

# **Diageo Finance plc**

## **Financial statements 30 June 2016**

Registered number: 213393

WEDNESDAY



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## **STRATEGIC REPORT**

The directors present their strategic report for the year ended 30 June 2016.

### **Activities**

The company is engaged in treasury risk and cash management for Diageo plc and its subsidiary undertakings. It raises the external funds it requires principally using the London financial markets. It operates as the bank of the group, finances operating companies via intra-group loans and deposits and makes third party payments on behalf of other group companies. Foreign exchange transactional hedging deals are carried out in the company to hedge brand owners' future foreign currency cash flows with a margin defined on an arms' length basis. Foreign exchange translation hedging, interest rate risk management, commodity price risk management and cash management is also performed by the company.

The company's operations are based in the United Kingdom. The directors foresee no changes in the company's activities.

### **Business review**

*Development and performance of the business of the company during the financial year and position of the company as at 30 June 2016*

The results of the company and the development of its business are influenced to a considerable extent by group financing requirements. Further information on the risk management policies of the Diageo group is included in the annual report of Diageo plc (see note 15 of the consolidated financial statements of Diageo plc).

Results from net interest income have decreased by £33 million in the year ended 30 June 2016 from £440 million in the year ended 30 June 2015, mainly driven by the decrease in the intercompany interest income due to the change in the intercompany loan structure of the company.

Amounts owed by fellow group undertakings increased by £3,765 million offset by an increase in amounts owed to fellow group undertakings of £3,869 million which resulted from changes in the funding requirements of fellow group undertakings.

## STRATEGIC REPORT (continued)

### Business review (continued)

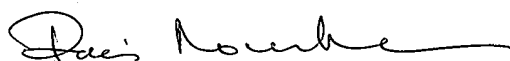
#### *Financial and other key performance indicators*

As the company forms part of the group's treasury operations, the principal key performance indicator used by management to analyse the development, performance and position of the company's business is net interest income in respect of intra-group lending.

#### *Principal risks and uncertainties facing the company as at 30 June 2016*

The company forms part of the Diageo group's treasury operations, which manage the Diageo group's funding, liquidity, interest rate, commodity price and foreign exchange risks. (See detailed description under note 10. Financial instruments and risk management.) The principal risks and uncertainties facing the company are foreign currency risk associated with certain foreign currency transactions and interest rate risk arising principally on changes in interest rates. The fair value movement on these financial instruments is recorded in the profit and loss account.

By order of the board



M Pais  
Director  
Lakeside Drive  
Park Royal  
London  
NW10 7HQ

12 December 2016

## **DIRECTORS' REPORT**

The directors have pleasure in submitting their annual report, together with the audited financial statements for the year ended 30 June 2016.

### **Going concern**

The company is expected to continue to generate profit for its own account and to remain in positive net asset position for the foreseeable future. The directors have no reason to believe that a material uncertainty exists that may cast significant doubt about the ability of the Diageo group to continue as a going concern. On the basis of their assessment, the company's directors have a reasonable expectation that the company will be able to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

### **Financial**

The results for the year ended 30 June 2016 are shown on page 9.

The profit for the year transferred to reserves is £449 million (2015 - £330 million).

No dividend was paid during the year (2015 - £nil) and there is no dividend proposed to be distributed to the shareholders in regards to the financial year (2015 - £nil).

The transition to FRS 101 did not change the reported figures as at 30 June 2016 nor for the year ended 30 June 2015.

### **Directors**

The directors who held office during the year were as follows:

S L Fennessy  
D Harlock (appointed 26 May 2016)  
E McShane  
J J Nicholls  
M Pais  
P D Tunnacliffe (resigned 30 June 2016)

### **Directors' remuneration**

None of the directors received any remuneration during the year in respect of their services as directors of the company (2015 - £nil).

### **Secretary**

On 5 November 2015, V Cooper was appointed as joint Company Secretary.

### **Internal control and risk management over financial reporting**

The company operates under the financial reporting processes and controls of the Diageo group. The internal control and risk management systems over the financial reporting process of Diageo plc, which include those of the company, are discussed in the Group's Annual Report 2016 on pages 60 to 61 at [www.diageo.com](http://www.diageo.com), which does not form part of this report.

## **DIRECTORS' REPORT (continued)**


### **Auditors**

Following an audit tender conducted during last year, PricewaterhouseCoopers LLP were selected as auditors for the Diageo group. Accordingly, PricewaterhouseCoopers LLP were appointed to replace KPMG LLP as auditors for the year ended 30 June 2016.

### **Disclosure of information to auditors**

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditors are unaware; and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

By order of the board



M Pais  
*Director*  
Lakeside Drive  
Park Royal  
London  
NW10 7HQ

12 December 2016

## **Statement of directors' responsibilities in respect of the strategic report, the directors' report and the financial statements**

The directors are responsible for preparing the strategic report, the directors' report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including Financial Reporting Standard 101 - Reduced Disclosure Framework (FRS 101).

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- notify its shareholder in writing about the use of disclosure exemptions, if any, of FRS 101 used in the preparation of financial statements; and
- 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 adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They 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.

# **INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF DIAGEO FINANCE PLC**

## **Report on the financial statements**

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### **Our opinion**

In our opinion, Diageo Finance Plc's financial statements (the "financial statements"):

- give a true and fair view of the state of the company's affairs as at 30 June 2016 and of its profit for the year then ended;
  - have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
  - have been prepared in accordance with the requirements of the Companies Act 2006.
- 

### **What we have audited**

The financial statements, included within the Financial Statements (the "Annual Report"), comprise:

- the Balance Sheet as at 30 June 2016;
- the Statement of Comprehensive Income for the year then ended;
- the Statement of Changes in Equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law (United Kingdom Generally Accepted Accounting Practice).

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

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## **Opinions on other matters prescribed by the Companies Act 2006**

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In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

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## **Other matters on which we are required to report by exception**

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### **Adequacy of accounting records and information and explanations received**

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

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### **Directors' remuneration**

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.



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## Responsibilities for the financial statements and the audit

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### Our responsibilities and those of the directors

As explained more fully in the Statement of directors' responsibilities in respect of the strategic report, the directors' report and the financial statements set out on page 6, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

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### What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.



Christopher Richmond (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London  
12 December 2016

**STATEMENT OF COMPREHENSIVE INCOME**

		<b>Year ended 30 June 2016 £'million</b>	<b>Year ended 30 June 2015 £'million</b>
	<i>Notes</i>		
Other operating income/(expenses)	2	42	(80)
Finance income	4	1,184	1,198
Finance charges	4	(777)	(758)
<b>Operating profit</b>		<b>449</b>	<b>360</b>
<b>Profit before taxation on ordinary activities</b>		<b>449</b>	<b>360</b>
Taxation on profit on ordinary activities	5	-	(30)
<b>Profit for the financial year and total comprehensive income for the year</b>		<b>449</b>	<b>330</b>

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

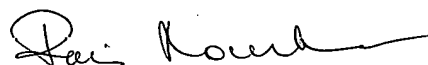
# BALANCE SHEET

		30 June 2016	30 June 2015 (represented)
	Notes	£'million	£'million
<b>Current assets: due after one year</b>			
Other financial assets	6	516	368
Trade and other receivables	7	3,341	3,360
<b>Current assets: due within one year</b>			
Trade and other receivables	7	33,803	30,049
Other financial assets	6	763	93
Cash and cash equivalents		486	14
		<b>38,909</b>	<b>33,884</b>
<b>Creditors: amounts falling due within one year</b>			
Other financial liabilities	6	(518)	(140)
Borrowings	9	(346)	(502)
Trade and other creditors	11	(30,686)	(26,817)
		<b>(31,550)</b>	<b>(27,459)</b>
<b>Net current assets</b>		<b>7,359</b>	<b>6,425</b>
<b>Creditors: amounts falling due after more than one year</b>			
Other financial liabilities	6	(515)	(365)
Borrowings	9	(2,243)	(1,908)
		<b>(2,758)</b>	<b>(2,273)</b>
<b>Net assets</b>		<b>4,601</b>	<b>4,152</b>
<b>Equity</b>			
Called up share capital	12	3,660	3,660
Retained earnings		941	492
<b>Total equity</b>		<b>4,601</b>	<b>4,152</b>

Figures for the year ended 30 June 2015 have been represented following the review of amounts owed by fellow group undertakings, which are not expected to be repaid in the foreseeable future are reclassified to non-current assets. The accounting policies and other notes on pages 12 to 30 form part of the financial statements.

These financial statements on pages 9 to 30 were approved by the board of directors on 12 December 2016 and were signed on its behalf by:

M Pais  
Director



## STATEMENT OF CHANGES IN EQUITY

### ATTRIBUTABLE TO SHAREHOLDERS OF THE COMPANY

	Share capital £'million	Retained earnings £'million	Total equity £'million
Balance at 30 June 2014	3,660	162	3,822
Profit for the financial year and total comprehensive income	-	330	330
Balance at 30 June 2015	3,660	492	4,152
Profit for the financial year and total comprehensive income	-	449	449
<b>Balance at 30 June 2016</b>	<b>3,660</b>	<b>941</b>	<b>4,601</b>

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

## NOTES TO THE FINANCIAL STATEMENTS

### 1. ACCOUNTING POLICIES

#### Basis of preparation

These financial statements are prepared in accordance with Financial Reporting Standard 101 *Reduced Disclosure Framework* (FRS 101).

In preparing these financial statements, the company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU (IFRS), but makes amendments where necessary in order to comply with Companies Act 2006 and sets out below where the FRS 101 disclosure exemptions have been taken.

#### Transition to FRS 101

The company has applied FRS 101 for the first time for the year ended 30 June 2016 with comparative information for the year ended 30 June 2015 also prepared under FRS 101. The accounting policies applicable to the company from 1 July 2014 are set out below. This involved preparation of an opening FRS 101 balance sheet as at 1 July 2014, which is the company's date of transition to FRS 101 reporting.

The transition to FRS 101 did not change the reported figures as at 30 June 2016 nor for the year ended 30 June 2015.

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

The company is a wholly owned subsidiary of Diageo plc and is included in the consolidated financial statements of Diageo plc which are publicly available.

The company has taken advantage of the following exemptions from the requirements of IFRS in the preparation of these financial statements, in accordance with FRS 101:

- A cash flow statement and related notes;
- Comparative period reconciliations for share capital;
- Disclosures in respect of transactions with wholly owned subsidiaries;
- The effects of new but not yet effective IFRSs;
- Disclosures in respect of the compensation of Key Management Personnel.

These financial statements are separate financial statements.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 1. ACCOUNTING POLICIES (continued)

#### Functional and presentational currency

These financial statements are presented in sterling (£), which is the company's functional currency. All financial information presented in sterling has been rounded to the nearest million.

#### Finance costs

Borrowing costs which are not capitalised are recognised in the income statement based on the effective interest method.

#### Foreign currencies

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the financial year end exchange rates and these foreign exchange differences are recognised in the income statement.

#### Financial assets

**Trade and other receivables** Amounts owed by other group companies are initially measured at fair value and are subsequently reported at amortised cost.

**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 fair value net of transaction costs and are subsequently reported at amortised cost. Certain bonds are designated as being part of a fair value hedge relationship. In these cases, the amortised cost is adjusted for the fair value of the risk being hedged, with changes in value recognised in the income statement. The fair value adjustment is calculated using a discounted cash flow technique based on unadjusted market data.

**Trade creditors** Amounts owed to other group companies are initially measured at fair value and are subsequently reported at amortised cost.

#### Derivative financial instruments

Derivative financial instruments are carried at fair value using a discounted cash flow technique based on market data applied consistently for similar type of instruments. Gains and losses on derivatives that do not qualify for hedge accounting treatment are taken to the income statement as they arise.

The company designates and documents certain derivatives as hedging instruments against changes in fair value of recognised assets and liabilities (fair value hedges). The effectiveness of such hedges is assessed at inception and at least on a quarterly basis, using prospective and retrospective testing. Methods used for testing effectiveness include dollar offset, critical terms, regression analysis and hypothetical derivative method.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 1. ACCOUNTING POLICIES (continued)

#### Derivative financial instruments (continued)

*Fair value hedges* are used to manage the currency and/or interest rate risks to which the fair value of certain assets and liabilities are exposed. Changes in fair value of the derivatives are recognised in the income statement, along with any changes in the relevant fair value of the underlying hedged asset or liability.

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 using the effective interest rate method.

#### Taxation

Current tax is based on taxable profit for the year. Taxable profit is different from accounting profit due to temporary differences between accounting and tax treatments, and due to items that are never taxable or tax deductible. Tax benefits are not recognised unless it is probable that the tax positions are sustainable. Once considered to be probable, tax benefits are reviewed each year 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. Tax provisions are included in current liabilities. Interests and penalties on tax liabilities are provided in the tax charge.

Full provision for deferred tax is made for temporary differences between the carrying value of assets and liabilities for financial reporting purposes and their value for tax purposes. 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 and is based on the expected manner of recovery settlement of the carrying amount of assets and liabilities, using the basis of taxation enacted or substantively enacted by 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.

#### Judgements in applying accounting policies and key sources of estimation uncertainty

The directors make estimates and assumptions concerning the future of the company. The resulting accounting estimates will, by definition, seldom equate to actual results. The company's directors are of the opinion that there are no estimates and assumptions that have a significant risk of casting material adjustment to the carrying value of the assets and liabilities for the company within the next financial year due to the nature of the business.

The critical accounting policies, which the directors consider are of greater complexity and/or particularly subject to the exercise of judgements, are the policies in relation to fair valuation of derivatives (see detailed description under note 10. Financial instruments and risk management (g) Fair value measurements).

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 2. OTHER OPERATING INCOME/(EXPENSES)

	Year ended 30 June 2016 £'million	Year ended 30 June 2015 £'million
Net foreign exchange gains/(losses)	33	(58)
Guarantee provided	-	(30)
Margin on transaction hedging	8	7
Other income	1	1
	<hr/>	<hr/>
	42	(80)
	<hr/>	<hr/>

Fees in respect of audit services provided by the auditors are: £16,000 (2015 - £112,000). There were no fees payable to the auditors in respect of non-audit services (2015 - £nil).

In the year ended 30 June 2015 other operating expenses included a charge of £30 million paid in respect of a guarantee provided to a third party financial institution.

### 3. EMPLOYEES

The company did not employ any staff during either the current or prior year.

None of the directors received any remuneration during the financial year in respect of their services as directors of the company (2015 - £nil).



## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 4. FINANCE INCOME AND CHARGES

	Year ended 30 June 2016 £'million	Year ended 30 June 2015 £'million
<b>Net interest</b>		
Interest from fellow group undertakings	887	930
Other interest income	159	168
Fair value differential on foreign exchange contracts	4	1
Fair value gain on intra-group derivative interest rate instruments	40	25
Fair value gain on external derivative interest rate instruments	49	26
Fair value gain on intra-group cross currency interest rate swaps	3	38
Fair value gain on external cross currency interest rate swaps	41	-
Amortization of bonds	-	10
Discount and premium amortisation	1	-
<b>Total interest income</b>	<b>1,184</b>	<b>1,198</b>
<b>Interest charge on bank loans and overdrafts</b>	<b>(41)</b>	<b>(37)</b>
<b>Interest to fellow group undertakings</b>	<b>(498)</b>	<b>(471)</b>
<b>Interest charge on all other borrowings</b>	<b>(104)</b>	<b>(152)</b>
Fair value differential on foreign exchange contracts	-	(3)
Fair value loss on intra-group derivative interest rate instruments	(49)	(24)
Fair value loss on external derivative interest rate instruments	(40)	(32)
Fair value loss on intra-group cross currency interest rate swaps	(41)	-
Fair value loss on external cross currency interest rate swaps	(3)	(38)
Fee amortisation	(1)	(1)
<b>Total interest charges</b>	<b>(777)</b>	<b>(758)</b>
<b>Net finance income</b>	<b>407</b>	<b>440</b>

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 5. TAXATION

	Year ended 30 June 2016 £'million	Year ended 30 June 2015 £'million
<b>(i) Analysis of taxation charge for the year</b>		
<b>Current tax</b>		
UK Corporation tax	(1)	-
Adjustment in respect of prior years	1	1
Overseas tax	(4)	(4)
	<hr/>	<hr/>
Total current tax charge	(4)	(3)
	<hr/>	<hr/>
<b>Deferred tax</b>		
Reversal of timing differences	(2)	(25)
Adjustment in respect of prior years	6	(3)
Effect of changes in tax rates	-	1
	<hr/>	<hr/>
Total deferred tax	4	(27)
	<hr/>	<hr/>
Taxation on profit on ordinary activities	-	(30)
	<hr/>	<hr/>
	<b>Year ended 30 June 2016 £'million</b>	<b>Year ended 30 June 2015 £'million</b>
<b>(ii) Factors affecting total tax charge for the year</b>		
Profit on ordinary activities before taxation	449	360
	<hr/>	<hr/>
Taxation on profit on ordinary activities at UK corporation tax rate of 20% (2015 - 20.75%)	(90)	(75)
Expenses not deductible for tax purposes	-	(6)
Items not chargeable for tax purposes	108	50
Overseas tax	(4)	(3)
Adjustment in respect of prior years	7	(2)
Effect of changes in tax rates	-	1
Other tax effects for reconciliation between accounting profit and tax income	(21)	5
	<hr/>	<hr/>
Total tax charge for the year	-	(30)
	<hr/>	<hr/>

The UK tax rate reduced from 21% to 20% on 1 April 2015. In November 2015 a reduction to 19% was substantively enacted (effective from 1 April 2017), whilst a further reduction to 17% (effective from 1 April 2020) was substantively enacted in September 2016.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 6. OTHER FINANCIAL ASSETS AND LIABILITIES

2016	Assets due after one year £'million	Assets due within one year £'million	Liabilities due within one year £'million	Liabilities due after one year £'million
<b>External derivative assets/(liabilities) not designated in hedge relationship</b>				
Foreign exchange contracts - transaction	-	7	(133)	(46)
Foreign exchange contracts – other	-	359	(109)	-
Interest rate derivatives	152	-	-	(85)
Cross currency interest rate swaps	232	107	-	-
	<u>384</u>	<u>473</u>	<u>(242)</u>	<u>(131)</u>
<b>Intra-group derivative assets/(liabilities) not designated in hedge relationship</b>				
Foreign exchange contracts - transaction	47	136	(7)	-
Foreign exchange contracts - other	-	154	(162)	-
Interest rate derivatives	85	-	-	(152)
Cross currency interest rate swaps	-	-	(107)	(232)
	<u>132</u>	<u>290</u>	<u>(276)</u>	<u>(384)</u>
<b>Total derivative assets/(liabilities)</b>	<u>516</u>	<u>763</u>	<u>(518)</u>	<u>(515)</u>

The company entered into external cross currency interest rate swaps on behalf of a fellow group undertaking, Diageo Capital plc, market value of which amounted to £339 million at the balance sheet date (2015 - £118 million). The external deals are mirrored through Diageo plc to Diageo Capital plc, the ultimate beneficiary. Market value of intra-group cross currency interest rate swaps amounts to a net liability of £339 million (2015 - £118 million).

Fair value movements of cross currency interest rate swaps are taken to the income statement: the foreign exchange component of change in market value is presented as foreign exchange result on operations, the interest related amounts are recognised as interest income or expense.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 6. OTHER FINANCIAL ASSETS AND LIABILITIES (continued)

2015	Assets due after one year £'million	Assets due within one year £'million	Liabilities due within one year £'million	Liabilities due after one year £'million
<b>External derivative assets/(liabilities) not designated in hedge relationship</b>				
Foreign exchange contracts - transaction	17	27	(43)	(1)
Foreign exchange contracts - commodity	-	1	-	-
Foreign exchange contracts - other	3	16	(66)	-
Interest rate derivatives	124	3	(1)	(67)
Cross currency interest rate swaps	137	-	-	(19)
	<u>281</u>	<u>47</u>	<u>(110)</u>	<u>(87)</u>
<b>Intra-group derivative assets/(liabilities) not designated in hedge relationship</b>				
Foreign exchange contracts - transaction	1	45	(25)	(16)
Foreign exchange contracts - commodity	-	-	(1)	-
Foreign exchange contracts - other	-	-	(1)	(1)
Interest rate derivatives	67	1	(3)	(124)
Cross currency interest rate swaps	19	-	-	(137)
	<u>87</u>	<u>46</u>	<u>(30)</u>	<u>(278)</u>
<b>Total derivative assets/(liabilities)</b>	<u>368</u>	<u>93</u>	<u>(140)</u>	<u>(365)</u>

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 7. TRADE AND OTHER RECEIVABLES

	30 June 2016		30 June 2015	
	Due within one year £'million	Due after one year £'million	Due within one year £'million	Due after one year £'million
Amounts owed by fellow group undertakings	33,763	3,341	29,979	3,360
Corporate taxation	1	-	1	-
Other receivables	-	-	33	-
Interest receivable	20	-	22	-
Deferred tax asset	19	-	14	-
	<b>33,803</b>	<b>3,341</b>	<b>30,049</b>	<b>3,360</b>

Amounts owed by fellow group undertakings include accrued and capitalised interest on the underlying balances at 30 June 2016 and at 30 June 2015. These balances are repayable on demand and bear interest at fixed and variable rates from 0.02% to 25.82% for the year ended 30 June 2016 (2015 - from 0.01% to 26.31%).

Amounts owed by fellow group undertakings represent transactions with companies in the Diageo group with which the company has a long term financing relationship. These financing relationships are expected to continue for the foreseeable future. Certain amounts owed by fellow group undertakings are reclassified to non-current assets as they are not expected to be repaid in the foreseeable future. Amounts owed by group undertakings are considered to have a fair value which is not materially different to the book value.

In the year ended 30 June 2015 other receivables included loans provided to ventures in South Africa formed by fellow group undertakings with third parties: DHN Drinks (Pty) Limited and Sedibeng Brewery (Pty) Limited, which were repaid during the year.

In the year ended 30 June 2015 deferred taxation asset has 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.

### 8. DEFERRED TAX ASSET

The amounts of deferred tax accounted for in the balance sheet comprises deferred tax assets in respect of tax losses.

	<b>Tax losses £'million</b>
At 30 June 2014	41
Adjustment in respect of prior years	(3)
Recognised in statement of comprehensive income	(24)
At 30 June 2015	<b>14</b>
Adjustment in respect of prior years	7
Recognised in statement of comprehensive income	(2)
At 30 June 2016	<b>19</b>

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 9. BORROWINGS AND BANK OVERDRAFTS

	30 June 2016 £'million	30 June 2015 £'million
Bank overdrafts	207	152
Commercial paper	-	274
Credit support obligations	139	76
	<hr/>	<hr/>
<b>Borrowings due within one year and bank overdrafts</b>	<b>346</b>	<b>502</b>
	<hr/>	<hr/>
€ 500 million 1.125% bonds due 2019	421	359
€ 850 million 1.125% bonds due 2019	707	601
€ 500 million 1.75% bonds due 2023	413	351
€ 850 million 2.375% bonds due 2026	702	597
	<hr/>	<hr/>
<b>Borrowings due after one year</b>	<b>2,243</b>	<b>1,908</b>
	<hr/>	<hr/>
<b>Total external borrowings</b>	<b>2,589</b>	<b>2,410</b>
	<hr/> <hr/>	<hr/> <hr/>

The interest rates shown above are contracted on the underlying borrowings before taking into account any interest rate protection. The above loans are stated net of unamortised finance costs of £7 million (2015 - £6 million).

All bonds and commercial paper issued by the company are fully and unconditionally guaranteed by Diageo plc.

### 10. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The company's funding, liquidity and exposure to foreign currency and interest rate risks are managed by the group's treasury department.

The treasury department uses a range of financial instruments to manage these underlying risks.

Treasury operations are conducted within a framework of board-approved policies and guidelines, which are recommended and monitored by the finance committee, chaired by the chief financial officer. The policies and guidelines include benchmark exposure and/or hedge cover levels for key areas of treasury risk which are periodically reviewed by the board following, for example, significant business, strategic or accounting changes. The framework provides for limited defined levels of flexibility in execution to allow for the optimal application of the board-approved strategies. Transactions arising from the application of this flexibility may give rise to exposures different from the defined benchmark levels that are separately monitored on a daily basis using Value at Risk analysis. These transactions are carried at fair value and gains or losses are taken to the income statement as they arise. In the year ended 30 June 2016 and 30 June 2015 gains and losses on these transactions were not material. The company does not use derivatives for speculative purposes. All transactions in derivative financial instruments are initially undertaken to manage the risks arising from underlying business activities.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 10. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

The finance committee receives monthly reports on the activities of the treasury department, including any exposures different from the defined benchmarks.

#### (a) Currency risk

The company presents its financial statements in sterling (which is the functional currency of the entity) and conducts business in many currencies. As a result, it is subject to foreign currency risk due to exchange rate movements, which will affect the company's transactions. To manage the currency risk the company uses certain financial instruments. Where hedge accounting is applied, hedges are documented and tested for effectiveness on an ongoing basis. The company expects hedges entered into to continue to be effective and therefore does not expect the impact of ineffectiveness on the income statement to be material.

##### *Hedge of foreign currency debt*

The company entered into external cross currency interest rate swaps on behalf of a fellow group undertaking, Diageo Capital plc to hedge the foreign currency risk associated with certain foreign currency denominated borrowings. The external deals are mirrored through Diageo plc to Diageo Capital plc, the ultimate beneficiary.

##### *Transaction exposure hedging*

The group's policy is to hedge up to 24 months forecast transactional foreign currency risk on the net US dollar exposure of the group targeting 75% coverage for the current financial year and up to 18 months for other currency pairs. Foreign exchange transactional hedging deals are carried out in the company to hedge brand owners' future foreign currency cash flows with a margin defined on an arms' length basis.

#### (b) Interest rate risk

The company 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 company manages its proportion of fixed to floating rate borrowings within limits approved by the board, primarily through issuing fixed and floating rate borrowings and commercial paper, and by utilising interest rate derivatives. These practices aim to minimise the company's net finance charges with acceptable year on year volatility. To facilitate operational efficiency and effective hedge accounting, the group's policy is to maintain fixed rate borrowings within a band of 40% to 60% of forecast net borrowings. For these calculations, net borrowings exclude interest rate related fair value adjustments. Fair value of the company's existing interest rate derivatives is recognised in the income statement, along with any changes in the relevant fair value of the underlying hedged asset or liability.

#### (c) Commodity price risk

The company performs commodity price risk management on behalf of fellow group undertakings exposed to commodity price risk. Commodity price risk is managed in line with the principles approved by the board either through long term purchase contracts with suppliers or, where appropriate, derivative contracts. Where derivative contracts are used the commodity price risk exposure is hedged up to 18 months forecasted volume usage with up to 80% coverage. Where derivative contracts are used the company manages exposures principally through exchange-traded futures.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 10. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

#### (d) Market risk sensitivity analysis

The company uses a sensitivity analysis that estimates the impacts on the statement of comprehensive income of either an instantaneous increase or decrease of 0.5% in market interest rates or a 10% strengthening or weakening in sterling against all other currencies, from the rates applicable at 30 June 2016 and 30 June 2015, for each class of financial instruments with all other variables remaining constant. The sensitivity analysis excludes the impact of market risks on the corporate tax payable. This analysis is for illustrative purposes only, as in practice interest and foreign exchange rates rarely change in isolation.

The sensitivity analysis estimates the impact of changes in interest and foreign exchange rates. All hedges are expected to be highly effective for this analysis and it considers the impact of all financial instruments including financial derivatives, cash and cash equivalents, borrowings and other financial assets and liabilities. The results of the sensitivity analysis should not be considered as projections of likely future events, gains or losses as actual results in the future may differ materially due to developments in the global financial markets which may cause fluctuations in interest and exchange rates to vary from the hypothetical amounts disclosed in the table below.

	0.5 % decrease in interest rates £'million	0.5 % increase in interest rates £'million	10 % weakening of sterlings £'million	10 % strengthening of sterling £'million
<b>30 June 2016</b>				
Impact on statement of comprehensive income- gain/(loss)	(16)	16	43	(35)
<b>30 June 2015</b>				
Impact on statement of comprehensive income- gain/(loss)	(20)	20	52	(43)

#### (e) Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the company. Credit risk arises on cash balances (including bank deposits and cash equivalents), derivative financial instruments and other receivables.

The carrying amount of financial assets represents the company's exposure to credit risk at the balance sheet date as disclosed in section (h), excluding the impact of any collateral held or other credit enhancements.

Credit risk is managed separately for financial and business related credit exposures.



## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 10. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

#### (e) Credit risk (continued)

##### *Financial credit risk*

Diageo aims to minimise its financial credit risk through the application of risk management policies approved and monitored by the Board. Counterparties are limited to major banks and financial institutions, primarily with a long term credit rating within the A band or better, and the policy restricts the exposure to any one counterparty by setting credit limits taking into account the credit quality of the counterparty. The group's policy is designed to ensure that individual counterparty limits are adhered to and that there are no significant concentrations of credit risk. The Board also defines the types of financial instruments which may be transacted. The credit risk arising through the use of financial instruments for currency and interest rate risk management is estimated with reference to the fair value of contracts with a positive value, rather than the notional amount of the instruments themselves.

When derivative transactions are undertaken with bank counterparties, the group may, where appropriate, enter into certain agreements with such bank counterparties whereby the parties agree to post cash collateral for the benefit of the other if the net valuations of the derivatives are above a predetermined threshold. At 30 June 2016, the collateral held under these agreements amounted to \$104 million (£78 million) and €73 million (£61 million) (2015– \$82 million (£52 million) and €34 million (£24 million)).

Diageo annually reviews the credit limits applied and regularly monitors the counterparties' credit quality reflecting market credit conditions.

##### *Business related credit risk*

Since trade and other receivables principally include balances with fellow group undertakings, the risk of non-performance is considered remote.

#### (f) Liquidity risk

Liquidity risk is the risk that Diageo may encounter difficulties in meeting its obligations associated with financial liabilities that are settled by delivering cash or other financial assets. The company uses short term commercial paper to finance its day-to-day operations. The group's policy with regard to the expected maturity profile of borrowings is to limit the amount of such borrowings maturing within 12 months to 50% of gross borrowings less money market demand deposits, and the level of commercial paper to 30% of gross borrowings less money market demand deposits. In addition, the group's policy is to maintain backstop facilities with relationship banks to support commercial paper obligations. The following tables provide an analysis of the anticipated contractual cash flows including interest payable for the company financial liabilities and derivative instruments on an undiscounted basis. Where interest payments are on a floating rate basis, rates of each cash flow until maturity of the instruments are calculated based on the forward yield curve prevailing at 30 June 2016 and 30 June 2015. The gross cash flows of derivative contracts are presented for the purposes of this table, although in practice, the group uses netting arrangements to reduce its liquidity requirements on these instruments.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 10. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

#### Contractual cash flows

	Due within 1 year £ million	Due between 1 and 3 years £ million	Due between 3 and 5 years £ million	Due after 5 years £ million	Total £ million	Carrying amount at balance sheet date £ million
<b>2016</b>						
Borrowings	(346)	(1,125)	-	(1,125)	(2,596)	(2,589)
Interest on borrowings	(37)	(74)	(48)	(113)	(272)	(9)
Trade and other financial liabilities	(30,686)	-	-	-	(30,686)	(30,686)
<b>Non-derivative financial liabilities</b>	<b>(31,069)</b>	<b>(1,199)</b>	<b>(48)</b>	<b>(1,238)</b>	<b>(33,554)</b>	<b>(33,284)</b>
Gross amount receivable from derivatives	2,182	6,763	946	3,153	13,044	-
Gross amount payable from derivatives	(1,942)	(6,787)	(946)	(3,153)	(12,828)	-
<b>Derivative instruments</b>	<b>240</b>	<b>(24)</b>	<b>-</b>	<b>-</b>	<b>216</b>	<b>246</b>
<b>2015</b>						
Borrowings	(502)	(957)	-	(957)	(2,416)	(2,410)
Interest on borrowings	(31)	(63)	(52)	(117)	(263)	(8)
Trade and other financial liabilities	(26,817)	-	-	-	(26,817)	(26,817)
<b>Non-derivative financial liabilities</b>	<b>(27,350)</b>	<b>(1,020)</b>	<b>(52)</b>	<b>(1,074)</b>	<b>(29,496)</b>	<b>(29,235)</b>
Gross amount receivable from derivatives	1,294	6,286	1,064	3,297	11,941	-
Gross amount payable from derivatives	(1,343)	(6,344)	(1,070)	(3,297)	(12,054)	-
<b>Derivative instruments</b>	<b>(49)</b>	<b>(58)</b>	<b>(6)</b>	<b>-</b>	<b>(113)</b>	<b>(44)</b>

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 10. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

The company had, along with other financing companies in the Diageo group, available undrawn committed bank facilities as follows:

	30 June 2016 £ million	30 June 2015 £ million
Expiring within one year	-	688
Expiring between one and two years	470	-
Expiring after two years	<u>2,072</u>	<u>1,541</u>
	<u>2,542</u>	<u>2,229</u>

The 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 group's material short and long term borrowings. Certain of these borrowings contain cross default provisions and negative pledges. 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 after tax results of associates and joint ventures, 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 noncompliance with covenants may, in particular circumstances, lead to an acceleration of maturity on certain borrowings and the inability to access committed facilities. Diageo was in full compliance with its financial, pari passu ranking and negative pledge covenants in respect of its material short and long term borrowings throughout each of the years presented.

#### (g) Fair value measurements

Fair value measurements of financial instruments are presented through the use of a three-level fair value hierarchy that prioritises the valuation techniques used in fair value calculations.

The group maintains policies and procedures to value instruments using the most relevant data available. If multiple inputs that fall into different levels of the hierarchy are used in the valuation of an instrument, the instrument is categorised on the basis of the most subjective input.

Foreign currency forwards and swaps, cross currency swaps and interest rate swaps are valued using discounted cash flow techniques. These techniques incorporate inputs at levels 1 and 2, such as foreign exchange rates and interest rates. These market inputs are used in the discounted cash flow calculation incorporating the instrument's term, notional amount and discount rate, and taking credit risk into account. As significant inputs to the valuation are observable in active markets, these instruments are categorised as level 2 in the hierarchy.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 10. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

The company's financial assets and liabilities measured at fair value are categorised as follows:

	30 June 2016 £ million	30 June 2015 £ million
Derivative assets	1,279	461
Derivative liabilities	(1,033)	(505)
<b>Valuation techniques based on observable market input (Level 2)</b>	<b>246</b>	<b>(44)</b>

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 10. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

#### (h) Reconciliation of financial instruments

The table below sets out the company's accounting classification of each class of financial assets and liabilities.

2016	Fair value through income statement £ million	Loans and receivables and liabilities at amortised cost £ million	Not categorised as a financial instrument £ million	Total £ million	Current £ million	Non- current £ million
Trade and other receivables	-	37,125	19	37,144	33,803	3,341
Cash and cash equivalents	-	486	-	486	486	-
External derivatives at fair value	857	-	-	857	473	384
Intra-group derivatives at fair value	422	-	-	422	290	132
<b>Total financial assets</b>	<b>1,279</b>	<b>37,611</b>	<b>19</b>	<b>38,909</b>	<b>35,052</b>	<b>3,857</b>
Borrowings	-	(2,589)	-	(2,589)	(346)	(2,243)
Trade and other payables	-	(30,686)	-	(30,686)	(30,686)	-
External derivatives at fair value	(373)	-	-	(373)	(242)	(131)
Intra-group derivatives at fair value	(660)	-	-	(660)	(276)	(384)
<b>Total financial liabilities</b>	<b>(1,033)</b>	<b>(33,275)</b>	<b>-</b>	<b>(34,308)</b>	<b>(31,550)</b>	<b>(2,758)</b>
<b>Total net financial assets/(liabilities)</b>	<b>246</b>	<b>(4,336)</b>	<b>19</b>	<b>4,601</b>	<b>3,502</b>	<b>1,099</b>

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 10. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

#### (h) Reconciliation of financial instruments (continued)

2015	Fair value through income statement £ million	Loans and receivables and liabilities at amortised cost £ million	Not categorised as a financial instrument £ million	Total £ million	Current £ million	Non-current £ million
Trade and other receivables	-	33,395	14	33,409	30,049	3,360
Cash and cash equivalents	-	14	-	14	14	-
External derivatives at fair value	328	-	-	328	47	281
Intra-group derivatives at fair value	133	-	-	133	46	87
<b>Total financial assets</b>	<b>461</b>	<b>33,409</b>	<b>14</b>	<b>33,884</b>	<b>30,156</b>	<b>3,728</b>
Borrowings	-	(2,410)	-	(2,410)	(502)	(1,908)
Trade and other payables	-	(26,817)	-	(26,817)	(26,817)	-
External derivatives at fair value	(197)	-	-	(197)	(110)	(87)
Intra-group derivatives at fair value	(308)	-	-	(308)	(30)	(278)
<b>Total financial liabilities</b>	<b>(505)</b>	<b>(29,227)</b>	<b>-</b>	<b>(29,732)</b>	<b>(27,459)</b>	<b>(2,273)</b>
<b>Total net financial assets/(liabilities)</b>	<b>(44)</b>	<b>(4,182)</b>	<b>14</b>	<b>4,152</b>	<b>2,697</b>	<b>1,455</b>

At 30 June 2016 and 30 June 2015, the carrying values of cash and cash equivalents, other financial assets and liabilities approximate to fair values. At 30 June 2016 the fair value of borrowings, based on unadjusted quoted market data, was £2,770 million (2015 – £2,425 million).

#### (i) Capital management

The group's management is committed to enhancing shareholder value in the long term, both by investing in the businesses and brands so as to deliver continued improvement in the return from those investments and by managing the capital structure. Diageo manages its capital structure to achieve capital efficiency, provide flexibility to invest through the economic cycle and give efficient access to debt markets at attractive cost levels.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 11. TRADE AND OTHER CREDITORS

	30 June 2016 £'million	30 June 2015 £'million
Amounts owed to fellow group undertakings	30,669	26,800
Interest payable	17	17
	<hr/>	<hr/>
	30,686	26,817
	<hr/>	<hr/>

Amounts owed to fellow group undertakings include accrued and capitalised interest on the underlying balances at 30 June 2016 and at 30 June 2015. These balances are repayable on demand and bear interest at fixed and variable rates from 0.02% to 12.62% for the year ended 30 June 2016 (2015 - from 0.01% to 21.4%).

Amounts owed to fellow group undertakings represent transactions with companies in the Diageo group with which the company has a long term financing relationship. These financing relationships are expected to continue for the foreseeable future. Amounts owed to group undertakings are considered to have a fair value which is not materially different to the book value.

### 12. SHARE CAPITAL

	30 June 2016 £'million
<i>Allotted, called up and fully paid:</i>	
73,200,000,000 ordinary shares of 5p each	3,660
	<hr/>

### 13. IMMEDIATE AND ULTIMATE PARENT UNDERTAKING

The immediate and ultimate parent undertaking of the company is Diageo plc which is the ultimate controlling party of Diageo group. Diageo plc is incorporated and registered in England. The consolidated financial statements of Diageo plc can be obtained from the registered office at Diageo, Lakeside Drive, Park Royal, London NW10 7HQ.