Based on the assets and liabilities held at the year-end, if the specified currencies were to strengthen 10% while all other market rates remained constant, the change in the fair value of financial instruments not designated as net investment hedges would have the following effect:

| | **Impact on profit for the year FY2023 £m** | **Gain/(loss) recognised in reserves FY2023 £m** | Impact on profit for the year FY2022 £m | Gain/(loss) recognised in reserves FY2022 £m |
|---|---|---|---|---|
| US dollar | – | 1 | (3) | 1 |
| Euro | 1 | – | 8 | (1) |
| Sterling | – | (1) | 4 | – |

These sensitivities were calculated before adjusting for tax and exclude the effect of quasi-equity intra-Group loans.

## Cash-flow hedging

The Group uses forward foreign exchange contracts to hedge future foreign currency sales and purchases. At 31 July 2023, contracts with a nominal value of £123m (FY2022: £141m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £252m (FY2022: £226m) which were being used to manage transactional foreign exchange exposures, but were not accounted for as cash-flow hedges. The fair value of the contracts is disclosed in note 20.

The majority of hedged transactions will be recognised in the consolidated income statement in the same period that the cash-flows are expected to occur, with the only differences arising because of normal commercial credit terms on sales and purchases. It is the Group's policy to hedge 80% of certain exposures for the next two years and 50% of highly probable exposures for the next 12 months.

Hedge effectiveness is determined at the inception of the hedge relationship, and through periodic prospective effectiveness assessments to ensure that an economic relationship exists between the hedged item and hedging instrument. The foreign exchange forward contracts have similar critical terms to the hedged items, such as the notional amounts and maturities. Therefore, there is an economic relationship and the hedge ratio is established as 1:1.

The main sources of hedge ineffectiveness in these hedging relationships are the effect of the Group's and the counterparty credit risks on the fair value of the foreign exchange forward contracts, which is not reflected in the fair value of the hedged item and the risk of over-hedging where the hedge relationship requires re-balancing. No other sources of ineffectiveness emerged from these hedging relationships. Any hedge ineffectiveness is recognised immediately in the income statement in the period that it occurs. Of the foreign exchange contracts designated as hedging instruments, 98% are for periods of 12 months or less (FY2022: 98%).

The following table presents a reconciliation by risk category of the cash-flow hedge reserve and analysis of other comprehensive income in relation to hedge accounting:

| | | **Year ended 31 July 2023 £m** | Year ended 31 July 2022 £m |
|---|---|---|---|
| Brought forward cash-flow hedge reserve at start of year | | (3) | 2 |
| Foreign exchange forward contracts: | Net fair value gains on effective hedges | 1 | (6) |
| | Amount reclassified to income statement – finance costs | 2 | 1 |
| **Carried forward cash-flow hedge reserve at end of year** | | **–** | **(3)** |

The following tables set out information regarding the change in value of the hedged item used in calculating hedge ineffectiveness as well as the impacts on the cash-flow hedge reserve:

| Hedged item | Hedged exposure | Hedging instrument | Financial year | **Changes in value of the hedged item for calculating ineffectiveness £m** | **Changes in value of the hedging instrument for calculating ineffectiveness £m** | **Cash-flow hedge reserve £m** |
|---|---|---|---|---|---|---|
| Sales and purchases | Foreign currency risk | Foreign exchange contracts | FY2023 | 1 | (1) | 1 |
| | | | FY2022 | (6) | 6 | (6) |

Cash-flow hedges generated £nil of ineffectiveness in FY2023 (FY2022: £nil) which was recognised in the income statement through finance costs.

## Translational currency exposure

The Group has significant investments in overseas operations, particularly in the US and Europe. As a result, the sterling value of the Group's balance sheet can be significantly affected by movements in exchange rates. The Group seeks to mitigate the effect of these translational currency exposures by matching the net investment in overseas operations with borrowings denominated in their functional currencies, except where significant adverse interest differentials or other factors would render the cost of such hedging activity uneconomic. This is achieved by borrowing primarily in the relevant currency or in some cases indirectly using cross-currency swaps.

## Net investment hedges

The table below sets out the currency of loans and swap contracts designated as net investment hedges:

| | **At 31 July 2023** | | | At 31 July 2022 | | |
|---|---|---|---|---|---|---|
| | **US$ £m** | **Euro £m** | **Total £m** | US$ £m | Euro £m | Total £m |
| Loans designated as net investment hedges | – | (293) | (293) | – | (451) | (451) |
| Cross-currency swap | (247) | – | (247) | (615) | – | (615) |
| | **(247)** | **(293)** | **(540)** | **(615)** | **(451)** | **(1,066)** |