Diageo Finance plc

Annual report and financial statements
30 June 2021

Registered number: 00213393

Diageo Finance plc
Registered number: 00213393
Year ended 30 June 2021

CONTENTS	**PAGES**

Diageo Finance plc
Registered number: 00213393
Year ended 30 June 2021

STRATEGIC REPORT

The Directors present their strategic report for the year ended 30 June 2021.

Principal activities

Diageo Finance plc (the "company") is engaged in the provision of treasury risk and cash management services for Diageo plc and its subsidiary undertakings (the "group"). Diageo Finance plc's principal activity is to raise external funds 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 arm's length basis. Interest rate risk management is performed by the company by swapping interest cash flows of its bonds and it assists other group undertakings in foreign exchange translation hedging and commodity price risk management.

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 2021

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 2021 of Diageo plc (see note 15 of the consolidated financial statements of Diageo plc).

Results from net finance income have decreased by £124 million to £20 million in the year ended 30 June 2021, from £144 million in the year ended 30 June 2020, 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 decreased by £1,290 million to £27,803 million and amounts owed to fellow group undertakings decreased by £1,320 million to £18,000 million, which resulted from changes in the funding requirements of fellow group undertakings.

External borrowings decreased by £862 million in the year ended 30 June 2021 to £6,634 million from £7,496 million in the year ended 30 June 2020, which was due to the £696 million bond repayment, which was partially offset by £395 million bond issuance, the EUR/GBP rate movement (£405 million decrease) and £147 million decrease in collaterals and bank overdrafts. The total amounts of £400 million bonds are measured at face value less the £1 million fees and the £4 million discounts. Bonds denominated in euro are converted at daily EUR/GBP rate to sterling.

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.

STRATEGIC REPORT (continued)

Business review (continued)

Principal risks and uncertainties facing the company as at 30 June 2021

The principal risks identified by the group are disclosed on pages 45-48 of the Annual Report 2021. The most relevant of the group risks to this entity are the ones we have selected and articulated below, together with specific considerations relating to the company's operations and environment. If any of these risks occur, the company's business, financial condition and operational results could suffer. As the company forms part of the group's financial operations, the financial risk management measures used by management to analyse the development, performance and position of the company's business are mainly similar to those facing the group as a whole and are managed by the group's treasury department.

In addition, given that the company performs treasury functions for the group, as set out in the detailed description under note 9 'Financial instruments and risk management', it is exposed to foreign currency risk associated with certain foreign currency denominated bonds and interest rate risk arising principally on changes in US dollar and sterling interest rates. The company uses derivative financial instruments to hedge its exposures to fluctuations in interest rates. Fair value hedges are carried out to manage the interest rate risks to which the fair value of certain assets and liabilities are exposed.

Brexit

The European Union and the United Kingdom have agreed the EU-UK Trade and Cooperation Agreement which fully came into force on 1 May 2021. We remain of the view that the direct financial impact to the group or the company will not be material. A cross-functional working group is in place to identify and assess the consequences of Brexit, with all major functions within our business represented, including the function of raising external funding. The group will monitor the implications of the Agreement very closely, as well as the broader environment risks, including a continuing focus on identifying critical decision points to ensure potential disruption is minimised, and take prudent actions to mitigate these risks wherever practical.

Pandemics

The global outbreak of a public health threat or fear of such an event could result in increased government restrictions and regulations including the shutdown of the on-trade, restrictions to travel, and quarantining of employees resulting in a negative impact to consumer demand. It could cause a slowdown or halting of the group business operations due to supply or logistic constraints and could adversely impact the group financial performance. To mitigate these challenges the group regularly gathers data and obtains insights which enable management to assess conditions in the markets where the group operates and to amend forecasts and investment decisions appropriately.

The Directors have assessed that the key impacts from the pandemic on the company would be in respect of any change in credit risk impacting the valuation of derivatives and the effect of Covid-19 on remote working and ability to access IT systems, along with a potentially heightened cyber risk.

The Directors believe that the risk mitigation actions taken in relation to the Covid-19 pandemic have been agile and effective and that the group will maintain adequate liquidity and be strongly positioned for a recovery in consumer demand. During the year, the group took actions to protect the business and support Diageo partners and communities.

STRATEGIC REPORT (continued)

Business review (continued)

Pandemics (continued)

As part of the group viability statement assessment, the group has prepared cash flow forecasts which have also been sensitised to reflect severe, but plausible downside scenarios taking into consideration the group's principal risks. The potential financial impact of a slower Covid-19 pandemic recovery has been modelled in the plausible downside scenarios. Even with these negative sensitivities, the group's cash position is still considered to remain strong, therefore it is not anticipated that the solvency or the liquidity of the company will deteriorate.

Climate Risk

Considering that the company forms part of the group's treasury operations, the probability of climate change related risks having a significant and direct impact on the activities and operation of the company is remote. The Directors believe that the risk mitigation actions taken in relation to climate risk by the group are appropriate measures in managing direct or indirect risks posed by climate change including the risk to the company of being able to access financing at competitive rates where borrowings could become sustainability linked. Based on the climate risk assessment performed by the group, the risk attached to the recoverability of intercompany balances is considered to be remote. Further information on the group's actions to combat climate change are disclosed on pages 50-55 of Diageo plc's 2021 Annual Report.

Statement on Section 172 of the Companies Act 2006

Section 172 of the Companies Act 2006 requires the Directors to promote the success of the company for the benefit of the members as a whole, having regard to the interests of stakeholders in their decision-making. In making decisions, the Directors consider what is most likely to promote the success of the company for its shareholders in the long term, as well as the interests of the group's stakeholders. The Directors understand the importance of taking into account the views of stakeholders and the impact of the company's activities on local communities, the environment, including climate change, and the group's reputation.

The company is a member of the group of companies (the "group") whose ultimate holding company is Diageo plc ("Diageo"). In accordance with the requirements of UK company law, Diageo has included in its 2021 Annual Report and Accounts on page 7 a statement as to how the Directors of Diageo have had regard to the matters set out in Section 172 of the Companies Act 2006. The company's principal activity is to raise external funds through debt capital markets in order to finance other companies in the group, and therefore in making their decisions, the Directors consider the interests of the holders of the company's listed debt securities as well as needs of the group.

In order to ensure consistency in how the group operates with regard to its wider stakeholders, the group has adopted an internal Code of Business Conduct alongside a comprehensive framework of global policies and standards that are designed to ensure, amongst other things, that all companies throughout the group, including the company, have regard to its wider stakeholders in a consistent manner.

The company has therefore had regard to the matters set out in Section 172 of the Act in a manner that is consistent with the approach adopted by Diageo, while at the same time ensuring the Directors of the company are fulfilling their duties.

STRATEGIC REPORT (continued)

Business review (continued)

Main activities of the Board

The activities of the Board during the year include:

- Approval of various agreements relating to intra-group funding;
- Approval of various transactions relating to an intra-group reorganisation including the assignment and settlement of various intra-group loans;
- Approval to issue listed debt instruments under the European debt issuance programme and approval of the updates to the listing prospectus and related documentation; and
- Approval of the financial statements for the year ended 30 June 2020.

On behalf of the Board

DocuSigned by:

BE6D9490FA5F4CA...

Cs Hajos
Director

Lakeside Drive
Park Royal
London
NW10 7HQ

9 December 2021

DIRECTORS' REPORT

The Directors have pleasure in submitting their Directors' report and the audited financial statements for the year ended 30 June 2021.

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

Going concern

The company's business activities, together with the factors likely to affect its future development and position, are set out in the business review section of the strategic report on pages 2 - 5. The company is expected to continue to generate profit for its own account and to remain in a positive net asset position for the foreseeable future. The company participates in the group's centralised treasury arrangements, profitable in both financial years presented and is in a strong net asset position. 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 a period of at least 12 months from the date the financial statements are approved and signed. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

In arriving at this conclusion, the Directors have also considered the potential impact that the Covid-19 outbreak may have on the company and believe that any impact would not be significant.

Financial performance

The results for the year ended 30 June 2021 are shown on page 15.

The profit for the year transferred to reserves is £24 million (2020 - £92 million).

No dividend was paid during the year (2020 - £nil) and there was no dividend proposed to be distributed to the shareholders in regards to the financial year (2020 - £nil).

Directors

The Directors of the company who were in office during the year and up to the date of signing the financial statements were:

M Pais
J M C Edmunds
K E Major
Cs Hajos
P Viswanathan (resigned 1 August 2020)
C M Lewin (appointed 1 August 2020 and resigned 30 September 2021)
I Thrustle (appointed 30 September 2021)

Directors' remuneration

None of the Directors received any remuneration during the year in respect of their services as Directors of the company (2020 - £nil). The Directors were paid by fellow group undertakings, and no cost was recharged to the company.

DIRECTORS' REPORT (continued)

Secretary

The secretary of the company who was in office during the year and up to the date of signing the financial statements was:

J M C Edmunds

Internal control and risk management over financial reporting

The company operates under the financial reporting processes and controls of the group. Diageo plc's internal control and risk management systems over the financial reporting process, which include those of the company, are discussed in the group's Annual Report 2021 on page 97 at www.diageo.com, which does not form part of this report.

Independent 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.

On behalf of the Board

DocuSigned by:
BE6D9490FA5F4CA...

Cs Hajos
Director

Lakeside Drive
Park Royal
London
NW10 7HQ

9 December 2021

Statement of Directors' responsibilities

The Directors are responsible for preparing the annual 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 the Directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 'Reduced Disclosure Framework', and applicable law). 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; and
- make judgements and accounting estimates that are reasonable and prudent; and
- state whether applicable United Kingdom Accounting Standards, comprising FRS 101, 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 safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are also 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.

Directors' confirmations

Each of the directors, whose names and functions are listed in Directors' report confirm that, to the best of their knowledge:

- the company financial statements, which have been prepared in accordance with United Kingdom Accounting Standards, comprising FRS 101, give a true and fair view of the assets, liabilities, financial position and profit of the company; and
- the Strategic report includes a fair review of the development and performance of the business and the position of the company, together with a description of the principal risks and uncertainties that it faces.

Independent auditors' report to the members of Diageo Finance plc

Report on the audit of the financial statements

Opinion

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

- give a true and fair view of the state of the Company's affairs as at 30 June 2021 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 Annual Report, which comprise: the Balance Sheet as at 30 June 2021; the Income Statement and 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.

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.

We have provided no non-audit services to the Company in the period under audit.

Our audit approach

Overview

Audit scope

- We conducted a full scope audit of the financial statements of Diageo Finance plc.
- We focused on the most significant areas, being hedging activity and the related assessment of hedge effectiveness and the valuation of derivative transactions.

Key audit matters

- Hedge effectiveness and valuation of certain derivative financial instruments

Materiality

- Overall materiality: £302,000,000 (2020: £326,000,000) based on approximately 1% of total assets.
- Performance materiality: £226,000,000.

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.

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.

We have combined our considerations around hedge effectiveness and the valuation of derivatives (presented separately in last year's audit report).

Impact of Covid-19, which was a key audit matter last year, is no longer included because of the evolution of the pandemic. Over the past financial year the Company has not suffered any significant impact from the pandemic and the inherent level of risk is considered to be low.

Key audit matter	How our audit addressed the key audit matter
Hedge effectiveness and valuation of certain derivative financial instruments Refer to Note 1 (Accounting policies) and Note 9 (Financial instruments and risk management) to the financial statements. The Company is exposed to treasury risk and is responsible for cash management for Diageo plc (the "Group"). As a part of its risk management activities, the Company trades in derivative transactions to hedge the 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 can be subject to management judgement, while the valuation of hedging instruments includes estimates associated with data inputs. The nature of the hedging relationships is typically straightforward and non-complex, and the methods applied to valuing derivatives are typically non-judgmental and can be independently validated. We include hedge effectiveness and valuation of certain derivatives as a focus area given the underlying audit work requires a high level of audit effort, and forms a large proportion of our overall audit work of the Company.	Our audit procedures included understanding and evaluating the controls and systems related to hedge accounting and determining the fair value of hedging instruments. We obtained audit evidence through testing the operating effectiveness of management's relevant controls, together with substantive audit procedures. Testing of management's controls and other substantive tests with respect to hedge accounting included obtaining evidence to support whether: • pre-conditions of hedge accounting had been met; • hedge designation documentation was appropriate; • a prospective hedge effectiveness assessment had been performed; • deal tickets and contracts had been properly authorised;

	• hedge accounting was accurately reflected in the ledger and all relevant transactions were included. On a sample basis, we also performed independent recalculations of qualitative hedge effectiveness tests. Our testing procedures with respect to the valuation of derivative instruments included: • obtaining independent valuations from our specialists who tested the accuracy and valuation of derivatives using independent data feeds; • circularising counterparties to confirm the existence and completeness of derivatives; • assessing the counterparty and Company's own credit risk incorporated into the fair value of derivatives, particularly in light of the impact of Covid-19 on the broader economy and credit risk. We also evaluated whether the derivative transactions and hedge relationships were appropriately disclosed in the financial statements. Based on all of the above procedures, we consider the Company's accounting and disclosure with respect to hedge relationships and valuation of derivatives to be appropriate.

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.

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements.

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:

Overall company materiality	£302,000,000 (2020: £326,000,000).
How we determined it	approximately 1% of total assets
Rationale for benchmark applied	We consider the 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 enters into derivatives to hedge the group's financial risks.

We use performance materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality. Specifically, we use performance materiality in determining the scope of our audit and the nature and extent of our testing of account balances, classes of transactions and disclosures, for example in determining sample sizes. Our performance materiality was 75% of overall materiality, amounting to £226,000,000 for the Company financial statements.

In determining the performance materiality, we considered a number of factors - the history of misstatements, risk assessment and aggregation risk and the effectiveness of controls - and concluded that an amount at the upper end of our normal range was appropriate.

We agreed with the directors that we would report to them misstatements identified during our audit above £15,000,000 (2020: £16,000,000) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

Our evaluation of the directors' assessment of the Company's ability to continue to adopt the going concern basis of accounting included:

- Understanding and assessing the appropriateness of the key assumptions used in the going concern assessment;
- Corroborating key assumptions to underlying documentation and ensured this was consistent with our audit work; and
- Reviewing the disclosures provided relating to the going concern basis of preparation.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

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

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

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 and Directors' report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on our work undertaken in the course of the audit, the Companies Act 2006 requires 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 2021 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, 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.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the Company and industry, we identified that the principal risks of non-compliance with laws and regulations related to the United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework" and applicable law), and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the financial statements such as the Companies Act 2006. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate manual journal entries to manipulate results and management bias in accounting estimates. Audit procedures performed by the engagement team included:

- Discussion with management and internal audit, including consideration of known and suspected instances of non compliance with laws and regulation and fraud;
- Enquiry of those charged with governance and the Diageo Group's in-house legal team around actual and potential litigations and claims;
- Identifying and testing journal entries, in particular any journal entries posted with unusual account combinations or posted by senior management;
- Reading the minutes of Board meetings;
- Reviewing financial statements disclosures to supporting documentation to assess compliance with applicable laws and regulations; and
- Challenging management's significant judgements and estimates in particular those related to hedge effectiveness and valuation of derivatives.

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the financial statements. Also, 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.

Our audit testing might include testing complete populations of certain transactions and balances, possibly using data auditing techniques. However, it typically involves selecting a limited number of items for testing, rather than testing complete populations. We will often seek to target particular items for testing based on their size or risk characteristics. In other cases, we will use audit sampling to enable us to draw a conclusion about the population from which the sample is selected.

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. 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.

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 obtained 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.

Appointment

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 6 years, covering the years ended 30 June 2016 to 30 June 2021.

Catherine Schroeder (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
9 December 2021

Diageo Finance plc
Registered number: 00213393
Year ended 30 June 2021

INCOME STATEMENT

	Notes	Year ended 30 June 2021 £ million	Year ended 30 June 2020 £ million
Other operating income/(expense)	2	**5**	(51)
Finance income	4	**824**	1,012
Finance charges	4	**(804)**	(868)
Operating profit		**25**	93
Profit before taxation on ordinary activities		**25**	93
Taxation on profit on ordinary activities	5	**(1)**	(1)
Profit for the financial year		**24**	92

The accompanying notes are an integral part of these financial statements.There was no other comprehensive income or expense in the year ended 30 June 2021 and 30 June 2020.

Diageo Finance plc
Registered number: 00213393
Year ended 30 June 2021

BALANCE SHEET

	Notes	**30 June 2021 £ million**	**30 June 2020 £ million**
Non-current assets			
Trade and other receivables	*7*	598	342
Other financial assets	*6*	426	714
		1,024	1,056
Current assets			
Trade and other receivables	*7*	27,205	28,822
Other financial assets	*6*	132	152
Cash and cash equivalents		1,844	2,615
		29,181	31,589
Total assets		**30,205**	32,645
Current liabilities			
Other financial liabilities	*6*	(113)	(134)
Borrowings	*8*	(908)	(997)
Trade and other payables	*10*	(18,035)	(19,360)
		(19,056)	(20,491)
Non-current liabilities			
Other financial liabilities	*6*	(397)	(653)
Borrowings	*8*	(5,726)	(6,499)
		(6,123)	(7,152)
Total liabilities		**(25,179)**	(27,643)
Net assets		**5,026**	5,002
Equity			
Called up share capital	*11*	3,660	3,660
Retained earnings		1,366	1,342
Total equity		**5,026**	5,002

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

These financial statements on pages 15 to 38 were approved by the Board of Directors on 9 December 2021 and were signed on its behalf by:

DocuSigned by:

BE6D9490FA5F4CA...

Cs Hajos
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 2019	3,660	1,250	4,910
Profit for the financial year	—	92	92
Balance at 30 June 2020	**3,660**	**1,342**	**5,002**
Profit for the financial year	—	24	24
Balance at 30 June 2021	**3,660**	**1,366**	**5,026**

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). These financial statements have been prepared in accordance with the requirements of the 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. Details of going concern considerations are in the Directors' report.

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;

These financial statements are separate financial statements.

New accounting standards and interpretations

The following amendments to the accounting standards, issued by the IASB which have been endorsed by the EU, have been adopted by the group and therefore by the company from 1 July 2020 with no impact on the company's results, financial position or disclosures:

- Amendments to References to the Conceptual Framework in IFRS Standards;
- Amendments to IFRS 3 – Definition of a Business;
- Amendments to IAS 1 and IAS 8 – Definition of Material;
- Amendments to IFRS 16 – Covid-19 - Related Rent Concessions.

The following amendments and standards issued by the IASB which have been endorsed by the EU, have been adopted by the group:

- Amendments to IFRS 9, IAS 39 and IFRS 7 – Interest rate benchmark reform (phase 1). The amendment provides temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by interbank offered rate (IBOR) reform. The reliefs have the effect that IBOR reform should not generally cause hedge accounting to terminate. The expectations are that the cash flows in relation to hedging relationships will not be altered by the reform and the derivative instruments used in hedge accounting will still provide a close approximation to the extent of the managed risk exposures.

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 unless otherwise stated.

Finance income and charges

Finance income and charges are recognised in the income statement in the year in which they are earned/ incurred and finance charges 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 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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

1. ACCOUNTING POLICIES (continued)

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 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 and other 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.

Derivative financial instruments

Derivative financial instruments are carried at fair value using a discounted cash flow model 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 testing. Methods used for testing effectiveness include dollar offset, critical terms and regression analysis method.

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 or 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 2021 are included in profit before taxation.

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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

1. ACCOUNTING POLICIES (continued)

Judgements in applying accounting policies and key sources of estimation uncertainty

The Directors make estimates and judgements concerning the future of the company. The resulting accounting estimates will, by definition, seldom equate to actual results.

The accounting policy, which the Directors consider is of greater complexity and particularly subject to estimation uncertainty, is that described above relating to derivative financial instruments. Judgment is applied when selecting inputs that derive fair value estimates of derivative assets and liabilities. The derivative instruments are plain vanilla instruments, fair valued using observable inputs and straightforward valuation techniques, therefore extent of the judgements and related estimation uncertainty is limited (see detailed description under note 9. Financial instruments and risk management (g) Fair value measurements).

NOTES TO THE FINANCIAL STATEMENTS (continued)

2. OTHER OPERATING INCOME/(EXPENSE)

	Year ended 30 June 2021 £ million	Year ended 30 June 2020 £ million
Net foreign exchange gain/(loss)	24	(18)
Margin on transaction hedging	7	7
Market value gain on foreign exchange derivatives	—	1
Other expense	(26)	(41)
	5	(51)

Net foreign exchange gain for the year ended 30 June 2021 was primarily driven by favourable exchange differences on Turkish Lira denominated foreign exchange swaps compared to the year ended 30 June 2020.
Based on management's assessment of expected credit losses, the company recognised an impairment provision of £27 million (2020 - £39 million) in respect of an intercompany loan receivable related to an Ethiopian entity in the year ended 30 June 2021 as these amounts are expected to be not recoverable.
The auditors' remuneration of £19,719 (2020 - £19,813) was paid on behalf of the company by a fellow group undertaking. There were no fees payable to the auditors in respect of non-audit services (2020 - £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 (2020 - £nil).

NOTES TO THE FINANCIAL STATEMENTS (continued)

4. FINANCE INCOME AND CHARGES

	Year ended 30 June 2021 £ million	**Year ended 30 June 2020 £ million**
Interest income from fellow group undertakings	329	541
Other interest income	117	208
Fair value differential on foreign exchange contracts	—	2
Fair value gain on intra-group derivative interest rate instruments	229	14
Fair value gain on external derivative interest rate instruments	7	101
Fair value gain on external cross currency interest rate swaps	123	146
Fair value adjustment to bonds in hedge relationship	19	—
Total finance income	**824**	1,012
Interest charge on bank loans and overdrafts	(19)	(35)
Interest charge to fellow group undertakings	(262)	(421)
Interest charge on all other borrowings	(143)	(136)
Fair value differential on foreign exchange contracts	(4)	(14)
Fair value loss on intra-group derivative interest rate instruments	(118)	(89)
Fair value loss on external derivative interest rate instruments	(135)	(20)
Fair value loss on intra-group cross currency interest rate swaps	(123)	(146)
Fair value adjustment to bonds in hedge relationship	—	(7)
Total finance charges	**(804)**	(868)
Net finance income	**20**	144

Other interest income includes Realised interest income on matured FX swaps and forwards of £43 million (2020 - £132 million), Interest income on interest rate swaps and cross currency swaps of £69 million (2020 – £59 million), and Interest income on bank accounts and Liquidity funds of £5 million (2020 – £17 million).
Interest charge on all other borrowings include Bond interest expenses of £95 million (2020 – £63 million), Realised interest expense on matured FX swaps and forwards of £34 million (2020 – £57 million), Interest expense on interest rate swaps of £6 million (2020 – £8 million) and Other items of £8 million (2020 – £8 million).

NOTES TO THE FINANCIAL STATEMENTS (continued)

5. TAXATION

(i) Analysis of taxation charge for the year	**Year ended 30 June 2021 £ million**	**Year ended 30 June 2020 £ million**
Current tax		
Adjustment in respect of prior years	—	1
Overseas tax	(1)	(2)
Total current tax	**(1)**	(1)
Taxation on profit on ordinary activities	**(1)**	(1)

(ii) Factors affecting total tax charge for the year	**Year ended 30 June 2021 £ million**	**Year ended 30 June 2020 £ million**
Profit on ordinary activities before taxation	**25**	93
Taxation on profit on ordinary activities at UK corporation tax rate of 19% (2020 - 19%)	(5)	(18)
Adjustments in respect of prior periods	—	1
Other tax effects for reconciliation between accounting profit and tax income	(6)	(6)
Expenses not deductible	(5)	(7)
Overseas tax	(1)	(2)
Effects of group relief	16	31
Total tax charge for the year	**(1)**	(1)

The UK corporation tax rate for the year ended 30 June 2021 is 19% which has been effective since 1 April 2017. In the Spring Budget 2021, the UK Government announced an increase in the corporation tax rate to 25% which will apply from 1 April 2023. The legislation increasing the tax rate to 25% rate was substantively enacted on 24 May 2021.

NOTES TO THE FINANCIAL STATEMENTS (continued)

6. OTHER FINANCIAL ASSETS AND LIABILITIES

2021	Assets due after one year £ million	Assets due within one year £ million	Liabilities due within one year £ million	Liabilities due after one year £ million
External derivative assets/(liabilities)				
Not designated in hedge relationship				
Foreign exchange contracts - transaction	4	69	(7)	(3)
Foreign exchange contracts – commodity	2	14	—	—
Foreign exchange contracts – other	—	34	(19)	—
Interest rate derivatives	84	3	—	(49)
Cross currency interest rate swaps	205	—	—	(51)
Designated in fair value hedge				
Interest rate derivatives	27	1	—	—
	322	**121**	**(26)**	**(103)**
Intra-group derivative assets/(liabilities)				
Not designated in hedge relationship				
Foreign exchange contracts - transaction	4	11	(70)	(3)
Foreign exchange contracts – commodity	—	—	(14)	(2)
Interest rate derivatives	49	—	(3)	(84)
Cross currency interest rate swaps	51	—	—	(205)
	104	**11**	**(87)**	**(294)**
Total derivative assets/(liabilities)	**426**	**132**	**(113)**	**(397)**

The company entered into external cross currency interest rate swaps on behalf of a fellow group undertaking, Diageo Capital plc, the market value of which amounted to £154 million at the balance sheet date (2020 - £469 million). The external deals are mirrored through Diageo plc to Diageo Capital plc, the ultimate beneficiary. The market value of intra-group cross currency interest rate swaps amounts to a net liability of £154 million (2020 - £469 million).

The company entered into interest rate swaps to hedge the fair value of bonds. The fair value of the interest rate swaps designated in fair value hedge relationships was £28 million (2020 - £46 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)

2020	**Assets due after one year £ million**	**Assets due within one year £ million**	**Liabilities due within one year £ million**	**Liabilities due after one year £ million**
External derivative assets/(liabilities)				
Not designated in hedge relationship				
Foreign exchange contracts - transaction	6	3	(64)	(14)
Foreign exchange contracts – commodity	1	—	(9)	(1)
Foreign exchange contracts - other	—	71	(43)	—
Interest rate derivatives	162	—	(14)	—
Cross currency interest rate swaps	469	—	—	—
Designated in fair value hedge				
Interest rate derivatives	46	—	—	—
	684	74	(130)	(15)
Intra-group derivative assets/(liabilities)				
Not designated in hedge relationship				
Foreign exchange contracts - transaction	15	69	(4)	(6)
Foreign exchange contracts – commodity	1	9	—	(1)
Foreign exchange contracts - other	—	—	—	—
Interest rate derivatives	14	—	—	(162)
Cross currency interest rate swaps	—	—	—	(469)
	30	78	(4)	(638)
Total derivative assets/(liabilities)	714	152	(134)	(653)

NOTES TO THE FINANCIAL STATEMENTS (continued)

7. TRADE AND OTHER RECEIVABLES

	30 June 2021		30 June 2020	
	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	27,185	598	28,797	342
Interest receivable	20	—	21	—
Accruals and deferred expense	—	—	4	—
	27,205	**598**	28,822	342

Amounts owed by fellow group undertakings include accrued and capitalised interest on the underlying balances at 30 June 2021 and at 30 June 2020. These balances bear interest at fixed and variable rates from (0.87%) to 14.11% for the year ended 30 June 2021 (2020 – from (0.88%) to 24.41%).

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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

8. BORROWINGS

	30 June 2021 £ million	30 June 2020 £ million
Bank overdrafts	40	105
Credit support obligations	98	180
€ 775 million 0% bonds due 2020	—	711
€ 900 million 0.25% bonds due 2021	769	—
Fair value adjustment to borrowings	1	1
Borrowings due within one year and bank overdrafts	**908**	997
€ 900 million 0.25% bonds due 2021	—	825
€ 600 million 0.125% bonds due 2023	511	548
€ 500 million 1.75% bonds due 2024	426	456
€ 500 million 0.5% bonds due 2024	425	456
€ 600 million 1% bonds due 2025	510	546
€ 850 million 2.375% bonds due 2026	723	776
£ 500 million 1.75% bonds due 2026	497	496
€ 750 million 1.875% bonds due 2027	637	683
€ 500 million 1.5% bonds due 2027	426	457
£ 300 million 2.875% bonds due 2029	298	298
€ 1000 million 2.5% bonds due 2032	850	911
£ 400 million 1.250% bonds due 2033	395	—
Fair value adjustment to borrowings	28	47
Borrowings due after one year	**5,726**	6,499
Total external borrowings	**6,634**	7,496

The interest rates of external borrowings shown in the table above are those contracted on the underlying borrowings before taking into account any interest rate protection. Bonds are stated net of unamortised finance costs of £32 million (2020 - £36 million). These fair value adjustments are determined using discounted cash flow method based on observable market input (Level 2). 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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. 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 2021 and 30 June 2020 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.

The finance committee receives monthly reports on the key 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 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 swaps. 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, for the year ended 30 June 2021 the group's policy was to maintain fixed rate borrowings within a band of 40% to 60% of forecast net borrowings.

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(b) Interest rate risk (continued)

In July 2020, the Board approved to temporarily amend the approved 40% - 60% fixed debt band to 40% - 80% and subsequently in December 2020, the Board approved to temporarily increase the band range to 40% - 90% for a period of 3 years until 31 December 2023. For these calculations, net borrowings exclude interest rate related fair value adjustments.

Beside the interest rate swaps traded on behalf of fellow group undertakings, the majority of the company's existing interest rate derivatives are designated as hedges and are expected to be effective. 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.

IBOR reform

In accordance with the UK Financial Conduct Authority's announcement on 5 March 2021, LIBOR benchmark rates will be discontinued after 31 December 2021 with the exception of the majority of US dollar settings which will be discontinued after 30 June 2023. There will be amendments to the contractual terms of IBOR-referenced interest rates and a corresponding update of the hedge designations. The changed reference rate may also affect other systems, processes, risks and fair valuation of financial instruments, however the company does not expect material tax and accounting implications. The company has interest rate swaps designated in fair value hedges, with a notional amount of £2,700 million (2020: £3,200 million) whose interest rates are based on EUR LIBOR.

(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).

(d) Market risk sensitivity analysis

The company uses a sensitivity analysis that estimates the impacts on the income statement 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 2021 and 30 June 2020, 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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(d) Market risk sensitivity analysis (continued)

	0.5 % decrease in interest rates £ million	0.5 % increase in interest rates £ million	10 % weakening of sterling £ million	10 % strengthening of sterling £ million
30 June 2021				
Impact on income statement - (loss)/gain	**(44)**	**44**	**9**	**(7)**
30 June 2020				
Impact on income statement - (loss)/gain	(40)	40	(3)	3

(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, trade and other receivables, loans, financial guarantees and committed transactions. 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. A financial asset is in default when the counterparty fails to pay its contractual obligations. Financial assets are written-off when there is no reasonable expectation of recovery. 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. The credit risk impact of Covid-19 pandemic has been assessed and considering the activity of the company the assessment and mitigation actions taken on group level are effective measures to ensure adequate level of liquidity.

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(e) Credit risk (continued)

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 2021, the collateral held under these agreements amounted to $136 million (£98 million) (2020 - $221 million (£180 million)).

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. 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 2021 and 30 June 2020. 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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(f) Liquidity risk (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
2021						
Bonds*	(907)	(940)	(1,666)	(3,123)	(6,636)	(6,634)
Interest on other payables	(2)	—	—	—	(2)	(2)
Interest on bonds	(97)	(190)	(171)	(218)	(676)	(33)
Trade and other financial liabilities	(18,000)	—	—	—	(18,000)	(18,000)
Non-derivative financial liabilities	**(19,006)**	**(1,130)**	**(1,837)**	**(3,341)**	**(25,314)**	**(24,669)**
Cross currency swaps (gross)						
- Receivable	239	1,591	134	2,281	4,245	—
- Payable	(239)	(1,591)	(134)	(2,281)	(4,245)	—
Other derivative instruments	99	8	5	—	112	—
Derivative instruments	**99**	**8**	**5**	**—**	**112**	**48**
2020						
Bonds	(711)	(826)	(2,018)	(3,644)	(7,199)	(7,496)
Interest on other payables	(6)	—	—	—	(6)	(6)
Interest on bonds	(97)	(192)	(187)	(278)	(754)	(34)
Trade and other financial liabilities	(19,320)	—	—	—	(19,320)	(19,320)
Non-derivative financial liabilities	(20,134)	(1,018)	(2,205)	(3,922)	(27,279)	(26,856)
Cross currency swaps (gross)						
- Receivable	106	1,726	145	2,522	4,499	—
- Payable	(106)	(1,726)	(145)	(2,522)	(4,499)	—
Other derivative instruments	40	19	15	5	79	—
Derivative instruments	40	19	15	5	79	79

^ *Difference between total contractual cash flow amount and carrying amount at balance sheet date is due to the unamortized discount and fee balances and fair value adjustments of bonds in fair value hedge relationships.*
* *In the year ended 30 June 2021 contractual cash flows from bonds within 1 year represent cash outflows of borrowings due within one year and bank overdrafts.*

On 30 June 2021 the group had available undrawn committed bank facilities of £2,518 million (2020 - £5,285).

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

The facilities can be used for general corporate purposes and, together with cash and cash equivalents, support the group's commercial paper programmes.

(f) Liquidity risk (continued)

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 the group's financing arrangements could, if not waived, constitute an event of default with respect to any such arrangements, and any non-compliance with covenants may, in particular circumstances, lead to an acceleration of maturity on certain borrowings and the inability to access committed facilities. The group 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.

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

	30 June 2021	30 June 2020
	£ million	£ million
Derivative assets	558	866
Derivative liabilities	(510)	(787)
Valuation techniques based on observable market input (Level 2)	**48**	79

There were no transfers between levels during the two years ended 30 June 2021 and 30 June 2020.

(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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(h) Results of hedging instruments (continued)

The notional amounts, contractual maturities and rates of the hedging instruments designated in hedging relationship as of 30 June 2021 by the main risk categories are as follows:

	Notional amounts £ million	Maturity	Range of hedged rates
2021			
Fair value hedges			
Derivatives in fair value hedge (interest rate risk)	**2,308**	**October 2021 – March 2027**	**(0.08) - 1.88%**
2020			
Fair value hedges			
Derivatives in fair value hedge (interest rate risk)	2,936	November 2020 – March 2027	(0.01) - 1.88%

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 2021, 2023, 2025 and 2027. 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 £18 million (2020 - £7 million gain).

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. 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.

2021	Fair value through income statement £ million	Asset and liabilities at amortised cost £ million	Total £ million	Current £ million	Non-current £ million
Trade and other receivables	—	27,803	27,803	27,205	598
Cash and cash equivalents	—	1,844	1,844	1,844	—
External derivatives at fair value	443	—	443	121	322
Intra-group derivatives at fair value	115	—	115	11	104
Total financial assets	**558**	**29,647**	**30,205**	**29,181**	**1,024**
Borrowings	—	(6,634)	(6,634)	(908)	(5,726)
Trade and other payables	—	(18,035)	(18,035)	(18,035)	—
External derivatives at fair value	(129)	—	(129)	(26)	(103)
Intra-group derivatives at fair value	(381)	—	(381)	(87)	(294)
Total financial liabilities	**(510)**	**(24,669)**	**(25,179)**	**(19,056)**	**(6,123)**
Total net financial assets/(liabilities)	**48**	**4,978**	**5,026**	**10,125**	**(5,099)**

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(i) Reconciliation of financial instruments (continued)

2020	Fair value through income statement £ million	Asset and liabilities at amortised cost £ million	Total £ million	Current £ million	Non-current £ million
Trade and other receivables	—	29,164	29,164	28,822	342
Cash and cash equivalents	—	2,615	2,615	2,615	—
External derivatives at fair value	758	—	758	74	684
Intra-group derivatives at fair value	108	—	108	78	30
Total financial assets	866	31,779	32,645	31,589	1,056
Borrowings	—	(7,496)	(7,496)	(997)	(6,499)
Trade and other payables	—	(19,360)	(19,360)	(19,360)	—
External derivatives at fair value	(145)	—	(145)	(130)	(15)
Intra-group derivatives at fair value	(642)	—	(642)	(4)	(638)
Total financial liabilities	(787)	(26,856)	(27,643)	(20,491)	(7,152)
Total net financial assets/(liabilities)	79	4,923	5,002	11,098	(6,096)

At 30 June 2021 and 30 June 2020, the carrying values of cash and cash equivalents, other financial assets and liabilities approximate to fair values. At 30 June 2021, the fair value of borrowings, based on unadjusted quoted market data (Level 1 sources as categorised by IFRS 13), was £7,085 million (2020 - £7,982 million).

(j) 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. The group 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)

10. TRADE AND OTHER PAYABLES

	30 June 2021 £ million	30 June 2020 £ million
Amounts owed to fellow group undertakings	18,000	19,320
Interest payable	35	40
	18,035	19,360

Amounts owed to fellow group undertakings include accrued and capitalised interest on the underlying balances at 30 June 2021 and at 30 June 2020. These balances are repayable on demand and bear interest at fixed and variable rates from (0.01)% to 19.95% for the year ended 30 June 2021 (2020 - from 0.12% to 7.85%).

Amounts owed to 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. Amounts owed to group undertakings are considered to have a fair value which is not materially different to the book value.

11. CALLED UP SHARE CAPITAL

	30 June 2021 £ million	30 June 2020 £ million
Allotted, called up and fully paid:		
73,200,000,000 (2020 - 73,200,000,000) ordinary shares of 5p each	**3,660**	3,660

12. 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. The ultimate parent undertaking and the smallest and largest group to consolidate these financial statements is Diageo plc. Diageo plc is incorporated and registered in England, United Kingdom. The consolidated financial statements of Diageo plc can be obtained from the registered office at Diageo, Lakeside Drive, Park Royal, London, NW10 7HQ, United Kingdom.

13. EVENTS AFTER REPORTING DATE

The company repaid €900 million bond on 22 September 2021 classified as borrowings due within one year at reporting date.