

DIAGEO PLC  
Form 20-F/A  
March 05, 2008

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# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## Form 20-F/A

Amendment No. 1

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended: 30 June 2007

Commission file number: 1-10691

## DIAGEO plc

(Exact name of Registrant as specified in its charter)

England

(Jurisdiction of incorporation or organization)

8 Henrietta Place, London, W1G 0NB, England

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

| <u>Title of each class</u>                                                                     | <u>Name of each exchange on which registered</u>    |
|------------------------------------------------------------------------------------------------|-----------------------------------------------------|
| American Depositary Shares<br>Ordinary shares of 28 <sup>101</sup> / <sub>108</sub> pence each | New York Stock Exchange<br>New York Stock Exchange* |

\*

Not for trading, but only in connection with the registration of American Depositary Shares representing such ordinary shares, pursuant to the requirements of the Securities and Exchange Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Act: **None**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the Annual Report: 2,931,085,864 ordinary shares of 28<sup>101</sup>/<sub>108</sub> pence each.

Indicate by check mark if each registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

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If this report is an annual or transition report, indicate by check mark if each registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether each registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP  International Financial Reporting Standards as issued by the International Accounting Standards Board  Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the Registrant has elected to follow.

Item 17  Item 18

If this is an annual report, indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

This document and the Annual Report on Form 20-F filed with the SEC on 17 September 2007 (the "Original 20-F") comprise the annual report on Form 20-F for the year ended 30 June 2007 of Diageo plc (the 2007 Form 20-F). Reference is made in the Original 20-F to the cross reference to Form 20-F table on pages 226 to 228 thereof (the Form 20-F Cross reference table). The 2007 Form 20-F includes only (i) the information in the Original 20-F that is referenced in the Form 20-F Cross reference table (except to the extent such information is amended herein), (ii) the cautionary statement concerning forward-looking statements on pages 25 and 26 of the Original 20-F, (iii) the Exhibits to the Original 20-F, and (iv) the entirety of this amendment, and only those materials shall be deemed to be filed with the Securities and Exchange Commission for any purpose, including incorporation by reference into the Registration Statements on Form F-3 (File Nos. 333-10410, 333-14100, 333-110804 and 333-132732) and Registration Statements on Form S-8 (File Nos. 333-08090, 333-08092, 333-08094, 333-08096, 333-08098, 333-08102, 333-08104, 333-08106, 333-09770, 333-11460 and 333-11462), and any other documents, including documents filed by Diageo plc pursuant to the Securities Act of 1933, as amended, which purport to incorporate by reference the 2007 Form 20-F.

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**Explanatory Note**

The sole purpose of this amendment to Diageo plc's Annual Report on Form 20-F for the year ended 30 June 2007 is to amend the consolidated financial statements that were originally approved on 29 August 2007 to include an unreserved and explicit statement of compliance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) as well as to include a re-issued audit report on the consolidated financial statements that includes an opinion on compliance with IFRS as issued by the IASB.

In its Form 20-F filed on 17 September 2007 Diageo plc stated in the 'basis of preparation' note that it prepared its consolidated financial statements in accordance with IFRS as endorsed and adopted for use in the European Union (EU). The company stated in Note 35 to its consolidated financial statements that it had prepared its consolidated financial statements in accordance with IFRS as adopted by the EU and that the consolidated financial statements would have been no different had the group applied IFRS as issued by the IASB.

The amendment to Item 18 revises the 'basis of preparation' portion of the accounting policies of the Group to provide an unreserved and explicit statement of compliance with IFRS as issued by the IASB and also revises Note 35 to give an unreserved and explicit statement as to compliance with IFRS as issued by the IASB. A re-issued audit report dated 29 August 2007 is also included whereby KPMG Audit Plc have opined as to compliance with IFRS as issued by the IASB, as stated therein.

Material information as to events occurring subsequent to 29 August 2007 is disclosed in Diageo plc's current reports on Form 6-K dated 5 March 2008, which are incorporated by reference herein.

Diageo plc is including certain mandatory certifications of the chief executive officer and the chief financial officer, which are included as Exhibits.

This amendment amends 'Item 18 Financial Statements' and 'Item 19 Exhibits'.

Other than as expressly set forth above, this Form 20-F/A does not, and does not purport to, amend, update or restate the information in any other Item of the Form 20-F filed on 17 September 2007 or reflect any events that have occurred after the Form 20-F was filed.

The consolidated financial statements are prepared in accordance with IFRS as endorsed and adopted for use in the EU and IFRS as issued by the IASB. References to IFRS hereafter should be construed as references to IFRS as adopted by the EU and IFRS as issued by the IASB.

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## Report of independent registered public accounting firm

### The Board of Directors and Shareholders of Diageo plc.

We have audited the accompanying consolidated balance sheets of Diageo plc and subsidiaries as of 30 June 2007 and 30 June 2006, and the related consolidated income statements, consolidated statements of recognised income and expense, and consolidated cash flow statements for each of the years in the three year period ended 30 June 2007. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the aforementioned consolidated financial statements present fairly, in all material respects, the financial position of Diageo plc and subsidiaries as of 30 June 2007 and 30 June 2006 and the results of their operations and their cash flows for each of the years in the three year period ended 30 June 2007 in conformity with International Financial Reporting Standards (IFRS) as adopted by the European Union and IFRS as issued by the International Accounting Standards Board (IASB).

As identified in the accounting policies of the group in the consolidated financial statements, the company has changed its method of accounting for certain financial instruments with effect from 1 July 2005.

IFRS as adopted by the European Union and IFRS as issued by the IASB vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in note 35 to the consolidated financial statements.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Diageo plc's internal control over financial reporting as of 30 June 2007, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated 29 August 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

### **KPMG Audit Plc**

Chartered Accountants

London, England  
29 August 2007

## Consolidated income statement

|                                            | Notes | Year ended<br>30 June<br>2007 | Year ended<br>30 June<br>2006 | Year ended<br>30 June<br>2005 |
|--------------------------------------------|-------|-------------------------------|-------------------------------|-------------------------------|
|                                            |       | £ million                     | £ million                     | £ million                     |
| <b>Sales</b>                               | 2     | <b>9,917</b>                  | 9,704                         | 8,968                         |
| Excise duties                              | 3     | (2,436)                       | (2,444)                       | (2,291)                       |
| <b>Net sales</b>                           |       | <b>7,481</b>                  | 7,260                         | 6,677                         |
| Cost of sales                              | 3,5   | (3,003)                       | (2,921)                       | (2,632)                       |
| <b>Gross profit</b>                        |       | <b>4,478</b>                  | 4,339                         | 4,045                         |
| Marketing expenses                         | 3     | (1,162)                       | (1,127)                       | (1,013)                       |
| Other operating expenses                   | 3,5   | (1,157)                       | (1,168)                       | (1,301)                       |
| <b>Operating profit</b>                    | 2     | <b>2,159</b>                  | 2,044                         | 1,731                         |
| Sale of General Mills and other businesses | 5     | (1)                           | 157                           | 214                           |
| Interest receivable                        | 6     | 111                           | 51                            | 121                           |
| Interest payable                           | 6     | (362)                         | (244)                         | (271)                         |
| Other finance income                       | 6     | 55                            | 24                            | 26                            |
| Other finance charges                      | 6     | (16)                          | (17)                          | (17)                          |
| Share of associates' profits after tax     | 7     | 149                           | 131                           | 121                           |
| <b>Profit before taxation</b>              |       | <b>2,095</b>                  | 2,146                         | 1,925                         |
| Taxation                                   | 8     | (678)                         | (181)                         | (599)                         |
| <b>Profit from continuing operations</b>   |       | <b>1,417</b>                  | 1,965                         | 1,326                         |
| Discontinued operations                    | 9     | 139                           |                               | 73                            |
| <b>Profit for the year</b>                 |       | <b>1,556</b>                  | 1,965                         | 1,399                         |
| <b>Attributable to:</b>                    |       |                               |                               |                               |
| Equity shareholders of the parent company  |       | 1,489                         | 1,908                         | 1,344                         |
| Minority interests                         |       | 67                            | 57                            | 55                            |
|                                            |       | <b>1,556</b>                  | 1,965                         | 1,399                         |
| <b>Basic earnings per share</b>            | 10    |                               |                               |                               |
| Continuing operations                      |       | 50.2p                         | 67.2p                         | 42.8p                         |
| Discontinued operations                    |       | 5.2p                          |                               | 2.4p                          |
|                                            |       | <b>55.4p</b>                  | 67.2p                         | 45.2p                         |
| <b>Diluted earnings per share</b>          | 10    |                               |                               |                               |
| Continuing operations                      |       | 49.9p                         | 66.9p                         | 42.8p                         |
| Discontinued operations                    |       | 5.1p                          |                               | 2.4p                          |
|                                            |       | <b>55.0p</b>                  | 66.9p                         | 45.2p                         |
| <b>Average shares</b>                      |       | <b>2,688m</b>                 | 2,841m                        | 2,972m                        |

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| Notes | Year ended<br>30 June<br>2007 | Year ended<br>30 June<br>2006 | Year ended<br>30 June<br>2005 |
|-------|-------------------------------|-------------------------------|-------------------------------|
|       |                               |                               |                               |

The accompanying notes are an integral part of these consolidated financial statements.



## Consolidated statement of recognised income and expense

|                                                                                | Year ended<br>30 June 2007 | Year ended<br>30 June 2006 | Year ended<br>30 June 2005 |
|--------------------------------------------------------------------------------|----------------------------|----------------------------|----------------------------|
|                                                                                | £ million                  | £ million                  | £ million                  |
| Exchange differences on translation of foreign operations excluding borrowings | (269)                      | (76)                       | 116                        |
| Exchange differences on borrowings and derivative net investment hedges        | 199                        | 52                         |                            |
| Effective portion of changes in fair value of cash flow hedges                 |                            |                            |                            |
| gains taken to equity                                                          | 28                         | 39                         |                            |
| transferred to income statement                                                | 35                         | 4                          |                            |
| Fair value movement on available for sale securities                           |                            | (148)                      |                            |
| Actuarial gains/(losses) on post employment plans                              | 328                        | 459                        | (238)                      |
| Tax on items taken directly to equity                                          | (99)                       | (97)                       | 33                         |
| <b>Net income/(expense) recognised directly in equity</b>                      | <b>222</b>                 | <b>233</b>                 | <b>(89)</b>                |
| <b>Profit for the year</b>                                                     | <b>1,556</b>               | <b>1,965</b>               | <b>1,399</b>               |
| <b>Total recognised income and expense for the year</b>                        | <b>1,778</b>               | <b>2,198</b>               | <b>1,310</b>               |
| <b>Attributable to:</b>                                                        |                            |                            |                            |
| Equity shareholders of the parent company                                      | 1,719                      | 2,146                      | 1,250                      |
| Minority interests                                                             | 59                         | 52                         | 60                         |
| <b>Total recognised income and expense for the year</b>                        | <b>1,778</b>               | <b>2,198</b>               | <b>1,310</b>               |

The accompanying notes are an integral part of these consolidated financial statements.

## Consolidated balance sheet

|                                     | Notes | 30 June 2007 |                | 30 June 2006 |                |
|-------------------------------------|-------|--------------|----------------|--------------|----------------|
|                                     |       | £ million    | £ million      | £ million    | £ million      |
| <b>Non-current assets</b>           |       |              |                |              |                |
| Intangible assets                   | 11    | 4,383        |                | 4,534        |                |
| Property, plant and equipment       | 12    | 1,932        |                | 1,952        |                |
| Biological assets                   | 13    | 12           |                | 13           |                |
| Investments in associates           | 14    | 1,436        |                | 1,341        |                |
| Other investments                   | 16    | 128          |                | 69           |                |
| Other receivables                   | 18    | 17           |                | 12           |                |
| Other financial assets              | 21    | 52           |                | 42           |                |
| Deferred tax assets                 | 25    | 771          |                | 1,113        |                |
| Post employment benefit assets      | 4     | 38           |                | 14           |                |
|                                     |       |              | 8,769          |              | 9,090          |
| <b>Current assets</b>               |       |              |                |              |                |
| Inventories                         | 17    | 2,465        |                | 2,386        |                |
| Trade and other receivables         | 18    | 1,759        |                | 1,681        |                |
| Other financial assets              | 21    | 78           |                | 71           |                |
| Cash and cash equivalents           | 19    | 885          |                | 699          |                |
|                                     |       |              | 5,187          |              | 4,837          |
| <b>Total assets</b>                 |       |              | <b>13,956</b>  |              | <b>13,927</b>  |
| <b>Current liabilities</b>          |       |              |                |              |                |
| Borrowings and bank overdrafts      | 20    | (1,535)      |                | (759)        |                |
| Other financial liabilities         | 21    | (43)         |                | (36)         |                |
| Trade and other payables            | 23    | (1,888)      |                | (1,803)      |                |
| Corporate tax payable               | 8     | (673)        |                | (681)        |                |
| Provisions                          | 24    | (60)         |                | (56)         |                |
|                                     |       |              | (4,199)        |              | (3,335)        |
| <b>Non-current liabilities</b>      |       |              |                |              |                |
| Borrowings                          | 20    | (4,132)      |                | (4,001)      |                |
| Other financial liabilities         | 21    | (104)        |                | (78)         |                |
| Other payables                      | 23    | (38)         |                | (37)         |                |
| Provisions                          | 24    | (274)        |                | (306)        |                |
| Deferred tax liabilities            | 25    | (582)        |                | (674)        |                |
| Post employment benefit liabilities | 4     | (457)        |                | (815)        |                |
|                                     |       |              | (5,587)        |              | (5,911)        |
| <b>Total liabilities</b>            |       |              | <b>(9,786)</b> |              | <b>(9,246)</b> |
| <b>Net assets</b>                   |       |              | <b>4,170</b>   |              | <b>4,681</b>   |
| <b>Equity</b>                       |       |              |                |              |                |
| Called up share capital             |       | 848          |                | 883          |                |
| Share premium                       |       | 1,341        |                | 1,340        |                |
| Other reserves                      |       | 3,186        |                | 3,168        |                |
| Retained deficit                    |       | (1,403)      |                | (889)        |                |

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|                                                                         | Notes             | 30 June 2007      | 30 June 2006      |
|-------------------------------------------------------------------------|-------------------|-------------------|-------------------|
|                                                                         | <u>          </u> | <u>          </u> | <u>          </u> |
| <b>Equity attributable to equity shareholders of the parent company</b> |                   | <b>3,972</b>      | 4,502             |
| <b>Minority interests</b>                                               |                   | <b>198</b>        | 179               |
|                                                                         |                   | <u>          </u> | <u>          </u> |
| <b>Total equity</b>                                                     | 26                | <b>4,170</b>      | 4,681             |
|                                                                         |                   | <u>          </u> | <u>          </u> |

The accompanying notes are an integral part of these consolidated financial statements.

These consolidated financial statements were approved by a duly appointed and authorised committee of the board of directors on 29 August 2007 and were signed on its behalf by PS Walsh and NC Rose, directors.

## Consolidated cash flow statement

| Notes                                                           | Year ended<br>30 June 2007 |                | Year ended<br>30 June 2006 |                | Year ended<br>30 June 2005 |                |
|-----------------------------------------------------------------|----------------------------|----------------|----------------------------|----------------|----------------------------|----------------|
|                                                                 | £ million                  | £ million      | £ million                  | £ million      | £ million                  | £ million      |
| <b>Cash flows from operating activities</b>                     |                            |                |                            |                |                            |                |
| Profit for the year                                             | 1,556                      |                | 1,965                      |                | 1,399                      |                |
| Discontinued operations                                         | (139)                      |                |                            |                | (73)                       |                |
| Taxation                                                        | 678                        |                | 181                        |                | 599                        |                |
| Share of associates' profits after tax                          | (149)                      |                | (131)                      |                | (121)                      |                |
| Net interest and other net finance income                       | 212                        |                | 186                        |                | 141                        |                |
| Losses/(gains) on disposal of businesses                        | 1                          |                | (157)                      |                | (214)                      |                |
| Depreciation and amortisation                                   | 210                        |                | 214                        |                | 241                        |                |
| Movements in working capital                                    | (180)                      |                | (192)                      |                | 89                         |                |
| Dividend income and other items                                 | 27                         | 83             |                            | 133            |                            | 212            |
|                                                                 |                            | <b>2,272</b>   |                            | <b>2,199</b>   |                            | <b>2,273</b>   |
| <b>Cash generated from operations</b>                           |                            | <b>2,272</b>   |                            | <b>2,199</b>   |                            | <b>2,273</b>   |
| Interest received                                               |                            | 42             |                            | 64             |                            | 146            |
| Interest paid                                                   |                            | (279)          |                            | (235)          |                            | (325)          |
| Dividends paid to equity minority interests                     |                            | (41)           |                            | (40)           |                            | (49)           |
| Taxation paid                                                   |                            | (368)          |                            | (393)          |                            | (320)          |
|                                                                 |                            | <b>1,626</b>   |                            | <b>1,595</b>   |                            | <b>1,725</b>   |
| <b>Net cash from operating activities</b>                       |                            | <b>1,626</b>   |                            | <b>1,595</b>   |                            | <b>1,725</b>   |
| <b>Cash flows from investing activities</b>                     |                            |                |                            |                |                            |                |
| Disposal of property, plant and equipment                       |                            | 69             |                            | 16             |                            | 18             |
| Purchase of property, plant and equipment                       |                            | (274)          |                            | (257)          |                            | (294)          |
| Net (purchase)/disposal of other investments                    |                            | (6)            |                            | 7              |                            | (6)            |
| Payment into escrow in respect of the UK pension fund           |                            | (50)           |                            |                |                            |                |
| Disposal of businesses                                          | 28                         | 4              |                            | 772            |                            | 1,194          |
| Purchase of businesses                                          | 29                         | (70)           |                            | (209)          |                            | (258)          |
|                                                                 |                            | <b>(327)</b>   |                            | <b>329</b>     |                            | <b>654</b>     |
| <b>Net cash (outflow)/inflow from investing activities</b>      |                            | <b>(327)</b>   |                            | <b>329</b>     |                            | <b>654</b>     |
| <b>Cash flows from financing activities</b>                     |                            |                |                            |                |                            |                |
| Proceeds from issue of share capital                            |                            | 1              |                            | 3              |                            | 6              |
| Net purchase of own shares for share schemes                    |                            | (25)           |                            | (32)           |                            | (29)           |
| Own shares repurchased                                          |                            | (1,405)        |                            | (1,407)        |                            | (710)          |
| Net increase/(decrease) in loans                                |                            | 1,226          |                            | 309            |                            | (379)          |
| Redemption of guaranteed preferred securities                   |                            |                |                            |                |                            | (302)          |
| Equity dividends paid                                           |                            | (858)          |                            | (864)          |                            | (849)          |
|                                                                 |                            | <b>(1,061)</b> |                            | <b>(1,991)</b> |                            | <b>(2,263)</b> |
| <b>Net cash used in financing activities</b>                    |                            | <b>(1,061)</b> |                            | <b>(1,991)</b> |                            | <b>(2,263)</b> |
| <b>Net increase/(decrease) in net cash and cash equivalents</b> |                            |                |                            |                |                            |                |
|                                                                 |                            | <b>238</b>     |                            | <b>(67)</b>    |                            | <b>116</b>     |
| Exchange differences                                            |                            | (50)           |                            | (11)           |                            | (55)           |
| Net cash and cash equivalents at beginning of the year          |                            | <b>651</b>     |                            | <b>729</b>     |                            | <b>668</b>     |
|                                                                 |                            | <b>839</b>     |                            | <b>651</b>     |                            | <b>729</b>     |
| <b>Net cash and cash equivalents at end of the year</b>         |                            | <b>839</b>     |                            | <b>651</b>     |                            | <b>729</b>     |

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|                                                  | Notes | Year ended<br>30 June 2007 | Year ended<br>30 June 2006 | Year ended<br>30 June 2005 |
|--------------------------------------------------|-------|----------------------------|----------------------------|----------------------------|
| <b>Net cash and cash equivalents consist of:</b> |       |                            |                            |                            |
| Cash and cash equivalents                        | 19    | 885                        | 699                        | 787                        |
| Bank overdrafts                                  | 20    | (46)                       | (48)                       | (58)                       |
|                                                  |       | <b>839</b>                 | 651                        | 729                        |

The accompanying notes are an integral part of these consolidated financial statements.

## Accounting policies of the group

### Basis of preparation

The consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed and adopted for use in the European Union (EU) and IFRS as issued by the International Accounting Standards Board (IASB). References to IFRS hereafter should be construed as references to both IFRS as adopted by the EU and IFRS as issued by the IASB.

The consolidated financial statements are prepared on a going concern basis under the historical cost convention, except that biological assets and certain financial instruments are stated at their fair value.

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The critical accounting policies, which the directors consider are of greater complexity and/or particularly subject to the exercise of judgement, are set out with related disclosures in 'Critical accounting policies' in the Business review section of this Annual Report.

### Business combinations

The consolidated financial statements include the results of the company and its subsidiaries together with the group's attributable share of the results of associates and joint ventures. The results of subsidiaries sold or acquired are included in the income statement up to, or from, the date that control passes.

On the acquisition of a business, or of an interest in an associate or joint venture, fair values, reflecting conditions at the date of acquisition, are attributed to the net assets including identifiable intangible assets acquired. Adjustments to fair values include those made to bring accounting policies into line with those of the group.

### Sales

Sales comprise revenue from the sale of goods, royalties receivable and rents receivable. Revenue from the sale of goods includes excise and import duties which the group pays as principal but excludes amounts collected on behalf of third parties, such as value added tax. Sales are recognised depending upon individual customer terms at the time of despatch, delivery or some other specified point when the risk of loss transfers. Provision is made for returns where appropriate. Sales are stated net of price discounts, allowances for customer loyalty and certain promotional activities and similar items.

### Advertising

Advertising production costs are charged in the income statement when the advertisement is first shown to the public.

### Research and development

Research expenditure in respect of new drinks products and package design is written off in the period in which it is incurred. Any subsequent development expenditure in the period leading up to product launch that meets the recognition criteria set out in the relevant standard is capitalised. If capitalised, any intangible asset is amortised on a straight-line basis over the period of the expected benefit.

## Accounting policies of the group (continued)

### Share-based payments employee benefits

The fair value of equity-settled share options granted is initially measured at grant date based on the binomial or Monte Carlo models and is charged in the income statement over the vesting period.

Shares of Diageo plc held by the company for the purpose of fulfilling obligations in respect of various employee share plans around the group are deducted from equity in the consolidated balance sheet. Any surplus or deficit arising on the sale of the Diageo plc shares held by the group is included as an adjustment to reserves.

### Pensions and other post employment benefits

The group's principal pension funds are defined benefit plans. In addition the group has defined contribution plans, unfunded post employment medical benefit liabilities and other unfunded defined benefit post employment liabilities. For defined benefit plans, the amount charged in the income statement is the cost of accruing pension benefits promised to employees over the year, plus any fully vested benefit improvements granted to members by the group during the year. It also includes a credit equivalent to the group's expected return on the pension plans' assets over the year, offset by a charge equal to the expected increase in the plans' liabilities over the year. The difference between the fair value of the plans' assets and the present value of the plans' liabilities is disclosed as an asset or liability on the consolidated balance sheet. Any differences between the expected return on assets and that actually achieved, and any changes in the liabilities over the year due to changes in assumptions or experience within the plans, are recognised in the statement of recognised income and expense.

Contributions payable by the group in respect of defined contribution plans are charged to operating profit as incurred.

### Exceptional items

Exceptional items are those that in management's judgement need to be disclosed by virtue of their size or incidence. Such items are included within the income statement caption to which they relate, and are separately disclosed either in the notes to the consolidated financial statements or on the face of the consolidated income statement.

### Foreign currencies

Items included in the financial statements of the group's subsidiaries, associates and joint ventures are measured using the currency of the primary economic environment in which each entity operates (its functional currency). The consolidated financial statements are presented in sterling, which is the functional currency of the parent company.

The income statements and cash flows of overseas entities are translated into sterling at weighted average rates of exchange, other than substantial transactions that are translated at the rate on the date of the transaction. The adjustment to closing rates is taken to reserves.

Balance sheets are translated at closing rates. Exchange differences arising on the re-translation at closing rates of the opening balance sheets of overseas entities are taken to reserves, as are exchange differences arising on related foreign currency borrowings and financial instruments designated as net investment hedges, to the extent that they are effective. Tax charges and credits arising on such items are also taken to reserves. Other exchange differences are taken to the income statement.

The results, assets and liabilities of operations in hyper-inflationary economies are adjusted to reflect the changes in the purchasing power of the local market currency of the entity.

## Accounting policies of the group (continued)

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction. If hedged forward, the impact of hedging is recognised, where permitted, under hedge accounting (refer to accounting policy for derivative financial instruments).

### Brands, goodwill and other intangible assets

When the cost of an acquisition exceeds the fair values attributable to the group's share of the net assets acquired, the difference is treated as purchased goodwill. Goodwill arising on acquisitions prior to 1 July 1998 was eliminated against reserves, and this goodwill has not been restated. Goodwill arising subsequent to 1 July 1998 has been capitalised.

Acquired brands and other intangible assets are recognised when they are controlled through contractual or other legal rights, or are separable from the rest of the business, and the fair value can be reliably measured.

Goodwill and intangible assets that are regarded as having indefinite useful economic lives are not amortised. Intangible assets that are regarded as having limited useful economic lives are amortised on a straight-line basis over those lives. Assets with indefinite lives are reviewed for impairment annually and other assets are reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. To ensure that goodwill and intangible assets are not carried at above their recoverable amounts, impairment reviews are carried out comparing the net carrying value with the recoverable amount, where the recoverable amount is the higher of value in use or fair value less cost to sell. Amortisation and any impairment write downs are charged in the income statement.

Computer software is amortised on a straight-line basis to estimated residual value over its expected useful life, expected to be up to five years. Residual values and useful lives are reviewed each year.

### Property, plant and equipment

Land and buildings are stated at cost less depreciation. Freehold land is not depreciated. Leaseholds are depreciated over the unexpired period of the lease. Other property, plant and equipment are depreciated on a straight-line basis to estimated residual values over their expected useful lives, and these values and lives are reviewed each year. Subject to these reviews, the estimated useful lives fall within the following ranges: industrial and other buildings 10 to 50 years; plant and machinery 5 to 25 years; fixtures and fittings 5 to 10 years; and casks and containers 15 to 20 years.

Reviews are carried out if there is some indication that impairment may have occurred, to ensure that property, plant and equipment are not carried at above their recoverable amounts.

### Leases

Where the group has substantially all the risks and rewards of ownership of an asset subject to a lease, the lease is treated as a finance lease. Other leases are treated as operating leases, with payments and receipts taken to the income statement on a straight-line basis over the life of the lease.

### Agriculture

Grape cultivation by the group's wine business is accounted for as an agricultural activity. Accordingly the group's biological assets (grape vines) are carried at fair value which is computed on the basis of a discounted cash flow computation. Agricultural produce (harvested grapes) is valued at market value on transfer into inventory.



## Accounting policies of the group (continued)

### Associates and joint ventures

An associate is an undertaking in which the group has a long-term equity interest and over which it has the power to exercise significant influence. The group's interest in the net assets of associates is included in investments in the consolidated balance sheet and its interest in their results is included in the income statement below the group's operating profit. Joint ventures, where there is contractual joint control over the entity, are accounted for by including on a line-by-line basis the attributable share of the results, assets and liabilities.

### Inventories

Inventories are stated at the lower of cost and net realisable value. Cost includes raw materials, direct labour and expenses, an appropriate proportion of production and other overheads, but not borrowing costs. Cost is calculated on an actual usage basis for maturing inventories and on a first in, first out basis for other inventories.

### Financial assets

**Trade receivables** Trade receivables are non-interest bearing and are stated at their nominal amount that is usually the original invoiced amount less provisions made for bad and doubtful receivables. Estimated irrecoverable amounts are based on the ageing of the receivable balances and historical experience. Individual trade receivables are written off when management deems them not to be collectable.

**Cash and cash equivalents** Cash and cash equivalents comprise cash in hand and deposits which are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value and have an original maturity of three months or less at acquisition, including money market deposits, commercial paper and investments.

### Financial liabilities

**Borrowings** Borrowings are initially measured at cost (which is equal to fair value at inception), and are subsequently measured at amortised cost using the effective interest rate method. Any difference between the proceeds, net of transaction costs, and the settlement or redemption of borrowings is recognised over the term of the borrowings using the effective interest rate method. The fair value adjustments for all loans designated as hedged items in a fair value hedge are shown separately as a net figure.

**Trade payables** Trade payables are non-interest bearing and are stated at their nominal value.

### Derivative financial instruments

The group uses derivative financial instruments to hedge its exposures to fluctuations in interest and exchange rates. The derivative instruments used by Diageo consist mainly of currency forwards, foreign currency swaps, interest rate swaps and cross currency interest rate swaps.

From 1 July 2005, derivative financial instruments are recognised in the balance sheet at fair value that is calculated using discounted cash flow techniques or option pricing models (such as Black Scholes) consistently for similar types of instruments. Both techniques take into consideration assumptions based on market data. Changes in the fair value of derivatives that do not qualify for hedge accounting treatment are charged or credited in the income statement.

## Accounting policies of the group (continued)

The purpose of hedge accounting is to mitigate the impact of potential volatility in the income statement of the group of changes in exchange or interest rates or commodity prices, by matching the impact of the hedged item and the hedging instrument in the income statement. To qualify for hedge accounting, the hedging relationship must meet several conditions with respect to documentation, probability of occurrence, hedge effectiveness and reliability of measurement. At the inception of the transaction, the group documents the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking the hedge transactions. This process includes linking all derivatives designated as hedges to specific assets and liabilities or to specific firm commitments or forecast transactions. The group also documents its assessment, both at the hedge inception and on a quarterly basis, as to whether the derivatives that are used in hedging transactions have been, and are likely to continue to be, effective in offsetting changes in fair value or cash flows of hedged items.

Diageo designates derivatives which qualify as hedges for accounting purposes as either: (a) a hedge of the fair value of a recognised asset or liability (fair value hedge); (b) a hedge of a forecast transaction or the cash flow risk from a change in interest rates or exchange rates (cash flow hedge); or (c) a hedge of a net investment in foreign operations.

The method of recognising the resulting gains or losses from movements in fair values is dependent on whether the derivative contract is designated to hedge a specific risk and qualifies for hedge accounting.

Derivative financial instruments are used to manage the currency and/or interest rate risks to which the fair value of certain assets and liabilities are exposed. From 1 July 2005, changes in the fair value of derivatives that are fair value hedges are recognised in the income statement, along with any changes in the relevant fair value of the underlying hedged asset or liability that is attributable to the hedged risk. If such a hedge relationship is de-designated, fair value movements on the derivative continue to be taken to the income statement while any fair value adjustments made to the underlying hedged item to that date are amortised through the income statement over its remaining life.

Derivative financial instruments are used to hedge the currency risk of highly probable future foreign currency cash flows, as well as the cash flow risk from changes in interest rates and exchange rates. From 1 July 2005, the effective part of the changes in fair value of cash flow hedges is recognised in the statement of recognised income and expense, while any ineffective part is recognised immediately in the income statement. Amounts recorded in the statement of recognised income and expense are transferred to the income statement in the same period in which the underlying interest or foreign exchange exposure affects the income statement.

Net investment hedges take the form of either foreign currency borrowings or derivatives. All foreign exchange gains or losses arising on translation of net investments are recorded in the statement of recognised income and expense and included in cumulative translation differences. Liabilities used as hedging instruments in a net investment hedge are revalued at closing exchange rates. The resulting gains or losses are taken to the statement of recognised income and expense to the extent that they are effective, with any ineffectiveness recognised in the income statement. Foreign exchange contracts hedging net investments in overseas businesses are revalued at fair value. Effective fair value movements are taken to the statement of recognised income and expense, with any ineffectiveness recognised in the income statement.

## Accounting policies of the group (continued)

**Year ended 30 June 2005** Financial instruments in the year ended 30 June 2005 remain recorded in accordance with the previous UK GAAP accounting policies as follows.

Instruments accounted for as hedges were structured so as to reduce the market risk associated with the underlying transaction being hedged and were designated as a hedge at the inception of the contract. If the underlying transaction to a hedge ceased to exist, the hedge was terminated and the profit or loss was recognised immediately. If the hedge transaction was terminated, the profit or loss was held in the balance sheet and amortised over the life of the original underlying transaction.

Receipts and payments on interest rate instruments were recognised on an accruals basis over the life of the instrument. Foreign exchange contracts hedging net investments in overseas businesses were revalued at closing rates and exchange differences arising were taken to reserves. Gains and losses on contracts hedging forecast transactional cash flows, and on option instruments hedging the sterling value of foreign currency denominated income, were recognised in the hedged periods.

Cash flows associated with derivative financial instruments were classified in the cash flow statement in a manner consistent with those of the transactions being hedged. Finance costs associated with debt issuances were charged to the profit and loss account over the life of the issue.

The cumulative adjustment from UK GAAP to IFRS has been reflected in the consolidated balance sheet at 1 July 2005.

### Taxation

Current tax payable is based on taxable profit for the year. This requires an estimation of the current tax liability together with an assessment of the temporary differences which arise as a consequence of different accounting and tax treatments.

Full provision for deferred tax is made for temporary differences between the carrying value of assets and liabilities in the consolidated financial statements and their tax bases. The amount of deferred tax reflects the expected recoverable amount and is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets are not recognised where it is more likely than not that the asset will not be realised in the future. No deferred tax liability is provided in respect of any future remittance of earnings of foreign subsidiaries where the group is able to control the remittance of earnings and it is probable that such earnings will not be remitted in the foreseeable future, or where no liability would arise on the remittance.

Tax benefits are not recognised unless it is probable that the tax positions are sustainable. Once considered to be probable, management reviews each material tax benefit to assess whether a provision should be taken against full recognition of the benefit on the basis of potential settlement through negotiation and/or litigation. Any interest and penalties on tax liabilities are provided for in the tax charge.

### Discontinued operations

Disposal groups are classified as discontinued operations where they represent a major line of business or geographical area of operations.

## Notes to the consolidated financial statements

### 1 New accounting policies

The following interpretations, issued by the International Financial Reporting Interpretations Committee (IFRIC), are effective for the first time in the current financial year and have been adopted by the group with no significant impact on its consolidated results or financial position:

*IFRIC 4 Determining whether an arrangement contains a lease* (effective for annual periods beginning on or after 1 January 2006).

*IFRIC 5 Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds* (effective for annual periods beginning on or after 1 January 2006).

*IFRIC 6 Liabilities arising from participating in a specific market: waste electrical and electronic equipment* (effective for annual periods beginning on or after 1 December 2005).

*IFRIC 7 Applying the restatement approach under IAS 29 Financial reporting in hyperinflationary economies* (effective for annual periods beginning on or after 1 March 2006).

*IFRIC 8 Scope of IFRS 2 Accounting for share-based payments* (effective for annual periods beginning on or after 1 May 2006).

*IFRIC 9 Reassessment of embedded derivatives* (effective for annual periods beginning on or after 1 June 2006).

In August 2005, the International Accounting Standards Board (IASB) issued *IFRS 7 Financial instruments: disclosures*, which contained new regulations concerning the disclosure of financial instruments. *IFRS 7* replaces the disclosure regulations of *IAS 32 Financial instruments: disclosure and presentation* and must be applied to reporting periods that commence on or after 1 January 2007. Diageo adopted *IFRS 7* early in its 2006 financial statements and applied the exemptions under *IFRS 1*, *IFRS 7* and *IAS 32* not to restate comparative information in respect of *IFRS 7*, *IAS 32* and *IAS 39 Financial instruments: recognition and measurement*. As a consequence, financial instruments are included in the 2005 comparative information in accordance with UK GAAP, whereas they are accounted for in accordance with *IAS 39* in the 2006 and 2007 results. In accordance with the transitional provisions of *IFRS*, this was treated as a change in accounting policy. The accounting policies for financial instruments under *IAS 39* and, for the year ended 30 June 2005, under UK GAAP are detailed in 'Accounting policies of the group'. The adjustments made to net assets as a result of adopting *IAS 39* on 1 July 2005 are detailed in note 34. If the group had not taken this exemption, a number of financial instruments would have been recognised or revalued in the opening balance sheet at 1 July 2004 and accounted for under *IAS 39* during the year ended 30 June 2005.

The following standards and interpretations, issued by the IASB or IFRIC, have not yet been adopted by the group:

*Amendment to IAS 1 Presentation of financial statements: capital disclosures* (effective for annual periods beginning on or after 1 January 2007).

*Amendment to IAS 23 Borrowing costs* (effective for annual periods beginning on or after 1 January 2009).

*IFRS 8 Operating segments* (effective for annual periods beginning on or after 1 January 2009).

*IFRIC 11 Group and treasury share transactions* (effective for annual periods beginning on or after 1 March 2007).

*IFRIC 12 Service concession arrangements* (effective for annual periods beginning on or after 1 January 2008).

## Notes to the consolidated financial statements (continued)

### 1 New accounting policies (continued)

*IFRIC 13 Customer loyalty programmes* (effective for annual periods beginning on or after 1 July 2008).

*IFRIC 14 IAS 19: The limit on a defined benefit asset, minimum funding requirements and their interaction* (effective for annual periods beginning on or after 1 January 2008).

The amendment to IAS 1 requires additional disclosures on the objectives, policies and processes for managing capital. Appropriate additional disclosures will be included in the 2008 Annual Report.

The amendment to IAS 23 generally eliminates the option to expense borrowing costs attributable to the acquisition, construction or production of a qualifying asset as incurred, and instead requires the capitalisation of such borrowing costs as part of the cost of specific assets. The group is currently assessing the impact of the amendment on the results and net assets of the group.

IFRS 8 contains requirements for the disclosure of information about an entity's operating segments and also about the entity's products and services, the geographical areas in which it operates, and its major customers. The standard is concerned only with disclosure and replaces *IAS 14 Segment reporting*. The group is currently assessing the impact this standard would have on the presentation of its consolidated results.

The group does not currently believe the adoption of the interpretations would have a material impact on the consolidated results or financial position of the group reported in these financial statements.

### 2 Segmental information

**Continuing operations** Diageo is an international manufacturer and distributor of premium drinks. The group produces, markets and distributes a wide range of premium brands, including Smirnoff vodka, Johnnie Walker scotch whiskies, Guinness stout, Baileys Original Irish Cream liqueur, Captain Morgan rum, J&B scotch whisky and Tanqueray gin. In addition, Diageo also owns the distribution rights for the José Cuervo tequila brands in the United States and other countries.

Diageo also owns a number of investments in unconsolidated associates, the principal investment being a 34% interest in Moët Hennessy, the spirits and wines subsidiary of LVMH Moët Hennessy Louis Vuitton SA. Moët Hennessy is based in France and is a leading producer and exporter of champagne and cognac.

Following the reorganisation in January 2007 of the way in which the business is managed, continuing operations now comprise the following segments: Diageo North America (United States and Canada), Diageo Europe (all European countries and territories including Russia), Diageo International (Africa, Latin America, Caribbean, Global Travel and Middle East), Diageo Asia Pacific (Greater China, India, Japan, Korea, South East Asia and Australia), Moët Hennessy and Corporate and other. The comparative information for prior years has been restated to reflect the current organisation.

Corporate revenues and costs are in respect of central costs, including finance, human resources and legal, as well as certain information system, service centre, facilities and employee costs that are not directly allocated to the geographical operating units. They also include the revenues and costs related to rents receivable in respect of properties not used by Diageo in the manufacture, sale or distribution of premium drinks, exchange movements on short term intercompany balances and the results of Gleneagles Hotel.

## Notes to the consolidated financial statements (continued)

### 2 Segmental information (continued)

**Discontinued operations** Included within discontinued operations are transactions relating to the disposal of the group's quick service restaurants business (Burger King, sold on 13 December 2002), and to the disposal of the group's packaged food business (Pillsbury, sold on 31 October 2001).

In the year ended 30 June 2007, a tax benefit of £82 million arose from the recognition of capital losses arising on the prior year disposals of the Pillsbury and Burger King businesses. In addition, a tax credit of £57 million arose following resolution with tax authorities of various audit issues (2005 £20 million tax credit in respect of the Pillsbury disposal).

In the year ended 30 June 2005, a gain of £53 million arose from the release of provisions held by Diageo as a result of the refinancing of Burger King on a stand-alone basis. In connection with the disposal of Burger King, Diageo guaranteed up to \$850 million (£459 million) of Burger King's external borrowings. On 13 July 2005, Burger King refinanced its external borrowings on a stand-alone basis, releasing Diageo from its obligations under guarantees relating to that debt, and repaid in full the subordinated debt and associated interest owed to Diageo.

## Notes to the consolidated financial statements (continued)

## (i) Segmental information Continuing operations

|                                                           | North<br>America | Europe    | Inter-<br>national | Asia<br>Pacific | Moët<br>Hennessy | Corporate<br>and other | Total     |
|-----------------------------------------------------------|------------------|-----------|--------------------|-----------------|------------------|------------------------|-----------|
|                                                           | £ million        | £ million | £ million          | £ million       | £ million        | £ million              | £ million |
| <b>2007</b>                                               |                  |           |                    |                 |                  |                        |           |
| Sales                                                     | 2,915            | 3,765     | 2,031              | 1,131           |                  | 75                     | 9,917     |
| Operating profit/(loss) before exceptional items          | 850              | 723       | 499                | 196             |                  | (149)                  | 2,119     |
| Exceptional items credited to operating profit            |                  |           |                    |                 |                  | 40                     | 40        |
| Operating profit/(loss)                                   | 850              | 723       | 499                | 196             |                  | (109)                  | 2,159     |
| Sale of investments and businesses                        |                  |           | 1                  |                 |                  | (2)                    | (1)       |
| Share of associates' profits after tax                    |                  | 5         | 7                  | 1               | 136              |                        | 149       |
| Profit/(loss) before interest, net finance income and tax | 850              | 728       | 507                | 197             | 136              | (111)                  | 2,307     |
| Depreciation                                              | (30)             | (83)      | (39)               | (23)            |                  | (6)                    | (181)     |
| Intangible asset amortisation                             | (7)              | (15)      | (1)                | (3)             |                  | (3)                    | (29)      |
| Capital expenditure on segment assets                     | 19               | 63        | 53                 | 20              |                  | 170                    | 325       |
| Segment assets                                            | 832              | 1,041     | 789                | 369             |                  | 312                    | 3,343     |
| Investments in associates                                 | 10               | 22        | 19                 | 37              | 1,348            |                        | 1,436     |
| Unallocated assets                                        |                  |           |                    |                 |                  | 9,177                  | 9,177     |
| Total assets                                              | 842              | 1,063     | 808                | 406             | 1,348            | 9,489                  | 13,956    |
| Segment liabilities                                       | 262              | 616       | 244                | 130             |                  | 425                    | 1,677     |
| Unallocated liabilities                                   |                  |           |                    |                 |                  | 8,109                  | 8,109     |
| Total liabilities                                         | 262              | 616       | 244                | 130             |                  | 8,534                  | 9,786     |
| <b>2006</b>                                               |                  |           |                    |                 |                  |                        |           |
| Sales                                                     | 2,968            | 3,834     | 1,784              | 1,042           |                  | 76                     | 9,704     |
| Operating profit/(loss)                                   | 829              | 737       | 445                | 199             |                  | (166)                  | 2,044     |
| Sale of investments and businesses                        |                  | 1         |                    |                 |                  | 156                    | 157       |
| Share of associates' profits after tax                    |                  | 5         | 4                  |                 | 122              |                        | 131       |
| Profit/(loss) before interest, net finance income and tax | 829              | 743       | 449                | 199             | 122              | (10)                   | 2,332     |
| Depreciation                                              | (31)             | (85)      | (48)               | (17)            |                  | (5)                    | (186)     |
| Intangible asset amortisation                             | (8)              | (14)      | (1)                | (3)             |                  | (2)                    | (28)      |
| Capital expenditure on segment assets                     | 28               | 246       | 61                 | 17              |                  | 111                    | 463       |
| Segment assets                                            | 872              | 1,171     | 770                | 350             |                  | 238                    | 3,401     |
| Investments in associates                                 |                  | 19        | 19                 |                 | 1,303            |                        | 1,341     |
| Unallocated assets                                        |                  |           |                    |                 |                  | 9,185                  | 9,185     |
| Total assets                                              | 872              | 1,190     | 789                | 350             | 1,303            | 9,423                  | 13,927    |
| Segment liabilities                                       | 260              | 628       | 218                | 118             |                  | 440                    | 1,664     |
| Unallocated liabilities                                   |                  |           |                    |                 |                  | 7,582                  | 7,582     |

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|                   | <b>North<br/>America</b> | <b>Europe</b> | <b>Inter-<br/>national</b> | <b>Asia<br/>Pacific</b> | <b>Moët<br/>Hennessy</b> | <b>Corporate<br/>and other</b> | <b>Total</b> |
|-------------------|--------------------------|---------------|----------------------------|-------------------------|--------------------------|--------------------------------|--------------|
| Total liabilities | 260                      | 628           | 218                        | 118                     |                          | 8,022                          | 9,246        |

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**Notes to the consolidated financial statements (continued)****(i) Segmental information Continuing operations (continued)**

| <b>2005</b>                                               |       |       |       |      |       |       |        |
|-----------------------------------------------------------|-------|-------|-------|------|-------|-------|--------|
| Sales                                                     | 2,622 | 3,860 | 1,552 | 872  |       | 62    | 8,968  |
| Operating profit/(loss) before exceptional items          | 779   | 702   | 427   | 188  |       | (164) | 1,932  |
| Exceptional items (charged)/credited to operating profit  | (30)  | (26)  | 4     |      |       | (149) | (201)  |
| Operating profit/(loss)                                   | 749   | 676   | 431   | 188  |       | (313) | 1,731  |
| Sale of investments and businesses                        | 2     | (8)   |       | (1)  |       | 221   | 214    |
| Share of associates' profits after tax                    |       | 3     | 5     |      | 113   |       | 121    |
| Profit/(loss) before interest, net finance income and tax | 751   | 671   | 436   | 187  | 113   | (92)  | 2,066  |
| Depreciation                                              | (44)  | (79)  | (34)  | (15) |       | (6)   | (178)  |
| Exceptional accelerated depreciation                      |       | (29)  |       |      |       |       | (29)   |
| Intangible asset amortisation                             | (7)   | (16)  | (3)   | (3)  |       |       | (29)   |
| Goodwill impairment charge                                |       | (5)   |       |      |       |       | (5)    |
| Capital expenditure on segment assets                     | 136   | 140   | 93    | 24   |       | 123   | 516    |
| Segment assets                                            | 872   | 1,055 | 779   | 324  |       | 373   | 3,403  |
| Investments in associates                                 |       | 19    | 22    |      | 1,220 |       | 1,261  |
| Unallocated assets                                        |       |       |       |      |       | 9,257 | 9,257  |
| Total assets                                              | 872   | 1,074 | 801   | 324  | 1,220 | 9,630 | 13,921 |
| Segment liabilities                                       | 257   | 660   | 240   | 103  |       | 502   | 1,762  |
| Unallocated liabilities                                   |       |       |       |      |       | 7,533 | 7,533  |
| Total liabilities                                         | 257   | 660   | 240   | 103  |       | 8,035 | 9,295  |

- (a) The segmental analysis of sales and operating profit/(loss) is based on the location of the third party customers.
- (b) The group interest expense is managed centrally and is not attributable to individual activities.
- (c) Segmental information for the 'Corporate and other' segment, which includes unallocated assets and liabilities, is as follows:

Sales, operating profit/(loss), profit/(loss) before interest, net finance income and tax, depreciation and amortisation comprise central items not readily allocable to the group's operating segments.

The operating loss of £109 million (2006 £166 million; 2005 £313 million) includes an exceptional credit of £40 million in respect of the sale of the site of the former brewery at Park Royal (2006 £nil; 2005 exceptional charge of £149 million in respect of the commitment for payments to the Thalidomide Trust).

The loss on sale of investments and businesses of £2 million (2006 gain of £156 million; 2005 gain of £221 million) includes £nil (2006 £151 million; 2005 £221 million) from the sale of General Mills shares.



## Notes to the consolidated financial statements (continued)

### (i) Segmental information Continuing operations (continued)

Capital expenditure on segment assets of £170 million (2006 £111 million; 2005 £123 million) includes expenditure on intangible assets and property, plant and equipment of £138 million (2006 £109 million; 2005 £117 million) in respect of unallocated assets relating to the worldwide supply of product which is not readily allocable to the group's operating segments.

Segment assets of £312 million (2006 £238 million; 2005 £373 million) comprise: property, plant and equipment of £80 million (2006 £64 million; 2005 £108 million); inventories of £61 million (2006 £15 million; 2005 £nil); and other assets of £171 million (2006 £159 million; 2005 £265 million).

Unallocated assets of £9,177 million (2006 £9,185 million; 2005 £9,257 million) comprise: brands of £4,085 million (2006 £4,283 million; 2005 £4,176 million); property, plant and equipment of £1,144 million (2006 £1,114 million; 2005 £1,149 million); the net investment in General Mills of £nil (2006 £nil; 2005 £508 million); maturing inventories of £1,582 million (2006 £1,483 million; 2005 £1,410 million); cash and cash equivalents of £885 million (2006 £699 million; 2005 £787 million); and other assets of £1,481 million (2006 £1,606 million; 2005 £1,227 million). Brands that are capitalised in the balance sheet are sold throughout the world and are not readily allocable to North America, Europe, International and Asia Pacific. Property, plant and equipment, maturing inventories and other assets classified as unallocated are principally located in Scotland and are not readily allocable to the group's operating segments.

Segment liabilities of £425 million (2006 £440 million; 2005 £502 million) comprise trade and other payables of £258 million (2006 £270 million; 2005 £320 million) and provisions of £167 million (2006 £170 million; 2005 £182 million).

Unallocated liabilities of £8,109 million (2006 £7,582 million; 2005 £7,533 million) comprise: external borrowings of £5,667 million (2006 £4,760 million; 2005 £4,546 million); corporate tax payable of £673 million (2006 £681 million; 2005 £777 million); post employment benefit liabilities of £457 million (2006 £815 million; 2005 £1,306 million); and other liabilities of £1,312 million (2006 £1,326 million; 2005 £904 million).

### (d)

The weighted average exchange rates used in the translation of income statements were US dollar £1 = \$1.93 (2006 £1 = \$1.78; 2005 £1 = \$1.86) and euro £1 = €1.48 (2006 £1 = €1.46; 2005 £1 = €1.46). Exchange rates used to translate assets and liabilities at the balance sheet date were US dollar £1 = \$2.01 (2006 £1 = \$1.85; 2005 £1 = \$1.79) and euro £1 = €1.48 (2006 £1 = €1.45; 2005 £1 = €1.48). The group uses foreign exchange transaction hedges to mitigate the effect of exchange rate movements.

**Notes to the consolidated financial statements (continued)****(ii) Geographical information**

|                                       | Great<br>Britain | Rest of<br>Europe | North<br>America | Asia<br>Pacific | Latin<br>America | Rest of<br>World | Total     |
|---------------------------------------|------------------|-------------------|------------------|-----------------|------------------|------------------|-----------|
|                                       | £ million        | £ million         | £ million        | £ million       | £ million        | £ million        | £ million |
| <b>2007</b>                           |                  |                   |                  |                 |                  |                  |           |
| Sales                                 | 1,470            | 2,442             | 2,958            | 1,179           | 813              | 1,055            | 9,917     |
| Long-lived assets                     | 2,070            | 614               | 2,551            | 675             | 54               | 363              | 6,327     |
| Segment assets                        | 468              | 895               | 813              | 371             | 182              | 614              | 3,343     |
| Capital expenditure on segment assets | 131              | 53                | 59               | 22              | 9                | 51               | 325       |
| <b>2006</b>                           |                  |                   |                  |                 |                  |                  |           |
| Sales                                 | 1,549            | 2,428             | 2,999            | 1,085           | 671              | 972              | 9,704     |
| Long-lived assets                     | 1,975            | 652               | 2,782            | 704             | 54               | 332              | 6,499     |
| Segment assets                        | 711              | 775               | 807              | 347             | 168              | 593              | 3,401     |
| Capital expenditure on segment assets | 70               | 247               | 64               | 17              | 13               | 52               | 463       |
| <b>2005</b>                           |                  |                   |                  |                 |                  |                  |           |
| Sales                                 | 1,553            | 2,421             | 2,658            | 918             | 564              | 854              | 8,968     |
| Long-lived assets                     | 1,784            | 661               | 2,838            | 690             | 51               | 318              | 6,342     |
| Segment assets                        | 723              | 642               | 987              | 324             | 144              | 583              | 3,403     |
| Capital expenditure on segment assets | 83               | 152               | 158              | 24              | 8                | 91               | 516       |

- (a) The geographical analysis of sales is based on the location of the third party customers and an allocation of certain corporate items. Certain businesses, for internal management purposes, have been reported within the appropriate region in the geographical analysis above. Corporate sales of £75 million (2006 £76 million; 2005 £62 million) are included in Great Britain.
- (b) Long-lived assets comprise intangible assets and property, plant and equipment after amortisation and depreciation, respectively, and biological assets. Brands are included at net book value in the geographical regions in which the brands originated.
- (c) The geographical analysis of segment assets and related capital expenditure is based on the geographical location of the assets and excludes investments in associates and assets and capital expenditure which are not readily allocable to the group's operating segments.
- (d) Exports from the United Kingdom were £2,316 million (2006 £1,952 million; 2005 £1,898 million).

## Notes to the consolidated financial statements (continued)

## 3 Operating costs

|                                                               | 2007         | 2006         | 2005         |
|---------------------------------------------------------------|--------------|--------------|--------------|
|                                                               | £ million    | £ million    | £ million    |
| Excise duties                                                 | 2,436        | 2,444        | 2,291        |
| Cost of sales                                                 | 3,003        | 2,921        | 2,632        |
| Marketing expenses                                            | 1,162        | 1,127        | 1,013        |
| Other operating expenses                                      | 1,157        | 1,168        | 1,301        |
|                                                               | <b>7,758</b> | <b>7,660</b> | <b>7,237</b> |
| <b>Comprising:</b>                                            |              |              |              |
| Excise duties                                                 |              |              |              |
| United States                                                 | 443          | 457          | 428          |
| Other                                                         | 1,993        | 1,987        | 1,863        |
| Change in inventories                                         | (65)         | (6)          | (84)         |
| Raw materials and consumables                                 | 1,692        | 1,729        | 1,545        |
| Advertising, marketing and promotion                          | 1,162        | 1,127        | 1,013        |
| Other external charges                                        | 1,345        | 1,225        | 1,306        |
| Staff costs (note 4)                                          | 993          | 952          | 884          |
| Depreciation and other amounts written off non-current assets | 210          | 214          | 241          |
| (Gains)/losses on disposal of property                        | (62)         | 4            | (7)          |
| Net foreign exchange losses/(gains)                           | 55           | (22)         | 53           |
| Other operating income                                        | (8)          | (7)          | (5)          |
|                                                               | <b>7,758</b> | <b>7,660</b> | <b>7,237</b> |

- (a) **Other external charges** Other external charges include operating lease rentals for plant and equipment of £7 million (2006 £5 million; 2005 £6 million), other operating lease rentals (mainly properties) of £58 million (2006 £64 million; 2005 £70 million), research and development expenditure of £17 million (2006 £18 million; 2005 £16 million), and maintenance and repairs of £53 million (2006 £45 million; 2005 £51 million).
- (b) **Exceptional operating costs** In the year ended 30 June 2007, gains on disposal of property of £62 million include an exceptional operating gain of £40 million in respect of the sale of the site of the former brewery at Park Royal. There were no exceptional operating items in the year ended 30 June 2006. Exceptional operating costs for continuing operations in the year ended 30 June 2005 amounted to £201 million as follows: other external charges £172 million; staff costs £5 million, and amounts written off assets £31 million, offset by £7 million gains on disposal of property.
- (c) **Auditor fees** The fees of the principal auditor of the group, KPMG Audit Plc, and its affiliates were as follows:

|                                                                       | United Kingdom | Rest of World | 2007      | 2006      | 2005      |
|-----------------------------------------------------------------------|----------------|---------------|-----------|-----------|-----------|
|                                                                       | £ million      | £ million     | £ million | £ million | £ million |
| Audit of these financial statements                                   | 0.8            |               | 0.8       | 0.9       | 0.8       |
| Audit of financial statements of subsidiaries pursuant to legislation | 1.4            | 2.8           | 4.2       | 2.9       | 2.9       |

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|                                             | United<br>Kingdom | Rest of<br>World | 2007       | 2006 | 2005 |
|---------------------------------------------|-------------------|------------------|------------|------|------|
| Other services pursuant to such legislation | 1.7               | 0.8              | 2.5        | 3.2  | 1.8  |
| Other services relevant to taxation         | 0.2               | 0.8              | 1.0        | 1.4  | 1.4  |
| All other services                          | 0.6               | 0.5              | 1.1        | 0.3  | 0.2  |
|                                             | <b>4.7</b>        | <b>4.9</b>       | <b>9.6</b> | 8.7  | 7.1  |

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## Notes to the consolidated financial statements (continued)

### 3 Operating costs (continued)

For the year ended 30 June 2007, other services pursuant to such legislation relate principally to reporting required under section 404 of US Sarbanes-Oxley Act (2006 principally to advisory services in respect of Diageo's preparedness for Sarbanes-Oxley Act section 404). Other services relevant to taxation comprise principally tax compliance services and tax advice. All other services relate principally to advisory services in respect of due diligence, services in relation to acquisitions and disposals, and audit services in respect of employee pension funds and benefit plans of £0.3 million (2006 £0.3 million; 2005 £0.2 million).

Under SEC regulations, the auditor fees of £9.6 million (2006 £8.7 million; 2005 £7.1 million) are required to be presented as follows: audit £7.1 million (2006 £4.4 million; 2005 £4.1 million); other audit-related £1.1 million (2006 £2.6 million; 2005 £1.6 million); tax £1.0 million (2006 £1.4 million; 2005 £1.4 million); and all other fees £0.4 million (2006 £0.3 million; 2005 £nil).

In addition to the amounts above, £0.1 million (2006 £0.3 million; 2005 £0.2 million) was charged in relation to the audit by firms other than KPMG.

### 4 Employees

|                                    | 2007              | 2006              | 2005              |
|------------------------------------|-------------------|-------------------|-------------------|
|                                    | <u>          </u> | <u>          </u> | <u>          </u> |
| <b>Average number of employees</b> |                   |                   |                   |
| Full time                          | 22,086            | 21,972            | 22,333            |
| Part time                          | 434               | 647               | 633               |
|                                    | <u>          </u> | <u>          </u> | <u>          </u> |
|                                    | 22,520            | 22,619            | 22,966            |
|                                    | <u>          </u> | <u>          </u> | <u>          </u> |
|                                    |                   |                   |                   |
|                                    | 2007              | 2006              | 2005              |
|                                    | <u>          </u> | <u>          </u> | <u>          </u> |
|                                    | £ million         | £ million         | £ million         |
| <b>Aggregate remuneration</b>      |                   |                   |                   |
| Wages and salaries                 | 796               | 761               | 708               |
| Share-based incentive plans        | 25                | 26                | 28                |
| Employer's social security         | 68                | 59                | 59                |
| Employer's pension                 | 97                | 99                | 84                |
| Other post employment              | 7                 | 7                 | 5                 |
|                                    | <u>          </u> | <u>          </u> | <u>          </u> |
|                                    | 993               | 952               | 884               |
|                                    | <u>          </u> | <u>          </u> | <u>          </u> |

Of the charge to the consolidated income statement for the year ended 30 June 2007: in respect of post employment benefits, £43 million (2006 £45 million; 2005 £41 million) has been included in cost of sales and £61 million (2006 £61 million; 2005 £48 million) has been included in other operating expenses; and in respect of share-based incentive plans, £5 million (2006 £5 million; 2005 £6 million) has been included in cost of sales and £20 million (2006 £21 million; 2005 £22 million) has been included in other operating expenses.

**Retirement benefits** The group operates a number of pension plans throughout the world, devised in accordance with local conditions and practices.

**Notes to the consolidated financial statements (continued)****4 Employees (continued)**

The larger plans are generally of the defined benefit type and are funded by payments to separately administered funds or insurance companies. The principal plans are in the United Kingdom, Ireland, United States and Canada. All valuations were performed by independent actuaries using the projected unit method to determine pension costs. The most recent full valuations of the significant defined benefit pension plans were carried out as follows: United Kingdom on 31 March 2006; United States on 1 January 2007; and Ireland on 31 December 2006. The measurement dates used to calculate the disclosures in the consolidated financial statements are the respective balance sheet dates. In the United Kingdom, the Diageo Pension Scheme closed to new members in November 2005. New employees in the United Kingdom now become members of the Diageo Lifestyle Plan, which is also a defined benefit pension plan.

The assets of the principal pension plans are held in separate funds administered by trustees to meet long term pension liabilities to past and present employees. The trustees are required to act in the best interests of the plans' beneficiaries. The two largest pension plans are the Diageo Pension Scheme in the United Kingdom and the Guinness Ireland Pension Scheme in Ireland. For the Diageo Pension Scheme in the United Kingdom, the trustee is Diageo Pension Trust Limited. The appointment of the directors to the board is determined by the Scheme's trust documentation. There is a policy that one-third of all directors should be nominated by members of the Scheme. Two member nominated directors have recently been appointed from the pensioner member community and two from the active member community. For the Guinness Ireland Pension Scheme, the appointment of trustees is strictly a company decision. Currently the company makes three nominations and appoints three further candidates nominated by representative groupings. The chairman is a former employee of the company and is viewed as independent.

The group also operates a number of plans, primarily in the United States, which provide employees with post employment benefits in respect of medical costs. These plans are generally unfunded. In addition, there are a number of other plans which provide post employment benefits other than pensions and medical benefits. These plans are also included in the figures presented below.

(a)

The following weighted average assumptions were used to determine the group's deficit/surplus in the main post employment plans at 30 June in the relevant year. The assumptions used to calculate the charge/credit in the consolidated income statement for the year to 30 June are based on the assumptions disclosed as at the previous 30 June.

|                                         | United Kingdom |      |      | Ireland    |      |      | United States |      |      |
|-----------------------------------------|----------------|------|------|------------|------|------|---------------|------|------|
|                                         | 2007           | 2006 | 2005 | 2007       | 2006 | 2005 | 2007          | 2006 | 2005 |
|                                         | %              | %    | %    | %          | %    | %    | %             | %    | %    |
| Rate of general increase in salaries    | <b>4.2</b>     | 3.8  | 3.9  | <b>4.2</b> | 4.0  | 4.0  | <b>3.3</b>    | 3.4  | 3.0  |
| Rate of increase to pensions in payment | <b>3.3</b>     | 2.9  | 2.6  | <b>2.3</b> | 2.1  | 2.1  |               |      |      |
| Rate of increase to deferred pensions   | <b>3.2</b>     | 2.8  | 2.5  | <b>2.2</b> | 2.0  | 2.1  |               |      |      |
| Medical inflation                       | <b>n/a</b>     | n/a  | n/a  | <b>n/a</b> | n/a  | n/a  | <b>10.0</b>   | 9.0  | 10.0 |
| Discount rate for plan liabilities      | <b>5.8</b>     | 5.2  | 4.9  | <b>5.3</b> | 4.8  | 4.0  | <b>6.2</b>    | 6.3  | 5.0  |
| Inflation                               | <b>3.2</b>     | 2.8  | 2.5  | <b>2.2</b> | 2.0  | 2.0  | <b>2.3</b>    | 2.4  | 2.0  |

For the UK and US plans, there are, in addition to the above percentages, age related promotional salary increases. The 2007 assumption for medical inflation in the United States reduces by 0.5% per year to 5% (2006 and 2005 1% per year to 5%).



**Notes to the consolidated financial statements (continued)****4 Employees (continued)**

In assessing the group's post retirement liabilities, the mortality assumption for the largest plan (which is in the United Kingdom) is based on the mortality experience of that plan. This mortality experience analysis was carried out in 2006 as part of the triennial funding valuation of that plan. The assumption is based on the PA92 birth year tables with scaling factors based on the experience of the plan. The assumption also allows for future improvements in life expectancy in line with the medium cohort effect. The mortality assumptions for the other plans around the world are based on relevant standard mortality tables in each country.

For the main UK and Irish pension funds, the table below illustrates the expected age at death of an average worker who retires currently at the age of 65, and one who is currently aged 45 and subsequently retires at the age of 65:

|                                              | United Kingdom |             |             | Ireland     |             |             |
|----------------------------------------------|----------------|-------------|-------------|-------------|-------------|-------------|
|                                              | 2007<br>Age    | 2006<br>Age | 2005<br>Age | 2007<br>Age | 2006<br>Age | 2005<br>Age |
| <b>Retiring currently at age 65</b>          |                |             |             |             |             |             |
| Male                                         | <b>84.4</b>    | 84.3        | 83.5        | <b>85.3</b> | 84.0        | 84.0        |
| Female                                       | <b>87.1</b>    | 87.1        | 86.4        | <b>87.9</b> | 86.9        | 86.9        |
| <b>Currently aged 45, retiring at age 65</b> |                |             |             |             |             |             |
| Male                                         | <b>86.7</b>    | 86.7        | 85.2        | <b>87.1</b> | 84.8        | 84.8        |
| Female                                       | <b>89.4</b>    | 89.4        | 88.1        | <b>89.7</b> | 87.8        | 87.8        |

## Notes to the consolidated financial statements (continued)

## 4 Employees (continued)

- (b) The amounts charged in respect of post employment plans to the consolidated income statement and consolidated statement of recognised income and expense for the three years ended 30 June 2007 are set out below:

|                                                                                                      | United<br>Kingdom | Ireland     | United States<br>and other | Total        |
|------------------------------------------------------------------------------------------------------|-------------------|-------------|----------------------------|--------------|
|                                                                                                      | £ million         | £ million   | £ million                  | £ million    |
| <b>2007</b>                                                                                          |                   |             |                            |              |
| <b>Operating profit</b>                                                                              |                   |             |                            |              |
| Current service cost                                                                                 | (57)              | (17)        | (24)                       | (98)         |
| Past service cost                                                                                    | (4)               |             |                            | (4)          |
|                                                                                                      | <u>(61)</u>       | <u>(17)</u> | <u>(24)</u>                | <u>(102)</u> |
| Total charge to operating profit                                                                     | (61)              | (17)        | (24)                       | (102)        |
| Net credit/(cost) to other finance income (note 6(ii))                                               | 36                | 17          | (5)                        | 48           |
|                                                                                                      | <u>(25)</u>       |             | <u>(29)</u>                | <u>(54)</u>  |
| <b>Charge before taxation</b>                                                                        |                   |             |                            |              |
| <b>Consolidated statement of recognised income and expense</b>                                       |                   |             |                            |              |
| Actual return on post employment plan assets                                                         | 374               | 150         | 44                         | 568          |
| Expected return on post employment plan assets                                                       | (230)             | (70)        | (24)                       | (324)        |
|                                                                                                      | <u>144</u>        | <u>80</u>   | <u>20</u>                  | <u>244</u>   |
| Actual return less expected return on post employment plan assets                                    | 144               | 80          | 20                         | 244          |
| Experience gains and losses arising on the plan liabilities                                          | (100)             | 7           | (17)                       | (110)        |
| Changes in assumptions underlying the present value of the plan liabilities                          | 200               | 10          | (21)                       | 189          |
|                                                                                                      | <u>244</u>        | <u>97</u>   | <u>(18)</u>                | <u>323</u>   |
| Actuarial gain recognisable in the reconciliation of the assets and liabilities                      | 244               | 97          | (18)                       | 323          |
| Changes in the recognisable surplus of the plans with a surplus restriction                          |                   |             | 5                          | 5            |
|                                                                                                      | <u>244</u>        | <u>97</u>   | <u>(13)</u>                | <u>328</u>   |
| <b>Total gain/(loss) recognisable in the consolidated statement of recognised income and expense</b> |                   |             |                            |              |
| <b>2006</b>                                                                                          |                   |             |                            |              |
| <b>Operating profit</b>                                                                              |                   |             |                            |              |
| Current service cost                                                                                 | (58)              | (22)        | (24)                       | (104)        |
| Past service cost                                                                                    | (1)               | (1)         |                            | (2)          |
| Gains on curtailments                                                                                | 1                 |             |                            | 1            |
|                                                                                                      | <u>(58)</u>       | <u>(23)</u> | <u>(24)</u>                | <u>(105)</u> |
| Total charge to operating profit                                                                     | (58)              | (23)        | (24)                       | (105)        |
| Net credit/(cost) to other finance income (note 6(ii))                                               | 14                | 11          | (6)                        | 19           |
|                                                                                                      | <u>(44)</u>       | <u>(12)</u> | <u>(30)</u>                | <u>(86)</u>  |
| <b>Charge before taxation</b>                                                                        |                   |             |                            |              |
| <b>Consolidated statement of recognised income and expense</b>                                       |                   |             |                            |              |
| Actual return on post employment plan assets                                                         | 513               | 84          | 15                         | 612          |
| Expected return on post employment plan assets                                                       | (191)             | (60)        | (24)                       | (275)        |
|                                                                                                      | <u>322</u>        | <u>24</u>   | <u>(9)</u>                 | <u>337</u>   |

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|                                                                                                   | United<br>Kingdom | Ireland           | United States<br>and other | Total             |
|---------------------------------------------------------------------------------------------------|-------------------|-------------------|----------------------------|-------------------|
|                                                                                                   | <u>          </u> | <u>          </u> | <u>          </u>          | <u>          </u> |
| Actual return less expected return on post employment<br>plan assets                              | 322               | 24                | (9)                        | 337               |
| Experience gains and losses arising on the plan liabilities                                       | (29)              | (14)              | (12)                       | (55)              |
| Changes in assumptions underlying the present value of the plan liabilities                       | (2)               | 149               | 36                         | 183               |
|                                                                                                   | <u>          </u> | <u>          </u> | <u>          </u>          | <u>          </u> |
| Actuarial gain recognisable in the reconciliation of the assets and liabilities                   | 291               | 159               | 15                         | 465               |
| Changes in the recognisable surplus of the plans with a surplus restriction                       |                   |                   | (6)                        | (6)               |
|                                                                                                   | <u>          </u> | <u>          </u> | <u>          </u>          | <u>          </u> |
| <b>Total gain recognisable in the consolidated statement of recognised<br/>income and expense</b> | <b>291</b>        | <b>159</b>        | <b>9</b>                   | <b>459</b>        |
|                                                                                                   | <u>          </u> | <u>          </u> | <u>          </u>          | <u>          </u> |

## Notes to the consolidated financial statements (continued)

## 4 Employees (continued)

|                                                                                                               | United<br>Kingdom | Ireland           | United States<br>and other | Total             |
|---------------------------------------------------------------------------------------------------------------|-------------------|-------------------|----------------------------|-------------------|
|                                                                                                               | £ million         | £ million         | £ million                  | £ million         |
| <b>2005</b>                                                                                                   |                   |                   |                            |                   |
| <b>Operating profit</b>                                                                                       |                   |                   |                            |                   |
| Current service cost                                                                                          | (58)              | (15)              | (20)                       | (93)              |
| Past service cost                                                                                             | (2)               | (10)              |                            | (12)              |
| Gains on curtailments                                                                                         | 18                |                   | 1                          | 19                |
| Losses on settlements                                                                                         |                   |                   | (2)                        | (2)               |
|                                                                                                               | <u>          </u> | <u>          </u> | <u>          </u>          | <u>          </u> |
| Total charge to operating profit                                                                              | (42)              | (25)              | (21)                       | (88)              |
| Net credit/(cost) to other finance income (note 6(ii))                                                        | 4                 | 9                 | (4)                        | 9                 |
|                                                                                                               | <u>          </u> | <u>          </u> | <u>          </u>          | <u>          </u> |
| <b>Charge before taxation</b>                                                                                 | <b>(38)</b>       | <b>(16)</b>       | <b>(25)</b>                | <b>(79)</b>       |
|                                                                                                               | <u>          </u> | <u>          </u> | <u>          </u>          | <u>          </u> |
| <b>Consolidated statement of recognised income and expense</b>                                                |                   |                   |                            |                   |
| Actual return on post employment plan assets                                                                  | 318               | 129               | 30                         | 477               |
| Expected return on post employment plan assets                                                                | (194)             | (62)              | (24)                       | (280)             |
|                                                                                                               | <u>          </u> | <u>          </u> | <u>          </u>          | <u>          </u> |
| Actual return less expected return on post employment plan assets                                             | 124               | 67                | 6                          | 197               |
| Experience gains and losses arising on the plan liabilities                                                   | 3                 | (15)              | (12)                       | (24)              |
| Changes in assumptions underlying the present value of the plan liabilities                                   | (171)             | (198)             | (50)                       | (419)             |
|                                                                                                               | <u>          </u> | <u>          </u> | <u>          </u>          | <u>          </u> |
| Actuarial loss recognisable in the reconciliation of the assets and liabilities                               | (44)              | (146)             | (56)                       | (246)             |
| Changes in the recognisable surplus of the plans with a surplus restriction                                   |                   |                   | 8                          | 8                 |
|                                                                                                               | <u>          </u> | <u>          </u> | <u>          </u>          | <u>          </u> |
| <b>Total loss recognisable in the consolidated statement of recognised income and expense</b>                 | <b>(44)</b>       | <b>(146)</b>      | <b>(48)</b>                | <b>(238)</b>      |
|                                                                                                               | <u>          </u> | <u>          </u> | <u>          </u>          | <u>          </u> |
| <b>Total cumulative gain/(loss) recognised in the consolidated statement of recognised income and expense</b> |                   |                   |                            |                   |
| At 1 July 2004                                                                                                |                   |                   |                            |                   |
| Recognised in the year                                                                                        | (44)              | (146)             | (48)                       | (238)             |
|                                                                                                               | <u>          </u> | <u>          </u> | <u>          </u>          | <u>          </u> |
| At 30 June 2005                                                                                               |                   |                   |                            |                   |
| Recognised in the year                                                                                        | 291               | 159               | 9                          | 459               |
|                                                                                                               | <u>          </u> | <u>          </u> | <u>          </u>          | <u>          </u> |
| At 30 June 2006                                                                                               |                   |                   |                            |                   |
| Recognised in the year                                                                                        | 244               | 97                | (13)                       | 328               |
|                                                                                                               | <u>          </u> | <u>          </u> | <u>          </u>          | <u>          </u> |
| At 30 June 2007                                                                                               |                   |                   |                            |                   |
|                                                                                                               | <b>491</b>        | <b>110</b>        | <b>(52)</b>                | <b>549</b>        |
|                                                                                                               | <u>          </u> | <u>          </u> | <u>          </u>          | <u>          </u> |

Included in the total cumulative gain recognised at 30 June 2007 is a cumulative gain of £7 million (2006 £2 million; 2005 £8 million) in respect of changes in the surplus restriction.

## Notes to the consolidated financial statements (continued)

## 4 Employees (continued)

(c) The expected long term rates of return and fair values of the assets of the significant defined benefit post employment plans were as follows:

|                                            | United Kingdom                     |              | Ireland                            |              | United States and other            |              | Total                              |              |
|--------------------------------------------|------------------------------------|--------------|------------------------------------|--------------|------------------------------------|--------------|------------------------------------|--------------|
|                                            | Expected long term rates of return | Fair value   | Expected long term rates of return | Fair value   | Expected long term rates of return | Fair value   | Expected long term rates of return | Fair value   |
|                                            | %                                  | £ million    | %                                  | £ million    | %                                  | £ million    | %                                  | £ million    |
| <b>2007</b>                                |                                    |              |                                    |              |                                    |              |                                    |              |
| <b>Fair value of plan assets</b>           |                                    |              |                                    |              |                                    |              |                                    |              |
| Equities                                   | 8.4                                | 1,988        | 8.0                                | 574          | 8.4                                | 230          | 8.3                                | 2,792        |
| Bonds                                      | 5.6                                | 749          | 4.8                                | 325          | 5.5                                | 116          | 5.4                                | 1,190        |
| Property                                   | 7.4                                | 455          | 7.0                                | 161          | 11.6                               | 11           | 7.4                                | 627          |
| Other                                      | 5.8                                | 299          | 3.0                                | 83           | 6.2                                | 28           | 5.3                                | 410          |
|                                            |                                    | <u>3,491</u> |                                    | <u>1,143</u> |                                    | <u>385</u>   |                                    | <u>5,019</u> |
| Present value of funded plan liabilities   |                                    | (3,702)      |                                    | (1,125)      |                                    | (464)        |                                    | (5,291)      |
| Present value of unfunded plan liabilities |                                    | (64)         |                                    |              |                                    | (66)         |                                    | (130)        |
| (Deficit)/surplus in post employment plans |                                    | (275)        |                                    | 18           |                                    | (145)        |                                    | (402)        |
| Surplus restriction                        |                                    |              |                                    |              |                                    | (17)         |                                    | (17)         |
| <b>Post employment benefit liabilities</b> |                                    | <u>(275)</u> |                                    | <u>18</u>    |                                    | <u>(162)</u> |                                    | <u>(419)</u> |
| <b>2006</b>                                |                                    |              |                                    |              |                                    |              |                                    |              |
| <b>Fair value of plan assets</b>           |                                    |              |                                    |              |                                    |              |                                    |              |
| Equities                                   | 7.8                                | 2,504        | 7.6                                | 759          | 8.5                                | 213          | 7.8                                | 3,476        |
| Bonds                                      | 4.9                                | 224          | 4.4                                | 146          | 5.6                                | 125          | 4.9                                | 495          |
| Property                                   | 6.8                                | 389          | 6.6                                | 138          | 11.6                               | 10           | 6.8                                | 537          |
| Other                                      | 4.1                                | 93           | 2.8                                | 16           | 5.8                                | 30           | 4.3                                | 139          |
|                                            |                                    | <u>3,210</u> |                                    | <u>1,059</u> |                                    | <u>378</u>   |                                    | <u>4,647</u> |
| Present value of funded plan liabilities   |                                    | (3,688)      |                                    | (1,149)      |                                    | (363)        |                                    | (5,200)      |
| Present value of unfunded plan liabilities |                                    | (73)         |                                    |              |                                    | (151)        |                                    | (224)        |
| Deficit in post employment plans           |                                    | (551)        |                                    | (90)         |                                    | (136)        |                                    | (777)        |
| Surplus restriction                        |                                    |              |                                    |              |                                    | (24)         |                                    | (24)         |
| <b>Post employment benefit liabilities</b> |                                    | <u>(551)</u> |                                    | <u>(90)</u>  |                                    | <u>(160)</u> |                                    | <u>(801)</u> |
| <b>2005</b>                                |                                    |              |                                    |              |                                    |              |                                    |              |
| <b>Fair value of plan assets</b>           |                                    |              |                                    |              |                                    |              |                                    |              |
| Equities                                   | 7.5                                | 2,254        | 6.9                                | 712          | 8.0                                | 215          | 7.4                                | 3,181        |
| Bonds                                      | 4.7                                | 128          | 3.4                                | 159          | 5.1                                | 112          | 4.3                                | 399          |
| Property                                   | 6.5                                | 322          | 5.9                                | 120          | 12.1                               | 10           | 6.5                                | 452          |
| Other                                      | 3.8                                | 82           | 2.0                                | 9            | 3.5                                | 13           | 3.6                                | 104          |

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|                                            | United Kingdom    | Ireland           | United States and other | Total             |
|--------------------------------------------|-------------------|-------------------|-------------------------|-------------------|
|                                            | <u>          </u> | <u>          </u> | <u>          </u>       | <u>          </u> |
|                                            | 2,786             | 1,000             | 350                     | 4,136             |
| Present value of funded plan liabilities   | (3,562)           | (1,238)           | (373)                   | (5,173)           |
| Present value of unfunded plan liabilities | (76)              |                   | (163)                   | (239)             |
|                                            | <u>          </u> | <u>          </u> | <u>          </u>       | <u>          </u> |
| Deficit in post employment plans           | (852)             | (238)             | (186)                   | (1,276)           |
| Surplus restriction                        |                   |                   | (18)                    | (18)              |
|                                            | <u>          </u> | <u>          </u> | <u>          </u>       | <u>          </u> |
| <b>Post employment benefit liabilities</b> | (852)             | (238)             | (204)                   | (1,294)           |
|                                            | <u>          </u> | <u>          </u> | <u>          </u>       | <u>          </u> |

**Notes to the consolidated financial statements (continued)****4 Employees (continued)**

Included in the post employment plan deficit of £402 million (2006 £777 million; 2005 £1,276 million) is £111 million (2006 £101 million; 2005 £95 million) in respect of post employment medical benefit liabilities and £40 million (2006 £41 million; 2005 £43 million) in respect of other non pension post employment liabilities.

Included in other assets in the United Kingdom at 30 June 2007 is cash of approximately £350 million intended for subsequent investment in bonds. The expected long term rate of return on other assets in the UK has been adjusted to reflect this.

Included in the plan assets above is £1 million (2006 £7 million; 2005 £19 million) invested in the ordinary shares of Diageo plc.

Post employment benefit assets and liabilities are recognised in the consolidated balance sheet, depending on whether an individual plan is in surplus or deficit, as follows:

|                         | 2007         | 2006         |
|-------------------------|--------------|--------------|
|                         | £ million    | £ million    |
| Non-current assets      | 38           | 14           |
| Non-current liabilities | (457)        | (815)        |
|                         | <b>(419)</b> | <b>(801)</b> |

The expected long term rates of return for equities have been determined by reference to government bond rates (minimum risk rates) in the countries in which the plans are based. As at 30 June 2007, to reflect the additional risks associated with equities, expected long term rates of return on equities include a risk premium of 3.25% per year (2006 and 2005 3.25% per year) in excess of the expected return from government bonds. This risk premium is a long term assumption which is set after taking actuarial advice and considering the assumptions used by other FTSE 100 companies. The expected long term rates of return for other assets are determined in a similar way, by using an appropriate risk premium relative to government bonds in the relevant country.

The group's investment strategy for its funded post employment plans is decided locally by the trustees of the plan and/or Diageo, as appropriate, and takes account of the relevant statutory requirements. The group's objective for the investment strategy is to achieve a target rate of return in excess of the return on the liabilities, while taking an acceptable amount of investment risk relative to the liabilities. This objective is implemented by using specific allocations to a variety of asset classes that are expected over the long term to deliver the target rate of return. Most investment strategies have significant allocations to equities, with the intention that this will result in the ongoing cost to the group of the post employment plans being lower over the long term, and will be within acceptable boundaries of risk. Each investment strategy is also designed to control investment risk by managing allocations to asset classes, geographical exposures and individual stock exposures.

**Notes to the consolidated financial statements (continued)****4 Employees (continued)**

In the United Kingdom, as at 30 June 2007, the target investment allocations for the Diageo Pension Scheme were approximately 55% of the assets in equities, 30% in bonds, 10% in property and 5% in other assets (2006 85%, 5%, 10% and nil, respectively). In addition, the UK Diageo Pension Scheme uses interest rate and inflation swaps to help manage the mismatch between the Scheme's assets and the present value of its liabilities. At 30 June 2007, approximately 40% (2006 40%) of the Scheme's liabilities were hedged against future movements in interest rates and inflation through the use of swaps and the fair value of these swaps was a liability of £64 million (2006 asset of £3 million). This amount is included in other assets in the table of fair value of plan assets. For the principal Irish pension plan, as at 30 June 2007, the target investment allocations were approximately 45% of the assets in equities, 40% in bonds and 15% in property (2006 70%, 20% and 10%, respectively).

The trustees of the UK pension plans and principal Irish pension plan continue to review their investment strategies and have been using a phased approach to increase asset diversification and, subject to solvency triggers, a phased approach to progressively reduce risk by increasing the bond allocation and introducing swap investments. During the year ended 30 June 2007, approximately 20% of the assets globally were transferred out of equities into either bonds or cash to be invested in bonds.

The discount rate is based on the yields of high quality, long dated, fixed income investments of similar duration to the liabilities. For the UK pension plans, which represent approximately 70% of total post employment benefit liabilities, the discount rate is based on the i-Box over 15-year AA sterling corporate bond index at 30 June rounded to the nearest 0.1%. A similar process is used to determine the discount rate for the non-UK plans.

The percentages of investments at fair value held by the pension plans at 30 June 2007 and 30 June 2006, analysed by category, were as follows:

|             | United<br>Kingdom | Ireland    | United States<br>and other | Total      |
|-------------|-------------------|------------|----------------------------|------------|
|             | %                 | %          | %                          | %          |
| <b>2007</b> |                   |            |                            |            |
| Equities    | 57                | 50         | 60                         | 56         |
| Bonds       | 21                | 29         | 30                         | 24         |
| Property    | 13                | 14         | 3                          | 12         |
| Other       | 9                 | 7          | 7                          | 8          |
|             | <b>100</b>        | <b>100</b> | <b>100</b>                 | <b>100</b> |
| <b>2006</b> |                   |            |                            |            |
| Equities    | 78                | 72         | 56                         | 75         |
| Bonds       | 7                 | 14         | 33                         | 10         |
| Property    | 12                | 13         | 3                          | 12         |
| Other       | 3                 | 1          | 8                          | 3          |
|             | <b>100</b>        | <b>100</b> | <b>100</b>                 | <b>100</b> |



**Notes to the consolidated financial statements (continued)****4 Employees (continued)**

(d) Movements in the present value of plan liabilities during the three years ended 30 June 2007:

|                                                          | United<br>Kingdom | Ireland      | United States<br>and other | Total        |
|----------------------------------------------------------|-------------------|--------------|----------------------------|--------------|
|                                                          | £ million         | £ million    | £ million                  | £ million    |
| Present value of plan liabilities at 1 July 2004         | 3,374             | 994          | 444                        | 4,812        |
| Exchange differences                                     |                   | 4            | 15                         | 19           |
| Acquisition of businesses                                |                   |              | 3                          | 3            |
| Current service cost                                     | 58                | 15           | 20                         | 93           |
| Past service cost                                        | 2                 | 10           |                            | 12           |
| Interest cost                                            | 190               | 53           | 28                         | 271          |
| Actuarial loss                                           | 168               | 213          | 62                         | 443          |
| Employee contributions                                   | 8                 | 2            | 1                          | 11           |
| Benefits paid                                            | (144)             | (53)         | (38)                       | (235)        |
| Curtailments                                             | (18)              |              | (1)                        | (19)         |
| Settlements                                              |                   |              | 2                          | 2            |
| <b>Present value of plan liabilities at 30 June 2005</b> | <b>3,638</b>      | <b>1,238</b> | <b>536</b>                 | <b>5,412</b> |
| Exchange differences                                     |                   | 25           | (8)                        | 17           |
| Acquisition of businesses                                | 8                 |              | 1                          | 9            |
| Current service cost                                     | 58                | 22           | 24                         | 104          |
| Past service cost                                        | 1                 | 1            |                            | 2            |
| Interest cost                                            | 177               | 49           | 30                         | 256          |
| Actuarial loss/(gain)                                    | 31                | (135)        | (24)                       | (128)        |
| Employee contributions                                   | 8                 | 2            | 1                          | 11           |
| Benefits paid                                            | (153)             | (53)         | (38)                       | (244)        |
| Curtailments                                             | (1)               |              |                            | (1)          |
| Settlements                                              | (6)               |              | (8)                        | (14)         |
| <b>Present value of plan liabilities at 30 June 2006</b> | <b>3,761</b>      | <b>1,149</b> | <b>514</b>                 | <b>5,424</b> |
| Exchange differences                                     |                   | (25)         | (34)                       | (59)         |
| Current service cost                                     | 57                | 17           | 24                         | 98           |
| Past service cost                                        | 4                 |              |                            | 4            |
| Interest cost                                            | 194               | 53           | 29                         | 276          |
| Actuarial (gain)/loss                                    | (100)             | (17)         | 38                         | (79)         |
| Employee contributions                                   | 10                | 2            |                            | 12           |
| Benefits paid                                            | (160)             | (54)         | (41)                       | (255)        |
| <b>Present value of plan liabilities at 30 June 2007</b> | <b>3,766</b>      | <b>1,125</b> | <b>530</b>                 | <b>5,421</b> |

For the year ended 30 June 2007, benefits paid include £6 million in respect of post employment medical benefits in the United States. The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 established a prescription drug benefit as well as a federal subsidy to sponsors of retiree healthcare benefit plans which provide a prescription drug benefit that is at least equivalent to Medicare's prescription drug coverage. A subsidy of £0.4 million has been received in the year ended 30 June 2007.

**Notes to the consolidated financial statements (continued)****4 Employees (continued)**

(e) Movements in the fair value of plan assets during the three years ended 30 June 2007:

|                                           | United<br>Kingdom | Ireland   | United States<br>and other | Total     |
|-------------------------------------------|-------------------|-----------|----------------------------|-----------|
|                                           | £ million         | £ million | £ million                  | £ million |
| Fair value of plan assets at 1 July 2004  | 2,499             | 906       | 315                        | 3,720     |
| Exchange differences                      |                   | 6         | 10                         | 16        |
| Acquisition of businesses                 |                   |           | 3                          | 3         |
| Expected return on plan assets            | 194               | 62        | 24                         | 280       |
| Actuarial gain                            | 124               | 67        | 6                          | 197       |
| Contributions by the group                | 105               | 10        | 29                         | 144       |
| Employee contributions                    | 8                 | 2         | 1                          | 11        |
| Benefits paid                             | (144)             | (53)      | (38)                       | (235)     |
| Fair value of plan assets at 30 June 2005 | 2,786             | 1,000     | 350                        | 4,136     |
| Exchange differences                      |                   | 21        | (7)                        | 14        |
| Acquisition of businesses                 | 6                 |           |                            | 6         |
| Reclassification from current assets      |                   |           | 18                         | 18        |
| Expected return on plan assets            | 191               | 60        | 24                         | 275       |
| Actuarial gain/(loss)                     | 322               | 24        | (9)                        | 337       |
| Contributions by the group                | 56                | 5         | 47                         | 108       |
| Employee contributions                    | 8                 | 2         | 1                          | 11        |
| Benefits paid                             | (153)             | (53)      | (38)                       | (244)     |
| Settlements                               | (6)               |           | (8)                        | (14)      |
| Fair value of plan assets at 30 June 2006 | 3,210             | 1,059     | 378                        | 4,647     |
| Exchange differences                      |                   | (22)      | (26)                       | (48)      |
| Expected return on plan assets            | 230               | 70        | 24                         | 324       |
| Actuarial gain                            | 144               | 80        | 20                         | 244       |
| Contributions by the group                | 57                | 8         | 30                         | 95        |
| Employee contributions                    | 10                | 2         |                            | 12        |
| Benefits paid                             | (160)             | (54)      | (41)                       | (255)     |
| Fair value of plan assets at 30 June 2007 | 3,491             | 1,143     | 385                        | 5,019     |

**Notes to the consolidated financial statements (continued)****4 Employees (continued)**

The group has agreed a deficit funding plan with the trustees of the UK Diageo Pension Scheme (the Scheme), which provides for the group to fund the Scheme deficit over a four year period beginning in the year ended 30 June 2007. For these purposes, the value of the deficit, calculated using the trustees' actuarial valuation of the Scheme, was ascertained through the triennial valuation as at 31 March 2006. Following the completion of that valuation, Diageo has undertaken to make an annual £50 million cash contribution in each of the four years of the funding plan, and the first payment of £50 million was made in the year ended 30 June 2007. Payments are made into an escrow account subject to an agreement between the group and the trustees, with release from escrow to either the group or the trustees determined by an agreed formula in the light of the actuarial valuation of the Scheme as at 31 March 2009. Investment returns on the funds held in escrow accrue to the group. This amount held in escrow is included in other investments on the consolidated balance sheet and is not included in the table above. In addition to the deficit funding, Diageo continues to make a cash contribution in respect of current service cost based on the trustees' valuation; this contribution is expected to be £50 million in the year ending 30 June 2008. Funding arrangements will be reviewed and adjusted in the light of future triennial actuarial valuations.

Contributions to other plans in the year ending 30 June 2008 are expected to be approximately £40 million.

(f) The future benefits expected to be paid by the post employment plans, up to 30 June 2017, are as follows:

|                          |                  | Payments due in the year ending 30 June |            |            |            |            |              |
|--------------------------|------------------|-----------------------------------------|------------|------------|------------|------------|--------------|
|                          |                  | 2008                                    | 2009       | 2010       | 2011       | 2012       | 2013 2017    |
|                          |                  | £ million                               | £ million  | £ million  | £ million  | £ million  | £ million    |
| United Kingdom           | pension benefits | 162                                     | 166        | 170        | 175        | 180        | 971          |
|                          | other            | 2                                       | 2          | 2          | 2          | 2          | 7            |
| Ireland                  | pension benefits | 55                                      | 56         | 56         | 56         | 57         | 298          |
| United States and Canada | pension benefits | 32                                      | 32         | 31         | 31         | 30         | 125          |
|                          | other            | 5                                       | 5          | 6          | 6          | 6          | 38           |
| Other countries          | pension benefits | 8                                       | 8          | 8          | 8          | 8          | 39           |
|                          | other            | 3                                       | 3          | 3          | 3          | 3          | 14           |
|                          |                  | <b>267</b>                              | <b>272</b> | <b>276</b> | <b>281</b> | <b>286</b> | <b>1,492</b> |

**Notes to the consolidated financial statements (continued)****4 Employees (continued)**

(g) Changes in the assumptions used for determining post employment costs and liabilities may have a material impact on the income statement and balance sheet. For the significant assumptions, the following sensitivity analysis gives an estimate of these impacts for the year ended 30 June 2007:

|                                                                                                           | <b>2007</b>      |
|-----------------------------------------------------------------------------------------------------------|------------------|
|                                                                                                           | <b>£ million</b> |
| A 0.5% decrease in the discount rate would have the following approximate effect:                         |                  |
| Increase in annual post employment cost                                                                   | 7                |
| Increase in post employment deficit                                                                       | 407              |
| A 1% decrease in the expected rates of return on plan assets would have the following approximate effect: |                  |
| Increase in annual post employment cost                                                                   | 45               |
| A one year increase in life expectancy would have the following approximate effect:                       |                  |
| Increase in annual post employment cost                                                                   | 11               |
| Increase in post employment deficit                                                                       | 173              |
| A 0.5% increase in inflation would have the following approximate effect:                                 |                  |
| Increase in annual post employment cost                                                                   | 31               |
| Increase in post employment deficit                                                                       | 350              |
| A 1% decrease in medical care inflation would have the following approximate effect:                      |                  |
| Decrease in annual post employment cost                                                                   | (1)              |
| Decrease in post employment deficit                                                                       | (11)             |

(h) Information on transactions between the group and its pension plans is given in note 31.

(i) The group also has a number of defined contribution plans, for which the total cost charged to the income statement of £2 million (2006 £1 million; 2005 £1 million) represents contributions payable to these plans by the group at rates specified in the rules of the plans.

**5 Exceptional items**

*IAS 1 Presentation of financial statements* requires material items of income and expense to be disclosed separately. Exceptional items are items which, in management's judgement, need to be disclosed by virtue of their size or incidence in order for the user to obtain a proper understanding of the financial information.

In the three years ended 30 June 2007, the following exceptional items arose in respect of continuing operations:

|                                                        | <b>2007</b>      | <b>2006</b>      | <b>2005</b>      |
|--------------------------------------------------------|------------------|------------------|------------------|
|                                                        | <b>£ million</b> | <b>£ million</b> | <b>£ million</b> |
| Items included in operating profit (note (i))          | 40               |                  | (201)            |
| Sale of General Mills and other businesses (note (ii)) | (1)              | 157              | 214              |
|                                                        | <b>39</b>        | <b>157</b>       | <b>13</b>        |

In the year ended 30 June 2006 there were exceptional tax credits of £315 million (2005 exceptional tax credits £78 million) see note 8 for further details of exceptional tax items in prior years.

## Notes to the consolidated financial statements (continued)

## 5 Exceptional items (continued)

## (i) Items included in operating profit

|                                                | 2007      | 2006      | 2005      |
|------------------------------------------------|-----------|-----------|-----------|
|                                                | £ million | £ million | £ million |
| Cost of sales                                  |           |           |           |
| Park Royal brewery accelerated depreciation(a) |           |           | (29)      |
| Other operating expenses                       |           |           |           |
| Disposal of Park Royal property(b)             | 40        |           |           |
| Seagram integration costs(c)                   |           |           | (30)      |
| Thalidomide Trust(d)                           |           |           | (149)     |
| Disposal of other property                     |           |           | 7         |
|                                                | 40        |           | (201)     |

- (a) In the year ended 30 June 2005, the charge for accelerated depreciation of the Park Royal brewery of £29 million related to the closure of that facility in June 2005. The original announcement of this closure was in April 2004.
- (b) In the year ended 30 June 2007, operating profit included an exceptional gain in respect of the sale of the site of the former brewery at Park Royal. The land was sold for £49 million, offset by £9 million expenditure in the year on preparing the site for sale.
- (c) A number of the former Seagram spirits and wine businesses were acquired on 21 December 2001. In the three and a half years to 30 June 2005, a total of £411 million was charged to the income statement for the integration of the businesses, principally in respect of Diageo North America, and 2,350 jobs were terminated. No amounts were charged to the income statement in respect of the Seagram integration in the years ended 30 June 2007 and 30 June 2006.

An analysis of the movement in the Seagram integration liability since 1 July 2004 is as follows:

|                             | Liability at<br>1 July<br>2004 | Charged to<br>income<br>statement<br>in year<br>ended<br>30 June<br>2005 | Cash<br>payments | Liability at<br>30 June<br>2005 | Cash<br>payments | Liability at<br>30 June<br>2006 | Cash<br>payments | Liability at<br>30 June<br>2007 |
|-----------------------------|--------------------------------|--------------------------------------------------------------------------|------------------|---------------------------------|------------------|---------------------------------|------------------|---------------------------------|
|                             | £ million                      | £ million                                                                | £ million        | £ million                       | £ million        | £ million                       | £ million        | £ million                       |
| Employee related            | 8                              | 5                                                                        | (5)              | 8                               | (7)              | 1                               | (1)              |                                 |
| Distributor rationalisation | 1                              |                                                                          | (1)              |                                 |                  |                                 |                  |                                 |
| Lease terminations          | 4                              | 4                                                                        | (6)              | 2                               | (1)              | 1                               | (1)              |                                 |
| Legal and professional      | 10                             | 2                                                                        | (5)              | 7                               | (6)              | 1                               | (1)              |                                 |
| Other                       | 5                              | 17                                                                       | (19)             | 3                               | (2)              | 1                               | (1)              |                                 |
|                             | 28                             | 28                                                                       | (36)             | 20                              | (16)             | 4                               | (4)              |                                 |
| Asset write downs           |                                | 2                                                                        |                  |                                 |                  |                                 |                  |                                 |

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| <b>Liability at<br/>1 July<br/>2004</b> | <b>Charged to<br/>income<br/>statement<br/>in year<br/>ended<br/>30 June<br/>2005</b> | <b>Cash<br/>payments</b> | <b>Liability at<br/>30 June<br/>2005</b> | <b>Cash<br/>payments</b> | <b>Liability at<br/>30 June<br/>2006</b> | <b>Cash<br/>payments</b> | <b>Liability at<br/>30 June<br/>2007</b> |
|-----------------------------------------|---------------------------------------------------------------------------------------|--------------------------|------------------------------------------|--------------------------|------------------------------------------|--------------------------|------------------------------------------|
|                                         | 30                                                                                    |                          |                                          |                          |                                          |                          |                                          |

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**Notes to the consolidated financial statements (continued)****5 Exceptional items (continued)**

(d)

In the year ended 30 June 2005, operating costs included an exceptional charge of £149 million in respect of payments to the Thalidomide Trust. It is expected that the future annual payment will be approximately £7 million per year. This amount will be index-linked and is expected to be a final settlement payable over the period to 2037. Provision has been made for the discounted value of these payments.

**(ii) Sale of General Mills and other businesses** In the year ended 30 June 2007 the group made a loss on the sale of businesses of £1 million (2006 gains £6 million; 2005 loss £7 million). In the year ended 30 June 2006, the group made a £151 million profit on the sale of 25 million shares in General Mills (2005 £221 million profit on the disposal of 54 million shares).

**6 Interest and other finance income and charges**

|                                                                          | 2007         | 2006         | 2005         |
|--------------------------------------------------------------------------|--------------|--------------|--------------|
|                                                                          | £ million    | £ million    | £ million    |
| <b>(i) Net interest</b>                                                  |              |              |              |
| Interest receivable                                                      | 78           | 27           | 121          |
| Fair value gain on interest rate instruments                             | 33           | 24           |              |
| <b>Total interest income</b>                                             | <b>111</b>   | <b>51</b>    | <b>121</b>   |
| Interest payable on bank loans and overdrafts                            | (16)         | (6)          | (15)         |
| Interest payable on all other borrowings                                 | (316)        | (223)        | (256)        |
| Fair value loss on interest rate instruments                             | (30)         | (15)         |              |
| <b>Total interest expense</b>                                            | <b>(362)</b> | <b>(244)</b> | <b>(271)</b> |
|                                                                          | <b>(251)</b> | <b>(193)</b> | <b>(150)</b> |
| <b>(ii) Other finance income</b>                                         |              |              |              |
| Interest on post employment plan liabilities                             | (276)        | (256)        | (271)        |
| Expected return on post employment plan assets                           | 324          | 275          | 280          |
| Net finance income in respect of post employment plans                   | 48           | 19           | 9            |
| Investment income – dividends receivable from General Mills              |              | 5            | 17           |
| Net exchange movements on short term intercompany loans                  | 6            |              |              |
| Net exchange movements on net debt not meeting hedge accounting criteria | 1            |              |              |
|                                                                          | <b>55</b>    | <b>24</b>    | <b>26</b>    |
| <b>(iii) Other finance charges</b>                                       |              |              |              |
| Other unwinding of discounts                                             | (16)         | (15)         | (7)          |
| Finance charge on finance lease obligations                              |              |              | (1)          |
| Other charges                                                            |              |              | (1)          |
| Net exchange movements on short term intercompany loans                  |              | (2)          | (8)          |
|                                                                          | <b>(16)</b>  | <b>(17)</b>  | <b>(17)</b>  |

## Notes to the consolidated financial statements (continued)

## 7 Associates

|                                                             | 2007       | 2006       | 2005       |
|-------------------------------------------------------------|------------|------------|------------|
|                                                             | £ million  | £ million  | £ million  |
| Share of sales                                              | 782        | 734        | 677        |
| Share of operating costs                                    | (549)      | (524)      | (492)      |
| <b>Share of operating profit</b>                            | <b>233</b> | <b>210</b> | <b>185</b> |
| Share of net interest payable                               | (12)       | (10)       | (2)        |
| Share of taxation                                           | (72)       | (69)       | (62)       |
| <b>Share of profits attributable to equity shareholders</b> | <b>149</b> | <b>131</b> | <b>121</b> |
| Dividends received by the group                             | (119)      | (106)      | (105)      |
| <b>Share of profits retained by associates</b>              | <b>30</b>  | <b>25</b>  | <b>16</b>  |

The dividends received by the group in the year ended 30 June 2007 include £42 million (2006 £39 million; 2005 £41 million) of receipts from Moët Hennessy in respect of amounts payable to the tax authorities.

Information on transactions between the group and its associates is given in note 31. Summarised financial information for the group's investments in associates is presented below:

(a) **Moët Hennessy** Moët Hennessy prepares its financial statements under IFRS in euros to 31 December each year. Summary information for Moët Hennessy for the three years ended 30 June 2007, in each year aggregating the results for the six month period ended 31 December with that of the following six months ended 30 June, translated at £1 = €1.48 (2006 £1 = €1.46; 2005 £1 = €1.46), is set out below:

|                     | 2007      |           | 2006      |           | 2005      |           |
|---------------------|-----------|-----------|-----------|-----------|-----------|-----------|
|                     | € million | £ million | € million | £ million | € million | £ million |
| Sales               | 3,066     | 2,072     | 2,795     | 1,914     | 2,382     | 1,632     |
| Profit for the year | 594       | 401       | 522       | 358       | 467       | 320       |

After adjustments to align Moët Hennessy's accounting policies with those of the group, the group's 34% share of operating profit and of profit after tax of Moët Hennessy were £218 million and £136 million, respectively (2006 £198 million and £122 million, respectively; 2005 £173 million and £113 million, respectively).

(b) **Other associates** For all of the group's investments in associates other than Moët Hennessy, summarised financial information, aggregating 100% of the sales and results of each associate, is presented below:

|                     | 2007      | 2006      | 2005      |
|---------------------|-----------|-----------|-----------|
|                     | £ million | £ million | £ million |
| Sales               | 378       | 399       | 398       |
| Profit for the year | 60        | 47        | 36        |



## Notes to the consolidated financial statements (continued)

## 8 Taxation

## (i) Analysis of taxation charge in the year

|                                                      | 2007       | 2006        | 2005       |
|------------------------------------------------------|------------|-------------|------------|
|                                                      | £ million  | £ million   | £ million  |
| <b>Current tax</b>                                   |            |             |            |
| Current year                                         | 387        | 302         | 303        |
| Benefit of previously unrecognised tax losses        |            | (1)         |            |
| Adjustments in respect of prior periods              | 6          | (38)        | (27)       |
|                                                      | <u>393</u> | <u>263</u>  | <u>276</u> |
| <b>Deferred tax</b>                                  |            |             |            |
| Origination and reversal of temporary differences    | 233        | 24          | 176        |
| Benefit of previously unrecognised tax losses        | (12)       | (11)        |            |
| Changes in tax rates                                 | 93         | 19          | 97         |
| Adjustments in respect of prior periods              | (29)       | (114)       | 50         |
|                                                      | <u>285</u> | <u>(82)</u> | <u>323</u> |
| <b>Taxation on profit from continuing operations</b> | <u>678</u> | <u>181</u>  | <u>599</u> |

Adjustments in respect of prior periods for current tax comprise a UK credit of £18 million (2006 £67 million charge; 2005 £55 million charge) and an overseas charge to tax of £24 million (2006 £105 million credit; 2005 £82 million credit).

The taxation charge includes the following items: in the year ended 30 June 2007, a net tax charge of £24 million from intra group reorganisations of brand businesses, a reduction in the carrying value of deferred tax assets of £74 million primarily following a reduction in tax rates, and a provision for settlement of tax liabilities related to the GrandMet/Guinness merger of £64 million; in the year ended 30 June 2006, an exceptional tax credit of £315 million arose as a consequence of the agreement with fiscal authorities of the carrying values of certain brands, which resulted in an increase to the group's deferred tax assets of £313 million; and in the year ended 30 June 2005, there were £58 million of tax credits on exceptional operating items and £20 million of tax credits on exceptional prior year business disposals.

|                                                      | 2007       | 2006        | 2005       |
|------------------------------------------------------|------------|-------------|------------|
|                                                      | £ million  | £ million   | £ million  |
| <b>Current tax</b>                                   |            |             |            |
| United Kingdom                                       | 49         | 121         | 98         |
| Overseas                                             | 344        | 142         | 178        |
|                                                      | <u>393</u> | <u>263</u>  | <u>276</u> |
| <b>Deferred tax</b>                                  |            |             |            |
| United Kingdom                                       | 38         | 13          | (41)       |
| Overseas                                             | 247        | (95)        | 364        |
|                                                      | <u>285</u> | <u>(82)</u> | <u>323</u> |
| <b>Taxation on profit from continuing operations</b> | <u>678</u> | <u>181</u>  | <u>599</u> |



**Notes to the consolidated financial statements (continued)****8 Taxation (continued)****(ii) Factors affecting tax charge for the year**

|                                                                       | 2007       | 2006       | 2005       |
|-----------------------------------------------------------------------|------------|------------|------------|
|                                                                       | £ million  | £ million  | £ million  |
| Profit from continuing operations before taxation                     | 2,095      | 2,146      | 1,925      |
| Notional charge at UK corporation tax rate of 30%                     | 629        | 644        | 578        |
| Elimination of notional tax on share of associates' profits after tax | (45)       | (39)       | (35)       |
| Differences in effective overseas tax rates                           | (35)       | (54)       | (31)       |
| Items not chargeable                                                  | (59)       | (73)       | (94)       |
| Items not deductible                                                  | 205        | 45         | 61         |
| Benefit of previously unrecognised tax losses                         | (12)       | (12)       |            |
| Deferred tax on intra group transfers                                 | (75)       | (197)      |            |
| Changes in tax rates                                                  | 93         | 19         | 97         |
| Adjustments in respect of prior periods                               | (23)       | (152)      | 23         |
| <b>Tax charge for the year</b>                                        | <b>678</b> | <b>181</b> | <b>599</b> |

**(iii) Factors that may affect future tax charges** As a group involved in worldwide operations, Diageo is subject to several factors which may affect future tax charges, principally the levels and mix of profitability in different jurisdictions, transfer pricing policies and tax rates imposed.

**(iv) Corporate tax payable** The current corporate tax liability of £673 million (2006 £681 million) represents the amount of taxes payable in respect of current and prior periods that exceed payments made, and includes any interest and penalties payable thereon.

**(v) Material tax liabilities** In the past, the group has undergone significant restructuring involving the acquisition and disposal of material businesses and the transfer of businesses intra group. As a consequence of this restructuring, a number of potential tax exposures have arisen. In addition, as the group operates throughout the world, it faces a number of potential transfer pricing issues in many jurisdictions relating to goods, services and financing. The issues are often complex, inter-related and can take many years to resolve. The group has a liability (after applicable reliefs) of £377 million (2006 £393 million) for these exposures, which is included in corporate tax payable in current liabilities. The decrease is due to a number of audit settlements offset by changes to estimates in relation to existing audits and identification of new exposures.

The group has a number of tax audits ongoing worldwide but does not currently expect material additional tax exposures to arise, above the amounts provided, as and when audits are concluded.

Provision is also made for penalties and interest on tax liabilities, and these are included in corporate tax payable in current liabilities and in the corporation tax charge.

**9 Discontinued operations**

In the year ended 30 June 2007, a tax benefit of £82 million arose from the recognition of capital losses arising on the prior year disposals of the Pillsbury and Burger King businesses. In addition, a tax credit of £57 million arose following resolution with tax authorities of various audit issues (2005 £20 million tax credit in respect of the Pillsbury disposal).

**Notes to the consolidated financial statements (continued)****9 Discontinued operations (continued)**

In the year ended 30 June 2005, a gain of £53 million arose from the release of provisions held by Diageo as a result of the refinancing of Burger King on a stand-alone basis. In connection with the disposal of Burger King, Diageo guaranteed up to \$850 million (£459 million) of Burger King's external borrowings. On 13 July 2005, Burger King refinanced its external borrowings on a stand-alone basis, releasing Diageo from its obligations under guarantees relating to that debt, and repaid in full the subordinated debt and associated interest owed to Diageo.

**10 Earnings per share**

|                                                   | 2007         | 2006      | 2005      |
|---------------------------------------------------|--------------|-----------|-----------|
|                                                   | £ million    | £ million | £ million |
| <b>Profit attributable to equity shareholders</b> |              |           |           |
| Continuing operations                             | 1,350        | 1,908     | 1,271     |
| Discontinued operations                           | 139          |           | 73        |
|                                                   | <b>1,489</b> | 1,908     | 1,344     |
| <b>Pence per share</b>                            |              |           |           |
| Continuing operations                             |              |           |           |
| basic earnings                                    | 50.2p        | 67.2p     | 42.8p     |
| diluted earnings                                  | 49.9p        | 66.9p     | 42.8p     |
| Continuing and discontinued operations            |              |           |           |
| basic earnings                                    | 55.4p        | 67.2p     | 45.2p     |
| diluted earnings                                  | 55.0p        | 66.9p     | 45.2p     |

Excluding shares held by share trusts and treasury shares, the weighted average number of shares for the year ended 30 June 2007 was 2,688 million (2006 2,841 million; 2005 2,972 million). The effect of dilutive potential ordinary shares was to increase the weighted average number of shares for the year ended 30 June 2007 by 19 million to 2,707 million (2006 increase by 11 million to 2,852 million; 2005 increase by 1 million to 2,973 million).

## Notes to the consolidated financial statements (continued)

## 11 Intangible assets

|                                         | Brands       | Goodwill   | Other<br>intangibles | Computer<br>software | Total        |
|-----------------------------------------|--------------|------------|----------------------|----------------------|--------------|
|                                         | £ million    | £ million  | £ million            | £ million            | £ million    |
| <b>Cost</b>                             |              |            |                      |                      |              |
| At 30 June 2005                         | 4,176        | 128        | 64                   | 120                  | 4,488        |
| Exchange differences                    | (55)         |            |                      | (2)                  | (57)         |
| Acquisition of businesses               | 144          | 43         |                      |                      | 187          |
| Other movements                         | 18           | (15)       | (6)                  | 16                   | 13           |
| At 30 June 2006                         | 4,283        | 156        | 58                   | 134                  | 4,631        |
| Exchange differences                    | (218)        | (4)        | (1)                  | (6)                  | (229)        |
| Acquisition of businesses               | 20           | 28         |                      |                      | 48           |
| Transfers                               |              |            |                      | 37                   | 37           |
| Other movements                         |              |            | 1                    | 9                    | 10           |
| <b>At 30 June 2007</b>                  | <b>4,085</b> | <b>180</b> | <b>58</b>            | <b>174</b>           | <b>4,497</b> |
| <b>Amortisation and impairment loss</b> |              |            |                      |                      |              |
| At 30 June 2005                         |              | 16         | 22                   | 41                   | 79           |
| Exchange differences                    |              |            |                      | (1)                  | (1)          |
| Amortisation for the year               |              |            | 5                    | 23                   | 28           |
| Other movements                         |              |            | (8)                  | (1)                  | (9)          |
| At 30 June 2006                         |              | 16         | 19                   | 62                   | 97           |
| Exchange differences                    |              | (1)        | (1)                  | (4)                  | (6)          |
| Amortisation for the year               |              |            | 5                    | 24                   | 29           |
| Other movements                         |              |            |                      | (6)                  | (6)          |
| <b>At 30 June 2007</b>                  |              | <b>15</b>  | <b>23</b>            | <b>76</b>            | <b>114</b>   |
| <b>Carrying amount</b>                  |              |            |                      |                      |              |
| <b>At 30 June 2007</b>                  | <b>4,085</b> | <b>165</b> | <b>35</b>            | <b>98</b>            | <b>4,383</b> |
| At 30 June 2006                         | 4,283        | 140        | 39                   | 72                   | 4,534        |
| At 30 June 2005                         | 4,176        | 112        | 42                   | 79                   | 4,409        |

(a)

Brands are stated at fair value on acquisition. The principal acquired brands are as follows:

| Product   | Currency of<br>investment | Remaining<br>amortisation<br>period | Carrying<br>amount |
|-----------|---------------------------|-------------------------------------|--------------------|
| £ million |                           |                                     |                    |

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|                 | <b>Product</b> | <b>Currency of investment</b> | <b>Remaining amortisation period</b> | <b>Carrying amount</b> |
|-----------------|----------------|-------------------------------|--------------------------------------|------------------------|
| Johnnie Walker  | Whisky         | Sterling                      | Indefinite life                      | <b>625</b>             |
| Smirnoff        | Vodka          | US dollar                     | Indefinite life                      | <b>411</b>             |
| Crown Royal     | Whisky         | US dollar                     | Indefinite life                      | <b>728</b>             |
| Captain Morgan  | Rum            | US dollar                     | Indefinite life                      | <b>598</b>             |
| Windsor Premier | Whisky         | Korean won                    | Indefinite life                      | <b>468</b>             |

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## Notes to the consolidated financial statements (continued)

### 11 Intangible assets (continued)

Capitalised brands are regarded as having indefinite useful economic lives and have not been amortised. These brands are protected in all of the major markets where they are sold by trademarks, which are renewable indefinitely. There are not believed to be any legal, regulatory or contractual provisions that limit the useful lives of these brands. The nature of the premium drinks industry is that obsolescence is not a common issue, with indefinite brand lives being commonplace, and Diageo has a number of brands that were originally created more than 100 years ago. Accordingly the directors believe that it is appropriate that the brands are treated as having indefinite lives for accounting purposes.

Impairment reviews are carried out annually to ensure that intangible assets, including brands, are not carried at above their recoverable amounts. In particular, the group performs a discounted cash flow analysis to compare discounted estimated future operating cash flows with the net carrying value of each acquired brand. The analysis is based on forecast cash flows for the next financial year, with terminal values being calculated using the long term growth rate (the real gross domestic product (GDP) growth rate of the country plus its inflation rate) of the principal countries in which the majority of the profits of each brand are generated. The estimated cash flows are discounted at the group's weighted average cost of capital in the relevant country. Any impairment write downs identified are charged to the income statement. The test is dependent on management estimates and judgments, in particular in relation to the forecasting of future cash flows, and the discount rate applied to these cash flows. Management has concluded that no reasonably possible change in the key assumptions on which it has determined the recoverable amounts of acquired brands would cause their carrying values to exceed their recoverable amounts.

(b) The group tests goodwill annually for impairment, or more frequently if there are indications that goodwill is impaired. The goodwill is allocated to cash generating units and a discounted cash flow analysis is computed to compare discounted estimated future operating cash flows with the net carrying value of each business. The analysis is based on forecast cash flows for the next financial year, with terminal values being calculated using the long term growth rate (the real GDP growth rate of the country plus its inflation rate) of the relevant country. The estimated cash flows are discounted at the group's weighted average cost of capital in the relevant country. Any impairment write downs identified are charged to the income statement. The test is dependent on management estimates and judgments, in particular in relation to the forecasting of future cash flows, and the discount rate applied to these cash flows. Management has concluded that no reasonably possible change in the key assumptions on which it has determined the recoverable amount of goodwill would cause its carrying value to exceed its recoverable amount.

(c) Other intangible assets, principally comprising distribution rights, are amortised on a straight-line basis over the length of the distribution arrangements, generally between 10 and 20 years.

(d) Computer software includes £19 million in respect of projects in the course of development.

## Notes to the consolidated financial statements (continued)

## 12 Property, plant and equipment

|                                  | Land and<br>buildings | Plant and<br>equipment | Fixtures and<br>fittings | Under<br>construction | Total        |
|----------------------------------|-----------------------|------------------------|--------------------------|-----------------------|--------------|
|                                  | £ million             | £ million              | £ million                | £ million             | £ million    |
| <b>Cost</b>                      |                       |                        |                          |                       |              |
| At 30 June 2005                  | 813                   | 1,622                  | 155                      | 187                   | 2,777        |
| Exchange differences             | (7)                   | (4)                    | (2)                      | (1)                   | (14)         |
| Acquisition of businesses        | 11                    | 14                     |                          |                       | 25           |
| Other additions                  | 11                    | 97                     | 14                       | 110                   | 232          |
| Disposals                        | (10)                  | (78)                   | (18)                     | (4)                   | (110)        |
| Transfers                        | 40                    | 92                     | 5                        | (137)                 |              |
|                                  | <b>858</b>            | <b>1,743</b>           | <b>154</b>               | <b>155</b>            | <b>2,910</b> |
| At 30 June 2006                  | 858                   | 1,743                  | 154                      | 155                   | 2,910        |
| Exchange differences             | (26)                  | (48)                   | (4)                      | (4)                   | (82)         |
| Additions                        | 14                    | 88                     | 16                       | 144                   | 262          |
| Disposals                        | (10)                  | (90)                   | (12)                     | (2)                   | (114)        |
| Transfers                        | 47                    | 41                     | 4                        | (129)                 | (37)         |
|                                  | <b>883</b>            | <b>1,734</b>           | <b>158</b>               | <b>164</b>            | <b>2,939</b> |
| <b>At 30 June 2007</b>           | <b>883</b>            | <b>1,734</b>           | <b>158</b>               | <b>164</b>            | <b>2,939</b> |
| <b>Depreciation</b>              |                       |                        |                          |                       |              |
| At 30 June 2005                  | 127                   | 652                    | 79                       |                       | 858          |
| Depreciation charge for the year | 25                    | 142                    | 19                       |                       | 186          |
| Disposals                        | (3)                   | (74)                   | (9)                      |                       | (86)         |
|                                  | <b>149</b>            | <b>720</b>             | <b>89</b>                |                       | <b>958</b>   |
| At 30 June 2006                  | 149                   | 720                    | 89                       |                       | 958          |
| Exchange differences             | (5)                   | (23)                   | (2)                      |                       | (30)         |
| Depreciation charge for the year | 33                    | 126                    | 22                       |                       | 181          |
| Disposals                        | (3)                   | (90)                   | (9)                      |                       | (102)        |
|                                  | <b>174</b>            | <b>733</b>             | <b>100</b>               |                       | <b>1,007</b> |
| <b>At 30 June 2007</b>           | <b>174</b>            | <b>733</b>             | <b>100</b>               |                       | <b>1,007</b> |
| <b>Carrying amount</b>           |                       |                        |                          |                       |              |
| <b>At 30 June 2007</b>           | <b>709</b>            | <b>1,001</b>           | <b>58</b>                | <b>164</b>            | <b>1,932</b> |
| At 30 June 2006                  | 709                   | 1,023                  | 65                       | 155                   | 1,952        |
| At 30 June 2005                  | 686                   | 970                    | 76                       | 187                   | 1,919        |

- (a) The net book value of land and buildings comprises freeholds of £689 million (2006 £689 million), long leaseholds of £16 million (2006 £18 million) and short leaseholds of £4 million (2006 £2 million). Depreciation was not charged on £187 million (2006 £186 million) of land.
- (b) Included in the total net book value of property, plant and equipment is £16 million (2006 £14 million) in respect of assets held under finance leases; depreciation for the year on these assets was £4 million (2006 £4 million).
- (c) Transfers represent assets brought into use during the year, of which £37 million was in respect of computer software.





## Notes to the consolidated financial statements (continued)

## 13 Biological assets

|                                             | Grape vines |
|---------------------------------------------|-------------|
|                                             | £ million   |
| <b>Fair value</b>                           |             |
| At 30 June 2005                             | 14          |
| Exchange differences                        | (1)         |
| Harvested grapes transferred to inventories | (19)        |
| Changes in fair value                       | 19          |
| At 30 June 2006                             | 13          |
| Exchange differences                        | (1)         |
| Harvested grapes transferred to inventories | (19)        |
| Changes in fair value                       | 19          |
| <b>At 30 June 2007</b>                      | <b>12</b>   |

- (a) Biological assets comprise grape vines and grapes on the vine. At 30 June 2007, grape vines comprise approximately 1,910 hectares (2006 1,769 hectares) of vineyards, ranging from newly established vineyards to vineyards that are 88 years old.
- (b) There are no outstanding commitments for the acquisition or development of vineyards.

## 14 Investments in associates

|                             | Moët<br>Hennessy | Other<br>associates | Total        |
|-----------------------------|------------------|---------------------|--------------|
|                             | £ million        | £ million           | £ million    |
| <b>Cost less provisions</b> |                  |                     |              |
| At 30 June 2005             | 1,220            | 41                  | 1,261        |
| Adoption of IAS 39          | (6)              |                     | (6)          |
| At 1 July 2005 as adjusted  | 1,214            | 41                  | 1,255        |
| Exchange differences        | 25               | (3)                 | 22           |
| Share of retained profits   | 64               |                     | 64           |
| At 30 June 2006             | 1,303            | 38                  | 1,341        |
| Exchange differences        | (25)             |                     | (25)         |
| Additions                   |                  | 48                  | 48           |
| Share of retained profits   | 70               | 4                   | 74           |
| Disposals                   |                  | (2)                 | (2)          |
| <b>At 30 June 2007</b>      | <b>1,348</b>     | <b>88</b>           | <b>1,436</b> |

Investments in associates comprise the cost of shares, less goodwill written off on acquisitions prior to 1 July 1998, of £922 million (2006 £892 million) plus the group's share of post acquisition reserves of £514 million (2006 £449 million).



## Notes to the consolidated financial statements (continued)

### 14 Investments in associates (continued)

(a) **Moët Hennessy** Moët Hennessy prepares its financial statements under IFRS in euros to 31 December each year. A summary of Moët Hennessy's consolidated balance sheet as at 30 June 2007 and 30 June 2006, translated at £1 = €1.48 (2006 £1.45), is set out below:

|                                                                      | 2007           |                | 2006           |                |
|----------------------------------------------------------------------|----------------|----------------|----------------|----------------|
|                                                                      | € million      | £ million      | € million      | £ million      |
| Non-current assets                                                   | 4,095          | 2,768          | 2,517          | 1,736          |
| Current assets                                                       | 4,489          | 3,032          | 4,011          | 2,766          |
| <b>Total assets</b>                                                  | <b>8,584</b>   | <b>5,800</b>   | <b>6,528</b>   | <b>4,502</b>   |
| Current liabilities                                                  | (1,609)        | (1,087)        | (1,323)        | (913)          |
| Non-current liabilities                                              | (1,111)        | (750)          | (866)          | (597)          |
| <b>Total liabilities</b>                                             | <b>(2,720)</b> | <b>(1,837)</b> | <b>(2,189)</b> | <b>(1,510)</b> |
| <b>Net assets attributable to equity shareholders of the company</b> | <b>5,864</b>   | <b>3,963</b>   | <b>4,339</b>   | <b>2,992</b>   |

The 34% net investment in Moët Hennessy has been accounted for by aggregating the group's share of the net assets of Moët Hennessy with fair value adjustments on acquisition, principally in respect of Moët Hennessy's brands.

(b) **Other associates** For all of the group's investments in associates other than Moët Hennessy, summarised financial information, aggregating 100% of the assets and liabilities of each associate, is presented below:

|                          | 2007         | 2006        |
|--------------------------|--------------|-------------|
|                          | £ million    | £ million   |
| Non-current assets       | 172          | 165         |
| Current assets           | 198          | 102         |
| <b>Total assets</b>      | <b>370</b>   | <b>267</b>  |
| Current liabilities      | (109)        | (84)        |
| Non-current liabilities  | (25)         | (12)        |
| <b>Total liabilities</b> | <b>(134)</b> | <b>(96)</b> |
| <b>Net assets</b>        | <b>236</b>   | <b>171</b>  |

Included in other associates is a 17% effective interest held indirectly in Sichuan ShuiJingFang Joint Stock Co Ltd ('ShuiJingFang'), a manufacturer and distributor of Chinese white spirits, which is quoted on the Shanghai Stock Exchange. At 30 June 2007, ShuiJingFang's share price was RMB15 which valued the group's interest at £83 million.

## Notes to the consolidated financial statements (continued)

### 15 Investments in joint ventures

The group consolidates its attributable share of the results and net assets of joint ventures on a line-by-line basis, measured according to the terms of the arrangements. The group's principal joint ventures that are consolidated on a proportional basis are as follows:

|                                     | <u>Country of<br/>incorporation</u> | <u>Country of<br/>operation</u> | <u>Percentage of<br/>equity owned</u> | <u>Principal activities</u>                              |
|-------------------------------------|-------------------------------------|---------------------------------|---------------------------------------|----------------------------------------------------------|
| Don Julio BV                        | Netherlands                         | Mexico                          | 50%                                   | Production, marketing and distribution of premium drinks |
| Guinness Anchor Berhad              | Malaysia                            | Malaysia                        | 50%                                   | Production, marketing and distribution of premium drinks |
| Moët Hennessy Diageo (China) Co Ltd | China                               | China                           | 50%                                   | Marketing and distribution of premium drinks             |
| MHD Diageo Moët Hennessy KK         | Japan                               | Japan                           | 50%                                   | Marketing and distribution of premium drinks             |

In addition, the group consolidates on a proportional basis a number of other joint ventures involved in the production, marketing and distribution of premium drinks in Europe, South Africa and the Far East.

Included in the consolidated financial statements are the following amounts that represent the group's interest in the results and assets and liabilities of joint ventures:

|                          | <u>2007</u> | <u>2006</u>  | <u>2005</u>  |
|--------------------------|-------------|--------------|--------------|
|                          | £ million   | £ million    | £ million    |
| Sales                    | 479         | 428          | 365          |
| Operating costs          | (449)       | (394)        | (334)        |
| <b>Profit before tax</b> | <b>30</b>   | <b>34</b>    | <b>31</b>    |
|                          |             | <u>2007</u>  | <u>2006</u>  |
|                          |             | £ million    | £ million    |
| Non-current assets       |             | 74           | 84           |
| Current assets           |             | 208          | 190          |
| <b>Total assets</b>      |             | <b>282</b>   | <b>274</b>   |
| Current liabilities      |             | (89)         | (76)         |
| Non-current liabilities  |             | (68)         | (84)         |
| <b>Total liabilities</b> |             | <b>(157)</b> | <b>(160)</b> |
| <b>Net assets</b>        |             | <b>125</b>   | <b>114</b>   |

## Notes to the consolidated financial statements (continued)

## 16 Other investments

|                                           | General<br>Mills | Loans<br>and other | Total      |
|-------------------------------------------|------------------|--------------------|------------|
|                                           | £ million        | £ million          | £ million  |
| <b>Cost less provisions or fair value</b> |                  |                    |            |
| At 30 June 2005                           | 508              | 211                | 719        |
| Adoption of IAS 39                        | 148              |                    | 148        |
| At 1 July 2005 as adjusted                | 656              | 211                | 867        |
| Exchange differences                      |                  | 3                  | 3          |
| Fair value movements included in equity   | 33               |                    | 33         |
| Additions                                 |                  | 16                 | 16         |
| Disposals and repayments                  | (689)            | (161)              | (850)      |
| At 30 June 2006                           |                  | 69                 | 69         |
| Exchange differences                      |                  | (2)                | (2)        |
| Additions                                 |                  | 77                 | 77         |
| Disposals and repayments                  |                  | (16)               | (16)       |
| <b>At 30 June 2007</b>                    |                  | <b>128</b>         | <b>128</b> |

**(a) General Mills** At 30 June 2005, the group owned 25 million shares in General Mills. With effect from 1 July 2005, the group adopted the provisions of IAS 39 and the shares were reclassified as an investment available for sale and restated to fair value. During the year ended 30 June 2006, the 25 million shares in General Mills were sold.

**(b) Loans** Included within loans at 30 June 2005 was \$266 million (£148 million) receivable in respect of the disposal of Burger King. The loan earned interest at 9%, which was rolled up until the loan and associated interest were repaid in full when Burger King refinanced its credit facilities on 13 July 2005.

**(c) Other** Other investments at 30 June 2007 include £50 million (2006 and 2005 – £nil) paid into an escrow account and invested subject to an agreement between the group and the trustees of the Diageo Pension Scheme in the United Kingdom. This amount is not available for the general use of the group (see note 4).

## 17 Inventories

|                                     | 2007         | 2006         |
|-------------------------------------|--------------|--------------|
|                                     | £ million    | £ million    |
| Raw materials and consumables       | 239          | 236          |
| Work in progress                    | 14           | 17           |
| Maturing inventories                | 1,745        | 1,644        |
| Finished goods and goods for resale | 467          | 489          |
|                                     | <b>2,465</b> | <b>2,386</b> |

**Notes to the consolidated financial statements (continued)****17 Inventories (continued)**

Inventories are disclosed net of provisions for obsolescence, an analysis of which is as follows:

|                                  | 2007      | 2006      | 2005      |
|----------------------------------|-----------|-----------|-----------|
|                                  | £ million | £ million | £ million |
| Balance at beginning of the year | 44        | 45        | 49        |
| Exchange differences             | (2)       |           | (1)       |
| Income statement charge          | 9         | 2         | 5         |
| Written off                      | (8)       | (3)       | (8)       |
|                                  | <u>43</u> | <u>44</u> | <u>45</u> |

**18 Trade and other receivables**

|                                | 2007           |                    | 2006           |                    |
|--------------------------------|----------------|--------------------|----------------|--------------------|
|                                | Current assets | Non-current assets | Current assets | Non-current assets |
|                                | £ million      | £ million          | £ million      | £ million          |
| Trade receivables              | 1,380          |                    | 1,332          |                    |
| Other receivables              | 288            | 12                 | 260            | 8                  |
| Prepayments and accrued income | 91             | 5                  | 89             | 4                  |
|                                | <u>1,759</u>   | <u>17</u>          | <u>1,681</u>   | <u>12</u>          |

Trade and other receivables are disclosed net of provisions for bad and doubtful debts, an analysis of which is as follows:

|                                  | 2007      | 2006      | 2005      |
|----------------------------------|-----------|-----------|-----------|
|                                  | £ million | £ million | £ million |
| Balance at beginning of the year | 65        | 68        | 94        |
| Exchange differences             | (2)       | 1         | 3         |
| Income statement charge          | 5         | 5         | 13        |
| Disposal of businesses           |           |           | (32)      |
| Written off                      | (15)      | (9)       | (10)      |
|                                  | <u>53</u> | <u>65</u> | <u>68</u> |

**19 Cash and cash equivalents**

|                  | 2007      | 2006      |
|------------------|-----------|-----------|
|                  | £ million | £ million |
| Cash at bank     | 618       | 483       |
| Cash equivalents | 267       | 216       |

|  | <u>2007</u> | <u>2006</u> |
|--|-------------|-------------|
|  | <b>885</b>  | 699         |



## Notes to the consolidated financial statements (continued)

## 20 Borrowings and bank overdrafts

|                                                                 | Repayment date | Currency  | Year end interest rates | 2007         | 2006         |
|-----------------------------------------------------------------|----------------|-----------|-------------------------|--------------|--------------|
|                                                                 |                |           | %                       | £ million    | £ million    |
| Bank overdrafts                                                 | 2007           | Various   | Various                 | 46           | 48           |
| Commercial paper                                                | 2007           | US dollar | Various                 | 299          |              |
| Bank and other loans                                            | Various        | Various   | Various                 | 192          | 126          |
| Guaranteed bonds 2006                                           | 2006           | US dollar | 3.0                     |              | 271          |
| Guaranteed bonds 2007                                           | 2007           | US dollar | 3.5                     | 498          |              |
| Guaranteed bonds 2008                                           | 2008           | US dollar | 3.375                   | 497          |              |
| Medium term notes                                               | 2006           | Euro      | Floating                |              | 207          |
| Medium term notes                                               | 2007           | US dollar | Floating                |              | 108          |
| Medium term notes                                               | 2007 2008      | US dollar | Various                 | 7            |              |
| Fair value adjustment to borrowings                             |                |           |                         | (4)          | (1)          |
| <b>Borrowings due within one year and bank overdrafts</b>       |                |           |                         | <b>1,535</b> | <b>759</b>   |
| Guaranteed bonds 2007                                           | 2007           | US dollar | 3.5                     |              | 540          |
| Guaranteed bonds 2008                                           | 2008           | US dollar | 3.375                   |              | 539          |
| Guaranteed bonds 2010                                           | 2010           | US dollar | 4.375                   | 372          | 404          |
| Guaranteed bonds 2011                                           | 2011           | US dollar | 3.875                   | 248          | 268          |
| Guaranteed bonds 2012                                           | 2012           | US dollar | 5.125                   | 298          |              |
| Guaranteed bonds 2012                                           | 2012           | Euro      | Floating                | 507          |              |
| Guaranteed bonds 2013                                           | 2013           | US dollar | 5.5                     | 298          | 324          |
| Guaranteed bonds 2015                                           | 2015           | US dollar | 5.3                     | 372          | 405          |
| Guaranteed bonds 2016                                           | 2016           | US dollar | 5.5                     | 298          |              |
| Guaranteed bonds 2035                                           | 2035           | US dollar | 7.45                    | 199          | 216          |
| Guaranteed bonds 2036                                           | 2036           | US dollar | 5.875                   | 296          |              |
| Guaranteed debentures 2011                                      | 2011           | US dollar | 9.0                     | 148          | 161          |
| Guaranteed debentures 2022                                      | 2022           | US dollar | 8.0                     | 148          | 160          |
| Medium term notes                                               | 2008           | US dollar | Floating                | 124          | 135          |
| Medium term notes                                               | 2009           | US dollar | Floating                | 199          | 216          |
| Medium term notes                                               | 2009           | US dollar | 7.25                    | 149          | 162          |
| Medium term notes                                               | 2009           | Euro      | 3.875                   | 337          | 344          |
| Medium term notes                                               | 2018           | US dollar | 4.85                    | 100          | 108          |
| Bank and other loans                                            | Various        | Various   | Various                 | 59           | 65           |
| Fair value adjustment to borrowings                             |                |           |                         | (20)         | (46)         |
| <b>Borrowings due after one year</b>                            |                |           |                         | <b>4,132</b> | <b>4,001</b> |
| <b>Total borrowings before derivative financial instruments</b> |                |           |                         | <b>5,667</b> | <b>4,760</b> |
| Fair value of foreign currency swaps and forwards               | Various        | Various   | Various                 | 29           | 17           |
| Fair value of interest rate hedging instruments                 | Various        | Various   | Various                 | 20           | 44           |
| <b>Total borrowings after derivative financial instruments</b>  |                |           |                         | <b>5,716</b> | <b>4,821</b> |

**Notes to the consolidated financial statements (continued)****20 Borrowings and bank overdrafts (continued)**

Bank overdrafts that are repayable on demand and form an integral part of the group's cash management are included as a component of net cash and cash equivalents in the consolidated cash flow statement.

The interest rates shown in the table above are those contracted on the underlying borrowings before taking into account any interest rate protection (see note 22). Based on average net borrowings and taking into account interest rate protection, the effective interest rate for the year, excluding finance charges unrelated to net borrowings, was 5.5% (2006 4.8%; 2005 4.1%). The loans above are stated net of unamortised finance costs of £14 million (2006 £8 million; 2005 £14 million).

The weighted average interest rate for short term borrowings, before interest rate protection, at 30 June 2007 was 4.4% (2006 2.9%) The weighted average interest rate for medium term notes included within borrowings due after one year at 30 June 2007 was 5.1% (2006 5.1%). The group's policy on the management of liquidity risk and a sensitivity analysis are reported in the Business review (see 'Risk management' and 'Market risk sensitivity analysis').

Certain borrowings are reported in the table above at amortised cost with a fair value adjustment shown separately. The financial instruments disclosures in note 22 detail the fair value hedge relationships between the group's borrowings and interest rate swaps.

**(i) Analysis of net borrowings**

|                                                   | <u>2007</u>       | <u>2006</u>       |
|---------------------------------------------------|-------------------|-------------------|
|                                                   | <u>£ million</u>  | <u>£ million</u>  |
| Bank overdrafts                                   | (46)              | (48)              |
| Borrowings due within one year                    | (1,489)           | (711)             |
| Borrowings due after one year                     | (4,132)           | (4,001)           |
| Fair value of interest rate hedging instruments   | (20)              | (44)              |
| Fair value of foreign currency swaps and forwards | (29)              | (17)              |
| Finance lease liabilities                         | (14)              | (9)               |
|                                                   | <u>          </u> | <u>          </u> |
| <b>Gross borrowings</b>                           | <b>(5,730)</b>    | <b>(4,830)</b>    |
| Offset by:                                        |                   |                   |
| Cash and cash equivalents                         | 885               | 699               |
| Other liquid resources                            |                   | 49                |
|                                                   | <u>          </u> | <u>          </u> |
| <b>Net borrowings</b>                             | <b>(4,845)</b>    | <b>(4,082)</b>    |
|                                                   | <u>          </u> | <u>          </u> |

£59 million (2006 £49 million) of net borrowings due within one year and £38 million (2006 £35 million) of net borrowings due after one year were secured on assets of the group.

Interest rate hedging instruments, foreign currency swaps and forwards, other liquid resources and finance lease liabilities are included in other financial assets and other financial liabilities on the consolidated balance sheet.

## Notes to the consolidated financial statements (continued)

## 20 Borrowings and bank overdrafts (continued)

## (ii) Reconciliation of movement in net borrowings

|                                                                      | 2007           | 2006           |
|----------------------------------------------------------------------|----------------|----------------|
|                                                                      | £ million      | £ million      |
| Net borrowings at beginning of the year                              | (4,082)        | (3,706)        |
| Adoption of IAS 39                                                   |                | 3              |
| <b>Restated net borrowings at beginning of the year</b>              | <b>(4,082)</b> | <b>(3,703)</b> |
| Increase/(decrease) in net cash and cash equivalents before exchange | 238            | (67)           |
| Cash flow from change in loans                                       | (1,226)        | (309)          |
| <b>Change in net borrowings from cash flows</b>                      | <b>(988)</b>   | <b>(376)</b>   |
| Exchange differences on net borrowings                               | 211            | 15             |
| Other non-cash items                                                 | 14             | (18)           |
| <b>Net borrowings at end of the year</b>                             | <b>(4,845)</b> | <b>(4,082)</b> |

## 21 Other financial assets and liabilities

|                                                   | Non-current<br>assets | Current<br>assets | Current<br>liabilities | Non-current<br>liabilities |
|---------------------------------------------------|-----------------------|-------------------|------------------------|----------------------------|
|                                                   | £ million             | £ million         | £ million              | £ million                  |
| <b>2007</b>                                       |                       |                   |                        |                            |
| <b>Derivative assets/(liabilities)</b>            |                       |                   |                        |                            |
| Designated in a cash flow hedge                   | 37                    | 74                | (15)                   | (40)                       |
| Designated in a fair value hedge                  | 8                     |                   | (3)                    | (25)                       |
| Designated in a net investment hedge              |                       | 4                 | (20)                   |                            |
| Not designated in a hedge relationship            | 7                     |                   |                        | (13)                       |
|                                                   | <b>52</b>             | <b>78</b>         | <b>(38)</b>            | <b>(78)</b>                |
| <b>Non-derivative liabilities</b>                 |                       |                   |                        |                            |
| Contingent consideration payable                  |                       |                   |                        | (17)                       |
| Finance lease liabilities                         |                       |                   | (5)                    | (9)                        |
|                                                   |                       |                   | <b>(5)</b>             | <b>(26)</b>                |
| <b>Total other financial assets/(liabilities)</b> | <b>52</b>             | <b>78</b>         | <b>(43)</b>            | <b>(104)</b>               |
| <b>2006</b>                                       |                       |                   |                        |                            |
| <b>Derivative assets/(liabilities)</b>            |                       |                   |                        |                            |
| Designated in a cash flow hedge                   | 24                    | 22                | (14)                   | (4)                        |
| Designated in a fair value hedge                  | 9                     |                   | (3)                    | (50)                       |
| Designated in a net investment hedge              |                       |                   | (17)                   |                            |
| Not designated in a hedge relationship            | 9                     |                   |                        | (17)                       |

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|                                                   | Non-current<br>assets | Current<br>assets | Current<br>liabilities | Non-current<br>liabilities |
|---------------------------------------------------|-----------------------|-------------------|------------------------|----------------------------|
|                                                   | 42                    | 22                | (34)                   | (71)                       |
| <b>Non-derivative assets/(liabilities)</b>        |                       |                   |                        |                            |
| Other liquid resources                            |                       | 49                |                        |                            |
| Finance lease liabilities                         |                       |                   | (2)                    | (7)                        |
|                                                   |                       | 49                | (2)                    | (7)                        |
| <b>Total other financial assets/(liabilities)</b> | 42                    | 71                | (36)                   | (78)                       |

The Smirnov brand in Russia was acquired through a company in which the group holds a 75% interest. Contingent consideration payable of £17 million has been included in non-current liabilities in respect of the consideration payable for the remaining 25% interest.

## Notes to the consolidated financial statements (continued)

### 22 Financial instruments and risk management

Derivative financial instruments are used to hedge exposure to fluctuations in foreign exchange rates, interest rates and commodity price movements that arise in the normal course of the group's business. The group's treasury objectives, risk management strategies and policies are disclosed in the Business review (see 'Risk management').

**(i) Currency risk management** The group publishes its consolidated financial statements in sterling and conducts business in many foreign currencies. As a result, it is subject to foreign currency exchange risk due to exchange rate movements, which will affect the group's transaction costs, and the translation of the results and underlying net assets of its foreign operations.

**Hedge of net investment in foreign operations** The group hedges a substantial portion of its exposure to fluctuations on the translation into sterling of its foreign operations by holding net borrowings in foreign currencies and by using foreign currency swaps and forwards. During the year ended 30 June 2007, the group's policy, where a liquid foreign exchange market exists, was to hedge currency exposure on its net foreign operations before net borrowings at approximately the following percentages: 90% US dollars, 90% euros and 50% for other significant currencies. This policy leaves the remaining part of the group's net foreign operations before net borrowings subject to currency movements. The effective portion of exchange differences arising on the retranslation of foreign currency borrowings (including foreign currency swaps and forwards) is recognised in the statement of recognised income and expense to match exchange differences on foreign equity investments. Any ineffectiveness is taken to the income statement in accordance with IAS 39. Hedge documentation is prepared for all net investment hedges at inception and effectiveness testing is carried out quarterly.

**Transaction exposure hedging** For currencies in which there is an active market, the group seeks to hedge between 80% and 100% of forecast transactional foreign exchange rate risk, for up to a maximum of 21 months forward, using forward foreign currency exchange contracts. The gain or loss on the hedge is recognised in the statement of recognised income and expense to the extent it is effective and recycled into the income statement at the same time as the underlying hedged transaction affects the income statement. Any ineffectiveness is taken to the income statement in accordance with IAS 39.

**Hedge of foreign currency debt** The group uses cross currency interest rate swaps to hedge the forward foreign currency risk associated with certain foreign currency denominated bonds. As a cash flow hedge, the effective portion of the gain or loss on the hedge is recognised in the statement of recognised income and expense to the extent it is highly effective and recycled into the income statement at the same time as the underlying hedged transaction affects the income statement. Any ineffectiveness is taken to the income statement in accordance with IAS 39.

At 30 June 2007, as a result of the net investment, transaction exposure and foreign currency debt cover outlined above, the group had outstanding gross foreign exchange contracts as disclosed in note 22(vi). Further quantitative analysis of the sensitivity to movements in currency rates is reported in the 'Market risk sensitivity analysis' in the Business review.

## Notes to the consolidated financial statements (continued)

### 22 Financial instruments and risk management (continued)

**(ii) Commodity price risk** The group uses commodity futures to hedge against price risk in certain commodities. All commodity futures contracts hedge a projected future purchase of raw material. Commodity futures are then either closed out at the time the raw material is purchased or they are exchanged with the company manufacturing the raw material to determine the contract price. Commodity contracts are held in the balance sheet at fair value. To the extent that they are considered an effective hedge under IAS 39, the fair value movements are recognised in the statement of recognised income and expense and recycled into the income statement at the same time as the underlying hedged transaction affects the income statement.

Realised net gains recognised in the income statement in the year ended 30 June 2007 were £2 million. Unrealised net gains on the balance sheet at 30 June 2007 were £1 million.

**(iii) Interest rate risk management** The group has an exposure to interest rate risk arising principally on changes in US dollar, euro and sterling interest rates. To manage interest rate risk, the group manages its proportion of fixed to floating rate borrowings within limits approved by the board, primarily through issuing fixed and floating term debt, commercial paper, and by utilising interest rate derivatives. These practices serve to reduce the volatility of the groups reported financial performance. During the year ended 30 June 2007 the profile of fixed rate to floating rate net borrowings was maintained according to a duration measure that was approximately equivalent to a 50% fixed and 50% floating amortising profile. The duration measure and the number of years within the amortising profile depend on the template approved by the board, which indicated, as at 30 June 2007 and 30 June 2006, that a higher proportion than 50% of fixed rate net borrowings was appropriate for the group.

**Notes to the consolidated financial statements (continued)****22 Financial instruments and risk management (continued)****Analysis of net borrowings**

|                                                 | US dollar      | Euro           | Sterling     | Other        | Total          | Total      |
|-------------------------------------------------|----------------|----------------|--------------|--------------|----------------|------------|
|                                                 | £ million      | £ million      | £ million    | £ million    | £ million      | %          |
| <b>2007</b>                                     |                |                |              |              |                |            |
| Fixed rate                                      | (2,055)        | (418)          | (632)        |              | (3,105)        | 64         |
| Floating rate                                   | (2,396)        | (303)          | 692          | 227          | (1,780)        | 37         |
| Impact of foreign currency swaps and forwards   | 1,849          | (1,083)        | (190)        | (605)        | (29)           |            |
| Interest free                                   | 65             |                |              |              | 65             | (1)        |
| Fair value adjustment to borrowings             | 24             |                |              |              | 24             |            |
| Fair value of interest rate hedging instruments | (20)           |                |              |              | (20)           |            |
| <b>Net borrowings</b>                           | <b>(2,533)</b> | <b>(1,804)</b> | <b>(130)</b> | <b>(378)</b> | <b>(4,845)</b> | <b>100</b> |
| Percentage of net borrowings                    | 52%            | 37%            | 3%           | 8%           | 100%           |            |
| <b>2006</b>                                     |                |                |              |              |                |            |
| Fixed rate                                      | (2,062)        | (544)          | 12           | (12)         | (2,606)        | 64         |
| Floating rate                                   | (1,922)        | 80             | 102          | 187          | (1,553)        | 38         |
| Impact of foreign currency swaps and forwards   | 1,774          | (878)          | (370)        | (543)        | (17)           |            |
| Interest free                                   | 91             |                |              |              | 91             | (2)        |
| Fair value adjustment to borrowings             | 47             |                |              |              | 47             | (1)        |
| Fair value of interest rate hedging instruments | (44)           |                |              |              | (44)           | 1          |
| <b>Net borrowings</b>                           | <b>(2,116)</b> | <b>(1,342)</b> | <b>(256)</b> | <b>(368)</b> | <b>(4,082)</b> | <b>100</b> |
| Percentage of net borrowings                    | 52%            | 33%            | 6%           | 9%           | 100%           |            |

Other net borrowings of £378 million (2006 £368 million) principally comprise £252 million (2006 £201 million) of Korean won. The split of fixed and floating net borrowings above is after taking into account interest rate protection. The average net borrowings for the year were £4,596 million (2006 £4,017 million) and the effective interest rate was 5.5% (2006 3.8%). At 30 June 2007, after taking account of interest rate derivative instruments, the average fixed rates for US dollar, euro and sterling borrowings were 5.4%, 3.0% and 5.2%, respectively (2006 5.2%, 3.0% and nil, respectively).

At 30 June 2007, the currency split of cash and cash equivalents was: US dollar 23%, sterling 15%, euro 13% and other 49% (2006 21%, 20%, 12% and 47%, respectively).

## Notes to the consolidated financial statements (continued)

## 22 Financial instruments and risk management (continued)

## Portfolio of interest rate derivative instruments

|                                    | Receive fixed<br>notional | Pay fixed<br>notional | Weighted<br>average fixed<br>interest rate | Weighted<br>average time<br>to maturity | Maturity Year |
|------------------------------------|---------------------------|-----------------------|--------------------------------------------|-----------------------------------------|---------------|
|                                    | £ million                 | £ million             | %                                          | Years                                   |               |
| <b>2007</b>                        |                           |                       |                                            |                                         |               |
| <b>Currency instrument</b>         |                           |                       |                                            |                                         |               |
| <b>US dollar:</b>                  |                           |                       |                                            |                                         |               |
| Interest rate swaps                | 1,848                     |                       | 4.8                                        | 4.6                                     | 2007-2022     |
| Interest rate swaps                |                           | 572                   | 5.7                                        | 8.3                                     | 2009-2022     |
| Cross currency interest rate swaps | 598                       |                       | 5.7                                        | 19.3                                    | 2016-2036     |
| <b>Euro:</b>                       |                           |                       |                                            |                                         |               |
| Interest rate swaps                |                           | 81                    | 4.2                                        | 0.0                                     | 2007          |
| <b>Sterling:</b>                   |                           |                       |                                            |                                         |               |
| Cross currency interest rate swaps |                           | 632                   | 5.2                                        | 19.3                                    | 2016-2036     |
| <b>2006</b>                        |                           |                       |                                            |                                         |               |
| <b>Currency instrument</b>         |                           |                       |                                            |                                         |               |
| <b>US dollar:</b>                  |                           |                       |                                            |                                         |               |
| Interest rate swaps                | 2,202                     |                       | 4.6                                        | 4.8                                     | 2006-2022     |
| Interest rate swaps                |                           | 704                   | 5.6                                        | 8.4                                     | 2006-2022     |
| <b>Euro:</b>                       |                           |                       |                                            |                                         |               |
| Interest rate swaps                |                           | 200                   | 4.4                                        | 0.5                                     | 2006-2007     |

## (iv) Maturity of financial liabilities

|                                       | 2007                         |                     |           |           | 2006                         |                     |           |           |
|---------------------------------------|------------------------------|---------------------|-----------|-----------|------------------------------|---------------------|-----------|-----------|
|                                       | Bank loans<br>and overdrafts | Other<br>borrowings | Other     | Total     | Bank loans<br>and overdrafts | Other<br>borrowings | Other     | Total     |
|                                       | £ million                    | £ million           | £ million | £ million | £ million                    | £ million           | £ million | £ million |
| <b>Analysis by year of repayment:</b> |                              |                     |           |           |                              |                     |           |           |
| After five years                      | 15                           | 1,702               | 73        | 1,790     | 12                           | 1,368               | 26        | 1,406     |
| From four to five years               | 4                            | 953                 | 4         | 961       | 6                            | 255                 | 15        | 276       |
| From three to four years              | 10                           | 239                 | 14        | 263       | 9                            | 561                 | 13        | 583       |
| From two to three years               | 5                            | 519                 | 17        | 541       | 11                           | 695                 | 3         | 709       |
| From one to two years                 | 25                           | 660                 | 12        | 697       | 17                           | 1,067               | 35        | 1,119     |
| Due after one year                    | 59                           | 4,073               | 120       | 4,252     | 55                           | 3,946               | 92        | 4,093     |
| Due within one year                   | 238                          | 1,297               | 1,820     | 3,355     | 171                          | 605                 | 1,713     | 2,489     |
|                                       | 297                          | 5,370               | 1,940     | 7,607     | 226                          | 4,551               | 1,805     | 6,582     |

Other financial liabilities primarily consist of trade payables and finance lease obligations.



**Notes to the consolidated financial statements (continued)****22 Financial instruments and risk management (continued)**

The group had available undrawn committed bank facilities as follows:

|                                 | <b>2007</b>      | <b>2006</b>      |
|---------------------------------|------------------|------------------|
|                                 | <b>£ million</b> | <b>£ million</b> |
| Expiring within one year        | <b>498</b>       | 676              |
| Expiring in more than two years | <b>1,109</b>     | 1,070            |
|                                 | <b>1,607</b>     | 1,746            |

Commitment fees are paid on the undrawn portion of these facilities. Borrowings under these facilities will be at prevailing LIBOR rates (dependent on the period of drawdown) plus an agreed margin. These facilities can be used for general corporate purposes and, together with cash and cash equivalents, support the group's commercial paper programmes.

There are no financial covenants on the above short and long term borrowings. Certain of these borrowings contain cross default provisions and negative pledges (and related sale and lease back provisions).

The committed bank facilities are subject to a single financial covenant, being minimum interest cover ratio of two times (defined as the ratio of operating profit before exceptional items, aggregated with share of associates' profits, to net interest). They are also subject to pari passu ranking and negative pledge covenants.

Any non-compliance with covenants underlying Diageo's financing arrangements could, if not waived, constitute an event of default with respect to any such arrangements, and any non-compliance with covenants may, in particular circumstances, lead to an acceleration of maturity on certain notes and the inability to access committed facilities. Diageo was in full compliance with its financial covenants throughout each of the periods presented.

**Notes to the consolidated financial statements (continued)****22 Financial instruments and risk management (continued)**

(v) **Total financial assets and liabilities** The table below sets out the group's accounting classification of each class of financial assets and liabilities, and their fair values at 30 June 2007 and 30 June 2006.

|                                | Designated at<br>fair value(a) | Other<br>derivatives at<br>fair value(b) | Available for<br>sale | Loans and<br>receivables | Amortised cost | Total<br>carrying<br>value | Fair value |
|--------------------------------|--------------------------------|------------------------------------------|-----------------------|--------------------------|----------------|----------------------------|------------|
|                                | £ million                      | £ million                                | £ million             | £ million                | £ million      | £ million                  | £ million  |
| <b>2007</b>                    |                                |                                          |                       |                          |                |                            |            |
| Cash and cash equivalents      |                                |                                          | 885                   |                          |                | 885                        | 885        |
| Bank overdrafts                |                                |                                          |                       |                          | (46)           | (46)                       | (46)       |
| Borrowings due within one year | (419)                          |                                          |                       |                          | (1,070)        | (1,489)                    | (1,489)    |
| Borrowings due after one year  | (1,219)                        |                                          |                       |                          | (2,913)        | (4,132)                    | (4,212)    |
| Derivative assets              | 123                            | 7                                        |                       |                          |                | 130                        | 130        |
| Derivative liabilities         | (103)                          | (13)                                     |                       |                          |                | (116)                      | (116)      |
| Other assets                   |                                |                                          | 50                    | 61                       | 1,635          | 1,746                      | 1,746      |
| Other liabilities              |                                | (17)                                     |                       |                          | (1,807)        | (1,824)                    | (1,824)    |
|                                | (1,618)                        | (23)                                     | 935                   | 61                       | (4,201)        | (4,846)                    | (4,926)    |
| <b>2006</b>                    |                                |                                          |                       |                          |                |                            |            |
| Cash and cash equivalents      |                                |                                          | 699                   |                          |                | 699                        | 699        |
| Other liquid resources         |                                |                                          | 49                    |                          |                | 49                         | 49         |
| Bank overdrafts                |                                |                                          |                       |                          | (48)           | (48)                       | (48)       |
| Borrowings due within one year | (242)                          |                                          |                       |                          | (469)          | (711)                      | (711)      |
| Borrowings due after one year  | (2,345)                        |                                          |                       |                          | (1,656)        | (4,001)                    | (4,058)    |
| Derivative assets              | 55                             | 9                                        |                       |                          |                | 64                         | 64         |
| Derivative liabilities         | (88)                           | (17)                                     |                       |                          |                | (105)                      | (105)      |
| Other assets                   |                                |                                          |                       | 51                       | 1,534          | 1,585                      | 1,585      |
| Other liabilities              |                                |                                          |                       |                          | (1,717)        | (1,717)                    | (1,717)    |
|                                | (2,620)                        | (8)                                      | 748                   | 51                       | (2,356)        | (4,185)                    | (4,242)    |

(a) Includes borrowings designated as hedged items in fair value hedging relationships with respect to foreign currency or interest rate risks.

(b) Derivative financial instruments not designated in hedging relationships.

Under IAS 39, all derivative financial instruments not in a hedge relationship are classified as derivatives at fair value through the income statement. The group does not use derivatives for speculative purposes. All transactions in derivative financial instruments are undertaken to manage the risks arising from underlying business activities.

The fair values of quoted borrowings are based on the asking price. The fair values of other borrowings, derivatives, financial instruments and other financial assets and liabilities are estimated using appropriate yield curves at 30 June each year by discounting the future contractual cash flows to the net present values.

## Notes to the consolidated financial statements (continued)

### 22 Financial instruments and risk management (continued)

**Fair value hedging relationships** Certain borrowings due within and after one year are part of qualifying fair value interest rate hedging relationships. Accordingly there is a fair value adjustment for these liabilities with respect to the hedged interest rate risk, with changes being recognised in the income statement, as disclosed in note 22(vi). Diageo has not designated any non-derivative financial assets or liabilities at fair value through the income statement upon initial recognition.

**(vi) Hedging instruments** Diageo designates derivatives which qualify as hedges for accounting purposes as either: (a) a hedge of the fair value of a recognised asset or liability (fair value hedge); (b) a hedge of a forecast transaction or the cash flow risk from a change in interest rates or foreign exchange rates (cash flow hedge); or (c) a hedge of a net investment in foreign operations. The accounting treatment for hedges is disclosed in 'Accounting policies of the group'.

Diageo tests effectiveness on a prospective and retrospective basis to ensure compliance with IAS 39. Methods for testing effectiveness include dollar offset, critical terms, regression analysis, hypothetical derivative method and volatility reduction.

All fair value hedges were effective during the year. The gain on hedging instruments for the year was £20 million (2006 £117 million loss) and the loss on the hedged items attributable to the hedged risks was £17 million (2006 £114 million gain), resulting in a net loss of £25 million (2006 £4 million net loss) recognised in interest expense and finance charges and a net gain of £28 million (2006 £1 million) in interest income and finance income for the year.

For the year ended 30 June 2007, all cash flow hedges were effective and gains of £28 million (2006 £39 million gains) have been recognised in equity as the changes in fair value. A loss of £43 million and a gain of £8 million have been transferred out of equity to other operating expenses and to other finance income, respectively, in the year (2006 £11 million loss and £7 million gain, respectively).

With respect to hedges of forecast transactions and the cash flow risk from a change in interest rates, balances related to cash flow hedged items at 30 June 2007 will affect the income statement in 2008 and 2009 by £59 million and £10 million, respectively. With respect to hedges of the cash flow risk from a change in forward foreign exchange rates using cross currency interest rate swaps, the retranslation of the related bond principal to closing foreign exchange rates and recognition of interest on the related bonds will affect the income statement at each period end date until the related bonds mature in 2016 and 2036. Foreign exchange retranslation and the interest on the hedged bonds taken to the income statement is expected to offset against the foreign exchange retranslation and the interest on the cross currency swaps in each of the years.

## Notes to the consolidated financial statements (continued)

### 22 Financial instruments and risk management (continued)

**Cash flow and net investment hedges** The following table shows the contractual maturities of designated transaction, cross currency interest rate swaps and derivative net investment hedging instruments at 30 June 2007 and 30 June 2006:

|                                          | Foreign currency amount |           |           | Percentage of total |      | Financial year ending 30 June |
|------------------------------------------|-------------------------|-----------|-----------|---------------------|------|-------------------------------|
|                                          | Purchase                | Sell      | Total     | US dollar           | Euro |                               |
|                                          | £ million               | £ million | £ million | %                   | %    |                               |
| <b>2007</b>                              |                         |           |           |                     |      |                               |
| Transaction                              | 671                     | 1,565     | 2,236     | 39                  | 39   | 2008                          |
| Transaction                              | 324                     | 828       | 1,152     | 44                  | 40   | 2009                          |
| Total transaction hedges                 | 995                     | 2,393     | 3,388     | 41                  | 39   | 2008-2009                     |
| Cross currency interest rate swaps       | 299                     |           | 299       | 100                 |      | 2017                          |
| Cross currency interest rate swaps       | 299                     |           | 299       | 100                 |      | 2037                          |
| Total cross currency interest rate swaps | 598                     |           | 598       | 100                 |      | 2017-2037                     |
| Net investment hedging instruments       | 1,914                   | 2,352     | 4,266     | 54                  | 29   | 2008                          |
| <b>2006</b>                              |                         |           |           |                     |      |                               |
| Transaction                              | 798                     | 1,586     | 2,384     | 40                  | 45   | 2007                          |
| Transaction                              | 323                     | 813       | 1,136     | 38                  | 39   | 2008                          |
| Total transaction hedges                 | 1,121                   | 2,399     | 3,520     | 42                  | 38   | 2007-2008                     |
| Net investment hedging instruments       | 2,441                   | 2,087     | 4,528     | 64                  | 22   | 2007                          |

**(vii) Credit risk** Details of Diageo's credit risk policies and exposures are presented under 'Risk management' in the Business review.

Cash and cash equivalents comprise cash in hand and deposits which are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value and have an original maturity of three months or less at acquisition including money market deposits, commercial paper and investments. At 30 June 2007, approximately 37% and 28% of the group's cash and cash equivalents of £885 million were invested with counterparties based in the United Kingdom and United States, respectively.

At 30 June 2007, approximately 19% of the group's trade receivables of £1,380 million were due from counterparties based in the United Kingdom and approximately 19% were due from counterparties based in the United States.

### 23 Trade and other payables

|                | 2007                |                         | 2006                |                         |
|----------------|---------------------|-------------------------|---------------------|-------------------------|
|                | Current liabilities | Non-current liabilities | Current liabilities | Non-current liabilities |
|                | £ million           | £ million               | £ million           | £ million               |
| Trade payables | 558                 |                         | 494                 |                         |

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|                                              | 2007         |           | 2006         |           |
|----------------------------------------------|--------------|-----------|--------------|-----------|
|                                              |              |           |              |           |
| Tax and social security excluding income tax | 293          | 1         | 255          | 2         |
| Other payables                               | 464          | 37        | 407          | 35        |
| Accruals and deferred income                 | 573          |           | 647          |           |
|                                              | <b>1,888</b> | <b>38</b> | <b>1,803</b> | <b>37</b> |

**Notes to the consolidated financial statements (continued)****24 Provisions**

|                                     | <b>Thalidomide<br/>Trust</b> | <b>Onerous<br/>contracts</b> | <b>Disposal</b>  | <b>Vacant<br/>properties</b> | <b>Other</b>     | <b>Total</b>     |
|-------------------------------------|------------------------------|------------------------------|------------------|------------------------------|------------------|------------------|
|                                     | <b>£ million</b>             | <b>£ million</b>             | <b>£ million</b> | <b>£ million</b>             | <b>£ million</b> | <b>£ million</b> |
| At 30 June 2006                     | 145                          | 102                          | 13               | 29                           | 73               | 362              |
| Exchange differences                |                              | (8)                          |                  |                              | (4)              | (12)             |
| Provisions charged during the year  |                              |                              |                  |                              | 18               | 18               |
| Provisions used during the year     | (9)                          | (13)                         | (1)              | (6)                          | (13)             | (42)             |
| Provisions reversed during the year |                              |                              | (3)              |                              | (3)              | (6)              |
| Unwinding of discounts              | 7                            | 6                            |                  | 1                            |                  | 14               |
| <b>At 30 June 2007</b>              | <b>143</b>                   | <b>87</b>                    | <b>9</b>         | <b>24</b>                    | <b>71</b>        | <b>334</b>       |
| Included in current liabilities     | 9                            | 9                            | 5                | 7                            | 30               | 60               |
| Included in non-current liabilities | 134                          | 78                           | 4                | 17                           | 41               | 274              |
|                                     | <b>143</b>                   | <b>87</b>                    | <b>9</b>         | <b>24</b>                    | <b>71</b>        | <b>334</b>       |

Provisions by their nature are subject to uncertainties with respect to the timing and outcomes of future events.

- (a) The Thalidomide Trust provision was established in the year ended 30 June 2005 in respect of the discounted value of the group's commitment to the Thalidomide Trust, and will be utilised over the period of the commitment, up to 2037.
- (b) Included in onerous contracts provisions is £80 million (2006 £94 million) in respect of the discounted value of an onerous supply contract arising on the acquisition of the Seagram spirits and wine business on 21 December 2001. This provision will be utilised over the 10 year duration of the contract.
- (c) The disposal provisions arose from commitments in respect of businesses sold and will predominantly be utilised within the next few years.
- (d) The vacant property provision is based on the estimated discounted rental shortfall over the terms of the leases up to 2031.
- (e) Other provisions include £31 million (2006 £28 million) in respect of employee deferred compensation plans and £9 million (2006 £8 million) in respect of restructuring and integration costs.

**Notes to the consolidated financial statements (continued)****25 Deferred tax assets and liabilities**

The amounts of deferred tax accounted for in the consolidated balance sheet comprise the following net deferred tax assets/(liabilities):

|                            | Property,<br>plant and<br>equipment | Intangible<br>assets | Post employment<br>plans | Tax losses | Other<br>temporary<br>differences | Total      |
|----------------------------|-------------------------------------|----------------------|--------------------------|------------|-----------------------------------|------------|
|                            | £ million                           | £ million            | £ million                | £ million  | £ million                         | £ million  |
| At 30 June 2005            | (175)                               | 123                  | 340                      | 25         | 167                               | 480        |
| Adoption of IAS 39         |                                     |                      |                          |            | 10                                | 10         |
| At 1 July 2005 as adjusted | (175)                               | 123                  | 340                      | 25         | 177                               | 490        |
| Exchange differences       | 2                                   | 11                   | 2                        |            | (7)                               | 8          |
| Recognised in income       | (39)                                | 81                   | (16)                     | (10)       | 66                                | 82         |
| Recognised in equity       |                                     |                      | (85)                     |            | (6)                               | (91)       |
| Acquisition of businesses  | (5)                                 | (46)                 |                          | 4          | (3)                               | (50)       |
| At 30 June 2006            | (217)                               | 169                  | 241                      | 19         | 227                               | 439        |
| Exchange differences       | 7                                   | 46                   | (5)                      |            | (9)                               | 39         |
| Recognised in income       | (6)                                 | (158)                | (19)                     | 2          | (18)                              | (199)      |
| Recognised in equity       |                                     |                      | (81)                     |            | (6)                               | (87)       |
| Acquisition of businesses  |                                     | (3)                  |                          |            |                                   | (3)        |
| <b>At 30 June 2007</b>     | <b>(216)</b>                        | <b>54</b>            | <b>136</b>               | <b>21</b>  | <b>194</b>                        | <b>189</b> |

In the year ended 30 June 2007, the net amount of £199 million recognised in income comprises £285 million charged in respect of continuing operations less £86 million credited in respect of discontinued operations.

After offsetting deferred tax assets and liabilities where appropriate within territories, the net deferred tax asset comprises:

|                          | 2007       | 2006       |
|--------------------------|------------|------------|
|                          | £ million  | £ million  |
| Deferred tax assets      | 771        | 1,113      |
| Deferred tax liabilities | (582)      | (674)      |
|                          | <b>189</b> | <b>439</b> |

Included within deferred tax liabilities are liabilities of £21 million (2006 £93 million asset) in respect of the United Kingdom.

The net deferred tax asset of £54 million (2006 £169 million) in respect of intangible assets comprises deferred tax assets of £835 million (2006 £919 million) less deferred tax liabilities of £781 million (2006 £750 million).

**Notes to the consolidated financial statements (continued)****25 Deferred tax assets and liabilities (continued)**

**Unrecognised deferred tax assets** Deferred tax assets have been recognised to the extent that it is considered more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted. Where this is not the case, deferred tax assets have not been recognised, as set out below:

|                           | 2007       |           | 2006       |           |
|---------------------------|------------|-----------|------------|-----------|
|                           | Tax losses | Other     | Tax losses | Other     |
|                           | £ million  | £ million | £ million  | £ million |
| Gross deferred tax assets | 287        | 1,010     | 349        | 1,139     |
| Amounts not recognised    | (266)      | (175)     | (330)      | (220)     |
|                           | 21         | 835       | 19         | 919       |

Of the amount recognised in respect of tax losses, £14 million has expiration dates through to 2017 (2006 £8 million; through to 2026) and £7 million (2006 £11 million) can be carried forward indefinitely. Of the amounts unrecognised in respect of tax losses, £23 million has expiration dates through to 2017 (2006 £118 million; through to 2026) and £243 million (2006 £212 million) can be carried forward indefinitely.

**Unrecognised deferred tax liabilities** No deferred tax liability is provided in respect of any future remittance of earnings of foreign subsidiaries where the group is able to control the remittance of earnings and it is probable that such earnings will not be remitted in the foreseeable future, or where no liability would arise on the remittance.



## Notes to the consolidated financial statements (continued)

## 26 Total equity movements in capital and reserves

|                                     | Retained earnings/(deficit) |               |                            |                                          |                             |                         |           |                                                    |                    |              |
|-------------------------------------|-----------------------------|---------------|----------------------------|------------------------------------------|-----------------------------|-------------------------|-----------|----------------------------------------------------|--------------------|--------------|
|                                     | Share capital               | Share premium | Capital redemption reserve | Fair value, hedging and exchange reserve | Retained earnings/(deficit) |                         |           | Equity attributable to parent company shareholders | Minority interests | Total equity |
|                                     |                             |               |                            |                                          | Own shares                  | Other retained earnings | Total     |                                                    |                    |              |
| £ million                           | £ million                   | £ million     | £ million                  | £ million                                | £ million                   | £ million               | £ million | £ million                                          | £ million          |              |
| At 1 July 2004                      | 885                         | 1,331         | 3,058                      |                                          | (331)                       | (181)                   | (512)     | 4,762                                              | 467                | 5,229        |
| Total recognised income and expense |                             |               |                            | 121                                      |                             | 1,129                   | 1,129     | 1,250                                              | 60                 | 1,310        |
| Share trust arrangements            |                             |               |                            |                                          | (7)                         | (21)                    | (28)      | (28)                                               |                    | (28)         |
| Share-based incentive plans         |                             |               |                            |                                          |                             | 28                      | 28        | 28                                                 |                    | 28           |
| Shares issued                       |                             | 6             |                            |                                          |                             |                         |           | 6                                                  |                    | 6            |
| Own shares repurchased              | (2)                         |               | 2                          |                                          | (649)                       | (61)                    | (710)     | (710)                                              |                    | (710)        |
| Dividends paid                      |                             |               |                            |                                          |                             | (849)                   | (849)     | (849)                                              | (60)               | (909)        |
| Acquisitions and disposals          |                             |               |                            |                                          |                             |                         |           |                                                    | (300)              | (300)        |
| At 30 June 2005                     | 883                         | 1,337         | 3,060                      | 121                                      | (987)                       | 45                      | (942)     | 4,459                                              | 167                | 4,626        |
| Adoption of IAS 39                  |                             |               |                            | 123                                      |                             | 41                      | 41        | 164                                                |                    | 164          |
| At 1 July 2005 as adjusted          | 883                         | 1,337         | 3,060                      | 244                                      | (987)                       | 86                      | (901)     | 4,623                                              | 167                | 4,790        |
| Total recognised income and expense |                             |               |                            | (136)                                    |                             | 2,282                   | 2,282     | 2,146                                              | 52                 | 2,198        |
| Share trust arrangements            |                             |               |                            |                                          | 4                           | (14)                    | (10)      | (10)                                               |                    | (10)         |
| Share-based incentive plans         |                             |               |                            |                                          |                             | 26                      | 26        | 26                                                 |                    | 26           |
| Tax on share-based incentive plans  |                             |               |                            |                                          |                             | 6                       | 6         | 6                                                  |                    | 6            |
| Shares issued                       |                             | 3             |                            |                                          |                             |                         |           | 3                                                  |                    | 3            |
| Own shares repurchased              |                             |               |                            |                                          | (1,421)                     | (7)                     | (1,428)   | (1,428)                                            |                    | (1,428)      |
| Dividends paid                      |                             |               |                            |                                          |                             | (864)                   | (864)     | (864)                                              | (40)               | (904)        |
| At 30 June 2006                     | 883                         | 1,340         | 3,060                      | 108                                      | (2,404)                     | 1,515                   | (889)     | 4,502                                              | 179                | 4,681        |
| Total recognised income and expense |                             |               |                            | (17)                                     |                             | 1,736                   | 1,736     | 1,719                                              | 59                 | 1,778        |
| Share trust arrangements            |                             |               |                            |                                          | 67                          | (15)                    | 52        | 52                                                 |                    | 52           |
| Share-based incentive plans         |                             |               |                            |                                          |                             | 25                      | 25        | 25                                                 |                    | 25           |
| Tax on share-based incentive plans  |                             |               |                            |                                          |                             | 12                      | 12        | 12                                                 |                    | 12           |
| Shares issued                       |                             | 1             |                            |                                          |                             |                         |           | 1                                                  |                    | 1            |
| Own shares repurchased              | (35)                        |               | 35                         |                                          | (263)                       | (1,218)                 | (1,481)   | (1,481)                                            |                    | (1,481)      |
| Dividends paid                      |                             |               |                            |                                          |                             | (858)                   | (858)     | (858)                                              | (41)               | (899)        |
| Acquisitions                        |                             |               |                            |                                          |                             |                         |           |                                                    | 1                  | 1            |
| At 30 June 2007                     | 848                         | 1,341         | 3,095                      | 91                                       | (2,600)                     | 1,197                   | (1,403)   | 3,972                                              | 198                | 4,170        |



## Notes to the consolidated financial statements (continued)

### 26 Total equity movements in capital and reserves (continued)

**(a) Share capital and share premium** The authorised share capital of the company at 30 June 2007 was 5,329 million ordinary shares of 28<sup>101/108</sup> pence each (2006 and 2005 5,329 million) with an aggregate nominal value of £1,542 million (2006 and 2005 £1,542 million). The allotted and fully paid share capital was 2,931 million ordinary shares of 28<sup>101/108</sup> pence each with an aggregate nominal value of £848 million (2006 3,051 million shares, aggregate nominal value £883 million; 2005 3,050 million shares, aggregate nominal value £883 million).

During the year, the company purchased, and subsequently cancelled, 120 million ordinary shares with an aggregate nominal value of £35 million for a consideration including expenses of £1,213 million (2006 nil; 2005 8.4 million ordinary shares, nominal value £2.4 million, consideration £61 million).

During the year, 0.1 million ordinary shares with an aggregate nominal value of less than £0.1 million were allotted under employee share option schemes for a total consideration of £1 million (2006 0.6 million ordinary shares, nominal value £0.2 million, consideration £3 million; 2005 1.3 million ordinary shares, nominal value £0.4 million, consideration £6 million).

**(b) Capital redemption reserve** During the year, the company purchased, and subsequently cancelled, 120 million ordinary shares with nominal value £35 million (2006 nil; 2005 8.4 million ordinary shares, nominal value £2.4 million).

**(c) Fair value, hedging and exchange reserve** Movements in the fair value, hedging and exchange reserve represent changes in the fair value of cash flow hedges and the recycling of those changes through the income statement, primarily in respect of cash flow hedging instruments offsetting the impact of changes in value of the underlying hedged items, and changes in the impacts of foreign currency on the translation of foreign operations. The impact of the adoption of IAS 39 on the fair value, hedging and exchange reserve at 1 July 2005 is explained in note 34.

During the year ended 30 June 2006, the group revalued its available for sale investment in General Mills by £33 million through the fair value reserve, and this amount, in addition to the fair value adjustment of £148 million recognised on adoption of IAS 39 on 1 July 2005, was recycled to the income statement on the disposal of this investment.

The cumulative translation reserve decreased to £42 million at 30 June 2007 from £107 million at 30 June 2006 due to exchange differences that have arisen during the year. The exchange differences in the year on translation of foreign operations were offset by gains in respect of foreign currency borrowings and derivative financial instruments which form part of the group's net investment in foreign operations of £199 million (2006 gains of £52 million; 2005 losses of £136 million in respect of foreign currency borrowings only).

**(d) Own shares** At 30 June 2007, own shares comprised: 33 million ordinary shares in the company, purchased for a consideration of £267 million, in respect of shares held by employee share trusts (2006 42 million ordinary shares, consideration £334 million; 2005 43 million ordinary shares, consideration £338 million); 271 million ordinary shares, purchased for a consideration of £2,240 million, in respect of shares repurchased as part of the company's share buyback programmes and held as treasury shares (2006 250 million ordinary shares, consideration £2,049 million; 2005 86 million ordinary shares, consideration £649 million); and 10 million ordinary shares, purchased for a consideration of £93 million, held as treasury shares for hedging share scheme grants provided to employees during the year (2006 2 million ordinary shares, consideration £21 million; 2005 nil, £nil).

**Notes to the consolidated financial statements (continued)****26 Total equity movements in capital and reserves (continued)**

At 30 June 2007, employee share trusts funded by the group held shares in the company as follows: 30.2 million ordinary shares held in respect of long term incentive plans for executive directors and senior executives; and 2.5 million ordinary shares held in respect of grants under UK, Irish and US savings-related share option schemes. The market value of these shares at 30 June 2007 was £339 million (2006 41.5 million ordinary shares, market value £377 million; 2005 42.7 million ordinary shares, market value £351 million). Dividends are waived on all shares in the company owned by the employee share trusts.

During the year ended 30 June 2007, the company purchased 30 million ordinary shares, with an aggregate nominal value of £9 million, representing approximately 1% of the issued ordinary share capital (excluding treasury shares), to be held as treasury shares, for a consideration of £273 million (2006 166 million ordinary shares, nominal value £48 million, 6% of issued share capital, consideration £1,421 million; 2005 86 million ordinary shares, nominal value £25 million, 2.8% of issued share capital, consideration £649 million). These shares have not been cancelled, but are deducted from shareholders' equity. Dividends are waived on these shares. In addition, the company utilised 1 million ordinary shares held as treasury shares, with an aggregate nominal value of £0.3 million and an historic purchase cost of £10 million, to satisfy options exercised by employees during the year (2006 and 2005 nil, £nil, £nil).

**(e) Other retained earnings** Included in other retained earnings is a credit of £25 million (2006 £26 million; 2005 £28 million) in respect of the charge for the year to the income statement for share-based incentive plans.

**(f) Dividends**

|                                                                               | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|-------------------------------------------------------------------------------|-------------|-------------|-------------|
|                                                                               | £ million   | £ million   | £ million   |
| <b>Amounts recognised as distributions to equity shareholders in the year</b> |             |             |             |
| Final dividend for the year ended 30 June 2006                                |             |             |             |
| 19.15 pence per share (2005 18.2 pence; 2004 17.0 pence)                      | 524         | 529         | 512         |
| Interim dividend for the year ended 30 June 2007                              |             |             |             |
| 12.55 pence per share (2006 11.95 pence; 2005 11.35 pence)                    | 334         | 335         | 337         |
|                                                                               | <u>858</u>  | <u>864</u>  | <u>849</u>  |
| <b>Proposed final dividend for the year ended 30 June 2007</b>                |             |             |             |
| 20.15 pence per share (2006 19.15 pence; 2005 18.2 pence)                     | 523         | 524         | 529         |

The proposed final dividend was approved by the board of directors on 29 August 2007. As this was after the balance sheet date and is also subject to approval by shareholders at the Annual General Meeting, this dividend has not been included as a liability in these consolidated financial statements. There are no corporate tax consequences.

**(g) Minority interests** Included in minority interests at 1 July 2004 were non-equity interests comprising £312 million (\$568 million) 9.42% cumulative guaranteed preferred securities issued by subsidiaries. These securities were classified as non-equity minority interests under UK GAAP and were redeemed during the year ended 30 June 2005 at a cost of £302 million.

## Notes to the consolidated financial statements (continued)

### 27 Dividend income and other items

Dividend income and other items in the year ended 30 June 2007 included dividends received of £119 million (2006 £115 million; 2005 £115 million), the exceptional gain on the sale of the site of the former brewery at Park Royal of £40 million (2006 and 2005 £nil) and the fair value charge in respect of share-based incentive plans of £25 million (2006 £26 million; 2005 £28 million).

### 28 Disposal of businesses

There were no significant business disposals in the year ended 30 June 2007.

**Disposal of shares in General Mills** In November 2005, Diageo sold 25 million shares in General Mills resulting in a net cash inflow of £651 million. On 4 October 2004, Diageo sold 50 million shares in General Mills and transferred a further 4 million General Mills shares to the Diageo UK pension fund, resulting in a net cash inflow of £1,210 million.

**Burger King** On 13 July 2005, Diageo received \$212.5 million (£121 million) from Burger King in full repayment of the principal of the subordinated debt, together with cumulative interest of \$54 million (£30 million) which is classified with other interest received in net cash from operating activities.

In the year ended 30 June 2005, net cash payments of £16 million were in respect of business disposals in prior years.

## Notes to the consolidated financial statements (continued)

## 29 Purchase of businesses

|                                                         | Net assets acquired and consideration |                        |                    |                    |                    |
|---------------------------------------------------------|---------------------------------------|------------------------|--------------------|--------------------|--------------------|
|                                                         | Book value                            | Fair value adjustments | 2007<br>Fair value | 2006<br>Fair value | 2005<br>Fair value |
|                                                         | £ million                             | £ million              | £ million          | £ million          | £ million          |
| Brands                                                  |                                       | 20                     | 20                 | 144                | 97                 |
| Property, plant and equipment                           |                                       |                        |                    | 25                 | 66                 |
| Other investments                                       |                                       |                        |                    |                    | 7                  |
| Working capital                                         | 4                                     |                        | 4                  | 37                 | 35                 |
| Deferred taxation                                       |                                       | (3)                    | (3)                | (50)               | (25)               |
| Bank overdrafts                                         | (3)                                   |                        | (3)                |                    | (41)               |
| <b>Net identifiable assets and liabilities</b>          | <b>1</b>                              | <b>17</b>              | <b>18</b>          | <b>156</b>         | <b>139</b>         |
| Goodwill arising on acquisition                         |                                       |                        | 28                 | 43                 | 98                 |
| Minority interests                                      |                                       |                        | (1)                |                    | (11)               |
| <b>Consideration payable</b>                            |                                       |                        | <b>45</b>          | <b>199</b>         | <b>226</b>         |
| Satisfied by:                                           |                                       |                        |                    |                    |                    |
| Cash consideration paid                                 |                                       |                        | 30                 | 209                | 217                |
| Contingent/deferred consideration payable/(receivable)  |                                       |                        | 15                 | (10)               | 9                  |
|                                                         |                                       |                        | <b>45</b>          | <b>199</b>         | <b>226</b>         |
| Cash consideration paid for investments in subsidiaries |                                       |                        | 30                 | 209                | 217                |
| Cash consideration paid for investments in associates   |                                       |                        | 48                 |                    |                    |
| Bank overdrafts acquired                                |                                       |                        | 3                  |                    | 41                 |
| Prior year purchase consideration adjustment            |                                       |                        | (11)               |                    |                    |
| <b>Net cash outflow</b>                                 |                                       |                        | <b>70</b>          | <b>209</b>         | <b>258</b>         |

The principal acquisition in the year ended 30 June 2007 was the Smirnov brand in Russia through a company in which Diageo holds a 75% stake, acquired on 3 July 2006 for approximately £28 million, with an agreement to acquire the remaining 25% at fair value from 2016, for which Diageo has provided £15 million as contingent consideration payable. Net assets acquired at fair value were £17 million with goodwill of £26 million arising on the acquisition. For the period since acquisition, sales of £8 million and an operating loss of £2 million are included within the income statement in respect of the Russian business.

Acquisitions of investments in associates in the year ended 30 June 2007 comprised:

The acquisition of a 43% equity stake in Sichuan Chengdu Quanxing Group Co Ltd, a company holding 39.48% of the equity in Sichuan ShuiJingFang Joint Stock Co Ltd, acquired on 27 January 2007 for £37 million.

Other acquisitions (aggregate consideration of £11 million) included minority interests in Stirrings LLC and London Group LLC.

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In the year ended 30 June 2006, The "Old Bushmills" Distillery Company Limited was acquired on 25 August 2005 and the consideration paid was £209 million. In the year ended 30 June 2007, Diageo received £11 million following the settlement of working capital balances acquired.

## Notes to the consolidated financial statements (continued)

### 29 Purchase of businesses (continued)

The acquisitions in the year ended 30 June 2005 comprised:

The Chalone Wine Group acquired on 8 February 2005 for approximately £153 million (\$285 million) including net debt acquired of £41 million. Net assets acquired at fair value were £126 million with goodwill of £27 million arising on the acquisition.

Ursus Vodka Holding BV acquired on 25 February 2005 for approximately £99 million (€146 million). Net assets acquired at fair value were £34 million with goodwill of £65 million arising on acquisition.

Other acquisitions, which included the acquisition of a controlling interest in Ghana Breweries Limited, gave rise to goodwill of £6 million.

### 30 Contingent liabilities and legal proceedings

**(i) Guarantees** In connection with the disposal of Pillsbury, Diageo has guaranteed the debt of a third party to the amount of \$200 million (£100 million) until November 2009. Including this guarantee, but net of the amount provided in the consolidated financial statements, at 30 June 2007 the group has given performance guarantees and indemnities to third parties of £106 million.

There has been no material change since 30 June 2007 in the group's performance guarantees and indemnities.

**(ii) Colombian litigation** An action was filed on 8 October 2004 in the United States District Court for the Eastern District of New York by the Republic of Colombia and a number of its local government entities against Diageo and other spirits companies. The complaint alleges several causes of action. Included among the causes of action is a claim that the defendants allegedly violated the Federal RICO Act by facilitating money laundering in Colombia through their supposed involvement in the contraband trade to the detriment of government owned spirits production and distribution businesses. Diageo is unable to quantify meaningfully the possible loss or range of loss to which the lawsuit may give rise. Diageo intends to defend itself vigorously against this lawsuit.

**(iii) Alcohol advertising litigation** A number of similar putative class actions are pending in state and federal courts in the United States against Diageo plc, Diageo North America Inc and other Diageo entities, along with a large group of other beverage alcohol manufacturers, brewers and importers. All have been brought by the same national counsel. In each action, the plaintiffs seek to pursue their claims on behalf of parents and guardians of people under the legal drinking age who illegally bought alcohol beverages during the period from 1982 to the present. Plaintiffs allege several causes of action, principally for negligence, unjust enrichment and violation of state consumer fraud statutes. Some complaints include additional claims based on conspiracy, nuisance and other legal theories. Diageo is unable to quantify meaningfully the possible loss or range of loss of which these actions may give rise. Diageo intends to defend itself vigorously against these claims.



## Notes to the consolidated financial statements (continued)

### 30 Contingent liabilities and legal proceedings (continued)

(iv) **Turkish customs litigation** In common with other beverage alcohol importers, litigation is ongoing against Diageo's Turkish subsidiary in the Turkish Civil Courts in connection with the methodology used by the Turkish customs authorities in assessing the importation value of and duty payable on the beverage alcohol products sold in the domestic channel in Turkey. The matter involves multiple cases against Diageo's Turkish subsidiary at various stages of litigation, including a group of cases under correction appeal following an adverse finding at the Turkish Supreme Court. Diageo's Turkish subsidiary is unable to quantify meaningfully the possible loss or range of loss to which these cases may give rise. Diageo's Turkish subsidiary intends to defend its position vigorously.

(v) **Other** The group has extensive international operations and is defendant in a number of legal proceedings incidental to these operations. There are a number of legal claims against the group, the outcome of which cannot at present be foreseen.

Save as disclosed above, neither Diageo, nor any member of the Diageo group, is or has been engaged in, nor (so far as Diageo is aware) is there pending or threatened by or against it, any legal or arbitration proceedings which may have a significant effect on the financial position of the Diageo group.

### 31 Related party transactions

**Subsidiaries** Transactions between the company and its subsidiaries are eliminated on consolidation and therefore are not disclosed.

**Associates** Transactions between the group and its associates were as follows:

Group sales include sales to associates of £6 million (2006 £9 million; 2005 £7 million) and operating costs include purchases from associates of £3 million (2006 £nil; 2005 £4 million).

There were no amounts receivable from or payable to associates at 30 June 2007 and 30 June 2006.

**Joint ventures** Due to the nature of the proportional basis of consolidation applied according to the relevant contractual arrangements, transactions between the group and its joint ventures are eliminated on consolidation and therefore are not disclosed.

**Key management personnel** The key management of the group comprises the executive and non-executive directors, the members of the executive committee and the company secretary. They are listed under 'Directors and senior management'.

|                                           | 2007      | 2006      | 2005      |
|-------------------------------------------|-----------|-----------|-----------|
|                                           | £ million | £ million | £ million |
| Salaries and short term employee benefits | 12        | 10        | 10        |
| Non-executive directors' fees             | 1         | 1         | 1         |
| Share-based payments(a)                   | 6         | 6         | 5         |
| Other long term benefits                  | 2         | 3         | 3         |
| Post employment benefits(a)               | 3         | 3         | 2         |
|                                           | <b>24</b> | <b>23</b> | <b>21</b> |

(a)

Non-executive directors do not receive share-based payments or post employment benefits.

## Notes to the consolidated financial statements (continued)

### 31 Related party transactions (continued)

Details are given in the directors' remuneration report of the individual director's remuneration and transactions between the group and key management personnel.

**Pension plans** The Diageo pension plans are recharged with the cost of administration and professional fees paid for by the company in respect of the pension plans. The total amount recharged for the year was £17 million (2006 £10 million; 2005 £9 million).

### 32 Commitments

**Capital expenditure** Commitments not provided for in these consolidated financial statements are estimated at £86 million (2006 £56 million).

#### Operating lease commitments

|                              | 2007       | 2006       |
|------------------------------|------------|------------|
|                              | £ million  | £ million  |
| Payments falling due:        |            |            |
| Within one year              | 72         | 78         |
| Between one and two years    | 64         | 68         |
| Between two and three years  | 60         | 61         |
| Between three and four years | 50         | 57         |
| Between four and five years  | 41         | 45         |
| After five years             | 280        | 258        |
|                              | <b>567</b> | <b>567</b> |

### 33 Employee share compensation

The group uses a number of equity settled share plans to grant options and shares to its directors and employees. For the year ended 30 June 2007, the fair value charge to the consolidated income statement in respect of these plans was £25 million (2006 £26 million; 2005 £28 million).

#### Executive share option plans

(a) **Diageo executive share option plan (DSOP)** This scheme was introduced in December 1999 and grants options to executives at the market price on the date of grant. Options granted under this scheme may normally be exercised between three and 10 years after the date granted. There are no performance conditions to be satisfied although the top 100 senior executives are required to hold shares in Diageo plc. US executives are granted options over the company's ADSs (one ADS is equivalent to four ordinary shares).

## Notes to the consolidated financial statements (continued)

### 33 Employee share compensation (continued)

**(b) Diageo senior executive share option plan (SESOP)** This scheme was introduced with effect from 1 January 2000 and grants options to senior executives at the market price on the date of grant. Options granted under the scheme cannot normally be exercised unless a performance condition is satisfied. The current performance condition is based on the increase in Diageo's adjusted earnings per share (EPS) measure over a three year period. If the increase in this EPS measure is at least 15 percentage points greater than the increase in the RPI over the same period, then all the options can be exercised. If the increase in this EPS measure is at least 12 percentage points greater than that of the RPI but less than 15 percentage points, half of the options can be exercised. For options granted prior to October 2004, if the options fail either initial performance condition, the three year assessment period will be rolled forward by a year and a re-test carried out at that time. If the performance condition is satisfied, options can be exercised up to 10 years after the date of grant. For options granted from 1 October 2004, no re-testing is permitted. US executives are granted options over the company's ADSs.

**(c) Diageo associated companies share option plan (DACSOP)** This scheme was introduced in March 2001 and grants options to executives in a number of associated companies. The terms of the scheme are the same as for DSOP.

**(d) UK executive share option schemes (ESOS)** The last options granted under these schemes were in 1997. The group operated executive share option schemes and a supplemental scheme for senior executives. These schemes incorporated the former GrandMet scheme, the former Guinness Group executive share option schemes and the Guinness Group 1994 employee incentive trust.

Options were granted at the market price on the date of the grant and there are no performance criteria. Options issued under these schemes may normally be exercised between three and 10 years after the date granted.

#### Savings plans

**(a) UK savings-related share option scheme (SRSOS)** The UK savings-related share option scheme is an Inland Revenue approved scheme available to all UK employees. The scheme provides a long term savings opportunity for employees. The options may normally be exercised after three or five years, according to the length of the option period chosen by the employee, at a price not less than 80% of the market value of the shares at the time of the option grant.

**(b) US employee stock purchase plan (USESPP)** This scheme provides a long term savings and investment opportunity for US employees. The options may normally be exercised 12 months after the grant of the option at a price equivalent to 85% of the market value of the ADSs at the time of the option grant.

**(c) International savings-related share option plan (International)** The group also operates an international savings-related share option plan. The scheme provides a long term savings opportunity for employees outside the United Kingdom. The options may be exercised between one and five years after grant. The scheme has discount criteria ranging from nil to 20% devised in accordance with local conditions and practices.

## Notes to the consolidated financial statements (continued)

### 33 Employee share compensation (continued)

#### Executive share award plans

(a) **Total shareholder return (TSR) plan** Under the TSR plan, participants are granted a conditional right to receive shares. All conditional rights awarded vest after a three year period – the 'performance cycle' – subject to achievement of two performance tests. The primary performance test is a comparison of Diageo's three year total shareholder return – the percentage growth in Diageo's share price (assuming all dividends and capital distributions are reinvested) – with the TSR of a peer group of 17 other companies. TSR calculations are converted into a common currency (US dollars). The second performance test requires that the remuneration committee not recommend the release of awards unless it considers that there has been an underlying improvement in Diageo's three year financial performance, typically measured by improvement in an adjusted earnings per share measure.

(b) **Discretionary incentive plan (DIP), formerly Diageo share incentive plan** The first awards were in the year ended 30 June 2000 to a small number of senior executives. The scheme involves awards of shares or ADSs over a three to five year period with performance criteria varying by employee.

Awards under the TSR plan and DIP were at nil award price.

**Notes to the consolidated financial statements (continued)****33 Employee share compensation (continued)**

For the three years ended 30 June 2007, the calculation of the fair value of each option and share award used the binomial (share option plans) and Monte Carlo (share award plans) option pricing models and the following weighted average assumptions:

|                                                                   | <b>Executive<br/>share option<br/>plans</b> | <b>Savings<br/>plans</b> | <b>Executive<br/>share award<br/>plans</b> |
|-------------------------------------------------------------------|---------------------------------------------|--------------------------|--------------------------------------------|
| <b>2007</b>                                                       |                                             |                          |                                            |
| Weighted average assumptions                                      |                                             |                          |                                            |
| Risk free interest rate                                           | 4.9%                                        | 5.1%                     | 5.0%                                       |
| Expected life of the options                                      | 60 months                                   | 35 months                | 36 months                                  |
| Expected volatility                                               | 18%                                         | 13%                      |                                            |
| Dividend yield                                                    | 4.0%                                        | 3.7%                     | 4.0%                                       |
| Weighted average fair value of options/awards granted in the year | 144p                                        | 200p                     | 841p                                       |
| Number of options/awards granted in the year                      | 8.3 million                                 | 2.7 million              | 2.1 million                                |
| Fair value of all options/awards granted in the year              | £12 million                                 | £5 million               | £18 million                                |
| <b>2006</b>                                                       |                                             |                          |                                            |
| Weighted average assumptions                                      |                                             |                          |                                            |
| Risk free interest rate                                           | 4.2%                                        | 4.3%                     | 4.2%                                       |
| Expected life of the options                                      | 60 months                                   | 43 months                | 36 months                                  |
| Expected volatility                                               | 30%                                         | 29%                      |                                            |
| Dividend yield                                                    | 4.0%                                        | 4.0%                     | 4.0%                                       |
| Weighted average fair value of options/awards granted in the year | 187p                                        | 224p                     | 733p                                       |
| Number of options/awards granted in the year                      | 9.2 million                                 | 2.0 million              | 1.5 million                                |
| Fair value of all options/awards granted in the year              | £17 million                                 | £4 million               | £11 million                                |
| <b>2005</b>                                                       |                                             |                          |                                            |
| Weighted average assumptions                                      |                                             |                          |                                            |
| Risk free interest rate                                           | 4.6%                                        | 4.7%                     | 4.6%                                       |
| Expected life of the options                                      | 60 months                                   | 40 months                | 36 months                                  |
| Expected volatility                                               | 30%                                         | 30%                      |                                            |
| Dividend yield                                                    | 4.0%                                        | 4.0%                     | 4.0%                                       |
| Weighted average fair value of options/awards granted in the year | 165p                                        | 214p                     | 649p                                       |
| Number of options/awards granted in the year                      | 10.7 million                                | 2.9 million              | 0.8 million                                |
| Fair value of all options/awards granted in the year              | £18 million                                 | £6 million               | £5 million                                 |

The risk free interest rate is based on the UK treasury coupon strips in effect at the time of the grant, for the expected life of the option. The expected life of the options represents the period of time that options granted are expected to be outstanding. The group uses historical data to estimate option exercise and employee termination within the valuation model. Expected volatility is based on implied volatilities from traded options on the group's shares, historical volatility of the group's shares and other factors.

**Notes to the consolidated financial statements (continued)****33 Employee share compensation (continued)**

Option holdings in the following tables are stated as ordinary share equivalents in pence. Options prices are translated at the following exchange rates; grants at actual exchange rates; exercises and cancellations at average exchange rates; and closing balances at year end exchange rates.

(i) **Outstanding options** Options over ordinary shares and over ADSs (US schemes only) outstanding at 30 June 2007 were as follows:

|                              | Range of<br>exercise<br>prices<br>pence | Number at<br>30 June<br>2007 | Weighted<br>average<br>remaining<br>contractual<br>life<br>months | Weighted<br>average<br>exercise<br>price<br>pence |
|------------------------------|-----------------------------------------|------------------------------|-------------------------------------------------------------------|---------------------------------------------------|
| Executive share option plans | 300-399                                 | 24,952                       | 32                                                                | 332                                               |
|                              | 400-499                                 | 1,318,071                    | 44                                                                | 456                                               |
|                              | 500-599                                 | 4,692,942                    | 65                                                                | 558                                               |
|                              | 600-699                                 | 9,669,008                    | 75                                                                | 643                                               |
|                              | 700-799                                 | 10,944,540                   | 87                                                                | 730                                               |
|                              | 800-899                                 | 7,916,367                    | 105                                                               | 842                                               |
|                              | 900-999                                 | 4,806,345                    | 111                                                               | 932                                               |
|                              |                                         | <b>39,372,225</b>            | <b>86</b>                                                         | <b>726</b>                                        |
| Savings plans                | 400-499                                 | 133,545                      | 22                                                                | 498                                               |
|                              | 500-599                                 | 2,690,753                    | 23                                                                | 550                                               |
|                              | 600-699                                 | 2,295,418                    | 27                                                                | 641                                               |
|                              | 700-799                                 | 2,720,216                    | 34                                                                | 747                                               |
|                              |                                         | <b>7,839,932</b>             | <b>28</b>                                                         | <b>644</b>                                        |

The intrinsic value of an option is the amount by which the market value of the share at the balance sheet date exceeds the exercise price of the option.

(a) For the executive share option plans, the intrinsic values of the options outstanding and exercisable at 30 June 2007 were £123 million and £60 million, respectively, and the intrinsic value of options exercised in the year ended 30 June 2007 was £31 million (2006 £17 million; 2005 £19 million). At 30 June 2007, options exercisable under these plans had a weighted average remaining contractual life of 63 months (2006 64 months; 2005 64 months).

(b) For the savings plans, the intrinsic values of the options outstanding and exercisable at 30 June 2007 were £31 million and £0.4 million, respectively, and the intrinsic value of options exercised in the year ended 30 June 2007 was £12 million (2006 £6 million; 2005 £5 million). At 30 June 2007, options exercisable under these plans had a weighted average remaining contractual life of 2 months (2006 1 month; 2005 2 months).

(c) For the executive share award plans, the intrinsic value of the awards outstanding at 30 June 2007 was £45 million, and the fair value of shares vested in the year ended 30 June 2007 was £8 million (2006 £4 million; 2005 £7 million).

(d) The tax benefit realised from options exercised during the year was £9 million.

**Notes to the consolidated financial statements (continued)****33 Employee share compensation (continued)**

(ii) **Transactions on schemes** Transactions on the share option and share award plans and the weighted average grant date fair value for options and shares for the three years ended 30 June 2007 were as follows:

|                                            | Executive share option plans |                                       | Savings plans     |                                       | Executive share award plans |
|--------------------------------------------|------------------------------|---------------------------------------|-------------------|---------------------------------------|-----------------------------|
|                                            | Number of options            | Weighted average exercise price pence | Number of options | Weighted average exercise price pence | Number of awards            |
| Balance outstanding at 1 July 2004         | 42,782,785                   | 615                                   | 9,409,464         | 535                                   | 3,207,242                   |
| Granted                                    | 10,701,977                   | 690                                   | 2,905,629         | 570                                   | 772,630                     |
| Exercised/awarded                          | (10,589,959)                 | 555                                   | (2,645,056)       | 517                                   | (980,224)                   |
| Forfeited/expired                          | (1,196,964)                  | 685                                   | (682,120)         | 556                                   | (248,999)                   |
| Balance outstanding at 30 June 2005        | 41,697,839                   | 660                                   | 8,987,917         | 554                                   | 2,750,649                   |
| Granted                                    | 9,248,402                    | 833                                   | 1,992,329         | 662                                   | 1,498,243                   |
| Exercised/awarded                          | (8,372,821)                  | 645                                   | (2,466,992)       | 488                                   | (532,397)                   |
| Forfeited/expired                          | (1,212,827)                  | 611                                   | (665,862)         | 574                                   | (300,911)                   |
| Balance outstanding at 30 June 2006        | 41,360,593                   | 689                                   | 7,847,392         | 576                                   | 3,415,584                   |
| Granted                                    | 8,259,306                    | 930                                   | 2,657,279         | 758                                   | 2,141,688                   |
| Exercised/awarded                          | (8,818,488)                  | 641                                   | (2,238,254)       | 526                                   | (735,318)                   |
| Forfeited/expired                          | (1,429,186)                  | 667                                   | (426,485)         | 584                                   | (464,747)                   |
| <b>Balance outstanding at 30 June 2007</b> | <b>39,372,225</b>            | <b>726</b>                            | <b>7,839,932</b>  | <b>644</b>                            | <b>4,357,207</b>            |
| Number of options exercisable at:          |                              |                                       |                   |                                       |                             |
| <b>30 June 2007</b>                        | <b>14,461,984</b>            | <b>621</b>                            | <b>77,842</b>     | <b>564</b>                            |                             |
| 30 June 2006                               | 13,412,979                   | 583                                   | 92,899            | 546                                   |                             |
| 30 June 2005                               | 11,598,959                   | 595                                   | 63,263            | 658                                   |                             |

**(iii) Employee share trusts, potential issues of ordinary shares and voting rights**

(a) In order to hedge its obligations under the share option and share award plans, the group either purchases own shares directly and holds them as treasury shares, or it funds trusts to acquire shares in the company. Under IFRS and US GAAP, the shares held are accounted for as a deduction in arriving at shareholders' equity. Call options are used to manage some of the group's obligations. Dividends receivable by the employee share trusts on the shares are waived.

(b) Shares used to satisfy the group's obligations under the employee share plans can be newly issued shares, treasury shares or shares purchased on the open market by the employee share trusts.

(c) Where shares held by employee share trusts have been allocated to employee share plan participants, they may exercise their voting rights. Where shares are held by employee share trusts and have not been allocated to participants, the trustee abstains from voting.

**Notes to the consolidated financial statements (continued)****34 Adoption of IAS 39**

The group adopted IAS 39 with effect from 1 July 2005, the principal impact of this standard being to change the carrying value of financial instruments in the group's financial statements. In accordance with the exemption available in IFRS 1, the comparative information presented for the year ended 30 June 2005 does not comply with *IAS 39 Financial instruments: recognition and measurement*, *IAS 32 Financial instruments: presentation and disclosure* and *IFRS 7 Financial instruments: disclosures*. Financial instruments for the year ended 30 June 2005 and as at 30 June 2005 have been recognised and presented in accordance with previous UK GAAP accounting policies.

The impact of adoption of IAS 39 on the balance sheet at 1 July 2005 (date of adoption) is set out in the following table:

|                                                                         | <b>30 June<br/>2005</b> | <b>Impact of<br/>IAS 39</b> | <b>1 July<br/>2005</b> |
|-------------------------------------------------------------------------|-------------------------|-----------------------------|------------------------|
|                                                                         | <b>£ million</b>        | <b>£ million</b>            | <b>£ million</b>       |
| <b>Non-current assets</b>                                               |                         |                             |                        |
| Investments in associates                                               | 1,261                   | (6)                         | 1,255                  |
| Other investments                                                       | 719                     | 148                         | 867                    |
| Other financial assets                                                  | 32                      | 152                         | 184                    |
| Deferred tax assets                                                     | 778                     | 10                          | 788                    |
| Other non-current assets                                                | 6,398                   |                             | 6,398                  |
|                                                                         | <b>9,188</b>            | <b>304</b>                  | <b>9,492</b>           |
| <b>Current assets</b>                                                   | <b>4,733</b>            |                             | <b>4,733</b>           |
| <b>Total assets</b>                                                     | <b>13,921</b>           | <b>304</b>                  | <b>14,225</b>          |
| <b>Non-current liabilities</b>                                          |                         |                             |                        |
| Borrowings                                                              | (3,677)                 | (67)                        | (3,744)                |
| Other financial liabilities                                             | (9)                     | (69)                        | (78)                   |
| Other non-current liabilities                                           | (2,003)                 |                             | (2,003)                |
|                                                                         | <b>(5,689)</b>          | <b>(136)</b>                | <b>(5,825)</b>         |
| <b>Current liabilities</b>                                              | <b>(3,606)</b>          | <b>(4)</b>                  | <b>(3,610)</b>         |
| <b>Total liabilities</b>                                                | <b>(9,295)</b>          | <b>(140)</b>                | <b>(9,435)</b>         |
| <b>Net assets</b>                                                       | <b>4,626</b>            | <b>164</b>                  | <b>4,790</b>           |
| <b>Equity</b>                                                           |                         |                             |                        |
| Called up share capital and share premium                               | 2,220                   |                             | 2,220                  |
| Other reserves                                                          | 3,181                   | 123                         | 3,304                  |
| Retained deficit                                                        | (942)                   | 41                          | (901)                  |
| <b>Equity attributable to equity shareholders of the parent company</b> | <b>4,459</b>            | <b>164</b>                  | <b>4,623</b>           |
| <b>Minority interests</b>                                               | <b>167</b>              |                             | <b>167</b>             |
| <b>Total equity</b>                                                     | <b>4,626</b>            | <b>164</b>                  | <b>4,790</b>           |

**35 Reconciliation to US generally accepted accounting principles**

Diageo plc is a public limited company incorporated under the laws of England and Wales and the group's consolidated financial statements are prepared in accordance with IFRS as endorsed and adopted for use in the EU and IFRS as issued by the IASB, which differ in certain respects from US GAAP.





**Notes to the consolidated financial statements (continued)****35 Reconciliation to US generally accepted accounting principles (continued)**

The differences between IFRS and US GAAP, in respect of net income and shareholders' equity, are set out below:

**Effect on net income of differences between IFRS and US GAAP:**

| Notes                                                                                               | 2007         | 2006      | 2005      |
|-----------------------------------------------------------------------------------------------------|--------------|-----------|-----------|
|                                                                                                     | £ million    | £ million | £ million |
| <b>Net income attributable to equity shareholders of the parent company in accordance with IFRS</b> | <b>1,489</b> | 1,908     | 1,344     |
| Adjustments to conform with US GAAP:                                                                |              |           |           |
| Inventories and land and buildings (a)                                                              | (20)         | (24)      | (24)      |
| Intangibles (b)                                                                                     | (6)          | (6)       | (2)       |
| Pensions and other post employment benefits (c)                                                     | (130)        | (96)      | (6)       |
| Derivative instruments in respect of General Mills shares (d)                                       |              |           | 27        |
| Financial instruments (e)                                                                           | 78           | (31)      | (46)      |
| Intercompany balances (f)                                                                           | 30           | (1)       | 14        |
| Moët Hennessy (g)                                                                                   | (5)          | (7)       | (16)      |
| Disposal of General Mills shares (h)                                                                |              | (92)      | (160)     |
| Disposal of tangible fixed assets and businesses (i)                                                | (9)          | (1)       | 5         |
| Burger King (j)                                                                                     |              | 18        | (17)      |
| Employee share options (k)                                                                          | (3)          | (2)       | 9         |
| Other items                                                                                         | 10           | (3)       | 29        |
| Deferred taxation (l)                                                                               |              |           |           |
| on above adjustments                                                                                | 26           | (53)      | 36        |
| other                                                                                               | 132          | (181)     | 277       |
| <b>Net income before cumulative effect of accounting change</b>                                     | <b>1,592</b> | 1,429     | 1,470     |
| Cumulative effect of change in accounting principle, net of tax (k)                                 |              | (2)       |           |
| <b>Net income in accordance with US GAAP</b>                                                        | <b>1,592</b> | 1,427     | 1,470     |
| <b>Earnings per ordinary share in accordance with US GAAP</b> (m)                                   |              |           |           |
| <b>Basic earnings per ordinary share</b>                                                            |              |           |           |
| Net income before cumulative effect of accounting change                                            | 59.2p        | 50.3p     | 49.5p     |
| Cumulative effect of change in accounting principle, net of tax                                     |              | (0.1)p    |           |
| Net income                                                                                          | 59.2p        | 50.2p     | 49.5p     |
| <b>Diluted earnings per ordinary share</b>                                                          |              |           |           |
| Net income before cumulative effect of accounting change                                            | 58.8p        | 50.1p     | 49.4p     |
| Cumulative effect of change in accounting principle, net of tax                                     |              | (0.1)p    |           |
| Net income                                                                                          | 58.8p        | 50.0p     | 49.4p     |
| Basic earnings per ADS after cumulative effect of accounting change                                 | 236.8p       | 200.8p    | 198.0p    |
| Diluted earnings per ADS after cumulative effect of accounting change                               | 235.2p       | 200.0p    | 197.6p    |

**Notes to the consolidated financial statements (continued)****35 Reconciliation to US generally accepted accounting principles (continued)****Cumulative effect on shareholders' equity of differences between IFRS and US GAAP:**

|                                                                                                 | Notes   | 30 June<br>2007 | 30 June<br>2006 |
|-------------------------------------------------------------------------------------------------|---------|-----------------|-----------------|
|                                                                                                 |         | £ million       | £ million       |
| <b>Equity attributable to equity shareholders of the parent company in accordance with IFRS</b> |         | <b>3,972</b>    | 4,502           |
| Adjustments to conform with US GAAP:                                                            |         |                 |                 |
| Inventories and land and buildings                                                              | (a)     | 115             | 144             |
| Brands                                                                                          | (a),(b) | 3,061           | 3,084           |
| Goodwill                                                                                        | (a),(b) | 3,163           | 3,201           |
| Other intangibles                                                                               | (a),(b) | 4               | 16              |
| Pensions and other post employment benefits                                                     | (c)     | 18              | 648             |
| Financial instruments                                                                           | (e)     | (4)             | (17)            |
| Moët Hennessy                                                                                   | (g)     | 308             | 322             |
| Employee share options                                                                          | (k)     | (6)             | (8)             |
| Other items                                                                                     |         | 3               | (14)            |
| Deferred taxation                                                                               | (l)     |                 |                 |
| on above adjustments                                                                            |         | (1,244)         | (1,380)         |
| other                                                                                           |         | (855)           | (990)           |
|                                                                                                 |         | <b>8,535</b>    | 9,508           |
| <b>Shareholders' equity in accordance with US GAAP</b>                                          |         | <b>8,535</b>    | 9,508           |

A description of accounting differences between IFRS and US GAAP that are material to the group is set out below.

**(a) Accounting for the merger of GrandMet and the Guinness Group** Under the transitional provisions of IFRS 1, the group has opted not to restate the accounting for business combinations that occurred prior to the date of transition to IFRS (1 July 2004) from that previously applied under UK GAAP. In the group's primary financial statements, the merger of GrandMet and the Guinness Group has therefore been accounted for under merger accounting principles (pooling of interests), where the results, cash flows and balance sheets of both entities, having made adjustments to achieve uniformity of accounting policies, were aggregated with no adjustment to fair value. Under US GAAP, the merger was accounted for as an acquisition of the Guinness Group by GrandMet with an effective acquisition date of 31 December 1997. Consequently the Guinness Group's assets and liabilities, including land and buildings, were recorded at fair values on 31 December 1997. Under US GAAP, the excess of the consideration over the fair value of the net assets has been allocated firstly to identifiable intangible assets, including brands, based on their fair values, with the remainder allocated to goodwill. Fair value adjustments to the recorded amounts of inventories, net of deferred tax, are expensed in the period in which the inventory is sold.

## Notes to the consolidated financial statements (continued)

### 35 Reconciliation to US generally accepted accounting principles (continued)

**(b) Brands, goodwill and other intangibles** Under both IFRS and US GAAP, significant owned brands acquired by the group are recorded on the balance sheet. Under IFRS, the group has written off goodwill and other intangible assets acquired up to 30 June 1998 direct to reserves in the period when acquired. All intangible assets acquired from 1 July 1998 have been capitalised in the balance sheet. Capitalised goodwill and other intangibles, apart from brands, acquired between 1 July 1998 and 30 June 2004 were amortised over their useful economic lives, up to a maximum of 20 years. From the date of transition to IFRS, goodwill and brands are not amortised but are subject to impairment tests at least annually.

Under US GAAP, up to 30 June 2001, intangible assets have been capitalised in the balance sheet and amortised through the statement of income over their useful economic lives, not exceeding 40 years. On 1 July 2001, the group adopted the provisions of *SFAS No.142 Goodwill and Other Intangible Assets* and ceased to amortise goodwill and brands from this date. Instead goodwill and brands have been subject to impairment tests at least annually, as under IFRS.

**(c) Pensions and other post employment benefits** There are a number of significant differences between IFRS and US GAAP in accounting for pension and other post employment benefit costs that have an impact on the group:

(i) Under IFRS, the pension cost for the period is based on an actuarial valuation at the start of the financial period. The current service cost is charged to operating profit. The interest cost (being the unwinding of the discount on the fund's liabilities for the period) and the expected return on assets for the period (calculated using the fair value of assets) are charged/credited to other finance income in the income statement. The group has taken the option permitted under IFRS to include any amount arising from changes in the assumptions used for the actuarial valuation at the commencement of the period and those at the end of the period, and any differences between the actual and expected returns on the plan's assets, in the statement of recognised income and expense. Under US GAAP, the pension cost for the period is based on an actuarial valuation at the start of the financial period. The current service cost, the interest cost (being the unwinding of the discount on the fund's liabilities for the period) and the expected return on assets for the period (calculated using a smoothed market value of assets) are all charged/credited to operating income. The cumulative amounts arising from changes in the assumptions used for the actuarial valuation at the commencement of the period and those at the end of the period, and any differences between the actual and expected returns on the plan's assets, are amortised through operating income over the average remaining service lives of the employees. As there was an unrecognised loss under US GAAP at 30 June 2006, this led to an additional charge to operating income for the year ended 30 June 2007 of £95 million (2006 £96 million; 2005 £26 million) under US GAAP compared with IFRS.

(ii) The expected return on assets for the period is calculated using the fair value of assets under IFRS, but is calculated using a smoothed fair value of assets under US GAAP. This smoothing can lead to differences in the amount included in the statement of income from the expected return on investments in the pension funds. For the year ended 30 June 2007, the income was £324 million (2006 £275 million; 2005 £280 million) under IFRS, whereas it was £304 million (2006 £298 million; 2005 £347 million) under US GAAP. This amount is included in other finance income under IFRS, but in operating income under US GAAP.

## Notes to the consolidated financial statements (continued)

### 35 Reconciliation to US generally accepted accounting principles (continued)

(iii) Under IFRS, gains from curtailments are recognised immediately as a credit to the income statement, but under US GAAP, where net losses not previously recognised in the income statement exceed curtailment gains, the net loss is spread through the income statement over the average remaining service lives of the active members. In addition under US GAAP, any prior service cost not previously recognised in the income statement in respect of members involved in the curtailment must be recognised immediately as a charge to operating income. For the year ended 30 June 2006, this led to an additional charge to the income statement of £5 million (2005 £40 million) under US GAAP compared with IFRS.

(iv) There are some historical losses from past service costs that were not recognised immediately as a charge to operating income under US GAAP. These losses are amortised over the average remaining service lives of the employees. For the year ended 30 June 2007, this led to an additional charge to operating income of £15 million (2006 £15 million; 2005 £17 million) under US GAAP compared with IFRS.

(v) Under IFRS, the surplus or deficit in post employment plans at the balance sheet date is reported as part of the group's consolidated net assets. On 30 June 2007, the group adopted *SFAS No.158 Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* for US GAAP reporting. Under SFAS No.158, the difference between the fair value of the plan assets and the projected benefit obligations of the plan is recognised as an asset or liability on the consolidated balance sheet, with changes in the funded status recognised through other comprehensive income. The adoption of SFAS No.158 has eliminated the difference in shareholders' equity under IFRS and US GAAP, apart from if the post employment plan is in surplus. Under IFRS, the amount recognised is limited to the present value of any economic benefits available in the form of refunds or future contribution reductions, plus unrecognised actuarial losses and unrecognised past service costs, whereas under US GAAP there is no such restriction. Retrospective application of SFAS No.158 is not permitted and, at 30 June 2006, postretirement plans were accounted for under SFAS Nos.87, 88 and 106. Under SFAS Nos.87 and 106, only when the plan was in deficit, calculated on the plan's accrued rather than projected liabilities, was the difference between the plan assets and liabilities included in the group's consolidated net assets, with changes in the funded status recognised through other comprehensive income. If the plan was in surplus, the group's consolidated net assets included a prepayment or provision which was the difference between the cumulative charges to operating income and the cumulative cash contributions made to the plan.

**(d) Derivative instruments in respect of General Mills shares** Under IFRS prior to 30 June 2005, the premium received from the sale to General Mills of options over 29 million ordinary shares of Diageo's holding in that company was deferred in the balance sheet pending exercise or lapse of the options. On 4 October 2004, 4 million of the shares over which the options were exercisable were disposed of to the group's UK pension fund. The premium in respect of the option over the 4 million shares was realised in the statement of income in the year ended 30 June 2005. Under US GAAP, the option contracts represented derivatives and, accordingly, were held at their estimated fair values at the balance sheet dates, with changes in fair value included in the statement of income.

## Notes to the consolidated financial statements (continued)

### 35 Reconciliation to US generally accepted accounting principles (continued)

From 1 July 2005, following the adoption of *IAS 39 Financial instruments: recognition and measurement*, under both IFRS and US GAAP, any changes in fair value of the options have been included in the statement of income. The options over the remaining 25 million ordinary shares expired in October 2005 and resulted in a gain of £8 million for the year ended 30 June 2006 under both IFRS and US GAAP.

**(e) Financial instruments** The group uses derivative financial instruments for risk management purposes. Under IFRS, prior to the adoption of IAS 39 on 1 July 2005, changes in the fair value of interest rate derivatives and derivatives hedging forecast transactions were not recognised until realised. Since 1 July 2005, all such derivatives are carried at fair value at the balance sheet date. Under IFRS, prior to 1 July 2005, for derivatives hedging the translation of net assets of overseas operations in respect of foreign exchange differences arising on translation to closing rates, changes in their fair value were taken to the statement of recognised income and expense. Under US GAAP, all derivatives are carried at fair value at the balance sheet date. Certain of the group's derivatives qualified for and are designated as hedges under US GAAP. Gains and losses that arose from changes in the fair value of derivatives, and gains and losses that arose from changes in the fair value of hedged items attributable to the hedged risk, were charged or credited in determining net income under US GAAP.

From 1 July 2005, there are differences between IFRS and US GAAP in respect of the following items:

(i) For interest rate hedging, there are differences between hedge designation, effectiveness testing methods and IAS 39 transition requirements which result in: (a) some derivatives not being designated as hedges under US GAAP; (b) a lower level of ineffectiveness arising on those derivatives which can be designated as hedges under US GAAP; and (c) an adjustment being made to the hedged item for fair value hedges at transition to IAS 39 which is not made under US GAAP. As a result, under US GAAP, for the year ended 30 June 2007 this led to an additional credit to net interest of £12 million (2006 £19 million charge) as compared with IFRS.

(ii) For cash flow hedging, at transition to IAS 39 all derivatives designated as cash flow hedges are considered as hedges prior to the transition date, while for US GAAP the hedge relationship starts from the time the hedge is documented, which in certain cases is the date that IAS 39 was first adopted. Therefore there are differences with respect to the amounts recognised in the hedging reserves and the amount recycled to the income statement at the time the hedged item matures. As a result, under US GAAP, for the year ended 30 June 2007 this led to an additional credit to operating income of £9 million (2006 £13 million) as compared with IFRS.

(iii) For net investment hedging, there are differences between hedge designation and effectiveness testing requirements, and some loans and derivatives that are designated as hedges under IFRS are not designated as hedges under US GAAP. As a result, under US GAAP, for the year ended 30 June 2007 this led to an additional credit to net finance charges of £57 million (2006 £25 million charge) as compared with IFRS.

**(f) Intercompany balances** Under IFRS and US GAAP, exchange differences arising on long term intercompany balances, for which settlement is not planned nor likely to occur in the foreseeable future, are generally included as equity movements. However, under US GAAP, there is a restriction whereby one of the companies with the intercompany balance must have the same functional currency as the common parent company, and there must be no intermediate parent company with a different functional currency. Otherwise any exchange differences arising are taken to net income.

## Notes to the consolidated financial statements (continued)

### 35 Reconciliation to US generally accepted accounting principles (continued)

**(g) Moët Hennessy** The operations of Moët Hennessy are conducted both through a partnership and through a limited company in which the group has 34% interests. Under both IFRS and US GAAP, the investments in Moët Hennessy are accounted for using the equity method of accounting but, as a result of applying accounting differences between IFRS and US GAAP, primarily in respect of accounting for the merger of GrandMet and the Guinness Group referred to in (a) above, the group's share of the carrying values of the investments are different under IFRS and US GAAP. The group's share of net income from Moët Hennessy is different between IFRS and US GAAP primarily in respect of accounting differences on fair value accounting for vines and grapes.

**(h) Disposal of General Mills shares** Applying the accounting differences between IFRS and US GAAP resulted in different carrying values for the shares held in General Mills. As a consequence of these different values, different gains arose on the subsequent disposals of the shares in October 2004 and November 2005. Under IFRS, the investment in General Mills was classified as a non-current investment for the year ended 30 June 2005 at deemed cost and, on the adoption of IAS 39 on 1 July 2005, was reclassified as an available for sale security. Under US GAAP, the investment was held from 1 July 2004 as an available for sale security. Under both IFRS and US GAAP, available for sale securities are held on the balance sheet at fair value with changes in the fair value included in equity. On the disposal of the shares in General Mills, the amount included in equity in respect of the shares disposed of, representing the cumulative change in fair value, was included in net income.

**(i) Disposal of tangible fixed assets and businesses** Applying the accounting differences between IFRS and US GAAP can result in changes to the carrying values of certain assets and liabilities. As a consequence of these different carrying values, including related tax balances, different gains or losses may arise on the subsequent disposal of the assets. In addition, the timing of the recognition of a loss on a disposal may be different under IFRS and US GAAP.

**(j) Burger King** Under IFRS, the sale of Burger King on 13 December 2002 (the completion date) was accounted for as a disposal in the year ended 30 June 2003, and interest receivable on the subordinated debt was included in interest income in the period to which it related. Under US GAAP, the transaction was not accounted for as a disposal in the year ended 30 June 2003 due to the size of the investment made by the buyer and Diageo's continued involvement through the guarantee provided by Diageo in respect of the acquisition finance.

Under US GAAP, following the completion date, Diageo did not recognise profits of Burger King, nor interest receivable on the subordinated debt due from Burger King, in its income statement but, generally, reflected losses as an impairment charge against the assets retained in the balance sheet. On 13 July 2005, Burger King refinanced its external borrowings on a stand-alone basis, resulting in the release of Diageo from its obligations under the guarantee and the receipt by Diageo of amounts owed in respect of the subordinated debt and cumulative interest. As a consequence, under US GAAP, Burger King was accounted for as a disposal in the year ended 30 June 2006 and the cumulative deferred interest and cumulative translation adjustment in respect of Burger King were recognised in the income statement.

## Notes to the consolidated financial statements (continued)

### 35 Reconciliation to US generally accepted accounting principles (continued)

**(k) Employee share options** From 1 July 2005, Diageo adopted the provisions of *SFAS No. 123(R) Share-Based Payment* for its US GAAP reporting. As a consequence, for the two years ended 30 June 2007, the accounting treatment for equity classified employee stock options was the same under both IFRS and US GAAP. US GAAP has more stringent criteria than IFRS for determining whether a plan is classified as an equity or liability plan. Liability classified awards are re-measured to fair value at each balance sheet date until the award is settled, whereas equity classified awards are measured at grant date fair value and are not subsequently re-measured. Diageo's senior executive share option plan (SESOP) is accounted for as a liability plan under US GAAP, whereas under IFRS it is treated as an equity plan. On adoption of SFAS No. 123(R) on 1 July 2005, Diageo revalued unvested awards in the SESOP plan and recognised a charge of £2 million net of tax in respect of the cumulative effect of the accounting change.

For the year ended 30 June 2005, under US GAAP, the group accounted for employee share options in compliance with *APB Opinion No. 25 Accounting for Stock Issued to Employees* which differs in certain respects from IFRS. Under APB 25, compensation cost for fixed awards (being awards under which both the exercise price and the number of ordinary shares are fixed) is determined as the difference between the fair value of the ordinary shares at the date of the award and the amount the employee has to pay for the ordinary shares. Compensation cost for variable awards (including awards subject to future performance conditions) is measured as the difference between the market price at the period end and the exercise price and is based on the number of awards expected to vest.

**(l) Deferred taxation** IFRS requires deferred tax to be recognised, with limited exceptions, in respect of temporary differences arising between the tax written down value of assets and liabilities and the book value, including temporary differences arising as a result of intra group transactions. Similarly US GAAP requires deferred tax to be recognised, with limited exceptions, for taxable temporary differences but, where assets or liabilities are transferred within a group, no deferred tax asset or liability is recognised in respect of changes in tax written down values.

IFRS and US GAAP require deferred tax liabilities to be set up for all assets separately identified, where there are temporary differences, including brands, but excluding goodwill not deductible for tax, recognised on a business combination. As the combination of GrandMet and the Guinness Group was accounted for as a merger under IFRS but as an acquisition under US GAAP, as referred to in (a) above, deferred tax liabilities arose in respect of the additional acquired brand values.

In addition, under IFRS, deferred tax is based on the tax rates and laws that have been enacted, or substantially enacted, at the balance sheet date. For US GAAP, only tax rates and laws that have been enacted are taken into account. Other differences exist between IFRS and US GAAP, including differences in respect of share options and profit on the intra group sale of inventories.

IFRS requires deferred tax assets and liabilities to be disclosed as non-current items on the balance sheet. Under US GAAP, deferred tax assets and liabilities are classified between current and non-current depending on the items to which they relate or, where there is no underlying item, the period in which they are expected to reverse.

**(m) Earnings per ordinary share** Under IFRS and US GAAP, the calculation of earnings per ordinary share is generally consistent and is based on the weighted average number of ordinary shares outstanding during the period. Earnings per American Depositary Share are calculated on the basis of one American Depositary Share representing four ordinary shares.



## Notes to the consolidated financial statements (continued)

### 35 Reconciliation to US generally accepted accounting principles (continued)

**(n) Variable interest entities** US GAAP requires the results, assets and liabilities of variable interest entities to be consolidated if the group is regarded as the primary beneficiary. The primary beneficiary is generally defined as the party whose variable interests absorb the majority of the expected losses or residual returns of the variable interest entity. The group has a number of joint arrangements with Moët Hennessy in France and the Far East, involved in the marketing and distribution of the group's and Moët Hennessy's premium drinks, where the group is regarded as the primary beneficiary, which have been consolidated. Under IFRS, the group only consolidates the attributable share of the results, assets and liabilities of the joint arrangements measured according to the terms of the arrangement.

For the year ended 30 June 2007, the consolidation of variable interest entities under US GAAP increased sales by £500 million (2006 £437 million; 2005 £303 million) and operating income by £44 million (2006 £38 million; 2005 £25 million) as compared with IFRS. This accounting difference has no effect on US GAAP net income or shareholders' equity as compared with IFRS.

**(o) Basis of consolidation** The group has interests in a number of other jointly controlled entities. Under IFRS, the group reports its interest in jointly controlled entities using proportionate consolidation. The group's share of the assets, liabilities, sales, income and cash flows of jointly controlled entities are included in the appropriate categories of the group's financial statements on a line-by-line basis. Under US GAAP, these interests are accounted for using the equity method. Under the equity method, the group's share of the net income and net assets of the jointly controlled entities are reported as one line in the income statement and balance sheet.

Applying the equity method of accounting under US GAAP for the year ended 30 June 2007 decreased sales by £128 million (2006 £110 million; 2005 £100 million) and operating income by £17 million (2006 £19 million; 2005 £16 million) as compared with IFRS. This accounting difference has no effect on US GAAP net income or shareholders' equity as compared with IFRS.

**(p) Discontinued operations** Under IFRS, the original disposals of Burger King and Pillsbury met the conditions for separate disclosure as discontinued operations. Under US GAAP, due to Diageo's continuing involvement in Burger King at the date of disposal through the guarantee provided by Diageo in respect of the acquisition finance, and in Pillsbury due to the shareholding in General Mills, these disposals did not meet the criteria to be classified as discontinued operations.

In the year ended 30 June 2007, a tax benefit of £82 million arose from the recognition of capital losses arising on the prior year disposals of Pillsbury and Burger King, and a tax credit of £57 million arose following resolution with tax authorities of various audit issues (2005 £20 million tax credit in respect of the Pillsbury disposal). In the year ended 30 June 2005, the group released a provision of £53 million in respect of the disposal of Burger King.

Under IFRS, the disposal of Burger King and the tax credits arising from the disposal of Pillsbury and Burger King have been classified in discontinued operations, consistent with the accounting for the original disposals. These transactions have been included in continuing operations or have been deferred under US GAAP.

**Notes to the consolidated financial statements (continued)****35 Reconciliation to US generally accepted accounting principles (continued)**

US GAAP statements of income for the three years ended 30 June 2007 are set out below:

|                                                                 | 2007          | 2006      | 2005      |
|-----------------------------------------------------------------|---------------|-----------|-----------|
|                                                                 | £ million     | £ million | £ million |
| <b>Sales</b>                                                    | <b>10,289</b> | 10,031    | 9,170     |
| Excise duties                                                   | (2,424)       | (2,431)   | (2,272)   |
| <b>Net sales</b>                                                | <b>7,865</b>  | 7,600     | 6,898     |
| Cost of sales                                                   | (3,314)       | (3,248)   | (2,834)   |
| <b>Gross profit</b>                                             | <b>4,551</b>  | 4,352     | 4,064     |
| Selling, general and administrative expenses                    | (2,546)       | (2,408)   | (2,235)   |
| Seagram integration                                             |               |           | (30)      |
| Thalidomide provision                                           |               |           | (121)     |
| Derivative instruments in respect of General Mills shares       |               | (30)      | 27        |
| Burger King                                                     |               | 21        | 53        |
| Disposal of other businesses                                    | (1)           | 2         | (2)       |
| Other operating income                                          | 60            | 5         | 12        |
| <b>Operating income</b>                                         | <b>2,064</b>  | 1,942     | 1,768     |
| Disposal of General Mills shares                                |               | 89        | 61        |
| Earnings from unconsolidated affiliates (net of tax)            | 201           | 177       | 150       |
| Investment income                                               |               | 5         | 17        |
| Interest expense and other finance charges                      | (351)         | (263)     | (205)     |
| Interest income and other finance income                        | 211           | 23        | 60        |
| <b>Income before income taxes</b>                               | <b>2,125</b>  | 1,973     | 1,851     |
| Income taxes                                                    | (434)         | (462)     | (313)     |
| Minority interest charges                                       | (99)          | (82)      | (68)      |
| <b>Net income before cumulative effect of accounting change</b> | <b>1,592</b>  | 1,429     | 1,470     |
| Cumulative effect of change in accounting principle, net of tax |               | (2)       |           |
| <b>Net income after cumulative effect of accounting change</b>  | <b>1,592</b>  | 1,427     | 1,470     |

Excise duties comprise £463 million (2006 £468 million; 2005 £417 million) of duties charged as tax on sales and £1,961 million (2006 £1,963 million; 2005 £1,855 million) of duties charged as production and importation taxes.

Research and development expenditure was written off to selling, general and administrative expenses in the year in which it was incurred. A taxation charge of £42 million (2006 £39 million; 2005 £41 million) in respect of the Moët Hennessy partnership is included in 'income taxes' under US GAAP and in 'share of associates' profits after tax' under IFRS.

**Notes to the consolidated financial statements (continued)****35 Reconciliation to US generally accepted accounting principles (continued)**

**Statement of comprehensive income under US GAAP** Under IFRS, the group presents a consolidated statement of recognised income and expense which is similar to a statement of comprehensive income required by US GAAP. Comprehensive income, under US GAAP, for the three years ended 30 June 2007 is as follows:

|                                                          | 2007         |              |              |              |              |              | 2007       |           |           |
|----------------------------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|------------|-----------|-----------|
|                                                          | Before tax   | Tax          | Net          |              |              |              | Before tax | Tax       | Net       |
|                                                          | £ million    | £ million    | £ million    |              |              |              | £ million  | £ million | £ million |
| Net income                                               | 2,026        | (434)        | 1,592        |              |              |              |            |           |           |
| Exchange differences                                     | (215)        | 17           | (198)        |              |              |              |            |           |           |
| Changes in fair value of cash flow hedges                | 54           | (12)         | 42           |              |              |              |            |           |           |
| Minimum pension liabilities                              | 380          | (113)        | 267          |              |              |              |            |           |           |
| <b>Comprehensive income</b>                              | <b>2,245</b> | <b>(542)</b> | <b>1,703</b> |              |              |              |            |           |           |
|                                                          | 2006         |              |              |              |              |              | 2007       |           |           |
|                                                          | Before tax   | Tax          | Net          | Before tax   | Tax          | Net          |            |           |           |
|                                                          | £ million    | £ million    | £ million    | £ million    | £ million    | £ million    |            |           |           |
| Net income                                               | 1,889        | (462)        | 1,427        | 1,783        | (313)        | 1,470        |            |           |           |
| Exchange differences and changes in fair value of hedges | 32           | (18)         | 14           | 185          |              |              | 185        |           |           |
| Holding gains on available for sale securities           |              |              |              |              |              |              |            |           |           |
| unrealised gains/(losses) arising during the year        | 33           |              |              | (80)         |              |              | (80)       |           |           |
| realised gains reclassified to net income                | (106)        |              |              | (117)        |              |              | (117)      |           |           |
| Minimum pension liabilities                              | 685          | (120)        | 565          | (361)        | 33           | (328)        |            |           |           |
| <b>Comprehensive income</b>                              | <b>2,533</b> | <b>(600)</b> | <b>1,933</b> | <b>1,410</b> | <b>(280)</b> | <b>1,130</b> |            |           |           |

**Notes to the consolidated financial statements (continued)****35 Reconciliation to US generally accepted accounting principles (continued)****Movements in US GAAP shareholders' equity**

|                                                                                    | 2007         | 2006      | 2005      |
|------------------------------------------------------------------------------------|--------------|-----------|-----------|
|                                                                                    | £ million    | £ million | £ million |
| <b>Shareholders' equity in accordance with US GAAP at beginning of the year</b>    | <b>9,508</b> | 9,853     | 10,287    |
| Net income                                                                         | 1,592        | 1,427     | 1,470     |
| Minimum pension liabilities (net of tax)                                           | 267          | 565       | (328)     |
| Net loss upon adoption of SFAS No. 158 (net of tax)                                | (413)        |           |           |
| Dividends                                                                          | (858)        | (864)     | (849)     |
| New share capital issued                                                           | 1            | 3         | 6         |
| Net change in employee share trust arrangements (net of tax)                       | 75           | 11        | (11)      |
| Repurchase of own shares                                                           | (1,481)      | (1,428)   | (710)     |
| Gains/(losses) on available for sale securities                                    |              | 33        | (80)      |
| Realised gains on available for sale securities reclassified to income in the year |              | (106)     | (117)     |
| Exchange differences and changes in fair value of hedges (net of tax)              | (156)        | 14        | 185       |
| <b>Shareholders' equity in accordance with US GAAP at end of the year</b>          | <b>8,535</b> | 9,508     | 9,853     |

**US GAAP summary consolidated balance sheet**

|                                                   | 2007          | 2006      |
|---------------------------------------------------|---------------|-----------|
|                                                   | £ million     | £ million |
| Current assets                                    | 5,455         | 5,026     |
| Property, plant and equipment                     | 2,055         | 2,057     |
| Brands                                            | 7,116         | 7,336     |
| Goodwill                                          | 3,318         | 3,333     |
| Other intangible assets                           | 39            | 55        |
| Other long term assets                            | 2,130         | 2,265     |
| <b>Total assets</b>                               | <b>20,113</b> | 20,072    |
| Short term borrowings                             | 1,567         | 775       |
| Other current liabilities                         | 2,777         | 2,650     |
| Long term borrowings                              | 4,132         | 4,016     |
| Other long term liabilities                       | 2,844         | 2,921     |
| Minority interests                                | 258           | 202       |
| Shareholders' equity                              | 8,535         | 9,508     |
| <b>Total liabilities and shareholders' equity</b> | <b>20,113</b> | 20,072    |

At 30 June 2007, capitalised software of £98 million (2006 £72 million) is included above in property, plant and equipment on the US GAAP consolidated balance sheet, but is included in intangible assets on the IFRS consolidated balance sheet.

**US GAAP cash flows** The group's consolidated financial statements include a consolidated cash flow statement in accordance with IAS 7 *Cash flow statements*. The objective and principles of IAS 7 are similar to those set out in the US accounting standard SFAS No. 95 *Statement of Cash Flows*.



**Notes to the consolidated financial statements (continued)****35 Reconciliation to US generally accepted accounting principles (continued)**

However, under IAS 7, 'cash' for the purposes of the cash flow statement includes bank overdrafts. Under US GAAP, bank overdrafts are classified as borrowings and the movements thereon are included in financing activities. In addition, the accounting for variable interest entities and jointly controlled entities differs between IFRS and US GAAP, which changes the amounts included as cash and cash equivalents.

Calculated in accordance with SFAS No. 95, cash and cash equivalents at 30 June 2007 and 2006 were as follows:

|                                                                                                      | <u>2007</u> | <u>2006</u> |
|------------------------------------------------------------------------------------------------------|-------------|-------------|
|                                                                                                      | £ million   | £ million   |
| <b>Net cash and cash equivalents in the consolidated cash flow statement in accordance with IFRS</b> | <b>839</b>  | <b>651</b>  |
| Adjustments to conform with US GAAP:                                                                 |             |             |
| Bank overdrafts                                                                                      | 46          | 48          |
| Variable interest entities                                                                           | 67          | 33          |
| Jointly controlled entities                                                                          | (25)        | (23)        |
|                                                                                                      | <u>927</u>  | <u>709</u>  |
| <b>Cash and cash equivalents in accordance with US GAAP</b>                                          | <b>927</b>  | <b>709</b>  |

**US GAAP taxation** An analysis of taxation expense in the US GAAP statement of income is as follows:

|                                                                  | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|------------------------------------------------------------------|-------------|-------------|-------------|
|                                                                  | £ million   | £ million   | £ million   |
| Current tax expense                                              | 394         | 302         | 292         |
| Deferred tax expense                                             | 40          | 160         | 21          |
|                                                                  | <u>434</u>  | <u>462</u>  | <u>313</u>  |
| <b>Total taxation expense in the US GAAP statement of income</b> | <b>434</b>  | <b>462</b>  | <b>313</b>  |

An analysis of deferred tax included in the US GAAP summary consolidated balance sheet is as follows:

|                                   | <u>2007</u>    | <u>2006</u>    |
|-----------------------------------|----------------|----------------|
|                                   | £ million      | £ million      |
| Current assets                    | 80             | 30             |
| Other long term assets            | 18             | 37             |
| Other current liabilities         | (38)           | (6)            |
| Other long term liabilities       | (1,964)        | (1,986)        |
|                                   | <u>(1,904)</u> | <u>(1,925)</u> |
| <b>Net deferred tax liability</b> | <b>(1,904)</b> | <b>(1,925)</b> |

**Notes to the consolidated financial statements (continued)****35 Reconciliation to US generally accepted accounting principles (continued)**

The components of deferred tax assets and liabilities under US GAAP are as follows:

|                                   | <b>2007</b>      | <b>2006</b>      |
|-----------------------------------|------------------|------------------|
|                                   | <b>£ million</b> | <b>£ million</b> |
| Plant and equipment               | (233)            | (237)            |
| Intangible assets                 | (1,972)          | (2,018)          |
| Postretirement benefit plans      | 135              | 104              |
| Tax losses                        | 21               | 19               |
| Other temporary differences       | 145              | 207              |
|                                   | <b>(1,904)</b>   | <b>(1,925)</b>   |
| <b>Net deferred tax liability</b> | <b>(1,904)</b>   | <b>(1,925)</b>   |

**US GAAP intangible assets** Under US GAAP, up to 30 June 2001, intangible assets were capitalised in the balance sheet and amortised through the statement of income over their useful economic lives, not exceeding 40 years. On 1 July 2001, the group adopted the provisions of SFAS No. 142 and ceased to amortise goodwill from this date. The standard directs that goodwill is tested at least annually for impairment rather than being subject to amortisation. The group conducts annual impairment reviews of goodwill at the level of the reporting units which make up each operating segment. Potential impairment is assessed by comparing the carrying value of each reporting unit with its fair value. Fair value is calculated using a discounted cash flow methodology and estimates regarding future growth. These cash flows are discounted at the rate estimated by management to be the weighted average cost of capital for each particular reporting unit. The estimates are based on historical data, various internal estimates and a variety of external sources, and are developed as part of the long term planning process.

**Notes to the consolidated financial statements (continued)****35 Reconciliation to US generally accepted accounting principles (continued)**

An analysis of movements in intangible assets for the two years ended 30 June 2007 is as follows:

|                                               | Brands       | Goodwill     | Other<br>intangibles | Total         |
|-----------------------------------------------|--------------|--------------|----------------------|---------------|
|                                               | £ million    | £ million    | £ million            | £ million     |
| <b>Cost</b>                                   |              |              |                      |               |
| At 30 June 2005                               | 7,829        | 3,614        | 169                  | 11,612        |
| Exchange differences                          | (53)         | (14)         | (1)                  | (68)          |
| Additions                                     | 144          | 43           | 2                    | 189           |
| Adjustments to tax in respect of acquisitions |              | 76           |                      | 76            |
| Reclassifications                             | 16           | (16)         |                      |               |
| Disposals                                     |              | (1)          |                      | (1)           |
|                                               | <u>7,936</u> | <u>3,702</u> | <u>170</u>           | <u>11,808</u> |
| At 30 June 2006                               | 7,936        | 3,702        | 170                  | 11,808        |
| Exchange differences                          | (259)        | (44)         | (1)                  | (304)         |
| Additions                                     | 20           | 26           | 1                    | 47            |
| Transfers                                     |              |              | (6)                  | (6)           |
|                                               | <u>7,697</u> | <u>3,684</u> | <u>164</u>           | <u>11,545</u> |
| <b>At 30 June 2007</b>                        | <b>7,697</b> | <b>3,684</b> | <b>164</b>           | <b>11,545</b> |
| <b>Amortisation</b>                           |              |              |                      |               |
| At 30 June 2005                               | 606          | 369          | 105                  | 1,080         |
| Exchange differences                          | (6)          |              | (1)                  | (7)           |
| Provided during the year                      |              |              | 11                   | 11            |
|                                               | <u>600</u>   | <u>369</u>   | <u>115</u>           | <u>1,084</u>  |
| At 30 June 2006                               | 600          | 369          | 115                  | 1,084         |
| Exchange differences                          | (19)         | (3)          |                      | (22)          |
| Provided during the year                      |              |              | 10                   | 10            |
|                                               | <u>581</u>   | <u>366</u>   | <u>125</u>           | <u>1,072</u>  |
| <b>At 30 June 2007</b>                        | <b>581</b>   | <b>366</b>   | <b>125</b>           | <b>1,072</b>  |
| <b>Net book value</b>                         |              |              |                      |               |
| <b>At 30 June 2007</b>                        | <b>7,116</b> | <b>3,318</b> | <b>39</b>            | <b>10,473</b> |
| At 30 June 2006                               | 7,336        | 3,333        | 55                   | 10,724        |
| At 30 June 2005                               | 7,223        | 3,245        | 64                   | 10,532        |

The differences in the shareholders' equity reconciliation between IFRS and US GAAP for brands, goodwill and other intangibles are attributable to historical cost differences of £3,642 million, £3,514 million and £106 million, respectively (2006 £3,684 million, £3,554 million and £112 million, respectively), less differences on accumulated amortisation of £581 million, £351 million and £102 million, respectively (2006 £600 million, £353 million and £96 million, respectively). In addition, differences in respect of unconsolidated affiliates amount to £40 million (2006 £39 million). In segmental information, brands would be reported within 'Corporate and other'.



**Notes to the consolidated financial statements (continued)****35 Reconciliation to US generally accepted accounting principles (continued)**

An analysis of the net book value of goodwill by reporting segment is as follows:

|                                   | North<br>America | Europe       | Asia Pacific | International | Total        |
|-----------------------------------|------------------|--------------|--------------|---------------|--------------|
|                                   | £ million        | £ million    | £ million    | £ million     | £ million    |
| At 30 June 2005                   | 959              | 973          | 367          | 946           | 3,245        |
| Exchange differences              | (7)              | 3            | (9)          | (1)           | (14)         |
| Additions                         |                  | 43           |              |               | 43           |
| Reclassifications and adjustments | 78               | (10)         | (8)          |               | 60           |
| Disposals                         |                  | (1)          |              |               | (1)          |
| <b>At 30 June 2006</b>            | <b>1,030</b>     | <b>1,008</b> | <b>350</b>   | <b>945</b>    | <b>3,333</b> |
| Exchange differences              | (20)             | (8)          | (12)         | (1)           | (41)         |
| Additions                         |                  | 26           |              |               | 26           |
| <b>At 30 June 2007</b>            | <b>1,010</b>     | <b>1,026</b> | <b>338</b>   | <b>944</b>    | <b>3,318</b> |

The estimated amortisation expense for other intangibles for the succeeding five years ending 30 June is as follows: 2008 £8 million, 2009 £4 million, 2010 £4 million, 2011 £4 million and 2012 £4 million.

**Employee share compensation** For the year ended 30 June 2005, the group complied with *APB Opinion No. 25 Accounting for Stock Issued to Employees*. From 1 July 2005, the group adopted the provisions of *SFAS No. 123(R) Share-Based Payment* using the modified prospective transition method. Under this method, compensation expense, determined using the fair value of the underlying option or share, is charged to the income statement for new grants made in the year and any unvested grants made in prior years. Compensation expense is recognised on a straight-line basis over the vesting period of the share option or grant. For the year ended 30 June 2007, this resulted in a charge of £23 million (2006 £23 million) included in selling, general and administrative expenses and £5 million (2006 £5 million) in cost of goods sold. In accordance with the modified prospective transition method, the US GAAP financial information for the year ended 30 June 2005 has not been restated.

At 30 June 2007, there was £34 million (2006 £34 million) of unrecognised compensation cost in respect of non vested share-based compensation granted under the various share option and share award plans. The cost is expected to be recognised over a weighted average period of two years.

For the year ended 30 June 2007, the cash received from employees in respect of the exercise of options was £74 million (2006 £69 million; 2005 £69 million).

All share option schemes, with the exception of SESOP, are equity-classified awards under SFAS No. 123(R). SESOP is a liability-classified award which is re-measured to fair value at each balance sheet date until the award vests.

**Notes to the consolidated financial statements (continued)****35 Reconciliation to US generally accepted accounting principles (continued)**

If the group had elected to recognise compensation expense based upon SFAS No. 123 in prior years, the net income and basic and diluted earnings per ordinary share for the year ended 30 June 2005 would have been the pro forma amounts set out below:

|                                                                                                                     | <b>2005</b>      |
|---------------------------------------------------------------------------------------------------------------------|------------------|
|                                                                                                                     | <b>£ million</b> |
| <b>Net income</b>                                                                                                   |                  |
| As reported under US GAAP                                                                                           | 1,470            |
| Stock-based compensation, net of related tax effects, included in the determination of net income as reported       | 17               |
| Stock-based employee compensation expense, under fair value based method for all awards, net of related tax effects | (26)             |
| <b>Pro forma net income</b>                                                                                         | <b>1,461</b>     |
| <b>Basic earnings per ordinary share</b>                                                                            |                  |
| As reported under US GAAP                                                                                           | 49.5p            |
| Pro forma basic earnings per ordinary share                                                                         | 49.2p            |
| <b>Diluted earnings per ordinary share</b>                                                                          |                  |
| As reported under US GAAP                                                                                           | 49.4p            |
| Pro forma diluted earnings per ordinary share                                                                       | 49.1p            |

**Pension and other postretirement benefits** The group operates a number of pension plans throughout the world, devised in accordance with local conditions and practices. The plans are generally of the defined benefit type. The significant plans are in the United Kingdom, Ireland, the United States and Canada. The principal plans are funded by payments to separately administered funds or insurance companies. Contributions are made by the group, on actuarial advice, to provide assets sufficient to cover the benefit entitlements of plan participants. Generally, benefits are based on a formula recognising length of service and earnings close to retirement.

The group also operates a number of plans which provide employees with postretirement insurance. The plans are generally unfunded. The liability in respect of these benefits is assessed by qualified independent actuaries under the projected unit method and is included in other long term liabilities. For all pension and other postretirement benefits, the measurement dates used to calculate the figures in the US GAAP financial information are the appropriate balance sheet dates.

The following weighted average assumptions were used to determine the benefit obligations for the group's pension and other postretirement benefit plans at 30 June in the relevant year. The assumptions used to calculate the net periodic costs for the year to 30 June are based on the assumptions disclosed as at the previous 30 June:

|                                                  | <b>US plans</b> |             |             | <b>Non-US plans</b> |             |             |
|--------------------------------------------------|-----------------|-------------|-------------|---------------------|-------------|-------------|
|                                                  | <b>2007</b>     | <b>2006</b> | <b>2005</b> | <b>2007</b>         | <b>2006</b> | <b>2005</b> |
|                                                  | %               | %           | %           | %                   | %           | %           |
| Rate of general increase in salaries             | <b>3.3</b>      | 3.4         | 3.0         | <b>4.2</b>          | 3.9         | 3.9         |
| Discount rate for plan liabilities               | <b>6.2</b>      | 6.3         | 5.0         | <b>5.7</b>          | 5.1         | 4.7         |
| Expected long term rate of return on plan assets | <b>7.4</b>      | 7.4         | 6.5         | <b>7.2</b>          | 7.3         | 6.9         |

For the UK and US plans, there are, in addition to the above percentages, age related promotional salary increases.

**Notes to the consolidated financial statements (continued)****35 Reconciliation to US generally accepted accounting principles (continued)**

The weighted average medical inflation for beneficiaries is 10% reducing by 0.5% per year to 5% (2006 9% reducing by 1% per year to 5%; 2005 10% reducing by 1% per year to 5%).

Where appropriate, the disclosures for the year ended 30 June 2007 in the following tables reflect the requirements of *SFAS No. 158 Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment of SFAS Nos. 87, 88, 106 and 132(R).

The net periodic charges for all of the group's pension and other postretirement benefits were as follows:

|                                            | Pension benefits |              |             | Other postretirement benefits |             |            |
|--------------------------------------------|------------------|--------------|-------------|-------------------------------|-------------|------------|
|                                            | 2007             | 2006         | 2005        | 2007                          | 2006        | 2005       |
|                                            | £ million        | £ million    | £ million   | £ million                     | £ million   | £ million  |
| Service cost                               | (90)             | (103)        | (96)        | (7)                           | (7)         | (2)        |
| Interest cost                              | (268)            | (245)        | (264)       | (9)                           | (10)        | (5)        |
| Expected return on assets                  | 304              | 297          | 347         |                               |             |            |
| Amortisation of                            |                  |              |             |                               |             |            |
| unrecognised prior service cost            | (15)             | (15)         | (16)        |                               |             |            |
| unrecognised net loss                      | (94)             | (94)         | (27)        | (1)                           | (2)         |            |
| Terminations, curtailments and settlements | (4)              | (3)          | (22)        |                               |             |            |
| <b>Net periodic charge</b>                 | <b>(167)</b>     | <b>(163)</b> | <b>(78)</b> | <b>(17)</b>                   | <b>(19)</b> | <b>(7)</b> |
| United Kingdom                             | (130)            | (114)        | (56)        |                               | (1)         | (1)        |
| Ireland                                    | (17)             | (28)         | (2)         |                               |             |            |
| United States and other                    | (20)             | (21)         | (20)        | (17)                          | (18)        | (6)        |
|                                            | (167)            | (163)        | (78)        | (17)                          | (19)        | (7)        |

**Notes to the consolidated financial statements (continued)****35 Reconciliation to US generally accepted accounting principles (continued)**

The funded status of the group's pension and other postretirement benefit plans under US GAAP was as follows:

|                                                        | Pension benefits |              | Other postretirement benefits |              |
|--------------------------------------------------------|------------------|--------------|-------------------------------|--------------|
|                                                        | 2007             | 2006         | 2007                          | 2006         |
|                                                        | £ million        | £ million    | £ million                     | £ million    |
| Projected benefit obligations at beginning of the year | 5,252            | 5,297        | 146                           | 118          |
| Exchange differences                                   | (51)             | 10           | (10)                          | (2)          |
| Reclassification (to)/from other postretirement plans  |                  | (24)         |                               | 24           |
| Acquisition of businesses                              |                  | 9            |                               |              |
| Service cost                                           | 90               | 103          | 7                             | 7            |
| Interest cost                                          | 268              | 245          | 9                             | 10           |
| Actuarial (gain)/loss                                  | (87)             | (157)        | 14                            |              |
| Employee contributions                                 | 12               | 11           |                               |              |
| Benefits and expenses paid                             | (245)            | (243)        | (9)                           | (12)         |
| Special termination settlements                        | 4                | 1            |                               |              |
| Plan amendments                                        |                  |              |                               | 1            |
|                                                        | <b>5,243</b>     | <b>5,252</b> | <b>157</b>                    | <b>146</b>   |
| Plan assets at fair value at beginning of the year     | 4,600            | 4,142        | 6                             | 5            |
| Exchange differences                                   | (49)             | 6            |                               |              |
| Reclassification to other postretirement plans         |                  | (3)          |                               |              |
| Acquisition of businesses                              |                  | 6            |                               |              |
| Actual return on plan assets                           | 574              | 584          | 1                             |              |
| Contributions by the group                             | 85               | 97           | 10                            | 10           |
| Employee contributions                                 | 12               | 11           |                               |              |
| Benefits and expenses paid                             | (245)            | (243)        | (9)                           | (9)          |
| Settlements                                            |                  |              | (2)                           |              |
|                                                        | <b>4,977</b>     | <b>4,600</b> | <b>6</b>                      | <b>6</b>     |
| Excess of benefit obligations over plan assets         | (266)            | (652)        | (151)                         | (140)        |
| Unrecognised prior service cost                        |                  | 59           |                               | 4            |
| Unrecognised net loss                                  |                  | 1,224        |                               | 19           |
|                                                        | <b>(266)</b>     | <b>631</b>   | <b>(151)</b>                  | <b>(117)</b> |
| Accumulated other comprehensive income                 |                  | (685)        |                               |              |
| minimum pension liability                              |                  |              |                               |              |
|                                                        | <b>(266)</b>     | <b>(54)</b>  | <b>(151)</b>                  | <b>(117)</b> |

**Notes to the consolidated financial statements (continued)****35 Reconciliation to US generally accepted accounting principles (continued)**

An analysis of the assets and liabilities of the group's pension and other postretirement benefit plans was as follows:

|                                                       | Pension benefits |              | Other postretirement benefits |              |
|-------------------------------------------------------|------------------|--------------|-------------------------------|--------------|
|                                                       | 2007             | 2006         | 2007                          | 2006         |
|                                                       | £ million        | £ million    | £ million                     | £ million    |
| <b>Assets</b>                                         |                  |              |                               |              |
| United Kingdom                                        | 3,466            | 3,188        |                               |              |
| Ireland                                               | 1,143            | 1,056        |                               |              |
| United States and other                               | 369              | 356          | 6                             | 6            |
| <b>Liabilities</b>                                    |                  |              |                               |              |
| United Kingdom                                        | (3,718)          | (3,715)      | (20)                          | (21)         |
| Ireland                                               | (1,125)          | (1,148)      |                               |              |
| United States and other                               | (401)            | (389)        | (137)                         | (125)        |
| <b>Excess of benefit obligations over plan assets</b> | <b>(266)</b>     | <b>(652)</b> | <b>(151)</b>                  | <b>(140)</b> |

The amounts before deferred taxes recognised in the US GAAP consolidated balance sheet were as follows:

|                                  | Pension benefits |           | Other postretirement benefits |           |
|----------------------------------|------------------|-----------|-------------------------------|-----------|
|                                  | 2007             | 2006      | 2007                          | 2006      |
|                                  | £ million        | £ million | £ million                     | £ million |
| <b>Other long term assets</b>    |                  |           |                               |           |
| pension prepayment               | 73               | 284       | 1                             |           |
| other assets                     |                  | 62        |                               |           |
| <b>Other current liabilities</b> |                  |           |                               |           |
| Other long term liabilities      | (336)            | (400)     | (144)                         | (117)     |
|                                  | (266)            | (54)      | (151)                         | (117)     |

The total accumulated benefit obligation at 30 June 2007 was £4,857 million (2006 £4,874 million). There are a number of pension plans where the plan assets are less than the accumulated benefit obligations at 30 June 2007. With respect to these plans, the aggregated projected benefit obligations, accumulated benefit obligations and fair value of plan assets were £3,985 million, £3,733 million and £3,649 million, respectively (2006 £4,093 million, £3,855 million and £3,464 million, respectively).

The impact on the aggregated service cost and interest cost and on the projected benefit obligations of a 1% increase and a 1% decrease in future medical care inflation is as follows:

|                                                               | 2007      | 2006      | 2005      |
|---------------------------------------------------------------|-----------|-----------|-----------|
|                                                               | £ million | £ million | £ million |
| <b>Impact of 1% increase in medical care inflation rates:</b> |           |           |           |
| Increase in aggregate of service cost and interest cost       | 1         | 2         | 1         |
| Increase in projected benefit obligations at end of the year  | 13        | 13        | 13        |

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|                                                              | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|--------------------------------------------------------------|-------------|-------------|-------------|
| Impact of 1% decrease in medical care inflation rates:       |             |             |             |
| Decrease in aggregate of service cost and interest cost      | (1)         | (1)         | (1)         |
| Decrease in projected benefit obligations at end of the year | (11)        | (12)        | (11)        |
| 95                                                           |             |             |             |

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**Notes to the consolidated financial statements (continued)****35 Reconciliation to US generally accepted accounting principles (continued)**

The following table presents the effect of the adoption of SFAS No. 158 on the group's consolidated balance sheet at 30 June 2007:

|                                            | Pension benefits                |                        |                                | Other post retirement benefits  |                        |                                |
|--------------------------------------------|---------------------------------|------------------------|--------------------------------|---------------------------------|------------------------|--------------------------------|
|                                            | Before adoption of SFAS No. 158 | Effect of SFAS No. 158 | After adoption of SFAS No. 158 | Before adoption of SFAS No. 158 | Effect of SFAS No. 158 | After adoption of SFAS No. 158 |
|                                            | £ million                       | £ million              | £ million                      | £ million                       | £ million              | £ million                      |
| Other intangible assets                    | 46                              | (46)                   |                                |                                 |                        |                                |
| Other long term assets                     |                                 |                        |                                |                                 |                        |                                |
| pension prepayment                         | 303                             | (230)                  | 73                             |                                 | 1                      | 1                              |
| deferred taxation                          |                                 | (4)                    | (4)                            | 23                              | (2)                    | 21                             |
| Other current liabilities – postretirement |                                 | (3)                    | (3)                            |                                 | (8)                    | (8)                            |
| Other long term liabilities                |                                 |                        |                                |                                 |                        |                                |
| retirement benefit obligations             | (105)                           | (231)                  | (336)                          | (120)                           | (24)                   | (144)                          |
| deferred taxation                          | (33)                            | 119                    | 86                             | 17                              | 15                     | 32                             |
|                                            | <b>211</b>                      | <b>(395)</b>           | <b>(184)</b>                   | <b>(80)</b>                     | <b>(18)</b>            | <b>(98)</b>                    |

The net reduction in accumulated other comprehensive income and shareholders' equity at 30 June 2007 on adoption of SFAS No. 158 was £413 million.

The amounts recognised in accumulated other comprehensive loss at 30 June 2007, which have not been recognised as components of the net periodic charge for pension and other postretirement benefits, were as follows:

|                         | Pension benefits | Other post retirement benefits | Total      |
|-------------------------|------------------|--------------------------------|------------|
|                         | £ million        | £ million                      | £ million  |
| Prior service cost      | 45               | 3                              | 48         |
| Net actuarial loss      | 760              | 27                             | 787        |
|                         | <b>805</b>       | <b>30</b>                      | <b>835</b> |
| United Kingdom          | 509              | (11)                           | 498        |
| Ireland                 | 216              |                                | 216        |
| United States and other | 80               | 41                             | 121        |
|                         | <b>805</b>       | <b>30</b>                      | <b>835</b> |

**Notes to the consolidated financial statements (continued)****35 Reconciliation to US generally accepted accounting principles (continued)**

It is estimated that the following amounts will be recognised in the net periodic charge for pension and other postretirement benefits in the year ending 30 June 2008:

|                         | <b>Pension<br/>benefits</b> | <b>Other post<br/>retirement<br/>benefits</b> | <b>Total</b>     |
|-------------------------|-----------------------------|-----------------------------------------------|------------------|
|                         | <b>£ million</b>            | <b>£ million</b>                              | <b>£ million</b> |
| Prior service cost      | 12                          |                                               | 12               |
| Net actuarial loss      | 76                          | 2                                             | 78               |
|                         | <b>88</b>                   | <b>2</b>                                      | <b>90</b>        |
| United Kingdom          | 62                          | (1)                                           | 61               |
| Ireland                 | 14                          |                                               | 14               |
| United States and other | 12                          | 3                                             | 15               |
|                         | <b>88</b>                   | <b>2</b>                                      | <b>90</b>        |

**New accounting standards and pronouncements in the United States**

**SFAS No. 155 Accounting for Certain Hybrid Financial Instruments (an amendment of FASB Statements Nos. 133 and 140)** In February 2006, the FASB issued SFAS No. 155. This statement provides a fair value measurement option for certain hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation, and requires that beneficial interests in securitised financial assets be analysed to determine whether they are free standing derivatives or whether they are hybrid instruments that contain embedded derivatives requiring bifurcation. SFAS No. 155 is effective for financial years beginning after 15 September 2006. The adoption of SFAS No. 155 is not expected to have a material effect on the results or net assets of the group.

**SFAS No. 157 Fair Value Measurements** In September 2006, the FASB issued SFAS No. 157, which defines fair value, establishes a framework for measuring fair value and expands disclosures about assets and liabilities measured at fair value. SFAS No. 157 addresses standardising the measurement of fair value for companies that are required to use a fair value measure for recognition or disclosure purposes. The FASB defines fair value as 'the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date'. SFAS No. 157 is effective for financial years beginning after 15 November 2007, and interim periods within those financial years. The adoption of SFAS No. 157 is not expected to have a material effect on the results or net assets of the group.



## Notes to the consolidated financial statements (continued)

### 35 Reconciliation to US generally accepted accounting principles (continued)

**SFAS No. 158 Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans** In September 2006, the FASB issued SFAS No. 158, an amendment of FASB Statements Nos. 87, 88, 106 and 132(R). SFAS No. 158 requires an employer that is a business entity and sponsors one or more single employer benefit plans to: (1) recognise the funded status of the benefit plan in its statement of financial position; (2) recognise as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognised as components of net periodic benefit cost; (3) measure defined benefit plan assets and obligations as of the date of the employer's financial year end statement of financial position; and (4) disclose in the notes to the financial statements additional information about certain effects on net periodic benefit cost for the next financial year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition assets or obligations. The group adopted SFAS No. 158 with effect from 30 June 2007. As a result, under US GAAP, the group recognised a decrease of £281 million in total assets, an increase of £132 million in total liabilities, and an additional charge of £413 million to accumulated other comprehensive income.

**SFAS No. 159 Fair Value Option for Financial Assets and Financial Liabilities** In February 2007, the FASB issued SFAS No. 159. This statement expands opportunities to use fair value measurement in financial reporting and permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective for financial years beginning after 15 November 2007. The group has not designated any non-derivative financial assets or liabilities at fair value through profit or loss upon initial recognition under IFRS, and therefore does not expect to measure any financial instruments at fair value under the provisions of SFAS No. 159.

**FIN 48 Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109** In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48). This interpretation clarifies the accounting for uncertainty in income taxes recognised in an enterprise's financial statements in accordance with FASB Statement No. 109 Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for the group's financial year ending 30 June 2008. The adoption of FIN 48 is not expected to have a material effect on the results or net assets of the group.

**SAB 108 Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements** In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108 (SAB 108), which provides interpretive guidance on how registrants should quantify misstatements when evaluating the materiality of financial statement errors. SAB 108 also provides transition accounting and disclosure guidance for situations in which there existed an error in prior period financial statements, the correction of which could be considered material in the current year, by allowing companies to restate prior period financial statements or recognise the cumulative effect of initially applying SAB 108 through an adjustment to opening retained earnings in the year of adoption. SAB 108 is effective for financial years ending after 15 November 2006. The adoption of SAB 108 had no impact on the group's financial position, results of operations or cash flows.

Other recent accounting pronouncements issued by the FASB (including the Emerging Issues Task Force), the AICPA and the SEC are not believed by management to have a material impact on the group's present or future consolidated financial statements.

## Notes to the consolidated financial statements (continued)

### 36 Post balance sheet events

In the period 1 July 2007 to 29 August 2007, the company acquired and cancelled 24 million shares for a total consideration of £249 million including expenses.

**Principal group companies**

|                               | Country of<br>incorporation | Country of<br>operation | Percentage of<br>equity owned | Business description                                     |
|-------------------------------|-----------------------------|-------------------------|-------------------------------|----------------------------------------------------------|
| <b>Subsidiaries</b>           |                             |                         |                               |                                                          |
| Diageo Ireland                | Ireland                     | Worldwide               | 100%                          | Production, marketing and distribution of premium drinks |
| Diageo Great Britain Limited  | England                     | Worldwide               | 100%                          | Production, marketing and distribution of premium drinks |
| Diageo Scotland Limited       | Scotland                    | Worldwide               | 100%                          | Production, marketing and distribution of premium drinks |
| Diageo Brands BV              | Netherlands                 | Worldwide               | 100%                          | Production, marketing and distribution of premium drinks |
| Diageo North America, Inc     | United States               | Worldwide               | 100%                          | Production, importing and marketing of premium drinks    |
| Diageo Capital plc(a)         | Scotland                    | United Kingdom          | 100%                          | Financing company for the group                          |
| Diageo Finance plc(a)         | England                     | United Kingdom          | 100%                          | Financing company for the group                          |
| Diageo Capital BV             | Netherlands                 | Netherlands             | 100%                          | Financing company for the group                          |
| Diageo Finance BV             | Netherlands                 | Netherlands             | 100%                          | Financing company for the group                          |
| Diageo Investment Corporation | United States               | United States           | 100%                          | Financing company for the US group                       |
| <b>Associate</b>              |                             |                         |                               |                                                          |
| Moët Hennessy, SNC(b)         | France                      | France                  | 34%                           | Production and distribution of premium drinks            |

(a) Directly owned by Diageo plc

(b) French partnership

All percentages, unless otherwise stated, relate to holdings of ordinary share capital and are equivalent to the percentages of voting rights held by the group.

**SIGNATURE**

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the Registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this Amendment No. 1 to its Annual Report to be signed on its behalf by the undersigned, thereunto duly authorised.

Diageo plc  
(Registrant)

/s/ NC ROSE

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**NC Rose**  
Chief financial officer  
5 March 2008

## Exhibits

- 12.3 Certification of Paul S. Walsh filed pursuant to 17 CFR 240.13a-14(a)
- 12.4 Certification of Nicholas C. Rose filed pursuant to 17 CFR 240.13a-14(a)
- 13.3 Certification of Paul S. Walsh furnished pursuant to 17 CFR 240.13a-14(b) and 18 U.S.C.1350(a) and (b)
- 13.4 Certification of Nicholas C. Rose furnished pursuant to 17 CFR 240.13a-14(b) and 18 U.S.C.1350(a) and (b)
- 15.2 Consent of independent registered public accounting firm

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