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By email: brydonreview@beis.gov.uk

5 June 2019

Dear Sir/Madam,

Independent review of the Quality and Effectiveness of Audit - The Brydon Review

The independent review by Sir Donald Brydon is seeking views ("Call for Views") on the quality and effectiveness of audit and Diageo plc ("Diageo") welcomes the opportunity to respond. This Call for Views invites opinion, information and evidence on, in particular:

- the purpose of audit and for whom it should be carried out
- whether its scope and purpose should be widened and strengthened, in light of changing expectations of audit and a perceived expectations gap
- how the quality of the audit process and product could be improved
- whether audit findings could be better communicated
- the role of audit within wider business assurance and in relation to directors' legal responsibilities
- the role of audit in detecting fraud
- auditor liability.

The Call for Views is aimed at anyone with a direct or indirect interest in the audit product in the UK.

As a company incorporated in the UK, listed on the London and New York stock exchanges, Diageo has a strong interest in ensuring that the purpose of audit is clearly defined, its scope is achievable in light of that purpose and that purpose and scope are adequately communicated and understood by Diageo's shareholders and other stakeholders. We are therefore highly supportive of the aims of the Brydon review and are mindful in particular of the broader context in which the Brydon review is being conducted. In particular, we note the continuing evolution in the wider regulatory and corporate governance framework with its emphasis on ensuring long-term sustainable success as well as increased consideration of the impact of business decisions on wider stakeholder groups. The Brydon review should be seen within the context of these other assurance and governance developments as well as other reviews, including the Kingman review, the BEIS Parliamentary Committee report on The Future of Audit, the CMA's statutory market study and the FRC review of Corporate Reporting. All of these initiatives, and any recommendations which are proposed as a result of them, will impact the UK audit market and therefore need to be coordinated and considered as a whole to achieve the best possible environment for business and its stakeholders, providing a simple, proportionate and sustainable framework to enhance audit quality and effectiveness in a manner which builds trust in the UK as a place to do business. As a company subject to US regulatory requirements due to our New York stock exchange listing, we are also mindful of evolution in relation to audit requirements for US listed issuers and would suggest that it would be preferable to avoid divergence with key overseas audit requirements, including those in Europe and the US.

We also note that, in his introduction to the Call for Views, Sir Donald Brydon remarks that he is conscious of not wanting to "discard what is good in the search for what is better" and fully support the view that the irresponsible behaviour of a minority of companies in the UK, as well as slow or

inadequate action by regulators, should not be taken to be symptomatic of a more general failing in corporate governance and assurance quality across UK businesses as a whole.

In this letter we have focused our considerations and responses on certain key themes emerging from the Call for Views rather than commenting on each specific proposal. Therefore, where we have not submitted an answer to a specific question or proposal, it should not be inferred that we are supportive of that particular proposal.

Use and purpose of audit – who is an audit for?

Q1: For whose benefit should audit be conducted? How is it of value to users?
Q2: Should the audit be designed to enhance the degree of confidence of intended users in the entity or just in the financial statements?
Q7: What should be the role of audit within wider assurance?
Q8: Can the level of assurance that an audit provides legitimately vary in different circumstances, for example depending on the business sector in question, and the nature of the entity's business risks?
Q9: Are the existing boundaries between internal and external audit clear?
Q10: To what extent should external auditors be able to use evidence obtained from work performed by internal auditors in drawing conclusions?

It is our view that the primary stakeholder group for whom the audit is designed is the company and its shareholders as a whole, as caselaw has established that an auditor owes its legal duty of care to the company's shareholders as a whole, rather than to individual shareholders or to other stakeholder groups. We also acknowledge that other stakeholder groups derive secondary benefits from corporate reporting, - whether or not it is audited - and the assurance that audit provides, and it is therefore important to consider who else are the users of corporate information and whether this requires companies to adapt their reporting to a broader group of users. We are of the view that it is appropriate for the Brydon Review to consider a diverse range of stakeholders who all have different expectations about the information they are receiving, but that the primary role of the audit is maintained as being for the benefit of the company's shareholders as a whole. Such diverse expectations may benefit from clarity through additional codification through legislation.

In order to ensure better understanding of the role of the auditor, it may be useful for those sections of a company's annual report and accounts which are audited or subjected to some level of assurance by an auditor, are clearly noted as such in the annual report and accounts. This would enable readers to more readily understand the scope of the auditor's assurance role in relation to the published document.

Audit report, Internal controls

Q12: Should directors make a more explicit statement in respect of risk management and internal controls? If so, should such a statement be subject to audit?
Q13: Should auditors' responsibilities regarding assessing the effectiveness of an entity's system of internal control be extended or clarified?
Q14: Auditors are currently required to report to audit committees their views on the effectiveness of relevant internal controls for listed and other relevant entities. Should auditors be required to report publicly these views?
Q25: What additional benefit might a switch from a binary audit opinion to a more graduated disclosure of auditor conclusions provide?
Q34: Should more of the communication and resulting judgments that occur between the auditor and the audit committee be made transparent to users of the financial statements?

We are not in favour of directors making more explicit statement in respect of risk management and internal controls.

We would support a review into the current control environments at the companies in the UK to identify areas where improvement, clarification may be required, before determining whether, and to what extent, the UK control framework needs changing.

Any UK control regime should give equivalence to companies already subject to compliance with reporting regimes under other jurisdictions which can be recognized as adequate, including for example Sarbanes-Oxley Act ("SOX"), in order to minimise inefficiencies or duplication of reporting. We believe

that consideration should be given to whether it would be advantageous to implement requirements similar to the SOX requirements in the US.

Being an entity listed on the New York stock exchange, Diageo operates a SOX compliant control environment which we find effective and robust, albeit that the additional burden that this places on a business, from both time and cost perspectives, should not be underestimated. Therefore, any new requirement in this respect must take into consideration the importance of proportionality, in particular when considered in relation to the size of the company and its resources. We would not suggest introducing a new compliance regime which was either substantively inconsistent with or more onerous than SOX, and that future divergence between any such new regime and SOX be avoided.

We strongly agree that audit firms need to be taking advantage of technology to enhance reliability and focus assurance on both the financial statements and other key indicators (both financial and non-financial), assuming there is a framework to ensure consistency (refer to next section). Since future technology is expected to be more integrated into business and financial processes, audit work should mirror and follow that, resulting in a more efficient audit. In our view, where auditors are able to place reliance on internal audit's technology or testing results in a manner which does not infringe their ability to remain independent, this would be beneficial.

We support the Brydon review in its view that new technology offers an opportunity to move away from the sampling of transactions and instead look at most or all of them through application of data analytics. Technology already supports analytical reviews, exception reporting, controls testing or segregation of duties testing.

Regarding audit reports, in our view users of corporate information are more interested in the robust assurance work and audit quality rather than reading more extensive and lengthy audit reports.

Audit scope, Forward looking audits, Viability statement

Q15: Is the current regulatory framework relating to going concern fit for purpose (including company law and accounting standards)?

Q16: Should there be greater transparency regarding identified "events or conditions that may cast significant doubt on the entity's ability to continue as a going concern"?

Q17: Should directors make a statement about the sustainability of the entity's business model beyond that already provided in the viability statement?

Q20: Is there a case for a more forward-looking audit? What would be the main benefits and risks?

Q21: Would audit or assurance over financial and non-financial information outside the annual financial statements (for example KPIs or non-financial metrics, payment practices or half-yearly reports) enhance its reliability and therefore be of benefit to users?

The Brydon Review may need to consider the extent to which sufficiently valuable assurance can be given on forward looking statements and other non-financial information. While such information is becoming increasingly important to a company's stakeholders, including investors, these data can be challenging to assure. There are also difficulties in seeing what degree of assurance can be given in respect of non-financial data in the absence of a standardised approach across companies operating in the same industry.

However, we agree that greater transparency around management's assessment of going concern data, the viability statement, the work the auditor has performed in these areas and clarity as to what assurance is provided would be useful.

We acknowledge that the quality of viability statements varies across the market as a whole and therefore are supportive of their being reviewed and reformed to enhance consistency. We would support abolishing the viability statement and focusing instead on greater clarity, including expectations, of the going concern statement and its coverage period. In the event that Brydon were to recommend enhanced or additional statements concerning the sustainability of a company, we believe that it is important that any such statements should be given by the board as a whole. We would not be supportive of any provisions which confer additional liabilities on certain directors but not on others, as has been recommended by the Kingman review in relation to reporting requirements and dealings with auditors, on the basis that this would undermine long-standing company law principles of a unitary board whereby all directors have the same duties and obligations.

Audit reports, Communication of audit findings

Q25: What additional benefit might a switch from a binary audit opinion to a more graduated disclosure of auditor conclusions provide? Q33: Should there be more open dialogue between the auditor and the users of their reports? For example, might an annual assurance meeting open to all stakeholders prove valuable?

Q34: Should more of the communication and resulting judgments that occur between the auditor and the audit committee be made transparent to users of the financial statements?

Q52: Would interaction between shareholders and auditors outside the AGM be practical and/or desirable?

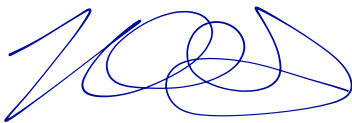
As noted above, we believe that, while stakeholders would value more assurance in relation to corporate information, they will gain more benefit from substantive and robust assurance work rather than simply by increasing disclosure requirements.

The current long-form audit opinion has been well received by investors and we are therefore supportive of further reviews to enhance insights provided for stakeholders. However, we are of the view that introducing graduated findings would not be of significant value unless accompanied by sufficient narrative in the audit report. Comparability of audit reports across industry or comparable companies provided by different audit firms is of the utmost importance. It is therefore critical that a method to ensure such comparability is maintained if graduated findings are introduced.

We believe that a company's AGM is the most natural venue for discussion of audit findings, given that this is the principal forum for direct dialogue between a company's board and its investors and at which shareholders have the ability to put questions directly to the board. We believe that encouraging questions to be directed to the Audit Committee chair and to auditors at the AGM, perhaps as part of a session of the AGM specifically dedicated to assurance, would be the most efficient and effective way of ensuring better engagement and transparency. Holding a separate meeting dealing purely with assurance matters would, we believe, give rise to confusion amongst shareholders as to the purpose of the AGM and the assurance meeting.

We trust that this response to your Call for Views is of use and we look forward to seeing your report in due course. In the meantime, if we can assist your review further please do not hesitate to contact me.

Yours sincerely,



Kathryn Mikells

Chief Financial Officer