Corporate governance report

Dear Shareholder

On behalf of the board, we are pleased to present the corporate governance report for the year ended 30 June 2013.

The board of directors is responsible for both the stewardship and governance of your company. As part of this, it sets the company's strategic aims and values and oversees the executive management who carry out the operational running of the business. The board is also charged with reporting to shareholders on the company's performance and, in this area, we feel that we are already well placed to comply next year with the revised requirements of the UK Corporate Governance Code (as defined below) to make the annual report fair, balanced and understandable.

We continue to believe that our board has the diversity and the mix of skills, experience, independence and knowledge of the company to enable it to discharge its responsibilities successfully.

In presenting this report, we seek to explain how your company is directed and controlled, by describing the membership and work of the board and its committees, the approach to ensuring board members have an appropriate understanding of the business, and how the board considers its effectiveness. The report also explains the executive direction and control and our corporate governance structures and procedures.

During the year, the company announced the succession of its chief executive, which was effective on 1 July 2013. Several other changes to the membership of the executive committee (as defined below) were made during the year, which were also effective on 1 July 2013 (as shown above in the biographies of directors and members of the executive committee). Changes have also been made to some of the ways of working of the executive committee and these are explained below, in this report.

The principal corporate governance rules applying to UK companies listed on the London Stock Exchange (LSE) for the year ended 30 June 2013 are contained in The UK Corporate Governance Code as updated and published by the Financial Reporting Council (FRC) in May 2010 (the Code) and the UK Financial Conduct Authority (FCA) Listing Rules, which require companies listed on the Main Market of the LSE to describe, in their annual report, their corporate governance from two points of view: the first dealing generally with their application of the Code's main principles and the second dealing specifically with non-compliance with any of the Code's provisions. The two descriptions together are designed to give shareholders a picture of governance arrangements in relation to the Code as a criterion of good practice. Diageo has complied with all relevant provisions set out in the Code throughout the year. The Code is publicly available under the heading 'Corporate Governance' at the website of the FRC, www.frc.org.uk.

Diageo must also comply with corporate governance rules contained in the FCA Disclosure and Transparency Rules as well as certain related provisions in the Companies Act 2006 (the Act).

As well as being subject to UK legislation and practice, as a company listed on the New York Stock Exchange (NYSE), Diageo is subject to the listing requirements of the NYSE and the rules of the Securities and Exchange Commission (SEC). Compliance with the provisions of the US Sarbanes-Oxley Act of 2002 (SOX), as it applies to foreign issuers, is continually monitored. While the directors believe that the group's corporate governance policies continue to be robust, changes have been and will continue to be made in light of the rules that are in place at any point in time. Diageo follows UK corporate governance practice; differences from the NYSE corporate governance standards are summarised below within this report and on the company's website at www.diageo.com.

The way in which the Code's principles of good governance and relevant provisions of SOX and applicable laws and regulations are applied is described within this corporate governance report.

Dr Franz B Humer
Chairman

PD Tunnacliffe
Company Secretary

Board of directors

Membership of the board and board committees, other directorships and attendance at meetings

The chairmen, senior non-executive director and other members of the board, audit committee, nomination committee and remuneration committee are as set out above in the biographies of directors and members of the executive committee. The directors' biographies also show the significant other commitments of the chairman and other directors and whether there have been any changes to them during the year. Directors' attendance during the year at board meetings, meetings of the audit, nomination and remuneration committees and at the annual general meeting (AGM) was as set out in the table at the end of this report.

The board considers that it is beneficial for the executive directors to hold an external directorship to broaden their experience and normally this would be limited to one company. The Chief Executive, Ivan Menezes, holds a US non-executive directorship in Coach, Inc. The Chief Financial Officer, Deirdre Mahlan holds a UK non-executive directorship in Experian plc. The former Chief Executive, Paul Walsh (who remains on the board until the AGM in September 2013), holds UK non-executive directorships in Unilever plc and Avanti Communications Group plc and a US non-executive directorship in FedEx Corporation.

There is a clear separation of the roles of the chairman and the chief executive. The Chairman, Dr Franz B Humer, is responsible for the running of the board and for ensuring all directors are fully informed of matters sufficient to make informed judgements. As Chief Executive, Mr Menezes has responsibility for implementing the strategy agreed by the board and for managing the group. He is supported in this role by the executive committee.

The non-executive directors, all of whom the board has determined are independent, are experienced and influential individuals from a range of industries, backgrounds and countries. Their diverse mix of skills and business experience is a major contribution to the proper functioning of the board and its committees, ensuring that matters are fully debated and that no individual or group dominates the board's decision-making processes.

Through the nomination committee, the board ensures that plans are in place for the succession of the executive and non-executive directors.

A summary of the terms and conditions of appointment of the non-executive directors is available at www.diageo.com or on request from the company secretary.

Activities and duties of the board

It is the responsibility of the chairman and the company secretary to work closely together in planning the annual programme and agendas for meetings. During the year, five scheduled board meetings were held, all in the United Kingdom. In addition, an annual strategy conference with the full executive committee was held offsite at which the group's strategy was reviewed in depth and two further board meetings were held, in relation to the acquisition of United Spirits Limited.

Attendance at meetings has been at a high level. Nevertheless when directors were unable to attend a meeting, they received full information on the matters to be discussed and took advantage of the opportunity to make their views known to the chairman prior to the meeting. The board managed overall control of the company's affairs with reference to the formal schedule of matters reserved for the board for decision. The schedule was last revised in June 2012.

The board makes decisions and reviews and approves key policies and decisions of the company, in particular in relation to: group strategy and operating plans; corporate governance; compliance with laws, regulations and the company's code of business conduct; business development, including major investments and disposals; financing and treasury; appointment or removal of directors and the company secretary; risk management; financial reporting and audit; corporate reputation, sustainability and responsibility, ethics and the environment; and pensions.

The Act sets out directors' general duties concerning conflicts of interest and related matters. The board has agreed an approach and adopted guidelines for dealing with conflicts of interest and responsibility for authorising conflicts of interest is included in the schedule of matters reserved for the board. The board confirmed that it was aware of no situations that may or did give rise to conflicts with the interests of the company other than those that may arise from directors' other appointments as disclosed in their biographies above. In accordance with the articles, the board authorised the chairman or the company secretary, as appropriate, to receive notifications of conflicts of interest on behalf of the board and to make recommendations as to whether the relevant matters should be authorised by the board. The company has complied with these procedures during the year.

While all directors are equally accountable for the proper stewardship of the company's affairs, the non-executive directors have a particular responsibility for ensuring that the business strategies proposed are fully discussed and critically reviewed. This enables the directors to promote the success of the company for the benefit of its shareholders as a whole, while having regard to, among other matters, the interests of employees, the fostering of business relationships with customers, suppliers and others, and the impact of the company's operations on the communities and environment in which the business operates.

The non-executive directors also oversee the operational performance of the whole group. To do this they have full and timely access to all relevant information, with updates also provided on governance and regulatory matters affecting the company. In addition, executive committee members and other senior executives are invited, as appropriate, to board and strategy meetings to make presentations on their areas of responsibility.

In order to fulfil their duties, procedures are in place for directors to seek both independent advice and the advice and services of the company secretary who is responsible for advising the board, through the chairman, on all governance matters. The non-executive directors meet without the chairman present, and also meet with the chairman without management present, on a regular basis.

The non-executive directors fulfil a key role in corporate accountability. The remits of the audit, the nomination and the remuneration committees of the board are set out below and membership of these committees is as set out above in the 'Board of directors and executive committee' section of this annual report. The company secretary acts as secretary to all of these committees. The terms of reference of the committees are available on the company's website at www.diageo.com/en-row/ourbusiness/aboutus/corporategovernance.

Induction, training and business engagement

There is a formal induction programme for new directors, which was followed during this year in respect of Ho KwonPing. He met with executive committee members and other senior executives individually and received orientation training from the relevant senior executive in relation to the group and its business. This included a visit to the Supply operations in Scotland, to the customer collaboration centre in the United Kingdom and meeting with local management in the Asia Pacific business. Following the initial induction for non-executive directors, appropriate business engagements continue to be arranged, with the chairman and non-executive directors also taking advantage of business visits overseas to meet with local management.

All directors were also provided with the opportunity, and encouraged, to attend regular training to ensure they were kept up to date on relevant legal developments or changes and best practice and changing commercial and other risks. Typical training experience for directors included attendance at seminars, forums, conferences and working groups and, during the year ended 30 June 2013, also included internally led risk-based training on digital marketing and social media. Training for directors is kept under review during the year and forms part of the chairman's individual meetings held with each director, with feedback sought from directors on areas and topics that they want to be covered.

Performance evaluation

During the year, an evaluation of the board's effectiveness, including the effectiveness of the audit committee, the nomination committee and the remuneration committee was undertaken internally by way of a written questionnaire followed by the chairman of the board meeting individually with all directors.

The board questionnaire had a particular emphasis on how well the board measured against 'best practice' boardroom behaviour and enhancing the effectiveness and added value of the board. The evaluation of the performance of the board throughout the year concentrated on framing the future focus of the board, against a backdrop of how the board perceived it had performed; the boardroom dynamics; feedback received in prior evaluation; a breakdown of time allocation; and the company's strategy. The aim was to clearly identify areas to enable the board to positively affirm that it was playing an effective role in supporting the success of Diageo. The questionnaires for the committees focused on the performance of the respective committees throughout the year; whether the agendas appropriately covered the remits of the committees; how the performance of the respective committees could be enhanced; and areas of focus for the forthcoming year.

A report was prepared for the board on its effectiveness and that of its committees. The report concluded that the board and its committees continued to operate effectively, meeting the requirements and spirit of the Code. Processes were seen to have improved to allow a focus and time spent on the most important matters for the company, including the development of strategy, and the climate in the boardroom continued to create the optimum conditions for good decision making and sound guidance. The importance of ensuring appropriate succession to the board to maintain boardroom dynamics and the appropriate balance of skills, knowledge, diversity and experience had resulted in the appointment, with effect from 1 October 2012, of Ho KwonPing. Recognising the changes in the composition of top management of the group and the further development of the company's strategy and activity on the acquisition agenda, the board decided that of key importance would be: the monitoring of progress of the transition of the management changes; an enhanced focus on the execution of strategy; and a close review of the performance of acquisitions.

Areas identified for the board and committees to maintain the appropriate governance for and development of the business have been integrated into the evolving annual agendas of the board and its committees.

The performance of each director was evaluated by the chairman based on self-analysis and input from the other directors. A report on the individual performance evaluation process was given to the nomination committee. Following the performance evaluation of individual directors, the chairman has confirmed that the non-executive directors standing for re-election at this year's AGM continue to perform effectively and demonstrate commitment to their roles. The senior non-executive director led a performance evaluation of the chairman. Feedback from directors was discussed in a meeting with the executive and non-executive directors and then privately with the chairman.

It is the board's intention to continue to review annually its performance and that of its committees and individual directors. In respect of the evaluation process in 2014, it is expected that an externally facilitated evaluation will be carried out (the last externally facilitated performance evaluation having been done in 2011).

Audit committee

Role of the audit committee

The audit committee is responsible for monitoring and reviewing:

- the integrity of the financial statements, including a review of the significant financial reporting judgements contained in them;
- the effectiveness of the group's internal control and risk management and of control over financial reporting;
- the effectiveness of the global audit and risk function, including the programme of work undertaken by that function;
- the group's policies and practices concerning business conduct and ethics, including whistleblowing;
- the group's overall approach to securing compliance with laws, regulations and company policies in areas of risk; and
- the company's relationship with the external auditor, including its independence and management's response to any major external audit recommendations.

For the purposes of the Code and the relevant rule under the US Securities Exchange Act of 1934 (Exchange Act), the board has determined that Philip Scott is independent and may be regarded as an audit committee financial expert.

The chairman, the chief financial officer, the group controller, the head of global audit and risk, the global risk and compliance director, the group chief accountant and the external auditor are normally invited to attend meetings.

The audit committee met privately with the external auditor and with the head of global audit and risk as appropriate.

Work of the audit committee

During the year, the audit committee formally reviewed 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. In addition, the audit committee reviewed the interim results announcement, which included the interim financial statements and the company's interim management statements. The audit committee also reviewed the work of the filings assurance committee described below and was updated on litigation risks by the group's general counsel.

The audit committee received detailed presentations from certain senior executives on the management of key risk and control issues in their respective business areas, reviewed the effectiveness and findings from internal control and risk management processes described below and reviewed the work of the compliance and ethics programme and the work of the audit and risk committee, described below.

The audit committee had available to it the resources of the global audit and risk function, the activities of which are described below.

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 and, on the audit committee's recommendation, the board agreed in July 2013 to recommend to shareholders at the AGM in 2013, the re-appointment of the external auditor for a period of one year. The current overall tenure of the external auditor dates from 1997. Any decision to open the external auditor to tender is taken on the recommendation of the audit committee, based on the results of the effectiveness review described below. There are no contractual obligations that restrict the company's current choice of external auditor. Following a review of KPMG's performance and independence in 2013, including compliance with rules on non-audit services, the audit committee was satisfied with the auditors' effectiveness and independence and has recommended to the board that KPMG be reappointed as the company's external auditor for the year ending 30 June 2014. The committee will continue to review the performance of the external auditors on an annual basis, and consider their independence and objectivity taking into account all appropriate guidelines.

The audit committee assessed the ongoing effectiveness of the external auditor and audit process on the basis of meetings and a questionnaire-based internal review with finance and global audit and risk staff and other senior executives. In reviewing the independence of the external auditor, the audit committee considered a number of factors. These include: the standing, experience and tenure of the external audit director; the nature and level of services provided by the external auditor; and confirmation from the external auditor that it has complied with relevant UK and US independence standards.

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 2013. Under this 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. These pre-approved service categories may be summarised as follows:

- accounting advice, employee benefit plan audits, and audit or other attestation services, not otherwise prohibited;
- due diligence and other support in respect of acquisitions, disposals, training and other business initiatives; and
- certain specified tax services, including tax compliance, tax planning and related implementation advice in relation to acquisitions, disposals and other reorganisations.

Fees paid to the auditor for audit, audit related and other services are analysed in note 3(c) to the consolidated financial statements. The main non-audit related services provided by the auditor during the year were in respect of due diligence work for potential acquisitions and tax advice. The auditor was considered to be best placed to provide these services and was the provider that offered the best value. The nature and level of all services provided by the external auditor is a factor taken into account by the audit committee when it reviews annually the independence of the external auditor.

The audit committee has noted the changes to the Code introduced by the FRC in September 2012 and, in particular, the new requirement contained in the Guidance on Audit Committees to put the external audit contract out to tender in future at least every 10 years. The FRC has suggested possible transitional arrangements, under which an external audit tender process would fit the cycle of audit partner rotation. The audit was last tendered in 1999, and since then there have been four different lead audit partners in accordance with KPMG's own guidance on independence, most recently for the year ended 30 June 2013. Having previously conducted a full tender exercise and considered retendering in subsequent years, the committee will continue to give consideration to the timing of the next formal tender in light of the 2012 Code requirements noted above and any further changes in the regulatory framework. In any event, we do not anticipate that this will be later than the date of the rotation of the current lead audit partner.

Nomination committee

Role of the nomination committee

The nomination committee is responsible for keeping under review the composition of the board and succession to it, and succession planning for senior management positions. It makes recommendations to the board concerning appointments to the board, whether of executive or non-executive directors, having regard to the balance and structure of the board and the required blend of skills, experience, independence and diversity.

The nomination committee also makes recommendations to the board concerning the re-appointment of any non-executive director at the conclusion of his or her specified term and the re-election of any director by shareholders under the retirement provisions of the company's articles of association. No director is involved in determining his or her own re-appointment or re-election.

Any new directors are appointed by the board and, in accordance with the company's articles of association, they must be elected at the next AGM to continue in office. All existing directors retire by rotation every year, as required by the Code.

Activities of the nomination committee

The principal activities of the nomination committee during the year were: the review of individual performance; a review of the executive committee structure, membership and succession planning for it and senior leadership positions; the consideration of potential non-executive directors and the succession to the role of chief executive.

In respect of the appointment of Ho KwonPing to the board with effect from 1 October 2012, the recruitment process included the development of a candidate profile and the engagement of a professional search agency specialising in the recruitment of high calibre non-executive directors. Reports on potential appointees were provided to the committee, which, after careful consideration, made a recommendation to the board.

In respect of the appointment of Ivan Menezes as Chief Executive, the committee made a recommendation to the board, believing that the appointment was appropriate for the future executive leadership of the business.

Diageo supports diversity within its board of directors, including gender diversity. Currently there are four female directors, out of a total of eleven board members. We believe that all four bring a wealth of international business experience and are an asset to the company and the board.

Without seeking to set a specific goal for female representation on the board, it remains our aspiration to maintain a high level of diversity, including gender diversity, within the boardroom, appropriate to and reflecting the global nature of the company and the strategic imperatives the board has agreed upon.

For similar reasons, Diageo has set itself a goal to increase the number of women in leadership positions in the company. Currently, five of the fifteen members of the executive committee are women (compared to one of fourteen shown in last year's annual report), and 28% (2012 – 26%) of leadership positions across the business are filled by women. The aim of the board is to continue to ensure that the company has the right balance of skills, diversity, in all forms, and experience.

This approach has led Diageo to be well represented by women on the board and the executive committee and having fully considered the succession to leadership positions over the ensuing years, the board is confident it will continue to be able to report progress on the gender diversity agenda.

Remuneration committee

Role of the remuneration committee

The role of the remuneration committee and details of how the company applies the principles of the Code in respect of directors' remuneration are set out in the directors' remuneration report.

The chairman and the chief executive may, by invitation, attend remuneration committee meetings, except when their own remuneration is discussed. No director is involved in determining his or her own remuneration.

Executive direction and control

Executive committee

The executive committee, appointed and chaired by the chief executive, consists of the individuals responsible for the key components of the business: the North America, Western Europe, AEET (Africa, Eastern Europe and Turkey), Latin America and Caribbean and Asia Pacific markets, global supply and global functions. The members of the committee and their biographies are set out above in the 'Board of directors and executive committee' section of this annual report. During the year, Ivan Menezes was appointed Chief Executive (with effect from 1 July 2013).

The executive committee met, fully, five times during the year, and spent most of its time discussing strategy, including individual market and brand (and category) strategies, management succession and talent and other people matters, and financial, brand and operational performance. Meetings were held in the United States, the United Kingdom (three meetings) and the Netherlands. In addition, scheduled interim update meetings were held by teleconference throughout the year. Responsibility and authority (within the financial limits set by the board) were delegated by the chief executive to individual members of the executive committee who were accountable to him for the performance of their business units.

To support the executive direction, executive working groups were in operation to which were delegated particular tasks, generally with specific time spans and success criteria.

A focus on the ways of working of the executive committee and performance management was undertaken for the year commencing 1 July 2013. No change was made to the responsibility and authority delegated by the chief executive to individual members or the executive committee as outlined above.

The executive committee agendas will focus specifically on delivery of the company's performance ambition and how to achieve the performance imperatives. Time will be allocated throughout the year for specific focus on each of these imperatives and performance metrics have been developed to measure progress. While time will be built in for other important business issues as they arise, a further designated focus will be on the company's reputation.

Additionally monthly performance delivery calls will be held with the managing directors of the key markets and members of the executive committee.

To support the market visits made by the regional presidents in the ordinary course of their business, a small group led by the chief executive will also make regular market visits focused on the execution of strategy and designed to assist in continuing the development of strategy and in the annual target planning process.

This revised approach and focus will reduce the amount of overall meeting time and need for the continuation of a number of the established executive working groups.

Committees intended to have an ongoing remit are outlined below.

Audit and risk committee

Chaired by the chief executive and responsible for: overseeing the approach to securing effective internal control and risk management in the group; reviewing the adequacy of the group's sources of assurance over the management of key risks; reviewing management's self-assessment process over internal controls; reviewing the effectiveness of the group's compliance and ethics programme; and reporting periodically on the above to the audit committee or to the board. In addition, the audit and risk committee is responsible for promoting the culture and processes that support effective compliance with the group's codes of conduct, global policies and business guidelines throughout the business and supports the audit committee, board and executive committee in satisfying its corporate governance responsibilities relating to internal control and risk management within the group.

Corporate citizenship committee

Chaired by the chief executive and responsible for making decisions or, where appropriate, recommendations to the board or executive committee concerning policies, issues and measurement and reporting for the following impacts across Diageo's value chain: alcohol in society; water; broader environmental sustainability; community; our people and governance and ethics. Progress in these areas is reported periodically to the board and publicly through a separate Sustainability & Responsibility Report, selected aspects of which are subject to external assurance. This report and the group's social, ethical and environmental policies are published on the Diageo website.

During the year, two executive working groups (one on alcohol in society, chaired by the corporate relations director, and one on environmental performance, chaired by the president, global supply and procurement) assisted the committee with decisions on specific issues.

Finance committee

Chaired by the chief financial officer and including the chief executive, this committee is responsible for making recommendations to the board on funding strategy, capital structure and management of financial risks and the policies and control procedures (including financial issues relating to treasury and taxation) required to implement the company's financial strategy and financial risk management policies. In certain specific circumstances, the board has delegated authority to the finance committee to make decisions in these areas. Treasury activity is managed centrally within tightly defined dealing authorities and procedures recommended by the finance committee and approved by the board.

Filings assurance committee

Chaired by the chief financial officer and including the chief executive, this committee is responsible for implementing and monitoring the processes which are designed to ensure that the company complies with relevant UK, US and other regulatory reporting and filing provisions, including those imposed by SOX or derived from it. As at the end of the period covered by this report, the filings assurance committee, with the participation of the chief executive and chief financial officer, carried out an evaluation of the effectiveness of the design and operation of disclosure controls and procedures. These are defined as those controls and procedures that are designed to ensure that information required to be disclosed in reports filed under the Exchange Act is recorded, processed, summarised and reported within specified time periods. As of the date of the evaluation, the chief executive and the chief financial officer concluded that the design and operation of these disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports that the company files or submits under the Exchange Act is accumulated and communicated to the management, including the company's chief executive and chief financial officer, as appropriate, to allow timely decisions regarding disclosure.

Additional information

Internal control and risk management

Diageo's aim is to manage risk and to control its business and financial activities cost-effectively and in a manner that enables it to: exploit profitable business opportunities in a disciplined way; avoid or reduce risks that can cause loss, reputational damage or business failure; support operational effectiveness; and enhance resilience to external events. To achieve this, an ongoing process has been established for identifying, evaluating and managing risks faced by the group. This process, which complies with the requirements of the Code, has been in place for the full financial year and up to the date the financial statements were approved and accords with the guidance issued by the Financial Reporting Council in October 2005, 'Internal Control: Revised Guidance for Directors on the Combined Code', also known as the Turnbull guidance (as amended by the Flint review).

The board acknowledges that it is responsible for the company's systems of internal control and risk management and for reviewing their effectiveness. The board confirms that, through the activities of the audit committee described above, it has reviewed the effectiveness of the company's systems of internal control and risk management described below.

All business units and the executive committee are required to maintain a process to ensure key risks are identified, evaluated and managed appropriately. This process is also applied to major business decisions or initiatives, such as systems implementations, new product development, business combination activity or significant business strategy implementation. Additional risk management activity is focused directly towards operational risks within the business, including health and safety, product quality and environmental risk management.

Business unit risk assessments, and the activities planned to manage those risks, are reviewed by relevant executives, for example at periodic business reviews. The oversight of primary level risks, as detailed in the executive committee risk assessment, is allocated as appropriate between the board, board committees and the executive committee. The executive committee risk assessment, and selected key risk assessments, are reviewed by the audit and risk committee and by the audit committee.

In addition, business units are required to self-assess the effectiveness of the design of their internal control framework. Relevant executives review the results of these self-assessments and summary reporting is provided to the audit and risk committee and audit committee. Risk management and internal control processes encompass activity to mitigate financial, operational, compliance and reputational risk. Specific processes are also in place to ensure management maintain adequate internal control over financial reporting, as separately reported below.

A network of risk management committees is in place across the group, which has overall accountability for supporting the audit and risk committee in its corporate governance responsibilities by proactively and effectively identifying and managing risk and monitoring the effectiveness of internal controls.

Processes are in place to ensure appropriate action is taken, where necessary, to remedy any deficiencies identified through the group's internal control and risk management processes.

The global risk and compliance and global audit and risk functions give the audit committee, board and executive committee visibility and understanding of the group's key risks and risk management capability and provide assurance over the quality of the group's internal control and management of key risks in line with a plan agreed by the audit committee.

These risk management processes and systems of internal control, together with the filings assurance processes, are designed to manage, rather than eliminate, the risk of failure to achieve the group's strategic objectives. It should be recognised that such systems can only provide reasonable, not absolute, assurance against material misstatement or loss.

During the year, in line with the revised principles of the Code, the board considered the nature and extent of the risks it was willing to take to achieve its strategic goals and reviewed the existing internal statement of risk appetite, which describes existing risk behaviours and identifies a set of high level risk statements underpinning them. The statement of risk appetite serves to complement Diageo's risk policy and was considered and recommended to the board by both the audit and risk committee and the audit committee.

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. These systems are described above and under the headings 'Filings assurance committee', 'Audit and risk committee' and 'Management's report on internal control over financial reporting'. Diageo's filings assurance committee and audit and risk committee are each responsible for overseeing elements of these internal control and risk management systems. Furthermore, a review of the consolidated financial statements is completed by management to ensure that the financial position and results of the group are appropriately reflected therein.

Compliance and ethics programme

Diageo is committed to conducting its business responsibly and in accordance with all laws and regulations to which its business activities are subject. The board has a comprehensive training and education programme for both employees and the network of control, compliance and ethics teams, whose role it is to be the key point of contact for compliance within each market and function. The code of business conduct is also supported by a set of global policies. During the year these policies were reviewed and revised where necessary to ensure they remained relevant.

The Diageo marketing code together with Diageo's digital code of practice remain the principles that Diageo follows in relation to marketing and promotional activities of its brands and products.

In addition, 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, regional presidents and other identifiable persons in the group, including those performing senior accounting and controller functions. No amendments to, or waivers in respect of, the code of ethics were made during the year. The full texts of the code of ethics, code of business conduct, marketing code and other Diageo policies that comprise the compliance programme are available on the company's website at www.diageo.com/en-row/ourbusiness/aboutus/corporategovernance.

Compliance and ethics programme guidelines specify the manner in which any potential violations of these codes should be dealt with, including line manager reporting and an independent 'SpeakUp' employee help line. The latter is operated independently and all reports are sent, in confidence, to the global risk and compliance director and head of corporate security for review, and where appropriate, investigation and escalation to the audit committee as required. There is an annual certification requirement for all management level employees to confirm compliance with the code of business conduct and to identify areas of possible non-compliance to the global risk and compliance director. During the year this requirement was extended to the greater part of the non-management population. To reinforce our stand against bribery or corruption in any form and to create greater simplicity in our guidance in this area, Diageo launched a new global anti-corruption policy during the year.

During the year, the global compliance and ethics team was integrated with the global governance and control team to create a new combined team, global risk and compliance, which is responsible for risk management, internal control and compliance and ethics across the group. This integration recognises the connectivity between these pillars of governance and has been carried out to further improve the effectiveness of these activities by enhancing the existing connections, eliminating any duplication and improving the understanding of the risk across our business. The new structure is in line with industry practice and has been endorsed by the board.

Both the audit and risk committee and the audit committee review the operation of the compliance and ethics programme.

Relations with shareholders

The company values its dialogue with both institutional and private investors. The board's primary contact with institutional shareholders is through the chief executive and chief financial officer.

The chief executive and chief financial officer are supported by the investor relations department, who are in regular contact with institutional shareholders and sell-side analysts. Coverage of the company by sell-side analysts is circulated to the board. The board also ensures that all directors develop an understanding of the views of major institutional shareholders through an independent survey of shareholder opinion. In addition, major shareholders are invited to raise any company matters of interest to them at meetings with the chairman and the chairman of the remuneration committee. The chairman reports on any meeting to the board.

Investor seminars and analyst presentations, including those following the announcement of interim results and preliminary year end results, are webcast and other presentations made to institutional investors are available on the company's website.

For the year ended 30 June 2013, Diageo produced an annual report, which is available to all shareholders on its website, or in paper form by election or on request. As an alternative to receiving a paper notification through the post, shareholders may elect to receive email notification that the documents are available to be accessed on the company's website. Shareholders can also choose to receive email notification when new company information is published on www.diageo.com. The website also provides private shareholders with the facility to check their shareholdings online and to send any questions they may have to the company.

Private shareholders are invited to write to the chairman or any other director and express their views on any issues of concern at any time and the AGM provides an opportunity for private shareholders to put their questions in person.

The chairmen of the audit, nomination and remuneration committees are normally available at the AGM to take any relevant questions and all other directors attend, unless illness or another pressing commitment precludes them from doing so. At general meetings, a schedule of the proxy votes cast is made available to all shareholders and is published on www.diageo.com. The company proposes a separate resolution on each substantially separate issue and does not bundle resolutions together inappropriately. Non-binding resolutions on the receipt of the reports and accounts and the approval of the directors' remuneration report are put to shareholders at the AGM.

Charitable and political donations

During the year, total charitable donations made by the group were £32.1 million (2012 – £28.7 million). UK group companies made donations of £14.7 million (2012 – £13.5 million) to charitable organisations including £1.1 million (2012 – £1.1 million) to the Diageo Foundation, £8.3 million (2012 – £8.1 million) to the Thalidomide Trust and £1.7 million to the Thalidomide Foundation Ltd in Australia (2012 – £1.5 million). In the rest of the world, group companies made charitable donations of £17.4 million (2012 – £15.2 million).

The group has not given any money for political purposes in the United Kingdom and made no donations to EU political organisations and incurred no EU political expenditure during the year. The group made contributions to non-EU political parties totalling £0.5 million during the year (2012 – £0.4 million). These were all made, consistent with applicable laws, to federal and state candidates and committees in North America, where it is common practice to make political contributions. No particular political persuasion was supported and contributions were made with the aim of promoting a better understanding of the group and its views on commercial matters, as well as a generally improved business environment.

Supplier payment policies and performance

Given the international nature of the group's operations, there is no group standard in respect of payments to suppliers. The group applies a standard term of 60 days in respect of payments to the majority of suppliers. Where this standard term does not yet apply, operating companies are responsible for agreeing terms and conditions for their business transactions when orders for goods and services are placed, so that suppliers are aware of the terms of payment and the relevant terms are included in contracts where appropriate. Creditor days for Diageo plc have not been calculated, as the company had no material trade creditors at 30 June 2013. The majority of the company's invoices for goods and services are settled by subsidiaries acting on its behalf.

Going concern

The group's business activities together with significant risk factors are set out above in the 'Business description' section of this annual report. The liquidity position, capital resources and risk management processes covering exposure to currency, interest rate, credit, liquidity and commodity price risk are described in the notes to the consolidated financial statements.

The group has significant financial resources, strong cash generation from operations and good access to debt markets. Consequently, the directors believe that the group is well placed to manage its business risks despite the current uncertain economic environment.

The directors confirm that, after making appropriate enquiries, they have reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

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. Diageo's internal control over financial reporting includes policies and procedures that: pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the EU and IFRS as issued by the International Accounting Standards Board (IASB); provide reasonable assurance that receipts and expenditures are made only in accordance with authorisation of management and the directors of the company; and provide reasonable assurance regarding prevention or timely detection of any unauthorised acquisition, use or disposition of assets that could have a material effect on the consolidated financial statements.

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 Exchange Act) based on the framework in 'Internal Control – Integrated Framework', issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO). Based on this assessment, management concluded that, as at 30 June 2013, internal control over financial reporting was effective.

Any internal control framework, no matter how well designed, has inherent limitations, including the possibility of human error and the circumvention or overriding of controls and procedures and may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or because the degree of compliance with the policies or procedures may deteriorate.

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.

KPMG Audit Plc, an independent registered public accounting firm, who also audit 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 will be included in the company's Form 20-F filed with the SEC.

Directors' responsibilities in respect of the annual report and financial statements

The directors are responsible for preparing the annual report, the information filed with the SEC on Form 20-F and the group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law they are required to prepare the group financial statements in accordance with IFRS as adopted for use in the EU and applicable law and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice). The directors have taken responsibility to prepare the group financial statements also in accordance with IFRS as issued by the IASB. The directors have also presented certain additional information required by the SEC for the purposes of the company's Form 20-F.

The group financial statements are required by law and IFRS to present fairly the financial position and the performance of the group; the Act provides in relation to such financial statements that references in the relevant part of the Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

The parent company financial statements are required by law to give a true and fair view of the state of affairs of the parent company.

In preparing each of the group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- for the group financial statements, state whether they have been prepared in accordance with IFRS as adopted for use in the EU and IFRS as issued by the IASB;
- for the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business.

The directors are responsible for keeping proper accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006 and, with regard to group consolidated financial statements, Article 4 of the IAS Regulation. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

Under applicable UK and US law and regulations, the directors are also responsible for preparing a directors' report, a directors' remuneration report and a corporate governance report that comply with that law and those regulations.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement

Each of the directors, whose names are set out above in the 'Board of directors and executive committee' section of this annual report, confirms that to the best of his or her knowledge:

- the consolidated financial statements contained in the annual report for the year ended 30 June 2013, which have been prepared in accordance with IFRS as issued by the IASB and as adopted for use in the EU, give a true and fair view of the assets, liabilities, financial position and profit of the group; and
- the management report represented by the directors' report contained in the annual report for the year ended 30 June 2013 includes a fair review of the development and performance of the business and the position of the group, together with a description of the principal risks and uncertainties that the group faces.

The responsibility statement was approved by the board of directors on 30 July 2013.

New York Stock Exchange corporate governance rules

Under applicable SEC rules and the NYSE's corporate governance rules for listed companies, Diageo must disclose any significant ways in which its corporate governance practices differ from those followed by US companies under NYSE listing standards.

Diageo believes the following to be the significant areas in which there are differences between its corporate governance practices and NYSE corporate governance rules applicable to US companies. This information is also provided on the company's website at www.diageo.com.

- Basis of regulation: UK listed companies are required to include in their annual report a narrative statement of (i) how they have applied the principles of the Code and (ii) whether or not they have complied with the best practice provisions of the Code. NYSE listed companies must adopt and disclose their corporate governance guidelines. Diageo complied throughout the year with the best practice provisions of the Code.
- Director independence: the Code requires at least half the board (excluding the chairman) to be independent non-executive directors, as determined by affirmatively concluding that a director is independent of management and free from any relationship that could materially interfere with the exercise of independent judgement. NYSE rules require a majority of independent directors, according to the NYSE's own 'brightline' tests and an affirmative determination by the board that the director has no material relationship with the listed company. Diageo's board has determined that, in its judgement and without taking into account the NYSE brightline tests, all of the non-executive directors (excluding the chairman) are independent. As such, currently seven of Diageo's eleven directors are independent.
- Chairman and chief executive: the Code requires these roles to be separate. There is no corresponding requirement for US companies. Diageo has a separate chairman and chief executive.

- Non-executive director meetings: NYSE rules require non-management directors to meet regularly without management and independent directors to meet separately at least once a year. The Code requires non-executive directors to meet without the chairman present at least annually to appraise the chairman's performance. During the year, Diageo's chairman and non-executive directors met six times as a group without executive directors being present, and the independent directors met once without the chairman.
- Board committees: Diageo has a number of board committees that are similar in purpose and constitution to those required by NYSE rules. Diageo's audit, remuneration and nomination committees consist entirely of independent non-executive directors (save that the chairman of the nomination committee, Dr Humer, is not independent). Under NYSE standards, companies are required to have a nominating/corporate governance committee, which develops and recommends a set of corporate governance principles and is composed entirely of independent directors. The terms of reference for Diageo's nomination committee, which comply with the Code, do not contain such a requirement. In accordance with the requirements of the Code, Diageo discloses in its annual report the results and means of evaluation of the board, its committees and the directors, and it provides extensive information regarding directors' compensation in the directors' remuneration report.
- Code of ethics: NYSE rules require a code of business conduct and ethics to be adopted for directors, officers and employees and disclosure of any waivers for executive directors or officers. Diageo has adopted a code of business conduct for all directors, officers and employees, as well as a code of ethics for senior officers in accordance with the requirements of SOX. Currently, no waivers have been granted to directors or executive officers.
- Compliance certification: NYSE rules require chief executives to certify to the NYSE their awareness of any NYSE corporate governance violations. Diageo is exempt from this as a foreign private issuer but is required to notify the NYSE if any executive officer becomes aware of any non-compliance with NYSE corporate governance standards. No such notification was necessary during the period covered by this report.

Directors' attendance record at the AGM, board meetings and board committee meetings, for the year ended 30 June 2013 was as set out in the table below. For board and board committee meetings, attendance is expressed as the number of meetings attended out of the number that each director was eligible to attend.

	Annual General Meeting 2012	Board (maximum 7)	Audit committee (maximum 4)	Nomination committee (maximum 3)	Remuneration committee (maximum 5)
Dr Franz B Humer	✓	7/7	4/4*	3/3	5/5*
Paul Walsh	✓	7/7	2/4*	3/3*	5/5*
Ivan Menezes	✓	7/7	n/a	1/3*	2/5*
Deirdre Mahlan	✓	7/7	4/4*	n/a	1/5**
Lord Davies	✓	7/7	4/4	3/3	5/5
Peggy Bruzelius	✓	7/7	4/4	3/3	5/5
Laurence Danon	✓	7/7	3/4	3/3	5/5
Betsy Holden	✓	7/7	4/4	3/3	5/5
Ho KwonPing	✓	6/6	3/3	2/2	3/4
Philip Scott	✓	7/7	4/4	3/3	5/5
Todd Stitzer	✓	6/7	4/4	3/3	5/5

* Attended by invitation.
** Attended by invitation, for part only.