

# **Diageo Finance plc**

## **Annual Report and Financial statements 30 June 2018**

Registered number: 213393



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## **STRATEGIC REPORT**

The directors present their strategic report for the year ended 30 June 2018.

### **Activities**

The company is engaged in treasury risk and cash management for Diageo plc and its subsidiary undertakings ("the group"). 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 and commodity price risk management are 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 2018*

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 group is included in the annual report of the group (see note 15 of the consolidated financial statements of the group).

Results from net interest income have increased by £40 million in the year ended 30 June 2018, from £444 million in the year ended 30 June 2017, mainly driven by the increase in the intercompany interest income due to the change in the intercompany loan structure of the company and the increase in the USD Libor.

Amounts owed by fellow group undertakings increased by £3,569 million, partially offset by an increase in amounts owed to fellow group undertakings of £1,544 million, which resulted from changes in the funding requirements of fellow group undertakings.

External borrowings increased by £1,094 million in the year ended 30 June 2018 to £3,705 million from £2,611 million in the year ended 30 June 2017, which was mainly due to the £1,136 million bond issue. The €775 million and €500 million bonds are measured at face value less the €1.2 million and €1 million fees, the €0.2 million and €3.9 million discounts and converted at daily EUR/GBP rate to sterling.

## STRATEGIC REPORT (continued)

### Business review (continued)

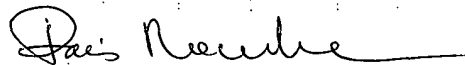
#### *Financial and other key performance indicators*

As the company forms part of the group's treasury operations, the company's performance is measured at the group level.

#### *Principal risks and uncertainties facing the company as at 30 June 2018*

Treasury operations manage the 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 Statement of comprehensive income.

By order of the board



M Pais  
Director  
Lakeside Drive  
Park Royal  
London  
NW10 7HQ

5 December 2018

## **DIRECTORS' REPORT**

The directors have pleasure in submitting their annual report, together with the audited financial statements for the year ended 30 June 2018.

The company is incorporated and domiciled as a public limited company in the United Kingdom. The registered address is Lakeside Drive, Park Royal, London, NW10 7HQ.

### **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 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 2018 are shown on page 11.

The profit for the year transferred to reserves is £463 million (2017 - £436 million).

No dividend was paid during the year (2017 - £nil) and there is no dividend proposed to be distributed to the shareholders in regards to the financial year (2017 - £nil).

### **Directors**

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

J M C Edmunds (appointed 8 March 2018)

E McShane (resigned 31 August 2017)

J J Nicholls (resigned 9 March 2018)

M Pais

V Rao

P Viswanathan (appointed 31 August 2017)

The following director was appointed after the year end:

K E Major (appointed 1 August 2018)

The following director resigned after the year end:

D F Harlock (resigned 1 August 2018)

### **Directors' remuneration**

None of the directors received any remuneration during the year in respect of their services as directors of the company (2017 - £nil).

### **Secretary**

On 5 January 2018, C. E. Matthews resigned as secretary of the company.

On 8 March 2018, J. M. Guttridge resigned and J. M. C. Edmunds was appointed as Secretary of the company.

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

The company operates under the financial reporting processes and controls of the group. The internal control and risk management systems over the financial reporting process of the group, which include those of the company, are discussed in the Group's Annual Report 2018 on pages 69 to 70 at [www.diageo.com](http://www.diageo.com), which does not form part of this report.

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

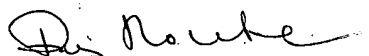
### **Auditors**

Pursuant to Section 487 of the Companies Act 2006, the auditors, PricewaterhouseCoopers LLP, have been reappointed and will continue in office as auditors of the company.

### **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

5 December 2018

## **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; 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 audit of the financial statements**

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### **Opinion**

In our opinion, Diageo Finance Plc's financial statements:

- give a true and fair view of the state of the company's affairs as at 30 June 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law); and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Financial Statements (the "Annual Report"), which comprise: the balance sheet as at 30 June 2018; the statement of comprehensive income, the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Directors.

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### **Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### **Independence**

We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

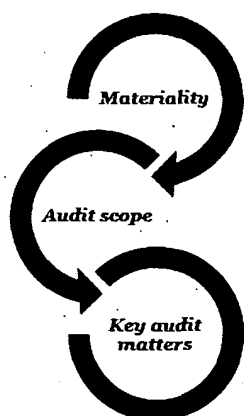
To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the company.

We have provided no non-audit services to the company in the period from 1 July 2017 to 30 June 2018.

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### **Our audit approach**

#### **Overview**



- Overall materiality: £414 million (2017: £385 million), based on 1% of total assets.
  - We conducted full scope audit work on the Financial Statements of Diageo Finance plc
  - We focused on the most significant areas being the assessment of hedge effectiveness and the valuation of derivative transactions.
  - Valuation of derivatives
  - Hedge effectiveness
-



## *The scope of our audit*

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the company and the industry in which it operates, and considered the risk of acts by the company which were contrary to applicable laws and regulations, including fraud. We designed audit procedures to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the company's financial statements, including, but not limited to, the United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law) and the requirements of the Companies Act 2006. Our tests included, but were not limited to, the review of the financial statements. There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

## *Key audit matters*

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

<i>Key audit matter</i>	<i>How our audit addressed the key audit matter</i>
<i>Valuation of derivatives</i> The company is engaged in treasury risk and cash management for Diageo plc and its subsidiary undertakings. The company enters into derivative transactions to hedge the brand owners' future foreign currency cash flows, the group's foreign exchange translation risk, interest rate risk and commodity price risk. Valuation of derivatives is a complex process. Therefore our focus area was the determination of fair value of derivative transactions.	Our audit procedures included understanding and evaluating the controls and systems related to the determination of fair value of derivatives, and where appropriate obtaining audit evidence through testing operating effectiveness of relevant controls together with substantive audit procedures. Testing of controls included examining appropriate authorisation of deal tickets and contracts for derivatives, as well as assessment of completeness of system recording of derivative transactions. The substantive audit procedures performed included the following tests, on a sample basis: <ul style="list-style-type: none"><li>– The valuation of derivatives with independent input data collected from publicly available markets;</li><li>– Circularising external confirmations to the banks to confirm the existence and valuation of derivatives.</li></ul> We also evaluated whether the liabilities and potential exposures were appropriately disclosed in the Financial Statements.
<i>Hedge effectiveness</i> As a part of risk management activity the company trades in derivative transactions to hedge the group's foreign currency and interest rate risk. The company applies hedge accounting in its Financial Statements. The accounting framework applied by the company requires certain pre-conditions to be met upon designation of a hedge relationship and throughout the term of the relationship, some of which are complex and are subject to management judgement.	Our audit procedures included understanding and evaluating the controls and systems related to hedge accounting including that the pre-conditions of hedge accounting were met, the prospective and retrospective assessment of hedge effectiveness were appropriately performed and resulting entries were properly accounted for. Where relevant, we obtained audit evidence through testing operating effectiveness of relevant controls together with substantive audit procedures. Testing of controls included examining appropriate

<b>Key audit matter</b>	<b>How our audit addressed the key audit matter</b>
Therefore, our areas of focus included hedge accounting applied by the company.	<p>authorisation of hedge designation, review of hedge effectiveness tests and resulting accounting entries.</p> <p>The substantive audit procedures performed included the following tests, on a sample basis:</p> <ul style="list-style-type: none"> <li>• review of appropriateness of hedge designation documents;</li> <li>• the independent recalculation of hedge effectiveness tests;</li> <li>• review of appropriateness of accounting entries relating to hedge accounting.</li> </ul> <p>We also evaluated whether derivative transactions were appropriately disclosed in the Financial Statements.</p>

### **How we tailored the audit scope**

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which it operates.

### **Materiality**

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

<b>Overall materiality</b>	£414 million (2017: £385 million).
<b>How we determined it</b>	1% of total assets.
<b>Rationale for benchmark applied</b>	We consider total assets measure to reflect the nature of the company, which primarily acts as a funding and cash management company for the group's investments and carries out derivative transactions to hedge the group's financial risks.

We agreed with the Directors that we would report to them misstatements identified during our audit above £20.7 million (2017: £19.3 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

### **Conclusions relating to going concern**

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern.

### **Reporting on other information**

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that

there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report, Directors' Report and Corporate Governance Statement, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

### ***Strategic Report and Directors' Report***

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 30 June 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report.

## **Responsibilities for the financial statements and the audit**

### ***Responsibilities of the directors for the financial statements***

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 in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

### ***Auditors' responsibilities for the audit of the financial statements***

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of our auditors' report.

### ***Use of this report***

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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## **Other required reporting**

### **Companies Act 2006 exception reporting**

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 by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; 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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## Appointment

Following the recommendation of the group audit committee, we were appointed by the members on 1 September 2015 to audit the financial statements for the year ended 30 June 2016 and subsequent financial periods. The period of total uninterrupted engagement is 3 years, covering the years ended 30 June 2016 to 30 June 2018.



Christopher Richmond (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London  
5 December 2018

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# STATEMENT OF COMPREHENSIVE INCOME

	<i>Notes</i>	<b>Year ended 30 June 2018 £'million</b>	<b>Year ended 30 June 2017 £'million</b>
Other operating income/(expense)	2	(19)	13
Finance income	4	1,336	1,295
Finance charges	4	(852)	(851)
<b>Operating profit</b>		<b>465</b>	<b>457</b>
<b>Profit before taxation on ordinary activities</b>		<b>465</b>	<b>457</b>
Taxation on profit on ordinary activities	5	(2)	(21)
<b>Profit for the financial year</b>		<b>463</b>	<b>436</b>
<b>Other comprehensive income</b>		<b>-</b>	<b>-</b>
<b>Total comprehensive income for the year</b>		<b>463</b>	<b>436</b>

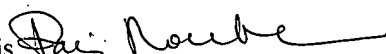
The accompanying notes are an integral part of these financial statements.

# **BALANCE SHEET**

	<i>Notes</i>	<b>30 June 2018 £'million</b>	<b>30 June 2017 £'million</b>
<b>Non-current assets</b>			
Other financial assets	6	271	317
Trade and other receivables	7	3,180	3,478
		<hr/>	<hr/>
		3,451	3,795
<b>Current assets</b>			
Trade and other receivables	7	37,891	34,031
Other financial assets	6	48	164
Cash and cash equivalents		24	537
		<hr/>	<hr/>
		37,963	34,732
<b>Total assets</b>		<hr/>	<hr/>
		41,414	38,527
<b>Current liabilities</b>			
Other financial liabilities	6	(50)	(214)
Borrowings	9	(1,394)	(249)
Trade and other payables	11	(31,890)	(30,348)
		<hr/>	<hr/>
		(33,334)	(30,811)
<b>Non-current liabilities</b>			
Other financial liabilities	6	(269)	(317)
Borrowings	9	(2,311)	(2,362)
		<hr/>	<hr/>
		(2,580)	(2,679)
<b>Total liabilities</b>		<hr/>	<hr/>
		(35,914)	(33,490)
<b>Net assets</b>		<hr/>	<hr/>
		5,500	5,037
<b>Equity</b>			
Called up share capital	12	3,660	3,660
Retained earnings		1,840	1,377
		<hr/>	<hr/>
<b>Total equity</b>		5,500	5,037
		<hr/>	<hr/>

These financial statements on pages 3 to 5 were approved by the board of directors on 5 December 2018 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 2016	3,660	941	4,601
Profit for the financial year and total comprehensive income	-	436	436
Balance at 30 June 2017	3,660	1,377	5,037
Profit for the financial year and total comprehensive income	-	463	463
<b>Balance at 30 June 2018</b>	<b>3,660</b>	<b>1,840</b>	<b>5,500</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.

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 the group 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;
- 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.

#### New accounting policies

• **IFRS 9 - Financial instruments replaces IAS 39** (Financial instruments - Recognition and measurement) and addresses the classification and measurement of financial instruments, introduces new principles for hedge accounting and a new forward-looking impairment model for financial assets. The adoption of IFRS 9 hedge accounting principles did not result in a restatement of the company's results and the impact on the year ended 30 June 2018 is not material. The adoption of IFRS 9 did not result in any changes in the measurement or classification of financial instruments as at 1 July 2017. All classes of financial assets and financial liabilities had as at 1 July 2017 the same carrying values under IFRS 9 as they had under IAS 39. The new impairment model under IFRS 9 requires the recognition of allowances for doubtful debt based on expected credit losses (ECL), rather than incurred credit losses as under IAS 39. The adoption of the ECL approach did not result in any additional impairment loss for trade and loan receivables as at 1 July 2017.



## 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 and liabilities

Financial assets and liabilities are initially recorded at fair value including, where permitted by IFRS 9, any directly attributable transaction costs. For those financial assets that are not subsequently held at fair value, the company assesses whether there is evidence of impairment at each balance sheet date. The company classifies its financial assets and liabilities into the following categories: financial assets and liabilities at amortised cost, financial assets and liabilities at fair value through profit and loss and financial assets at fair value through other comprehensive income. Under IFRS 9, classification and measurement of financial assets depend on the company's business model for managing the asset and the cash flow characteristics of the assets. The business model and cash flow characteristics assessment is carried out on instrumental basis. Where financial assets or liabilities are eligible to be carried at either amortised cost or fair value the company does not apply the fair value option.

**Trade and other receivables** Amounts owed by other group companies are initially measured at fair value and are subsequently reported at amortised cost. Non-interest bearing trade receivables are stated at their nominal value as they are due on demand. Allowance for expected credit losses are made based on the risk of non-payment taking into account ageing, previous experience, economic conditions and forward-looking data. Such allowance are measured as either 12-months expected credit losses or lifetime expected credit losses depending on changes in the credit quality of the counterparty.

**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, including money market deposits, commercial paper and investments.

**Borrowings** Borrowings are initially recognised at fair value net of transaction costs and are subsequently reported at amortised cost. 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 payables** Amounts owed to other group companies are initially measured at fair value and are subsequently reported at amortised cost. Non-interest bearing trade payables are stated at their nominal value as they are due on demand.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 1. ACCOUNTING POLICIES (continued)

#### 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). Methods used for testing effectiveness include dollar offset, critical terms, regression analysis and hypothetical derivative models.

*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 no longer meets hedge accounting criteria, 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. Penalties and interest on tax liabilities for the year ended 30 June 2018 are included in profit before taxation. In prior years penalties and interest on tax liabilities were provided for 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 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 2018 £'million	Year ended 30 June 2017 £'million
Net foreign exchange (loss)/gain	(25)	6
Margin on transaction hedging	7	7
Market value gain/(loss) on foreign exchange derivatives	1	(1)
Other (expense)/income	(2)	1
	<u>(19)</u>	<u>13</u>

Fees in respect of audit services provided by the auditors are: £17,000 (2017 - £17,000).  
There were no fees payable to the auditors in respect of non-audit services (2017 - £nil).

### 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 (2017 - £nil).

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 4. FINANCE INCOME AND CHARGES

	Year ended 30 June 2018 £'million	Year ended 30 June 2017 £'million
<b>Net interest</b>		
Interest from fellow group undertakings	991	907
Other interest income	187	178
Fair value differential on foreign exchange contracts	1	1
Fair value gain on intra-group derivative interest rate instruments	60	105
Fair value gain on external derivative interest rate instruments	40	55
Fair value gain on intra-group cross currency interest rate swaps	57	49
<b>Total interest income</b>	<b>1,336</b>	<b>1,295</b>
<b>Interest charge on bank loans and overdrafts</b>	<b>(43)</b>	<b>(46)</b>
<b>Interest to fellow group undertakings</b>	<b>(524)</b>	<b>(498)</b>
<b>Interest charge on all other borrowings</b>	<b>(127)</b>	<b>(97)</b>
<b>Fair value differential on foreign exchange contracts</b>	<b>(1)</b>	<b>(1)</b>
<b>Fair value loss on intra-group derivative interest rate instruments</b>	<b>(40)</b>	<b>(55)</b>
<b>Fair value loss on external derivative interest rate instruments</b>	<b>(60)</b>	<b>(105)</b>
<b>Fair value loss on external cross currency interest rate swaps</b>	<b>(57)</b>	<b>(49)</b>
<b>Total interest charges</b>	<b>(852)</b>	<b>(851)</b>
<b>Net finance income</b>	<b>484</b>	<b>444</b>

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 5. TAXATION

	Year ended 30 June 2018 £'million	Year ended 30 June 2017 £'million
<b>(i) Analysis of taxation charge for the year</b>		
<b>Current tax</b>		
UK Corporation tax	-	-
Adjustment in respect of prior years	-	1
Overseas tax	(2)	(3)
<b>Total current tax charge</b>	<b>(2)</b>	<b>(2)</b>
<b>Deferred tax</b>		
Adjustment in respect of prior years	-	(19)
<b>Total deferred tax</b>	<b>-</b>	<b>(19)</b>
<b>Taxation on profit on ordinary activities</b>	<b>(2)</b>	<b>(21)</b>
<b>(ii) Factors affecting total tax charge for the year</b>	<b>Year ended 30 June 2018 £'million</b>	<b>Year ended 30 June 2017 £'million</b>
Profit on ordinary activities before taxation	463	457
Taxation on profit on ordinary activities at UK corporation tax rate of 19% (2017 – 19.75%)	(87)	(90)
Items not chargeable for tax purposes	-	-
Overseas tax	(2)	(3)
Adjustment in respect of prior years	-	(18)
Effects of group relief	88	97
Other tax effects for reconciliation between accounting profit and tax income	(1)	(7)
<b>Total tax charge for the year</b>	<b>(2)</b>	<b>(21)</b>

The UK tax rate reduced from 20% to 19% on 1 April 2017 and as such a tax rate of 19% (2017: 19.75%) is applied for the year ended 30 June 2018. A further reduction to 17% (effective from 1 April 2020) was enacted in September 2016.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 6. OTHER FINANCIAL ASSETS AND LIABILITIES

2018	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	-	16	(12)	(16)
Foreign exchange contracts - other	-	18	(22)	-
Interest rate derivatives	24	-	(1)	(25)
Cross currency interest rate swaps	160	-	-	(48)
	<b>184</b>	<b>34</b>	<b>(35)</b>	<b>(89)</b>
<b>Intra-group derivative assets/(liabilities) not designated in hedge relationship</b>				
Foreign exchange contracts - transaction	16	14	(15)	-
Foreign exchange contracts - other	-	-	-	-
Interest rate derivatives	25	-	-	(22)
Cross currency interest rate swaps	48	-	-	(160)
	<b>89</b>	<b>14</b>	<b>(15)</b>	<b>(182)</b>
<b>Total derivative assets/(liabilities)</b>	<b>273</b>	<b>48</b>	<b>(50)</b>	<b>(271)</b>

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 £112 million at the balance sheet date (2017 - £193 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 £112 million (2017 - £193 million).

The company entered into interest rate swaps to hedge the fair value of bonds issued in the current financial year. The gain on fair value of the interest rate swaps designated in fair value hedge relationships was £0.4 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)

	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>2017</b>				
<b>External derivative assets/(liabilities) not designated in hedge relationship</b>				
Foreign exchange contracts - transaction	9	10	(64)	(1)
Foreign exchange contracts - other	-	57	(106)	-
Interest rate derivatives	41	14	(11)	(25)
Cross currency interest rate swaps	217	-	-	(24)
	<u>267</u>	<u>81</u>	<u>(181)</u>	<u>(50)</u>
<b>Intra-group derivative assets/(liabilities) not designated in hedge relationship</b>				
Foreign exchange contracts - transaction	1	72	(15)	(9)
Foreign exchange contracts - other	-	-	(4)	-
Interest rate derivatives	25	11	(14)	(41)
Cross currency interest rate swaps	24	-	-	(217)
	<u>50</u>	<u>83</u>	<u>(33)</u>	<u>(267)</u>
<b>Total derivative assets/(liabilities)</b>	<u>317</u>	<u>164</u>	<u>(214)</u>	<u>(317)</u>

## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 7. TRADE AND OTHER RECEIVABLES

	30 June 2018		30 June 2017	
	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	37,882	3,180	34,015	3,478
Corporate taxation	-	-	1	-
Interest receivable	9	-	15	-
Deferred tax assets	-	-	-	-
	<b>37,891</b>	<b>3,180</b>	<b>34,031</b>	<b>3,478</b>

Amounts owed by fellow group undertakings include accrued and capitalised interest on the underlying balances at 30 June 2018 and at 30 June 2017. These balances bear interest at fixed and variable rates from -0.20% to 23.46% for the year ended 30 June 2018 (2017 - from 0.00% to 27.81%).

Amounts owed by fellow group undertakings represent transactions with companies in the 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.

### 8. DEFERRED TAX ASSET

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

	Tax losses £'million
At 30 June 2016	19
Adjustment in respect of prior years	(19)
Recognised in statement of comprehensive income	-
At 30 June 2017	-
Adjustment in respect of prior years	-
Recognised in statement of comprehensive income	-
At 30 June 2018	-



## NOTES TO THE FINANCIAL STATEMENTS (continued)

### 9. BORROWINGS AND BANK OVERDRAFTS

	30 June 2018 £'million	30 June 2017 £'million
Bank overdrafts	139	175
Bank loan	6	-
Credit support obligations	54	74
€ 500 million 1.125% bonds due 2019	444	-
€ 850 million 1.125% bonds due 2019	751	-
<b>Borrowings due within one year and bank overdrafts</b>	<b>1,394</b>	<b>249</b>
€ 500 million 1.125% bonds due 2019	-	441
€ 850 million 1.125% bonds due 2019	-	745
€ 500 million 1.75% bonds due 2024	440	436
€ 850 million 2.375% bonds due 2026	747	740
€ 775 million 0.0% bonds due 2020	685	-
€ 500 million 0.5% bonds due 2024	439	-
<b>Borrowings due after one year</b>	<b>2,311</b>	<b>2,362</b>
<b>Total external borrowings</b>	<b>3,705</b>	<b>2,611</b>

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 £12 million (2017 - £7 million). Bonds are reported at amortised cost with a fair value adjustment shown separately. All bonds 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 at the group level 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 2018 and 30 June 2017 gains and losses on these transactions were not material.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

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

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. 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 group has an exposure to interest rate risk, arising principally on changes in US dollar, euro and sterling interest rates. To manage interest rate risk, the group manages its proportion of fixed to floating rate borrowings within limits approved by the Board, primarily through issuing fixed and floating 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 24 months of forecast volume through exchange-traded and over-the-counter contracts (futures, forwards, swaps and options).

## 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 2018 and 30 June 2017, for each class of financial instruments with all other variables remaining constant. 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 2018</b>				
Impact on statement of comprehensive income- gain/(loss)	34	(34)	(161)	132
<b>30 June 2017</b>				
Impact on statement of comprehensive income- gain/(loss)	(22)	22	70	(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 (i), excluding the impact of any collateral held or other credit enhancements. Financial assets are written-off when the counterparty fails to pay its contractual obligations (default event). The gross carrying amount of the financial asset has to be reduced (written off) in case there is no reasonable expectation of recovering the contractual cash flows on the asset in its entirety or its portion only. Expected recovery of contractual cash flows is assessed individually, on instrumental basis. 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*

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

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 2018, the collateral held under these agreements amounted to \$71 million (£54 million) (2017 - \$96 million (£74 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. Under IFRS 9, the significant increase in credit risk of financing relationships with fellow group undertakings is determined based on the group's internal credit rating assessment. The assessment practice takes into account as inputs the historical default of the financial instruments, currently available information about fellow group undertakings' financial performance and forward-looking information. The total balance of trade and other receivables is qualified as performing in accordance with internal credit rating assessment. As a result of low risk credit risk these financial assets have a very low risk of default (probability of default (PD)) and the 12-months expected credit loss is considered to be immaterial.

#### (f) Liquidity risk

Liquidity risk is the risk that the group 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. There were no commercial papers issued at year-end. 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 2018 and 30 June 2017. In order to align with the group reporting the cash flows of cross currency swaps are presented on a gross basis while all other derivative contracts are presented on a net basis. Financial assets and liabilities are presented gross in the balance sheet, 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						Carrying amount at balance sheet date £ million
	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	
<b>2018</b>						
Borrowings	(1,394)	(686)	-	(1,637)	(3,717)	(3,705)
Interest on other payables	(4)	-	-	-	(4)	(4)
Interest on borrowings	(41)	(56)	(56)	(71)	(224)	(10)
Trade and other financial liabilities	(31,876)	-	-	-	(31,876)	(31,876)
<b>Non-derivative financial liabilities</b>	<b>(33,315)</b>	<b>(742)</b>	<b>(56)</b>	<b>(1,708)</b>	<b>(35,821)</b>	<b>(35,595)</b>
Cross currency swaps (gross)						
- Receivable	102	203	1,664	2,558	4,526	-
- Payable	(102)	(203)	(1,664)	(2,558)	(4,526)	-
Other derivative instruments (net)	4	1	-	-	5	-
<b>Derivative instruments</b>	<b>4</b>	<b>1</b>	<b>-</b>	<b>-</b>	<b>5</b>	<b>-</b>
<b>2017</b>						
Borrowings	(249)	(1,184)	-	(1,184)	(2,617)	(2,611)
Interest on other payables	(7)	-	-	-	(7)	(7)
Interest on borrowings	(39)	(64)	(51)	(94)	(248)	(9)
Trade and other financial liabilities	(30,332)	-	-	-	(30,332)	(30,332)
<b>Non-derivative financial liabilities</b>	<b>(30,627)</b>	<b>(1,248)</b>	<b>(51)</b>	<b>(1,278)</b>	<b>(33,204)</b>	<b>(32,959)</b>
Cross currency swaps (gross)						
- Receivable	102	204	204	4,155	4,665	-
- Payable	(102)	(204)	(204)	(4,155)	(4,665)	-
Other derivative instruments (net)	(48)	-	-	-	(48)	-
<b>Derivative instruments</b>	<b>(48)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(48)</b>	<b>(50)</b>

## NOTES TO THE FINANCIAL STATEMENTS (continued)

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

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

	30 June 2018 £ million	30 June 2017 £ million
Expiring within one year	-	481
Expiring between one and two years	474	900
Expiring after two years	727	1,219
	<u>1,201</u>	<u>2,600</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 2018 £ million	30 June 2017 £ million
Derivative assets	319	481
Derivative liabilities	(319)	(531)
<b>Valuation techniques based on observable market input (Level 2)</b>	<b>-</b>	<b>(50)</b>

#### (h) Results of hedging instruments

The company targets a one-to-one hedge ratio. Strengths of the economic relationship between the hedged item and the hedging instrument is analysed on an ongoing basis. Ineffectiveness can arise from subsequent change in the forecast transactions as a result of timing, cash flows or value except when the critical terms of the hedging instrument and hedged item are closely aligned. The change in the credit risk of the hedging instruments or the hedged items is not expected to be the primary factor in the economic relationship.

The notional amounts, contractual maturities and rates of the hedging instruments designated in hedging relationship as of 30 June 2018 by the main risk categories are as follows:

	Notional amounts £ million	Maturity	Range of hedged rates
<b>2018</b>			
<b>Fair value hedges</b>			
Derivatives in fair value hedge (interest rate risk)	1,327	May 2019 – November 2020	(0.26)-0%
<b>2017</b>			
<b>Fair value hedges</b>			
Derivatives in fair value hedge (interest rate risk)	-	-	-

With respect to hedges of the fair value risk from a change in interest rates using interest rate swaps, the retranslation of the related bond principal to closing foreign exchange rates and recognition of interest on the related bonds will affect the income statement in each year until the related bonds mature in 2020 and 2024. Foreign exchange retranslation and the interest on the hedged bonds in the income statement are expected to offset those on the interest rate swaps in each of the years.

The loss on fair value hedging instruments for the year was £0.5 million (2017 - £nil).

## NOTES TO THE FINANCIAL STATEMENTS (continued)

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

#### (i) Reconciliation of financial instruments

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

	Fair value through income statement £ million	Asset and liabilities at amortised cost £ million	Not categorised as a financial instrument £ million	Total £ million	Current £ million	Non- current £ million
<b>2018</b>						
Trade and other receivables	-	41,071	-	41,071	37,891	3,180
Cash and cash equivalents	-	24	-	24	24	-
External derivatives at fair value	218	-	-	218	34	184
Intra-group derivatives at fair value	103	-	-	103	14	89
<b>Total assets</b>	<b>321</b>	<b>41,095</b>	<b>-</b>	<b>41,416</b>	<b>37,963</b>	<b>3,453</b>
Borrowings	-	(3,705)	-	(3,705)	(1,394)	(2,311)
Trade and other payables	-	(31,890)	-	(31,890)	(31,890)	-
External derivatives at fair value	(124)	-	-	(124)	(35)	(89)
Intra-group derivatives at fair value	(197)	-	-	(197)	(15)	(182)
<b>Total liabilities</b>	<b>(321)</b>	<b>(35,595)</b>	<b>-</b>	<b>(35,916)</b>	<b>(33,334)</b>	<b>(2,582)</b>
<b>Total net financial assets/(liabilities)</b>	<b>-</b>	<b>5,500</b>	<b>-</b>	<b>5,500</b>	<b>4,629</b>	<b>871</b>



## NOTES TO THE FINANCIAL STATEMENTS (continued)

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

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

	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
<b>2017</b>						
Trade and other receivables	-	37,508	1	37,509	34,031	3,478
Cash and cash equivalents	-	537	-	537	537	-
External derivatives at fair value	348	-	-	348	81	267
Intra-group derivatives at fair value	133	-	-	133	83	50
<b>Total financial assets</b>	<b>481</b>	<b>38,045</b>	<b>1</b>	<b>38,527</b>	<b>34,732</b>	<b>3,795</b>
Borrowings	-	(2,611)	-	(2,611)	(249)	(2,362)
Trade and other payables	-	(30,348)	-	(30,348)	(30,348)	-
External derivatives at fair value	(231)	-	-	(231)	(181)	(50)
Intra-group derivatives at fair value	(300)	-	-	(300)	(33)	(267)
<b>Total financial liabilities</b>	<b>(531)</b>	<b>(32,959)</b>	<b>-</b>	<b>(33,490)</b>	<b>(30,811)</b>	<b>(2,679)</b>
<b>Total net financial assets/(liabilities)</b>	<b>(50)</b>	<b>5,086</b>	<b>1</b>	<b>5,037</b>	<b>3,921</b>	<b>1,116</b>

At 30 June 2018 and 30 June 2017, the carrying values of cash and cash equivalents, other financial assets and liabilities approximate to fair values. At 30 June 2018, the fair value of borrowings, based on unadjusted quoted market data, was £3,831 million (2017 - £2,490 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 PAYABLES

	30 June 2018 £'million	30 June 2017 £'million
Amounts owed to fellow group undertakings	31,876	30,332
Interest payable	14	16
	<u>31,890</u>	<u>30,348</u>

Amounts owed to fellow group undertakings include accrued and capitalised interest on the underlying balances at 30 June 2018 and at 30 June 2017. These balances are repayable on demand and bear interest at fixed and variable rates from 0.00% to 14.56% for the year ended 30 June 2018 (2017 - from 0.00% to 8.81%).

Amounts owed to fellow group undertakings represent transactions with companies in the group. 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 2018 £'million	30 June 2017 £'million
<i>Allotted, called up and fully paid:</i>		
73,200,000,000 ordinary shares of 5p each	<u>3,660</u>	<u>3,660</u>

### 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 the group. Diageo plc is incorporated and registered in England. The consolidated financial statements of the group can be obtained from the registered office at Diageo, Lakeside Drive, Park Royal, London NW10 7HQ.