

Ensuring integrity across the business



Dear Shareholder

On behalf of the Audit Committee, I am pleased to present the Committee's report for the year ended 30 June 2022.

The Audit Committee has carried out its duties during the year effectively and to a high standard, providing independent oversight with the support of management and external auditors.

During the year, the Committee discharged its role in monitoring and reviewing the integrity of the company's financial statements and reporting, its internal control and risk management processes, its audit and risk activities, business conduct and integrity, whistleblowing and breach allegation investigations, and the appointment and performance of the external auditor. The Committee also reviewed the company's principal and emerging risks and its approach to risk appetite and mitigations, focussing this year in particular on key risks including cyber security, climate change, data privacy and developments in international taxation. The Committee recommended the addition of a new principal risk relating to supply chain disruption, which the Board has approved. We also received and reviewed regular reports on internal audits, business integrity and controls assurance work, breach allegation and investigation processes, as well as updates on the steps being taken to address internal audit findings and controls issues.

The Audit Committee has also been looking ahead towards potential future regulatory changes and developing best practice. In particular, we note the UK government's proposed reforms to the audit and corporate governance regime which were published on 31 May 2022 and which include the creation of a new regulator for the audit industry, requirements in relation to assurance of non-financial information and increased disclosure requirements in respect of internal controls. In anticipation of these reforms and under the supervision of the Committee, management has reviewed and implemented a number of changes in its approach to external reporting, including preliminary steps in determining the scope and contents of the company's audit and assurance policy. The Committee has also monitored initiatives of other regulatory authorities to provide investors with consistent, comparable and reliable information on climate-related and ESG matters. We are supportive of regulation which enables informed investment decisions and support efforts to encourage harmonisation across regulatory regimes.

The performance of the Audit Committee was evaluated this year as part of the broader Board evaluation, concluding that the Audit Committee's performance over the past year had continued to be excellent. Further details of the evaluation, its recommendations and actions can be found on pages 95. We are committed to continue to focus on fulfilling our duties with diligence.

Alan Stewart
Chairman of the Audit Committee

Role and composition of the Audit Committee

The formal role of the Audit Committee is set out in its terms of reference, which are available at <https://www.diageo.com/en/our-business/corporate-governance>. The members of the Audit Committee are independent non-executive directors and it comprises Alan Stewart (Committee Chairman), Melissa Bethell, Karen Blackett, Susan Kilsby, Valérie Chapoulaud-Floquet, Sir John Manzoni, Lady Mendelsohn and Ireena Vittal. The Chairman of the Board, the Chief Financial Officer, the General Counsel & Company Secretary, the Group Controller, the Head of Global Audit & Risk (GAR), the Chief Business Integrity Officer, the General Counsel Corporate, the Group Chief Accountant and the external auditor regularly attend meetings of the Committee. The Audit Committee met privately with the external auditor, the Chief Business Integrity Officer and the Head of GAR regularly during the year. During the course of the year, the Committee met five times and its duly appointed subcommittee met once. Details of attendance of all Board and Committee meetings by Directors are set out on page 90.

Reporting and financial statements

During the year, the Audit Committee reviewed the interim results announcement, including the interim financial statements, the Annual Report and associated preliminary results announcement and Form 20-F, focussing on key areas of judgement and complexity, critical accounting policies, disclosures (including those relating to contingent liabilities, climate change and principal risks), viability and going concern assessments, provisioning and any changes required in these areas or policies. The Audit Committee has also focussed in particular on the company's approach to assurance, internal approvals processes, and developments in climate change risk reporting. Building on the approach taken during the previous year in relation to reporting in compliance with the recommendations of the Task Force on Climate-related Financial Disclosures, during the year ended 30 June 2022 the company has undertaken further risk assessments and scenario analyses, and accordingly increased its climate-related disclosures as further set out on pages 47-56.

The company has in place internal control and risk management systems in relation to the company's financial and non-financial reporting process including the group's process for the preparation of consolidated financial statements. 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 and non-financial information and disclosures, the effectiveness of internal controls relating to financial and non-financial reporting and disclosures, legal and compliance issues and determining whether the company's disclosures are accurate and adequate. The FAC comprises senior executives such as the Chief Executive, the Chief Financial Officer, the General Counsel & Company Secretary, the General Counsel Corporate & Deputy Company Secretary, the Group Controller, the Group Chief Accountant, the Head of Investor Relations, the Head of GAR and the Chief Business Integrity Officer. The company's external auditor also attends meetings of the FAC. 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.

As part of its review of the company's Annual Report and associated disclosures, the Audit Committee has considered whether the report is 'fair, balanced and understandable' and provides the information necessary for shareholders to assess the company's position, performance, business model and strategy, as required by Principle N of the Code. In doing so, the Committee has noted the guidance issued by the FRC on this subject as well as best practice recommendations from external advisors. The Committee has considered factors such as whether the report includes descriptions of the business model, strategy and principal risks which are sufficiently clear and detailed to enable users to understand their importance to the company, whether the report is consistent throughout with the narrative reflecting the financial statements and understanding of directors during the year, that information is presented fairly, without omission of material information and not in a manner which might mislead users.

The Committee has also considered the presentation of GAAP and non-GAAP measures to ensure appropriate prominence is given to GAAP measures and that non-GAAP measures are presented consistently and can be clearly reconciled. The Audit Committee has also considered the governance and processes undertaken by management in drafting, developing and reviewing the contents of the Annual Report, which have been designed to ensure the robustness and adequacy of the information contained in it, including review by and input from senior executives, the company's advisors and through the work of the FAC. On this basis, the Audit Committee recommended to the Board that it could make the required statement that the Annual Report is 'fair, balanced and understandable'.

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. Richard Oldfield became the lead audit partner for the year ended 30 June 2021, following the rotation of the previous partner, and will remain as audit partner for the year ending 30 June 2023 onwards. The company is required to have a mandatory audit tender after 10 years and, as the Audit Committee considers the relationship with the auditors to be working well and remains satisfied with their effectiveness and the quality of audit work, their geographical and professional capabilities, the Audit Committee does not currently anticipate that it will conduct an audit tender before it is required to do so in 2025. The Audit Committee considers this to be in the best interests of the company's shareholders for the reasons outlined above and will continue to monitor this annually to ensure the timing for the audit tender remains appropriate, taking into account the effectiveness and independence of the auditor.

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 2022.

External auditor effectiveness and quality

The Audit Committee assesses the ongoing effectiveness and quality of the external auditor and audit process through a number of methods, commencing with identification of appropriate risks by the external auditor as part of its detailed audit plan presented to the Audit Committee at the start of the audit cycle. These risks were reviewed by the Committee and the work performed by the auditor was used to test management's assumptions and estimates relating to such risks. The effectiveness of the audit process in addressing these matters was assessed through reports presented by the auditor to the Audit Committee which were discussed by the Committee at both the half-year, in January, and year-end, in July. Following completion of the audit process, feedback on its effectiveness was provided through review meetings with the company's finance team and management and completion of questionnaires, in advance of management and the auditor providing assessments of auditor effectiveness and quality to the Audit Committee for consideration at its meeting in December. This year the questionnaire was updated to ensure more focus on the extent to which the auditor had challenged management. The auditor assessment includes consideration of the findings of the FRC's Audit Quality Review team, periodic regulatory review carried out by the PCAOB and the Quality Assurance Department of the Institute of Chartered Accountants in England and Wales, as well as benchmarking of the auditor as against its peers. This year, overall performance of the auditor was assessed as solid, with consistent strong feedback provided as to auditor independence, quality control processes, professional expertise, business knowledge and quality communication between auditors and management. Areas where continued focus was required included timely review and feedback on audit matters, better alignment in internal communication, resource continuity and use, and pro-activity in driving efficiencies and reducing overruns. It was concluded that the relationship between auditor and management was strong and open, with good visibility of senior PwC team members.

During the external audit, the auditor challenged management during the course of drafting the Annual Report in relation to whether disclosures as to the impact of certain risks in the financial statements were sufficiently linked to the risks and disclosures set out in the Strategic Report and whether there was sufficient balance in the Strategic Report, on management's approach taken in relation to impairment testing and on other judgmental matters such as pensions valuations and actuarial assumptions. The Audit Committee assessed these challenges and sought additional evidence from management in support of their assessments. For example, the Audit Committee requested that independent legal opinions were sought as to the treatment of potential surplus assets under the rules of the relevant scheme in light of relevant accounting standards.

Auditor independence

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 2022. This year there were minor changes to the policy's contents, with amendments reflecting internal organisational changes. Under the auditor independence policy, any member of the PwC global network shall provide to the company, its subsidiaries or any related entity only permissible services, subject to the approval of the Audit Committee after it has properly assessed through its governance process the threats to independence and the safeguards applied in accordance with the FRC Ethical Standard and US Public Company Accounting Oversight Board rules. Any FRC permissible service to be provided by the auditor, regardless of the size of the engagement, must be specifically approved by the Audit Committee or its nominated delegate (being the Chairman of the Audit Committee) based on a defined scope of pre-approved services. The policy explicitly specifies the auditor independence review and approval mechanism process by the Committee for permissible engagements above the specified threshold of £100,000. 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. During the year, no non-audit services were provided by the external auditor to the company, its subsidiaries or any related entity other than personal tax services provided to two Non-Executive Directors and the provision of services in connection with the issuance of senior notes by a group company.

'Financial expert', recent and relevant financial experience

The Board has satisfied itself that the membership of the Audit Committee includes at least one Director with recent and relevant financial experience and has competence in accounting and/or auditing and in the sector which the company operates, and that all members are financially literate and have experience of corporate financial matters. 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. See pages 84-85 and 90 for details of relevant experience of Directors.

Internal audit and controls assurance

The company's internal GAR team undertakes an annual audit and risk plan by delivering a series of internal assurance and audit assignments across a variety of markets, processes, business units and functions. On the conclusion of each assignment, GAR issues a report on its findings which may also include an overall rating as to the status of the market, process or function being audited, detailed reasons for the rating and actions to be taken within a specific timetable. The Audit Committee receives regular reports from the Head of GAR on the latest reports issued.

This year GAR adapted its processes and audit design to undertake a number of audits of the group's end-to-end processes and procedures in addition to more customary market or functional audits. Increasingly during the year, GAR undertook audits in person as travel restrictions were lifted in a number of key markets. The Audit Committee assesses the effectiveness of GAR by reviewing its annual audit plan at the start of the financial year, monitoring its ongoing quality throughout the year, and assessing completion rates and feedback provided following completion of the annual audit plan. Having carried out this assessment, the Audit Committee is of the view that the quality, experience and expertise of GAR is appropriate for the business.

The company operates a global controls assurance programme for controls in each market and function, which monitors compliance with and effective operation of the company's controls framework. The Audit Committee receives regular reports on the status of the controls assurance plan, actions taken to enhance controls design and effectiveness, awareness training provided to employees, testing results and trends analysis derived from the company's integrated risk management system. During this year, the oversight and responsibility for operating the global controls assurance programme was integrated with the internal audit function. The Committee also reviewed and approved changes to the principal risk descriptions and risk footprint, including the elevation of Supply Chain Disruption as a separate principal risk, as further described on page 42.

Business Integrity programmes

Diageo is committed to conducting its business responsibly and in accordance with all laws and regulations to which its business activities are subject. We hold ourselves to the principles in our Code of Business Conduct, which is embedded through a comprehensive training and education programme for all employees. Our employees are expected to act in accordance with our values, the Code of Business Conduct and in compliance with applicable laws and regulations.

Our Code of Business Conduct and other global policies are available at <https://www.diageo.com/en/our-business/corporate-governance>.

The Audit Committee monitors compliance with the company's ethical standards through the Business Integrity framework, which helps enhance and protect all aspects of the company's business. Regular reports are provided to the Audit Committee by the Chief Business Integrity Officer on progress in providing guidance, training and tools for all levels in the business, completion rates for training modules, launch and rollout of new programmes or policies, monitoring use of whistle-blowing mechanisms and investigating allegations of breaches. The Business Integrity function use systems and data to allow for more efficient breach management oversight, analysis and identification of root causes, overall trends and indicators, and to monitor investigation closure rates, which are reported to the Audit Committee.

Senior financial officers' code of ethics

In accordance with the requirements of SOX and related SEC rules, Diageo has adopted a code of ethics covering its Chief Executive, Chief Financial Officer, and other senior financial officers. During the year, no waivers were granted in respect of, this code of ethics. The full text of the code of ethics is available at <https://www.diageo.com/en/our-business/corporate-governance>. Both the Audit & Risk Committee and the Audit Committee regularly review the strategy and operation of the Business Integrity programme through the year.

Management's report on internal control over financial reporting

Management, under the supervision of the Chief Executive and Chief Financial Officer, is responsible for establishing and maintaining adequate control over the group's financial reporting. The Filings Assurance Committee supports the Chief Executive and Chief Financial Officer in ensuring the accuracy of the company's financial reporting, filings and disclosures. As summarised on page 99, prior to interim reporting and preliminary reporting each year, the Filings Assurance Committee examines the company's financial information and processes, the effectiveness of its controls in respect of financial reporting, and the contents of its disclosures.

Management has assessed the effectiveness of Diageo's internal control over financial reporting (as defined in Rules 13(a)-13(f) and 15(d)-15(f) under the United States Securities Exchange Act of 1934) based on the framework in the document 'Internal Control - Integrated Framework', issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 2013. Based on this assessment, management concluded that, as at 30 June 2022, internal control over financial reporting was effective. During the period covered by this report, there were no changes in internal control over financial reporting that have materially affected or are reasonably likely to materially affect the effectiveness of internal control over financial reporting. The same independent registered public accounting firm which audits the group's consolidated financial statements has audited the effectiveness of the group's internal control over financial reporting, and has issued an unqualified report thereon, which is included in the integrated audit report which is included in the company's Form 20-F to be filed with the SEC.

Committee activities

Details of the main areas of focus of the Audit Committee during the year include those summarised below:

Areas of focus		Strategic priority	Strategic outcome
Corporate reporting	<ul style="list-style-type: none"> Half and full year external reporting updates Interim and preliminary results review and approval Annual Report and consolidated financial statements, Form 20-F review and approval 		
Internal controls	<ul style="list-style-type: none"> GAR updates Business Integrity updates including breach and reporting update Controls testing update and s. 404 assessment 		
External audit and assurance	<ul style="list-style-type: none"> Report on external audit at half and full year periods Insights and observations on reporting review Auditor independence and non-audit work reviews Auditor independence policy review Review of management representation letters Appointment of auditor and review of terms of engagement and fees Auditor performance and effectiveness review and assessment 		
Risk management	<ul style="list-style-type: none"> Principal and emerging risk reviews and tracking Risk updates, including group risk footprint and risk appetite review and approvals Litigation, cyber and tax risk reviews 		

Strategic priorities

- Sustain quality growth
- Invest smartly
- Champion inclusion and diversity
- Embed everyday efficiency
- Promote positive drinking
- Pioneer grain-to-glass sustainability

Strategic outcomes

- Efficient growth
- Credibility and trust
- Consistent value creation
- Engaged people

Significant issues and judgements

Significant issues and judgements that were considered in respect of the 2022 financial statements are set out below. Our consideration of issues included discussion of the key audit matters as outlined in the appendix to the independent auditors' report.

Matter considered	How the Audit Committee addressed the matter
The nature and size of any one-off items impacting the quality of the earnings and cash flows.	The Audit Committee assessed whether the related presentation and disclosure of those items in the financial statements were appropriate based on management's analysis, and concluded that they were.
Items that were to be presented as exceptional. <i>Refer to note 4 of the Financial Statements.</i>	The Audit Committee assessed whether the reporting of those items as exceptional was in line with the group's accounting policy, and that sufficient disclosure was provided in the financial statements, and concluded that they were.
Whether the carrying value of assets, in particular intangible assets, was supportable. <i>Refer to notes 6, 9 and 10 of the Financial Statements.</i>	The Audit Committee reviewed the key assumptions and result of management's impairment assessments that were performed during the year, and the methodology applied in conducting impairment assessments. The Committee was provided with information about the carrying amounts and the key assumptions incorporated in management's estimate of discounted cash flows. The Committee reviewed the key assumptions used in the impairment testing, including management's cash flow forecasts, growth rates and the discount rate used in value in use calculations and agreed they were appropriate. The Committee agreed with management's judgements regarding the McDowell's No.1 and Bell's brands, which resulted in the recognition of impairment of £317 million in the year ended 30 June 2022. The Committee agreed that the recoverable amount of the company's other assets was in excess of their carrying value and that appropriate disclosure was provided with respect to assets impaired, and whose value is more sensitive to changes in assumptions.
The group's more significant tax exposures and the appropriateness of any related provisions and financial statement disclosures. <i>Refer to page 44 of 'Our principal risks and risk management' and note 7 of the Financial Statements.</i>	The Audit Committee agreed that disclosure of tax risk appropriately addresses the significant change in the international tax environment, and that appropriate provisions and other disclosure with respect to uncertain tax positions were reflected in the financial statements.
The appropriateness of the valuation of post employment liabilities, and the recognition of any surplus. <i>Refer to note 14 of the Financial Statements.</i>	The measurement of post employment liabilities is sensitive to changes in long-term interest rates, inflation and mortality assumptions. Having reviewed management's papers setting out key changes to actuarial assumptions, the Audit Committee agreed that the assumptions used in the valuation are appropriate. The Committee reviewed management's assessment of the economic benefit available as a refund of the surplus or as a reduction of contribution and the key judgements made in respect of the surplus restriction and concluded that those judgements were appropriate. The Committee reviewed and concluded that sufficient disclosures were provided in the financial statements.
Significant legal matters impacting the group. <i>Refer to note 19 of the Financial Statements.</i>	The Committee agreed that adequate provision and/or disclosure have been made for all material litigation and disputes, based on the current most likely outcomes, including the litigation summarised in note 19 of the Financial Statements.
Accounting for business combinations. <i>Refer to note 8 of the Financial Statements.</i>	Diageo acquired 21Seeds on 31 March 2022 and completed a number of other smaller acquisitions during the year ended 30 June 2022, for an aggregate consideration of £162 million. As at the completion date of these acquisitions, Diageo performed valuations of the identifiable assets and liabilities and the resulting goodwill. The purchase price allocation exercises are subject to management's judgement and estimates, including forecast cash flows, buyer specific synergies and the applicable discount rates used in valuations. The Committee reviewed management's purchase price allocations and the disclosures provided in the Financial Statements and concluded they were appropriate.
The application of hyperinflationary accounting in Turkey. <i>Refer to note 1 of the Financial Statements.</i>	Hyperinflationary accounting became applicable to Turkey in the year ended 30 June 2022. The Audit Committee agreed with management's analysis of Turkey becoming a hyperinflationary economy. The Audit Committee reviewed and agreed with management's assessment of the hyperinflation adjustments and the presentation and disclosures made. The Committee reviewed and agreed with the recognition of the restatement of non-monetary items at the beginning of the reporting period, including the impairment of the restated non-current assets recognised, within equity. The Committee reviewed the disclosures in respect of hyperinflationary accounting, and concluded they were appropriate.
Whether the Annual Report is fair, balanced and understandable.	The Audit Committee concluded that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's performance, business model and strategy and that there is an appropriate balance between statutory (GAAP) and adjusted (non-GAAP) measures ensuring equal prominence.
The impact of climate change on the group's financial reporting and financial statements. <i>Refer to pages 47 to 56 of 'Responding to climate-related risks' and note 1 and note 9 of the Financial Statements.</i>	The Audit Committee agreed that the disclosures on pages 47 to 56 made in response to the recommendations of the Task Force on Climate-related Financial Disclosures are appropriate and that the assumptions used in the financial statements are consistent with these disclosures.