Good Together

from one generation to the next

Financial Statements

For the year ended 31 July 2022
Fonterra Co-operative Group Limited

Pūrongo pūtea
Te Mātāpuna

Fonterra
Dairy for life

Contents

IMAGE:
Henry & Andrew, Canterbury

OUR 2022 SUITE OF REPORTS

Annual Review 2022
(Referenced as **AR**)

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Farmgate Milk Price Statement 2022
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Income Statement

FOR THE YEAR ENDED 31 JULY 2022

		GROUP $ MILLION	
	NOTES	31 JULY 2022	31 JULY 2021[1]
Continuing operations			
Revenue from sale of goods	3	22,953	20,565
Cost of goods sold	4	(19,737)	(17,581)
Gross profit		3,216	2,984
Other operating income		141	129
Selling and marketing expenses		(581)	(574)
Distribution expenses		(516)	(476)
Administrative expenses		(831)	(816)
Other operating expenses		(415)	(365)
Share of profit of equity accounted investees		10	5
Profit before net finance costs and tax from continuing operations	6	1,024	887
Finance income		14	9
Finance costs		(208)	(261)
Net finance costs	10	(194)	(252)
Profit before tax from continuing operations		830	635
Tax expense	21	(169)	(103)
Profit after tax from continuing operations		661	532
Discontinued operations			
(Loss)/profit after tax from discontinued operations	2	(78)	67
Profit after tax		583	599

		GROUP $ MILLION	
	NOTES	31 JULY 2022	31 JULY 2021[1]
Profit after tax is attributable to:			
Profit attributable to equity holders of the Co-operative		584	578
(Loss)/profit attributable to non-controlling interests		(1)	21
Profit after tax		583	599
Earnings per share:			
Basic and diluted earnings per share from continuing operations	5	0.38	0.31
Basic and diluted (loss)/earnings per share from discontinued operations	5	(0.02)	0.05
Basic and diluted earnings per share	5	0.36	0.36

1 Comparative information includes re-presentations for consistency with the current period. Re-presentations have had no impact on the totals or sub-totals presented in the Income Statement.

Statement of Comprehensive Income

FOR THE YEAR ENDED 31 JULY 2022

	GROUP $ MILLION	
	31 JULY 2022	31 JULY 2021
Profit after tax	**583**	599
Items that may be reclassified subsequently to the Income Statement:		
Cash flow hedges and other costs of hedging, net of tax	**(320)**	(127)
Net investment hedges and translation of foreign operations, net of tax	**103**	(112)
Foreign currency translation reserve gains transferred to the Income Statement	**(1)**	(14)
Other movements in reserves	**4**	(3)
Total items that may be reclassified subsequently to the Income Statement	**(214)**	(256)
Items that will not be reclassified subsequently to the Income Statement:		
Net fair value gains on investments in shares	**16**	5
Foreign currency translation losses attributable to non-controlling interests	**(8)**	–
Other movements in reserves	**16**	(2)
Total items that will not be reclassified subsequently to the Income Statement	**24**	3
Total other comprehensive expense	**(190)**	(253)
Total comprehensive income	**393**	346
Total comprehensive income is attributable to:		
Equity holders of the Co-operative	**394**	327
Non-controlling interests	**(1)**	19
Total comprehensive income	**393**	346
Total comprehensive income arises from:		
Continuing operations	**461**	297
Discontinued operations	**(68)**	49
Total comprehensive income	**393**	346

Statement of Financial Position

AS AT 31 JULY 2022

	NOTES	GROUP $ MILLION 31 JULY 2022	GROUP $ MILLION 31 JULY 2021[1]
ASSETS			
Current assets			
Cash and cash equivalents		288	985
Trade and other receivables	12	2,482	1,802
Inventories	13	5,007	3,766
Intangible assets	18	78	47
Tax receivable		64	31
Derivative financial instruments		230	249
Other current assets		107	95
Assets held for sale	2	473	462
Total current assets		**8,729**	7,437
Non-current assets			
Property, plant and equipment	16	6,067	5,979
Right-of-use assets	17	398	486
Equity accounted investments		113	91
Intangible assets	18	2,216	2,195
Deferred tax assets	21	551	460
Derivative financial instruments		434	437
Long-term advances		154	163
Other non-current assets		119	93
Total non-current assets		**10,052**	9,904
Total assets		**18,781**	17,341

The Board approved and authorised for issue these Financial Statements on 21 September 2022.

For and on behalf of the Board:

PETER MCBRIDE
Chairman

BRUCE HASSALL
Director

	NOTES	GROUP $ MILLION 31 JULY 2022	GROUP $ MILLION 31 JULY 2021[1]
LIABILITIES			
Current liabilities			
Bank overdraft		31	20
Borrowings	9	356	818
Trade and other payables	14	2,403	2,208
Owing to suppliers	15	2,119	1,825
Tax payable		107	87
Derivative financial instruments		733	84
Provisions	22	70	72
Other current liabilities		71	57
Liabilities held for sale	2	628	542
Total current liabilities		**6,518**	5,713
Non-current liabilities			
Borrowings	9	4,900	4,254
Derivative financial instruments		313	359
Provisions	22	79	82
Deferred tax liabilities	21	50	25
Other non-current liabilities		15	39
Total non-current liabilities		**5,357**	4,759
Total liabilities		**11,875**	10,472
Net assets		**6,906**	6,869
EQUITY			
Subscribed equity	7	5,891	5,892
Retained earnings		1,611	1,350
Foreign currency translation reserve	20	(253)	(355)
Hedge reserves	20	(346)	(26)
Other reserves		30	2
Total equity attributable to equity holders of the Co-operative		**6,933**	6,863
Non-controlling interests		(27)	6
Total equity		**6,906**	6,869

1 Comparative information includes re-presentations for consistency with the current period.

Statement of Changes in Equity

FOR THE YEAR ENDED 31 JULY 2022

	GROUP $ MILLION							
	ATTRIBUTABLE TO EQUITY HOLDERS OF THE CO-OPERATIVE							
	SUBSCRIBED EQUITY	RETAINED EARNINGS	FOREIGN CURRENCY TRANSLATION RESERVE	HEDGE RESERVES	OTHER RESERVES	TOTAL	NON-CONTROLLING INTERESTS	TOTAL EQUITY
As at 1 August 2021	**5,892**	**1,350**	**(355)**	**(26)**	**2**	**6,863**	**6**	**6,869**
Profit after tax	**–**	**584**	**–**	**–**	**–**	**584**	**(1)**	**583**
Other comprehensive income/(expense)	**–**	**–**	**102**	**(320)**	**28**	**(190)**	**–**	**(190)**
Total comprehensive income/(expense)	**–**	**584**	**102**	**(320)**	**28**	**394**	**(1)**	**393**
Transactions with equity holders in their capacity as equity holders:								
Dividends paid to equity holders of the Co-operative (refer to Note 8)	**–**	**(323)**	**–**	**–**	**–**	**(323)**	**–**	**(323)**
Share buyback (refer to Note 7)	**(1)**	**–**	**–**	**–**	**–**	**(1)**	**–**	**(1)**
Dividends paid to non-controlling interests	**–**	**–**	**–**	**–**	**–**	**–**	**(32)**	**(32)**
As at 31 July 2022	**5,891**	**1,611**	**(253)**	**(346)**	**30**	**6,933**	**(27)**	**6,906**
As at 1 August 2020	5,887	933	(229)	101	–	6,692	11	6,703
Profit after tax	–	578	–	–	–	578	21	599
Other comprehensive (expense)/income	–	–	(126)	(127)	2	(251)	(2)	(253)
Total comprehensive income/(expense)	–	578	(126)	(127)	2	327	19	346
Transactions with equity holders in their capacity as equity holders:								
Dividends paid to equity holders of the Co-operative (refer to Note 8)	–	(161)	–	–	–	(161)	–	(161)
Equity instruments issued (refer to Note 7)	5	–	–	–	–	5	–	5
Dividends paid to non-controlling interests	–	–	–	–	–	–	(24)	(24)
As at 31 July 2021	5,892	1,350	(355)	(26)	2	6,863	6	6,869

Cash Flow Statement

FOR THE YEAR ENDED 31 JULY 2022

The Cash Flow Statement presents total Group cash flows from continuing and discontinued operations.

	NOTES	GROUP $ MILLION 31 JULY 2022	31 JULY 2021
Cash flows from operating activities			
Profit before net finance costs and tax from continuing operations		1,024	887
(Loss)/profit before net finance costs and tax from discontinued operations		(48)	72
Total Group profit before net finance costs and tax		976	959
Adjustments for:			
– Depreciation and amortisation		635	642
– Foreign exchange losses/(gains)		309	(136)
– Gain on sale of Global Dairy Trade		(42)	–
– Gain on sale of Ying and Yutian China farms	2	–	(32)
– Gain on sale of investment in Falcon China Farms JV		–	(40)
– Loss on sale of investment in Beingmate		–	49
– China Farms impairment reversal	2	–	(23)
– Brazil consumer and foodservice business impairment	2	57	39
– Other		(7)	(9)
Total adjustments		952	490
(Increase)/decrease in working capital:			
– Trade and other receivables		(821)	11
– Inventories		(1,222)	(556)
– Trade and other payables		201	199
– Owing to suppliers		293	238
– Other movements		(49)	(63)
Total increase in working capital		(1,598)	(171)
Net cash flows from operations		330	1,278
Net taxes paid		(137)	(84)
Net cash flows from operating activities		193	1,194

	NOTES	GROUP $ MILLION 31 JULY 2022	31 JULY 2021
Cash flows from investing activities			
Cash was provided from:			
– Proceeds from sale of businesses		26	638
– Proceeds from disposal of property, plant and equipment		17	9
– Proceeds from sale of livestock		2	25
– Proceeds from sale of investments		–	110
Cash was applied to:			
– Acquisition of property, plant and equipment		(480)	(441)
– Acquisition of livestock (including rearing costs)		(4)	(28)
– Acquisition of intangible assets		(72)	(80)
– Other cash outflows		(6)	(10)
Net cash flows from investing activities		(517)	223
Cash flows from financing activities			
Cash was provided from:			
– Proceeds from borrowings		3,919	2,402
– Interest received		15	10
– Other cash inflows		–	27
Cash was applied to:			
– Interest paid		(297)	(308)
– Repayment of borrowings		(3,634)	(3,142)
– Dividends paid to equity holders of the Co-operative		(323)	(157)
– Dividends paid to non-controlling interests		(32)	(24)
– Share buyback		(1)	–
Net cash flows from financing activities		(353)	(1,192)
Net (decrease)/increase in cash		(677)	225
Opening cash		982	780
Effect of exchange rate changes		(24)	(23)
Closing cash		281	982
Reconciliation of closing cash to the Statement of Financial Position			
Cash and cash equivalents		288	985
Bank overdraft		(31)	(20)
Cash balances included in assets and liabilities held for sale	2	24	17
Closing cash		281	982

Basis of Preparation

FOR THE YEAR ENDED 31 JULY 2022

a) About Fonterra

Fonterra Co-operative Group Limited (Fonterra, the Company or the Co-operative) is a multinational dairy co-operative. Fonterra is primarily involved in the collection, manufacture and sale of milk and milk-derived products through its Ingredients, Consumer and Foodservice channels.

Fonterra is incorporated and domiciled in New Zealand. Fonterra is registered under the Companies Act 1993 and the Co-operative Companies Act 1996, and is an FMC Reporting Entity under the Financial Markets Conduct Act 2013. Fonterra is also required to comply with the Dairy Industry Restructuring Act 2001 (DIRA).

b) Basis of preparation

These Financial Statements comprise Fonterra and its subsidiaries (together referred to as the Group) and the Group's interests in its equity accounted investments.

These Financial Statements:

- comply with International Financial Reporting Standards (IFRS);
- comply with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS);
- have been prepared in accordance with Generally Accepted Accounting Practice applicable to for-profit entities;
- have been prepared on a historical cost basis except where otherwise stated. Assets and liabilities measured at fair value are summarised in Note 25 *Fair value measurement*; and
- are presented in New Zealand dollars ($ or NZD), which is Fonterra's functional currency, and rounded to the nearest million, except where otherwise stated.

Re-presentations

Income Statement

Certain comparative period information has been re-presented for consistency with the current year presentation. Re-presentations have had no impact on the totals or sub-totals presented in the Income Statement.

Balance Sheet

During the year the Group reassessed the current/non-current classification of emissions units held for compliance purposes. Emissions units held for compliance purposes expected to be surrendered within twelve months are classified as current intangible assets. Previously the Group presented all emissions units held for compliance purposes as non-current intangible assets. Comparative year information has been re-presented for consistency with the current year presentation.

c) Basis of consolidation

In preparing these Financial Statements, subsidiaries are consolidated from the date the Group gains control until the date on which control ceases. The Group's share of results of equity accounted investments are included in the Financial Statements from the date that significant influence or joint control commences, until the date that significant influence or joint control ceases. All intercompany transactions are eliminated.

Translation of the Financial Statements into NZD

The assets and liabilities of Group companies whose functional currency is not NZD are translated into NZD at the year-end exchange rate. The revenue and expenses of these companies are translated into NZD at rates approximating those at the dates of the transactions. Exchange differences arising on this translation that are attributable to equity holders of the Co-operative are recognised in the foreign currency translation reserve (FCTR). On disposal or partial disposal of an entity, the related exchange differences that were recorded in equity are recognised in the Income Statement as part of the gain or loss on disposal.

Basis of Preparation (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

d) Material accounting policies

Accounting policies which are considered material to an understanding of the Financial Statements are provided throughout the notes in green shading.

New and amended International Financial Reporting Standards

No new or amended standards and interpretations that became effective for the year ended 31 July 2022 have had a material impact to the Group.

Accounting standards issued but not yet effective

NZ IFRS 17 Insurance Contracts (effective 1 August 2023) replaces the current guidance NZ IFRS 4 Insurance Contracts. The new standard provides a comprehensive accounting model, which applies to all types of insurance contracts regardless of the type of entity that issues them. Management is continuing to assess the effect of applying NZ IFRS 17.

There are no other new or amended standards that are issued but not yet effective that are expected to have a material impact to the Group.

e) Significant judgements and estimates

In the preparation of these Financial Statements, a number of judgements and estimates have been made. Accordingly, actual outcomes may differ to these estimates.

Information about judgements, estimates and assumptions which are considered material to an understanding of the Financial Statements are provided in the following notes in grey shading.

NOTE		ITEM INVOLVING SIGNIFICANT JUDGEMENT OR ESTIMATION
Note 2	*Divestments*	– Determining if a disposal group is held for sale – Fair value measurement of assets and liabilities held for sale
Note 3	*Revenue from sale of goods*	– Revenue recognition for transactions involving distributors
Note 16	*Property, plant and equipment*	– Determining residual values and useful lives
Note 18	*Intangible assets*	– Assumptions used in the impairment tests
Note 21	*Taxation*	– Utilisation of tax losses – Uncertain tax positions
Note 22	*Contingent liabilities, provisions and commitments*	– Measurement of provisions and contingent liabilities
Note 25	*Fair value measurement*	– Fair value measurement

f) Global uncertainties

Current global uncertainties exist in relation to the ongoing impact of COVID-19, financial markets and foreign exchange volatility, inflationary pressures and increasing interest rates, geopolitical events, as well as potential impacts on demand. The Group has assessed the impact on its assets and liabilities. Debtor collectability and inventory obsolescence continue to be closely monitored, and forecasts and budgets used for impairment testing include the Group's best estimate of the ongoing impact of such events.

Notes to the Financial Statements

FOR THE YEAR ENDED 31 JULY 2022

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

Performance

This section focuses on the Group's financial performance and the returns provided to equity holders. This section includes the following notes:

1. Segment reporting

Segment information provided in this note reflects the Group's performance from continuing operations only. The China Farms and Brazil consumer and foodservice businesses are considered discontinued operations and have been excluded from the disclosures in this note. Please see Note 2 *Divestments* for further information about the Group's discontinued operations.

a) Reportable segments

Operating segments reflect the way financial information is regularly reviewed by the Fonterra Management Team (FMT). The FMT is considered to be the Chief Operating Decision Maker. During the year ended 31 July 2022, the FMT consisted of the Group Chief Executive Officer (CEO), Chief Financial Officer and Chief Operating Officer, the CEOs of the three customer-facing regional business units (Asia Pacific, AMENA and Greater China), the Managing Director People & Culture and the Managing Director Co-operative Affairs.

The measure of profit or loss used by the FMT to evaluate the underlying performance of operating segments is normalised earnings before interest and tax (normalised EBIT).

The Group's operating model is based around the three customer-facing regional business units, supported by a shared infrastructure, referred to as Group Operations which comprises:

- the functions under the Chief Operating Office (COO) and includes New Zealand milk collection and processing operations and assets, supply chain, Group IT, Sustainability and Innovation;
- Fonterra Farm Source™ retail stores; and
- the Central Portfolio Management function (CPM).

The operating model forms the basis for the Group's operating segments. Under the operating model, the business is managed as a matrix form organisation, whereby regional business unit CEOs and the FMT members that have responsibility for COO and CPM have overlapping responsibility for performance. Information about the performance of Group Operations is reported to the FMT both separately and attributed to each of the regional business units.

The Group has determined that its reportable segments are Asia Pacific, AMENA and Greater China, inclusive of their respective attribution of Group Operations. This presentation provides a full end-to-end view of performance for each of the customer-facing regional business units.

REPORTABLE SEGMENTS	DESCRIPTION
Asia Pacific	Represents the Ingredients, Foodservice and Consumer channels in New Zealand, Australia, Pacific Islands, South East Asia and South Asia.
AMENA	Represents the Ingredients, Foodservice and Consumer channels in Africa, Middle East, Europe, North Asia and Americas.
Greater China	Represents the Ingredients, Foodservice and Consumer channels in Greater China.

The performance of large multi-national customers are reported within the reportable segment that they are managed by. This can differ from the geographical region of the destination of goods sold.

The attribution of Group Operations to reportable segments and transactions between reportable segments follow underlying business rules. These rules have been designed to reflect the end-to-end contribution of each reportable segment.

Where there is common activity amongst segments and there is an attribution of those revenues and costs across segments, the attribution is based on a number of principles. These principles include:

- activity-based allocation where appropriate; and
- share of product sold/manufactured in the segment.

The performance of Fonterra Farm Source™ retail stores are attributed to the Asia Pacific reportable segment.

The Group regularly reviews the application of these principles to ensure they continue to remain appropriate and where possible to expand the portion attributed using activity-based principles. Where appropriate, comparative information may be re-presented for consistency with the current period attribution.

For the year ended 31 July 2022, the Group has continued to refine its approach to attributing the change in the cost of milk across the season.

Unallocated costs represent corporate costs including Co-operative Affairs and Group Functions.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

1. Segment reporting CONTINUED

a) Reportable segments CONTINUED

	GROUP $ MILLION									
CONTINUING OPERATIONS	ASIA PACIFIC		AMENA		GREATER CHINA		UNALLOCATED COSTS AND ELIMINATIONS		TOTAL	
	31 JULY 2022	31 JULY 2021	**31 JULY 2022**	31 JULY 2021	**31 JULY 2022**	31 JULY 2021	**31 JULY 2022**	31 JULY 2021	**31 JULY 2022**	31 JULY 2021
Sales volume (metric tonnes, thousands)	**1,370**	1,386	**1,355**	1,352	**1,029**	1,176	**(48)**	(40)	**3,706**	3,874
Revenue from sale of goods	**7,879**	7,110	**8,612**	7,304	**6,660**	6,312	**(198)**	(161)	**22,953**	20,565
Cost of goods sold	**(6,652)**	(5,915)	**(7,475)**	(6,400)	**(5,794)**	(5,476)	**184**	210	**(19,737)**	(17,581)
Normalised gross profit	**1,227**	1,195	**1,137**	904	**866**	836	**(14)**	49	**3,216**	2,984
Operating expenses	**(941)**	(889)	**(674)**	(605)	**(464)**	(436)	**(205)**	(223)	**(2,284)**	(2,153)
Other[1]	**(49)**	(1)	**64**	37	**30**	3	**5**	26	**50**	65
Normalised EBIT	**237**	305	**527**	336	**432**	403	**(214)**	(148)	**982**	896
Normalisation adjustments:										
– Gain on sale of Falcon China Farms JV	**–**	–	**–**	–	**–**	40	**–**	–	**–**	40
– Income Statement impact of Beingmate investment	**–**	–	**–**	–	**–**	(49)	**–**	–	**–**	(49)
– Gain on sale of Global Dairy Trade	**–**	–	**–**	–	**–**	–	**42**	–	**42**	–
Profit/(loss) before net finance costs and tax	**237**	305	**527**	336	**432**	394	**(172)**	(148)	**1,024**	887
Other segment information:										
– Inter-segment revenue	**161**	155	**37**	6	**–**	–	**(198)**	(161)	**–**	–
– Depreciation and amortisation	**(240)**	(242)	**(204)**	(196)	**(172)**	(182)	**(19)**	(22)	**(635)**	(642)
– Share of (loss)/profit of equity accounted investments	**–**	(3)	**8**	6	**–**	–	**2**	2	**10**	5

1 Comprises other operating income, net foreign exchange gains/(losses) and share of profit/(loss) of equity accounted investments.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

1. Segment reporting CONTINUED

b) Geographical analysis of revenue

Revenue is analysed by geography on the basis of the destination of the goods sold. Geographical groupings in the following table are not aligned with the Group's reportable segments.

	GROUP $ MILLION						
	NEW ZEALAND	AUSTRALIA	CHINA	REST OF ASIA	AMERICAS	REST OF WORLD	TOTAL
Geographical external revenue							
Year ended 31 July 2022	**2,140**	**1,726**	**6,244**	**8,016**	**3,050**	**1,777**	**22,953**
Year ended 31 July 2021	1,726	1,699	6,119	7,056	2,597	1,368	20,565

c) Geographical analysis of non-current assets

Geographical groupings in the following table are not aligned with the Group's reportable segments.

	GROUP $ MILLION						
	NEW ZEALAND	AUSTRALIA	CHINA	REST OF ASIA	AMERICAS	REST OF WORLD	TOTAL
Geographical non-current assets							
As at 31 July 2022	**6,603**	**1,026**	**20**	**799**	**378**	**241**	**9,067**
As at 31 July 2021[1]	6,602	970	17	777	388	253	9,007

	GROUP $ MILLION	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021[1]
Reconciliation of geographical non-current assets to total non-current assets		
Geographical non-current assets	**9,067**	9,007
Deferred tax assets	**551**	460
Derivative financial instruments	**434**	437
Total non-current assets	**10,052**	9,904

1 Comparative information includes re-presentations for consistency with the current period.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

2. Divestments

This note provides information about the Group's disposal groups held for sale and discontinued operations for the year ended 31 July 2022.

At 31 July 2022, the Hangu China farm and the Brazil consumer and foodservice business continued to meet the definition of held for sale and are discontinued operations. The Group's divestment of the Chilean business is underway, however it does not meet the held for sale criteria at balance date and is not presented as held for sale in these Financial Statements.

a) Disposal groups held for sale

A disposal group is a group of assets and liabilities to be disposed of (by sale or otherwise) in a single transaction. A disposal group is classified as held for sale if it is available for immediate sale in its present condition and its sale is highly probable.

Disposal groups classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell. Immediately prior to being classified as held for sale, the carrying amounts of assets and liabilities in the disposal group are measured in accordance with the applicable accounting policy. Impairment losses on initial classification as held for sale and subsequent gains and losses on remeasurement are recognised in the Income Statement.

Once classified as held for sale, assets are no longer depreciated or amortised and equity accounted investments are no longer equity accounted.

Assets of disposal groups held for sale are presented in a single line item within current assets, and liabilities of disposal groups held for sale are presented in a single line item within current liabilities. Comparative period information for assets and liabilities held for sale is not re-presented in the Statement of Financial Position.

Judgement is involved in determining whether a disposal group is held for sale at balance date.

Uncertainty is involved in estimating fair value less costs to sell. The fair value less costs to sell for assets and liabilities held for sale has been estimated based on information received through the sales process.

The major classes of assets and liabilities held for sale are presented in the following table.

	$ MILLION	
ASSETS AND LIABILITIES HELD FOR SALE	AS AT 31 JULY 2022	AS AT 31 JULY 2021
Cash and cash equivalents	24	17
Trade receivables	58	39
Inventory	32	37
Property, plant and equipment	79	79
Livestock	21	25
Intangible assets	111	122
Other assets	148	143
Total assets held for sale	473	462
Borrowings	333	282
Trade and other payables	209	150
Provisions	42	54
Other liabilities	44	56
Total liabilities held for sale	628	542
Net liabilities held for sale	(155)	(80)

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

2. Divestments CONTINUED

Hangu China farm

In January 2022 the Group purchased the 15 percent non-controlling interest in the Hangu China farm, and as at 31 July 2022 the Hangu China farm continued to meet the requirements to be classified as held for sale (31 July 2021: held for sale).

The sale process was initially delayed due to a lack of progress in agreeing the specific terms of sale following the minority shareholder exercising their right of first refusal to purchase Fonterra's interest. Subsequent delays have been due to market conditions related to COVID-19, including the effect of lockdowns in China. However at 31 July 2022 the Group remains committed to the sale and the farm continues to be actively marketed. The Group expects the sale to be completed within one year of balance date.

At 31 July 2022 the Group reassessed the fair value less costs to sell of the Hangu China farm and no further adjustment has been recognised (31 July 2021: nil).

The foreign currency translation reserve balance as at 31 July 2022 attributable to the Hangu China farm was a debit balance of $3 million (31 July 2021: debit balance of $1 million).

Brazil consumer and foodservice business

As at 31 July 2022 the Brazil consumer and foodservice business continued to meet the requirements to be classified as held for sale (31 July 2021: held for sale).

The sale process has been delayed due to market conditions related to COVID-19, however at 31 July 2022 the Group remains committed to the sale and continues to actively progress the sale. The Group expects the sale to be completed within one year of balance date.

The Group has reassessed the fair value less costs to sell at 31 July 2022 and recognised a further write-down of $57 million ($50 million after tax) (31 July 2021: $39 million ($35 million after tax)), of which $26 million after tax is attributable to the Group's equity holders (31 July 2021: $18 million).

At 31 July 2022 the foreign currency translation reserve balance attributable to the Brazil consumer and foodservice business was a debit balance of $67 million (31 July 2021: debit balance of $63 million).

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

2. Divestments CONTINUED

b) Discontinued operations

A disposal group that meets the criterion to be classified as held for sale (or has been sold) is a discontinued operation if it represents, or is part of a single co-ordinated plan to dispose of, a separate major line of business or geographical area of operations, or is a subsidiary acquired exclusively with a view to resale.

Profit/(loss) after tax from discontinued operations is presented in a single line item in the Income Statement for both the current and comparative year.

The China Farms business and Brazil consumer and foodservice business both meet the definition of a discontinued operation.

For the year ended 31 July 2022, the China Farms business represents solely the Hangu China farm.

For the year ended 31 July 2021, the China Farms business also included the Ying and Yutian farms, up to the date of sale (1 April 2021). The financial performance of the Ying and Yutian farms has been recognised in profit/(loss) after tax from discontinued operations.

The summarised financial performance of the China Farms business and Brazil consumer and foodservice business, recognised in profit/(loss) after tax from discontinued operations in the Income Statement, is presented in the following table.

	$ MILLION	
DISCONTINUED OPERATIONS	31 JULY 2022	31 JULY 2021
Revenue from sale of goods	472	559
Cost of goods sold	(348)	(429)
China Farms impairment reversal	–	23
Gross profit	**124**	**153**
Other operating income	–	18
Other operating expenses	(115)	(92)
Gain on sale of Ying and Yutian China farms	–	32
Brazil consumer and foodservice impairment	(57)	(39)
(Loss)/profit before net finance costs and tax	**(48)**	**72**
Net finance costs	(37)	(10)
(Loss)/profit before tax	**(85)**	**62**
Tax credit	7	5
(Loss)/profit after tax from discontinued operations	**(78)**	**67**
Share of loss attributable to non-controlling interests	36	13
(Loss)/profit after tax attributable to equity holders of the Co-operative	**(42)**	**80**
Movement in exchange differences on translation of discontinued operations	3	2
Foreign currency translation reserve gains transferred to the Income Statement	(1)	(19)
Other reserve movements	8	(1)
Total comprehensive (expense)/income from discontinued operations	**(68)**	**49**
Net cash inflow/(outflow) from operating activities	9	(8)
Net cash (outflow)/inflow from investing activities	(5)	510
Net cash outflow from financing activities	–	(6)
Net increase in cash generated by the discontinued operations	**4**	**496**

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

3. Revenue from sale of goods

The Group recognises revenue from the sale of products when control of the products transfers to the customer. The transfer of control of products typically occurs at the following times:

- Ingredient products (export sales) - once the products are loaded onto the ship.
- Ingredient products (domestic sales) - on delivery of the products to the customer's designated location.
- Consumer and foodservice products - on delivery of the products to the customer's designated location.

The amount of revenue recognised reflects the consideration that the Group expects to be entitled to for providing the products to the customer. Revenue is measured as the sales price specified in the contract adjusted for pricing adjustments, trade spend and rebates. Pricing adjustments, trade spend and rebates are recognised as deductions from revenue at the time that the related sale is recognised. The estimated amount of the deduction from revenue is based on historical experience and the specific terms of the contracts with customers so that it is highly probable that a significant reversal of revenue recognised will not occur.

For export sales the Group sells a significant proportion of its products on terms that include freight and insurance to the destination port. For these sales the Group has a separate performance obligation to arrange freight and insurance services for the customers after the date at which control of the products passes to the customer. As the Group does not control the freight and insurance services before those services are transferred to the customer, the Group is acting as an agent. Therefore, the Group recognises the net agency fee as revenue when freight and insurance services are made available to customers, usually this is when the products are loaded onto the ship.

The Group offers credit terms which are short-term in nature. In addition, as part of its normal trade terms, the Group receives payments in advance from certain customers. Contracts with customers do not contain significant financing components.

The Group sells products either directly to customers or through distributors. For transactions involving distributors, judgement is required to assess whether:

- control of the products passes and therefore revenue is recognised when the products are transferred to the distributor, in which case the distributor is the Group's customer; or
- the Group retains control of the products after transfer to the distributor, in which case control of the products does not pass until the products reach the customer in the supply chain who does obtain control of the product. In this situation the customer, referred to as the 'end customer' may be a retailer, reseller or food manufacturer. Revenue is not recognised until the products are transferred to the end customer.

The assessment of whether control of the products passes to the distributor can involve significant judgement. In assessing control, the following indicators are considered:

- The ability to direct the use of the product. This includes consideration of who has the primary responsibility for providing the products to the end customer and whether the Group can restrict who the distributor sells the product to.
- The transfer of inventory risk and demand risk. This includes consideration of the level of, or allowance for, product returns and who bears the residual risk of product expiry.
- The level of support provided by the Group to assist the distributor to on-sell the product. This includes consideration of collaboration on marketing plans, financial support provided by the Group through pricing discounts or funding of promotional activity.

Sales to distributors where significant judgement is involved in determining the timing of revenue recognition are primarily in the Foodservice channel.

Contractual terms vary across markets and sales channels. In most arrangements the contractual terms indicate that the distributor is responsible for providing the products to the end customer and has assumed the inventory risk. The Group often retains price risk through the provision of price discounts, funding promotional activity or influence over price setting. In general, these pricing mechanisms impact the amount of revenue recognised by the Group rather than indicating control of the products is retained.

In order to conclude on the transfer of control of the products the contract must be assessed in its entirety, along with implied contractual terms based on commercial customary practices.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

3. Revenue from sale of goods CONTINUED

Revenue is disaggregated by Ingredients, Foodservice and Consumer channels across the Group's reportable segments in the following table.

	GROUP $ MILLION							
	ASIA PACIFIC		AMENA		GREATER CHINA		TOTAL	
	31 JULY 2022	31 JULY 2021	**31 JULY 2022**	31 JULY 2021	**31 JULY 2022**	31 JULY 2021	**31 JULY 2022**	31 JULY 2021
Ingredients channel revenue	**4,189**	3,521	**6,883**	5,783	**4,479**	4,259	**15,551**	13,563
Foodservice channel revenue	**1,075**	928	**393**	333	**1,824**	1,691	**3,292**	2,952
Consumer channel revenue	**2,454**	2,506	**1,299**	1,182	**357**	362	**4,110**	4,050
Revenue from sale of goods	**7,718**	6,955	**8,575**	7,298	**6,660**	6,312	**22,953**	20,565

Revenue is disaggregated by geography on the basis of the destination of the goods sold in Note 1 *Segment reporting*.

4. Cost of goods sold

Cost of goods sold is primarily made up of New Zealand-sourced cost of milk.

New Zealand-sourced cost of milk includes the cost of milk supplied by farmer shareholders, supplier premiums paid, and the cost of milk purchased from contract milk suppliers during the financial year.

New Zealand-sourced cost of milk supplied by farmer shareholders comprises the volume of milk solids supplied at the Farmgate Milk Price as determined by the Board for the relevant season. In making that determination the Board takes into account the Farmgate Milk Price calculated in accordance with the Farmgate Milk Price Manual, which is independently assured. The Fonterra Farmgate Milk Price Statement sets out information about the Farmgate Milk Price, and how it is calculated. It can be found in the 'Investors/Farmgate Milk Prices/Milk Price Methodology' section of Fonterra's website.

Other costs include purchases of other products, raw materials and packing, direct labour costs, depreciation and other costs directly incurred to bring inventory to its final point of sale location.

	GROUP $ MILLION	
	31 JULY 2022	31 JULY 2021
Opening inventory	**3,766**	3,268
Cost of milk:		
– New Zealand-sourced	**13,722**	11,660
– Non-New Zealand-sourced	**1,113**	994
Other costs	**6,143**	5,425
Closing inventory	**(5,007)**	(3,766)
Total cost of goods sold	**19,737**	17,581

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

5. Earnings per share

Basic earnings per share is calculated as profit after tax attributable to equity holders of the Co-operative divided by the weighted average number of shares on issue for the period.

Diluted earnings per share is determined by adjusting profit after tax attributable to equity holders of the Co-operative and the weighted average number of shares on issue for the effects of all shares with dilutive potential. There were no shares on issue with dilutive potential for either of the years presented.

	GROUP	
	31 JULY 2022	31 JULY 2021
Basic and diluted earnings per share from continuing operations ($)	**0.38**	0.31
Basic and diluted (loss)/earnings per share from discontinued operations ($)	**(0.02)**	0.05
Basic and diluted earnings per share ($)	**0.36**	0.36
Profit attributable to equity holders of the Co-operative ($ million)	**584**	578
Weighted average number of shares (thousands of shares)	**1,613,353**	1,613,105

Normalised earnings per share

Normalised earnings per share is calculated as normalised profit after tax attributable to equity holders of the Co-operative divided by the weighted average number of shares on issue for the period.

	GROUP	
	31 JULY 2022	31 JULY 2021
Normalised basic and diluted earnings per share ($)	**0.35**	0.34
Normalised profit after tax attributable to equity holders of the Co-operative ($ million)	**568**	550
Weighted average number of shares (thousands of shares)	**1,613,353**	1,613,105

A reconciliation of profit after tax attributable to equity holders of the Co-operative to normalised profit after tax attributable to equity holders of the Co-operative is presented in the following table.

	GROUP $ MILLION	
	31 JULY 2022	31 JULY 2021
Profit after tax attributable to equity holders of the Co-operative	**584**	578
Less: Gain on sale of Global Dairy Trade	**(42)**	–
Less: Loss on sale of Ying and Yutian China farms	**–**	(32)
Less: China Farms impairment reversal	**–**	(23)
Less: Loss on sale of Falcon China Farms JV	**–**	(40)
Add: Income Statement impact of Beingmate investment	**–**	49
Add: Brazil consumer and foodservice business impairment	**57**	39
Total normalisation adjustments	**15**	(7)
Less: Tax on normalisation adjustments	**(7)**	(4)
Less: Normalisation adjustments attributable to non-controlling interests	**(24)**	(17)
Normalised profit after tax attributable to equity holders of the Co-operative	**568**	550

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

6. Profit before net finance costs and tax

a) Additional information about items included in profit before net finance costs and tax

The following items have been included in profit before net finance costs and tax in the Income Statement.

	GROUP $ MILLION	
	31 JULY 2022	31 JULY 2021
Total employee benefits expense	**2,159**	2,117
Depreciation and amortisation expense	**635**	642
Research and development costs	**115**	110
Contributions to defined contribution plans included in employee benefits expense	**91**	83
Donations	**2**	–
Net foreign exchange losses	**58**	26

b) Fees paid to the auditor and network firms

KPMG has been appointed the Group's external auditor for three consecutive years. The lead audit partner has served for three consecutive years. The Board has overseen compliance with the Group's Audit Independence Policy. KPMG has not provided any services during the year other than audit and audit-related services.

A breakdown of fees paid to the auditor and network firms which are included in the Income Statement is presented in the following table. Fees are inclusive of any disbursements.

	GROUP $ MILLION	
	31 JULY 2022	31 JULY 2021
Audit and review of the Financial Statements of the Group and its subsidiaries:		
– New Zealand	**6.0**	6.2
– Network firms of the auditor	**1.7**	2.4
Total fees for the audit and review of the Financial Statements	**7.7**	8.6
Audit-related services:		
– Assurance services in respect of the Farmgate Milk Price Statement	**0.1**	0.1
– Other audit-related services[1]	**0.1**	0.1
Total fees for audit-related services	**0.2**	0.2
Total fees paid to auditor	**7.9**	8.8

1 Other audit-related services include assurance and agreed upon procedure engagements.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

Debt and equity

This section outlines the Group's capital structure and the related financing costs. It also provides information on how the funds that finance current and future activities are raised and how the Group manages capital.

This section includes the following notes:

7. Subscribed equity instruments

Subscribed equity instruments comprise Co-operative shares and units in the Fonterra Shareholders' Fund (the Fund). Incremental costs directly attributable to equity transactions are recognised as a deduction from subscribed equity.

a) Co-operative shares, including shares held within the Group

Co-operative shares may only be held by a shareholder supplying milk to Fonterra (farmer shareholder), by former farmer shareholders for up to three seasons after cessation of milk supply, or by Fonterra Farmer Custodian Limited (the Custodian). Voting rights in Fonterra are dependent on milk supply supported by Co-operative shares, these rights are also attached to vouchers when backed by milk supply (subject to limits).

The rights attaching to Co-operative shares are set out in Fonterra's Constitution, available in the 'Our Co-operative/Governance and Management' section of Fonterra's website.

On 8 June 2022, Fonterra announced that it would allocate up to $50 million to an on-market share buyback programme commencing 30 June 2022.

At 31 July 2022, Fonterra had bought back 532,294 shares (31 July 2021: nil) at a total cost of $1 million. The shares bought back were cancelled on acquisition.

At 31 July 2022 there were 1,612,825,585 Co-operative shares on issue (31 July 2021: 1,613,357,879 shares).

During the year ended 31 July 2022 no shares were issued under the Dividend Reinvestment Plan (31 July 2021: 1,138,230 shares) or the Farm Source Rewards scheme (31 July 2021: 122,582 shares).

Co-operative shares can be traded between farmer shareholders on the Fonterra Shareholders' Market (a private market operated by NZX Limited). At a Special Meeting held on 9 December 2021, Fonterra shareholders voted in favour of capital structure related amendments to Fonterra's Constitution that would give effect to the Flexible Shareholding structure. Subsequently, on 27 April 2022 the Government announced that it intends to amend the DIRA to support Fonterra's new structure, signalling it expects the amendments to DIRA to pass through Parliament in the 2022 calendar year. The Constitution amendments and new structure will come into effect once the Fonterra Board is satisfied that any steps necessary for implementation have been (or will be) completed. The Co-operative is aiming to implement the changes as soon as possible. Share compliance obligations will remain on hold for all shareholders holding a minimum of 1,000 shares and exiting suppliers that are selling shares over three seasons in accordance with Fonterra's Constitution, until at least six months after the new structure comes into effect. The current cap on the Fund remains, so Fonterra shares are not able to be exchanged into units in the Fund on a day-to-day basis. A capped Fund is a feature of the Flexible Shareholding structure.

Information about the Group's capital structure review is available in the 'Investors/Capital Structure' section of Fonterra's website.

b) Units in the Fonterra Shareholders' Fund

The Custodian holds legal title of Co-operative shares of which the Economic Rights have been sold to the Fund on trust for the benefit of the Fund. At 31 July 2022 107,417,322 Co-operative shares (31 July 2021: 107,420,162) were legally owned by the Custodian, on trust for the benefit of the Fund.

Units in the Fund are traded on the New Zealand Stock Exchange (NZX) and Australian Securities Exchange (ASX).

During the year ended 31 July 2022, the Fund issued no units (31 July 2021: 11,794,492 units) and redeemed 2,840 units (31 July 2021: 8,955,846 units).

Under the capital structure related amendments to Fonterra's Constitution the overall limit on the Fund size reduces from 20% to 10%. The current cap on the Fund remains, so Fonterra shares are not able to be exchanged into units in the Fund on a day-to-day basis. The Fonterra share buyback programme has not had a material impact on the Fund size as a percentage of the total number of Fonterra shares on issue.

The rights attaching to units are set out in the Fonterra Shareholders' Fund 2022 Annual Report, available in the 'Investors/Fonterra Shareholders' Fund' section of Fonterra's website.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

7. Subscribed equity instruments CONTINUED

c) Market capitalisation

The Group's market capitalisation has been below the carrying amount of net assets since Fonterra's capital review announcement in May 2021. Accounting standards consider this to be an indicator of impairment. The Group does not believe the current share price provides an accurate reflection of the fair value of the net assets, due to factors such as being traded in a restricted market and the reduced levels of liquidity following the announcement of the capital review.

The Group has undertaken an impairment test and obtained an independent valuation to determine the recoverable amount of its net assets. The independent valuation was used to determine the Group's recoverable amount on a fair value less costs of disposal basis. The valuation uses a sustainable EBIT based on normalised earnings and an appropriate range of earnings multiples based on benchmarking against peers.

The estimate of the recoverable amount exceeded the carrying amount and as such, no impairment has been identified.

8. Dividends

All Co-operative shares, including those held by the Custodian, are eligible to receive dividends if declared by the Board. As set out in Fonterra's Constitution, dividends on Co-operative shares held by farmer shareholders in excess of the maximum number of Co-operative shares that the shareholder is permitted to hold at compliance date, shall be forfeited by the shareholder and retained by the Group.

Dividends are recognised as a liability in the Group's Financial Statements in the period in which they are declared by the Board. The Group's Dividend Policy can be found in the 'Investors/Results & Reporting/Dividends & Reinvestment Plan' section of Fonterra's website.

The Group has a Dividend Reinvestment Plan, where eligible shareholders can choose to reinvest all or part of their future dividend in additional Co-operative shares. The Group's Dividend Reinvestment Plan can be found in the 'Investors/Results & Reporting/Dividends & Reinvestment Plan' section of Fonterra's website.

	$ MILLION	
DIVIDENDS	31 JULY 2022	31 JULY 2021
2022 Interim dividend – 5 cents per share[1]	**81**	–
2021 Final dividend – 15 cents per share[2]	**242**	–
2021 Interim dividend – 5 cents per share[3]	**–**	80
2020 Final dividend – 5 cents per share[4]	**–**	81

1 Declared on 16 March 2022 and paid on 14 April 2022 to all Co-operative shares on issue at 24 March 2022. The Dividend Reinvestment Plan did not apply to this dividend.
2 Declared on 22 September 2021 and paid on 15 October 2021 to all Co-operative shares on issue at 30 September 2021. The Dividend Reinvestment Plan did not apply to this dividend.
3 Declared on 16 March 2021 and paid on 15 April 2021 to all Co-operative shares on issue at 24 March 2021. The Dividend Reinvestment Plan did not apply to this dividend.
4 Declared on 17 September 2020 and paid on 15 October 2020 to all Co-operative shares on issue at 25 September 2020. The Dividend Reinvestment Plan applied to this dividend.

Dividend declared after balance date

On 21 September 2022, the Board declared a final dividend of 15 cents per share, to be paid on 14 October 2022 to all holders of Co-operative shares on issue at 29 September 2022.

The Dividend Reinvestment Plan does not apply to this dividend.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

9. Borrowings

The Group borrows in the form of bonds, bank facilities and other financial instruments. The Group also recognises lease liabilities within borrowings. Refer to Note 17 *Leases* for further information about the Group's lease liabilities and related right-of-use assets.

The interest expense incurred on the Group's borrowings is presented in Note 10 *Net finance costs*.

Borrowings (excluding lease liabilities) are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortised cost using the effective interest method, with the hedged risks on certain debt instruments measured at fair value.

a) Total borrowings

	GROUP $ MILLION	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021
Total current borrowings	**356**	818
Total non-current borrowings	**4,900**	4,254
Total borrowings[1]	**5,256**	5,072

1 Borrowings of $333 million attributable to disposal groups held for sale are not included in the table above (31 July 2021: $282 million).

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

9. Borrowings CONTINUED

a) Total borrowings CONTINUED

A breakdown of total borrowings is presented in the following tables.

	GROUP $ MILLION							
	BALANCE AS AT 1 AUGUST 2021	PROCEEDS	NEW LEASE LIABILITIES	REPAYMENTS	FOREIGN EXCHANGE MOVEMENT	CHANGES IN FAIR VALUES	OTHER	BALANCE AS AT 31 JULY 2022
Commercial paper	–	1,469	–	(1,375)	–	–	4	98
Bank loans	11	2,425	–	(1,437)	–	–	–	999
Lease liabilities[1]	523	–	41	(106)	–	–	(20)	438
Capital notes[2]	35	–	–	–	–	–	–	35
NZX-listed bonds	600	–	–	(350)	–	–	–	250
Medium-term notes	3,903	–	–	(366)	168	(270)	1	3,436
Total borrowings[3]	5,072	3,894	41	(3,634)	168	(270)	(15)	5,256

	GROUP $ MILLION							
	BALANCE AS AT 1 AUGUST 2020	PROCEEDS	NEW LEASE LIABILITIES	REPAYMENTS	FOREIGN EXCHANGE MOVEMENT	CHANGES IN FAIR VALUES	OTHER	BALANCE AS AT 31 JULY 2021
Commercial paper	–	444	–	(444)	–	–	–	–
Bank loans	20	1,882	–	(1,888)	(3)	–	–	11
Lease liabilities[1]	604	–	34	(109)	(6)	–	–	523
Capital notes[2]	35	–	–	–	–	–	–	35
NZX-listed bonds	600	–	–	–	–	–	–	600
Medium-term notes	4,782	–	–	(633)	(97)	(151)	2	3,903
Total borrowings[3]	6,041	2,326	34	(3,074)	(106)	(151)	2	5,072

1 Refer to Note 17 *Leases* for further information about lease liabilities.
2 Capital notes are unsecured subordinated borrowings.
3 All borrowings other than lease liabilities and capital notes are unsecured and unsubordinated.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

9. Borrowings CONTINUED

b) Adjusted net debt

The Group uses adjusted net debt, a non-GAAP debt measure in monitoring its net debt position and in calculating the Group's debt to EBITDA ratio, gearing ratio, and return on capital. Refer to Note 11 *Capital management* for further information about this ratio.

Adjusted net debt is total borrowings, plus bank overdraft, less cash and cash equivalents, plus borrowings attributable to disposal groups held for sale, less cash and cash equivalents attributable to disposal groups held for sale, plus a cash adjustment for 25% of cash and cash equivalents held by the Group's subsidiaries (including cash and cash equivalents attributable to disposal groups held for sale), less derivatives used to manage changes in hedged risks on debt instruments.

The Group believes that adjusted net debt provides useful information as it is aligned with how certain rating agencies calculate the Group's debt to EBITDA and gearing ratios.

	GROUP $ MILLION	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021
Total borrowings	**5,256**	5,072
Plus: Bank overdraft	**31**	20
Less: Cash and cash equivalents	**(288)**	(985)
Plus: Borrowings attributable to disposal groups held for sale	**333**	282
Less: Cash and cash equivalents attributable to disposal groups held for sale	**(24)**	(17)
Plus: Cash adjustment for cash held by subsidiaries	**77**	110
Less: Adjusted for the carrying value of derivatives used to manage changes in hedged risks on debt instruments	**(46)**	(157)
Adjusted net debt	**5,339**	4,325

10. Net finance costs

Interest income and expense is recognised on an accrual basis in the Income Statement, using the effective interest method.

Finance costs also include the changes in fair value relating to derivatives used to manage interest rate risk, and the associated changes in fair value of the borrowings designated in a hedge relationship attributable to the hedged risk. Information about the Group's hedge accounting policies are included in Note 20 *Hedge accounting*.

	GROUP $ MILLION	
	31 JULY 2022	31 JULY 2021
Finance income	**14**	9
Interest expense[1,2]	**(263)**	(299)
Changes in fair value relating to:		
– Borrowings designated in a hedge relationship	**270**	151
– Derivatives designated in a hedge relationship	**(225)**	(107)
– Derivatives where hedge accounting has not been applied	**10**	(6)
Total interest income from fair value movements	**55**	38
Finance costs	**(208)**	(261)
Net finance costs	**(194)**	(252)

1 Includes interest expense of $3 million (31 July 2021: $2 million) relating to derivatives where hedge accounting has not been applied.
2 Includes interest expense of $13 million (31 July 2021: $17 million) relating to lease liabilities.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

11. Capital management

The Group is not subject to debt covenants or any other externally imposed capital requirements. The Board closely monitors the following non-GAAP measures: debt to EBITDA ratio, gearing ratio and return on capital.

a) Debt to EBITDA ratio

Debt to EBITDA is calculated as adjusted net debt divided by total Group normalised earnings before interest, tax, depreciation and amortisation (total Group normalised EBITDA) excluding share of profit/loss of equity accounted investees and net foreign exchange gains/losses.

Total Group normalised EBITDA includes amounts relating to discontinued operations.

Debt to EBITDA is a key ratio considered by the credit rating agencies when determining Fonterra's credit rating. The Board approved Debt Policy establishes a maximum debt to EBITDA of 3.75x, with a long-term target range of 2.5 to 3.0x.

	GROUP $ MILLION	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021
Adjusted net debt[1]	5,339	4,325
Profit after tax	583	599
Add: Net finance costs from continuing operations	194	252
Add: Net finance costs from discontinued operations	37	10
Add: Tax expense from continuing operations	169	103
Less: Tax credit from discontinued operations	(7)	(5)
Total Group EBIT	976	959
Add: Depreciation and amortisation from continuing operations	635	642
Total Group EBITDA	1,611	1,601
Add/(less): Normalisation adjustments[2]	15	(7)
Total Group normalised EBITDA	1,626	1,594
Less: Share of profit of equity accounted investments	(10)	(5)
Add: Net foreign exchange losses from continuing operations	58	26
Less: Net foreign exchange losses included in normalisation adjustments	–	(2)
Add/(less): Net foreign exchange losses/(gains) from discontinued operations	2	(7)
Total Group normalised EBITDA excluding share of profit/loss of equity accounted investees and net foreign exchange gains/losses	1,676	1,606
Debt to EBITDA ratio	3.2x	2.7x

1 Refer to Note 9 *Borrowings* for further information about adjusted net debt.
2 Refer to Note 5 *Earnings per share* for further information about normalisation adjustments.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

11. Capital management CONTINUED

b) Gearing ratio

Adjusted net debt gearing ratio

The adjusted net debt gearing ratio is calculated as adjusted net debt divided by total capital.

Total capital is equity excluding hedge reserves, plus adjusted net debt.

The Board approved Gearing Policy establishes a maximum adjusted net debt gearing ratio of 45%, with a long-term target range of 30% to 40%.

	GROUP $ MILLION	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021
Adjusted net debt[1]	5,339	4,325
Equity excluding hedge reserves	7,252	6,895
Total capital	12,591	11,220
Adjusted net debt gearing ratio (%)	42.4%	38.5%

1 Refer to Note 9 *Borrowings* for further information about adjusted net debt.

c) Return on capital

Return on capital is calculated as total Group normalised earnings before interest and tax (total Group normalised EBIT) plus finance income on long-term advances less a notional tax charge, divided by average capital employed. Return on capital is reported regularly to key management personnel, and compared against budget and prior years return on capital.

Total Group normalised EBIT includes both continuing operations and discontinued operations.

Capital employed is adjusted net debt, less the cash adjustment (used in calculating adjusted net debt), plus cash and cash equivalents held by subsidiaries for working capital purposes, plus equity excluding hedge reserves and net deferred tax assets. Average capital employed is calculated as a 13-month rolling average of capital employed.

	GROUP $ MILLION	
	31 JULY 2022	31 JULY 2021
Total Group EBIT	976	959
Add/(less): Normalisation adjustments[1]	15	(7)
Total Group normalised EBIT	991	952
Plus: Finance income on long-term advances	7	8
Less: Notional tax charge	(161)	(155)
Total Group normalised EBIT including finance income on long-term advances less notional tax charge	837	805
Adjusted net debt[2]	5,339	4,325
Less: Cash adjustment[2]	(77)	(110)
Plus: Cash and cash equivalents held by subsidiaries for working capital purposes	166	188
Plus: Total equity	6,906	6,869
Plus: Hedge reserves	346	26
Less: Net deferred tax assets	(501)	(435)
Capital employed	12,179	10,863
Impact of seasonal variation in capital employed	177	1,418
Average capital employed	12,356	12,281
Return on capital	6.8%	6.6%

1 Refer to Note 5 *Earnings per share* for further information about normalisation adjustments.
2 Refer to Note 9 *Borrowings* for further information about adjusted net debt.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

Working capital

This section provides information about the primary elements of the Group's working capital. Working capital represents the short-term operating assets and liabilities generated by the Group. Movements in these items have a direct impact on the net cash flows generated from operating activities.

This section includes the following notes:

Note 12: *Trade and other receivables*

Note 13: *Inventories*

Note 14: *Trade and other payables*

Note 15: *Owing to suppliers*

12. Trade and other receivables

Trade receivables are amounts due from customers for products sold and services provided. Trade receivables are recognised initially at their transaction price and subsequently measured at the amount expected to be collected. Due to their short-term nature trade receivables are not discounted.

The Group recognises an allowance for expected credit losses on trade receivables based on the lifetime expected credit loss at balance date.

	GROUP $ MILLION	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021
Trade receivables	**2,355**	1,673
Less: Allowance for expected credit losses on trade receivables	**(12)**	(18)
Trade receivables net of allowance for expected credit losses	**2,343**	1,655
Receivables from related parties[1]	**19**	25
Other receivables	**50**	67
Total trade and other receivables (excluding prepayments)	**2,412**	1,747
Prepayments	**70**	55
Total trade and other receivables	**2,482**	1,802

1 Refer to Note 23 *Related party transactions* for further information about receivables from related parties.

Amounts received in advance from customers of $58 million (31 July 2021: $17 million) have been recognised in trade and other payables.

The Group has a receivables management programme. At 31 July 2022 the Group's exposure was $20 million, which reflects the first loss component of amounts managed at balance date (31 July 2021: $17 million).

The ageing profile of the Group's trade and other receivables (excluding prepayments) is presented in the following table.

	GROUP $ MILLION				
	CURRENT	LESS THAN 1 MONTH PAST DUE	MORE THAN 1 MONTH BUT LESS THAN 3 MONTHS PAST DUE	MORE THAN 3 MONTHS PAST DUE	TOTAL
As at 31 July 2022	**2,164**	**166**	**55**	**27**	**2,412**
As at 31 July 2021	1,579	114	32	22	1,747

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

13. Inventories

Raw materials and finished goods

Raw materials and finished goods are measured at the lower of cost or net realisable value on a first-in-first-out basis.

In the case of manufactured inventories, cost includes all direct costs plus the portion of fixed and variable production overheads incurred in bringing inventories to their present location and condition.

Net realisable value is the estimated selling price, less the costs of completion and selling expenses.

Emissions units held for trading

The Group holds emissions units for trading and compliance purposes.

Emissions units held for trading purposes are accounted for as inventories and measured at fair value. Refer to Note 18 *Intangible assets* for further information about emissions units held for compliance purposes.

	GROUP $ MILLION	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021
Raw materials	**802**	678
Finished goods	**4,261**	3,133
Less: Provision for impairment of raw materials and finished goods	**(95)**	(69)
Total raw materials and finished goods	**4,968**	3,742
Emissions units held for trading	**39**	24
Total inventories	**5,007**	3,766

14. Trade and other payables

Trade and other payables are recognised at the amount invoiced by the supplier. Due to their short-term nature, they are not discounted. Amounts owing to farmer shareholders and New Zealand contract milk suppliers are recognised in owing to suppliers (refer to Note 15 *Owing to suppliers*).

	GROUP $ MILLION	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021
Trade payables	**1,863**	1,677
Amounts due to related parties[1]	**14**	9
Other payables	**158**	190
Total trade and other payables (excluding employee entitlements)	**2,035**	1,876
Employee entitlements	**368**	332
Total trade and other payables	**2,403**	2,208

1 Refer to Note 23 *Related party transactions* for further information about payables to related parties.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

15. Owing to suppliers

Amounts owing to suppliers are amounts the Group owes to farmer shareholders and New Zealand contract milk suppliers for the collection of milk, which includes end of season adjustments, offset by amounts owing from farmer shareholders for goods and services provided to them by the Group.

These amounts are recognised at the net amount due to the supplier for the milk provided. Due to their short-term nature, they are not discounted.

The Board uses its discretion in establishing the rate at which the Group will pay suppliers for the milk supplied over the season. This is referred to as the advance rate. A breakdown of the advance payments made to suppliers is presented in the following table.

	GROUP	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021
Owing to suppliers ($ million)	**2,119**	1,825
Details relating to the season ended 31 May:		
Farmgate Milk Price[1] (per kgMS)	**$9.30**	$7.54
– Total advance payments made during the year	**$7.90**	$6.41
– Total owing as at 31 July	**$1.40**	$1.13
Amount advanced during the year as a percentage of the milk price	**85%**	85%

1 Represents the average price for milk supplied on standard terms of supply. The Fonterra Farmgate Milk Price Statement sets out information about the Farmgate Milk Price as calculated in accordance with the Farmgate Milk Price Manual. It can be found in the 'Investors/Farmgate Milk Prices/Milk Price Methodology' section of Fonterra's website.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

Long-term assets

This section provides information about the investments the Group has made in long-term assets to operate the business and generate returns to equity holders. These assets include physical assets such as land and buildings, and non-physical assets such as right-of-use assets, brands and goodwill.

This section includes the following notes:

Note 16: *Property, plant and equipment*

Note 17: *Leases*

Note 18: *Intangible assets*

16. Property, plant and equipment

Items of property, plant and equipment are measured at cost less accumulated depreciation and any impairment losses. Cost includes the purchase consideration and those costs directly attributable to bringing the asset to the location and condition necessary for its intended use. It also includes financing costs directly attributable to the acquisition, production or construction of the asset. Subsequent costs are capitalised only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of any replaced part is derecognised. All other repairs and maintenance costs are charged to the Income Statement during the financial period in which they are incurred.

Gains and losses on disposals are determined by comparing the disposal proceeds with the carrying amount and are recognised in the Income Statement.

Depreciation

Depreciation is calculated on a straight-line basis to allocate the cost of the asset, less any residual value, over its estimated useful life. The range of estimated useful lives for each class of property, plant and equipment is as follows:

– Land	Indefinite
– Buildings and leasehold improvements	2–55 years
– Plant, vehicles and equipment	2–50 years

Judgement is involved in determining the assets' residual values and useful lives, which are reviewed and adjusted, where required, each financial year.

	GROUP $ MILLION				
	LAND	BUILDINGS AND LEASEHOLD IMPROVEMENTS	PLANT, VEHICLES AND EQUIPMENT	CAPITAL WORK IN PROGRESS	TOTAL
As at 31 July 2022					
Cost	**368**	**2,706**	**8,356**	**508**	**11,938**
Accumulated depreciation and impairment	**–**	**(1,189)**	**(4,682)**	**–**	**(5,871)**
Net book value at 31 July 2022	**368**	**1,517**	**3,674**	**508**	**6,067**
As at 31 July 2021					
Cost	350	2,670	8,170	371	11,561
Accumulated depreciation and impairment	–	(1,118)	(4,464)	–	(5,582)
Net book value at 31 July 2021	350	1,552	3,706	371	5,979

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

16. Property, plant and equipment CONTINUED

	GROUP $ MILLION				
	LAND	BUILDINGS AND LEASEHOLD IMPROVEMENTS	PLANT, VEHICLES AND EQUIPMENT	CAPITAL WORK IN PROGRESS	TOTAL
Net book value					
As at 1 August 2021	350	1,552	3,706	371	5,979
Additions[1]	22	16	5	490	533
Transferred from capital work in progress	–	35	309	(344)	–
Depreciation charge	–	(87)	(352)	–	(439)
Impairment	–	–	–	(8)	(8)
Disposals	(6)	(1)	(5)	–	(12)
Foreign currency translation	2	2	11	(1)	14
As at 31 July 2022	368	1,517	3,674	508	6,067

	LAND	BUILDINGS AND LEASEHOLD IMPROVEMENTS	PLANT, VEHICLES AND EQUIPMENT	CAPITAL WORK IN PROGRESS	TOTAL
Net book value					
As at 1 August 2020	357	1,523	3,810	316	6,006
Additions[1]	14	6	2	427	449
Transferred from capital work in progress	–	109	261	(370)	–
Transferred to buildings and leasehold improvements	(19)	19	–	–	–
Acquisition from business combination	–	–	16	–	16
Depreciation charge	–	(86)	(350)	–	(436)
Impairment	–	–	(5)	–	(5)
Disposals	(1)	(5)	(9)	(1)	(16)
Foreign currency translation	(1)	(14)	(19)	(1)	(35)
As at 31 July 2021	350	1,552	3,706	371	5,979

1 Additions include borrowing costs of $7 million (31 July 2021: $5 million) capitalised using a weighted average interest rate of 4.74% (31 July 2021: 4.94%).

There has been no significant impairment of assets during the year ended 31 July 2022.

New Zealand ingredients manufacturing assets

The Group's New Zealand ingredients manufacturing sites are utilised as a single network for processing raw milk supply. In estimating useful lives and residual values of its New Zealand ingredients manufacturing assets, the Group has considered the impact of:

- possible flat or declining milk supply scenarios (together with individual plant peak milk processing requirements);
- environmental matters (such as the New Zealand Government's Emissions Reduction Plan); and
- the Group's investment in sustainability, including its decarbonisation plan to exit coal by 2037.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

17. Leases

The Group is a lessee of various types of assets, including buildings, plant, vehicles and equipment. Right-of-use assets reflect the Group's right to use leased assets. Corresponding lease liabilities reflect the present value of the related future lease payments.

The Group has elected not to recognise right-of-use assets and lease liabilities for leases of low-value assets and short-term leases. These lease costs are recognised as an expense in the Income Statement as incurred.

a) Right-of-use assets

Right-of-use assets are measured at cost, less any accumulated depreciation and any impairment losses. Cost is calculated as the initial amount of the lease liability plus any initial direct costs incurred and an estimate of costs required to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located.

Right-of-use assets are depreciated on a straight-line basis over the lease term, unless the useful life of the asset is less than the lease term or if the Group will own the asset at the end of the lease term. In these situations, the right-of-use asset is depreciated over the useful life of the asset, which is determined on the same basis as those of property, plant and equipment. Right-of-use assets are also adjusted for any impairment losses and certain remeasurements of the lease liability.

The Group enters into lease arrangements for land and buildings with options for renewal that typically run for a period of three to ten years, however some property leases can run up to a period of 50 years. Lease payment changes are renegotiated at periods specified in the lease contracts and are usually based on local price indices or market rental rates.

Leases for plant, vehicles and equipment typically run for a period of two to five years.

Information about right-of-use assets from leases for which the Group is a lessee is presented in the following table.

	GROUP $ MILLION			
	NET BOOK VALUE		DEPRECIATION CHARGE	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021[1]	**YEAR ENDED 31 JULY 2022**	YEAR ENDED 31 JULY 2021
Land	**22**	22	**1**	8
Buildings	**275**	331	**64**	58
Plant, vehicles and equipment	**101**	133	**39**	42
Total	**398**	486	**104**	108

1 Comparative information has been re-presented for consistency with the current period.

Additions to right-of-use assets during the year were $15 million (31 July 2021: $32 million).

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

17. Leases CONTINUED

b) Lease liabilities

Lease liabilities are recognised at the commencement date of the lease as the present value of the lease payments over the lease term. The lease payments include the exercise price of a purchase option where the Group is reasonably certain to exercise the option.

The lease payments are discounted using the incremental borrowing rate at the lease commencement date if the interest rate implicit in the lease is not readily determinable.

The lease term is the non-cancellable period, plus renewal options if they are reasonably certain to be exercised. Once a lease has commenced, the Group will only reassess the lease term on the occurrence of a significant event or change in circumstance that is within its control and affects its ability to exercise, or not exercise, an option not previously included in the lease term.

Total lease liabilities included within borrowings in the Statement of Financial Position are presented in the following table.

	GROUP $ MILLION	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021
Current lease liabilities	94	99
Non-current lease liabilities	344	424
Total lease liabilities	438	523

During the year ended 31 July 2022 total cash payments for leases were $145 million (31 July 2021: $145 million).

In addition to the lease liability recognised, the Group's lease arrangements include renewal options, termination options and residual guarantees that have been assessed as unlikely to result in cash payments.

As at 31 July 2022, the Group has entered into a number of lease arrangements that have not yet commenced. The total lease liability that will be recognised on commencement of these leases in the next 12 months is $1 million (31 July 2021: $2 million).

c) Other lease-related expenses recognised in the Income Statement

	GROUP $ MILLION	
	31 JULY 2022	31 JULY 2021
Interest on lease liabilities	13	17
Variable lease payments not included in the measurement of lease liabilities	4	5
Expenses relating to short-term leases	10	8
Expenses relating to low value leases	10	10
Income from sub-leasing right-of-use assets	1	–

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

18. Intangible assets

The significant intangible assets recognised by the Group are goodwill, brands, software assets, and emissions units.

Goodwill

Goodwill represents the premium paid by the Group over the fair value of the Group's share of the net identifiable assets of an acquired business at the date of acquisition. Goodwill is initially recognised at cost and subsequently measured at cost less accumulated impairment losses. Goodwill is tested for impairment annually and is not amortised.

Brands

Brands that are purchased by the Group are initially recognised at cost, or at their fair value if acquired as part of a business combination, and subsequently measured at cost less any impairment losses. A brand is determined to have an indefinite life where there is an intention to maintain and support the brand for an indefinite period.

Indefinite life brands are tested for impairment annually and are not amortised.

Indefinite life brands that have been impaired are reviewed for possible reversal of impairment annually. A reversal of an impairment loss shall not exceed the carrying amount that would have been recognised had no impairment loss occurred in prior years.

Software assets

Software assets, both purchased and internally developed, are capitalised provided there is an identifiable asset that will generate future economic benefits through cost savings or supporting revenue generation. Subsequent costs are capitalised if they extend the useful life or enhance the functionality of the asset.

Software assets are amortised on a straight-line basis over their estimated useful lives (two to 13 years). Software assets are tested for impairment when an indicator of impairment exists.

Emissions units held for compliance purposes

Emissions units held for compliance purposes are accounted for as intangible assets with an indefinite life and measured at cost less any impairment losses. Emissions units are not amortised.

Refer to Note 13 *Inventories* for further information about emissions units held for trading.

The Group's obligation to surrender emissions units is included in other current liabilities. Emissions units held for compliance purposes expected to be surrendered within twelve months are classified as current intangible assets, and are derecognised as they are surrendered to settle the Group's emissions obligation.

Impairment testing

A cash-generating unit (CGU) is tested for impairment when there are indicators of impairment. An impairment test is also completed on an annual basis when a CGU has goodwill or indefinite life intangibles allocated to it. To determine if an asset or CGU is impaired, the carrying amount of the asset or CGU is compared to its recoverable amount, being the higher of its value in use and fair value less costs to dispose. If the carrying amount is higher than the recoverable amount, the CGU is impaired to its recoverable amount.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

18. Intangible assets CONTINUED

Uncertainty is involved in estimating value in use and fair value less costs to dispose.

Value in use is determined as the present value of the future cash flows expected to be derived from the CGU. The value in use calculation requires the Group to estimate future cash flows, discount rates and terminal growth rates. Cash flows are based on approved forecasts which are consistent with the Board approved strategy. Cash flows do not exceed five years. Discount rates are based on external data where possible.

Where the Group has applied the relief from royalty method for valuing its brands, judgement is involved in estimating royalty rates.

Fair value less costs to dispose reflects the price that would be received to sell the CGU in an orderly transaction between market participants at the measurement date less the costs of disposal.

	GROUP $ MILLION	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021[1]
Current intangible assets	78	47
Non-current intangible assets	2,216	2,195
Total intangible assets	**2,294**	2,242

1 Comparative information includes re-presentations for consistency with the current period.

A breakdown of total intangible assets is presented in the following table.

	GROUP $ MILLION						
	GOODWILL	BRANDS	SOFTWARE	SOFTWARE WIP	EMISSIONS UNITS	OTHER	TOTAL INTANGIBLES
As at 31 July 2022							
Cost	**852**	**1,485**	**1,497**	**74**	**141**	**36**	**4,085**
Accumulated amortisation and impairment	**(319)**	**(237)**	**(1,214)**	**–**	**–**	**(21)**	**(1,791)**
Net book value at 31 July 2022	**533**	**1,248**	**283**	**74**	**141**	**15**	**2,294**
As at 31 July 2021							
Cost	839	1,399	1,493	80	97	28	3,936
Accumulated amortisation and impairment	(310)	(175)	(1,191)	–	–	(18)	(1,694)
Net book value at 31 July 2021	529	1,224	302	80	97	10	2,242

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

18. Intangible assets CONTINUED

	GROUP $ MILLION						
	GOODWILL	BRANDS	SOFTWARE	SOFTWARE WIP	EMISSIONS UNITS	OTHER	TOTAL INTANGIBLES
Net book value							
As at 1 August 2021	529	1,224	302	80	97	10	2,242
Additions	–	–	–	63	113	8	184
Transferred from work in progress	–	–	69	(69)	–	–	–
Impairment	–	(34)	–	–	–	–	(34)
Amortisation	–	–	(89)	–	–	(3)	(92)
Disposals/surrender of units	–	–	–	–	(69)	–	(69)
Foreign currency translation	4	58	1	–	–	–	63
As at 31 July 2022	533	1,248	283	74	141	15	2,294
Net book value							
As at 1 August 2020	537	1,247	354	40	50	12	2,240
Additions	–	–	4	84	96	–	184
Transferred from work in progress	–	–	44	(44)	–	–	–
Amortisation	–	–	(96)	–	–	(2)	(98)
Disposals/surrender of units	–	(2)	(3)	–	(49)	–	(54)
Foreign currency translation	(8)	(21)	(1)	–	–	–	(30)
As at 31 July 2021	529	1,224	302	80	97	10	2,242

Amortisation is recognised in cost of goods sold and other operating expenses in the Income Statement. Impairment is recognised within other operating expenses in the Income Statement.

Goodwill and indefinite life brands

The allocation of goodwill and brands across the Group's reportable segments is presented in the following table. All brands presented in the following table have indefinite lives.

	GROUP $ MILLION					
	AS AT 31 JULY 2022			AS AT 31 JULY 2021		
	GOODWILL	BRANDS	TOTAL	GOODWILL	BRANDS	TOTAL
Asia Pacific reportable segment						
– New Zealand consumer and foodservice CGU	229	282	511	229	282	511
– Australia CGU	140	148	288	131	148	279
– Asia brands	–	678	678	–	653	653
– NZMP brand	–	120	120	–	120	120
AMENA reportable segment						
– Chile CGU	90	20	110	97	21	118
Other CGUs	74	–	74	72	–	72
Total	533	1,248	1,781	529	1,224	1,753

Impairment testing of goodwill and indefinite life brands

The Group has performed impairment tests for CGUs with goodwill or intangible assets with indefinite useful lives. Impairment has been recognised on the Group's Asia brands. No further impairment was identified.

Further information about impairment tests performed for CGUs (or groups of CGUs) with significant goodwill or indefinite life brands is provided below.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

18. Intangible assets CONTINUED

a) New Zealand consumer and foodservice CGU

The recoverable amount of the business was determined on a value in use basis using a discounted cash flow methodology.

The model uses a five-year cash flow forecast based on the three-year business plan approved by the Board. Cash flows for years four and five have been prepared based on growth expectations for the business.

The key drivers for the business to achieve its performance targets are volume growth, margin growth, increases in intra-group revenues and operational cost management. These key assumptions are set as part of the three-year business plan approved by the Board, and reflect past experience and Management's future expectations for the business.

The long-term growth rate applied to the future cash flows after year five of the forecast was 2.0% (31 July 2021: 2.0%). This reflects the expected long-term economic growth rate for New Zealand.

The post-tax discount rate was 8.4% (31 July 2021: 7.5%). The pre-tax discount rate was 11.0% (31 July 2021: 9.8%).

The recoverable amount of the business exceeds its carrying amount by $66 million. The Group has identified that a reasonably possible change in five key assumptions could cause the carrying amount to exceed the recoverable amount. The following table shows the amount by which these assumptions would need to change individually for the carrying amount to exceed estimated recoverable amount.

KEY ASSUMPTIONS	VALUE ATTRIBUTED	CHANGE REQUIRED FOR THE CARRYING AMOUNT TO EXCEED THE RECOVERABLE AMOUNT
Volume growth	2.3%	A decrease in volume growth of 0.5%
Margin growth	3.8%	A decrease in margin growth of 0.5%
Increase in intra-group revenues	$14 million per annum from FY23	A decrease of $6 million per annum
Operational cost management	$15 million by FY25	Savings of $6 million by FY25 not achieved
Discount rate (post-tax)	8.4%	An increase in the discount rate of 0.6%

b) Australia CGU

The recoverable amount of the business was determined on a value in use basis using a discounted cash flow methodology.

The model uses a five-year cash flow forecast based on the three-year business plan approved by the Board. Cash flows for years four and five have been prepared based on growth expectations for the business. A key driver for the business to achieve its performance targets is delivery on identified consumer and foodservice growth opportunities. This key assumption was based on business cases prepared by Management, leveraging from past experience.

The long-term growth rate applied to the future cash flows after year five of the forecast was 2.5% (31 July 2021: 2.0%). This reflects the expected long-term economic growth rate for Australia.

The post-tax discount rate was 7.0% (31 July 2021: 6.5%). The pre-tax discount rate was 9.3% (31 July 2021: 8.7%).

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

18. Intangible assets CONTINUED

c) Asia brands

Asia brands represent the Group's trademarks and other intellectual property in territories outside of New Zealand and Australia, relating to the Anchor, Anmum, Anlene and Chesdale brands.

The relief from royalty method has been used to calculate the recoverable amounts of the brands. The relief from royalty methodology is a value in use calculation which determines the recoverable amount by calculating the present value of what a licensee would theoretically pay as a royalty to use the brands. The royalty rates applied in the calculation are determined based on comparable market data and range from 3% to 7% (31 July 2021: 3% to 7%). The key assumption used in the relief from royalty method is forecast sales growth. The value attributed to the assumption is based on five-year cash flow forecasts using the three-year business plans approved by the Board. Cash flows for years four and five have been prepared based on growth expectations for the brand.

For these brands, the long-term growth rates applied to the future sales revenue used in the valuation model range from 1.6% to 7.4% (31 July 2021: 2.0% to 6.5%) and the range of discount rates (post-tax) that have been applied in the valuation model range from 8.8% to 31.5% (31 July 2021: 7.0% to 18.0%), country dependent. The range of pre-tax discount rates was 11.1% to 41.4% (31 July 2021: 8.8% to 23.1%).

The carrying amount for the Anchor, Anlene and Anmum brands and cash flow forecasts for each region are in local currency and converted to NZD.

Anlene brand

The recoverable amount of the Anlene brand was assessed to be $195 million. This was lower than the carrying value of the brand, resulting in an impairment of $22 million. The impairment was a result of changes in discount rates, long-term growth rates and foreign exchange rates. Impairment was recognised in the Group's Asia Pacific operating segment.

As the brand is sold across a number of markets, all with different characteristics, the range of post-tax discount rates applied was 9.2% to 31.5% (31 July 2021: 7.0% to 18.0%). The range of pre-tax discount rates was 11.1% to 41.4% (31 July 2021: 8.8% to 23.1%).

Anmum brand

The recoverable amount of the Anmum brand was assessed to be $114 million. This was lower than the carrying value of the brand, resulting in an impairment of $11 million. The impairment was a result of changes in discount rates, long-term growth rates and foreign exchange rates. Impairment was recognised in the Group's Asia Pacific operating segment.

As the brand is sold across a number of markets, all with different characteristics, the range of post-tax discount rates applied was 9.2% to 15.8% (31 July 2021: 7.0% to 11.5%). The range of pre-tax discount rates was 11.1% to 19.8% (31 July 2021: 8.8% to 14.4%).

Chesdale brand

The recoverable amount of the Chesdale brand was assessed to be $27 million. This was lower than the carrying value of the brand, resulting in an impairment of $1 million. The impairment was a result of changes in discount rates, long-term growth rates and foreign exchange rates. Impairment was recognised in the Group's Greater China operating segment.

As the brand is sold across a number of markets, all with different characteristics, the range of post-tax discount rates applied was 8.8% to 31.5% (31 July 2021: 7.0% to 16.5%). The range of pre-tax discount rates was 11.1% to 41.4% (31 July 2021: 8.8% to 21.7%).

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

Financial risk management

This section outlines the key risk management activities undertaken to manage the Group's exposure to financial risk.

This section includes the following notes:

Note 19: *Financial risk management*

Note 20: *Hedge accounting*

19. Financial risk management

The Group has exposure to the following financial risks:

- market risk;
- liquidity risk; and
- credit risk.

The Group's overall financial risk management programme focuses primarily on maintaining a financial risk profile that provides flexibility to implement the Group's strategies, while optimising return on assets. Financial risk management is centralised, which supports compliance with the financial risk management policies and procedures set by the Board.

The Group uses derivatives, such as forwards, futures, options and swaps to manage its exposure to certain risks as described in this section. Derivatives are measured at fair value.

Measurement differences between derivatives and the associated item being hedged can present volatility in the Income Statement. To reduce this volatility the Group applies hedge accounting. Refer to Note 20 *Hedge accounting* for further information.

Market risk

a) Foreign exchange risk

Nature and exposure of risk

Foreign exchange risk is the risk that changes in foreign exchange rates will affect the Group's future cash flows or fair value of financial instruments.

The Group is exposed to movements in foreign exchange rates through transactions and balances denominated in foreign currencies. The Group's exposure to foreign currency before applying risk management strategies are as follows:

- forecast foreign currency transactions, which predominately includes the Group's forecast sales transactions which are mainly denominated in United States Dollars.
- net investments in foreign operations of $4,067 million (31 July 2021: $3,729 million). This amount excludes net investments in foreign operations held for sale and borrowings held by the Group in the same currency as the investment.
- borrowings denominated in foreign currency of $3,506 million (31 July 2021: $3,780 million).
- foreign currency receivables of $2,089 million (31 July 2021: $1,459 million) and payables of $1,075 million (31 July 2021: $991 million).

How foreign exchange risk is managed

Forecast foreign currency transactions

The Group enters into foreign currency forward contracts and foreign currency options to manage foreign exchange risk on the following forecast foreign currency transactions:

- forecast cash receipts from foreign currency sales for a period of up to 18 months within decreasing limits approved by the Board; and
- up to 100% of other forecast foreign currency transactions.

Foreign operations

The Group uses foreign currency denominated borrowings and foreign currency swaps to manage foreign exchange risk on net investments in foreign operations.

Foreign currency denominated borrowings

To the extent the Group has monetary assets in the same foreign currency as the borrowing, the Group has a reduced exposure to foreign exchange risk. Foreign currency gains and losses relating to these balances are offset in the Income Statement.

The Group uses cross-currency interest rate swaps (CCIRS) to manage residual foreign exchange and interest rate risk on foreign currency denominated borrowings. CCIRS exchange fixed rate foreign currency borrowings and interest payments into equivalent New Zealand Dollar-denominated amounts of principal with floating interest rates. The Group's policy is to maintain its net exposure to a foreign currency within predefined limits.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

19. Financial risk management CONTINUED

a) Foreign exchange risk CONTINUED

Receivables and payables denominated in foreign currency

The Group typically enters into foreign currency forward contracts and foreign currency options for 100% of its net foreign currency receivables and payables which generate foreign exchange risk within the Income Statement.

Derivatives used to hedge the changes in the value of foreign currency receivables and payables are not hedge accounted. Changes in the fair value of these derivatives provide an offset to the changes in the value of foreign currency receivables and payables recognised in the Income Statement. These are recognised within other operating expenses in the Income Statement.

Sensitivity analysis

The following table presents the Group's sensitivity, after taking into consideration the impact of hedge accounting, from a reasonably possible strengthening or weakening NZD against foreign currencies, with all other variables held constant.

Assets and liabilities held for sale have been excluded from the sensitivity analysis in the following table.

	GROUP $ MILLION			
	31 JULY 2022		31 JULY 2021	
	EQUITY	PROFIT	EQUITY	PROFIT
10% strengthening of the NZD	**513**	**10**	351	16
10% weakening of the NZD	**(617)**	**(13)**	(366)	(17)

b) Interest rate risk

Nature and exposure of risk

Interest rate risk is the risk that changes in interest rates will affect the Group's future cash flows or fair value of financial instruments.

Changes in interest rates expose the Group to changes in the fair value of borrowings subject to fixed interest rates (fair value risk), and changes in future interest payments on borrowings subject to floating interest rates (cash flow risk).

The Group is exposed to movements in interest rates on its interest-bearing borrowings. The Group's exposure before applying risk management strategies is $4,845 million (31 July 2021: $3,944 million).

How interest rate risk is managed

The Group issues fixed and floating rate debt and uses interest rate swaps (IRS) to manage interest rate exposure on its borrowings within a Board approved target ratio of fixed and floating rate exposure.

Sensitivity analysis

The following table presents the Group's sensitivity, after taking into consideration the impact of hedge accounting, from a reasonably possible increase or decrease in interest rates, with all other variables held constant. Hedge ineffectiveness relating to interest rate swaps that have been designated into hedge relationships after their initial recognition contributes to $3 million of the impact on profit from a 100 basis point movement (31 July 2021: $20 million).

Assets and liabilities held for sale have been excluded from the sensitivity analysis in the following table.

	GROUP $ MILLION			
	31 JULY 2022		31 JULY 2021	
	EQUITY	PROFIT	EQUITY	PROFIT
100 basis point increase	**48**	**3**	48	21
100 basis point decrease	**(50)**	**(3)**	(55)	(17)

A change in interest rates would also impact floating rate interest payments and receipts on the Group's borrowing and derivatives held at balance date. The impact of a change in interest rates on one-year contracted cash flows is presented in the following table.

	GROUP $ MILLION	
	31 JULY 2022	31 JULY 2021
100 basis point increase	**(7)**	(1)
100 basis point decrease	**7**	1

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

19. Financial risk management CONTINUED

c) Commodity price risk

Nature and exposure of risk

Commodity price risk is the risk that changes in commodity prices will affect the Group's future cash flows or fair value of financial instruments.

The Group is exposed to dairy commodity price risk through changes in selling prices and the cost of milk. In addition, the Group is a large purchaser of electricity and diesel and is exposed to changes in the cost of these commodities.

How commodity price risk is managed

Dairy commodity price risk

The Group manages its exposure to dairy commodity price risk by:

- determining the most appropriate mix of products to manufacture based on expected milk supply and global demand for dairy products;
- governing the length and terms of sales contracts, so that sales revenue is reflective of current market prices and is, where possible, linked to Global Dairy Trade prices; and
- using dairy commodity derivative contracts to obtain a certain price for future sales, or the cost of milk, to manage margin risk. The markets for dairy commodity derivatives are relatively limited, which reduces the ability to manage earnings volatility. As markets for these derivatives grow, the use of dairy commodity derivatives to manage dairy commodity price risk may increase.

Other commodity price risk

The Group manages its exposure to other commodity price risk through the use of derivative contracts, which are transacted at Board approved levels, to hedge the cost of electricity and diesel.

Sensitivity analysis

The following table presents the Group's sensitivity on its commodity derivatives, after taking into consideration the impact of hedge accounting, from a reasonably possible increase or decrease in commodity prices, with all other variables held constant. Commodity price sensitivity arises from the revaluation of derivative assets and liabilities in the Statement of Financial Position at balance date.

	GROUP $ MILLION			
	31 JULY 2022		31 JULY 2021	
	EQUITY	PROFIT	EQUITY	PROFIT
10% increase in commodity prices	76	35	40	31
10% decrease in commodity prices	(77)	(35)	(40)	(31)

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

19. Financial risk management CONTINUED

Liquidity risk

Nature and exposure of risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. Timings of the gross contractual cash flows for the Group's financial instruments are presented in the following tables.

	GROUP $ MILLION					
	AS AT 31 JULY 2022					
	CARRYING AMOUNT	CONTRACTUAL CASH FLOWS	3 MONTHS OR LESS	3-12 MONTHS	1-5 YEARS	MORE THAN 5 YEARS
Non-derivative financial liabilities						
Borrowings						
– Bank loans	(999)	(1,119)	(17)	(33)	(1,069)	–
– Commercial paper	(98)	(100)	–	(100)	–	–
– Lease liabilities	(438)	(443)	(26)	(70)	(210)	(137)
– Capital notes	(35)	(41)	–	(1)	(5)	(35)
– NZX-listed bonds	(250)	(270)	(3)	(157)	(110)	–
– Medium-term notes	(3,436)	(4,031)	(25)	(117)	(2,450)	(1,439)
Bank overdraft	(31)	(31)	(31)	–	–	–
Owing to suppliers	(2,119)	(2,119)	(2,018)	(101)	–	–
Trade and other payables (excluding employee entitlements)	(2,035)	(2,035)	(2,035)	–	–	–
Other financial liabilities	(32)	(32)	(17)	–	(15)	–
Financial guarantees issued[1]	–	(1)	(1)	–	–	–
Total non-derivative financial liabilities	(9,473)	(10,222)	(4,173)	(579)	(3,859)	(1,611)
Derivative financial instruments						
Gross settled derivatives						
Inflow		22,840	7,871	10,153	3,589	1,227
Outflow		(23,476)	(8,098)	(10,605)	(3,721)	(1,052)
Total gross settled derivative financial instruments	(639)	(636)	(227)	(452)	(132)	175
Net settled derivatives	257	274	109	70	97	(2)
Total financial liabilities and derivatives	(9,855)	(10,584)	(4,291)	(961)	(3,894)	(1,438)

1 Maximum cash flows under guarantees provided by the Group.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

19. Financial risk management CONTINUED

	GROUP $ MILLION					
	AS AT 31 JULY 2021					
	CARRYING AMOUNT	CONTRACTUAL CASH FLOWS	3 MONTHS OR LESS	3-12 MONTHS	1-5 YEARS	MORE THAN 5 YEARS
Non-derivative financial liabilities						
Borrowings						
– Bank loans	(11)	(11)	(6)	(5)	–	–
– Lease liabilities	(523)	(528)	(27)	(74)	(252)	(175)
– Capital notes	(35)	(40)	–	(1)	(4)	(35)
– NZX-listed bonds	(600)	(639)	(361)	(7)	(271)	–
– Medium-term notes	(3,903)	(4,344)	(126)	(383)	(2,116)	(1,719)
Bank overdraft	(20)	(20)	(20)	–	–	–
Owing to suppliers[1]	(1,825)	(1,825)	(1,718)	(107)	–	–
Trade and other payables (excluding employee entitlements)	(1,876)	(1,876)	(1,876)	–	–	–
Other financial liabilities	(60)	(60)	(15)	(6)	(38)	(1)
Financial guarantees issued[2]	–	(1)	(1)	–	–	–
Total non-derivative financial liabilities	(8,853)	(9,344)	(4,150)	(583)	(2,681)	(1,930)
Derivative financial instruments						
Gross settled derivatives						
Inflow		18,662	6,850	7,577	2,731	1,504
Outflow		(18,524)	(6,776)	(7,562)	(2,833)	(1,353)
Total gross settled derivative financial instruments	142	138	74	15	(102)	151
Net settled derivatives	101	120	28	13	70	9
Total financial liabilities and derivatives	(8,610)	(9,086)	(4,048)	(555)	(2,713)	(1,770)

1 Comparative information includes re-presentations for consistency with the current period.
2 Maximum cash flows under guarantees provided by the Group.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

19. Financial risk management CONTINUED

How liquidity risk is managed

The Group's approach to managing liquidity risk is to ensure that it will always have sufficient funds to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group has a Board approved policy in place to ensure that it has sufficient cash or facilities on demand to meet expected operational expenses for a period of at least 80 days, including the servicing of financial obligations. This excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters. In such situations back-up funding lines are maintained and as set out in Fonterra's Constitution, the Group can defer payments to farmer shareholders if necessary.

The Group manages its liquidity by retaining cash and marketable securities, the availability of funding from an adequate amount of committed credit facilities and the ability to close out market positions. The Group's funding facilities are reviewed at least annually, which is one of the key financial risk management activities undertaken by the Group to ensure an appropriate maturity profile given the nature of the Group's business. At balance date the Group had undrawn lines of committed credit totalling $2,345 million (31 July 2021: $2,905 million).

Liquidity and refinancing risks are also managed by ensuring that the Group can maintain access to funding markets throughout the world. To that end, the Group maintains debt issuance programmes in a number of key markets and manages relationships with international investors.

The concentration of NZX-listed bonds and medium-term notes by currency is presented in the following table.

	GROUP $ MILLION	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021
New Zealand Dollar	345	908
Australian Dollar	708	894
United States Dollar	1,437	1,432
British Pound	447	488
European Euro	559	603
Chinese Renminbi	190	178
Total	3,686	4,503

Credit risk

Nature and exposure of risk

Credit risk is the risk of loss to the Group due to customer or counterparty default on the Group's receivable balances. The Group's maximum exposure to credit risk is represented by the carrying amounts of cash and cash equivalents, trade and other receivables, long-term advances and derivative assets.

The Group has no significant concentrations of credit risk.

How credit risk is managed

The Group sets minimum credit quality requirements, credit limits and uses other credit mitigation tools to manage its credit risk. The Group's Board approved policy is to actively manage its exposure to credit risk through the following actions:

Derivative contracts, cash and cash equivalents and other balances

- Use of financial counterparties that have a credit rating of at least 'A-' from Standard & Poor's (or equivalent);
- Use of commodity counterparties that have a credit rating of at least 'BBB-' from Standard & Poor's (or equivalent) for commodity derivative contracts; and
- Posting or receiving margin in respect of derivative contracts transacted on exchanges. As at 31 July 2022 the Group received $54 million (31 July 2021: received $14 million) of margin as collateral for derivative financial instruments.

The Group further manages its credit risk through the following:

Trade and other receivables

- Application of credit limits, and credit mitigation tools, such as letters of credit.

Long-term advances

- Counterparty creditworthiness is assessed before the commencement of any long-term advances. Depending on the nature and amount of the advance, they are subject to Board approval. The collectability of long-term advances is monitored on a regular basis.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

20. Hedge accounting

Derivatives are measured at fair value. Refer to Note 25 *Fair value measurement* for information on how fair value is determined.

The resulting gain or loss on re-measurement is recognised immediately in the Income Statement, unless the derivative is designated into an effective hedge relationship as a hedging instrument, in which case the timing of recognition in the Income Statement depends on the nature of the designated hedge relationship.

The Group may designate derivatives as:

- fair value hedges (where the derivative is used to manage the variability in the fair value of recognised assets and liabilities);
- cash flow hedges (where the derivative is used to manage the variability in cash flows relating to recognised liabilities or forecast transactions); or
- net investment hedges (where borrowings or derivatives are used to manage the risk of fluctuation in the translated value of its foreign operations).

Hedge accounting is discontinued when the hedging instrument expires, is terminated, is exercised, or no longer qualifies for hedge accounting.

Fair value hedges

For fair value hedges the following are recognised in the Income Statement:

- the change in fair value of the hedging instruments; and
- the change in the fair value of the underlying hedged item attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, hedge accounting is discontinued. The fair value adjustment to the carrying amount of the hedged item upon discontinuance is amortised and recognised in the Income Statement over the remaining term of the original hedge. If the hedged item is sold or extinguished any unamortised fair value adjustment is immediately recognised in the Income Statement.

Cash flow hedges

The effective portion of changes in the fair value of the hedging instruments are recognised in other comprehensive income in the Statement of Comprehensive Income and accumulated in a separate reserve in equity. Subsequently the cumulative amount is transferred to the Income Statement when the underlying transactions are recognised in the Income Statement.

The ineffective portion of changes in the fair value of the hedging instruments are recognised immediately in the Income Statement.

If the hedge no longer meets the criteria for hedge accounting, hedge accounting is discontinued. The cumulative gain or loss recognised in other comprehensive income remains in the hedge reserve until the forecast transaction occurs, or it is immediately recognised in the Income Statement if the transaction is no longer expected to occur.

Net investment hedges

The effective portion of changes in the fair value of the hedging instruments are recognised in the Statement of Comprehensive Income and transferred to the Income Statement when the foreign operation is disposed of or sold.

The ineffective portion of changes in the fair value of the hedging instruments are recognised immediately in the Income Statement.

Costs of hedging

The change in fair value of a hedging instrument relating to the time-value of foreign currency options, and the foreign currency basis component of cross-currency interest rate swaps are recognised in other comprehensive income and accumulated within hedge reserves in the Statement of Financial Position. Subsequently, the cumulative amount is transferred to the Income Statement at the same time as the hedged item impacts the Income Statement.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

20. Hedge accounting CONTINUED

The Group's risk management activities described in Note 19 *Financial risk management* result in volatility to the Income Statement caused by timing and measurement differences between hedging instruments and the associated item being hedged. Where a hedge relationship between a hedged item and the hedging instrument (e.g. a derivative) qualifies for hedge accounting, and the Group applies hedge accounting, the volatility in the Income Statement caused by the timing and measurement differences between hedging instruments and the associated hedged item is reduced. The Group applies the following hedge accounting activities.

Foreign exchange risk

Forecast foreign currency transactions

The Group applies cash flow hedge accounting where derivatives are used to manage foreign exchange risk on forecast foreign currency transactions. The amount and maturity of the derivative and the forecast transaction is aligned to ensure that the hedge relationship remains effective, with any undesignated costs of hedging accounted for separately.

Hedge ineffectiveness arises if the amount of the forecast transactions falls below the amount of the designated hedging instruments.

The Income Statement impact of hedge accounting effectiveness and ineffectiveness is recognised in revenue from sale of goods.

Foreign operations

The Group's net investments are designated in hedge relationships to the extent borrowings denominated in the same foreign currency and foreign currency swaps are directly attributed to the net investment.

Hedge ineffectiveness arises if the carrying amount of the net investment falls below the amount of the designated hedging instruments.

The Income Statement impact of hedge accounting effectiveness and ineffectiveness is recognised in other operating expenses.

Foreign currency denominated borrowings

The Group applies hedge accounting to foreign currency denominated borrowings that are managed by CCIRS. The amount and maturity of the CCIRS and the hedged debt is aligned to ensure that the hedge relationship remains effective, with any undesignated costs of hedging accounted for separately.

The hedge relationship may be designated into separate cash flow hedges and fair value hedges to manage the different components of foreign currency and interest rate risk:

- fair value hedge relationship where CCIRS are used to manage the interest rate and foreign currency risk in relation to foreign currency denominated borrowings with fixed interest rates.
- cash flow hedge relationship where CCIRS are used to manage the variability in cash flows arising from interest rate movements on floating interest rate payments and foreign exchange movements on payments of principal and interest.

Hedge ineffectiveness arises in relation to CCIRS that have been designated in hedge relationships after their initial recognition, or from changes in counterparty credit risk and cross currency basis spreads.

The Income Statement impact of hedge accounting effectiveness and ineffectiveness is recognised in net finance costs and other operating expenses.

Interest rate risk

The Group applies hedge accounting to the borrowings and the associated IRS, for movements in benchmark market interest rates (i.e. excluding any margin component).

Hedge ineffectiveness arises in relation to IRS that have been designated to hedge relationships after their initial recognition or from changes in counterparty credit risk.

In specific situations, where changes in the fair value of fixed to floating IRS provide an offset to the changes in the fair value of other associated floating-to-fixed IRS, hedge accounting is not applied. The changes in fair values of these IRS offset each other and are recognised within net finance costs in the Income Statement.

The Income Statement impact of hedge accounting effectiveness and ineffectiveness is recognised in net finance costs.

Commodity price risk

The Group applies cash flow hedge accounting where derivatives are used to manage commodity price risk on certain forecast transactions. The amount and maturity of the derivative and the forecast transaction is aligned to ensure that the hedge relationship remains effective.

Hedge ineffectiveness arises if the amount of the forecast transactions falls below the amount of the designated hedging instruments.

The Income Statement impact of hedge accounting effectiveness and ineffectiveness is recognised in cost of goods sold and other operating expenses.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

20. Hedge accounting CONTINUED

a) Hedging instruments designated in a hedge accounting relationship

Information about hedging instruments that the Group has designated in a hedge accounting relationship is presented in the following tables.

	AS AT 31 JULY 2022					
			GROUP $ MILLION			
				CARRYING AMOUNT IN THE STATEMENT OF FINANCIAL POSITION		
RISK AND HEDGING INSTRUMENTS	MATURITY (MONTHS)	WEIGHTED AVERAGE RATE/PRICE	NOMINAL AMOUNT[1]	DERIVATIVE ASSETS	DERIVATIVE LIABILITIES	BORROWINGS
Foreign exchange risk – Forecast foreign currency transactions						
Cash flow hedges						
NZD:USD forwards and options (sales)	1–18	0.663	14,636	42	(610)	–
USD:CNY forwards and options (sales)	1–12	6.615	708	14	(2)	–
AUD:USD forwards (sales)	1–12	0.714	165	1	(4)	–
USD:AUD forwards (purchases)	1–30	0.714	125	4	(2)	–
AUD:AED forwards (sales)	1–9	2.573	46	–	–	–
Total			15,680	61	(618)	–
Foreign exchange risk – Foreign operations						
Net investment hedges						
AUD borrowings	64	–	89	–	–	(89)
EUR borrowings	28	–	157	–	–	(157)
NZD:CNY forwards	5	4.340	19	–	(1)	–
Total			265	–	(1)	(246)
Foreign exchange risk and interest rate risk – Foreign currency denominated borrowings						
Cash flow and fair value hedges						
NZD:USD CCIRS	50–97	0.760/Floating	1,184	239	–	–
NZD:GBP CCIRS	17	0.361/Floating	623	9	(206)	–
NZD:EUR CCIRS	28	0.656/Floating	386	10	–	–
NZD:CNY CCIRS	36	4.669/Floating	171	16	–	–
Total			2,364	274	(206)	–

1 Nominal amount is the face value converted into New Zealand Dollars using the exchange rate at year-end, except for CCIRS which are converted using the weighted average contracted foreign exchange rate.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

20. Hedge accounting CONTINUED

a) Hedging instruments designated in a hedge accounting relationship CONTINUED

	AS AT 31 JULY 2022					
			GROUP $ MILLION			
				CARRYING AMOUNT IN THE STATEMENT OF FINANCIAL POSITION		
RISK AND HEDGING INSTRUMENTS	MATURITY (MONTHS)	WEIGHTED AVERAGE RATE/PRICE	NOMINAL AMOUNT[1]	DERIVATIVE ASSETS	DERIVATIVE LIABILITIES	BORROWINGS
Interest rate risk – Borrowings						
Cash flow hedges						
NZD IRS	1–60	2.43%	4,193	106	(12)	–
AUD IRS	23–25	3.34%	178	–	–	–
Total			4,371	106	(12)	–
Fair value hedges						
NZD IRS	8–40	Floating	250	–	(4)	–
AUD IRS	47–64	Floating	534	–	(19)	–
Total			784	–	(23)	–
Commodity price risk – Forecast transactions						
Cash flow hedges[2]						
Fuel futures	1–18	$109.55	25	5	–	–
Milk Price futures and options	3–27	$8.50	1,291	130	–	–
Electricity futures	1–45	$119.81	138	28	–	–
Total			1,454	163	–	–

1 Nominal amount is the face value converted into New Zealand Dollars using the exchange rate at year-end, except for CCIRS which are converted using the weighted average contracted foreign exchange rate.
2 The weighted average prices for commodity hedges are presented as the price per barrel for fuel futures (shown in USD), kilogram of milk solid for milk price futures and options, and per megawatt hour for electricity futures.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

20. Hedge accounting CONTINUED

a) Hedging instruments designated in a hedge accounting relationship CONTINUED

	AS AT 31 JULY 2021					
			GROUP $ MILLION			
				CARRYING AMOUNT IN THE STATEMENT OF FINANCIAL POSITION		
RISK AND HEDGING INSTRUMENTS	MATURITY (MONTHS)	WEIGHTED AVERAGE RATE/PRICE	NOMINAL AMOUNT[1]	DERIVATIVE ASSETS	DERIVATIVE LIABILITIES	BORROWINGS
Foreign exchange risk – Forecast foreign currency transactions						
Cash flow hedges						
NZD:USD forwards and options (sales)	1–18	0.707	11,205	152	(98)	–
USD:CNY forwards and options (sales)	1–12	6.672	1,117	3	(18)	–
AUD:USD forwards (sales)	2–13	0.776	72	1	(4)	–
Total			12,394	156	(120)	–
Foreign exchange risk – Foreign operations						
Net investment hedges						
AUD borrowings	76	–	84	–	–	(84)
EUR borrowings	40	–	164	–	–	(164)
NZD:CNY forwards	11	4.603	18	–	–	–
Total			266	–	–	(248)
Foreign exchange risk and interest rate risk – Foreign currency denominated borrowings						
Cash flow and fair value hedges						
NZD:USD CCIRS	62–109	0.760/Floating	1,184	227	–	–
NZD:GBP CCIRS	29	0.361/Floating	623	40	(211)	–
NZD:EUR CCIRS	40	0.656/Floating	386	39	–	–
NZD:CNY CCIRS	48	4.669/Floating	171	5	–	–
Total			2,364	311	(211)	–

1 Nominal amount is the face value converted into New Zealand Dollars using the exchange rate at year-end, except for CCIRS which are converted using the weighted average contracted foreign exchange rate.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

20. Hedge accounting CONTINUED

a) Hedging instruments designated in a hedge accounting relationship CONTINUED

	AS AT 31 JULY 2021					
			GROUP $ MILLION			
				CARRYING AMOUNT IN THE STATEMENT OF FINANCIAL POSITION		
RISK AND HEDGING INSTRUMENTS	MATURITY (MONTHS)	WEIGHTED AVERAGE RATE/PRICE	NOMINAL AMOUNT[1]	DERIVATIVE ASSETS	DERIVATIVE LIABILITIES	BORROWINGS
Interest rate risk – Borrowings						
Cash flow hedges						
NZD IRS	3–60	2.39%	4,018	22	(103)	–
AUD IRS	35–37	3.34%	169	–	(14)	–
Total			4,187	22	(117)	–
Fair value hedges						
NZD IRS	20–52	Floating	250	10	–	–
AUD IRS	10–76	Floating	559	46	–	–
Total			809	56	–	–
Commodity price risk – Forecast transactions						
Cash flow hedges[2]						
Fuel futures	1–18	$65.38	13	3	–	–
Milk Price futures and options	3–27	$6.95	707	83	–	–
Electricity futures	1–30	$100.15	109	21	–	–
Total			829	107	–	–

1 Nominal amount is the face value converted into New Zealand Dollars using the exchange rate at year-end, except for CCIRS which are converted using the weighted average contracted foreign exchange rate.
2 The weighted average prices for commodity hedges are presented as the price per barrel for fuel futures (shown in USD), kilogram of milk solid for milk price futures and options, and per megawatt hour for electricity futures.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

20. Hedge accounting CONTINUED

b) Impact of hedge accounting

Information about the impact of hedge accounting on the Group's Financial Statements is presented in the following tables.

	GROUP $ MILLION					
	AS AT 31 JULY 2022		YEAR ENDED 31 JULY 2022			
RISK AND HEDGING INSTRUMENTS USED	ACCUMULATED COST OF HEDGING	CHANGE IN VALUE USED TO CALCULATE HEDGE EFFECTIVENESS[1]	CHANGE IN VALUE OF HEDGING INSTRUMENT RECOGNISED IN OCI	AMOUNT RECLASSIFIED FROM HEDGING RESERVE TO INCOME STATEMENT	FAIR VALUE HEDGE ADJUSTMENTS RECOGNISED IN THE INCOME STATEMENT GAIN/(LOSS)[2]	HEDGE INEFFECTIVENESS RECOGNISED IN THE INCOME STATEMENT GAIN/(LOSS)
Foreign exchange risk – Forecast foreign currency transactions						
Cash flow hedges	(56)	(545)	(973)	409	–	–
Foreign exchange risk – Foreign operations						
Net investment hedges	–	2	2	–	–	–
Foreign exchange risk and interest rate risk – Foreign currency denominated borrowings						
Cash flow and fair value hedges	(8)	145	14	5	(82)	5
Interest rate risk – Borrowings						
Cash flow hedges	–	168	106	42	–	42
Fair value hedges	–	(26)	–	–	(79)	–
Commodity price risk – Forecast transactions						
Cash flow hedges	–	158	127	(148)	–	3
Total	(64)	N/A	(724)	308	(161)	50

1 For those borrowings in a net investment hedge, the change in value to calculate hedge effectiveness is for the year ended 2022.
2 For those borrowings in fair value hedges, life-to-date fair value hedge adjustments decrease the carrying amount of borrowings by $9 million.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

20. Hedge accounting CONTINUED

b) Impact of hedge accounting CONTINUED

	GROUP $ MILLION					
	AS AT 31 JULY 2021		YEAR ENDED 31 JULY 2021			
RISK AND HEDGING INSTRUMENTS USED	ACCUMULATED COST OF HEDGING	CHANGE IN VALUE USED TO CALCULATE HEDGE EFFECTIVENESS[1]	CHANGE IN VALUE OF HEDGING INSTRUMENT RECOGNISED IN OCI	AMOUNT RECLASSIFIED FROM HEDGING RESERVE TO INCOME STATEMENT	FAIR VALUE HEDGE ADJUSTMENTS RECOGNISED IN THE INCOME STATEMENT GAIN/(LOSS)[2]	HEDGE INEFFECTIVENESS RECOGNISED IN THE INCOME STATEMENT GAIN/(LOSS)
Foreign exchange risk – Forecast foreign currency transactions						
Cash flow hedges	(24)	19	323	(664)	–	–
Foreign exchange risk – Foreign operations						
Net investment hedges	–	10	10	–	–	–
Foreign exchange risk and interest rate risk – Foreign currency denominated borrowings						
Cash flow and fair value hedges	(14)	189	(42)	57	(152)	(1)
Interest rate risk – Borrowings						
Cash flow hedges	–	3	70	51	–	45
Fair value hedges	–	54	–	–	(31)	–
Commodity price risk – Forecast transactions						
Cash flow hedges	–	107	154	(95)	–	–
Total	(38)	N/A	515	(651)	(183)	44

1 For those borrowings in a net investment hedge, the change in value to calculate hedge effectiveness is for the year ended 2021.
2 For those borrowings in fair value hedges, life-to-date fair value hedge adjustments increase the carrying amount of borrowings by $260 million.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

20. Hedge accounting CONTINUED

c) Impact to reserves in equity

Hedge reserves

	GROUP $ MILLION	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021
Opening balance	**(26)**	101
Movements attributable to cash flow hedges		
Change in value of effective derivative hedging instruments	**(726)**	505
Reclassifications to the Income Statement:		
– As hedged transactions occurred	**308**	(651)
Net change in the cost of hedging reserve	**(26)**	(30)
Tax credit	**124**	49
Total movement	**(320)**	(127)
Closing balance[1]	**(346)**	(26)

1 Included in the closing balance of the hedge reserves is a credit balance of $1 million (31 July 2021: credit balance of $1 million) relating to hedge relationships for which hedge accounting is no longer applied.

Foreign currency translation reserve

	GROUP $ MILLION	
	31 JULY 2022	31 JULY 2021
Opening balance	**(355)**	(229)
Movements attributable to net investments in foreign operations and net investment hedges		
Net translation loss on:		
– Borrowings and derivative hedging instruments	**76**	(67)
– Net investments in foreign operations	**27**	(42)
Reclassifications to the Income Statement:		
– Disposals of foreign operations	**(1)**	(14)
– Tax expense	**–**	(3)
Total movement	**102**	(126)
Closing balance[1]	**(253)**	(355)

1 Included in the closing balance of the foreign currency translation reserve is a debit balance of $26 million (31 July 2021: debit balance of $22 million) relating to hedge relationships for which hedge accounting is no longer applied.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

20. Hedge accounting CONTINUED

d) Income Statement impact from derivatives not designated in a hedge relationship

In addition to derivatives that are designated and qualify for hedge accounting, the Group also holds certain derivatives as economic hedges of foreign currency, commodity and interest rate exposure.

The impact of derivatives not designated in a hedging relationship is presented in the following table.

		GROUP $ MILLION	
DERIVATIVES NOT DESIGNATED IN A HEDGING RELATIONSHIP	LOCATION OF GAIN/(LOSS) IN INCOME STATEMENT	**31 JULY 2022**	31 JULY 2021
Foreign currency contracts	Revenue from sale of goods	**–**	4
Foreign currency contracts	Other operating expenses[1]	**(182)**	25
Commodity contracts	Cost of goods sold	**(39)**	14
Commodity contracts	Other operating expenses	**9**	(1)
Interest rate contracts	Finance costs	**7**	(2)
Total		**(205)**	40

1 These predominantly relate to foreign currency contracts hedging net receivables. The revaluation of the net receivables also recognised in other operating expenses is a gain of $207 million (31 July 2021: loss of $35 million).

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

Other

This section contains additional notes and disclosures that aid in understanding the Group's position and performance but do not form part of the primary sections.

This section includes the following notes:

21. Taxation

Tax expense comprises current and deferred tax. Tax expense, including the tax consequences of distributions to farmer shareholders, is recognised in the Income Statement. The tax consequences of distributions to farmer shareholders are recognised in the year to which the distribution relates. Other than distributions to farmer shareholders, tax consequences of items recognised directly in equity are also recognised in equity.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at balance date, and any adjustment to tax payable or receivable in respect of previous years.

Deferred tax arises due to certain temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and those for taxation purposes. Deferred tax is measured at the tax rate that is expected to apply to the temporary differences when they reverse, based on laws that have been enacted or substantively enacted at balance date.

Deferred tax is not recognised on the following temporary differences:

- the initial recognition of goodwill;
- the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit; and
- differences relating to investments in subsidiaries and equity accounted investees to the extent that the timing of the reversal is controlled by the Group and it is probable that they will not reverse in the foreseeable future.

In determining the probability of reversal, consideration is taken of whether the related assets are held for sale, future expectations of exiting, and if applicable, the impact any exit would have on the crystallisation of the deferred tax.

Deferred tax assets are recognised to the extent it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

21. Taxation CONTINUED

a) Taxation – Income Statement

The total tax expense in the Income Statement is summarised in the following table.

	GROUP $ MILLION	
	31 JULY 2022	31 JULY 2021
Current tax expense	118	83
Prior period adjustments to current tax	(9)	11
Deferred tax movements:		
– Origination and reversal of temporary differences	60	9
Tax expense	**169**	103

The taxation charge that would arise at the standard rate of corporation tax in New Zealand is reconciled to the tax expense as follows:

	GROUP $ MILLION	
	31 JULY 2022	31 JULY 2021
Profit before tax from continuing operations	**830**	635
Prima facie tax expense at 28%	232	178
(Deduct)/add tax effect of:		
– Effect of tax rates in foreign jurisdictions	(11)	(9)
– Non-deductible expenses/additional assessable income	95	85
– Non-assessable income/additional deductible expenses	(62)	(85)
– Prior year (over)/under provision	(9)	11
Tax expense before distributions and deferred tax	**245**	180
Effective tax rate before distributions and deferred tax	**29.5%**	28.3%
Tax effect of distributions to farmer shareholders	(79)	(77)
Tax expense before deferred tax	**166**	103
Effective tax rate before deferred tax	**20.0%**	16.2%
(Deduct)/add tax effect of:		
– Origination and reversal of other temporary differences	2	(2)
– Losses of overseas Group entities not recognised	1	2
Tax expense from continuing operations	**169**	103
Effective tax rate	**20.4%**	16.2%
Imputation credits		
Imputation credits available for use in subsequent reporting periods	20	20
Tax losses		
Gross tax losses available for which no deferred tax asset has been recognised	54	45

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

21. Taxation CONTINUED

b) Taxation – Statement of Financial Position

Deferred tax assets and deferred tax liabilities relate to the following:

	GROUP $ MILLION					
	AS AT 31 JULY 2022			AS AT 31 JULY 2021		
	DEFERRED TAX ASSET	DEFERRED TAX LIABILITY	NET	DEFERRED TAX ASSET	DEFERRED TAX LIABILITY	NET
Deferred tax						
Property, plant and equipment	1,613	(1,658)	(45)	1,589	(1,637)	(48)
Intangible assets	–	(380)	(380)	–	(380)	(380)
Right-of-use assets	117	(109)	8	142	(134)	8
Derivative financial instruments	131	–	131	17	–	17
Employee entitlements	93	–	93	85	–	85
Inventories	79	–	79	45	–	45
Receivables, payables and provisions	92	–	92	82	–	82
New Zealand tax losses	348	–	348	434	–	434
Offshore tax losses	187	–	187	215	–	215
Other	9	(21)	(12)	7	(30)	(23)
Total before offsetting	2,669	(2,168)	501	2,616	(2,181)	435
Offset adjustment	(2,118)	2,118	–	(2,156)	2,156	–
Total	551	(50)	501	460	(25)	435

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

21. Taxation CONTINUED

b) Taxation – Statement of Financial Position CONTINUED

	GROUP $ MILLION	
	31 JULY 2022	31 JULY 2021
Movements for the year		
Opening balance	435	401
Recognised in the Income Statement[1]	(60)	(9)
Recognised directly in other comprehensive income	124	46
Foreign currency translation	2	(3)
Closing balance	501	435

1 Comparative information has been re-presented for consistency with the current period.

Tax losses

Judgement is involved in assessing the availability of future taxable income against which tax losses carried forward can be utilised.

New Zealand tax losses

The New Zealand tax consolidated group generated taxable income in the current year. The deferred tax asset relating to New Zealand tax losses of $348 million (31 July 2021: $434 million) has been recognised on the basis that taxable income will be generated in the future against which the tax losses can be utilised.

The key assumptions in the assessment of future taxable income are New Zealand earnings, and the tax-deductible dividend. The estimate of New Zealand earnings is based on performance of the New Zealand tax consolidated group relative to the overall Group. This ratio has been applied to the profit before tax forecast in the Group's three-year business plan. The tax-deductible dividend assumption is based on the Group's Dividend Policy. The Group determines its Dividend Policy and therefore has the ability to influence utilisation of the losses.

The time horizon for utilising these losses is estimated at seven years (31 July 2021: seven years). Changes in the key assumptions used could impact the expected time horizon for utilisation of the tax losses, for example higher dividends could extend the utilisation horizon and could impact the carrying amount of deferred tax assets available to be utilised against future taxable profits. A reasonably possible change in the key assumptions does not change the carrying amount of the deferred tax asset recognised.

Offshore tax losses

Gross tax losses of $54 million reflecting a deferred tax asset of $15 million (31 July 2021: $45 million gross, deferred tax asset of $14 million) relating to offshore entities have not been recognised as they may not be utilised.

Deferred tax liabilities

Earnings made by foreign subsidiaries could be subject to withholding and other taxes on remittance. Deferred tax liabilities are not recognised in respect of unremitted earnings that are considered indefinitely reinvested in foreign subsidiaries. During the year, the Group assessed the likelihood of earnings being remitted to New Zealand and has recorded a deferred tax liability of $21 million (31 July 2021: $30 million).

As at 31 July 2022, unremitted earnings that are considered indefinitely reinvested in foreign subsidiaries amount to $185 million (31 July 2021: $128 million). The Group made a judgement not to recognise deferred tax liabilities in respect of these amounts because it can control the timing and the manner in which the associated temporary difference will reverse. This includes controlling the timing of dividends, and in the event of divestments made because of the strategic review, the manner in which divestment proceeds are remitted, and therefore the associated tax consequences.

Uncertain Tax Positions

In determining the amount of current and deferred tax, the Group takes into account the effect of uncertain tax positions and whether additional taxes, penalties and interest may be due. The Group operates in several different tax jurisdictions. This leads to complex tax issues. The ultimate decision regarding these complex tax issues is often outside the control of the Group and depends on the efficiency of the legal processes in the relevant tax jurisdiction. The Group believes that its estimation of accruals for tax liabilities are adequate for all open tax years based on its assessment of many factors, including interpretations of tax law and prior experience. This assessment relies on estimates and assumptions about future events. New information may become available that causes the Group to change its estimate of uncertain tax positions. Such changes to tax liabilities will affect tax expense in the period that such determination is made.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

22. Contingent liabilities, provisions and commitments

Provisions are recognised in the Statement of Financial Position only where the Group has a present legal or constructive obligation. This obligation must be the result of a past event, when it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made.

Estimates and assumptions are made in determining the likelihood, amount and timing of cash outflows when the outcome is uncertain. Legal counsel or other experts are consulted on matters that may give rise to a provision or a contingent liability.

In the normal course of business, the Group is exposed to claims and legal proceedings that may in some cases result in costs.

In June 2020 a class action was filed in the Supreme Court of Victoria against Fonterra Australia Pty. Ltd., Fonterra Milk Australia Pty. Ltd. and Fonterra Brands (Australia) Pty. Ltd. (collectively, Fonterra Australia) by Geoffrey and Lynden Iddles on behalf of farmers who supplied milk to Fonterra Australia during the 2015/2016 season. The class action relates to actions taken by Fonterra Australia in connection with its milk price in the 2015/2016 season including the manner in which Fonterra Australia set its opening milk price and forecast closing milk price at the outset of that season, its communications with suppliers about the milk price throughout the season, and its reduction of the milk price in May 2016. The plaintiffs are alleging that Fonterra Australia breached its contracts with suppliers, engaged in misleading and deceptive conduct and engaged in unconscionable conduct in connection with these matters. Fonterra is vigorously defending these claims, with compulsory mediation and the trial scheduled for later in 2022.

	GROUP $ MILLION	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021
Current provisions	70	72
Non-current provisions	79	82
Total provisions	**149**	154

A breakdown of total provisions is presented in the following table.

	GROUP $ MILLION		
	EMPLOYEE RELATED PROVISIONS	OTHER PROVISIONS	TOTAL PROVISIONS
As at 1 August 2021[1]	108	46	154
Additional provisions	20	103	123
Unused amounts reversed	(44)	(17)	(61)
Charged to Income Statement	(24)	86	62
Charged to equity	(3)	–	(3)
Utilised during the year	(7)	(52)	(59)
Foreign currency translation	(5)	–	(5)
As at 31 July 2022	69	80	149

1 Categories have been re-presented for consistency with the current period.

Employee related provisions include defined benefit scheme obligations, other obligations that fall due on termination of employment, and long-term employee benefits.

Other provisions include obligations relating to customs and duties, legal matters, product quality claims and other claims arising in the normal course of business. The timing and amount of settlement is uncertain as it depends on the outcome of judicial proceedings or commercial negotiations relating to each individual claim.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

22. Contingent liabilities, provisions and commitments CONTINUED

At year end the Group was committed to future capital expenditure for:

	GROUP $ MILLION	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021
Buildings	20	19
Plant, vehicles and equipment	192	92
Software	13	2
Total commitments	**225**	113

The above table does not include lease commitments. Refer to Note 17 *Leases* for information about the Group's lease commitments.

23. Related party transactions

Information about transactions with related parties and year end balances that arose from those transactions are presented within this note.

a) Key management personnel remuneration

Key management personnel comprise members of the Board and members of the Fonterra Management Team.

	GROUP $ MILLION	
	31 JULY 2022	31 JULY 2021
Short-term employee benefits[1]	21	21
Long-term employee benefits	5	1
Directors' remuneration	3	2
Total key management personnel remuneration	**29**	24

1 In addition to the amount disclosed in the table above, the Group has previously recognised a provision of $2 million relating to the pending judicial interpretation of the requirements of the Holidays Act 2003 for former key management personnel. This interpretation was concluded in the current year and the Group released the provision.

b) Transactions with related parties during the year

Transactions with related parties are on normal trade terms and no balances are secured.

	GROUP $ MILLION	
	31 JULY 2022	31 JULY 2021
Equity accounted investees		
Revenue from the sale of goods[1]	82	83
Sale of services[2]	4	7
Royalty and other income	–	1
Dividends received	6	8
Interest income from financing arrangements	–	1
Purchases of goods[3]	(81)	(61)
Purchases of services[4]	(167)	(171)
Key management personnel		
Purchases of goods[5]	(157)	(135)
Sale of goods[6]	8	8
Dividends paid	3	2

1 Goods sold are primarily commodity products.
2 Services provided include management fees.
3 Goods purchased are primarily commodity products.
4 Services provided are primarily freight services.
5 Purchases from key management personnel primarily relate to milk supplied by farmer shareholder Directors.
6 Sales to key management personnel primarily related to sales through Farm Source™ retail stores.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

23. Related party transactions CONTINUED

c) Outstanding balances with related parties

	GROUP $ MILLION	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021
Equity accounted investees		
Total receivables arising from the sale of goods or services[1]	19	25
Total payables arising from the purchase of goods or services	(14)	(9)
Key management personnel		
Total payables and provisions arising from remuneration[2]	(22)	(16)
Total payables arising from the sale or purchase of goods or services[3]	(24)	(21)

1 As at 31 July 2022, there was no provision for impairment of receivables from equity accounted investees (31 July 2021: nil).

2 In addition to the amount disclosed in the table above, the Group has previously recognised a provision of $2 million relating to the pending judicial interpretation of the requirements of the Holidays Act 2003 for former key management personnel. This interpretation was concluded in the current year and the Group released the provision.

3 Payables to key management personnel relate to amounts owing for milk supplied by farmer shareholder Directors and are recognised in owing to suppliers.

d) Financial guarantees

The Group provides financial guarantees for certain equity accounted investees. At 31 July 2022, the aggregate drawn down amount of equity accounted investees' liabilities for which the Group is jointly and severally liable is $1 million (31 July 2021: $1 million).

e) Transactions with related entities

As part of the administration of Trading Among Farmers, the Group entered into an Authorised Fund Contract to provide administrative services in relation to the Fund and meet the operating expenses of the Fund. In addition, the Group has agreed to provide corporate facilities, support functions and other services at no cost to the Fund.

f) Commitments

The Group has prospective commitments with related parties including contracts with equity accounted investments for the sale, supply and purchase of dairy products, energy and the provision of various management services.

24. Subsidiaries

Subsidiaries are entities controlled by the Group. Subsidiaries are consolidated from the date the Group gains control until the date on which control ceases.

Non-controlling interests are allocated their share of profit after tax in the Income Statement and are presented within equity in the Statement of Financial Position separately from equity attributable to equity holders of the Co-operative. The effect of all transactions with non-controlling interests that change the Group's ownership interest but do not result in a change in control are recorded in equity. Where control is lost, the remaining interest in the investment is remeasured to fair value and any surplus or deficit arising from that remeasurement is recognised in the Income Statement.

The Group's subsidiaries are involved in the marketing, distribution, processing and financing of dairy products. All Group subsidiaries have a balance date of 31 July unless otherwise indicated. Subsidiaries with different balance dates from that of the Group are due to legislative requirements in the country the entities are domiciled.

The Group holds investments in certain countries that have restrictions on the repatriation of funds back to New Zealand. This does not result in any significant restriction on the flow of funds for the Group.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

24. Subsidiaries CONTINUED

The significant subsidiaries of the Group are presented in the following table.

SUBSIDIARY NAME	COUNTRY OF INCORPORATION AND PRINCIPAL PLACE OF BUSINESS	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2022	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2021
New Zealand Milk (Australasia) Pty Limited	Australia	**100**	100
Fonterra Australia Pty Limited[1]	Australia	**100**	100
Fonterra Brands (Australia) Pty Limited[1]	Australia	**100**	100
Dairy Partners Americas Brasil Limitada[2]	Brazil	**51**	51
Soprole Inversiones S.A.[2]	Chile	**99.9**	99.9
Comercial Santa Elena S.A.[3]	Chile	**99.9**	99.9
Soprole S.A.[3]	Chile	**99.9**	99.9
Prolesur S.A.[3]	Chile	**99.9**	99.9
Fonterra Commercial Trading (Shanghai) Company Limited[2]	China	**100**	100
Tangshan Fonterra Dairy Farm Limited[2,4]	China	**100**	85
Fonterra Brands (Hong Kong) Limited	Hong Kong	**100**	100
Fonterra Brands Indonesia, PT	Indonesia	**100**	100
Fonterra Brands (Malaysia) Sdn Bhd	Malaysia	**100**	100
Fonterra (Europe) Coöperatie U.A.	Netherlands	**100**	100
Fonterra Europe Manufacturing B.V.	Netherlands	**100**	100
Fonterra (New Zealand) Limited	New Zealand	**100**	100
Fonterra Brands (New Zealand) Limited	New Zealand	**100**	100
Fonterra Dairy Solutions Limited	New Zealand	**100**	100
Fonterra Ingredients Limited	New Zealand	**100**	100
Fonterra Limited	New Zealand	**100**	100
New Zealand Milk Brands Limited	New Zealand	**100**	100
RD1 Limited	New Zealand	**100**	100
Kotahi Logistics LP	New Zealand	**90**	91
Fonterra Brands (Singapore) Pte Limited	Singapore	**100**	100
Fonterra Brands Lanka (Private) Limited	Sri Lanka	**100**	100
Fonterra (USA) Inc.	United States	**100**	100

1 These entities are subsidiaries of New Zealand Milk (Australasia) Pty Limited.
2 Balance date 31 December.
3 Balance date 31 December and these entities are subsidiaries of Soprole Inversiones S.A.
4 The Group purchased the 15% non-controlling interest in January 2022. Refer to Note 2 *Divestments* for more information.

The Group's ownership interest of the following entities is 50% or less. However, they have been consolidated on the basis that the Group controls them through its exposure or rights to variable returns and the power to affect those returns.

OVERSEAS SUBSIDIARIES 50% OR LESS OWNERSHIP	COUNTRY OF INCORPORATION AND PRINCIPAL PLACE OF BUSINESS	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2022	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2021
Fonterra (Japan) Limited	Japan	**50**	50
Fonterra Brands (Middle East) L.L.C.	UAE	**49**	49

In addition to the entities above, the Group controls the Fonterra Shareholders' Fund and Fonterra Farmer Custodian Limited and consolidates these two entities. The trustees of the Fonterra Farmer Custodian Trust own the legal title to all of the shares of the Custodian. The Fund is a managed investment scheme with an independent trustee. In concluding that the Group controls the Fund and the Custodian, the Directors took into consideration that they form an integral part of the structure and operation of Trading Among Farmers.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

25. Fair value measurement

The fair value is the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date.

The fair values of financial assets and liabilities are calculated by reference to quoted market prices where that is possible. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

If quoted market prices are not available, the methodology used to calculate the fair values of financial assets and liabilities is to identify the expected cash flows under the terms of each specific contract and then discount these values back to the present value. These models use as their basis independently sourced market data where it is available and rely as little as possible on entity-specific estimates.

The calculation of the fair value of financial instruments reflects the impact of credit risk where applicable.

Specific valuation techniques used to value financial instruments include:

- the fair value of foreign exchange contracts is determined using observable currency exchange rates, option volatilities and interest rate yield curves;
- the fair value of interest rate contracts is calculated as the present value of the estimated future cash flows based on observable interest rate yield curves;
- the fair value of commodity contracts that are not exchange traded is determined by calculating the present value of estimated future cash flows based on observable quoted prices for similar instruments; and
- the fair value on the hedged risks of borrowings and long-term advances that are not exchange traded is calculated as the present value of the estimated future cash flows based on observable currency exchange rates and interest rate yield curves.

Fair value hierarchy

The fair value hierarchy described below is used to provide an indication of the level of estimation or judgement required in determining fair value:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: Inputs for the assets or liabilities that are not based on observable market data (unobservable inputs).

The Group recognises transfers between levels of the fair value hierarchy at the end of the reporting period during which the change occurred.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

25. Fair value measurement CONTINUED

The fair value hierarchy for assets and liabilities measured at fair value are presented in the following table.

	GROUP $ MILLION					
	LEVEL 1		LEVEL 2		LEVEL 3	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021	**AS AT 31 JULY 2022**	AS AT 31 JULY 2021	**AS AT 31 JULY 2022**	AS AT 31 JULY 2021
Measured at fair value on a recurring basis						
Derivative assets						
– Commodity derivatives	**211**	107	**7**	4	**–**	–
– Foreign exchange derivatives	**–**	–	**64**	185	**–**	–
– Interest rate derivatives[1]	**–**	–	**382**	390	**–**	–
Derivative liabilities						
– Commodity derivatives	**(40)**	(2)	**(3)**	–	**–**	–
– Foreign exchange derivatives	**–**	–	**(760)**	(102)	**–**	–
– Interest rate derivatives[1]	**–**	–	**(243)**	(339)	**–**	–
Emissions units held for trading	**39**	24	**–**	–	**–**	–
Investments in shares	**24**	20	**18**	18	**36**	22
Measured at fair value on a non-recurring basis						
Net liabilities held for sale	**–**	–	**–**	–	**(155)**	(80)
Fair value	**234**	149	**(535)**	156	**(119)**	(58)

1 Includes cross-currency interest rate swaps.

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

25. Fair value measurement CONTINUED

The fair value hierarchy for each class of financial asset and liability where the carrying amount differs from the fair value is presented in the following table.

	GROUP $ MILLION					
			FAIR VALUE			
	CARRYING AMOUNT		LEVEL 1		LEVEL 2	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021	**AS AT 31 JULY 2022**	AS AT 31 JULY 2021	**AS AT 31 JULY 2022**	AS AT 31 JULY 2021
Financial assets						
Long-term advances	**154**	163	**–**	–	**153**	182
Financial liabilities						
Borrowings						
– NZX-listed bonds	**(250)**	(600)	**(246)**	(611)	**–**	–
– Capital notes	**(35)**	(35)	**(34)**	(35)	**–**	–
– Medium-term notes	**(3,436)**	(3,903)	**–**	–	**(3,511)**	(4,056)

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

26. Offsetting of financial assets and liabilities

Financial assets and liabilities are offset, and the net amount reported in the Statement of Financial Position, where there currently is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

The Group enters into various master netting arrangements or similar agreements that do not meet the criteria for offsetting in the Statement of Financial Position but still allow for the related amounts to be offset in certain circumstances. These principally relate to derivative transactions under ISDA (International Swap and Derivative Association) agreements where each party has the option to settle amounts on a net basis in the event of default of the other party.

Financial assets and financial liabilities subject to offsetting, enforceable master netting arrangements and other agreements are presented in the following table.

	GROUP $ MILLION				
	AMOUNTS OFFSET IN THE STATEMENT OF FINANCIAL POSITION				
	GROSS FINANCIAL ASSETS/ (LIABILITIES)	GROSS FINANCIAL ASSETS/ (LIABILITIES) SET OFF	NET FINANCIAL ASSETS/ (LIABILITIES) PRESENTED	AMOUNTS NOT OFFSET	NET
Derivative financial assets	**944**	**(280)**	**664**	**(444)**	**220**
Trade and other receivables (excluding prepayments)	**2,523**	**(111)**	**2,412**	**–**	**2,412**
	3,467	**(391)**	**3,076**	**(444)**	**2,632**
Derivative financial liabilities	**(1,326)**	**280**	**(1,046)**	**363**	**(683)**
Total trade and other payables (excluding employee entitlements)	**(2,035)**	**–**	**(2,035)**	**66**	**(1,969)**
Owing to suppliers	**(2,230)**	**111**	**(2,119)**	**–**	**(2,119)**
Borrowings	**(5,256)**	**–**	**(5,256)**	**15**	**(5,241)**
	(10,847)	**391**	**(10,456)**	**444**	**(10,012)**
As at 31 July 2022	**(7,380)**	**–**	**(7,380)**	**–**	**(7,380)**
Derivative financial assets	851	(165)	686	(337)	349
Trade and other receivables (excluding prepayments)	1,841	(94)	1,747	–	1,747
	2,692	(259)	2,433	(337)	2,096
Derivative financial liabilities	(608)	165	(443)	292	(151)
Total trade and other payables (excluding employee entitlements)	(1,876)	–	(1,876)	45	(1,831)
Owing to suppliers	(1,919)	94	(1,825)	–	(1,825)
	(4,403)	259	(4,144)	337	(3,807)
As at 31 July 2021	(1,711)	–	(1,711)	–	(1,711)

Notes to the Financial Statements (CONTINUED)

FOR THE YEAR ENDED 31 JULY 2022

27. Net tangible assets per quoted equity security

Net tangible assets is calculated as net assets less intangible assets.

	GROUP	
	AS AT 31 JULY 2022	AS AT 31 JULY 2021
Net tangible assets per security		
$ per equity instrument on issue	**2.86**	2.87
Equity instruments on issue (million)	**1,613**	1,613

Independent Auditor's Report

To the shareholders of Fonterra Co-operative Group Limited

Report on the audit of the consolidated financial statements

Opinion

In our opinion, the consolidated financial statements of Fonterra Co-operative Group Limited (the 'Company') and its subsidiaries (the 'Group') on pages 3 to 68:

i. present fairly in all material respects the Group's financial position as at 31 July 2022 and its financial performance and cash flows for the year ended on that date; and

ii. comply with New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

We have audited the accompanying consolidated financial statements which comprise:

— the consolidated statement of financial position as at 31 July 2022;

— the consolidated income statement, statements of other comprehensive income, changes in equity and cash flows for the year then ended; and

— notes, including a summary of significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) ('ISAs (NZ)'). We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

We are independent of the Group in accordance with Professional and Ethical Standard 1 *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* ('IESBA Code'), and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

Our responsibilities under ISAs (NZ) are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

Our firm has also provided other services to the Group that are related to our role as the Group's auditor, such as assurance and agreed upon procedures services. This includes an engagement to provide a separate reasonable assurance report in connection with the Farmgate Milk Price. A copy of this assurance report is attached as an appendix to Fonterra's Farmgate Milk Price Statement. Subject to certain restrictions, partners and employees of our firm may also deal with the Group on normal terms within the ordinary course of trading activities of the business of the Group. These matters have not impaired our independence as auditor of the Group. The firm has no other relationship with, or interest in, the Group.

Independent Auditor's Report (CONTINUED)

Materiality

The scope of our audit was influenced by our application of materiality. Materiality helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the consolidated financial statements as a whole. The materiality for the consolidated financial statements as a whole was set at $60 million determined with reference to a benchmark of the cost of New Zealand sourced milk. We chose the benchmark because, in our view, this is a key measure of the Group's performance.

Scoping

The scope of our audit is designed to ensure that we perform adequate work to be able to give an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the financial reporting systems, processes and controls, and the industry in which it operates.

In establishing the overall approach to our audit, we considered the centralised nature of the Group's operations, the risk profile of countries where the Group operates, and changes taking place within the business. We also considered the financial significance of each business unit together with any local statutory audit requirements.

The Group financial statements are a consolidation of over 100 individual subsidiaries and equity accounted investees. We scoped in 12 subsidiaries in New Zealand, Australia, Chile, and the USA to be subject to audit due to their financial significance and risk profile. We undertook audits of these subsidiaries ourselves, or by instructing participating overseas KPMG audit teams. In addition, we performed specified risk-focused audit procedures on certain transactions and balances in respect of a further 4 subsidiaries in Chile, Japan, the Netherlands and Singapore, as well as 3 subsidiaries accounted for as held for sale during the year in Brazil, China and New Zealand.

Taken together, the subsidiaries in scope for the Group audit accounted for 85% of the Group's revenue and 87% of the Group's total assets. For the remaining subsidiaries, we performed analysis at an aggregated Group level to confirm our assessment that there were no significant risks of material misstatement associated with them.

We assigned materiality levels to in scope subsidiaries for performance of audits and specified audit procedures. These were lower than the materiality level for the Group as a whole, ranging from $5 million to $40 million, and determined with reference to the size and risk profile of the subsidiary.

We visited subsidiary locations in New Zealand, Australia, Chile and the Netherlands. We held meetings with management responsible for the financial information of all in scope subsidiaries.

We led the participation of overseas KPMG audit teams in the Group audit. We issued detailed audit instructions to auditors of in scope subsidiaries. These instructions set out the significant audit areas that we required audit teams to consider, and the information required to be reported back to the Group audit team. We held audit planning meetings with overseas KPMG audit teams subject to both audit and specified audit procedures to explain our audit instructions and discuss their audit plans. In addition, we held meetings to discuss the findings they reported to us in more detail.

We audited the Group consolidation, financial statement disclosures and a number of complex items centrally in New Zealand. These included general IT controls, controls operated through Fonterra's shared service centre environment, revenue recognition, the cost of New Zealand sourced milk, impairment, accounting for divestments and assets held for sale, taxation and financial instruments.

Independent Auditor's Report (CONTINUED)

KPMG

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements in the current period. We summarise below those matters and our key audit procedures to address those matters in order that the shareholders as a body may better understand the process by which we arrived at our audit opinion. Our procedures were undertaken in the context of and solely for the purpose of our statutory audit opinion on the consolidated financial statements as a whole and we do not express discrete opinions on separate elements of the consolidated financial statements.

THE KEY AUDIT MATTER	HOW THE MATTER WAS ADDRESSED IN OUR AUDIT
Revenue recognition	
Refer to Note 3 to the financial statements. We considered the recognition of revenue from contracts with key customers and distributors to be a key audit matter due to: — the significance of the Group's $23.0 billion of revenue to the financial statements as a whole; — the level of judgement involved in establishing the timing and amount of revenue recognised for certain customers and distributors, in particular judgement related to agent versus principal considerations; and — the extent of audit effort required to examine the Group's contracts with customers in the context of the size and complexity of this area, and the requirement under auditing standards for us to consider fraud risk associated with revenue recognition.	The procedures we performed to evaluate whether revenue had been recognised appropriately included: — identifying and testing relevant controls over revenue recognition, and using data analytics routines to evaluate 100% of sales transactions undertaken through the Group's two core ERP systems (representing 85% of Group revenue); — assessing the Group's revenue recognition accounting policies, and evaluating the application of these policies to actual contracts with customers as noted below; — evaluating contractual arrangements with key customers and distributors through discussion with management and inspection of the underlying documentation, as well as sample testing other sales arrangements; and — performing other audit procedures specifically designed to address the risk of management override of controls including journal entry testing, applying particular focus to the timing of revenue transactions. We completed these procedures and have no matters to report.

Independent Auditor's Report (CONTINUED)

THE KEY AUDIT MATTER	HOW THE MATTER WAS ADDRESSED IN OUR AUDIT
Goodwill and brands	
Refer to Notes 7 and 18 to the financial statements. We considered the Group's annual impairment testing of goodwill and brands to be a key audit matter due to the significance of the balance of $1.8 billion to the financial statements as a whole and the level of judgement involved in determining the methodology and assumptions used in the testing. $0.8 billion of goodwill and brands is included within two cash generating units ('CGUs'), which are tested using discounted cash flow models: — Fonterra Brands New Zealand ('FBNZ') ($511 million of goodwill and brands); and — Fonterra Australia ($288 million of goodwill and brands). The Group's portfolio of consumer & foodservice brands within the Asia Pacific segment of $0.7 billion are tested using the relief from royalty valuation method. We focused on the significant forward-looking assumptions the Group applied in their impairment testing, including: — forecast cash flows, taking into account the Group's profit improvement plans for FBNZ and Fonterra Australia; — branded consumer & foodservice sales forecasts and market royalty rates appropriate to each brand; and — terminal growth rates and discount rates, as the Group's models are highly sensitive to small changes in these assumptions. In addition to the above, the carrying amount of the Group's net assets at 31 July 2022 was $6.9 billion whilst the market capitalisation of Fonterra Co-operative Group Limited was $4.4 billion. This is an indicator of impairment and required additional analysis and interpretation.	The procedures we performed to evaluate the impairment assessments included: — assessing whether the methodology adopted was consistent with accepted valuation approaches of IAS 36 Impairment of Assets; — evaluating the significant assumptions by comparing to historical trends, approved budgets, business plans and external market data; — comparing the discount rates and terminal growth rates applied to the estimated future cash flows to relevant benchmarks using KPMG valuation specialists; — challenging the above assumptions and judgements by performing sensitivity analysis, considering a range of likely outcomes based on various scenarios; — evaluating the estimate of the recoverable amount of the Group as a whole, including evaluating the work performed by the Group's external valuation specialist; and — considering the appropriateness of the disclosures in the financial statements. No impairment of goodwill was recognised. However, the Group recognised an impairment of brands amounting to $34 million. We found the impairment testing methodologies to be consistent with IAS 36. We found the discount and terminal growth rates were in an acceptable range, and that the significant assumptions were largely supported by comparison to the sources we considered. For FBNZ, our scenario analysis indicated there is limited headroom in the recoverable amount over the carrying value, and there are reasonably possible scenarios that would result in impairment (which are disclosed in Note 18). For Anlene, Anmum and Chesdale, our scenario analysis indicated that the impairments recognised were appropriate. As there is no headroom over the carrying value of these brands, any adverse movement in key assumptions would result in further impairments. For Fonterra Australia and the Anchor consumer & foodservice brand, our scenario analysis indicated that the recoverable amount of each of these assets exceeded its carrying value. The estimate of the recoverable amount for the Group as a whole exceeded the carrying amount of the Group's net assets. The evidence we obtained in respect of valuation ranges for the Group as a whole did not indicate that further impairment of goodwill and brands was necessary. We consider the impairment disclosures to be a fair reflection of the underlying impairment tests.

Independent Auditor's Report (CONTINUED)

THE KEY AUDIT MATTER	HOW THE MATTER WAS ADDRESSED IN OUR AUDIT
The cost of New Zealand sourced milk	
Refer to Notes 4 and 13 to the financial statements. The cost of New Zealand sourced milk supplied by farmer shareholders amounted to \$13.7 billion and comprises the volume of milk solids supplied at the Farmgate Milk Price as determined by the Board of Directors for the relevant season. In making that determination, the Board takes into account the Farmgate Milk Price calculated in accordance with the Farmgate Milk Price Manual. We considered the cost of New Zealand sourced milk to be a key audit matter due to: — its significance to the financial statements as a whole. The cost of New Zealand sourced milk is a key component of the Group's cost of goods sold of \$19.7 billion and the carrying value of the Group's inventory of \$5.0 billion. — the extent of audit effort required to examine the cost of New Zealand sourced milk due to the complexity of applying the Board approved milk price to cost of goods sold and inventory.	The procedures we performed to evaluate the impact of the Farmgate Milk Price calculation on the cost of New Zealand sourced milk included: — examining minutes of Milk Price Panel meetings and confirming with the Company Secretary that the Board considered the recommended Farmgate Milk Price from the Milk Price Panel and approved the payment of \$9.30 per kgMS for New Zealand sourced milk for the season ended 31 May 2022; and — examining the application of the Board approved Farmgate Milk Price to cost of goods sold and inventory. This involved understanding and evaluating relevant controls to ensure that the latest milk price forecast series has been applied to cost of goods sold and inventory. At season end, we checked that the cost of New Zealand sourced milk reflected the Board approved Farmgate Milk Price for the season, particularly where there has been a dynamic monthly milk price and how that should be correctly applied to the month of collection. We completed these procedures and have no matters to report. The Farmgate Milk Price calculation prepared by the Milk Price Group amounted to \$9.30 per kgMS (which equates to \$13.7 billion in total) and we confirmed with the Company Secretary that the Board of Directors approved a payment of \$9.30 per kgMS for New Zealand sourced milk for the season ended 31 May 2022 at their meeting on 21 September 2022.

Independent Auditor's Report (CONTINUED)

Other information

The Directors, on behalf of the Company, are responsible for the other information included in the entity's Annual Review and supporting reports. Other information includes:

— the Annual Review;

— the Corporate Governance Statement and Statutory Information; and

— the Business Performance Report.

Our opinion on the consolidated financial statements does not cover any other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements, or our knowledge obtained in the audit or otherwise appears materially misstated. 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 in this regard.

Use of this independent auditor's report

This independent auditor's report is made solely to the shareholders as a body. Our audit work has been undertaken so that we might state to the shareholders those matters we are required to state to them in the independent auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the shareholders as a body for our audit work, this independent auditor's report, or any of the opinions we have formed.

Responsibilities of the Directors for the consolidated financial statements

The Directors, on behalf of the Company, are responsible for:

— the preparation and fair presentation of the consolidated financial statements in accordance with generally accepted accounting practice in New Zealand (being New Zealand Equivalents to International Financial Reporting Standards) and International Financial Reporting Standards;

— implementing necessary internal control to enable the preparation of a consolidated set of financial statements that is fairly presented and free from material misstatement, whether due to fraud or error; and

— assessing the ability to continue as a going concern. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate or to cease operations or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objective is:

— to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error; and

— to issue an independent auditor's 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 NZ will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error. They are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

A further description of our responsibilities for the audit of these consolidated financial statements is located at the External Reporting Board (XRB) website at:

http://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-1/

This description forms part of our independent auditor's report.

The engagement partner on the audit resulting in this independent auditor's report is Matthew Diprose.

For and on behalf of

KPMG

KPMG
Auckland

21 September 2022

fonterra.com

Dairy for life