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Every day, everywhere
2001 Annual Report and Accounts

DIAGEO

Statements by the Chairman and the Group Chief Executive are included in a separate document entitled 2001 Annual Review. That document and this Annual Report and Accounts together comprise the full annual reports and accounts of Diageo plc for the year ended 30 June 2001.

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Operating and financial review

Highlights

Operating profit growth for the year ended 30 June 2001

	Operating profit £ million	Organic growth at level exchange %
Premium Drinks	1,432	14
Quick Service Restaurants	177	(12)
Packaged Food	518	5
	2,127	9

Summary of results

On a reported basis, turnover increased by £951 million (8%) from £11,870 million in the year ended 30 June 2000 to £12,821 million in the year ended 30 June 2001. Excluding the favourable effects of currency, turnover increased 3% and on an organic basis grew 5%.

Reported operating profit before goodwill amortisation and exceptional items increased £147 million (7%) from £1,980 million to £2,127 million. Excluding the favourable effects of currency, operating profit before goodwill amortisation and exceptional items increased 7% and on an organic basis increased 9%.

On a reported basis, advertising, marketing and promotion expenditure increased 12% from £1,706 million to £1,917 million. Organically advertising, marketing and promotion expenditure increased by 8%.

Profit before goodwill amortisation, exceptional items, taxation and minority interests increased by £165 million (9%) from £1,815 million in the year ended 30 June 2000 to £1,980 million in the year ended 30 June 2001. In local currency terms this was an increase of 8%. The net interest charge decreased by £13 million (4%) from £363 million to £350 million in the year ended 30 June 2001.

Exceptional items before taxation were a charge of £232 million in the year ended 30 June 2001. After exceptional items, profit before taxation and minority interests increased by £271 million from £1,451 million to £1,722 million in the year ended 30 June 2001, and profit for the year increased by £250 million from £976 million to £1,226 million in the year ended 30 June 2001.

Unless otherwise stated, percentage movements for turnover, operating profit and advertising, marketing and promotion (marketing) expenditure throughout the operating and financial review are organic movements (at level exchange and after adjusting for acquisitions and disposals). They are before goodwill amortisation and exceptional items. Comparisons are with the equivalent period last year.

Volume has been measured on an equivalent servings basis to nine litre cases of spirits. Equivalent cases are calculated as follows: beer in hectolitres divide by 0.9, wine in nine litre cases divide by 5, ready to drink in nine litre cases divide by 10.

Net sales are turnover less excise duty.

This document contains forward-looking statements that involve risk uncertainty. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including factors beyond Diageo's control. For more details, please refer to the operating and financial review – cautionary statement concerning forward-looking statements.

Operating review

Premium Drinks

Strong organic top line growth continued to be achieved with turnover up 7%.

Reported turnover increased by £463 million (7%) from £7,117 million in the year ended 30 June 2000 to £7,580 million in the year ended 30 June 2001. Reported operating profit before exceptional items increased by £146 million (11%) from £1,286 million to £1,432 million. On an organic basis, turnover increased 7% and operating profit increased 14%.

Volume increased by 4% as a result of volume growth of 6% in global priority brands and 4% in local priority brands. Volume in other categories, which account for 30% of total volume and 28% of total net sales, declined 1% mainly due to continued weakness in other spirits, which were down 1%, and other wines, where volume was down 5% compared to last year.

Net sales increased by 9% to £5,722 million, driven by a combination of price increases, mix improvement and the continued growth of the ready to drink portfolio.

Volume and net sales growth by brand classification

	Equivalent cases millions	Volume growth %	Net sales growth %
Johnnie Walker	10.6	3	7
Guinness	11.0	3	6
Smirnoff	18.4	12	52
J&B	6.2	2	4
Baileys	5.1	10	11
Cuervo	4.3	(6)	9
Tanqueray	1.9	4	7
Malibu	2.3	20	21
Total global priority brands	59.8	6	15
Local priority brands	14.2	4	8
Other	32.5	(1)	(2)
	106.5	4	9
Acquisitions	2.1		
Total	108.6		

Marketing investment increased 10% to £995 million. Marketing spend on the global priority brands grew by 15% to £708 million, particularly behind the launch of Smirnoff Ice in North America, the Keep Walking campaign for Johnnie Walker, and on Baileys. Marketing investment as a percentage of net sales increased by 0.2 percentage points.

Market review

Volume growth by market	Global priority brands %	Local priority brands %	Other brands %	Total %
Major markets				
North America	6	4	–	4
Great Britain	8	3	–	6
Ireland	1	(1)	(2)	–
Spain	7	23	(10)	4
	6	2	(1)	4
Key markets	4	4	1	3
Venture markets	10	8	(5)	4
Total	6	4	(1)	4
Net sales growth by market				
Major markets				
North America	21	13	1	14
Great Britain	16	3	(3)	9
Ireland	7	5	4	5
Spain	12	29	(10)	9
	17	7	–	11
Key markets	10	12	(4)	5
Venture markets	15	8	(6)	7
Total	15	8	(2)	9

Operating profit by market

	2001 £ million	2000 £ million	Organic growth %
Major markets			
North America	363	317	20
Great Britain	162	150	9
Ireland	156	135	11
Spain	85	96	20
	766	698	16
Key markets	447	392	7
Venture markets	219	196	20
Total	1,432	1,286	14

Global Duty Free operations are now reported in key markets and therefore the North American operating profit reported for the year ended 30 June 2000 has been adjusted by £10 million from £327 million to £317 million.

North America

In North America, volume increased by 4%, net sales grew by 14%, marketing investment was up 10% and operating profit grew by 20% as a result of continued strong growth.

Johnnie Walker volume grew 3% and net sales rose 9%. This was the result of strong growth from Johnnie Walker Black, which increased market share by 3 percentage points. The Keep Walking campaign launched in February 2001 was a key driver of this growth. The standard Scotch category remains soft. J&B volume declined by 3%, against a decline of 15% last year, and this decline was offset by price increases resulting in net sales growth of 2%.

Smirnoff volume grew by 11% with the successful launch of Smirnoff Ice, which achieved a volume of 1.1 million equivalent cases, representing 14% of total Smirnoff volume. Excluding Smirnoff Ice, volume declined by 4%, as the price increases implemented last year to reposition the brand continued to impact volume, though net sales increased by 4%.

Baileys volume continued to grow and was up 5% in the year. Malibu volume grew by 29%. Cuervo volume continues to be affected by the agave shortage, and while volume was down 6%, net sales grew 8%.

Volume of local priority brands grew by 4% to 2.6 million equivalent cases. Buchanan's volume grew by 22% and net sales grew by 24%, following a 3% price increase. Beaulieu Vineyard continued to perform strongly with volume up 15% and net sales up 23%.

Marketing increased by 10% to £302 million mainly due to increases in spend behind flavoured Smirnoff line extensions and the introduction of Smirnoff Ice. Marketing investment behind Baileys was up 19% with the launch of the Celebrate campaign.

Great Britain

Volume increased by 6%, net sales grew by 9%, marketing investment was up 6% and operating profit grew by 9% in Great Britain, led by the continued growth of Smirnoff Ice.

Smirnoff volume grew 18% driven by strong performances by both Smirnoff Ice and Smirnoff Red. Smirnoff, excluding Smirnoff Ice, grew 4% driven by increased promotional activity and the brand's association with dance music events. Smirnoff Ice volume doubled to 0.8 million equivalent cases in its second full year following launch, reflecting trade distribution increases in both the off and on trade. In the on trade, distribution doubled to nearly 50%.

Baileys volume grew 14%, with continued growth in its share of both liqueurs and total spirits categories. Net sales grew 11%. Marketing investment increased by 30% over the prior year. Malibu volume declined by 2% as ready to drink products took some share from the specialities category; however, the second half performance showed signs of improvement driven by a successful advertising campaign.

Guinness volume increased 1% compared to a strong performance in the previous year, despite a decline of around 4% in the beer category. Growth has been driven by Guinness Draught Extra Cold and the rollout of the new Guinness fount. Marketing overall fell by 10%, reflecting the high level of investment in the Rugby World Cup in 1999.

Local priority brands volume grew by 3%. Bell's volume grew by 3%, helped by marketing investment up 10% behind promotional activity at Christmas and a new advertising campaign. Archers Aqua, a new ready to drink product designed to leverage the female franchise of Archers, was launched in May 2001. The launch has been very successful and, with initial sales of 40,000 equivalent cases, performance is ahead of expectations.

Ireland

Volume was flat, net sales grew by 5%, marketing investment was up 9% and operating profit grew by 11%.

The decline in Guinness volume in Ireland slowed from 4% last year to 3%. In the Republic of Ireland, the long term decline in Guinness' share of the long alcoholic drinks market has halted, and market share has remained constant at about 34% over the past year. Net sales grew by 1%. Marketing investment, which was 4% lower, was refocused around the Witnness programme.

Smirnoff volume grew by 9% and net sales grew by 36%. Smirnoff Ice volume doubled to 118,000 equivalent cases. Smirnoff Ice is the market leader in premium packaged spirits in the Republic of Ireland with 50% market share. Smirnoff volume, excluding Smirnoff Ice, grew by 1% and net sales grew by 3%. Marketing investment grew by over 50% behind a new advertising campaign launched in December 2000.

Baileys volume and net sales both grew by 21%. Baileys has increased its market share by 3 percentage points to 42%. Marketing spend increased with a year round media presence and sponsorship of television programmes.

Spain

In Spain, volume increased by 4%, net sales grew by 9%, marketing investment was up 14% and operating profit grew by 20% as a result of continued strong growth in all key brands. Reported movements were affected by the disposal last year of Grupo Cruzcampo SA.

J&B volume grew by 7% while maintaining share. Price increases of 2% were implemented in October 2000. Marketing was up 1%. Johnnie Walker volume grew 1%, with a 24% growth in Johnnie Walker Black in response to the introduction of the Keep Walking campaign. Cardhu volume also grew strongly, up 23% to 169,000 cases, and net sales grew 29%. The premium malts category has been growing at about 20% per annum and Diageo's market share increased from 50% to 53%.

Smirnoff volume grew by 2%. This volume growth together with a significant price increase led to net sales growth of 27%. Marketing investment grew by 26%. Baileys volume grew by 6%, supported by the introduction of a year round advertising campaign, and marketing investment grew by 10%. Baileys net sales grew by 12% driven by price increases.

Malibu volume grew by 37% to 195,000 equivalent cases. Marketing investment grew by 38% behind the introduction of a new advertising campaign.

Pampero dark rum volume grew 60% to 100,000 cases and it is the fastest growing brand in the fastest growing premium drinks category of the Spanish market.

Key markets

Key markets operating profit grew by 7%, reflecting varied performance across a number of markets.

Reported operating profit for key markets grew by 14% to £447 million, as East Africa Breweries and Bundaberg are now accounted for as subsidiaries following the acquisition of further shares. Reported turnover increased £192 million (12%) despite the disposal in Brazil of certain non-core brands including Dreher. Operating profit growth was 7%.

In the African key markets, Guinness volume was up 8%, with strong growth in Nigeria and Cameroon driven by the Michael Power advertising campaign. Spirits volume was up by 8% driven by the performance of Smirnoff Ice in South Africa and Johnnie Walker in West Africa.

In Venezuela, where the economy has benefited from an increase in oil prices, the business has performed well and volume was up 77%. Johnnie Walker Black and Deluxe grew 30% and VAT69 volume tripled to 0.9 million cases. Overall the other Latin American markets designated as key (Brazil, Paraguay, Colombia and Mexico) reported results down compared with last year, as volume declined due to duty increases and distributor de-stocking.

In Thailand, economic conditions and an excise duty increase in April 2001 impacted the business' performance. Volume declined by 2% and net sales declined by 1%. Marketing expenditure was up 66%, due to the impact of staging the Johnnie Walker Classic golf tournament.

In Taiwan, the successful introduction of the Keep Walking campaign for Johnnie Walker and a distribution drive for Johnnie Walker Black and Red into independent off trade retail led to a strong year. Johnnie Walker volume growth in total was 26% with Black up 69%.

Volume in Korea was up by 30%, with a 25% increase in Dimple volume to over 700,000 cases. Approximately 50% of the volume growth could be attributed to an increase in distributor stocks before the introduction of a new liquor purchase card in the market.

In Greece, there was strong volume growth across global priority brands. Gordon's Space volume was up 30% and it is the number one ready to drink brand in the market.

Venture markets

Venture markets operating profit increased by 20% to £219 million with strong performances in most markets.

Volume grew by 4%, with global and local priority brands growing 10% and 8%, respectively. Net sales increased by 7% and marketing investment grew by 16%, reflecting increased investment behind Johnnie Walker Black and Baileys, as well as the launch of Smirnoff Ice in a number of markets. The European venture businesses performed well and although the Asian venture businesses had a challenging year, being impacted by economic down turn in Asia, overall they delivered both volume and profit growth compared with the previous year.

Burger King

> System sales were down 1%
> Total restaurants up 2% compared with 30 June 2000 to 11,372
> Worldwide comparable restaurant sales down 4%
> Operating profit declined 12% to £177 million
> Operating margin down 2.9 percentage points to 17.0%

Fewer restaurant openings and more closures in the year; reported operating profit fell by £25 million to £177 million.

In the year ended 30 June 2001, 550 new restaurants were opened against 796 new openings in the prior year. In addition, restaurant closures were 339 in the year compared with 161 last year. These adverse movements were due to a weaker financial position of some parts of the franchisee system and a tightened lending environment.

Worldwide comparable restaurant sales declined by 4%, with 4% decline in the United States. The decline in operating profit reflects the decline in worldwide comparable restaurant sales and the lower level of increases in restaurant numbers.

In North America, system sales were down 2%, which led to an 18% decline in operating profit.

The North American business declined 24% in the second half of the year compared to a 12% decline in the first half. The reduction in the number of new restaurant openings and the closure of an increased number of poor performing restaurants has reduced profits.

The International business experienced a decline in comparable restaurant sales of 4%.

The International business suffered significant decline in comparable restaurant sales in the second half, driven primarily by the slowdown in Europe, where comparable restaurant sales were down 9%.
In addition, new restaurant openings were lower than in the prior year and 23 restaurants were closed in Poland and 45 in Japan as a result of the decision to exit this market.

Pillsbury

> Volume flat
> Turnover up 2% to £4,199 million
> Marketing expenditure up 6% to £886 million
> Operating profit up 5% to £518 million
> Operating margin up 0.3 percentage points to 12.3%

Improved performance in Pillsbury North America was offset by the impact of softness in the Foodservice category.

Pillsbury's turnover increased 2% as a result of higher pricing and improved mix of value added products in Pillsbury North America and volume growth in International. Overall top line growth was limited by Pillsbury Bakeries and Foodservice where turnover declined due to category softness and aggressive competitor activity. Investment in marketing activities, mainly in Pillsbury North America, increased 6% during the year to £886 million in support of new products and other growth initiatives. Growth in turnover, coupled with lower overheads, due in part to the restructuring actions taken last year, improved operating profit by 5% and operating margin by 0.3 percentage points during the year.

Pillsbury North America

Pillsbury's largest business, Pillsbury North America, achieved turnover growth of 4%. Operating margin growth was achieved as a result of pricing actions across the portfolio and volume increases in value added products. An increase of 7% in marketing investment provided the foundation for continuing growth.

Turnover increases were led by Progresso up 21%, Totino's up 9% and Old El Paso up 7%. Progresso continued to gain market share behind a 30% increase in marketing investment and the successful introduction of new products. Strong category performance and successful merchandising programmes drove Totino's growth during the year. Old El Paso returned to growth on the strength of Meal Dinner Kit products. Refrigerated Baked Goods achieved double digit operating profit growth driven by improved pricing, operational efficiencies and more efficient marketing investment. Frozen Breakfast turnover and profit declined during the year as competitive activities increased in the waffles segment and as expenditure increased in support of new product introductions.

Pillsbury Bakeries and Foodservice

Turnover for Pillsbury Bakeries and Foodservice declined 6% as the foodservice and in-store retail channels experienced softness due to weaker demand and increased competitor activity. These trends have impacted Pillsbury Bakeries and Foodservice sales to a number of quick serve and midsize restaurants and also volume sold through distributors. The reduction in turnover, combined with margin pressures from a more intense competitive environment, resulted in a 39% decline in operating profit during the year. In recent months Pillsbury Bakeries and Foodservice has made improvements which have lowered costs and streamlined manufacturing operations.

International

Turnover growth of 3% was achieved in International driven by volume increases in key markets such as the United Kingdom, Venezuela, the Middle East and Australia. The Häagen-Dazs and Old El Paso brands achieved strong volume growth. Turnover growth was limited by soft volume performance in Brazil and Argentina due to unfavourable economic conditions. Overall, increased investment in marketing and local infrastructure outweighed turnover gains during the year.

Strategic initiatives

Progress is continuing on the group's strategic initiatives.

The new management team at Burger King has been strengthened by a number of key appointments of executives with wide experience in the relevant areas of hospitality, fast food and marketing. They are working on the strategy to restore market share and improve operating performance, as well as to facilitate the separation of Burger King from Diageo.

The regulatory review of the proposed combination of Pillsbury, the Packaged Food business, with General Mills has extended beyond the period originally expected by the parties and, although the contract remains in place, either Diageo or General Mills may terminate the contract without penalty. The parties are continuing to work hard to address outstanding issues with the FTC and currently expect that the FTC review process will conclude in October.

The proposed acquisition of the Seagram spirits and wine business with Pernod Ricard is also awaiting regulatory approval and the parties are endeavouring to resolve the issues raised by regulators in the United States and Canada. Meanwhile, excellent progress has been made on plans for the integration of the businesses using the experience gained from the UD/IDV integration. It is expected that net proceeds from disposals will be slightly higher than originally anticipated.

Financial review

Exchange rates

Exchange rate movements during the year, including the effect of the currency option cylinders, favourably impacted profit before goodwill, exceptional items and tax by £11 million. The adverse impact of exchange rate movements on the translation of overseas operating profit was £22 million, which was more than offset by the favourable impact on transactions in the year of £28 million, giving a net favourable impact on operating profit of £6 million. Exchange rate movements also favourably affected the share of profits of associates by £1 million and the interest charge by £4 million.

Based on current exchange rates, it is estimated that the impact from exchange rate movements on profit before exceptional items and tax for the year ending 30 June 2002 will be a favourable impact of approximately £30 million.

Associates

The group's share of profits of associates before interest and exceptional items was £203 million for the year compared with £198 million for last year, an organic growth of 7%.

Goodwill

Goodwill amortisation in the year was £26 million compared with £17 million in the previous year. The increase is in respect of Burger King and Pillsbury acquisitions.

Exceptional items

Exceptional operating cost items amounted to a charge of £228 million before taxation. This comprised integration and restructuring costs of £163 million and net charges in respect of Burger King of £65 million.

The principal restructuring cost was £74 million in respect of the integration of the UDV (spirits and wine) and the Guinness (beer) businesses. It is expected that the total costs of this merger will be approximately £170 million and that most of the balance will be incurred next year. The other costs were £54 million for the reorganisation of beer production facilities in Great Britain and Ireland, £25 million relating to restructuring of ownership and management within premium drinks, and £10 million in respect of production facilities in Pillsbury Bakeries and Foodservice.

Exceptional items also included three items relating to Burger King. Following a review by management, provisions of £49 million have been made against certain fixed assets. In addition, there were costs associated with litigation amounting to £21 million. These costs have been partly offset by exceptional income of £5 million in respect of successor franchise fees.

The disposals of premium drinks brands in Latin America resulted in a profit of £28 million. Professional fees, retention bonuses and other costs totalling £51 million were incurred in the year relating to the Pillsbury/General Mills transaction.

Interest

The interest charge in the year decreased to £350 million from £363 million in the comparable period. The benefits in respect of the disposal of businesses and cash flow were partly offset by the funding of acquisitions and share repurchases.

Taxation

The effective rate of taxation on profit before goodwill amortisation and exceptional items for the year was 23.0%, compared with 26.2% for the year ended 30 June 2000 and a 25% effective rate estimated for the interim results. The two percentage points reduction in the effective rate from 25% reflects a low effective rate of taxation in respect of associated companies which is not expected to recur.

Dividend

The directors recommend a final dividend of 13.4 pence per share to be paid on 5 November 2001 to shareholders on the register on 21 September 2001. Dividends for the year will total 22.3 pence per share, an increase of 6% on last year's dividends. A dividend reinvestment plan is available in respect of the final dividend and the plan notice date is 15 October 2001.

Cash flow

Free cash inflow was £1,220 million, compared with £864 million in the prior year. Cash inflow from operating activities was £2,276 million compared with £2,043 million. This inflow was after £144 million of restructuring and integration costs and a £54 million increase in working capital, compared with £198 million and £62 million, respectively. Net interest payments were £446 million against £405 million in the comparable year. Purchases of tangible fixed assets in the year amounted to £439 million, a decrease of £108 million. Tax payments were £230 million compared with £285 million, the reduction being mainly due to a repayment of UK advance corporation tax.

	2001 £ million	2000 £ million
Operating profit before exceptionals	2,101	1,963
Depreciation and amortisation charge	403	365
Working capital	(54)	(62)
Restructuring and integration	(144)	(198)
Other items	(30)	(25)
Operating cash flow	2,276	2,043
Interest less dividends from associates	(376)	(368)
Taxation	(230)	(285)
Purchase of own shares (net)	(54)	(38)
Net capital expenditure	(396)	(488)
Free cash flow	1,220	864

Acquisitions of businesses cost £136 million and the purchase of 17.8 million ordinary shares for cancellation in the year cost £108 million. Sales of businesses generated £31 million.

Balance sheet

Total shareholders' funds were £5,187 million at 30 June 2001 compared with £4,711 million at 30 June 2000. The principal reason for the increase was the £475 million retained income for the year, with the repurchase of shares of £108 million being broadly offset by exchange gains of £95 million.

Net borrowings were £5,479 million, a decrease of £66 million from 30 June 2000. This decrease reflects the free cash inflow of £1,220 million noted above, partly offset by dividends paid of £725 million, increases due to exchange movements of £229 million and net payments from sales/purchases of businesses of £105 million.

Share repurchase

The group's management is committed to enhancing shareholder value, both by investing in the businesses and brands so as to maximise the return on investment and by managing the capital structure so as to minimise the cost of capital, whilst maintaining prudent financial ratios.

The company acquired, and subsequently cancelled, 17.8 million ordinary shares in the financial year, pursuant to the company's authority from shareholders granted in 1999. This repurchase represented 0.52% of the issued share capital at 30 June 2001 and cost £108 million. The group will continue to review its capital structure in the light of market conditions and to conduct share buy-backs when appropriate. The group has authority to repurchase up to 10% of its shares.

Adoption of new accounting standards

The financial statements comply with the transitional disclosure requirements of FRS 17 and with FRS 18. These are described in note 1 to the financial statements. Compliance with these two standards did not give rise to any restatement of prior periods, though a restatement in respect of FRS 17 is expected when full compliance is required.

Risk management

The group's funding, liquidity and exposure to interest rate and foreign exchange rate risks are managed by the group's treasury department. The treasury department uses a combination of derivative and conventional financial instruments to manage these underlying treasury risks.

Treasury operations are conducted within a framework of board-approved policies and guidelines. These include benchmark exposure and/or hedge cover levels for each of the above areas of treasury risk. The framework provides for limited defined levels of flexibility in execution to allow for the optimal application of the board-approved strategies. Transactions giving rise to exposures away from the defined benchmark levels arising from the application of this flexibility are separately monitored on a daily basis using value at risk analysis. They are carried at fair value and gains or losses are taken to the profit and loss account as they arise.

The board receives bi-monthly reports on the activities of the treasury department, including any exposures away from the defined benchmarks. The internal control environment is reviewed regularly.

Currency risk The group publishes its 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 subsidiaries.

The group hedges a substantial portion of its exposure to fluctuations on the translation into sterling of its foreign currency net assets by holding net borrowings in foreign currencies and by using foreign currency swaps and cross-currency interest rate swaps. The group's current policy is to hedge currency exposure on its net assets before net borrowings at approximately the following percentages – 75% for US dollars, 90% for euro currencies and 50% for other significant currencies. Although this leaves the remaining part of the group's net assets subject to currency movements, this policy reduces the volatility of the interest charge, interest cover, gearing and absolute debt levels. Exchange differences arising on the retranslation of foreign currency net borrowings and foreign exchange swaps are recognised in the statement of total recognised gains and losses to match exchange differences on foreign currency equity investments, in accordance with SSAP 20.

It is group policy to hedge, normally on a rolling 12 month basis, the translation of a proportion of its forecast future profits denominated in US dollars and euro currencies, primarily with currency option cylinders (which consist of separate put and call options). This limits in part the translation exposure of the group's profit to movements in the exchange rates. For the profits hedged with currency option cylinders, the group is only exposed to exchange rate movements within a specified range. The impact of exchange rate movements outside that range is taken by the counterparty to the hedge. Gains and losses on option cylinders are recognised in the underlying hedged periods.

For currencies in which there is an active market, the group hedges between 80% and 100% of transactional foreign exchange rate risk, up to 18 months forward, using forward foreign currency exchange contracts. The gain or loss on the hedge is recognised at the same time as the underlying transaction.

Interest rate risk The group has an exposure to interest rate risk and, within this category of market risk, is most vulnerable to changes in US dollar, sterling and euro interest rates. To manage interest rate risk, the group manages its proportion of fixed to variable rate borrowings within limits approved by the board, primarily through issuing long term fixed rate bonds, medium term notes and floating rate commercial paper, and by utilising interest rate swaps, cross-currency interest rate swaps and swaptions. The profile of fixed rate to floating rate net borrowings is maintained such that projected net borrowings are fully floating after five years, and are approximately 50% fixed and 50% floating within five years. The floating element of US dollar net borrowings within five years is partly protected using interest rate collars. In addition, where appropriate, the group uses forward rate agreements to manage short term interest rate exposures. Swaps, swaptions, forward rate agreements and collars are accounted for as hedges.

Such management serves to increase the accuracy of the business planning process and to help manage the interest cover ratio, which the group currently aims to maintain at a minimum level of five times over the long term. The group's interest cover ratio may, however, go below such minimum level in the short term.

After the year end, Diageo entered into $1,000 million nominal value of interest rate swaps. These were transacted in order to take advantage of low interest rate levels and guarantee a low funding rate for a proportion of future funding needs. This represented an exception to the group's interest rate risk policy. Accordingly, it was approved by the board.

Liquidity risk The group's strategy with regard to the maturity profile of borrowings is to maintain the proportion of borrowings maturing within one year at below 60% of total borrowings, and to maintain the level of commercial paper at below 50% of total borrowings. In addition it is group policy to maintain backstop facility terms from relationship banks to support commercial paper obligations.

Credit risk A large number of major international financial institutions are counterparties to the interest rate swaps, foreign exchange contracts and deposits transacted by the group. Counterparties for such transactions entered into during the year have a long term credit rating of A or better. The group monitors its credit exposure to its counterparties, together with their credit ratings.

Commodity price risk The group uses commodity futures and options to hedge against price risk in certain major agricultural commodities purchased by the Packaged Food business. All commodity futures and options contracts hedge a projected future purchase of raw material. Commodity futures are then either sold 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 but any gains and losses are deferred until the contracts are sold or exchanged. Open contracts at 30 June 2001 and gains and losses realised in the period or deferred at the balance sheet date were not significant.

Employee share schemes Awards and option grants vesting under the various employee share schemes are generally satisfied by the transfer of existing shares. These awards and option grants are hedged through the purchase of shares or call options. Exceptions to this policy, are exercises under certain GrandMet and international schemes which are are satisfied by the issue of new equity.

Sensitivity analysis

For financial instruments held, the group has used a sensitivity analysis technique that measures the change in the fair value of the group's financial instruments from hypothetical changes in market rates.

The amounts generated from the sensitivity analysis are forward-looking estimates of market risk assuming certain adverse market conditions occur. Actual results in the future may differ materially from those projected results due to developments in the global financial markets which may cause fluctuations in interest and exchange rates to vary from the hypothetical amounts disclosed in the table below, which therefore should not be considered a projection of likely future events and losses.

The estimated changes in the fair values of borrowings, the guaranteed preferred securities and the associated derivative financial instruments at 30 June 2001 are set out in the table below. The basis of the estimated fair values is set out in note 18 to the financial statements.

The estimated changes in fair values for interest rate movements are based on an instantaneous decrease of 1% (100 basis points) in the specific rate of interest applicable to each class of financial instruments from the levels effective at 30 June 2001, with all other variables remaining constant. The estimated changes in the fair value for foreign exchange rates are based on an instantaneous 10% weakening in sterling against all other currencies from the levels applicable at 30 June 2001, with all other variables remaining constant. Such analysis is for illustrative purposes only – in practice, market rates rarely change in isolation.

Sensitivity analysis table at 30 June 2001

		Fair value changes arising from:	
	Estimated fair value £ million	1% fall in interest rates £ million	10% weakening in sterling £ million
Borrowings	(7,807)	(188)	(664)
Interest rate contracts	351	61	45
Foreign exchange contracts:			
Transaction	(27)	–	(141)
Balance sheet translation	17	–	2
Foreign exchange options profit translation	(22)	–	(99)
Guaranteed preferred securities	(451)	(12)	(50)
Commodity contracts	(4)	–	–
Other financial net assets	182	6	20

Euro

In accordance with the Treaty on European Union, signed at Maastricht on 7 February 1992, the third stage of Economic and Monetary Union (EMU) commenced on 1 January 1999. The following 12 member states have transferred authority for conducting monetary policy to a European Central Bank: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal and Spain. A single currency called the euro was introduced and its value as against the currencies of each of the participating member states was irrevocably fixed. The euro exists in parallel with national currencies, and transactions may be denominated in either currency until 31 December 2001. From 1 January 2002, euro notes and coins will be introduced and all transactions currently denominated in national currencies will be re-denominated into euros. National currencies will be withdrawn by 30 June 2002.

The group has significant operations within the European Union. The implications include: preparing business systems for trading in euros and converting the accounting systems of companies in the common currency area from their national currency to euros; the benefit of the elimination of exchange rate risk in cross-border transactions within the common currency area; the potential impact of increased pricing transparency on price differentials between member states; and training and human resources issues. In addition, monetary union may have a significant impact on macro-economic factors, including interest and foreign exchange rates.

All businesses, and the corporate centre, will have systems and procedures in place which enable them to conduct euro transactions appropriate to their local market requirements.

Litigation

On 3 April 2000, partial summary judgement was granted against UDV North America, Inc (UDVNA) in US litigation on the loss of control provision in its arrangements with Tequila Cuervo La Rojena, SA de CV for the distribution of Jose Cuervo tequila brands. The loss of control issue arose as a result of the merger between GrandMet and Guinness in 1997. The effect of the court's decision, if upheld in all respects, would be to recognise the right of Tequila Cuervo La Rojena, SA de CV to terminate the current arrangement for the distribution of Jose Cuervo brands in the United States by UDVNA. The judgement has been appealed and the result of this is currently awaited. The distribution arrangements remain currently in effect under a standstill agreement during negotiations on a new distribution agreement. The Jose Cuervo brands contributed approximately £320 million to group sales in North America and approximately £95 million, before the allocation of certain overhead costs, to group operating profit in the year ended 30 June 2001. In the ordinary course of business, UDVNA does not allocate such overhead costs to individual brands, and in the event that the distribution rights were terminated the directors do not expect that the reduction in such costs would be material. The group's 45% holding in the ordinary share capital of Jose Cuervo SA is not directly affected by this judgement.

In August 2000, Diageo learned that the Governors of the Departments of the Republic of Colombia and the City of Bogotá (the 'Departments') were considering initiating legal proceedings against major spirits companies in relation to unpaid excise duties and taxes on products which are smuggled into Colombia by third parties. Such proceedings are thought to be likely to be similar to those brought against RJR Reynolds Tobacco Holdings, Inc. (RJR) in December 1999 by the Attorney General of Canada in the Northern District of New York. In the latter proceedings, the complaint was dismissed on RJR's motion to dismiss on 30 June 2000. An appeal against that decision is currently pending. The directors intend that any proceedings of this kind which might be brought against Diageo will be strenuously defended. In December 2000, Diageo filed suits against the Departments challenging the legality of any claim outside the Colombian administration and judicial system and also challenging the legality of the discriminatory nature of the Colombian taxing system; these suits are pending.

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.

Cautionary statement concerning forward-looking statements

This report contains statements with respect to the financial condition, results of operations and business of Diageo and certain of the plans and objectives of Diageo with respect to these items. These forward-looking statements are made pursuant to the 'Safe Harbor' provisions of the US Private Securities Litigation Reform Act of 1995. In particular, in the operating and financial review, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of interest or exchange rates, and anticipated cost savings or synergies are forward-looking statements. In addition, certain statements with regard to the completion of strategic transactions, to the outcome of certain litigation, to risk management, interest and exchange rates, and to the impact of the euro are also forward-looking in nature. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including factors that are outside Diageo's control.

These factors include, but are not limited to:

> Changes in economic conditions in countries in which Diageo operates, including changes in levels of consumer spending;
> Renewal of distribution rights on favourable terms when they expire;
> Changes in financial and equity markets, including significant interest rate and foreign currency rate fluctuations, which may affect access to or increase the cost of financing for operations and investments;
> Levels of marketing and promotional expenditure by Diageo and its competitors;
> Increased competitive product and pricing pressures and unanticipated actions by competitors that could impact Diageo's market share, increase expenses and hinder growth potential;
> Changes in the cost of raw materials and labour costs;
> Changes in consumer preferences and tastes, demographic trends or perception about health-related issues, which may affect all business segments;
> Legal and regulatory developments, including changes in regulations regarding consumption of or advertising for beverage alcohol, changes in accounting standards, taxation requirements, such as the impact of excise tax increases with respect to the premium drinks business, and environmental laws;
> The receipt of regulatory approvals for pending acquisitions and disposals and any conditions imposed by regulatory authorities;
> The effects of future business combinations, acquisitions or disposals and the ability to realise expected synergies and/or cost savings; and
> Technological developments that may affect the distribution of products or create new risks to Diageo's ability to protect intellectual property rights.

Directors' reports

Directors' report

The directors have pleasure in submitting their annual reports and accounts for the year ended 30 June 2001.

Business activities and development

Statements by the Chairman and the Group Chief Executive on the performance during the year and the future development of the group's businesses are included in the Annual Review. Detailed comments on the activities of the group are set out in the operating and financial review in this annual report.

During the year, the group completed the disposals of certain non-core brands. The group also carried out research and development in support of existing activities, specific new product development and the improvement of production processes.

Dividends

Diageo paid an interim dividend of 8.9 pence per share on 23 April 2001. The directors recommend a final dividend of 13.4 pence per share. Subject to approval by members, the final dividend will be paid on 5 November 2001 to shareholders on the register on 21 September 2001. A dividend reinvestment plan is available in respect of the final dividend and the plan notice date is 15 October 2001.

Share capital

At the 2000 Annual General Meeting shareholders gave the company renewed authority to purchase a maximum of 342 million ordinary shares of $28^{101}/_{108}$ pence each. The company purchased a total of 17.8 million shares for cancellation during the financial year; details are given in the operating and financial review and the financial statements.

Annual General Meeting

The AGM will be held at The Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE at 2.30 pm on 30 October 2001.

Directors

The directors of the company are as follows: Lord Blyth of Rowington (Chairman); PS Walsh (Group Chief Executive); RF Chase; JMJ Keenan; M Lilja; JK Oates; NC Rose; WS Shanahan; and Sir Robert Wilson. In addition, DN Malamatinas, JB McGrath and CA Storm served as directors during the financial year.

Lord Blyth, RF Chase and NC Rose retire by rotation at the AGM in accordance with the articles and, being eligible, offer themselves for re-election.

JMJ Keenan retires from the company on the day of the AGM and is not offering himself for re-election.

Auditors

The auditors, KPMG Audit Plc, are willing to continue in office and a resolution for their re-appointment as auditors of the company will be submitted to the AGM.

Employment policies

Diageo's employment policies are designed to ensure that the group is able to attract the highest calibre of employee from all sections of the communities within which it operates. The group values diversity in the work place and is committed to providing equality of opportunity to all employees and potential employees. It actively encourages continuous training and skill development in all its businesses. Employment policies and training programmes have been developed to attract and retain the best people on the basis of their skills and abilities. This ensures that the group offers people with disability the same opportunities for employment, training and career progression as other employees. If an employee becomes disabled when in the group's employment, full support is given through the provision of training, special equipment or other resources to facilitate continued employment wherever possible.

To support the group's commitment to open communication with employees, a senior manager is responsible for designing management processes and media which encourage employee involvement and foster team working. In addition, the group has an intranet web site from which employees with access to a computer can obtain timely and accurate news and information.

A Diageo European Forum exists at which employee representatives are briefed and consulted on pan-European issues. The group has formal and informal mechanisms to communicate and consult with employees in all locations, and it ensures that legal obligations to consult with employees and their representatives are complied with by all businesses.

Corporate citizenship

Diageo published its 2001 Environmental Report on the internet in September 2001. It can be accessed at www.diageo.com, together with Diageo's corporate citizenship guidelines, which set out the group's overall approach to social and environmental issues and the measurement of its impact in these areas.

Community relations and charitable donations

During the year, UK group companies made donations of £6.0 million (2000 – £5.5 million) to charitable organisations including the Diageo Foundation and £2.6 million (2000 – £2.5 million) to the Thalidomide Trust. The Diageo Foundation made charitable donations of £1.7 million (2000 – £2.4 million) during the year. In the rest of the world, group companies made charitable donations of £10.1 million (2000 – £9.0 million). The group made no political donations in the United Kingdom.

Supplier payment policies and performance

Given the international nature of the group's operations, there is no group standard in respect of payments to suppliers. Operating companies are responsible for agreeing terms and conditions for their business transactions when orders for goods and services are placed, ensuring that suppliers are aware of the terms of payment and including the relevant terms in contracts where appropriate. These arrangements are adhered to when making payments, subject to the terms and conditions being met by the supplier.

Creditor days have not been calculated as the company had no trade creditors at 30 June 2001. The company's invoices for goods and services are settled by subsidiaries acting as agents for the company.

Shareholdings in the company

At 1 September 2001, the following substantial interest (3% or more) in the company's ordinary share capital had been notified to the company: nominees for Brandes Investment Partners, L.P. – 4.04%.

By order of the board

Roger H Myddelton
Secretary
5 September 2001

Corporate governance report

Combined Code

Listed companies are required to disclose how they have applied the principles of Section 1 of the Combined Code on Corporate Governance, which is appended to the listing rules of the Financial Services Authority, and whether they have complied with the Code's provisions throughout the accounting period.

Directors

Diageo's board comprises the non-executive Chairman, three executive directors and five non-executive directors including the senior non-executive director, Sir Robert Wilson. Biographical details of all the directors are given in the Annual Review. The roles of Chairman and Group Chief Executive are clearly defined, the Chairman being responsible primarily for the running of the board, while the board has delegated full authority for the day-to-day management of the group's affairs to the Group Chief Executive. He is supported and advised in this task by the Executive Committee, which was established by the Group Chief Executive on 1 January 2001.

The board meets regularly during the year, normally seven times, including a two-day off-site session specifically to discuss the group's strategy. All directors receive written reports prior to each board meeting which enable them to make an informed decision on the corporate and business issues under consideration. There is a formal schedule of matters specifically reserved for the board's decision and a procedure for directors to take independent professional advice in the course of their duties, if considered appropriate, at the company's expense.

The company secretary is responsible to the board for ensuring that board procedures are followed and all directors have access to his advice and services. The company secretary is also responsible for ensuring that new directors receive appropriate training and induction to Diageo.

All the non-executive directors are considered to be independent, except the Chairman, Lord Blyth, due to the closer relationship he has with the company by virtue of his position as Chairman. The mix of skills and business experience of the non-executive directors is a major contribution to the proper functioning of the board, ensuring matters are debated and that no individual or group dominates the board's decision-making process. Non-executive directors are appointed for a specified term (normally three years), subject to re-election, and all directors are subject to election by shareholders at the first AGM after their appointment. The number of directors, and the requirement of the company's articles of association on rotation, result in each director standing for re-election not less frequently than every three years.

Board committees

The board has established several committees, each with defined terms of reference, procedures, responsibilities and powers. The minutes of committee meetings are normally sent to all directors and oral updates are given at board meetings. Committee membership is shown in the Annual Review.

Audit committee The audit committee comprises all the non-executive directors except for Lord Blyth and is chaired by JK Oates. The group finance director, external auditors and the group director of business risk assurance normally attend all meetings and the committee also meets the external auditors without management present.
The audit committee is charged with: monitoring the adequacy and effectiveness of the systems of control and risk management; reviewing the scope and results of the work of the external auditors; and reviewing the annual and interim financial statements and related policies and assumptions.

Nomination committee Chaired by Lord Blyth, this committee comprises all the non-executive directors. The committee keeps under review the composition of the board and makes recommendations to the board concerning all new appointments, and re-appointments of non-executive directors.

Remuneration committee Comprising all the non-executive directors except for Lord Blyth. The committee is chaired by the senior non-executive director, Sir Robert Wilson. It is responsible for making recommendations to the board concerning matters relating to remuneration policy. Details of the policy and of the remuneration of the directors are given in the remuneration report. The group's incentive plans are generally subject to challenging performance criteria, as required by the Combined Code.

Relations with shareholders

The company values its dialogue with both institutional and private investors. Institutional shareholders, fund managers and analysts are kept informed through regular meetings and presentations. For the benefit of private investors, Diageo produces the short-form Annual Review which contains the information believed to be of most interest to them. (Approximately 88% of private investors receive only this document rather than the full Annual Report and Accounts.) Shareholders are invited to write in to the Chairman (or any other director) and express their views on any issues of concern at any time and the AGM provides an opportunity for shareholders to put their questions in person. The chairmen of the audit, nomination and remuneration committees are available at AGMs to take any relevant questions.

At general meetings, a schedule of the proxy votes cast is made available to all shareholders. The company proposes a separate resolution on each substantially separate issue and does not bundle resolutions together inappropriately. The receipt of the report and accounts is put to the shareholders.

Accountability and audit

Financial reporting A statement on the responsibilities of the directors in relation to financial statements follows this report.

The directors, having made appropriate enquiries, consider that the company and the group have adequate resources to continue in operational existence for the foreseeable future, and that therefore it is appropriate to adopt the going concern basis in preparing the financial statements.

Internal control The directors acknowledge that they are responsible for the group's systems of internal control and for reviewing their effectiveness.

An ongoing process, in accordance with the guidance of the Turnbull Committee on internal control, has been established for identifying, evaluating and managing risks faced by the group. This process has been in place for the full financial year and up to the date the financial statements were approved. The risk management process and systems of internal control are designed to manage rather than eliminate the risk of failure to achieve the group's strategic objectives. It should be recognised that such systems can only provide reasonable, not absolute, assurance against material misstatement or loss.

Risk assessment and evaluation takes place as an integral part of the annual strategic planning cycle. Having identified the risks to achievement of their strategic objectives, each business unit is required to document the management and mitigating actions in place and proposed in respect of each significant risk. This information is reviewed by senior management as part of the strategy review.

Each business (Guinness UDV, Pillsbury and Burger King) then prepares a risk footprint which summarises the risks, the processes for managing and mitigating them and the means for assuring management that the processes are effective. The corporate centre also considers the risks to the group's strategic objectives which are not addressed by the businesses and develops its own risk footprint.

These footprints are then considered by the directors as part of the annual strategic review. Thereafter this subject forms part of the agenda for each business' regular performance review meeting. Control issues arising from assurance processes, including risk assurance and external audit findings, are also discussed at these meetings.

Each business has its own business risk assurance team (incorporating its internal audit function) which is responsible to the business' chief executive officer for ensuring that adequate assurance is gained on the management of risk. Their work is supported by a comprehensive control self-assessment programme which is completed on an annual basis.

The directors obtain assurance directly from each business, and also from the business risk assurance teams. Assurance issues are regularly reported to the audit committee.

Audit committee and auditors The constitution and remit of the audit committee is described above. The audit committee oversees the work of the business risk assurance functions, approving plans in advance and reviewing conclusions. Assurance plans are drawn up based on assessments of business risk carried out in conjunction with the businesses and in accordance with the group's risk management framework.

Compliance with the Combined Code

The company has complied with the requirements of the Combined Code throughout the accounting period.

Remuneration report

The remuneration committee is responsible for making recommendations to the board on remuneration policy as applied to Diageo's senior executives (including executive directors). It consists wholly of independent non-executive directors: Sir Robert Wilson (chairman), RF Chase, M Lilja, JK Oates and WS Shanahan. This report sets out the policy and disclosures on directors' remuneration.

1 Executive remuneration policy

Diageo's policy on senior executive remuneration is to provide a direct link between executive incentives and Managing For Value. The success of this strategy is assessed primarily by Diageo's performance, as measured by total shareholder return, against a peer group of world class companies. The senior executives across the group participate in an annual performance bonus plan and long term incentive plans – with variable rewards based on challenging targets for economic profit improvement and total shareholder return performance respectively. Total remuneration for senior executives is set with regard to the competitive practice for the markets in which Diageo operates. The remuneration committee annually reviews independent market data and recommends whatever adjustments to the policy are necessary.

The emoluments of executive directors and other senior executives are made up of the following components:

(i) Basic salary Basic salaries are determined according to the competitive market for senior executives, taking into account their experience, contribution and performance.

(ii) Annual performance bonus Bonus payments are based on improvement in the economic profit (EP) of Diageo and its businesses for the year in question. The targets for EP and for the level of bonus are determined by the remuneration committee at the commencement of each year. EP is calculated on a net trading profit after tax, less a capital charge which takes into account returns expected by lenders and shareholders.

(iii) Long term incentive plans Senior executives are eligible to be considered for participation in long term incentive plans. These comprise the Total Shareholder Return (TSR) plan and the Senior Executive Share Option Plan (SESOP). For executive directors, the TSR plan and SESOP each comprise 50% of the expected value of their long term incentive plans for each year.

(a) *TSR plan* Under this plan, executives are granted a conditional right to receive shares or, exceptionally, a cash sum. The plan is hedged through the purchase of shares to avoid dilution of shareholders' interests – see risk management in the operating and financial review. The rights are awarded with effect from 1 January each year, and vest after a three-year period (the 'performance cycle') subject to achievement of a performance test and to the discretion of the trustees.

The performance test is a comparison of the annualised percentage growth in Diageo's share price (assuming all dividends and capital distributions are re-invested), known as total shareholder return, with the total shareholder returns of a defined peer group of companies over a three-year period. The rules of the TSR plan provide that in the event of any peer group company being taken over or merged during a performance cycle, then that company will be excluded from the comparison over the whole cycle with the payout schedules being adjusted accordingly. This has resulted in the exclusion of Bestfoods and Seagram from the 20 company peer group previously reported. For the performance cycle commencing 1 January 2001, these companies were not replaced and, accordingly, for the performance cycles commencing 1 January 1998, 1999, 2000 and 2001, the peer group consists of Diageo and: Allied Domecq, Anheuser-Busch, Campbell Soup, Carlsberg, Coca-Cola, Colgate-Palmolive, Gillette, Heineken, Heinz, Kellogg, McDonald's, Nestlé, PepsiCo, Philip Morris, Procter & Gamble, Tricon and Unilever. For the existing performance cycles, the TSR calculations will continue to be made in local currencies, as previously notified to shareholders. However, for future performance cycles, commencing 1 January 2002, the TSR calculations will be converted to a common currency (US dollar) when determining the peer group rankings.

The following table shows the percentage of each award which will normally be released at the end of the relevant performance cycle, depending on the peer group ranking achieved in an 18 company peer group:

	Ranking in peer group								
	1-2	3	4	5	6	7	8	9	10-18
%	150	142	114	94	83	72	61	50	–

The remuneration committee will not recommend the release of awards if there has not been an underlying improvement in Diageo's financial performance.

The awards to executive directors for the 2001 cycle were for a number of shares equivalent to 150% of their basic salaries.

Senior executives are required to hold shares in Diageo to qualify for the full benefits of the TSR plan. This is consistent with the company's belief that the most senior managers in the group should also be shareholders.

(b) *SESOP* Under SESOP, an annual grant of options, is made to participants. The remuneration committee decides the level of awards each year in the light of market practice. The share option awards made to executive directors in the year ended 30 June 2001 had a total face value of 375% of their basic salaries at the date of grant.

Options granted under SESOP may not normally be exercised unless a performance condition is satisfied. The performance condition applicable to the options granted to date under SESOP is linked to the increase in Diageo's earnings per share (EPS), and is initially applied over the three-year period commencing on the date the options are granted. If the increase in EPS over this period is at least 15% greater than the increase in the RPI over the same period, then all the options can be exercised. If the EPS increase is at least 12% greater than that of the RPI but less than 15%, half of the options can be exercised. If all or half of the options fail the initial performance condition, the three-year assessment period will be rolled forward by a year and a retest carried out at that time. However, the performance condition can only be rolled forward a maximum of three times.

(iv) Profit sharing schemes For most employees in the United Kingdom and Ireland, Diageo operates tax favoured profit share plans. Diageo may appropriate shares to individuals annually up to the value of 10% of salary, subject to a cap of £8,000 (IR£10,000 in Ireland). Shares which have been appropriated are held in trust for the individual for a minimum two-year period. If the shares are transferred to the individual after three years from the date of appropriation, no income tax is payable. Due to a change in legislation, it is intended to replace the UK scheme for 2002.

(v) Savings-related share option schemes The group has established savings-related share option schemes which provide a savings and investment opportunity for employees in the United Kingdom, United States and many other countries. The UK scheme options may normally be exercised after three or five years, at a price equivalent to not less than 80% of the market value of the shares at the time of grant. The US scheme options may be exercised after 12 months, at a price equivalent to 85% of the market value of the shares at the time of grant. The international scheme has eligibility and discount criteria devised in accordance with local conditions and practices but within the parameters approved by shareholders.

1 Executive remuneration policy continued

(vi) Directors' contracts The executive directors have service agreements which provide for 6 months' notice by the director or 12 months by the company and contain non-compete obligations. In the event of early termination by the company without cause, the agreements provide for predetermined compensation to be paid, equivalent to 12 months' basic salary for the notice period and an equal amount in respect of all benefits. The Chairman has a letter of appointment for an intended five year term with an initial period of two years from 1 July 2000. Thereafter it is terminable on six months' notice by either party or, if terminated by the company, by payment of six months' fees in lieu of notice. The independent non-executive directors do not have service contracts.

The executive director proposed for re-election at the forthcoming AGM will have an unexpired contract term of one year. The non-executive directors proposed for re-election do not have service contracts.

(vii) Pre-merger incentive plans Diageo's current incentive plans have replaced the previous incentive arrangements within GrandMet and Guinness, which were approved by their respective shareholders and were described in previous annual reports. Whilst awards and options granted under some of these plans continue to be held and exercised, no further grants will be made under them.

(a) *Executive share option schemes* Options were granted at market value at the date of grant, generally exercisable between a minimum of three or five years, and a maximum of ten years, after grant. The last grants were made in 1997.

(b) *Senior executive phantom share option scheme (SEPSOS)* This share price related bonus scheme was established for a small number of GrandMet senior executives including executive directors. The last grants were made in 1996 and all payments will have been made within ten years from date of grant.

2 Directors' emoluments and other payments

					2001	2000
	Basic salary £000	Performance bonuses £000	Profit share £000	Other benefits (b) £000	Total £000	Total £000
Executive directors						
JMJ Keenan	637	1,335	–	149	2,121	2,097
DN Malamatinas (resigned 30.8.00)	102	–	–	34	136	974
JB McGrath (retired 31.12.00)	229	330	8	28	595	952
NC Rose	373	449	8	207	1,037	868
CA Storm (resigned 12.4.01)	256	377	8	182	823	630
PS Walsh	687	928	8	126	1,749	1,505
Former executive directors	–	–	–	–	–	835
	2,284	3,419	32	726	6,461	7,861
Non-executive directors – fees						
Lord Blyth (chairman)	300	–	–	13	313	31
RF Chase	35	–	–	1	36	31
M Lilja	35	–	–	–	35	20
JK Oates	45	–	–	1	46	41
WS Shanahan	35	–	–	–	35	30
Sir Robert Wilson	55	–	–	1	56	51
Former non-executive directors	–	–	–	–	–	30
	505	–	–	16	521	234
Total	2,789	3,419	32	742	6,982	8,095

Notes

(a) In addition to the above emoluments, the directors received payments and made gains under longer term incentive arrangements of £6,701,000 (2000 – £2,422,000). See section 3 below.

(b) Other benefits include company cars, private use of chauffeur, fuel, product allowance, financial counselling, spouse travel, medical insurance and life insurance premiums. Additional payments made to or on behalf of JMJ Keenan, who is an expatriate, are treated as other benefits in the above table. They include allowances for working overseas and the provision of accommodation. NC Rose's other benefits include £175,000 (2000 – £75,000) in respect of his participation in an individual deferred compensation agreement entered into in 1998. CA Storm's other benefits include a payment of £150,000 in respect of his secondment to the United States. PS Walsh's other benefits include £72,000 (2000 – £360,000) in respect of his relocation to the United Kingdom.

(i) Directors' pension provision NC Rose and PS Walsh are members of the Diageo Pension Scheme, as were JB McGrath and CA Storm until their respective retirements. They accrue, or accrued, pension rights at the rate of one-thirtieth of basic salary per annum subject only to Inland Revenue limits. No actuarial reduction is applied to pensions payable from the age of 57, subject to company consent. Bonus payments are not included in pensionable pay. Their pensions are guaranteed to increase in line with inflation up to a level of 5%, and, other than CA Storm, they have guarantees that such increases will not be lower than 3% per annum and that their pensions at normal pension age of 62 will not be less than two-thirds of basic salary in the 12 months prior to retirement. On death in service, a lump sum of four times pensionable salary is paid, along with a spouse's pension of two-thirds of the member's prospective pension. When a director dies after retirement, a spouse's pension of two-thirds of the member's pension is paid. None of the directors is required to make pension contributions and no company contributions were paid during the year.

2 Directors' emoluments and other payments continued

For executives who entered service after 31 May 1989, the benefits which can be provided from the Diageo Pension Scheme are restricted by the operation of the earnings cap. Such executives, including any directors, receive total pension benefits of the same value as if the earnings cap did not apply. All benefits earned during the year in respect of earnings above the cap will be provided by the company on an unfunded basis; consequently, no contributions were payable during the year in respect of the current directors.

DN Malamatinas participated in the Burger King retirement plan in the United States with effect from 1 July 1998 and in the Diageo Pension Scheme in the United Kingdom prior to this. The UK plan benefits have been fully protected and will be based on his UK equivalent basic salary in the 12 months prior to exit. The Burger King plan is a defined benefit plan. Spouses' pensions on death after retirement are payable only by waiving part of the member's pension. There is no commitment to the provision of increases to pensions in payment. DN Malamatinas also participated in the Burger King savings plan, which is a defined contribution plan with a limited company match; company contributions in the year were £4,000 (2000 – £43,000).

The accrued pension entitlements earned by the directors as at 30 June 2001 are shown in the table below. The increase over inflation reflects entitlements earned during the year ended 30 June 2001.

	Age at 30 June 2001 (or date of leaving) Years	Pensionable service Years	Increase over inflation £000	Accrued pension £000
DN Malamatinas (until 31.8.00)	45	10	–	88
JB McGrath (until 31.12.00)	62	15	17	411
NC Rose	43	9	16	108
CA Storm (until 30.6.01)	62	40	103	385
PS Walsh	46	19	31	396

As indicated last year, the Inland Revenue limits applicable to CA Storm took into account bonuses paid after 30 June 2000. These bonuses are reflected for the first time in the above figures.

The accrued pensions shown above represent the annual pension to which each director will be entitled at normal retirement age of 62. JMJ Keenan, the highest paid director, did not have any accrued pension at either 30 June 2000 or 30 June 2001.

3 Incentive plans

(i) Payments and gains under longer term incentive arrangements The table below shows payments and gains for the year ended 30 June 2001.

	Awards vested under TSR plan (a)		SEPSOS payments (b)	Share option gains (c)	Total	2000
	Shares	£000	£000	£000	£000	£000
JMJ Keenan	162,548	1,136	–	–	1,136	385
DN Malamatinas	–	–	90	57	147	152
JB McGrath	57,641	402	914	1,262	2,578	387
NC Rose	22,008	153	56	246	455	67
CA Storm	26,200	183	–	74	257	82
PS Walsh	184,580	1,290	155	683	2,128	570
Former executive directors	–	–	–	–	–	779
Total	452,977	3,164	1,215	2,322	6,701	2,422

Notes

(a) The performance cycle for the 1998 TSR award ended on 31 December 2000. Diageo's TSR over the performance cycle exceeded the rise in the UK RPI, so there was an underlying improvement in financial performance which permitted release of the awards. The number of shares released was determined by the remuneration committee at 61.1% of the original award. The values are calculated as at the date of vesting although the shares may have been retained.

(b) SEPSOS payments are attributable to exercises in 2001 and previous years.

(c) Share option gains are calculated as at the date of exercise although the shares may have been retained.

(ii) SEPSOS interests The following table shows the number of options held under SEPSOS which were granted between 1992 and 1996 at prices between 382 pence and 475 pence. Payments are normally spread over the period from exercise to the tenth anniversary of the date of grant. 'Exercisable' options are those that were vested and could be exercised at the period end; 'not exercisable' are those options where the minimum holding period was not then completed. The 'option period' starts from the earliest month any options could have been, or may be, exercised under their terms and ends with the month in which the last options lapse. These definitions also apply to section 5 below.

		30 June 2000	Granted	Exercised	Option price	Market price	30 June 2001	Option price and period	
DN Malamatinas	Exercisable	179,327	–	(179,327)	390	590	–		
JB McGrath	Exercisable	303,977					75,381	459	Jan 01 – Dec 01
	Not exercisable	75,381					–		
		379,358	–	(303,977)	431	732	75,381		
NC Rose	Exercisable	40,075	–	(40,075)	422	750	–		
PS Walsh	Exercisable	74,680					127,620	459	Jan 01 – Jan 06
	Not exercisable	127,620					–		
		202,300	–	(74,680)	475	686	127,620		

4 Share and other interests

The beneficial interests of the directors in office at 30 June 2001 in the ordinary shares (or equivalent for ADS awards) awarded under the Diageo TSR plan and in the ordinary shares of the company are shown in the table below.

	TSR plan (a)			Ordinary shares (b)	
	Performance cycle commencing:				
	1 January 1999	1 January 2000	1 January 2001	30 June 2001	30 June 2000
Executive directors					
JMJ Keenan	168,422	63,836	–	364,679	171,524
NC Rose	23,646	13,772	113,106	50,596	13,145
PS Walsh	191,246	75,935	208,354	341,527	107,132
Non-executive directors					
Lord Blyth				10,792	10,206
RF Chase				10,677	10,000
M Lilja				1,507	1,507
JK Oates				3,039	2,844
WS Shanahan				8,000	8,000
Sir Robert Wilson				8,263	8,252
Total	383,314	153,543	321,460	799,080	332,610

Notes

(a) The number of shares released by the TSR plan will normally be based on the company's position within the peer group at the end of the relevant three-year performance period. For illustrative purposes, the interests shown above reflect the number of shares which would be released if the company were to continue to be ranked at its position as at 30 June 2001 (positions 7, 9 and 4 for the performance cycles commencing 1 January 1999, 2000 and 2001, respectively).

(b) At 30 June 2001, JMJ Keenan, NC Rose and PS Walsh had an interest in 46,480 shares and 2,079,419 shares subject to call options (30 June 2000 – 0 and 3,123,181; 1 September 2001 – 28,528 and 2,079,419) held by a trust to satisfy grants made under ex-GrandMet incentive plans; and the executive directors had an interest in 9,831,421 shares (30 June 2000 – 15,167,223; 1 September 2001 – 9,756,861) held by trusts to satisfy grants made under Diageo incentive plans and savings-related share option schemes.

(c) At 1 September 2001, the beneficial interests of the continuing directors were unchanged.

(d) In accordance with the rules of the TSR plan, awards less than 18 months old lapse on retirement and the remainder continue to be held subject to the performance test. At 30 June 2001, using the illustrative basis set out in (a) above, the retained interests in TSR plan shares were 61,932 for JB McGrath and 45,450 for CA Storm.

Lord Blyth is a senior adviser to Greenhill & Co., which will receive a fee on the completion of the proposed combination of Pillsbury with General Mills for its advice to Diageo. Lord Blyth did not participate in the selection of advisers, nor did he advise Greenhill & Co., in relation to Pillsbury.

Other than disclosed in this report, no director had any interest, beneficial or non-beneficial, in the share capital of the proposed company. The register of directors' interests (which is open to shareholders' inspection) contains full details of directors' share interests. Save as disclosed above, no director has or has had any interest in any transaction which is or was unusual in its nature, or which is or was significant to the business of the group and which was effected by any member of the group during the financial year, or which having been effected during an earlier financial year, remains in any respect outstanding or unperformed.

5 Executive share options and savings-related share options

The following table shows, for the directors who held office during the year, the number of options held under all executive share option schemes and savings-related schemes. Option and market prices in the table are weighted average prices in pence.

For executive share option schemes, UK grants were between 1992 and 2000 at prices between 402 pence and 587 pence with the 2000 grants being at 587 pence, and US grants were between 1996 and 1999 at prices between US $29.38 and US $33.63 per ADS. US options were granted over ADSs at dollar prices (one ADS is equivalent to four ordinary shares); the option holdings and prices in the table are stated as ordinary share equivalents in pence. The mid-market price of the ordinary shares at 30 June 2001 was 780 pence (2000 – 593 pence). The highest mid-market price during the year was 792 pence and the lowest mid-market price was 560 pence. Definitions of terms are given in section 3 above.

		30 June 2000	Granted	Exercised	Option price	Market price	30 June 2001	Option price and period	
UK options									
DN Malamatinas	Exercisable	36,000							
	Not exercisable	–							
		36,000	–	(36,000)	429	587	–		
JB McGrath	Exercisable	397,628							
	Not exercisable	4,151							
		401,779	–	(401,779)	419	733	–		
NC Rose	Exercisable	171,434					90,264	418	Jun 98 – Jun 06
	Not exercisable	139,998					382,758	562	Dec 02 – Sep 10
		311,432	242,760	(81,170)	430	733	473,022		
CA Storm (b)	Exercisable	158,933					155,642	483	May 95 – Jun 02
	Not exercisable	101,238					78,422	517	Jul 01 – Jun 03
		260,171	383	(26,490)	454	733	234,064		
PS Walsh	Exercisable	–					–		
	Not exercisable	470,559					917,748	551	Dec 02 – Sep 10
		470,559	447,189	–			917,748		
US options									
JMJ Keenan	Exercisable	–					–		
	Not exercisable	400,240					400,240	580	Dec 02 – Dec 09
		400,240	–	–			400,240		
PS Walsh	Exercisable	421,752					198,232	507	Jan 99 – Jan 06
	Not exercisable	–					–		
		421,752	–	(223,520)	424	729	198,232		

Notes

(a) Options granted during the year to NC Rose and PS Walsh are principally options granted under SESOP, which are subject to performance conditions.

(b) In accordance with the rules governing normal retirement, CA Storm will be able to exercise all his outstanding options for a period of 12 months from his date of retirement, with the exception of his SESOP options. Subject to the rules of the plan and performance conditions, SESOP options may be exercised within 6 months after retirement or the third anniversary of the grant, whichever is later.

Financial statements

Directors' responsibilities
in relation to financial statements

The following statement, which should be read in conjunction with the report of the auditors set out below, is made with a view to distinguishing for shareholders the respective responsibilities of the directors and of the auditors in relation to the financial statements.

The directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the group at the end of the financial year and of the profit or loss for the financial year. The directors, in preparing these financial statements, consider that the company has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all applicable accounting standards have been followed.

The directors have responsibility for ensuring that the company keeps accounting records which disclose with reasonable accuracy the financial position of the company and which enable them to ensure that the financial statements comply with the Companies Act 1985. The directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

Report of the auditors
to the members of Diageo plc

We have audited the financial statements on pages 18 to 41.

Respective responsibilities of the directors and auditors The directors are responsible for preparing the Annual Report and Accounts. As described above this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

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

We review whether the statement on page 11 reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report, including the corporate governance statement, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

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

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

Opinion In our opinion the financial statements give a true and fair view of the state of affairs of the company and the group as at 30 June 2001 and of the profit of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London, 5 September 2001

Consolidated profit and loss account

	Notes	Year ended 30 June 2001 Before goodwill and exceptional items £ million	Goodwill and exceptional items £ million	Total £ million	Year ended 30 June 2000 Before goodwill and exceptional items £ million	Goodwill and exceptional items £ million	Total £ million
Turnover	2	12,821	–	12,821	11,870	–	11,870
Operating costs	4	(10,694)	(254)	(10,948)	(9,890)	(198)	(10,088)
Operating profit	2	2,127	(254)	1,873	1,980	(198)	1,782
Share of profits of associates	6	203	–	203	198	(3)	195
Trading profit		2,330	(254)	2,076	2,178	(201)	1,977
Disposal of fixed assets		–	19	19	–	5	5
Sale of businesses	7	–	(23)	(23)	–	(168)	(168)
Interest payable (net)	8	(350)	–	(350)	(363)	–	(363)
Profit on ordinary activities before taxation		1,980	(258)	1,722	1,815	(364)	1,451
Taxation on profit on ordinary activities	9	(455)	39	(416)	(476)	75	(401)
Profit on ordinary activities after taxation		1,525	(219)	1,306	1,339	(289)	1,050
Minority interests							
Equity		(43)	–	(43)	(37)	–	(37)
Non-equity		(37)	–	(37)	(37)	–	(37)
Profit for the year		1,445	(219)	1,226	1,265	(289)	976
Dividends	10	(751)	–	(751)	(713)	–	(713)
Transferred to reserves		694	(219)	475	552	(289)	263
Earnings per share	11						
Basic		42.8p	(6.5)p	36.3p	37.3p	(8.5)p	28.8p
Diluted		42.8p	(6.5)p	36.3p	37.2p	(8.5)p	28.7p

Consolidated statement of total recognised gains and losses

	Year ended 30 June 2001 £ million	Year ended 30 June 2000 £ million
Profit for the year – group	1,056	858
– associates	170	118
	1,226	976
Exchange adjustments	95	25
Tax charge on exchange in reserves	(17)	(7)
Total recognised gains and losses	1,304	994

Note of consolidated historical cost profits and losses

There is no material difference between the reported profit shown in the consolidated profit and loss account and the profit for the relevant years restated on an historical cost basis.

Consolidated balance sheet

	Notes	30 June 2001 £ million	30 June 2001 £ million	30 June 2000 £ million	30 June 2000 £ million
Fixed assets					
Intangible assets	12		5,672		5,289
Tangible assets	13		3,176		3,078
Investments	14		1,473		1,496
			10,321		9,863
Current assets					
Stocks	15	2,232		2,139	
Debtors – due within one year	16	1,914		1,845	
Debtors – due after one year	16	1,280		1,187	
Debtors subject to financing arrangements (franchisee loans of £270 million, less non-returnable proceeds of £227 million)	16	43		39	
Cash at bank and in hand	17	1,842		1,063	
		7,311		6,273	
Creditors – due within one year					
Borrowings	17	(3,602)		(3,066)	
Other creditors	19	(3,495)		(3,275)	
		(7,097)		(6,341)	
Net current assets/(liabilities)			214		(68)
Total assets less current liabilities			10,535		9,795
Creditors – due after one year					
Borrowings	17	(3,993)		(3,716)	
Other creditors	19	(96)		(100)	
			(4,089)		(3,816)
Provisions for liabilities and charges	20		(653)		(694)
			5,793		5,285
Capital and reserves					
Called up share capital	22		987		990
Share premium account		1,314		1,285	
Revaluation reserve		137		138	
Capital redemption reserve		2,954		2,949	
Profit and loss account		(205)		(651)	
Reserves attributable to equity shareholders	23		4,200		3,721
Shareholders' funds			5,187		4,711
Minority interests					
Equity		207		169	
Non-equity	25	399		405	
			606		574
			5,793		5,285

These financial statements were approved by a duly appointed and authorised committee of the Board of Directors on 5 September 2001 and were signed on its behalf by PS Walsh and NC Rose, directors.

Consolidated cash flow statement

	Notes	Year ended 30 June 2001 £ million	Year ended 30 June 2001 £ million	Year ended 30 June 2000 £ million	Year ended 30 June 2000 £ million
Net cash inflow from operating activities	26		**2,276**		2,043
Dividends received from associates			**101**		64
Returns on investments and servicing of finance					
Interest paid (net)		**(446)**		(405)	
Dividends paid to equity minority interests		**(31)**		(27)	
			(477)		(432)
Taxation			**(230)**		(285)
Capital expenditure and financial investment					
Purchase of tangible fixed assets		**(439)**		(547)	
Purchase/sale of own shares		**(54)**		(38)	
Sale of fixed assets		**43**		59	
			(450)		(526)
Free cash flow			**1,220**		864
Acquisitions and disposals					
Purchase of subsidiaries	27	**(136)**		(151)	
Sale of subsidiaries and businesses	28	**12**		638	
Sale of associates		**19**		–	
			(105)		487
Equity dividends paid			**(725)**		(683)
Cash flow before management of liquid resources and financing			**390**		668
Management of liquid resources			**(572)**		(219)
Financing					
Issue of share capital		**31**		12	
Own shares purchased for cancellation		**(108)**		(54)	
Redemption of guaranteed preferred securities		**(39)**		–	
Increase/(decrease) in loans		**398**		(544)	
			282		(586)
Increase/(decrease) in cash in the year			**100**		(137)

	Notes				
Movements in net borrowings	17				
Increase/(decrease) in cash in the year			**100**		(137)
Cash flow from change in loans			**(398)**		544
Change in liquid resources			**572**		219
Change in net borrowings from cash flows			**274**		626
Exchange adjustments			**(229)**		(119)
Non-cash items			**21**		4
Decrease in net borrowings			**66**		511
Net borrowings at beginning of the year			**(5,545)**		(6,056)
Net borrowings at end of the year			**(5,479)**		(5,545)

Accounting policies

Basis of accounting
The accounts are prepared under the historical cost convention, modified by the revaluation of certain land and buildings, and in accordance with applicable UK accounting standards.

Basis of consolidation
The group accounts include the accounts of the company and its subsidiary undertakings (subsidiaries) together with the attributable share of the group's share of the results of joint arrangements and associated undertakings (associates). Unless otherwise stated, the acquisition method of accounting has been adopted. Under this method, the results of subsidiaries sold or acquired are included in the profit and loss account up to, or from, the date control passes.

Acquisitions and disposals
On the acquisition of a business, or of an interest in an associate, fair values, reflecting conditions at the date of acquisition, are attributed to the net assets including significant owned brands acquired. Adjustments are also made to bring accounting policies into line with those of the group. Where statutory merger relief is applicable, the difference between the fair value of the business acquired and the nominal value of shares issued as purchase consideration is treated as a merger reserve.

The profit and loss on the disposal of a previously acquired business includes the attributable amount of purchased goodwill relating to that business, including any goodwill written off direct to reserves prior to 1 July 1998.

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 from 1 July 1998 is capitalised; prior to that date it was eliminated against reserves, and this goodwill has not been restated.

Acquired brands and other intangible assets which are controlled through custody or legal rights and could be sold separately from the rest of the business are capitalised, where fair value can be reliably measured.

Where capitalised goodwill and intangible assets are regarded as having limited useful economic lives, their cost is amortised on a straight-line basis over those lives – up to 20 years. Where goodwill and intangible assets are regarded as having indefinite useful economic lives, they are not amortised. Impairment reviews are carried out to ensure that goodwill and intangible assets are not carried at above their recoverable amounts. Any amortisation or impairment write downs are charged to the profit and loss account.

Tangible fixed assets
Land and buildings are stated at cost or at professional valuation, less depreciation. Freehold land is not depreciated. Leaseholds are depreciated over the unexpired period of the lease. Other tangible fixed assets are depreciated on a straight-line basis to estimated residual values over their expected useful lives 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; casks and containers – 15 to 20 years; and computer software – up to 5 years.

Reviews are carried out if there is some indication that impairment may have occurred, to ensure that fixed assets 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 profit and loss account on a straight-line basis over the life of the lease.

Associates and joint arrangements
An associate is an undertaking in which the group has a long term equity interest and over which it exercises significant influence. The group's interest in the net assets of associates is included in investments in the group balance sheet. Joint arrangements, where each party has its own separate interest in particular risks and rewards, are accounted for by including the attributable share of the assets and liabilities, measured according to the terms of the arrangement.

Investment in own shares
Investment in own shares are held for the purpose of fulfilling obligations in respect of various employee share plans around the group. The difference between the purchase price of the shares and the exercise price of the option or grant is amortised over the relevant period (generally the three years from the date of an award), except for savings-related options granted prior to 1 July 1999 where the difference was taken as an exceptional charge on acquisition of the shares in 1999.

Stocks
Stocks are stated at the lower of cost and net realisable value. Cost includes raw materials, direct labour and expenses, and an appropriate proportion of production and other overheads.

Foreign currencies
The profit and loss accounts and cash flows of overseas subsidiaries and associates are translated into sterling at weighted average rates of exchange, other than substantial exceptional items which 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 subsidiaries and associates are taken to reserves, less exchange differences arising on related foreign currency borrowings and financial instruments. Tax charges and credits arising on such items are also taken to reserves. Other exchange differences are taken to the profit and loss account.

The results, assets and liabilities of operations in hyper-inflationary economies are determined using an appropriate relatively stable currency as the functional currency. The exchange differences arising from this process are taken to the profit and loss account.

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction or, if hedged forward, at the rate of exchange under the related foreign currency contract.

Turnover
Turnover represents the net invoice value of goods and services, including excise duties and royalties receivable, but excluding value added tax.

Advertising
Advertising production costs are charged to the profit and loss account when the advertisement is first shown to the public.

Franchising

Franchising generates initial franchise fees, as well as profits or losses arising from the franchising of developed or purchased outlets previously operated by the group, and ongoing royalty revenues based on sales made by franchisees. Income from franchising is included in operating profit, apart from any property element which is treated as a disposal of fixed assets.

Research and development

Research and development expenditure is written off in the period in which it is incurred.

Pensions and other post employment benefits

The cost of providing pensions and other post employment benefits is charged against profits on a systematic basis, with pension surpluses and deficits arising allocated over the expected average remaining service lives of current employees. Differences between the amounts charged in the profit and loss account and payments made to pension or other plans are treated as assets or liabilities. Deferred tax is accounted for on these assets and liabilities. Unfunded post employment medical benefit liabilities are included in provisions in the balance sheet.

Deferred taxation

Deferred taxation on differences between the treatment of certain items for accounting and taxation purposes is accounted for to the extent that a liability or an asset is expected to be payable or recoverable within the foreseeable future.

Financial instruments

The group uses derivative financial instruments to hedge its exposures to fluctuations in interest and foreign exchange rates. Instruments accounted for as hedges are structured so as to reduce the market risk associated with the underlying transaction being hedged and are designated as a hedge at the inception of the contract. If the underlying transaction to a hedge ceases to exist, the hedge is terminated and the profit or loss is recognised immediately. If the hedge transaction is terminated, the profit or loss is held in the balance sheet and amortised over the life of the original underlying transaction.

Receipts and payments on interest rate instruments are recognised on an accruals basis over the life of the instrument. Foreign exchange contracts hedging balance sheet assets and liabilities are revalued at closing rates and exchange differences arising are 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, are recognised in the hedged periods.

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

Notes to the consolidated accounts

1 New accounting standards

The financial statements comply, to the extent detailed below, with the following new Financial Reporting Standards issued by the UK Accounting Standards Board.

FRS 17 – Retirement benefits This standard replaces the use of actuarial values for assets in a pension scheme in favour of a market-based approach. In order to cope with the volatility inherent in this measurement basis, the standard requires that the profit and loss account shows the relatively stable ongoing service cost, interest cost and expected return on assets. Fluctuations in market values are reflected in the statement of total recognised gains and losses. The group has complied with the transitional disclosure requirements of the standard.

FRS 18 – Accounting policies The group complies with this standard, which deals with the selection, application and disclosure of accounting policies in financial statements.

Compliance with the above new standards has not given rise to any restatement of figures reported for prior periods, though a restatement in respect of FRS 17 is expected when full compliance is required.

2 Segmental analysis

	2001			2000		
	Turnover £ million	Operating profit £ million	Net assets £ million	Turnover £ million	Operating profit £ million	Net assets £ million
Class of business						
Premium Drinks	7,580	1,432	5,123	7,117	1,286	4,972
Quick Service Restaurants	1,042	177	1,432	941	202	1,356
Packaged Food	4,199	518	4,077	3,812	492	3,734
	12,821	2,127	10,632	11,870	1,980	10,062
Investment in associates			1,193			1,230
Tax, dividend and other			(553)			(462)
Net borrowings			(5,479)			(5,545)
			5,793			5,285
Geographical area						
Europe	4,073	614	3,763	4,181	585	3,804
North America	6,401	1,001	6,193	5,639	956	5,696
Asia Pacific	990	206	246	886	170	183
Latin America	776	188	216	697	165	252
Rest of World	581	118	214	467	104	127
	12,821	2,127	10,632	11,870	1,980	10,062

(a) Profit before interest and tax for the year relates to the following activities: Premium Drinks £1,507 million; Quick Service Restaurants £101 million; Packaged Food £464 million; and corporate exceptional costs £nil (2000 – £1,216 million; £145 million; £456 million; and £(3) million, respectively).

(b) Profit before interest and tax, excluding the profit attributable to Moët Hennessy, for the year relates to the following geographical areas: Europe £465 million; North America £880 million; Asia Pacific £234 million; Latin America £215 million; and Rest of World £123 million (2000 – £402 million; £868 million; £156 million; £146 million; and £107 million, respectively).

(c) The analyses of operating profit in the tables above are before goodwill amortisation and exceptional items. The geographical analysis of turnover and operating profit is based on the location of the third party customers. The group interest expense is managed centrally and is not attributable to individual activities or geographical areas.

(d) The weighted average exchange rates used in the translation of profit and loss accounts were US dollar – £1 = $1.45 (2000 – £1 = $1.60) and euro – £1 = €1.63 (2000 – £1 = €1.59). Exchange rates used to translate assets and liabilities at the balance sheet date were US dollar – £1 = $1.41 (2000 – £1 = $1.52) and euro – £1 = €1.66 (2000 – £1 = €1.58). The group uses option cylinders and foreign exchange transaction hedges to mitigate the effect of exchange rate movements. The effective exchange rates taking into account the impact of these instruments were US dollar – £1 = $1.58 (2000 – £1 = $1.63) and euro – £1 = €1.60 (2000 – £1 = €1.50).

3 Turnover

Geographical area by location of selling company	2001 £ million	2000 £ million
Europe	4,080	4,810
North America	6,775	6,001
Asia Pacific	1,143	724
Latin America	879	525
Rest of World	664	407
	13,541	12,467
Less: Sales to group companies in other geographical areas	(720)	(597)
	12,821	11,870

Exports from the United Kingdom were £1,435 million (2000 – £1,285 million).

4 Operating costs

	2001 £ million	2000 £ million
Change in stocks	(11)	(2)
Raw materials and consumables	3,224	3,243
Excise duties – United States	353	328
– Other	1,505	1,451
Advertising, marketing and promotion	1,917	1,706
Other external charges	1,913	1,433
Staff costs (note 5)	1,605	1,612
Depreciation and other amounts written off fixed assets	485	374
Other operating income	(43)	(57)
	10,948	10,088

Other external charges include: operating lease rentals for plant and machinery of £27 million (2000 – £25 million); other operating lease rentals (mainly properties) of £107 million (2000 – £106 million); losses in respect of currency cylinders of £90 million (2000 – gain of £13 million) (see note 18(i)); and research and development expenditure of £71 million (2000 – £69 million). Other operating income includes £20 million (2000 – £17 million) from operating leases and £5 million (2000 – £17 million) exceptional income (see note 7(e)).

Goodwill and exceptional operating costs Operating costs in the year include goodwill amortisation of £26 million (2000 – £17 million) and exceptional operating costs of £228 million (2000 – £181 million) as follows: other external charges £81 million; staff costs £70 million; depreciation and amortisation of fixed assets £82 million; and other operating income £5 million (2000 – £125 million; £64 million; £9 million; and £17 million, respectively).

Fees paid to auditors Fees charged to operating profit in respect of the audit during the year were £2,800,000 (2000 – £2,500,000), including the statutory audit of the company of £23,000 (2000 – £23,000). Fees in respect of other services provided by KPMG Audit Plc and its associates were: to UK group companies £9,500,000 (2000 – £4,500,000); and to non-UK group companies £4,800,000 (2000 – £2,500,000).

5 Employees

	2001			2000		
Average number of employees	Full time	Part time	Total	Full time	Part time	Total
Premium Drinks	21,363	628	21,991	24,241	450	24,691
Quick Service Restaurants	19,396	10,770	30,166	18,420	10,012	28,432
Packaged Food	18,351	1,015	19,366	18,200	1,151	19,351
	59,110	12,413	71,523	60,861	11,613	72,474

Aggregate remuneration	£ million	£ million
Wages and salaries	1,491	1,472
Employer's social security	127	129
Employer's pension	(33)	(7)
Other post employment	20	18
	1,605	1,612

Retirement 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 and are funded by payments to separately administered funds or insurance companies. The principal plans are in the United Kingdom, the United States and Ireland.

Valuations are carried out annually for the UK, US and Irish plans. All valuations were performed by independent actuaries using the projected unit method to determine pension costs. The principal assumptions for the calculation under SSAP 24 of the profit and loss account credit, for the year ended 30 June 2001 were: real rate of return on assets 4% (2000 – 4%); real annual increase in wages and salaries 2% to 2.5% (2000 – 2% to 2.5%); real rate of future dividend growth for UK equities 1% (2000 – 1%); and pension increases approximately in line with inflation. Surpluses or deficits on the pension plans arising from the actuarial valuations are spread over the expected average service lives of the members (12 to 17.5 years) of the relevant plan on a straight-line basis using the single variation method.

The actuarial value of the assets of those plans was sufficient to cover approximately 133% of the benefits that had accrued to members after allowing for expected future increases in wages and salaries. The market values at 30 June 2001 of the assets of the principal funds are set out in the FRS 17 disclosures below.

Provision is made in the financial statements for the benefits accruing to members of unfunded pension schemes in accordance with the advice of independent actuaries.

The group also operates a number of plans, primarily in the United States, which provide employees with other post employment benefits in respect of medical costs. The plans are generally unfunded and the liability in respect of these benefits is included in provisions. The liability is assessed by qualified independent actuaries under the projected unit method, assuming a liability discount rate of 7.5% (2000 – 7.5%) and medical inflation of 7% reducing by 1% per year to 5% (2000 – 8% reducing by 1% per year to 5%).

The most recent full valuations of the significant defined benefit plans were carried out as follows: United Kingdom on 31 March 2000; United States on 31 March 2001; and Ireland on 31 December 2000. These valuations have been updated to 30 June 2001 by qualified independent actuaries.

The additional disclosures required by FRS 17 are set out below.

Major assumptions	United Kingdom %	United States %	Ireland %
Rate of general increase in salaries	4.3	5.5	5.0
Rate of increase to pensions in payment	3.2	–	3.0
Rate of increase to deferred pensions	2.6	–	3.0
Discount rate for scheme liabilities	6.3	7.5	6.0
Inflation	2.6	3.5	3.0

The expected long term rate of returns and market values of the assets of the significant defined benefit plans at 30 June 2001 were as follows:

	United Kingdom		United States		Ireland	
	Expected long term rate of return %	Market value £ million	Expected long term rate of return %	Market value £ million	Expected long term rate of return %	Market value £ million
Market value of assets						
Equities	7.7	2,793	8.5	1,013	8.1	934
Bonds	–	–	6.5	311	5.6	61
Property	6.7	333	–	–	7.1	81
Other	5.2	85	6.0	1	5.6	2
		3,211		1,325		1,078
Present value of scheme liabilities		(2,720)		(1,162)		(727)
Surplus in the plans		491		163		351
Surplus restriction		–		(26)		–
Pension asset before deferred tax		491		137		351
Deferred tax		(147)		(53)		(35)
		344		84		316

The currently agreed rates of contribution by the group are nil for all significant defined benefit plans.

The Diageo Pension Scheme is recharged with the cost of administration and professional fees by the company. The total amount recharged for the year was £21 million (2000 – £14 million).

6 Associates

	2001 £ million	2000 £ million
Share of operating profit before exceptional items	**203**	198
Share of interest payable (net)	**(3)**	(3)
Share of exceptional items	**–**	(3)
Share of taxation	**(29)**	(72)
Equity minority interests	**(1)**	(2)
Dividends received by the group	**(101)**	(64)
Share of profits retained by associates	**69**	54

Group turnover includes sales to associates of £37 million (2000 – £35 million) and operating costs include purchases from associates of £117 million (2000 – £118 million). The group's share of the operating profit of Moët Hennessy, which is a subsidiary of LVMH, was £155 million (2000 – £135 million).

7 Exceptional items

Operating costs	2001 £ million	2000 £ million
Integration costs (a)	**(74)**	(83)
Premium Drinks production reorganisation (b)	**(54)**	–
Business ownership restructuring (c)	**(25)**	–
Packaged Food integration and restructuring (d)	**(10)**	(43)
Quick Service Restaurants (e)	**(65)**	(55)
	(228)	(181)

(a) £74 million costs were incurred in the year in respect of the integration of the Spirits and Wine and the Beer businesses to create Premium Drinks (2000 – £83 million for the integration of GrandMet and Guinness). Approximately £32 million costs were employee related, principally redundancy, £7 million were asset write downs, and the balance included consultancy and systems costs.

(b) £54 million costs were incurred in the reorganisation of beer production facilities in Great Britain and Ireland. Included in the costs were £23 million of employee related costs, principally redundancy, and £26 million of tangible fixed asset write downs.

(c) £25 million costs arose from the the restructuring of ownership and management within Guinness UDV. Approximately £12 million costs were employee related and the balance included branch establishment and systems development costs.

(d) Packaged Food incurred restructuring costs of £10 million in respect of production facilities in Pillsbury's Bakeries and Foodservice division (2000 – £43 million for the integration of DCA Bakery and organisational changes).

(e) Exceptional items relating to Quick Service Restaurants amounted to a net charge of £65 million. Following a review by management, provisions of £49 million have been made against certain fixed assets. In addition, costs associated with litigation amounted to £21 million (2000 – £34 million litigation damages and £38 million costs of US distributor changes). These costs have been partly offset by exceptional income of £5 million in respect of successor franchise fee income (2000 – £17 million).

Associates In the year ended 30 June 2000, £3 million was incurred in respect of reorganisation costs at Ice Cream Partners.

Sale of businesses		2001 £ million	2000 £ million
Premium Drinks	Latin American brands	**28**	–
	European and other brands	**–**	(165)
Packaged Food	Costs in respect of the proposed combination of Pillsbury with General Mills	**(51)**	–
	North American and other brands	**–**	(3)
Loss on sale		**(23)**	(168)

8 Interest payable (net)

	2001 £ million	2000 £ million
On bank loans and overdrafts	**32**	31
On all other borrowings	**418**	435
Share of net interest payable by associates	**3**	3
	453	469
Less: Other interest receivable	**(103)**	(106)
	350	363

9 Taxation

Tax charge	2001 £ million	2000 £ million
UK corporation tax payable at 30%	122	114
Less: Double taxation relief	(107)	(35)
	15	79
UK deferred taxation	28	10
Overseas corporate taxation	349	227
Overseas deferred taxation	16	12
Taxation on the group's share of profits of associates	29	72
Adjustments to prior period taxation charges	(21)	1
	416	401
Tax reconciliation		
Profit on ordinary activities before taxation	1,722	1,451
Notional charge at UK corporation tax rate 30%	517	435
Differences in effective overseas tax rates	(62)	(43)
Differences in effective tax rates on profits of associates	(31)	14
Exceptional items and goodwill	38	33
Adjustments to prior period taxation charges	(21)	1
Other items	(25)	(39)
Actual charge for taxation	416	401

The tax charge includes tax relief of £33 million (2000 – £71 million) in respect of exceptional items and £6 million (2000 – £4 million) in respect of goodwill amortisation.

10 Dividends

	2001 £ million	2000 £ million
Interim 8.9 pence per share (2000 – 8.4 pence)	298	285
Proposed final 13.4 pence per share (2000 – 12.6 pence)	453	428
	751	713

11 Earnings per share

	2001		2000	
	Earnings £ million	Shares million	Earnings £ million	Shares million
Basic (profit/weighted average number of shares)	1,226	3,377	976	3,393
Adjustments – potential employee share issues	–	3	–	5
Diluted	1,226	3,380	976	3,398

Basic and diluted earnings per share are also shown on the face of the profit and loss account calculated by reference to earnings before the £219 million (2000 – £289 million) charge for goodwill amortisation and exceptional items, and the related tax, since the directors consider that this gives a useful additional indication of underlying performance.

12 Fixed assets – intangible assets

	Brands £ million	Goodwill £ million	Other intangibles £ million	Total £ million
Cost				
At 30 June 2000	4,875	416	24	5,315
Exchange adjustments	288	19	(2)	305
Additions	50	41	21	112
At 30 June 2001	5,213	476	43	5,732
Amortisation				
At 30 June 2000	–	21	5	26
Provided during the year	–	26	3	29
Exceptional write downs	–	5	–	5
At 30 June 2001	–	52	8	60
Net book value				
At 30 June 2001	5,213	424	35	5,672
At 30 June 2000	4,875	395	19	5,289

Brands are stated at fair value on acquisition, denominated in the currencies of their principal markets. An annual review is carried out by the directors to consider whether any brand has suffered an impairment in value. The principal acquired brands included above are Johnnie Walker, Smirnoff, Pillsbury, Old El Paso, Progresso and Burger King.

13 Fixed assets – tangible assets

	Land and buildings £ million	Plant and machinery £ million	Fixtures and fittings £ million	Assets in course of construction £ million	Total £ million
Cost or valuation					
At 30 June 2000	1,901	2,378	224	263	4,766
Exchange adjustments	66	39	9	9	123
Additions	139	206	29	137	511
Disposals	(124)	(102)	(17)	(6)	(249)
Transfers	97	103	33	(233)	–
At 30 June 2001	2,079	2,624	278	170	5,151
Depreciation					
At 30 June 2000	492	1,048	148	–	1,688
Exchange adjustments	23	14	6	–	43
Provided during the year	79	227	43	–	349
Exceptional write downs	27	21	6	–	54
Disposals	(65)	(80)	(14)	–	(159)
At 30 June 2001	556	1,230	189	–	1,975
Net book value					
At 30 June 2001	1,523	1,394	89	170	3,176
At 30 June 2000	1,409	1,330	76	263	3,078

(a) The net book value of land and buildings comprises: freeholds of £1,347 million (2000 – £1,265 million); long leaseholds of £50 million (2000 – £50 million); and short leaseholds of £126 million (2000 – £94 million). Depreciation was not charged on £355 million (2000 – £322 million) of land.

(b) Included in the total net book value of tangible assets is £40 million (2000 – £41 million) in respect of assets under finance leases; depreciation for the year on these assets was £4 million (2000 – £4 million). Cost included £196 million (2000 – £184 million) in respect of assets held for the purpose of leasing out under operating leases; accumulated depreciation on these assets was £60 million (2000 – £55 million) and depreciation for the year was £3 million (2000 – £4 million).

(c) The total at cost or valuation for land and buildings comprises: £516 million (2000 – £558 million) at 1992 professional valuation; £112 million (2000 – £123 million) at 1988 professional valuation; and £1,451 million (2000 – £1,220 million) at cost. The professional valuations were made on an open market existing use basis except for specialised properties which were valued on a depreciated replacement cost basis.

(d) The historical cost of land and buildings, i.e. the original cost to the group of all land and buildings, was £1,941 million (2000 – £1,763 million) and the related accumulated depreciation was £555 million (2000 – £492 million).

14 Fixed assets – investments

	Investment in associates £ million	Investment in own shares £ million	Other investments £ million	Loans £ million	Total £ million
Cost					
At 30 June 2000	1,233	198	66	79	1,576
Exchange adjustments	(24)	–	2	3	(19)
Additions	5	82	40	16	143
Share of retained profits	69	–	–	–	69
Disposals and other	(80)	(66)	(47)	(11)	(204)
At 30 June 2001	1,203	214	61	87	1,565
Provisions/amortisation					
At 30 June 2000	3	56	10	11	80
Amortisation of own shares	–	25	–	–	25
Exceptional write downs	7	–	16	–	23
Disposals	–	(36)	–	–	(36)
At 30 June 2001	10	45	26	11	92
Net book value					
At 30 June 2001	1,193	169	35	76	1,473
At 30 June 2000	1,230	142	56	68	1,496

Investment in associates comprises the cost of shares, less goodwill written off on acquisitions prior to 1 July 1998, of £898 million (2000 – £962 million) plus the group's share of post-acquisition reserves of £295 million (2000 – £268 million). Investment in associates includes £922 million (2000 – £901 million) in respect of Moët Hennessy.

Investment in own shares at 30 June 2001 comprised 30.3 million ordinary shares held in respect of longer term incentive plans for executive directors and senior executives and 4.3 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 2001 was £270 million (2000 – 32.4 million ordinary shares, market value £192 million).

The net book value of other investments listed on UK stock exchanges was £2 million (2000 – £12 million), and on other stock exchanges was £7 million (2000 – £39 million). These investments had a market value of £8 million (2000 – £45 million).

15 Stocks

	2001 £ million	2000 £ million
Raw materials and consumables	281	234
Work in progress	25	34
Maturing stocks	1,298	1,281
Finished goods and goods for resale	628	590
	2,232	2,139

The group estimates that the replacement cost of the maturing stocks at 30 June 2001 was higher than the carrying value by approximately £600 million (2000 – £600 million).

16 Debtors

	2001		2000	
	Due within one year £ million	Due after one year £ million	Due within one year £ million	Due after one year £ million
Trade debtors	1,353	–	1,270	–
Amounts owed by associates	2	–	1	3
Amounts receivable under finance leases	8	94	6	90
Other debtors	334	327	320	243
Pension prepayments	–	795	–	711
Other prepayments and accrued income	210	13	130	36
Deferred taxation (note 21)	3	43	4	64
ACT recoverable	4	8	114	40
	1,914	1,280	1,845	1,187

Debtors subject to financing arrangements Franchisee loans originated by the group have been sold to a financial institution on a limited recourse basis, with the group retaining the net income from the portfolio after third party costs have been met. Loans outstanding at 30 June 2001 were £270 million (2000 – £258 million). They were subject to recourse of £43 million (2000 – £39 million), which is included in borrowings. The group is not obliged to support any losses in respect of the non-returnable finance and does not intend to do so. In addition, the provider of finance has agreed in writing to seek repayment only to the extent that sufficient funds are generated by the franchisee loans and not to seek recourse in any other form.

17 Net borrowings

Analysis of net borrowings	At 30 June 2000 £ million	Cash flow £ million	Non-cash items £ million	Exchange adjustments £ million	At 30 June 2001 £ million
Cash and overdrafts					
Cash at bank and in hand	1,063	751	–	28	1,842
Less: Bank deposits reclassified to liquid resources	(580)	(572)	–	(26)	(1,178)
Overdrafts	(179)	(79)	–	(4)	(262)
	304	100	–	(2)	402
Borrowings excluding overdrafts					
Borrowings due within one year	(2,887)	16	(354)	(115)	(3,340)
Borrowings due after one year	(3,716)	(388)	322	(211)	(3,993)
Interest rate and foreign currency swaps	213	(26)	53	75	315
Net obligations under finance leases	(39)	–	–	(2)	(41)
	(6,429)	(398)	21	(253)	(7,059)
Liquid resources					
Bank deposits reclassified from cash	580	572	–	26	1,178
Net borrowings	(5,545)	274	21	(229)	(5,479)

£19 million (2000 – £12 million) of net borrowings due after one year and £91 million (2000 – £109 million) of net borrowings due within one year were secured on assets of the group.

The interest rate swaps included in net borrowings comprise interest accruals on the swaps relating to the zero coupon bonds 2004. The foreign currency swaps comprise the net amount from the translation of the group's foreign currency swap principal amounts. The interest rate and foreign currency swaps are included in other debtors. Bank deposits represent amounts placed with financial institutions which require notice of withdrawal of more than 24 hours in order to avoid an interest penalty.

17 Net borrowings continued

Borrowings excluding overdrafts	Currency	Year end interest rates %	2001 £ million	2000 £ million
Commercial paper	US dollar	3.55-5.85	1,310	857
Guaranteed bonds 2000	US dollar	6.24	–	230
Guaranteed bonds 2000	US dollar	Variable	–	329
Guaranteed bonds 2000	US dollar	Variable	–	329
Guaranteed notes 2001	US dollar	8.625	213	197
Bonds 2002	French franc	6.25	138	145
Guaranteed bonds 2003	US dollar	6.0	354	327
Guaranteed bonds 2004	US dollar	6.625	707	656
Zero coupon bonds 2004	US dollar	8.13	710	609
Guaranteed notes 2004	US dollar	7.125	142	131
Guaranteed bonds 2005	US dollar	6.125	354	327
Guaranteed bonds 2005	Sterling	9.0	199	199
Guaranteed notes 2005/2035	US dollar	7.45	284	263
Guaranteed debentures 2011	US dollar	9.0	211	196
Guaranteed debentures 2022	US dollar	8.0	211	195
Medium term notes	Various	Various	832	716
Repurchase agreement	Sterling	5.86	500	500
Repurchase agreement	Sterling	5.53	300	–
Preferred capital securities	US dollar	5.66-5.86	532	–
Bank loans and others less swaps	Various	Various	62	223
Total			7,059	6,429

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 18). The effective interest rate payable for the year, based on average net borrowings, was 6.2%. The above loans are stated net of unamortised finance costs of £176 million (2000 – £217 million) of which £158 million (2000 – £197 million) relates to the zero coupon bonds 2004.

18 Financial instruments and risk management

A discussion of the group's objectives and policies with regard to risk management and the use of financial instruments can be found in the operating and financial review. Financial instruments comprise net borrowings (see note 17) together with other instruments deemed to be financial instruments including certain fixed asset investments, long term debtors, other long term creditors and provisions for liabilities and charges. Disclosures dealt with in this note exclude short term debtors and creditors where permitted by the accounting standard on derivatives and other financial instruments (FRS 13).

(i) Currency risk management At 30 June 2001, the group's US dollar and euro net assets before net borrowings were approximately 74% and 81% hedged by net borrowings, respectively.

As at 30 June 2001 and 1 September 2001, currency cylinders, forwards and options protect the translation of estimated overseas profits for the year ending 30 June 2002 within the following weighted average ranges:

		30 June 2001		1 September 2001	
		Hedged amount £ million	Average range	Hedged amount £ million	Average range
US dollar	– cylinders	713	1.44-1.49	628	1.43-1.48
	– forwards	121	1.43	121	1.43
Euro	– cylinders	223	1.56-1.64	169	1.55-1.64
	– options	108	1.75	108	1.75

The group's expected transaction exposure, for currencies in which there is an active market, is hedged forward between 80% and 100% for the period ending 31 December 2002.

At 30 June 2001, there were no material monetary assets or liabilities in currencies other than the functional currencies of group companies, having taken into account the effect of forward contract and other derivative financial instruments that have been utilised to match foreign currency exposure.

18 Financial instruments and risk management continued

(ii) Interest risk management At 30 June 2001, after taking account of interest rate swaps, cross-currency interest rate swaps and forward rate agreements, the currency and interest rate profile of the financial liabilities and assets of the group was as follows:

	Floating rate £ million	Fixed rate £ million	Interest free £ million	Sub-total £ million	Impact of foreign currency swaps £ million	Total £ million	Weighted average fixed rate %	Weighted average time to maturity Years
Financial liabilities:								
US dollar	(2,610)	(2,445)	(141)	(5,196)	(184)	(5,380)	5.8	2.5
Euro	(377)	(565)	(13)	(955)	(400)	(1,355)	4.3	3.8
Sterling	(1,128)	(425)	(35)	(1,588)	1,226	(362)	4.6	1.7
Other	(56)	(146)	–	(202)	(210)	(412)	4.1	0.5
	(4,171)	(3,581)	(189)	(7,941)	432	(7,509)	5.4	2.5
Guaranteed preferred securities	–	(399)	–	(399)	–	(399)	9.4	3.4
Financial assets:								
US dollar	798	137	161	1,096	–	1,096	6.5	7.4
Euro	204	–	15	219	–	219	–	–
Sterling	242	334	39	615	–	615	7.1	1.6
Other	300	–	1	301	–	301	–	–
	1,544	471	216	2,231	–	2,231	6.9	3.3
Net financial liabilities	(2,627)	(3,509)	27	(6,109)	432	(5,677)	5.6	2.5

At 30 June 2000, after taking account of interest rate swaps, cross-currency interest rate swaps and forward rate agreements, the currency and interest rate profile of the financial liabilities and assets of the group was as follows:

	Floating rate £ million	Fixed rate £ million	Interest free £ million	Sub-total £ million	Impact of foreign currency swaps £ million	Total £ million	Weighted average fixed rate %	Weighted average time to maturity Years
Financial liabilities:								
US dollar	(2,576)	(2,231)	(144)	(4,951)	382	(4,569)	6.4	2.7
Euro	(298)	(644)	(9)	(951)	(412)	(1,363)	4.2	2.5
Sterling	(585)	(525)	(42)	(1,152)	710	(442)	5.4	2.4
Other	(88)	(122)	–	(210)	(215)	(425)	5.0	0.8
	(3,547)	(3,522)	(195)	(7,264)	465	(6,799)	5.8	2.6
Guaranteed preferred securities	–	(405)	–	(405)	–	(405)	9.3	4.5
Financial assets:								
US dollar	225	133	159	517	–	517	7.5	8.4
Euro	109	–	12	121	–	121	–	–
Sterling	188	341	32	561	–	561	7.1	2.5
Other	244	–	6	250	–	250	–	–
	766	474	209	1,449	–	1,449	7.2	4.2
Net financial liabilities	(2,781)	(3,453)	14	(6,220)	465	(5,755)	6.0	2.6

Floating rate financial liabilities bear interest based on short term interbank rates (predominantly six months LIBOR) and commercial paper rates.

Interest bearing financial liabilities comprise bonds, medium term notes, commercial paper issued, money market loans, repurchase and forward rate agreements, net obligations under finance leases and bank overdrafts. Financial liabilities on which no interest is paid consist of: provisions for liabilities and charges payable after one year in respect of employee incentive plans and disposals of £21 million (2000 – £25 million); long term creditors of £60 million (2000 – £65 million); and derivative financial instruments of £108 million (2000 – £105 million). Interest bearing financial assets comprise cash, short term liquid investments with financial institutions and certain fixed asset investments, loans and long term debtors. Financial assets on which no interest is paid include certain fixed asset investments, loans and debtors.

The foreign currency swaps, in the table above, adjust the currency basis of borrowings as part of the group's policy to hedge its exposure to fluctuations on translation into sterling of its foreign currency net assets (see (i) above). The foreign currency swaps are short term in nature and therefore have a floating interest basis. They are shown after taking account of fixing interest rate swaps which transfer £417 million (2000 – £480 million) of euro floating rate interest liabilities arising from foreign currency swaps into euro fixed rate financial liabilities.

In addition to the interest rate and currency swaps reflected in the table above, the group has £1,947 million notional principal of US dollar interest rate collars which mature between 31 December 2001 and 31 December 2006 and have floors of 4.87% – 6.32% and caps of 6.25% – 8.75%.

(iii) Maturity of financial liabilities

	2001				2000			
Analysis by year of repayment:	**Bank loans and overdrafts £ million**	**Other borrowings £ million**	**Finance leases and other £ million**	**Total £ million**	Bank loans and overdrafts £ million	Other borrowings £ million	Finance leases and other £ million	Total £ million
After five years	**–**	**686**	**64**	**750**	1	962	25	988
From two to five years	**13**	**2,186**	**21**	**2,220**	9	2,176	28	2,213
From one to two years	**6**	**802**	**34**	**842**	7	333	72	412
Due after one year	**19**	**3,674**	**119**	**3,812**	17	3,471	125	3,613
Due within one year	**400**	**3,187**	**110**	**3,697**	328	2,753	105	3,186
	419	**6,861**	**229**	**7,509**	345	6,224	230	6,799

Other borrowings are net of interest rate and foreign currency swaps.

The group had available undrawn committed bank facilities at 30 June 2001 as follows:

	£ million
Expiring within one year	**1,248**
Expiring in more than two years	**1,021**
	2,269

Commitment fees are paid on the undrawn portion of these facilities. Borrowings under these facilities will be at prevailing LIBOR rates plus an agreed margin, which is dependent on the period of drawdown. These facilities can be used for general corporate purposes and together with cash and cash equivalents support the group's commercial paper programmes. In the event that the proposed acquisition of the Seagram spirits and wine business occurs before the completion of the combination of Pillsbury with General Mills, the group has additional contingent financing in place.

(iv) Fair values The estimated fair values of borrowings, guaranteed preferred securities, associated derivative financial instruments and other financial liabilities and assets at 30 June 2001 are set out below. The fair values of quoted borrowings and guaranteed preferred securities are based on year end mid-market quoted prices. The fair values of other borrowings, derivative financial instruments and other financial liabilities and assets are estimated by discounting the future cash flows to net present values using appropriate market rates prevailing at the year end. These are based on fair values obtained from third parties.

	2001		2000	
	Net carrying amount £ million	**Estimated fair value £ million**	Net carrying amount £ million	Estimated fair value £ million
Primary financial instruments:				
Borrowings due within one year including overdrafts	**(3,602)**	**(3,711)**	(3,066)	(3,064)
Borrowings due after one year	**(3,993)**	**(4,096)**	(3,716)	(3,745)
Cash at bank and in hand	**1,842**	**1,842**	1,063	1,063
Guaranteed preferred securities	**(399)**	**(451)**	(405)	(443)
Derivatives – interest rate contracts:				
Interest rate swaps – positive values	**349**	**498**	309	316
– negative values	**(32)**	**(107)**	(77)	(120)
Collars	**(13)**	**(42)**	(17)	7
Other interest rate contracts	**–**	**2**	2	5
Derivatives – foreign exchange contracts:				
Transaction – positive values	**–**	**23**	–	28
– negative values	**–**	**(50)**	–	(50)
Balance sheet translation – positive values	**25**	**27**	13	22
– negative values	**(10)**	**(10)**	(28)	(28)
Foreign exchange options (profit translation) – positive values	**–**	**17**	–	5
– negative values	**2**	**(39)**	(2)	(28)
Other:				
Derivatives – futures and option commodity contracts	**–**	**(4)**	–	(3)
Other financial liabilities	**(119)**	**(119)**	(109)	(110)
Other financial assets	**273**	**301**	278	298

The difference between net carrying amount and estimated fair value reflects unrealised gains or losses inherent in the instrument based on valuations at 30 June 2001. The volatile nature of the markets means that values at any subsequent date could be significantly different from the values reported above.

18 Financial instruments and risk management continued

(v) Hedges Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. The table below shows the extent to which the group has unrecognised gains and losses on financial instruments, and deferred gains and losses in respect of financial instruments and terminated financial instruments used as hedges, at the beginning and end of the year.

	Unrecognised			Deferred		
Gains/(losses):	Gains £ million	Losses £ million	Total £ million	Gains £ million	Losses £ million	Total £ million
On hedges at 30 June 2000	81	(122)	(41)	12	(27)	(15)
Arising in previous years recognised during 2001	36	(73)	(37)	3	(5)	(2)
On hedges at 30 June 2001	204	(197)	7	10	(23)	(13)
Of which gains/(losses) expected to be recognised in:						
– year ending 30 June 2002	99	(118)	(19)	3	(5)	(2)
– year ending 30 June 2003 or later	105	(79)	26	7	(18)	(11)

19 Other creditors

	2001		2000	
	Due within one year £ million	Due after one year £ million	Due within one year £ million	Due after one year £ million
Trade creditors	758	–	652	2
Corporate taxation	593	–	574	–
Other taxation including social security	253	–	217	–
Net obligations under finance leases	5	36	4	35
Other creditors	516	43	653	47
Ordinary dividends payable	453	–	428	–
Accruals and deferred income	917	17	747	16
	3,495	96	3,275	100

Gross obligation under finance leases due:		
After five years	55	51
From one to five years	31	30
	86	81
Less: Future finance charges	(50)	(46)
	36	35

20 Provisions for liabilities and charges

	Post employment £ million	Restructuring and integration £ million	Disposal £ million	Deferred taxation £ million	Other £ million	Total £ million
At 30 June 2000	269	55	37	50	283	694
Exchange adjustments	17	1	1	–	4	23
Profit and loss account charge	24	30	6	24	20	104
Disposals	–	–	–	–	(4)	(4)
Utilised	(29)	(52)	(11)	–	(72)	(164)
At 30 June 2001	281	34	33	74	231	653

Provisions at 30 June 2001

(a) Post employment provisions were £281 million, comprising £213 million post employment benefits in respect of US medical costs and £68 million in respect of unfunded pension liabilities (2000 – £197 million and £72 million, respectively). These provisions are mainly actuarially assessed and are long term.

20 Provisions for liabilities and charges continued

(b) Restructuring and integration provisions were £34 million, comprising £23 million for restructuring the beer and foodservice production facilities and £11 million in respect of other restructuring costs. The majority of these provisions will be utilised in the next financial year.

(c) Disposal provisions were £33 million arising from commitments in respect of businesses sold. These provisions will predominately be utilised within the next few years.

(d) Deferred taxation was £74 million (see note 21).

(e) Other provisions were £231 million, including £60 million for the estimated discounted rental shortfall in respect of vacant properties, £57 million for actuarially assessed non-insured claims and £42 million for employee incentive plans (2000 – £66 million, £57 million and £38 million, respectively). The vacant property provision is based on the estimated discounted rental shortfall over the terms of the leases; the non-insured claims are long term and the timing of their utilisation is not known; and the incentive plan provision will be utilised within the next few years.

21 Deferred taxation

	2001 £ million	2000 £ million
Accelerated depreciation	**141**	124
Pension prepayments and provisions	**204**	195
Post employment benefits other than pensions	**(75)**	(67)
Restructuring and integration costs	**(22)**	(21)
Vacant properties	**–**	(20)
Other timing differences	**(220)**	(229)
Net liability/(asset)	**28**	(18)
US and other overseas deferred tax assets (note 16)	**46**	68
UK deferred tax provision (note 20)	**74**	50

Provision for tax on capital gains payable on the disposal of revalued properties is made only when it is decided in principle to dispose of the asset. Other deferred taxation not provided amounted to £6 million (2000 – £2 million). Deferred tax is not generally provided in respect of liabilities which might arise on the distribution of unappropriated profits of overseas subsidiaries and associates, except where distributions of such profits are planned.

22 Called up share capital

Authorised and issued share capital The authorised share capital of the company at 30 June 2001 was £1,542 million (2000 – £1,542 million). The allotted and fully paid share capital was 3,411 million ordinary shares of $28^{101}/_{108}$ pence each with an aggregate nominal value of £987 million (2000 – 3,422 million shares, aggregate nominal value £990 million).

Movements in called up share capital

(a) During the year 7 million ordinary shares (nominal value £2 million) were allotted under the share option schemes for a total consideration of £31 million (2000 – 4 million ordinary shares, nominal value £1 million, consideration £12 million).

(b) The company purchased, and subsequently cancelled, 17.8 million ordinary shares (nominal value £5 million) during the year for a consideration including expenses of £108 million (2000 – 9.5 million ordinary shares, nominal value £3 million, consideration £54 million).

Potential issues of ordinary shares

(a) Under the executive share option schemes, directors and executives hold options to subscribe for up to 6 million (2000 – 12 million) ordinary shares at prices ranging between 391 pence and 744 pence per share exercisable by 2011.

(b) Under the savings-related share option schemes for employees, employees hold options to subscribe for up to 1 million (2000 – 1 million) ordinary shares at prices ranging between 240 pence and 611 pence per share exercisable by 2004.

23 Reserves attributable to equity shareholders

	Share premium account £ million	Revaluation reserve £ million	Capital redemption reserve £ million	Profit and loss account £ million	Total £ million
At 30 June 2000	1,285	138	2,949	(651)	3,721
Retained earnings	–	–	–	475	475
Exchange adjustments	–	–	–	95	95
Tax charge on exchange in reserves	–	–	–	(17)	(17)
Premiums on share issues, less expenses	29	–	–	–	29
Repurchase of own shares	–	–	5	(108)	(103)
Transfers	–	(1)	–	1	–
At 30 June 2001	1,314	137	2,954	(205)	4,200

Aggregate goodwill written off against the profit and loss account, net of disposals, is £4,288 million (2000 – £4,094 million) including £109 million (2000 – £156 million) in respect of associates. The exchange adjustments include losses of £229 million in respect of foreign currency net borrowings (2000 – £119 million).

24 Movements in consolidated shareholders' funds

	2001 £ million	2000 £ million
Profit for the year	1,226	976
Dividends	(751)	(713)
	475	263
Exchange adjustments	95	25
Tax charge on exchange in reserves	(17)	(7)
New share capital issued	31	12
Repurchase of own shares	(108)	(54)
Goodwill on disposals of businesses	–	446
Net movement in shareholders' funds	476	685
Shareholders' funds at beginning of the year	4,711	4,026
Shareholders' funds at end of the year	5,187	4,711

25 Minority interests – non-equity

Non-equity minority interests comprise £399 million 9.42% cumulative guaranteed preferred securities issued by subsidiaries (2000 – £368 million of 9.42% and £37 million of 7.973% securities). The holders of these securities have no rights against group companies other than the issuing entity and, to the extent prescribed by the guarantee, the company. To the extent that payments due under the guarantee are not made because the company has insufficient distributable profits, the company has covenanted that it will not make any distribution on any share capital which ranks junior to these securities.

26 Net cash inflow from operating activities

	2001 £ million	2000 £ million
Operating profit	1,873	1,782
Exceptional operating costs	228	181
Restructuring and integration payments	(144)	(198)
Depreciation and amortisation charge	403	365
Increase in stocks	(30)	(21)
(Increase)/decrease in debtors	(46)	4
Increase/(decrease) in creditors and provisions	22	(45)
Other items	(30)	(25)
Net cash inflow from operating activities	2,276	2,043

27 Purchase of subsidiaries

	2001			2000
	Balance sheet at acquisition £ million	Fair value adjustments £ million	Fair value balance sheets £ million	Fair value balance sheets £ million
Brands	–	50	50	–
Goodwill arising on acquisition	–	41	41	106
Tangible fixed assets	91	(18)	73	34
Investment in associates	(46)	3	(43)	–
Cash	10	–	10	–
Working capital	48	–	48	11
Net assets acquired	103	76	179	151
Minority interests	(33)	–	(33)	–
Purchase consideration paid			146	151
Cash acquired			(10)	–
			136	151

During the year the group acquired additional ordinary shares in Bundaberg Distilling Investments Pty Limited in Australia and East African Breweries Limited which, as a result, became subsidiaries.

28 Sale of subsidiaries and businesses

	2001 £ million	2000 £ million
Brands	–	149
Other fixed assets	7	222
Working capital and provisions	41	(1)
Cash	5	71
Minority interest	(13)	(10)
Goodwill	–	446
Loss on sale	(23)	(168)
Sale consideration received	17	709
Cash	(5)	(71)
	12	638

The sale consideration received includes the net proceeds in respect of the sale of UDV Industria e Comercio Ltda in Brazil, less costs in respect of the proposed combination of Pillsbury with General Mills.

29 Contingent liabilities

The group has given performance guarantees and indemnities to third parties of £47 million (2000 – £37 million).

There are a number of legal claims or potential claims against the group, the outcome of which cannot at present be foreseen. Details of the principal legal claims are set out under litigation in the operating and financial review. Provision is made in these financial statements for all liabilities which are expected to materialise.

30 Commitments

Capital expenditure Commitments not provided for in these financial statements are estimated at £69 million (2000 – £50 million).

	2001			2000		
Annual operating lease commitments	**Land and buildings £ million**	**Other £ million**	**Total £ million**	Land and buildings £ million	Other £ million	Total £ million
Annual payments under leases expiring:						
After five years	**82**	**8**	**90**	88	4	92
From one to five years	**48**	**19**	**67**	44	16	60
Within one year	**3**	**5**	**8**	3	6	9
	133	**32**	**165**	135	26	161

31 Pending transactions

On 17 July 2000, Diageo announced an agreement on the terms of the combination of Pillsbury, its Packaged Food business, with General Mills. General Mills will, subject to certain regulatory clearances, acquire Pillsbury. Under the agreement, at completion, Diageo will receive 141 million General Mills shares, comprising approximately 33% of General Mills enlarged issued share capital, and General Mills will acquire Pillsbury, which will have up to US$5,142 million of debt outstanding. The agreement remains in place, although it may be terminated by either Diageo or General Mills without penalty.

On 20 December 2000, Diageo and Pernod Ricard announced that they had signed an agreement to acquire the spirits and wine business of The Seagram Company Ltd., for US$8.15 billion (£5.5 billion) in cash on a debt free basis. The purchase consideration will be funded by Diageo and Pernod Ricard as to $5.0 billion and $3.15 billion, respectively. The agreement is principally conditional on clearance by the anti-trust regulatory authorities.

Company balance sheet

	Notes	30 June 2001 £ million	30 June 2001 £ million	30 June 2000 £ million	30 June 2000 £ million
Fixed assets					
Tangible assets	34		15		3
Investments	34		26,228		25,633
			26,243		25,636
Current assets					
Amounts owed by subsidiaries		5,763		5,455	
Other debtors – due within one year		30		137	
Other debtors – due after one year		18		46	
Cash at bank		165		13	
		5,976		5,651	
Creditors – due within one year					
Borrowings	36	(79)		(130)	
Other creditors	35	(493)		(482)	
		(572)		(612)	
Net current assets			5,404		5,039
Total assets less current liabilities			31,647		30,675
Creditors – due after one year					
Borrowings	36	(191)		(226)	
Amounts owed to subsidiaries	37	(14,600)		(15,110)	
			(14,791)		(15,336)
Provisions for liabilities and charges			(8)		(11)
			16,848		15,328
Capital and reserves					
Called up share capital	22		987		990
Share premium account		1,314		1,285	
Merger reserve		9,161		9,161	
Capital redemption reserve		2,954		2,949	
Profit and loss account		2,432		943	
Reserves attributable to equity shareholders	38		15,861		14,338
Shareholders' funds			16,848		15,328

These financial statements were approved by a duly appointed and authorised committee of the Board of Directors on 5 September 2001 and were signed on its behalf by PS Walsh and NC Rose, directors.

Notes to the company balance sheet

32 Company profit and loss account

The company's results are included in the consolidated profit and loss account, so a separate profit and loss account is not presented.

33 Directors' emoluments

	2001 £000	2000 £000
Executive directors – remuneration including bonuses	6,461	7,861
Fees to non-executive directors	521	234
	6,982	8,095

The total emoluments, share option gains and payments under other longer term incentive plans received by the highest paid director were £3,257,000 (2000 – £2,482,000). There were pension contributions of £4,000 (2000 – £43,000) to defined contribution schemes in the year in respect of executive directors. The aggregate amount of gains made by the directors from the exercise of share options and from the vesting of awards during the year was £5,486,000 (2000 – £2,272,000) and payments under other longer term incentive plans totalled £1,215,000 (2000 – £150,000). Further information on directors' emoluments, share interests and pension entitlements is included in the remuneration report.

34 Fixed assets

	Tangible assets	Investments			
	£ million	Shares in subsidiaries £ million	Own shares £ million	Other investments £ million	Total £ million
Cost					
At 30 June 2000	18	25,490	197	2	25,689
Additions	13	563	82	5	650
Disposals	(2)	–	(66)	–	(66)
At 30 June 2001	29	26,053	213	7	26,273
Depreciation/amortisation					
At 30 June 2000	15	–	56	–	56
Depreciation provided during the year	1	–	–	–	–
Amortisation of own shares – company	–	–	10	–	10
– subsidiaries	–	–	15	–	15
Disposals	(2)	–	(36)	–	(36)
At 30 June 2001	14	–	45	–	45
Net book value					
At 30 June 2001	15	26,053	168	7	26,228
At 30 June 2000	3	25,490	141	2	25,633

Investment in own shares at 30 June 2001 comprised 34.4 million ordinary shares (2000 – 32.3 million ordinary shares). The shares are held by employee trusts for the sole purpose of satisfying obligations under employee share schemes operated by the group. Details of the principal group companies are given after these financial statements.

35 Other creditors – due within one year

	2001 £ million	2000 £ million
Ordinary dividends payable	453	428
Other creditors and accruals	40	54
	493	482

36 Borrowings

Analysis by year of repayment	2001 Other borrowings £ million	2000 Bank loans and overdrafts £ million	2000 Other borrowings £ million	2000 Total £ million
From two to five years	25	–	145	145
From one to two years	166	–	81	81
Due after one year	191	–	226	226
Due within one year	79	90	40	130
	270	90	266	356

Other borrowings	Currency	Year end interest rates %	2001 £ million	2000 £ million
Bonds 2002	Swiss franc	3.0	79	121
Bonds 2002	French franc	6.25	138	145
Bonds 2003	US dollar	Various	53	–
			270	266

The interest rates shown in the table above are those contracted on the underlying borrowings before taking into account any interest rate protection.

37 Amounts owed to subsidiaries

The amounts owed to subsidiaries include £403 million 9.42% unsecured cumulative capital interests (2000 – £372 million of 9.42% and £37 million of 7.973% securities). These securities are subordinated to all other liabilities of the company. The securities are redeemable only at the option of the company in or after 2004 or in the event of certain fiscal or legal changes in the United States or the United Kingdom. Interest and redemption payments may only be made to the extent that the company has adequate distributable profits or, in the case of a redemption, out of the proceeds of an issue of shares. To the extent that dividend or redemption payments have not been made when due, the company has covenanted that it will not make any distribution on any share capital which ranks junior to these securities.

38 Reserves attributable to equity shareholders

	Share premium account £ million	Merger reserve £ million	Capital redemption reserve £ million	Profit and loss account £ million	Total £ million
At 30 June 2000	1,285	9,161	2,949	943	14,338
Profit for the year	–	–	–	2,348	2,348
Dividends	–	–	–	(751)	(751)
Premiums on share issues, less expenses	29	–	–	–	29
Repurchase of own shares	–	–	5	(108)	(103)
At 30 June 2001	1,314	9,161	2,954	2,432	15,861

39 Contingent liabilities

The company has guaranteed certain borrowings of subsidiaries which at 30 June 2001 amounted to £6,275 million (2000 – £5,339 million). The company has also provided irrevocable guarantees relating to the liabilities of certain of its Irish and Dutch subsidiaries. In addition, the company has certain obligations with regard to the group's non-equity minority interests (see note 25).

Reconciliation to US accounting principles

Diageo plc is a public limited company incorporated under the laws of England and Wales and the group's financial statements are prepared in accordance with generally accepted accounting principles (GAAP) applicable in the United Kingdom. UK GAAP differs in certain significant respects from US GAAP. The differences in respect of net income and shareholders' equity are set out below.

Effect on net income of differences between UK and US GAAP:

	Notes	Year ended 30 June 2001 £ million	Year ended 30 June 2000 £ million
Net income in accordance with UK GAAP		1,226	976
Adjustments to conform with US GAAP:			
Brands	(a)	(230)	(221)
Goodwill and other intangibles	(a)	(212)	(188)
Inventories	(b)	(74)	(94)
Derivative instruments	(d)	(17)	17
Pensions and other post employment benefits	(e)	28	(21)
Disposals of businesses	(f)	–	243
Employee share trust arrangements	(g)	(24)	(1)
Other items		(46)	3
Deferred taxation – on above adjustments	(h)	21	25
– other	(h)	86	59
Net income in accordance with US GAAP		**758**	798
Earnings per share	(j)		
Basic earnings per share in accordance with US GAAP		22.4p	23.5p
Basic earnings per American Depository Share in accordance with US GAAP		89.6p	94.0p

Cumulative effect on shareholders' equity of differences between UK and US GAAP:

	Notes	30 June 2001 £ million	30 June 2000 £ million
Shareholders' equity in accordance with UK GAAP		5,187	4,711
Adjustments to conform with US GAAP:			
Brands	(a)	2,125	2,431
Goodwill and other intangibles	(a)	6,313	6,370
Inventories	(b)	282	356
Revaluation of land and buildings	(c)	(41)	(42)
Pensions and other post employment benefits	(e)	(43)	(60)
Employee share trust arrangements	(g)	(169)	(145)
Ordinary dividends	(i)	453	428
Other differences in accounting principles		(72)	(52)
Deferred taxation – on above adjustments	(h)	(78)	(103)
– other	(h)	(2,077)	(2,092)
Shareholders' equity in accordance with US GAAP		**11,880**	11,802

(a) Brands, goodwill and other intangibles Significant owned brands acquired by the group are recorded on the balance sheet. Under UK GAAP, the group has written off other intangible assets acquired up to 30 June 1998 direct to reserves in the period acquired. All intangible assets acquired from 1 July 1998 have been capitalised in the balance sheet. Where capitalised goodwill and intangible assets are regarded as having limited useful economic lives, their cost is amortised on a straight line basis over those lives – up to 20 years. Where intangible assets are regarded as having indefinite useful economic lives, they are not amortised. Under US GAAP, 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. In addition, differences may arise when goodwill is impaired which has been written off to reserves under UK GAAP but capitalised under US GAAP.

(b) Accounting for the merger of the former GrandMet Group and the former Guinness Group For UK GAAP, the merger of the GrandMet Group and the Guinness Group was accounted under UK GAAP 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 assets and liabilities 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 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 utilised.

(c) Revaluation of land and buildings UK GAAP allows the periodic revaluation of land and buildings. Professional valuations of certain of the group's properties were carried out in 1988 which under US GAAP have not been reflected in the consolidated financial statements.

(d) Derivative instruments Some of the group's foreign currency interest and commercial contracts hedge forecast transactions which do not meet the US GAAP hedge accounting criteria. Such contracts are marked to market at the balance sheet date and gains or losses arising are recognised in net income. Under UK GAAP, these gains and losses can be deferred until the hedged transactions actually occur.

(e) Pensions and other post employment benefits There are differences in the methods of valuation required under UK and US GAAP for valuing assets and liabilities of defined benefit pension plans. US GAAP is generally more prescriptive in respect of actuarial assumptions and the allocation of costs to accounting periods.

(f) Disposals of businesses Applying the accounting differences between UK and US GAAP can result in changes to the carrying values of assets under UK and US GAAP. As a consequence of this, different gains or losses may result on the subsequent disposal of the assets. In addition, the timing of the recognition of a loss on a disposal may be different under UK and US GAAP.

(g) Employee share trust arrangements Share trusts have been established in order to hedge obligations in respect of options issued under certain employee share option schemes. Under UK GAAP, the company's ordinary shares held by the employee share trusts are included at cost in fixed asset investments. Under US GAAP, shares held by the share trusts are to the amount of the option price payable by employees treated as treasury shares at cost as a deduction from shareholders' equity.

(h) Deferred taxation UK GAAP permits that no provision for deferred taxation should be made where the group expects that there will be no net reversal of timing differences in the foreseeable future. Under US GAAP, all temporary differences between the financial statements and tax basis of assets and liabilities are fully provided for. In addition, US GAAP requires deferred tax assets to be recognised if their realisation is considered to be more likely than not.

(i) Ordinary dividends Under UK GAAP, the proposed dividends on ordinary shares, as recommended by the directors, are deducted from shareholders' equity and shown as a liability in the balance sheet at the end of the period to which they relate. Under US GAAP, such dividends are only deducted from shareholders' equity at the date of declaration of the dividend.

(j) Earnings per ordinary share Under UK GAAP and US GAAP, earnings per ordinary share are generally consistent and are 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.

Principal group companies

The companies listed below include those which principally affected the profits and assets of the group. The operating companies listed below may carry on the business described in the countries listed in conjunction with their subsidiaries and other group companies. A full list of subsidiaries, all of which are consolidated, will be included in the company's next annual return.

	Country of incorporation	Country of operation	Percentage of equity owned	Business description
Premium Drinks				
Guinness Limited (a)	England	Worldwide	100%	Brewing, marketing and distribution of beer.
Guinness Ireland Group	Ireland	Worldwide	100%	Brewing, marketing and distribution of beer.
Guinness United Distillers & Vintners Limited	England	Worldwide	100%	Production, marketing and distribution of premium drinks.
Guinness United Distillers & Vintners Scotland Limited	Scotland	Worldwide	100%	Production, marketing and distribution of premium drinks.
Guinness United Distillers & Vintners BV	Netherlands	Worldwide	100%	Production, marketing and distribution of premium drinks.
Guinness United Distillers & Vintners Amsterdam BV	Netherlands	Worldwide	100%	Production, marketing and distribution of premium drinks.
Guinness UDV North America, Inc	United States	Worldwide	100%	Production, importing and marketing of premium drinks.
Moët Hennessy, SA (b)	France	Worldwide	34%	Production and distribution of premium drinks.
Quick Service Restaurants				
Burger King Corporation	United States	Worldwide	100%	Quick service restaurants.
Packaged Food				
The Pillsbury Company	United States	United States	100%	Manufacturing, marketing and distribution of refrigerated dough products, breakfast and dessert products, frozen pizza, frozen and canned vegetables, Mexican foods, canned soups and foodservice baking mixes and frozen products.
Corporate				
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 Investment Corporation	United States	United States	100%	Financing company for the US group.

(a) Directly owned by Diageo plc.
(b) Issued share capital comprises 34,648,386 A class shares of FF50 each and 17,849,169 B class shares of FF50 each. The group's effective interest is 100% in the B class shares.

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.

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If you have access to the internet, you are invited to visit Diageo's web site at: www.diageo.com. This includes the full annual reports and accounts and, in due course, will include Diageo's US Annual Report filing on Form 20-F.

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