Notes to the consolidated financial statements continued

21. Capital and financial risk management

Capital management

The following table summarises the capital of the Group:

	2011 £m	2010 £m
Cash and cash equivalents	(6,252)	(4,423)
Borrowings	38,281	39,795
Other financial instruments	(2,171)	(2,056)
Net debt	**29,858**	**33,316**
Equity	87,561	90,810
Capital	**117,419**	**124,126**

The Group's policy is to borrow centrally using a mixture of long-term and short-term capital market issues and borrowing facilities to meet anticipated funding requirements. These borrowings, together with cash generated from operations, are loaned internally or contributed as equity to certain subsidiaries. The Board has approved three internal debt protection ratios being: net interest to operating cash flow (plus dividends from associates); retained cash flow (operating cash flow plus dividends from associates less interest, tax, dividends to minorities and equity dividends) to net debt; and operating cash flow (plus dividends from associates) to net debt. These internal ratios establish levels of debt that the Group should not exceed other than for relatively short periods of time and are shared with the Group's debt rating agencies being Moody's, Fitch Ratings and Standard & Poor's. The Group complied with these ratios throughout the financial year.

Financial risk management

The Group's treasury function provides a centralised service to the Group for funding, foreign exchange, interest rate management and counterparty risk management.

Treasury operations are conducted within a framework of policies and guidelines authorised and reviewed by the Board, most recently on 1 February 2011. A treasury risk committee comprising of the Group's Chief Financial Officer, Group General Counsel and Company Secretary, Corporate Finance Director and Director of Financial Reporting meets at least annually to review treasury activities and its members receive management information relating to treasury activities on a quarterly basis. The Group accounting function, which does not report to the Group Corporate Finance Director, provides regular update reports of treasury activity to the Board. The Group's internal auditor reviews the internal control environment regularly.

The Group uses a number of derivative instruments for currency and interest rate risk management purposes only that are transacted by specialist treasury personnel. The Group mitigates banking sector credit risk by the use of collateral support agreements.

Credit risk

The Group considers its exposure to credit risk at 31 March to be as follows:

	2011 £m	2010 £m
Bank deposits	896	745
Cash held in restricted deposits	338	274
Government bonds	610	388
Money market fund investments	5,015	3,678
Derivative financial instruments	2,045	2,128
Other investments – debt and bonds	75	2,366
Trade receivables	4,277	4,067
Other receivables	3,325	1,800
	16,581	**15,446**

The Group invests in UK index linked government bonds on the basis that they generate a swap return in excess of £ LIBOR and are amongst the most creditworthy of investments available.

Money market investments are in accordance with established internal treasury policies which dictate that an investment's long-term credit rating is no lower than single A. Additionally, the Group invests in AAA unsecured money market mutual funds where the investment is limited to 10% of each fund.

In respect of financial instruments used by the Group's treasury function, the aggregate credit risk the Group may have with one counterparty is limited by firstly, reference to the long-term credit ratings assigned for that counterparty by Moody's, Fitch Ratings and Standard & Poor's and secondly, as a consequence of collateral support agreements introduced from the fourth quarter of 2008. Under collateral support agreements the Group's exposure to a counterparty with whom a collateral support agreement is in place is reduced to the extent that the counterparty must post cash collateral when there is value due to the Group under outstanding derivative contracts that exceeds a contractually agreed threshold amount. When value is due to the counterparty the Group is required to post collateral on identical terms. Such cash collateral is adjusted daily as necessary.

In the event of any default ownership of the cash collateral would revert to the respective holder at that point. Detailed below is the value of the cash collateral, which is reported within short-term borrowings, held by the Group at 31 March 2011:

	2011 £m	2010 £m
Cash collateral	531	604

The majority of the Group's trade receivables are due for maturity within 90 days and largely comprise amounts receivable from consumers and business customers. At 31 March 2011 £2,233 million (2010: £2,111 million) of trade receivables were not yet due for payment. Total trade receivables consisted of £2,852 million (2010: £2,709 million) relating to the Europe region and £1,425 million (2010: £1,358 million) relating to the Africa, Middle East and Asia Pacific region. Accounts are monitored by management and provisions for bad and doubtful debts raised where it is deemed appropriate.

The following table presents ageing of receivables that are past due and are presented net of provisions for doubtful receivables that have been established.

	2011 £m	2010 £m
30 days or less	1,561	1,499
Between 31 – 60 days	100	119
Between 61 – 180 days	85	155
Greater than 180 days	298	183
	2,044	**1,956**

Concentrations of credit risk with respect to trade receivables are limited given that the Group's customer base is large and unrelated. Due to this management believes there is no further credit risk provision required in excess of the normal provision for bad and doubtful receivables. Amounts charged to administrative expenses during the year ended 31 March 2011 were £460 million (2010: £465 million, 2009: £423 million) (see note 17).

The Group's investments in preferred equity and a subordinated loan received as part of the disposal of Vodafone Japan to SoftBank in the 2007 financial year were disposed of during the year. The Group has a receivable of £1,488 million (2010: £nil) in relation to the second tranche of consideration receivable in relation to the disposal.

As discussed in note 28 the Group has covenanted to provide security in favour of the Trustee of the Vodafone Group UK Pension Scheme in respect of the funding deficit in the scheme. The security takes the form of an English law pledge over UK index linked government bonds.

Liquidity risk

At 31 March 2011 the Group had €4.2 billion and US$4.2 billion syndicated committed undrawn bank facilities and US$15 billion and £5 billion commercial paper programmes, supported by the €4.2 billion and US$4.2 billion syndicated committed bank facilities, available to manage its liquidity. The Group uses commercial paper and bank facilities to manage short-term liquidity and manages long-term liquidity by raising funds in the capital markets.

€4.2 billion of the syndicated committed facility has a maturity date of 1 July 2015 and US$4.2 billion has a maturity of 9 March 2016 which may be extended by a further year if agreed by those banks who have participated in the facility. Both facilities have remained undrawn throughout the financial year and since year end and provide liquidity support.

The Group manages liquidity risk on long-term borrowings by maintaining a varied maturity profile with a cap on the level of debt maturing in any one calendar year, therefore minimising refinancing risk. Long-term borrowings mature between one and 26 years.

Liquidity is reviewed daily on at least a 12 month rolling basis and stress tested on the assumption that all commercial paper outstanding matures and is not reissued. The Group maintains substantial cash and cash equivalents which at 31 March 2011 amounted to £6,252 million (2010: £4,423 million).

Market risk

Interest rate management

Under the Group's interest rate management policy, interest rates on monetary assets and liabilities denominated in euros, US dollars and sterling are maintained on a floating rate basis except for periods up to six years where interest rate fixing has to be undertaken in accordance with treasury policy. Where assets and liabilities are denominated in other currencies interest rates may also be fixed. In addition, fixing is undertaken for longer periods when interest rates are statistically low.

At 31 March 2011 71% (2010: 36%) of the Group's gross borrowings were fixed for a period of at least one year. For each one hundred basis point fall or rise in market interest rates for all currencies in which the Group had borrowings at 31 March 2011 there would be a reduction or increase in profit before tax by approximately £30 million (2010: increase or reduce by £165 million) including mark-to-market revaluations of interest rate and other derivatives and the potential interest on outstanding tax issues. There would be no material impact on equity.

Foreign exchange management

As Vodafone's primary listing is on the London Stock Exchange its share price is quoted in sterling. Since the sterling share price represents the value of its future multi-currency cash flows, principally in euro, US dollars and sterling, the Group maintains the currency of debt and interest charges in proportion to its expected future principal multi-currency cash flows and has a policy to hedge external foreign exchange risks on transactions denominated in other currencies above certain de minimis levels. As the Group's future cash flows are increasingly likely to be derived from emerging markets it is likely that more debt in emerging market currencies will be drawn.

As such, at 31 March 2011 130% of net debt was denominated in currencies other than sterling (55% euro, 47% US dollar and 28% other) while 30% of net debt had been purchased forward in sterling in anticipation of sterling denominated shareholder returns via dividends and share buybacks. This allows euro, US dollar and other debt to be serviced in proportion to expected future cash flows and therefore provides a partial hedge against income statement translation exposure, as interest costs will be denominated in foreign currencies. Yen debt is used as a hedge against the value of yen assets as the Group has minimal yen cash flows.

Notes to the consolidated financial statements continued

21. Capital and financial risk management continued

Under the Group's foreign exchange management policy foreign exchange transaction exposure in Group companies is generally maintained at the lower of €5 million per currency per month or €15 million per currency over a six month period. In addition, a US dollar denominated financial liability arising from the options granted over the Essar Group's interests in Vodafone Essar in the 2008 financial year and as discussed on page 51, was held by a legal entity with a euro functional currency. A 14% (2010: 12%) change in US$/€ exchange rates would have a £436 million (2010: £393 million) impact on profit or loss in relation to this financial instrument.

The Group recognises foreign exchange movements in equity for the translation of net investment hedging instruments and balances treated as investments in foreign operations. However, there is no net impact on equity for exchange rate movements as there would be an offset in the currency translation of the foreign operation.

The following table details the Group's sensitivity of the Group's operating profit to a strengthening of the Group's major currencies in which it transacts.

The percentage movement applied to each currency is based on the average movements in the previous three annual reporting periods. Amounts are calculated by retranslating the operating profit of each entity whose functional currency is either euro or US dollar.

	2011 £m
Euro 4% change – Operating profit	230
US dollar 13% change – Operating profit	594

At 31 March 2010 sensitivity of the Group's operating profit was analysed for euro 12% change and US dollar 15% change, representing £804 million and £617 million respectively.

Equity risk

The Group has equity investments, primarily in Bharti Infotel Private Limited, which is subject to equity risk. See note 15 to the consolidated financial statements for further details on the carrying value of this investment. The Group disposed of its 3.2% interest in China Mobile Limited on 10 September 2010.

Fair value of financial instruments

The table below sets out the valuation basis of financial instruments held at fair value by the Group at 31 March 2011.

	Level 1[1]		Level 2[2]		Total	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
Financial assets:						
Derivative financial instruments:						
Interest rate swaps	–	–	1,946	1,996	1,946	1,996
Foreign exchange contracts	–	–	99	132	99	132
Interest rate futures	–	–	31	20	31	20
	–	**–**	**2,076**	**2,148**	**2,076**	**2,148**
Financial investments available-for-sale:						
Listed equity securities[3]	1	4,072	–	–	1	4,072
Unlisted equity securities[3]	–	–	703	623	703	623
	1	**4,072**	**703**	**623**	**704**	**4,695**
	1	**4,072**	**2,779**	**2,771**	**2,780**	**6,843**
Financial liabilities:						
Derivative financial instruments:						
Interest rate swaps	–	–	395	365	395	365
Foreign exchange contracts	–	–	153	95	153	95
	–	**–**	**548**	**460**	**548**	**460**

Notes:
(1) Level 1 classification comprises financial instruments where fair value is determined by unadjusted quoted prices in active markets for identical assets or liabilities.
(2) Level 2 classification comprises where fair value is determined from inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. Fair values for unlisted equity securities are derived from observable quoted market prices for similar items. Derivative financial instrument fair values are present values determined from future cash flows discounted at rates derived from market sourced data.
(3) Details of listed and unlisted equity securities are included in note 15 "Other Investments".