. The directors of the Company are satisfied that it is the current intention of LBG to ensure that its subsidiaries, including the Company, should have at all times in the foreseeable future (being the period until at least 30 June 2012) access to adequate capital and liquidity resources to continue as a going concern. Accordingly, the financial statements have been prepared on a going concern basis.

The financial statements are presented in sterling which is the Company's functional and presentation currency and have been prepared on the historical cost basis (except that derivative financial instruments are stated at fair value).

**(b) Revenue recognition**

Interest receivable and similar income have been calculated using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the future cash flows are estimated after considering all the contractual terms of the instrument but not future credit losses.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**(c) Segment reporting**

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

The directors of the Company consider that the entity has only one geographical and one business segment and therefore is not required to produce additional segmental disclosure.

**(d) Financial instruments**

The Company's financial instruments comprise a mortgage portfolio, cash and liquid resources, a derivative contract ("swap"), an embedded derivative, interest-bearing loans and borrowings and various other 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.

**(d)(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 date of 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 (d)(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.

**(d)(ii) Cash and cash equivalents**

The Company holds bank accounts with BOS, its parent 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 Programme Documentation. As the cash can only be used to meet certain specific liabilities and is not available to be used with discretion, it is viewed as restricted cash.

These bank accounts are classified within "loans and receivables" in accordance with IAS 39 and income is being recognised using the effective interest method. The discount arising on initial recognition is being amortised over the expected life of the mortgages and Notes.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**(d) Financial instruments (continued)**

**(d)(iii) Interest-bearing loans and borrowings**

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

Interest-bearing loans and borrowings are recognised initially at fair value less directly related incremental transaction costs. Subsequent to initial recognition, interest-bearing loans and borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the Statement of Comprehensive Income over the period of the borrowings on an effective interest basis.

**(d)(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 Statement of Comprehensive Income. 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 Note holders and the swap provider.

The economic characteristics and risks of the shared appreciation rights receivable and payable are not viewed as being closely related to those arising on the mortgages and Notes, respectively. The shared appreciation rights receivable and payable have therefore been valued separately from the mortgages and Notes using discounted cash flow techniques and taking account of current 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 Statement of Comprehensive Income 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 (d)(i) and (d)(iii).

**(d)(v) Derivatives**

IAS 39 requires all derivative financial instruments to be recognised initially at fair value on the Balance Sheet and to be re-measured to fair value at subsequent reporting dates. Where the value of the derivative is positive, it is carried as a derivative asset and where negative, as a derivative liability. The gain or loss on re-measurement to fair value is recognised immediately in the Statement of Comprehensive Income. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged.

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 2010 (CONTINUED)**

**1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**(d) Financial instruments (continued)**

**(d)(v) Derivatives (continued)**

The gain or loss on re-measurement of the interest rate swap to fair value has been recognised immediately in net fair value gains and losses on derivatives in the Statement of Comprehensive Income. The shared appreciation payable is recorded in other operating income.

For 2009 the amounts receivable on the interest rate swap were accounted for on an accruals basis within interest receivable in the Statement of Comprehensive Income. The accrual was recognised in the Balance Sheet within cash and cash equivalents.

For 2010 the amounts receivable on the interest rate swap have been reclassified to net fair value gains and losses on derivatives as the directors consider that this is a fairer way to present all amounts in relation to the interest rate swap and matches the treatment adopted by other companies in the LBG Group. It has also meant that the interest accrual relating to the swap has been reclassified within the interest rate swap derivative liability from cash and cash equivalents. The restatement has had no effect on profit for the year or the comparative period.

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.

**(e) Critical Accounting Judgements and Estimates**

The preparation of the financial statements necessarily requires the exercise of judgement both in the application of accounting policies and in the selection of assumptions used in the calculation of estimates. These judgements are reviewed on an ongoing basis and are continually evaluated based on historical experience and other factors. The most significantly affected components of the financial statements and associated critical judgements are as follows:

**Effective Interest Rate Method**

The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts expected to be paid or received by the Company including expected early redemption fees and related penalties and premiums and discounts that are an integral part of the overall return. Direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument are also taken into account in the calculation. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

For the purpose of the effective yield calculation on the Notes, an average expected life has been calculated based on prepayment expectations for the mortgages. This is revised on a regular basis in light of actual redemption experience.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**(e) Critical Accounting Judgements and Estimates (continued)**

**Fair Value Calculations**

Fair value is defined as the value at which assets, liabilities or positions could be closed out or sold in a transaction with a willing and knowledgeable counterparty

The value of the embedded derivative 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. No assumption for future HPI has been included as this is not considered to be practical.

**(f) Taxation**

Income tax recognised in the Statement of Comprehensive Income comprises both current and deferred tax. Current income tax, which is payable on taxable profits, is recognised as an expense in the period in which the profits arise.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the Balance Sheet date which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

The Company's tax charge is calculated on an IFRS basis and disclosed in accordance with IAS 12.

**(g) 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.

**(h) Dividends**

Dividends on ordinary shares are recognised in equity in the year in which they are paid.

**(i) Trade and other payables**

Trade and other payables are stated at cost or at amortised cost if deemed to be a financial liability.

**(j) Prior year restatements**

Following the decision to reclassify the amounts receivable on the interest rate swap and the associated interest accruals (see (d)(v) above), the financial statements and associated notes to the financial statements have been restated to reflect the revised accounting position retrospectively. Further details of the balances affected are provided in note 21.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**2. INTEREST RECEIVABLE AND SIMILAR INCOME**

	2010 £	2009 £ Restated
Interest receivable on mortgage portfolio	679,470	679,470
Bank interest receivable from BOS	2,937,760	2,626,553
Bank interest receivable	-	128,794
	<u>3,617,230</u>	<u>3,434,817</u>

**3. INTEREST PAYABLE AND SIMILAR CHARGES**

	2010 £	2009 £
Interest payable on Notes	1,022,134	1,446,542
Amortisation of issue costs	22,388	22,388
	<u>1,044,522</u>	<u>1,468,930</u>

**4 NET FAIR VALUE GAINS AND LOSSES ON DERIVATIVES**

	2010 £	2009 £ Restated
Fair value movement on shared appreciation rights receivable	1,472,951	(19,659,042)
Fair value movement on shared appreciation rights payable	(1,431,745)	16,058,580
Fair value movement on interest rate derivative	(87,423)	3,229,223
	<u>(46,217)</u>	<u>(371,239)</u>
Income receivable on interest rate derivative	350,058	371,821
	<u>303,841</u>	<u>582</u>

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
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**5. OTHER OPERATING INCOME**

	2010 £	2009 £
Fees and commissions receivable	5,025	3,900
Shared appreciation receivable	7,143,455	5,732,168
Shared appreciation payable	(7,143,455)	(5,732,168)
	<u>5,025</u>	<u>3,900</u>

**6. OPERATING EXPENSES**

	2010 £	2009 £
Inter-company fees	43,928	46,181
Administration fees	10,545	19,327
Audit fees	3,475	3,220
	<u>57,948</u>	<u>68,728</u>

The Company has no employees (2009 nil) and none of the directors received any emoluments from the Company in the current or previous year

Audit fees relate to the statutory audit. There are no fees payable to the auditors and their associates for services other than the statutory audit.

The audit fee for the current year, net of VAT, was £2,870 (2009 £2,800)

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**7. TAXATION**

	2010 £	2009 £
<b>Current Tax</b>		
Corporation tax charge for the year at a rate of 28% (2009 28%)	809,512	551,357
	<u>809,512</u>	<u>551,357</u>
<b>Deferred Tax</b>		
Deferred tax change in tax rate – credit	(4,725)	-
Deferred tax credit for the year at a rate of 28% (2009 28%)	(18,898)	(18,897)
	<u>(23,623)</u>	<u>(18,897)</u>
<b>Total tax charge</b>	<u>785,889</u>	<u>532,460</u>
 <b>Reconciliation of effective tax rate</b>	 <b>2010</b>	 <b>2009</b>
The tax assessed for the year is lower than the standard rate of corporation tax in the UK of 28% (2009 28%)	<b>£</b>	<b>£</b>
Profit before tax	2,823,626	1,901,641
	<u>2,823,626</u>	<u>1,901,641</u>
Profit before tax multiplied by the standard rate of corporation tax in the UK of 28% (2009 28%)	790,614	532,460
Effects of		
Deferred tax change in tax rate – credit	(4,725)	-
	<u>(4,725)</u>	<u>-</u>
<b>Total tax charge in the Statement of Comprehensive Income</b>	<u>785,889</u>	<u>532,460</u>

The current tax liability of £809,512 (2009 £551,357 liability) represents the net amount of income tax payable in respect of the current year

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**8. MORTGAGE PORTFOLIO**

	2010 £	2009 £
At 1 January	14,129,109	15,082,385
Mortgage redemptions in the year	(1,446,028)	(1,632,746)
Amortisation of discount	679,470	679,470
	<hr/>	<hr/>
At 31 December	13,362,551	14,129,109
	<hr/>	<hr/>

The mortgage loans advanced by the Company have no fixed maturity date but would terminate on the earlier of, the date of 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 Note holders or the swap provider any amounts received from mortgage customers for the shared appreciation. A corresponding embedded derivative liability has therefore been recognised in the Balance Sheet (note 13).

**10. CASH AND CASH EQUIVALENTS**

	2010 £	2009 £ Restated
Bank accounts	40,386,997	42,494,084
Unamortised discount	(5,747,691)	(6,106,922)
	<hr/>	<hr/>
Bank overdraft	34,639,306 (61)	36,387,162 (1,466)
	<hr/>	<hr/>
	34,639,245	36,385,696
Unamortised discount	5,747,691	6,106,922
	<hr/>	<hr/>
Cash and cash equivalents per Cash Flow Statement	40,386,936	42,492,618
	<hr/>	<hr/>

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**10. CASH AND CASH EQUIVALENTS (CONTINUED)**

All income is accounted for on an effective yield basis. The use of the accounts is restricted by a detailed priority of payments set out in the Programme Documentation. As the cash can only be used to meet certain specific liabilities and is not available to be used with discretion, it is viewed as restricted cash. The accounts are held in the Company's name and meet the definition of cash and cash equivalents.

**11. SHARE CAPITAL**

	2010	2009
	£	£
<b>Authorised</b>		
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>
<b>Allotted, called up and fully paid</b>		
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 Company is a directly held subsidiary undertaking of BOS.

The £1 deferred share is held by Deutsche Trustee Company Limited (formerly Bankers Trustee Company Limited).

The holder of the ordinary shares is entitled to receive dividends as declared from time to time.

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.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**11. SHARE CAPITAL (CONTINUED)**

**Capital disclosures**

The Company is not subject to externally imposed capital requirements in either the current year or the prior year other than the minimum share capital required by the Companies Act with which it complies. The Company manages its ordinary share capital in order that there is sufficient capital, in the opinion of the directors, to support the transactions and level of business undertaken by the Company.

**12. 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.

	2010 £	2009 £
<b>Non-current liabilities</b>		
Notes	45,276,452	47,993,454
Deferred issue costs	(335,824)	(358,212)
	<u>44,940,628</u>	<u>47,635,242</u>
<b>Current liabilities</b>		
Accrued interest payable to Note holders	7,036	6,368
Deferred issue costs	(22,388)	(22,388)
	<u>(15,352)</u>	<u>(16,020)</u>

The mortgage-backed floating rate Notes are due in 2072. The interest rate applicable on the Notes up to and including the interest period ending in the quarter to 31 August 2027 is 60% of the three-month LIBOR rate for Sterling deposits less 0.30% per annum. Thereafter, the interest rate applicable to the Notes will be 60% of the three-month LIBOR rate for Sterling deposits plus 0.10% per annum until 2072 when the Notes become due.

The 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 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 Notes are secured on the mortgage portfolio, the bank accounts and certain other assets of the Company.



**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**13. SHARED APPRECIATION RIGHTS PAYABLE**

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

**14. DEFERRED TAX LIABILITY**

	2010 £	2009 £
At 1 January	151,183	170,080
Credit for year	(18,898)	(18,897)
Change in Tax Rate – credit	(4,725)	-
	<hr/>	<hr/>
At 31 December	127,560	151,183
	<hr/>	<hr/>

The deferred tax liability was recognised for the fair value adjustments that arose on transition to IFRS and is being released to the Statement of Comprehensive Income over a period of ten years from adoption.

The Finance (No 2) Act 2010 includes legislation to reduce the main rate of corporation tax from 28% to 27% with effect from 1 April 2011. This resulted in a decrease in the Company's provision for deferred tax at 31 December 2010 of £4,725.

**15. TRADE AND OTHER PAYABLES**

	2010 £	2009 £
Shared appreciation payable	333,756	447,383
Note redemptions payable	83,501	113,252
Accruals and deferred income	71,029	66,779
Amounts owed to BOS	3,668	3,927
	<hr/>	<hr/>
	491,954	631,341
	<hr/>	<hr/>

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**16. MANAGEMENT OF RISK**

The majority of the Company's assets and liabilities have been classified as financial instruments in accordance with IAS 32 "Financial Instruments Presentation"

The Company's financial instruments comprise a mortgage portfolio, cash and liquid resources, a derivative contract ("swap"), an embedded derivative, interest-bearing loans and borrowings and various other payables that arise directly from its operations

The principal risks arising from the Company's financial instruments are credit risk and interest rate risk. Further detailed analysis of the risks facing the Company in relation to its financial instruments is provided below

The activities of the Company are conducted primarily by reference to a series of transaction documents (the "Programme Documentation"). The structure was established as a means of raising finance for BOS and no business activities are undertaken by the Company beyond those set out in the Programme Documentation

The Company's exposure to risk on its financial instruments and the management of such risk is largely determined at the inception of the securitisation transaction. The Company's activities and the role of each party to the transaction is clearly defined and documented

**16(a) Credit risk**

Credit risk is the risk of financial loss arising from a customer's failure to settle financial obligations as they fall due

Credit risk arises on the individual loans within the mortgage portfolio which are in turn secured on the underlying UK residential properties. The performance of these loans is therefore influenced by the economic background and the UK housing market. Mortgage loans are no longer offered by the Company but the maximum loan-to-value of the original advances was 25% and the credit risk is considered to be low

The extent to which the Company can meet its obligations to pay interest and ultimately repay the Notes will be dependent upon the receipt of funds earned on the bank deposits, the swap agreement with the external provider, principal receipts on the mortgages and the Letter of Credit issued by BOS (see "Liquidity Risk"). To the extent that this income does not provide sufficient funds to cover the interest due on the Notes or the repayment of the Notes the Company has no claim on the assets of BOS

The terms of the Mortgage Portfolio Agreement given by BOS in respect of the mortgages require BOS to repurchase any mortgage which is found to be in breach of warranty. BOS will repurchase any mortgages that are found or held not to be valid, binding and enforceable

Although in such an event the total value of the outstanding loan and any accrued interest will be covered by BOS, the Note holder will not receive the benefit of any future payments of appreciation amounts or partial repayment of appreciation amounts in respect of the mortgages repurchased. In terms of the shared appreciation, in accordance with the Programme Documentation, amounts received by the Company from the borrower are required to be paid over to the Note holders and swap provider

Credit risk also exists on the derivative contract with an external provider that the Company has entered into to manage the interest rate risk arising on its operations and sources of finance (see 16(b) below). The swap counterparty, UBS, is a regulated financial institution with a long term rating from Standard and Poor's (S&P) of A+ (2009 S&P long-term rating A+)

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**16 MANAGEMENT OF RISK (CONTINUED)**

**16(a) Credit risk (continued)**

All loans in the mortgage portfolio pay a zero rate of interest. As a result, there are no arrears of interest, properties in possession or bad debts within the Company and therefore no impairment provision is considered to be necessary at 31 December 2010 or 31 December 2009.

The maximum exposure to credit risk arising on the Company's financial assets at the reporting date is disclosed in the table below.

	Note	Carrying Amount 2010 £	Maximum Exposure 2010 £	Carrying Amount 2009 £ Restated	Maximum Exposure 2009 £ Restated
<b>Assets held at amortised cost:</b>					
Mortgage portfolio	8	13,362,551	24,234,073	14,129,109	25,680,101
Cash and cash equivalents	10	34,639,306	40,386,936	36,387,162	42,494,084
<b>Assets held at fair value:</b>					
Shared appreciation rights receivable	9	113,583,458	113,583,458	112,110,507	112,110,507
<b>Total Assets</b>		<b>161,585,315</b>	<b>178,204,467</b>	<b>162,626,778</b>	<b>180,284,692</b>

At the Balance Sheet date all financial assets subject to credit risk were neither past due nor impaired. A financial asset is "past due" if a counterparty has failed to make a payment when contractually due.

**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, where this is not possible the Company uses a derivative financial instrument to mitigate interest rate risk. The Notes issued by the Company are exposed to cash flow interest rate risk as the Notes carry a floating interest rate that is reset as market rates change.

The Company has entered into an interest rate swap with an external swap provider, UBS, 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 main impact on profit is due to variable rate movements on interest payable on the Notes, movements on the derivative and the interest earned on the GIC balances currently held on deposit with BOS.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**16. MANAGEMENT OF RISK (CONTINUED)**

**16(b) Interest rate risk (continued)**

At 31 December 2010, if interest rates had been 100 basis points higher or lower with all other variables held constant (2009 100 basis points spread), the net effect on the Company's statement of Comprehensive Income would be as shown in the table below. For 2010 due to the historically low interest rates and potential for rates to fluctuate in the future, a 100 basis point shift in interest rates is deemed to be an appropriate sensitivity measure.

	-100bps 2010 £	Actual 2010 £	+100bps 2010 £
<b>Profit before tax</b>	3,397,635	2,823,626	2,247,317
	<hr/>	<hr/>	<hr/>
	-100bps 2009 £	Actual 2009 £	+100bps 2009 £
<b>Profit before tax</b>	2,452,654	1,901,641	1,348,205
	<hr/>	<hr/>	<hr/>

**16(c) Liquidity Risk**

Liquidity risk is the risk that the Company is not able to meet its financial obligations as they fall due or can do so only at an unacceptably high cost.

The extent to which the Company can meet its obligations to pay interest and ultimately repay the Notes will be dependent upon the receipt of funds earned on the bank deposits, the swap agreement with the external provider, principal receipts on the mortgages and the Letter of Credit issued by BOS.

The Company has an unconditional and irrevocable 364-day revolving Letter of Credit provided by BOS. The Letter of Credit is for a maximum aggregate principal amount of £1,165,000 to assist the Company should it not be able to meet its obligations under the Notes. The reliance on this facility is therefore dependent upon the creditworthiness of BOS, which currently has a long term rating from Standard and Poor's (S&P) of A+ (2009 S&P long-term rating A+).

The Company has not drawn on the Letter of Credit since inception.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**16. MANAGEMENT OF RISK (CONTINUED)**

**16(c) Liquidity Risk (continued)**

The liquidity tables reflect the undiscounted cash payments which will fall due if the structure continues until the earliest contractual maturity date as set out in the Programme Documentation. The Note repayment profile mirrors the repayment of the mortgages, and based on current modelling assumptions, it is not anticipated that any mortgages will still be outstanding beyond the step-up date of August 2027.

2010	Carrying amount	Contractual repayment value	Not later than one month	Later than one month but not later than three months	Later than three months but not later than one year	Later than one year and not later than five years	Later than five years
	£	£	£	£	£	£	£
<b>Principal</b>							
Notes	45,276,452	60,658,404	-	-	-	-	60,658,404
Derivative liability (swap)	18,071,554	13,875,768	-	(83,600)	(255,445)	(1,357,108)	15,571,921
Shared appreciation payable	94,024,742	97,793,578	-	-	-	-	97,793,578
Trade and other payables	491,954	491,954	-	488,510	3,444	-	-
<b>Interest payable</b>							
Interest payable on Notes	7,036	1,455,475	-	21,411	65,423	347,573	1,021,068
	<u>157,871,738</u>	<u>174,275,179</u>	<u>-</u>	<u>426,321</u>	<u>(186,578)</u>	<u>(1,009,535)</u>	<u>175,044,971</u>
<b>2009</b>							
	£	£	£	£	£	£	£
<b>Principal</b>	<b>Restated</b>						
Notes	47,993,454	64,361,310	-	-	-	-	64,361,310
Derivative liability (swap)	17,982,293	13,136,190	-	(88,588)	(270,687)	(1,438,086)	14,933,551
Shared appreciation payable	92,592,997	97,587,551	-	-	-	-	97,587,551
Trade and other payables	631,341	631,341	9,342	621,999	-	-	-
<b>Interest payable</b>							
Interest payable on Notes	6,368	766,857	-	10,646	32,529	172,818	550,864
	<u>159,206,453</u>	<u>176,483,249</u>	<u>9,342</u>	<u>544,057</u>	<u>(238,158)</u>	<u>(1,265,268)</u>	<u>177,433,276</u>

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)**

**16. MANAGEMENT OF RISK (CONTINUED)**

**16(d) Fair values**

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

	<b>Note</b>	<b>Carrying amount 2010 £</b>	<b>Fair value 2010 £</b>	<b>Carrying amount 2009 £</b>	<b>Fair value 2009 £</b>
<b>Loans and Receivables at amortised cost</b>					
Mortgage portfolio	8	13,362,551	3,206,456	14,129,109	4,321,126
<b>Financial liabilities at amortised cost</b>					
Interest-bearing loans and borrowings	12	(44,925,276)	(44,434,186)	(47,619,222)	(42,158,646)

The embedded derivatives for shared appreciation receivable and payable are recognised in the Balance Sheet at fair value

The following comments summarise the main methods and assumptions used in estimating the fair value of financial instruments

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

For this reason, in accordance with "IFRS 7 Financial Instruments Disclosures", the fair value measurement for the shared appreciation is deemed to be Level 2 in the Fair Value Hierarchy. The change in fair value that has been calculated using this valuation technique has been recognised in the Statement of Comprehensive Income for the year ended 31 December 2010.

The cash and cash equivalents and other payables are recognised on an amortised cost basis that is considered to be a close approximation to fair value.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
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**17. RELATED PARTIES**

The Company is a subsidiary undertaking of BOS and ultimately LBG. The Company receives bank interest from BOS, its immediate parent undertaking. BOS administers the mortgage portfolio on behalf of the Company, for which quarterly service fees are paid. In 2010, a dividend of £2,000,000 (2009: £171,000) was paid to BOS. The Company's transactions with related parties are summarised below:

	<b>LBG and subsidiary undertakings</b>	<b>LBG and subsidiary undertakings</b>
<b>At 31 December or for the year then ended</b>	<b>2010 £</b>	<b>2009 £ Restated</b>
<b>Statement of Comprehensive Income</b>		
Interest receivable and similar income	2,937,760	2,626,553
Operating expenses	(43,928)	(46,181)
<b>Balance Sheet</b>		
<b>Equity</b>		
Dividends paid	(2,000,000)	(171,000)
<b>Assets</b>		
Cash and cash equivalents	40,386,997	42,494,084
<b>Liabilities</b>		
Other payables	(3,668)	(3,927)
Bank overdraft	(61)	(1,466)

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**18. FUTURE ACCOUNTING PRONOUNCEMENTS**

The following pronouncements will be relevant to the Company but are not applicable for the year ending 31 December 2010 and have not been applied in preparing these financial statements. The full impact of these accounting changes is currently being assessed by the Company.

<b>Pronouncement</b>	<b>Nature of change</b>	<b>IASB effective date</b>
<i>IAS 24 Related Party Disclosures</i>	Simplifies the definition of a related party and provides a partial exemption from the disclosure requirements for government related entities	Annual periods beginning on or after 1 January 2011
<i>Improvements to IFRSs (issued May 2010)</i>	Sets out minor amendments to IFRS standards as part of the annual improvements process	Dealt with on a standard by standard basis but not earlier than annual periods beginning on or after 1 July 2010
<i>IFRS 7 Financial Instruments Disclosures – Disclosures – Transfers of Financial Assets</i>	Requires additional disclosures in respect of risk exposures arising from transferred financial assets	Annual periods beginning on or after 1 July 2011
<i>IFRS 9 Financial Instruments Classification and Measurement<sup>1</sup></i>	Replaces those parts of IAS 39 Financial Instruments Recognition and Measurement relating to the classification and measurement of financial assets and liabilities	Annual periods beginning on or after 1 January 2013

<sup>1</sup> IFRS 9 is the initial stage of the project to replace IAS 39. Future stages are expected to result in amendments to IFRS 9 to deal with changes to the impairment of financial assets measured at amortised cost and hedge accounting. Until all stages of the replacement project are complete, it is not possible to determine the overall impact on the financial statements of the replacement of IAS 39.



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**18. FUTURE ACCOUNTING PRONOUNCEMENTS (CONTINUED)**

<b>Pronouncement</b>	<b>Nature of change</b>	<b>IASB effective date</b>
<i>IFRS 9 Financial Instruments Classification and Measurement (continued)</i>	<p>Requires financial assets to be classified into two measurement categories, fair value and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instrument</p> <p>The available-for-sale financial asset and held-to-maturity categories in existing IAS 39 will be eliminated. The requirements for financial liabilities and derecognition are broadly unchanged from IAS 39</p>	

At the date of this report, IFRS 9 and Amendments to IFRS 7 are awaiting EU endorsement

**19. PARENT UNDERTAKING AND CONTROLLING PARTY**

The Company's immediate parent company is BOS plc. The company regarded by the directors as the ultimate controlling party is Lloyds Banking Group plc, a limited liability company incorporated and domiciled in Scotland, which is also the parent undertaking of the largest group of undertakings for which group financial statements are drawn up and of which the Company is a member. BOS plc is the parent undertaking of the smallest such group of undertakings. Copies of the group accounts of both companies may be obtained from Group Secretariat, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN.

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**20. POST BALANCE SHEET EVENTS**

As previously discussed in the Directors' Report, the GIC account has now been closed following a meeting of Note holders on 23 February 2011 where the Company's restructuring proposals were approved. As a result of this agreement, the balance on the GIC account at 28 February 2011 of £35,963,405 was used to pay down a proportion of the Notes in issue.

It was also agreed to change the remaining Notes in issue from interest-bearing to zero-coupon with effect from the same date. The remaining Notes retain the right to receive the shared appreciation on the underlying mortgage loans as per the original agreement.

As a result of these changes the effective yield adjustments will be fully amortised in 2011 on the associated financial instruments.

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**21. PRIOR YEAR RESTATEMENT**

**STATEMENT OF COMPREHENSIVE INCOME**

	2009 £	Reclassification £	2009 £ Restated
Interest receivable on mortgage portfolio	679,470	-	679,470
Bank interest receivable from BOS	2,626,553	-	2,626,553
Bank interest receivable	500,615	(371,821)	128,794
<b>Interest receivable and similar income</b>	<b>3,806,638</b>		<b>3,434,817</b>
Interest payable and similar charges	(1,468,930)	-	(1,468,930)
<b>Net interest income</b>	<b>2,337,708</b>		<b>1,965,887</b>
Net fair value gains and losses on derivatives	(371,239)	371,821	582
Other operating income	3,900	-	3,900
Operating expenses	(68,728)	-	(68,728)
<b>Profit before tax</b>	<b>1,901,641</b>		<b>1,901,641</b>
<b>Taxation</b>	<b>(532,460)</b>	-	<b>(532,460)</b>
<b>Profit / total comprehensive income attributable to equity holders</b>	<b>1,369,181</b>		<b>1,369,181</b>

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
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**21 PRIOR YEAR RESTATEMENT (CONTINUED)**

**BALANCE SHEET**

	31 Dec 2009 £	Reclassification £	31 Dec 2009 £ Restated
<b>Assets</b>			
Mortgage portfolio	14,129,109	-	14,129,109
Shared appreciation rights receivable	112,110,507	-	112,110,507
<b>Total non-current assets</b>	126,239,616		126,239,616
Cash and cash equivalents	36,417,833	(30,671)	36,387,162
<b>Total current assets</b>	36,417,833		36,387,162
<b>Total assets</b>	162,657,449		162,626,778
<b>Equity</b>			
Share capital	50,001	-	50,001
Retained profits	3,046,918	-	3,046,918
<b>Shareholders' equity</b>	3,096,919		3,096,919
<b>Liabilities</b>			
Interest-bearing loans and borrowings	47,635,242	-	47,635,242
Shared appreciation rights payable	92,592,997	-	92,592,997
Deferred tax liability	151,183	-	151,183
<b>Total non-current liabilities</b>	140,379,422		140,379,422
Interest-bearing loans and borrowings	(16,020)	-	(16,020)
Trade and other payables	631,341	-	631,341
Derivative liability	18,012,964	(30,671)	17,982,293
Bank overdraft	1,466	-	1,466
Current tax liability	551,357	-	551,357
<b>Total current liabilities</b>	19,181,108		19,150,437
<b>Total liabilities</b>	159,560,530		159,529,859
<b>Total equity and liabilities</b>	162,657,449		162,626,778

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**21. PRIOR YEAR RESTATEMENT (CONTINUED)**

**OPENING BALANCE SHEET**

	31 Dec 2008 £	Reclassification £	1 Jan 2009 £ Restated
<b>Assets</b>			
Mortgage portfolio	15,082,385	-	15,082,385
Shared appreciation rights receivable	131,769,549	-	131,769,549
<b>Total non-current assets</b>	146,851,934		146,851,934
Cash and cash equivalents	36,283,837	(32,529)	36,251,308
<b>Total current assets</b>	36,283,837		36,251,308
<b>Total assets</b>	183,135,771		183,103,242
<b>Equity</b>			
Share capital	50,001	-	50,001
Retained profits	1,848,737	-	1,848,737
<b>Shareholders' equity</b>	1,898,738		1,898,738
<b>Liabilities</b>			
Interest-bearing loans and borrowings	50,618,797	-	50,618,797
Shared appreciation rights payable	108,651,577	-	108,651,577
Deferred tax liability	170,080	-	170,080
<b>Total non-current liabilities</b>	159,440,454		159,440,454
Interest-bearing loans and borrowings	96,219	-	96,219
Trade and other payables	277,748	-	277,748
Derivative liability	21,242,188	(32,529)	21,209,659
Bank overdraft	2,506	-	2,506
Current tax liability	177,918	-	177,918
<b>Total current liabilities</b>	21,796,579		21,764,050
<b>Total liabilities</b>	181,237,033		181,204,504
<b>Total equity and liabilities</b>	183,135,771		183,103,242