

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

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 20-F/A

Amendment No. 1

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

Commission file number: 1-10691

DIAGEO plc

(Exact name of Registrant as specified in its charter)

England

(Jurisdiction of incorporation or organization)

8 Henrietta Place, London, W1G 0NB, England

(Address of principal executive offices)

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

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

*

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

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

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

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the Annual Report: 2,931,085,864 ordinary shares of 28¹⁰¹/108 pence each.

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

Yes No

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

Yes No

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

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

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

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

Item 17 Item 18

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

Yes No

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

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Explanatory Note

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

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

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

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

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

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

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

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

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Report of independent registered public accounting firm

The Board of Directors and Shareholders of Diageo plc.

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

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

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

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

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

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

KPMG Audit Plc

Chartered Accountants

London, England
29 August 2007

Consolidated income statement

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

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Notes	Year ended 30 June 2007	Year ended 30 June 2006	Year ended 30 June 2005
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The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statement of recognised income and expense

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

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

Consolidated balance sheet

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

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

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

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

Consolidated cash flow statement

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

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

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

Accounting policies of the group

Basis of preparation

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

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

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

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

Business combinations

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

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

Sales

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

Advertising

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

Research and development

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

Accounting policies of the group (continued)

Share-based payments employee benefits

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

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

Pensions and other post employment benefits

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

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

Exceptional items

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

Foreign currencies

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

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

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

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

Accounting policies of the group (continued)

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

Brands, goodwill and other intangible assets

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

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

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

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

Property, plant and equipment

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

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

Leases

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

Agriculture

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

Accounting policies of the group (continued)

Associates and joint ventures

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

Inventories

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

Financial assets

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

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

Financial liabilities

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

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

Derivative financial instruments

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

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

Accounting policies of the group (continued)

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

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

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

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

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

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

Accounting policies of the group (continued)

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

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

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

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

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

Taxation

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

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

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

Discontinued operations

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

Notes to the consolidated financial statements

1 New accounting policies

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

1 New accounting policies (continued)

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

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

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

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

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

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

2 Segmental information

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

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

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

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

Notes to the consolidated financial statements (continued)

2 Segmental information (continued)

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

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

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

Notes to the consolidated financial statements (continued)

(i) Segmental information Continuing operations

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

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

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

(i) Segmental information Continuing operations (continued)

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

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

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

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

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

(d)

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

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

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

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

Notes to the consolidated financial statements (continued)

3 Operating costs

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

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

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

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

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Notes to the consolidated financial statements (continued)**3 Operating costs (continued)**

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

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

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

4 Employees

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

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

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

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

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

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

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

(a)

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

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

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

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

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

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

4 Employees (continued)

	United Kingdom	Ireland	United States and other	Total
	£ million	£ million	£ million	£ million
2005				
Operating profit				
Current service cost	(58)	(15)	(20)	(93)
Past service cost	(2)	(10)		(12)
Gains on curtailments	18		1	19
Losses on settlements			(2)	(2)
	<u>(42)</u>	<u>(25)</u>	<u>(21)</u>	<u>(88)</u>
Total charge to operating profit	(42)	(25)	(21)	(88)
Net credit/(cost) to other finance income (note 6(ii))	4	9	(4)	9
	<u>(38)</u>	<u>(16)</u>	<u>(25)</u>	<u>(79)</u>
Charge before taxation	(38)	(16)	(25)	(79)
Consolidated statement of recognised income and expense				
Actual return on post employment plan assets	318	129	30	477
Expected return on post employment plan assets	(194)	(62)	(24)	(280)
	<u>124</u>	<u>67</u>	<u>6</u>	<u>197</u>
Actual return less expected return on post employment plan assets	124	67	6	197
Experience gains and losses arising on the plan liabilities	3	(15)	(12)	(24)
Changes in assumptions underlying the present value of the plan liabilities	(171)	(198)	(50)	(419)
	<u>(44)</u>	<u>(146)</u>	<u>(56)</u>	<u>(246)</u>
Actuarial loss recognisable in the reconciliation of the assets and liabilities	(44)	(146)	(56)	(246)
Changes in the recognisable surplus of the plans with a surplus restriction			8	8
	<u>(44)</u>	<u>(146)</u>	<u>(48)</u>	<u>(238)</u>
Total loss recognisable in the consolidated statement of recognised income and expense	(44)	(146)	(48)	(238)
Total cumulative gain/(loss) recognised in the consolidated statement of recognised income and expense				
At 1 July 2004				
Recognised in the year	(44)	(146)	(48)	(238)
	<u>(44)</u>	<u>(146)</u>	<u>(48)</u>	<u>(238)</u>
At 30 June 2005				
Recognised in the year	291	159	9	459
	<u>247</u>	<u>13</u>	<u>(39)</u>	<u>221</u>
At 30 June 2006				
Recognised in the year	244	97	(13)	328
	<u>491</u>	<u>110</u>	<u>(52)</u>	<u>549</u>
At 30 June 2007				

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

Notes to the consolidated financial statements (continued)

4 Employees (continued)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

5 Exceptional items

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

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

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

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

Notes to the consolidated financial statements (continued)

5 Exceptional items (continued)

(i) Items included in operating profit

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

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

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

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

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	Charged to income statement in year ended						
Liability at 1 July 2004	30 June 2005	Cash payments	Liability at 30 June 2005	Cash payments	Liability at 30 June 2006	Cash payments	Liability at 30 June 2007
	30						

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Notes to the consolidated financial statements (continued)

5 Exceptional items (continued)

(d)

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

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

6 Interest and other finance income and charges

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

Notes to the consolidated financial statements (continued)

7 Associates

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

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

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

8 Taxation

(i) Analysis of taxation charge in the year

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

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

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

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

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

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

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

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

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

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

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

9 Discontinued operations

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

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

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

10 Earnings per share

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

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

Notes to the consolidated financial statements (continued)

11 Intangible assets

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

(a)

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

Product	Currency of investment	Remaining amortisation period	Carrying amount
			£ million

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

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Notes to the consolidated financial statements (continued)

11 Intangible assets (continued)

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

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

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

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

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

Notes to the consolidated financial statements (continued)

12 Property, plant and equipment

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

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

Notes to the consolidated financial statements (continued)

13 Biological assets

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

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

14 Investments in associates

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

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

Notes to the consolidated financial statements (continued)

14 Investments in associates (continued)

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)**15 Investments in joint ventures**

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

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

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

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

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

Notes to the consolidated financial statements (continued)

16 Other investments

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

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

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

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

17 Inventories

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

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

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

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

18 Trade and other receivables

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

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

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

19 Cash and cash equivalents

	<u>2007</u>	<u>2006</u>
	£ million	£ million
Cash at bank	618	483
Cash equivalents	267	216

	<u>2007</u>	<u>2006</u>
	<u>885</u>	<u>699</u>

Notes to the consolidated financial statements (continued)

20 Borrowings and bank overdrafts

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

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

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

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

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

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

(i) Analysis of net borrowings

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

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

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

Notes to the consolidated financial statements (continued)

20 Borrowings and bank overdrafts (continued)

(ii) Reconciliation of movement in net borrowings

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

21 Other financial assets and liabilities

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

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

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

Notes to the consolidated financial statements (continued)

22 Financial instruments and risk management

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

22 Financial instruments and risk management (continued)

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

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

22 Financial instruments and risk management (continued)

Portfolio of interest rate derivative instruments

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

(iv) Maturity of financial liabilities

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

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

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

The group had available undrawn committed bank facilities as follows:

	2007	2006
	£ million	£ million
Expiring within one year	498	676
Expiring in more than two years	1,109	1,070
	1,607	1,746

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

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

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

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

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

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

22 Financial instruments and risk management (continued)

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

22 Financial instruments and risk management (continued)

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

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

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

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

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

23 Trade and other payables

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

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

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

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

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

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

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

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

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

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

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

	2007	2006
	£ million	£ million
Deferred tax assets	771	1,113
Deferred tax liabilities	(582)	(674)
	189	439

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

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

26 Total equity movements in capital and reserves

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

Notes to the consolidated financial statements (continued)

26 Total equity movements in capital and reserves (continued)

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

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

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

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

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

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

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

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

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

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

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

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

(f) Dividends

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

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

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

Notes to the consolidated financial statements (continued)

27 Dividend income and other items

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

28 Disposal of businesses

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

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

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

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

Notes to the consolidated financial statements (continued)

29 Purchase of businesses

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

29 Purchase of businesses (continued)

The acquisitions in the year ended 30 June 2005 comprised:

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

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

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

30 Contingent liabilities and legal proceedings

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

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

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

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

Notes to the consolidated financial statements (continued)

30 Contingent liabilities and legal proceedings (continued)

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

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

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

31 Related party transactions

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

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

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

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

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

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

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

(a)

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

Notes to the consolidated financial statements (continued)

31 Related party transactions (continued)

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

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

32 Commitments

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

Operating lease commitments

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

33 Employee share compensation

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

Executive share option plans

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

Notes to the consolidated financial statements (continued)

33 Employee share compensation (continued)

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

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

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

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

Savings plans

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

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

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

Notes to the consolidated financial statements (continued)

33 Employee share compensation (continued)

Executive share award plans

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

34 Adoption of IAS 39

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

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

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

35 Reconciliation to US generally accepted accounting principles

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

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

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

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

35 Reconciliation to US generally accepted accounting principles (continued)

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

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

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

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

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

35 Reconciliation to US generally accepted accounting principles (continued)

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

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

35 Reconciliation to US generally accepted accounting principles (continued)

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

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

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

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

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

Notes to the consolidated financial statements (continued)

35 Reconciliation to US generally accepted accounting principles (continued)

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

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

35 Reconciliation to US generally accepted accounting principles (continued)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

US GAAP summary consolidated balance sheet

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

New accounting standards and pronouncements in the United States

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

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

Notes to the consolidated financial statements (continued)

35 Reconciliation to US generally accepted accounting principles (continued)

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

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

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

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

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

Notes to the consolidated financial statements (continued)

36 Post balance sheet events

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

Principal group companies

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

(a) Directly owned by Diageo plc

(b) French partnership

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

SIGNATURE

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

Diageo plc
(Registrant)

/s/ NC ROSE

NC Rose
Chief financial officer
5 March 2008

Exhibits

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

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