THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Incorporated and registered in England and Wales. Registered no. 15454

Registered office: 142 Holborn Bars, London EC1N 2NH

CONTENTS

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THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Directors

J W Bloomer (Chairman)
D J Belsham
P A J Broadley
A R Cook
R J Field
K S Lerche-Thomsen
M J Moores
G M Wood

Secretary

R Walker

Auditors

KPMG Audit Plc, London

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2001

Principal activity and business review

The principal activities of the Company are transacting long-term insurance business and general insurance business in the United Kingdom and abroad. The Company also owns subsidiary undertakings and branches that transact insurance business in the United Kingdom and overseas. These activities will continue in 2002 with the exception of general insurance business operations written in the United Kingdom, which was sold to Winterthur Swiss Insurance Company and Churchill Management Limited, its UK subsidiary, with effect from 4 January 2002.

Subsidiary undertakings and branches

Particulars of the Company's principal subsidiary undertakings at 31 December 2001 are shown on page 21 in note 15. At the 31 December 2001 the Company had branches outside the United Kingdom in Hong Kong and France.

Accounts

The state of affairs of the Company at 31 December 2001 is shown in the balance sheet on pages 10 and 11. The profit and loss account appears on pages 6 to 8.

Dividends

No interim dividend was declared for 2001 (2000: Nil). The directors have not declared a final dividend for 2001 (2000: £330m).

Payment policy

The Company does not follow any code or standard on payment practice with its suppliers but it is the policy of the Company to agree terms of payment when orders for goods or services are placed and to pay in accordance with those terms. Trade creditor days, based on the ratio of trade creditors at the year end to the amounts invoiced by trade creditors during the year, were 22 days (2000: 24 days).

Directors

The present directors are shown on page 1.

Mr A R Cook and Mr K S Lerche-Thomsen were appointed directors of the Company on 19 February 2001. Mr R J Field and Mr M J Moores were appointed directors on 23 April 2001. Mr J K Elbourne resigned as a director on 15 June 2001. Mr G M Wood was appointed a director on 21 June 2001. Mr R P Baker-Bates, Mr K L Bedell-Pearce and Mr M E Tucker resigned as directors on 9 November 2001, 30 November 2001 and 3 December 2001 respectively. There were no other changes during the year.

Directors' Interests

Of the directors in office at the end of the year, Mr J W Bloomer, Mr P A Broadley and Mr G M Wood were also directors of Prudential plc and their interests are shown in the annual report and accounts of that company. Mr D J Belsham, Mr A R Cook, Mr R J Field, Mr K S Lerche-Thomsen and Mr M J Moores had interests in shares of 5p each in Prudential plc as follows:

(a) in shares, including shares awarded under the Prudential Share Participation Plan and shares allocated under the Prudential Restricted Share Plan:

	1.1.2001 or at date of appointment if later	31.12.2001
D J Belsham	24,957	53,918
A R Cook	23,185	22,006
R J Field	77	77
K S Lerche-Thomsen	23,216	25,215
M J Moores	18,721	47,621

Directors' Interests (continued)

(b) under the Prudential Restricted Share Plan, in which shares are held in trust and represent the maximum award that can be allocated if the performance requirements of the Plan are met:

	1.1.2001 or at date of appointment if later	31.12.2001
D J Belsham	30,625	28,921
A R Cook	31,179	32,181
R J Field	-	11,275
K S Lerche-Thomsen	37,523	42,218
M J Moores	16,291	19,582

(c) in options to subscribe for shares:

	1.1.2001 or at date of appointment if later	Granted in 2001	Exercised in 2001	31.12.2001	Exercise price (pence)	Earliest exercise date	Latest exercise date
D J Belsham*	2,005	-	2,005	-	344	2001	2001
D J Belsham*	1,922	-	1,922	-	359	2001	2002
D J Belsham*	454	-	-	454	759	2003	2003
D J Belsham*	-	1,110	-	1,110	608	2006	2006
D J Belsham+	25,000	-	25,000	-	256	1997	2002
A R Cook*	981	-	-	981	619	2004	2004
A R Cook*	1,202	-	-	1,202	730	2004	2005
A R Cook*	269	-	-	269	751	2005	2005
R J Field*	-	3,022	-	3,022	608	2008	2008
K S Lerche-Thomsen*	1,566	-	1,566	-	249	2001	2001
K S Lerche-Thomsen*	1,535	-	-	1,535	254	2002	2002
K S Lerche-Thomsen*	1,133	-	-	1,133	344	2003	2003
K S Lerche-Thomsen*	2,172	-	-	2,172	359	2003	2004
K S Lerche-Thomsen*	593	-	-	593	619	2006	2006
K S Lerche-Thomsen*	489	-	-	489	751	2007	2007
K S Lerche-Thomsen*	-	604	-	604	608	2008	2008
K S Lerche-Thomsen*	-	597	-	597	648	2004	2005
M J Moores*	2,726	-	-	2,726	730	2004	2005
M J Moores+	25,000	-	25,000	-	315	1998	2005

*Prudential Savings-Related Share Option Scheme
+Prudential Executive Share Option Scheme

No options lapsed during the year. The market price of shares in Prudential plc at 31 December 2001 was 796 pence and the highest share price during the year was 1095 pence. The lowest share price during the year was 568 pence.

The above directors also had interests in the 50p shares of Egg plc as follows:

	1.1.2001 or at date of appointment if later	31.12.2001
D J Belsham	1,410	1,410
A R Cook	1,410	1,410
K S Lerche-Thomsen	940	940

Except as stated above, none of the directors in office at the end of the year:

(a) had any interest in shares in, or debentures of, any group company either at the beginning of the year or at their later date of appointment or at the end of the year; or (b) was granted or exercised any right to subscribe for shares in, or debentures of, any group company during the year or, if appointed during the year, since the date of their appointment up to the end of the year.

Employees

The following information is given in respect of the employees of the Company in the United Kingdom. The policy towards employees overseas is the same but the practical application of the policy varies according to local requirements.

Equal Opportunity

Our equal opportunities policy is to be fair, responsible and caring in all aspects of our business. We recognise, respect and value difference and diversity. We will treat everyone fairly and with dignity. We are working towards equality as a part of our normal way of doing things because we believe it is the right thing to do for our people, our customers and our success. Full consideration is given to continuing the employment of staff who become disabled and to providing training and career development opportunities to disabled employees.

Employee Involvement

The Company has effective communication channels through which employees' views can be sought on issues which concern them. Prudential's European Employee Forum provides an opportunity for elected staff representatives to consult with senior management on strategic European business issues. Each Prudential business in Europe is represented on the Forum. In 2001 employees were again invited to participate in the Prudential Savings-Related Share Option Scheme. The scheme has now been operating for over 18 years.

The trustees of each of the Company's UK pension schemes include individuals elected by the members of those schemes.

Prior Year Adjustment

The Company has implemented Financial Reporting Standard Number 19 (FRS19) Deferred Tax in the current year. The comparative figures for 2000 have been restated. The impact on the shareholders' funds is to reduce opening reserves on 1 January 2000 by £56m and to reduce opening reserves on 1 January 2001 by £70m. The impact on the long-term funds is to reduce the fund for future appropriations on 1 January 2000 by £3,007m and reduce the fund for future appropriations by £2,244m on 1 January 2001. The impact on the tax charge for 2001 is to decrease it by £17m (2000: an increase of £14m) in the non-technical account and to decrease it by £574m (2000: £763m) in the long-term technical account.

Auditors

A resolution for the re-appointment of KPMG Audit Plc as auditors of the Company will be put to the Annual General Meeting.

On behalf of the Board of directors

R Walker

R Walker
Secretary
14 March 2002

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Profit and Loss Account for the year ended 31 December 2001

Note	General Business Technical Account	2001 £m	2000 £m
1b	Gross premiums written		
	Continuing operations	17	12
	Discontinued operations	390	333
		407	345
30	Outward reinsurance premiums	(339)	(16)
	Premiums written, net of reinsurance	68	329
	Change in the gross provision for unearned premiums	(26)	(11)
	Change in the provision for unearned premiums, reinsurers' share	158	-
8	Earned premiums, net of reinsurance	200	318
	Claims paid		
	Gross amount	(266)	(221)
	Reinsurers' share	8	8
	Claims paid, net of reinsurance	(258)	(213)
	Change in provision for claims		
	Gross amount	37	(30)
	Reinsurers' share	158	-
	Net of reinsurance	195	(30)
	Claims incurred, net of reinsurance	(63)	(243)
	Change in other technical provisions, net of reinsurance	1	1
4	Net operating expenses (including 2001 re-engineering costs of £7m)	(101)	(82)
7	Change in the equalisation provision	(2)	(8)
1b	**Balance on the general business technical account**	35	(14)
	Analysis:		
	Continuing operations	1	1
8	Discontinued operations	34	(15)
		35	(14)

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Profit and Loss Account for the year ended 31 December 2001 (continued)

Note	Long-term Business Technical Account	2001 £m	2000 £m Restated (See Note 31)
1a	Gross premiums written	**6,540**	6,001
	Outward reinsurance premiums	**(1,058)**	(904)
	Earned premiums, net of reinsurance	**5,482**	5,097
2	Investment income	**6,610**	9,800
	Claims paid		
	Gross amount	**(6,982)**	(6,266)
	Reinsurers' share	**928**	828
	Claims paid, net of reinsurance	**(6,054)**	(5,438)
	Change in provision for claims		
	Gross amount	**36**	(123)
	Reinsurers' share	**1**	-
	Claims incurred, net of reinsurance	**(6,017)**	(5,561)
	Long-term business provision		
	Gross amount	**(3,963)**	(4,446)
	Reinsurers' share	**623**	472
		(3,340)	(3,974)
	Technical provision for linked liabilities	**38**	46
	Change in other technical provisions, net of reinsurance	**(3,302)**	(3,928)
4	Net operating expenses (including 2001 re-engineering costs of £154m)	**(1,300)**	(977)
5	Investment expenses and charges	**(319)**	(270)
	Unrealised losses on investments	**(8,963)**	(7,242)
6	Tax attributable to the long-term business	**357**	249
	Transfer from the fund for future appropriations	**7,758**	3,142
	Balance on the long-term business technical account	**306**	310

All premiums and the balance on the long-term business technical account relate to continuing operations.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Profit and Loss Account for the year ended 31 December 2001 (continued)

Note	Non-Technical Account	2001 £m	2000 £m Restated (See Note 31)
	Balance on the general business technical account	35	(14)
	Balance on the long-term business technical account	306	310
6	Tax credit attributable to the balance on the long-term business technical account	133	133
1a	Balance on the long-term business technical account before tax	439	443
2	Investment income	59	144
	Unrealised (losses) gains on portfolio investments	(47)	9
5	Investment expenses and charges	-	(3)
	Other income	5	14
13	Amortisation of goodwill	(33)	(33)
	Other charges	(3)	(2)
1c	Total (loss) profit on other activities	(19)	129
9	Profit on disposal of associate undertaking	-	147
	Profit on ordinary activities before tax	455	705
6	Tax on profit on ordinary activities	(129)	(190)
	Profit for the financial year	326	515
	Dividends		
	Final proposed	-	(330)
		-	(330)
22	**Retained profit for the financial year**	326	185

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Statement of Total Recognised Gains and Losses for the year ended 31 December 2001

Note		2001 £m	2000 £m Restated (See Note 31)
	Profit for the financial year	**326**	515
	Other recognised gains and losses:		
22	Increase (decrease) in surplus on revaluation of investments in shareholder subsidiaries and associate undertaking	**114**	(66)
	Total recognised gains relating to the financial year	**440**	449

Reconciliation of Movement in Shareholders' Funds for the year ended 31 December 2001

Note		2001 £m	2000 £m Restated (See Note 31)
	Total recognised gains relating to the financial year	**440**	449
	Dividends	-	(330)
21	Increase on issue of shares	**1**	-
	Net movement in shareholders' funds	**441**	119
	Shareholders' funds at beginning of year as originally reported	**1,826**	1,693
31	Prior year adjustment	**(70)**	(56)
	Shareholders' funds at beginning of year as restated	**1,756**	1,637
	Shareholders' funds at end of year	**2,197**	1,756

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Balance sheet as at 31 December 2001

Note	Assets	2001 £m	2000 £m
13	Intangible assets		
	Licence	**180**	187
	Goodwill	**196**	229
		376	416
	Investments		
14	Land and buildings	**9,910**	9,806
15	Investments in group undertakings and participating interests	**2,936**	2,753
16	Other financial investments	**66,105**	71,052
		78,951	83,611
17	Assets held to cover linked liabilities	**330**	367
18	Reinsurers' share of technical provisions		
	Provision for unearned premiums	**164**	-
	Long-term business provision	**6,576**	5,952
	Claims outstanding	**206**	52
	Technical provisions for linked liabilities	**3,772**	3,991
		10,718	9,995
	Debtors		
	Debtors arising out of direct insurance operations		
	Policyholders	**210**	210
	Intermediaries	**2**	2
	Debtors arising out of reinsurance operations	**18**	23
19	Other debtors	**371**	420
		601	655
	Other assets		
	Tangible assets	**48**	29
	Cash at bank and in hand	**554**	712
		602	741
	Prepayments and accrued income		
	Accrued interest and rent	**539**	571
	Deferred acquisition costs		
	General business	**29**	17
	Long-term business	**1,331**	1,431
	Other prepayments and accrued income	**17**	-
		1,916	2,019
20	**Total assets**	**93,494**	97,804

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Balance sheet as at 31 December 2001 (continued)

Note	Liabilities	2001 £m	2000 £m Restated (See Note 31)
	Capital and reserves		
21	Share capital	**76**	75
22	Revaluation reserve	**742**	628
22	Other reserves	**535**	535
	Profit and loss account		
	Distributable	**559**	205
	Non-distributable	**285**	313
22		**844**	518
	Shareholders' funds - equity interests	**2,197**	1,756
24	Fund for future appropriations	**13,249**	20,973
	Technical provisions		
	Provision for unearned premiums	**202**	175
23	Long-term business provision	**69,274**	65,300
25	Claims outstanding	**764**	819
7	Equalisation provision	**40**	38
	Other technical provisions	**2**	3
	Total technical provisions	**70,282**	66,335
	Technical provisions for linked liabilities	**4,102**	4,358
	Provisions for other risks and charges		
6	Deferred taxation	**1,860**	2,583
	Creditors		
	Creditors arising out of direct insurance operations	**259**	41
	Creditors arising out of reinsurance operations	**336**	9
26	Other creditors including taxation and social security	**1,209**	1,749
		1,804	1,799
	Total liabilities	**93,494**	97,804

The accounts on pages 6 to 25 were approved by the Board of directors on 14 March 2002.

J W Bloomer
Chairman

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Accounting Policies

A. Basis of Preparation

The financial statements are prepared in accordance with the provisions of Section 255 of, and Schedule 9A to, the Companies Act 1985. The financial statements comply with applicable accounting standards and the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers in December 1998.

As the Company is a wholly owned subsidiary undertaking of another company registered in England and Wales, group financial statements are not prepared. Accordingly, the financial statements present information about the Company as an individual undertaking and are not consolidated.

The Company has taken advantage of the exemption under FRS1 (Revised) from preparing a cash flow statement.

B. Long-term Business

(i) Premiums and annuity considerations are accounted for when due. For unit linked business, premiums are accounted for when the liabilities arising from the premiums are created. Premiums exclude any taxes or duties based on premiums. Pensions annuity contracts that vest during the year are included in claims incurred and premium income at the annuity purchase price.

(ii) Maturity claims are accounted for on the policy maturity date. Annuities are accounted for when the annuity becomes due for payment. Surrenders are accounted for when paid and death claims when notified.

(iii) Bonus additions made to policies are included in the change in the long-term business provision or, where the policy is no longer in force, in claims incurred.

(iv) The costs of acquiring new insurance contracts, principally commission and certain costs associated with policy issue and underwriting, which are not matched by policy charges are amortised against margins in future revenues on the related insurance contracts.

(v) Investment income and realised and unrealised investment gains attributable to long-term business are credited to the long-term business technical account.

(vi) Profits comprise actuarial surpluses allocated to shareholders adjusted, other than for with-profits business, for the deferral of acquisition costs and movements in the shareholders' interest in reserves held within long-term funds. For with-profits business, unappropriated surplus is carried forward in the fund for future appropriations and no allocation is made to the shareholders.

(vii) The fund for future appropriations comprises amounts arising in relation to participating policies and other non-linked policies, the allocation of which to policyholders or to shareholders has not been determined at the balance sheet date.

(viii) For accumulating with-profits business the calculation of the long-term business provision is described in note 23 of the financial statements. One element of the calculation is a gross premium bonus reserve valuation under which future reversionary bonuses are added to the guaranteed liabilities existing at the valuation date. The provision is then calculated as the present value of future policyholder benefits plus the present value of future expenses. An addition is made in respect of future premiums if this produces a higher provision. The assumptions to which the estimation of the long-term business provision is particularly sensitive are the assumed future reversionary bonuses, the interest rate used to discount the provision, the assumed future per policy expenses and the assumed future mortality experience of policyholders.

Accounting Policies (continued)

For traditional with-profits and other non-linked business the net premium valuation method has been used to calculate the long-term business provision. The net premium is calculated such that it would be exactly sufficient at the outset of the policy to provide only for the discounted value of the original guaranteed death and maturity benefits. The provision is then calculated by subtracting the present value of future net premiums from the present value of future benefits (including bonuses added up to the valuation date) using a prudent discount rate. The assumptions to which the estimation of the long-term business provision is particularly sensitive are the interest rate used to discount the provision and the assumed future mortality experience of policyholders. These are disclosed in note 23 of the financial statements.

C. General Business

(i) General insurance business is accounted for on an annual accounting basis.

(ii) Premiums are accounted for when risks are assumed. Premiums are shown gross of commission and exclude any taxes or duties based on premiums. In determining the result, the proportion of premiums written relating to periods of risk beyond the year end is carried forward to subsequent accounting periods as unearned premiums, calculated on a daily basis, so that earned premiums relate to risks carried during the accounting period. A similar treatment is applied to acquisition expenses.

(iii) Claims incurred comprise the settlement and handling costs of paid and outstanding claims arising from events occurring in the year and adjustments to prior years' claims provisions. Outstanding claims comprise claims incurred up to but not paid at the end of the accounting period whether reported or not.

(iv) An unexpired risks provision is established for any excess of expected claims and deferred acquisition costs over unearned premiums and investment return. The assessment of expected claims has regard to claims experience up to the end of the accounting period. No specific provision is made for major events occurring after this date.

(v) An equalisation provision has been established in accordance with the requirements of the Insurance Companies (Reserves) Act 1995 in order to reduce the impact of claims volatility.

(vi) Investment income and investment gains earned on assets matching general business provisions and related solvency capital are credited to the non-technical account.

(vii) Transactions in respect of discontinued general business operations are accounted for within the general business technical account.

(viii) Certain long-tail liabilities in respect of discontinued operations with mean terms of settlement of at least four years are discounted to take account of the extended settlement period.

D. Investments

(i) Investment income and realised and unrealised gains in respect of long-term business are included in the long-term business technical account. Other investment income and realised gains and, except in respect of shareholder investments in subsidiaries and associates, unrealised gains are included in the non-technical account.

Realised gains are determined as the difference between net proceeds on disposal and the purchase price or, in the case of securities carried at amortised cost, their previous carrying value. Movements in unrealised gains comprise the change in the value of investments held at the balance sheet date and the reversal of unrealised investment gains and losses recognised in earlier accounting periods in respect of investment disposals.

(ii) Shareholder investments in subsidiaries and associates that undertake long-term business are shown at current values using the achieved profits basis shareholders' funds. Investments in other subsidiaries are valued at net asset value. The movement in values is taken to the revaluation reserve.

(iii) Other investments are shown at market value. Properties are valued annually by the Prudential group's qualified surveyors or by professional external valuers at market value. In accordance with SSAP 19, no depreciation is provided on investment properties as the directors consider that to depreciate them would not give a true and fair view. Depreciation is only one of the factors reflected in the valuations and the amount that might otherwise have been shown cannot reasonably be separately identified or quantified. For unlisted securities, market value is estimated by the directors.

E. Tax

Tax is charged on all taxable profits arising in the accounting period.

Except where otherwise required by accounting standards, full provision for deferred tax without discounting is made for all timing differences which have arisen but not reversed at the balance sheet date. In previous years' financial statements, provision was only made for deferred tax on timing differences that were considered likely to reverse in the foreseeable future. This change in accounting policy has been made to comply with the new Financial Reporting Standard Number 19, Deferred Tax (see note 31).

F. Foreign Currencies

Foreign currency revenue transactions are translated at average exchange rates for the year. Foreign currency assets and liabilities are translated at year end exchange rates. Exchange differences on long-term business and on net investments in foreign enterprises less matching borrowings are taken to reserves. Other exchange differences are included in the profit and loss account.

G. Tangible Assets

Tangible assets, principally computer equipment, software development expenditure, and fixtures and furniture, are capitalised and depreciated by equal annual instalments over their estimated useful lives.

H. Pension Costs

Charges in respect of employers' contributions to defined benefit schemes are calculated on a basis that spreads the costs over the service lives of scheme members. Contributions in respect of defined contribution schemes are recognised when incurred.

I. Intangible Assets

Intangible assets, including goodwill representing the excess of the fair value of the consideration given over the fair value of the separable net assets acquired, is capitalised in the balance sheet at cost and amortised through the profit and loss account on a straight line basis over its useful economic life. The gain or loss on subsequent disposal of a subsidiary or associated undertaking will include any attributable unamortised goodwill.

Notes on the accounts

1. Segmental analysis

(a) Long-term business

Premiums and profit	**Gross premiums written**		**Balance on the technical account before tax**	
	2001 £m	2000 £m	**2001 £m**	2000 £m
United Kingdom	**6,203**	5,823	**442**	438
Hong Kong	**294**	178	**6**	5
France	**43**	-	**(9)**	-
	6,540	6,001	**439**	443

New business	**Regular premiums**		**Single premiums**	
	2001 £m	2000 £m	**2001 £m**	2000 £m
United Kingdom	**174**	159	**3,411**	3,315
Hong Kong	**59**	47	**89**	15
France	-	-	**43**	-
	233	206	**3,543**	3,330

Single premiums include UK Department of Social Security rebates and increments under existing group pension schemes. Regular premiums are determined on an annualised basis.

Analysis of premium income	**2001 £m**	2000 £m
Gross written premiums:-		
Direct	**6,120**	5,785
Reinsurance accepted	**420**	216
	6,540	6,001
Analysis of gross direct premiums:-		
Individual business	**5,232**	5,001
Group contracts	**888**	784
	6,120	5,785
Regular premiums	**2,879**	2,671
Single premiums	**3,241**	3,114
	6,120	5,785
Participating contracts	**5,870**	5,456
Non-participating contracts	**121**	245
Linked long-term contracts	**129**	84
	6,120	5,785
United Kingdom	**5,783**	5,607
Hong Kong	**294**	178
France	**43**	-
	6,120	5,785

Net reinsurance income/expenditure

Net reinsurance income in respect of long-term business for the year ended 31 December 2001 was £274m (2000 £439m).

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the accounts (continued)

1. Segmental analysis (continued)

(b) General business

Premiums and underwriting result		Gross premiums written 2001 £m	Gross premiums written 2000 £m	Underwriting result 2001 £m	Underwriting result 2000 £m
Continuing operations	Hong Kong	**17**	12	**1**	1
Discontinued operations	United Kingdom	**390**	333	**34**	(15)
		407	345	**35**	(14)

Analysis of technical account	Gross premiums written 2001 £m	Gross premiums written 2000 £m	Gross premiums earned 2001 £m	Gross premiums earned 2000 £m	Gross claims incurred 2001 £m	Gross claims incurred 2000 £m	Gross operating expenses 2001 £m	Gross operating expenses 2000 £m	Reinsurance balance 2001 £m	Reinsurance balance 2000 £m
Motor										
-third party liability	**2**	2	**2**	3	**1**	1	**-**	-	**(1)**	-
-other classes	**82**	56	**73**	47	**61**	41	**16**	11	**(34)**	(4)
Marine, aviation and transport	**-**	-	**-**	-	**-**	8	**2**	2	**-**	(1)
Fire and other damage	**272**	272	**272**	270	**153**	199	**71**	62	**33**	(7)
Other	**51**	15	**34**	14	**14**	2	**13**	9	**(13)**	(3)
	407	345	**381**	334	**229**	251	**102**	84	**(15)**	(15)

The geographical analyses of long-term and general business premiums are based on the territory of the operating unit assuming the risk. Premiums by territory of risk are not materially different.

Notes on the accounts (continued)

1. Segmental analysis (continued)

(c) Net assets and shareholders' other income and funds

A segmental analysis of the technical provisions net of reinsurance is set out below which provides a more useful indication than net assets of the assets supporting the business.

Technical provisions (net of reinsurance)	Long-term business		General business	
	2001 £m	2000 £m	**2001 £m**	2000 £m
United Kingdom	**62,614**	59,562	**214**	526
Other countries	**824**	597	**14**	13
Total	**63,438**	60,159	**228**	539

Shareholders' other income and shareholders' funds, taking into account the location of business operations of subsidiaries, relate to the following countries:-

Shareholders' other income and funds	Shareholders' other income		Shareholders' funds	
	2001 £m	2000 £m	**2001 £m**	2000 £m Restated (See Note 31)
United Kingdom	**(35)**	129	**1,416**	1,003
Singapore	**-**	-	**438**	369
Malaysia	**14**	-	**218**	172
Taiwan	**2**	-	**78**	175
Other countries	**-**	-	**47**	37
	(19)	129	**2,197**	1,756

Notes on the accounts (continued)

2. Investment income

	Long-term business		Non-technical account	
	2001 £m	2000 £m	2001 £m	2000 £m
Income from:				
Group undertakings	1	(3)	7	71
Other investments				
Land and buildings	751	699	-	-
Listed investments	2,338	2,109	15	18
Unlisted investments	113	219	-	-
Other investments	271	301	13	14
	3,474	3,325	35	103
Gains on the realisation of investments	3,136	6,475	24	41
	6,610	9,800	59	144

3. Bonuses

Bonuses added during the year are included in the change in the long-term business provision or, where the policy is no longer in force, in claims incurred. The total cost of bonuses was £3,483m (2000 £3,437m).

4. Net operating expenses

	Long-term business		General business	
	2001 £m	2000 £m	2001 £m	2000 £m
Acquisition costs	407	400	50	35
Change in deferred acquisition costs	102	100	(13)	(2)
Administrative expenses	784	470	64	49
Amortisation of license	7	7	-	-
	1,300	977	101	82

Acquisition costs include commissions in respect of long-term direct insurance business of £148m (2000 £114m) and general direct insurance business of £26m (2000 £10m).

Administrative expenses include £650,000 relating to a fine levied by the Personal Investment Authority, following an inspection in 1999 of the Company's pension review procedures, which revealed instances of delay in making payments of redress and of inadequate record keeping.

Administrative expenses also include re-engineering costs of £154m (2000: nil) in the long-term business technical account and £7m (2000: nil) in the general business technical account.

5. Investment expenses and charges

	Long-term business		Non-technical account	
	2001 £m	2000 £m	2001 £m	2000 £m
Investment management expenses	285	243	-	1
Interest on bank borrowings	34	27	-	2
	319	270	-	3

Notes on the accounts (continued)

6. Tax

a) Tax (credited)/charged to long-term business technical account and non-technical account	Attributable to long-term funds		Attributable to shareholders' profits	
	2001 £m	2000 £m Restated (See Note 31)	2001 £m	2000 £m Restated (See Note 31)
Current Tax				
UK corporation tax	320	766	25	36
Double tax relief	(27)	(11)	(1)	-
Overseas tax	32	26	1	-
Prior year adjustments	26	-	(14)	-
Total current tax	351	781	11	36
Deferred tax				
Origination and reversal of timing differences	(708)	(898)	(15)	15
Effects of changes in tax on opening balance		(132)		6
Total deferred tax	(708)	(1,030)	(15)	21
Shareholders' attributable tax	-	-	133	133
Tax (credit)/charge on profit on ordinary activities	(357)	(249)	129	190

b) Factors affecting tax charge for the period	2001 £m	2000 £m
Profit on ordinary activities before tax	455	705
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30.00% (2000 30.00%)	137	212
Tax credit attributable to the balance on the long-term business technical account	(133)	(133)
Permanent differences	(1)	1
Deferred tax recognised in period	17	(8)
Adjustment to current tax in respect of previous periods	(15)	-
Difference between realised gains and capital gains tax basis	-	20
Franked investment income	(5)	(26)
Amortisation of goodwill not tax effective	10	10
Prior year underprovision	2	-
Difference in tax rates	(3)	(38)
Other	2	(2)
Current tax charge for the period	11	36

c) Balance Sheet	Attributable to long-term funds		Attributable to shareholders' funds	
	2001 £m	2000 £m Restated (See Note 31)	2001 £m	2000 £m Restated (See Note 31)
Provision for Deferred Tax				
Accelerated capital allowances	(20)	(32)	(2)	(4)
Short term timing differences	-	-	7	6
Unrealised gains	1,805	2,487	57	75
Deferred acquistion costs	13	51	-	-
Undiscounted provision for deferred tax liability	1,798	2,506	62	77
Deferred tax liability at start of the period	2,506	3,536	77	56
Deferred tax (credited)/charged in technical/ non-technical account for the period	(708)	(1,030)	(15)	21
Deferred tax liability at end of the period	1,798	2,506	62	77

Notes on the accounts (continued)

7. *Equalisation provision*

An equalisation provision has been established in accordance with the requirements of the Insurance Companies (Reserves) Act 1995. The provision, which is in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the balance sheet date, is required by Schedule 9A of the Companies Act 1985 to be included within technical provisions in the balance sheet, notwithstanding that it does not represent a liability at the balance sheet date. This has had the effect of reducing shareholders' funds by £40m (2000 £38m). The movement in the equalisation provision during the year resulted in a decrease in the general business technical account result and the profit before taxation of £2m (2000 £8m).

8. Discontinued operations

Discontinued operations comprise commercial lines general insurance business closed in 1992 and now in run off and the UK general insurance business operations transferred to Winterthur Swiss Insurance Company and Churchill Management Limited, its UK subsidiary on 4 January 2002. The general business technical account includes the following amounts in respect of these operations:

	2001 £m	2000 £m
Premiums earned, net of reinsurance	**190**	312
Claims incurred, net of reinsurance		
Claims paid	**(248)**	(223)
Change in provision for claims	**188**	(26)
Total	**(60)**	(249)
Net operating expenses	**(96)**	(78)
Technical result	**34**	(15)

The technical result excludes the return earned on the investments supporting the technical provisions of discontinued operations. This return is included in the non-technical account.

9. Disposal of subsidiary and associate undertaking

The Company's investment in the Taiwan life operation was transferred at cost to Prudential Corporation Holdings Limited, a fellow subsidiary, in December 2001 resulting in a nil profit on the transaction. The profit in 2000 relates to the disposal of the Company's holding in St. James's Place Capital plc, an associate undertaking. Proceeds for this disposal amounted to £294m. After taking into account cost of investment of £147m, the profit on disposal was also £147m. The tax charge associated with the disposal was £22m.

10. Information on staff

The average number of persons employed by the Company during the year was:	2001	2000
United Kingdom	**7,443**	8,820
Hong Kong	**288**	286
	7,731	9,106

The costs of employment were:	2001 £m	2000 £m
Wages and salaries	**222**	227
Social security costs	**20**	20
Other pension costs (see below)	**20**	20
	262	267

The Company's main pension scheme is the Prudential Staff Pension Scheme which covers 97% of members in all Company schemes. As employees of other Group companies are members of these schemes it is not possible to identify the share of the fund surplus in each scheme which is specifically attributable to the Company. This scheme is of the defined benefit type with scheme assets held in separate trustee administered funds and was last valued as at 5 April 1999 by Watson Wyatt Partners. Particulars of this scheme are shown in the accounts of the parent company, Prudential plc. £0.7m (2000 £0.5m) of the pension costs related to overseas schemes.

11. *Directors' emoluments*

Directors' emoluments amounted to £2,564,000 (2000 £1,362,000). Three (2000 one) directors exercised share options during the year. Eleven (2000 eight) directors were entitled to shares under Prudential's main long term incentive scheme and to retirement benefits under defined benefit schemes. Five (2000 six) directors, being subject to the earnings cap, were also entitled to retirement benefits under money purchase schemes. However, the Company only bears the cost in the case of three (2000 two) directors which totalled £153,000 (2000 £152,000) of which £56,000 (2000 £113,000) relates to the highest paid director. The highest paid director's emoluments were £734,000, his accrued pension at the end of the year was £1,000 and he did not exercise any share options but did receive shares under long-term incentive schemes. The highest paid director in 2000 received emoluments of £453,000, his accrued pension at the end of the year was £6,000 and he did not exercise any share options but did receive shares under long-term incentive schemes.

Notes on the accounts (continued)

12. Auditors' remuneration

Fees payable to KPMG Audit Plc (KPMG) in respect of the statutory audit were £0.5m (2000 £0.5m). Fees payable to KPMG and its associates in respect of other work were £9.6m (2000 £14.5m)

13. Intangible assets

	Goodwill £m	Licence £m	Total £m
Balance at beginning of year	229	187	416
Amortised in year			
Charged to non-technical account	(33)	-	(33)
Charged to the long-term business technical account	-	(7)	(7)
Balance at end of year	196	180	376

The goodwill arose on the purchase by the Company of the Scottish Amicable Life Assurance Society on 30 September 1997 and is being amortised from 1 January 1998 over a period of 10 years.

The licence primarily represents the value of an agreement with a fellow subsidiary company for the use of certain Scottish Amicable assets, which is being amortised over a period of 20 years to 30 September 2017, on a basis consistent with the revenue stream from the agreement. Under this basis, the amortisation commenced in the year 2000, when the benefits from the agreement first started to arise. The licence also includes £25m in respect of the estimated net present value of income from current service agreements which are being amortised from 1 January 1998 over a period of 10 years.

14. Land and buildings

	2001 £m	2000 £m
Current value		
Freeholds	**5,909**	5,778
Leaseholds with a term of over 50 years	**3,897**	3,870
Leaseholds with a term of less than 50 years	**104**	158
	9,910	9,806
Cost	**6,760**	6,455

The value of land and buildings occupied by the Company amounted to £129m (2000 £132m).

15. Investments in group undertakings and participating interests

	Cost		Current value	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Shares in group undertakings				
Long-term fund investments	**795**	785	**1,193**	1,161
Shareholder investments	**816**	765	**1,520**	1,354
	1,611	1,550	**2,713**	2,515
Participating interests				
Other participating interests	**24**	24	**48**	36
	24	24	**48**	36
Loans to group undertakings				
Long-term fund loans	**175**	202	**175**	202
Total	**1,810**	1,776	**2,936**	2,753

The principal subsidiary undertakings of the Company at 31 December 2001, wholly owned unless otherwise stated were:

		Class of shares held	Principal activity	Country of incorporation
	The Prudential Assurance Company Singapore (Pte) Limited	Ordinary shares S$1	Insurance	Singapore
	Prudential Pensions Limited	Ordinary shares £1	Pension annuities	England and Wales
	Scottish Amicable Life plc	Ordinary shares £1	Insurance	Scotland
	The Standard Trust Limited	Ordinary shares 25p 3.5% cumulative Preference shares £1 (99.95% holding)	Investment trust	England and Wales
*	Prudential Annuities Limited	Ordinary shares £1	Pension annuities	England and Wales

* owned by the long-term fund

Other participating interests comprise:

	Class of shares held	Proportion held	Country of incorporation
Life Assurance Holding Corporation Limited	Ordinary shares 1p	15.2%	England and Wales

Life Assurance Holding Corporation Limited is not listed on a recognised investment exchange and is a holding company for companies that transact long-term insurance business.

Notes on the accounts (continued)

16. Other financial investments

	Cost		Current value	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Shares and other variable yield securities and units in unit trusts	**24,899**	26,383	**40,116**	49,865
Debt securities and other fixed income securities	**23,095**	18,102	**23,374**	18,817
Loans secured by mortgages	**73**	17	**79**	17
Loans to policyholders secured by insurance policies	**104**	109	**104**	109
Other loans	**87**	84	**101**	104
Deposits with credit institutions	**2,331**	2,112	**2,331**	2,140
	50,589	46,807	**66,105**	71,052

Amounts included in the above ascribable to listed investments:	**2001 £m**	2000 £m
Shares and other variable yield securities and units in unit trusts	**39,291**	49,497
Debt securities and other fixed income securities	**20,725**	17,089
	60,016	66,586

17. *Assets held to cover linked liabilities*

	Cost		Current value	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Assets held to cover linked liabilities	**262**	*239*	**330**	*367*

18. Reinsurers' share of technical provisions

The reinsurers' share of the long-term business provision relates mainly to cessions to Prudential Annuities Limited, a subsidiary of the Company. The reinsurers' share of the technical provisions for linked liabilities relates mainly to cessions to Scottish Amicable Life plc, a subsidiary of the Company. The reinsurers' share of the general insurance business technical provision relates mainly to cessions to Winterthur Swiss Insurance Company.

19. Other debtors

	2001 £m	2000 £m
Amounts owed by fellow subsidiaries	**140**	45
Amounts owed by subsidiary companies	**11**	30
Tax recoverable	**49**	103
Other	**171**	242
	371	420

20. Assets attributable to the long-term business fund

Of the total amount of assets shown in the balance sheet on page 10, £90,310m (2000 £95,085m) is attributable to the long-term business fund.

21. Share capital

The Company's authorised share capital is £1,087,500,000 comprising 350,000,000 ordinary shares of 25p each, of which 298,388,254 shares have been issued and fully paid and 1,000,000,000 Preference Shares of £1 each, of which 1,000,000 shares were allotted to Prudential plc for cash at par on 8 May 2001. The Preference Shares issued shall be redeemed by the Company without notice on 8 May 2016 and carry the right to receive an index linked cumulative preferential dividend, payable annually. The Preference Shares carry no voting rights but carry preferential rights in priority to other shareholders to payment on a return of capital in the event of the winding up of the Company.

22. Shareholders' reserves

	Revaluation reserve	Other reserves	Profit and loss account Restated (See Note 31)	Total Restated (See Note 31)
	£m	£m	£m	£m
Balance at 1 January 2001	628	535	518	1,681
Revaluation of subsidiaries	114	-	-	114
Retained profit for the year	-	-	326	326
Balance at 31 December 2001	742	535	844	2,121

The profit and loss account includes £60m (2000 £41m) held within the long-term business fund and £225m (2000 £272m) of unrealised appreciation on shareholder portfolio investments. These amounts are non-distributable.

23. Long-term business provision

The principal valuation methods and bases adopted for the main relevant classes of business which are not reinsured are as follows:

Accumulating with-profits business
The provision has been taken as the lower of:
- the accumulated fund or the value at the bid price of the notional number of units allocated to policyholders, in both cases excluding terminal bonus, and
- the surrender or transfer value which, having regard to policyholders' reasonable expectations, would be payable at the valuation date,

or, if greater, the value of the guaranteed liabilities excluding terminal bonus calculated on a gross premium bonus reserve method. For the purpose of calculating the liability using the bonus reserve method, the assumed interest rates range from 1.6% to 5.0%, while future reversionary bonuses are assumed to fall from current levels to zero at 1.5% per year.

Traditional with-profits and other non-linked business
Provisions are calculated by the net premium valuation method on the following bases:

	Interest Rate %	Actuarial Mortality Table Reference
UK (excluding Scottish Amicable Insurance Fund)		
Ordinary branch with-profits assurances	3.00	AM/AF92+1
Industrial branch with-profits assurances	3.00	A1967/70+1
With-profits retirement annuities:		
(i) in deferment	5.35	AM92-3(m),-7(f)
(ii) in possession	3.75	70% PMA/PFA92(c=2002)
Term assurances - life business	3.00	AM/AF92+1
Term assurances - pensions business	3.75	AM/AF92+1
Scottish Amicable Insurance Fund		
With-profits assurances	3.00	AM/AF92+1 plus 1/3 AIDS "R6A"
With-profits retirement annuities:		
(i) Flexipension in deferment	5.00	AM/AF92-3
(ii) Flexipension in possession	4.00	70% PMA/PFA92(c=2002)
(iii) Other in deferment	4.50	AM/AF92+1 plus 1/3 AIDS "R6A"
(iv) Other in possession	3.75	70% PMA/PFA92(c=2002)
Term assurances - life business	3.00	AM/AF92+1 plus 1/3 AIDS "R6A"
Term assurances - pensions business	3.75	AM/AF92+1 plus 1/3 AIDS "R6A"
Annuities in payment	5.00	70% PMA/PFA92(c=2002)
Hong Kong		
With-profits assurances	4.00	AM80
Non-profit assurances	4.50	AM80

For retirement annuities, the interest rate used is adjusted where appropriate to allow for mortality improvements during deferment and for expenses.

For with-profits business, the net premium valuation has made explicit provision only for vested bonuses, including those vesting following the valuation at 31 December 2001.

Other long-term business provisions
Additional provisions have been established, the most significant being for the potential costs and expenses of compensating the Company's pension policyholders under the FSA review of pension opt-outs and transfer cases, for the potential cost of meeting annuity rate guarantees at vesting or on maturity of policies and for additional expenses, not otherwise catered for in the basic net premium valuation, of running off the industrial branch business.

Notes on the accounts (continued)

24. Fund for future appropriations

	2001 £m	2000 £m Restated (See Note 31)
Prudential Assurance Company with-profits fund	**11,435**	17,891
Scottish Amicable Insurance Fund (SAIF)	**1,814**	3,082
	13,249	20,973

The SAIF fund for future appropriations comprises amounts which are attributable, but not allocated, to SAIF policyholders.

25. Claims outstanding

To take account of the extended settlement period, discounting has been applied to certain asbestos, pollution and health hazard claims of the discontinued general business operations. The discount rate is 4% per annum with the projected settlement periods ranging from 5 to 12 years depending on the claim category. The overall effect of discounting is to reduce the liabilities at 31 December 2001 by £9m (2000 £10m).

26. Other creditors including taxation and social security

	2001 £m	2000 £m
Amounts owed to parent company and fellow subsidiaries	**240**	435
Amounts owed to subsidiary companies	**332**	277
Tax	**259**	626
Other creditors	**378**	411
	1,209	1,749

27. Ultimate parent company

The ultimate and immediate parent company is Prudential plc, which is the parent company which prepares group accounts. Copies of these accounts can be obtained from the Company Secretary, Laurence Pountney Hill, London EC4R 0HH.

28. Contingent liabilities

The Company has contingent liabilities in respect of insurance and other agreements entered into in the normal course of business and in respect of litigation arising therefrom.

a) Litigation
In 2000 proceedings were issued against the Company by a policyholder. The proceedings relate to the inherited estate in the Company's main with-profits fund and they essentially ask the Court to decide whether and, if so, to what extent the inherited estate should be distributed or applied for the benefit of policyholders and/or shareholders. Further details on the issue are given in the paragraph on Inherited Estate in the Company's main with-profits fund below.

b) Pensions Mis-selling Review
The costs associated with the review of personal pension mis-selling in the UK have been met from the free assets of the Company's long-term fund. Given the strength of the fund, the directors are of the opinion that charging the costs to the free assets of the fund will not have an adverse effect on the levels of bonuses paid to policyholders or their reasonable expectations. In the unlikely event of this proving not to be the case, the directors' intention would be that an appropriate contribution to the long-term fund would be made from *shareholders' funds. In view of the uncertainty, it is not practicable to estimate the level of this potential* contribution. The provision for the pension mis-selling at the end of the year was £1,065m (2000 £1,475m).

c) Free Standing Additional Voluntary Contribution (FSAVC) and Guaranteed Annuities Business
A provision of £42m (2000: £65m) at 31 December 2001 has been established for the FSAVC business review. The Company (excluding the Scottish Amicable Insurance Fund (SAIF)) did not sell significant volumes of guaranteed annuity products and has established a provision of £34m (2000: £40m) at 31 December 2001 to honour the guarantees on these products. The main exposure to guaranteed annuities is through SAIF and a provision of £758m *(2000: £816m) is held in SAIF at 31 December 2001 to honour the guarantees. SAIF is a separate sub-fund of the* Company's long-term business fund and has no impact on shareholders.

d) Inherited Estate in the main with-profits fund
The inherited estate is the assets in the main with-profits fund in excess of what is expected to be paid to policy-holders. The Company is currently discussing the attribution of its estate with the Financial Servises Authority (FSA), which may or may not result in a portion of the inherited estate being attributed solely to shareholders. The amount and timing of any attribution to shareholders is sufficiently uncertain that it is not possible to accurately estimate any *potential attribution.*

29. Related party transactions

The Company has taken advantage of the exemption under Paragraph 3(c) of Financial Reporting Standard 8 from disclosing transactions with other subsidiary undertakings of the Prudential group.

30. Post balance sheet event

In November 2001, the Company agreed to transfer its UK general business operations to Winterthur Swiss Insurance Company and Churchill Management Limited, its UK subsidiary. On 31 December 2001 the insurance liabilities of the business were almost wholly reassured with related cash transfer, to Winterthur. The sale of the business was completed on 4 January 2002 for a consideration of £353m. After allowing for the costs of the sale and other related items, it is anticipated that the profit on sale recorded in the 2002 results will be approximately £360m before tax.

31. Prior Year Adjustment

The Company has implemented Financial Reporting Standard Number 19 (FRS19) Deferred Tax in the current year. The comparative figures for 2000 have been restated. The impact on the shareholders' funds is to reduce opening reserves on 1 January 2000 by £56m and to reduce opening reserves on 1 January 2001 by £70m. The impact on the long term funds is to reduce the fund for future appropriations by £3,007m on 1 January 2000 and to reduce the fund for future appropriations £2,244m on 1 January 2001. The impact on the tax charge for 2001 is to decrease it by £17m (2000: an increase of £14m) in the non-technical account and to decrease it by £574m (2000: £763m) in the long term technical account.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Statement of Directors' Responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss for that period.

In preparing those financial statements, the directors are required to:
- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

J W Bloomer
Chairman
14 March 2002

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF THE PRUDENTIAL ASSURANCE COMPANY LIMITED

We have audited the *financial statements on pages* 6 to 25.

Respective Responsibilities of Directors and Auditors

The directors are responsible for preparing the directors' report and, as described on page 26, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Company is not disclosed.

Basis of Audit Opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the Company's affairs as at 31 December 2001 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London
14 March 2002