

Audit Committee report



Dear Shareholder

On behalf of the Audit Committee I am pleased to present its report for the year ended 30 June 2019.

The purpose of this report is to describe how the Committee has carried out its responsibilities during the year. In overview, the role of the Audit Committee is to monitor and review: the integrity of the company's financial statements; internal control and risk management; audit and risk programmes; business conduct and ethics; 'whistleblowing'; and the appointment of the external auditor.

The work of the Committee during the year gave attention to all elements of its remit. Over the year, the Committee continued to focus on particular topics within the company's risk management programme and emerging trends, including cyber security risks, global security trends, data management and migration risks, GDPR implementation, non-GAAP metrics and pensions governance.

As part of the annual Board evaluation, all members of the Audit Committee completed an evaluation of the Committee. This concluded that the performance of the Committee was consistently strong, with a clear and well defined remit and agenda. Further details of the evaluation can be found on page 73.

In discharging its duties, the Audit Committee seeks to balance independent oversight of the matters within its remit with providing support and guidance to management. I am confident that the Committee, supported by members of senior management and the external auditors, has carried out its duties in the year under review effectively and to a high standard.

Alan Stewart
Chairman of the Audit Committee

Role of the Audit Committee

The formal role of the Audit Committee is set out in its terms of reference, which are available at www.diageo.com/en-row/ourbusiness/aboutus/corporategovernance. Key elements of the role of the Committee and work carried out during the year are set out as follows.

Composition of the Audit Committee

The Audit Committee comprises Alan Stewart (Committee Chairman), Lord Davies, Debra Crew, Susan Kilsby, Ho KwonPing and Nicola Mendelsohn.

Financial statements

During the year, the Audit Committee met four times (and a sub-committee met twice) and reviewed both the interim results announcement, which included the interim financial statements, and the annual reports and associated preliminary year end results announcement, focusing on key areas of judgement and complexity, critical accounting policies, provisioning and any changes required in these areas or policies.

The company has in place internal control and risk management systems in relation to the company's financial reporting process and the group's process for preparation of consolidated accounts. A review of the consolidated financial statements is completed by the Filings Assurance Committee (FAC) to ensure that the financial position and results of the group are appropriately reflected therein. In addition to reviewing draft financial statements for publication at the half and full year, the FAC is responsible for examining the company's financial information and processes, the effectiveness of internal controls relating to financial reporting and disclosures, legal and compliance issues and determining whether the company's disclosures are accurate and adequate. The FAC comprises the Chief Executive, the Chief Financial Officer, the group general counsel & company secretary, the group general counsel corporate, the group financial controller, the group chief accountant, the group technical accounting director, the head of investor relations, the head of Global Audit & Risk and the company's external auditors. The Audit Committee reviewed the work of the FAC and a report on the conclusions of the FAC process was provided to the Audit Committee by the Chief Financial Officer.

Significant issues and judgements that were considered in respect of the 2019 financial statements were as follows. These include the matters relating to risks disclosed in the UK external auditor's report.

- Disclosure on the quality of the earnings and one-off items included in cash flow. The Audit Committee agreed that sufficient disclosure was made in the financial statements.
- The Audit Committee determined that exceptional items are appropriately classified considering their size and nature, and sufficient disclosure is provided in the financial statements (see note 4).
- Review of carrying value of assets, in particular intangible assets. The Audit Committee agreed that the fair value of the company's assets was in excess of their carrying value (see notes 6 and 10).
- Exchange rate used to translate operations in Venezuela. The Audit Committee agreed that the rate is reasonable for the year ended 30 June 2019 for consolidation purposes, that represents the best estimation of the rate at which capital and dividend repatriations are expected to be realised (see note 1).

- Disclosure on taxation. The Audit Committee agreed that the separate presentation of the tax risk appropriately addresses the significant change in the international tax environment and sufficient and transparent disclosures are provided for the ongoing tax discussions (see page 23 and note 7).
- Review of legal cases. The Audit Committee agreed that adequate provision and/or disclosure has been made for all material litigation and disputes, based on the currently most likely outcomes, including the litigation summarised in note 18.
- Assumptions used in respect of post employment plans. Having considered advice from external actuaries and assumptions used by companies with comparator plans, the Audit Committee agreed that the assumptions used to calculate the income statement and balance sheet assets and liabilities for post employment plans were appropriate (see note 13).
- Viability statement. The Audit Committee noted that severe but plausible risk scenarios had been identified; a robust risk assessment had been carried out; and the group's viability and going concern consideration proved with stress testing. Taking into account the company's balance sheet position, the Audit Committee expected the group to be able to meet its liabilities as they fell due over the three-year period ending 30 June 2022. The risk that the group would become insolvent during this timeframe was considered remote. The Audit Committee recommended to the Board that the Viability statement above be approved.

As part of its review of the Annual Report, the Audit Committee considered whether the report is 'fair, balanced and understandable' (noting the Code's reference to 'position' as well as 'performance, business model and strategy'). On the basis of this work, the Audit Committee recommended to the Board that it could make the required statement that the Annual Report is 'fair, balanced and understandable'.

Internal control and risk management; audit and risk programme; business conduct and ethics (including 'whistleblowing')

At each of its meetings, the Audit Committee reviewed detailed reports from the heads of the Global Risk & Compliance (GRC) and Global Audit & Risk (GAR) teams (including coverage of the areas mentioned in the title of this section) and had sight of the minutes of meetings of the Executive Audit & Risk Committee. The work and reporting to the Committee of both GRC and GAR during the year included focus on cyber risk, data management and migration risks, data privacy risks and risks associated with discrimination and harassment, given the external profile of this topic. The Committee in turn was thus able to keep under review the operation of the controls and compliance framework in these and other areas. The Committee also received regular updates from the group general counsel on significant litigation and from the head of tax on the group's tax profile and key issues.

The GRC reporting included a consideration of key risks and related mitigations, including those set out in the section of this Annual Report dealing with principal risks. Based on this activity during the year, the Audit Committee made a recommendation to the Board covering the nature and extent of the risks it was willing to take to achieve its strategic goals and its internal statement of risk appetite (which was considered also by the Executive Audit & Risk Committee). The Board agreed this recommendation.

Through the activities of the Audit Committee described in this report and its related recommendations to the Board, the Board confirms that it has reviewed the effectiveness of the company's

systems of internal control and risk management and that there were no material failings identified and no significant failings identified which require disclosure in this Annual Report.

External auditor

During the year, the Audit Committee reviewed the external audit strategy and the findings of the external auditor from its review of the interim results and its audit of the consolidated financial statements.

The Audit Committee reviews annually the appointment of the auditor (taking into account the auditor's effectiveness and independence and all appropriate guidelines) and makes a recommendation to the Board accordingly. Any decision to open the external audit to tender is taken on the recommendation of the Audit Committee. There are no contractual obligations that restrict the company's current choice of external auditor. Following the last tender process, PwC was appointed as auditor of the company in 2015 and the current audit partner is Ian Chambers.

The company has complied with the provisions of The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 ('CMA Order') for the year ended 30 June 2019.

The Audit Committee assesses the ongoing effectiveness and quality of the external auditor and audit process on the basis of meetings and a questionnaire-based internal review with the finance team and other senior executives.

The group has a policy on auditor independence and on the use of the external auditor for non-audit services, which is reviewed annually, most recently in July 2019. The review took into consideration effectiveness and upcoming expected changes to regulation on non-audit services. Under the group's auditor independence policy, the provision of any non-audit service must be approved by the Audit Committee, unless the proposed service is both expected to cost less than £250,000 and also falls within one of a number of service categories which the Audit Committee has pre-approved. Fees paid to the auditor for audit, audit related and other services are analysed in note 3(b) to the consolidated financial statements. The nature and level of all services provided by the external auditor are factors taken into account by the Audit Committee when it reviews annually the independence of the external auditor.

'Financial expert', composition and other attendees

For the purposes of the Code and the relevant rule under SOX, section 407, the Board has determined that Alan Stewart is independent and may be regarded as an Audit Committee financial expert, having recent and relevant financial experience, and that all members of the Audit Committee are independent Non-Executive Directors with relevant financial and sectoral competence.

The Chairman, the Chief Financial Officer, the group general counsel & company secretary, the group financial controller, the head of GAR, the GRC director, the group chief accountant and the external auditor regularly attend meetings of the Committee.

The Audit Committee met privately with the external auditor and with the head of GAR during the year.

Training and deep dives

During the year, the Audit Committee had risk reviews and training sessions, presented by senior executives, on cyber security risk management processes, the company's data protection risk mitigation approach following the implementation of the EU GDPR, global security trends and risks, and pension governance and risk associated with discrimination and harassment.