
**Severn Trent Plc
Audit Committee**

Terms of Reference

1 Constitution

The Board of Directors has established, in line with The Combined Code on Corporate Governance 2006¹, (“The Combined Code”), a committee of the Board, henceforth known as the Audit Committee (“the committee”). The board shall appoint the committee chairman, who will be an independent director as defined by The Combined Code².

2 Membership

Members of the committee shall be appointed by the board on the recommendation of the Nominations Committee in consultation with the chairman of the committee.

The committee shall consist of a minimum of three members. The Company Secretary or a nominee shall act as the secretary to the committee.

The committee shall only comprise independent non-executive directors of the company who shall have no links with the external auditors, at least one of whom must be identified as having recent & relevant financial experience¹.

Appointments to the committee shall be for a period of up to three years, which may be extended for no more than 2 additional periods of three years³ provided the director remains independent.

The Chairman of the Board shall not be a member of the committee.

3 Quorum

The quorum necessary for the transaction of business by the committee will be two.

In the event that a meeting of the committee is required but a quorum might not be secured, an existing member of the committee shall be empowered, following consultation with the chairman of the committee.

In the absence of the chairman the members attending will elect one of their number to chair the meeting.

¹ Combined Code C.3.1

² Combined Code A.3.1

³ ICSA best practice

4 Meetings

Meetings shall be held at least four⁴ times per year, and also at such other times as the chairman of the committee shall require. Only members of the committee have the right to attend.

Prior to the commencement of each calendar year, the chairman of the committee and the Secretary shall review the frequency and dates of meetings for the subsequent financial year and propose such dates for agreement by other members of the committee.

A meeting of the committee may be called by the Secretary at the request of any member of the committee, or at the request of the external auditors, or the Director of Internal Audit and the Secretary shall agree the agenda with the chairman.

The Chairman, Chief Executive, the Group Finance Director, the Director of Internal Audit, the external auditors, other executive and non-executive directors and other senior management may be invited to attend for all or part of any meeting as and when appropriate, particular care being taken to recognise and avoid any conflicts of interest.

At least once per year the committee should meet with the external auditors and the Group Director of internal audit without the management present.

Meetings of the committee shall be called by giving at least two working days' written notice unless all the members of the committee agree to shorter notice.

Members may participate in a meeting by means of a conference telephone, video conferencing facility or other suitable communicating equipment.

The Secretary shall minute the proceedings and resolutions of all meetings as well as keep appropriate records. Minutes of the meetings shall be circulated promptly to all members of the committee and, once agreed, to all members of the board, unless a conflict of interest arises.

5 Annual General Meeting

The chairman of the committee shall attend the annual general meeting prepared to respond to any shareholder questions on the committee's activities.

6 Authority

The committee is authorised to seek any information it requires from any employee and all employees shall be directed to co-operate with any request made by the committee.

⁴ ICSA best practice

7 Independent Advice and Resources

The committee is authorised by the board to obtain outside legal or other independent professional advice as it considers necessary to undertake its duties and to secure the attendance of any such advisers at any meetings of the committee.

In this regard any board policy document concerning the securing of such advice shall be adhered to by the committee.

The committee is exclusively responsible for establishing the selection criteria for such advisors and their appointment and terms of reference.

The appointment and performance of such advisors shall be reviewed by the committee on a regular basis and at least annually.

The committee shall have access to sufficient resources in order to carry out its duties, including access to Group General Counsel Department for assistance as required.

The committee shall be provided with appropriate and timely training, both in the form of an induction programme for new members and on an ongoing basis for all members.

8 Duties

The duties of the committee are as follows:-

8.1 To ensure:

- (a) due consideration of laws and regulations, the provisions of the Combined Code (as amended from time to time) and the requirements of the UK Listing Authority's Listing Rules as appropriate, including the requirement for explanation in the event of any permitted non-compliance;
- (b) the external auditors' compliance with relevant ethical and professional guidance on the rotation of audit partners, the level of fees paid by the Company compared to the overall fee income of the firm, office and partner and other related requirements;
- (c) that there are no relationships (such as family, employment, investment, financial or business) between the external auditors and the Company (other than in the ordinary course of business);
- (d) the co-ordination of the activities of the internal and external auditors;
- (e) that the Director of Internal Audit has the right of direct access to the Chairman of the board and to the committee⁵;

⁵ ICSA best practice (Smith 2.10)

- (f) the remit of the internal audit function is understood and ensure it has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards;
- (g) the maintenance of a sound system of internal control and risk management⁶;
- (h) any activities within its terms of reference are investigated as necessary;
- (i) that the committee chairman reports formally to the board on its proceedings after each meeting on all matters within its duties and responsibilities; and
- (j) that the committee's terms of reference are made publicly available⁷.

8.2 To review:

- (a) the integrity of the financial statements of the Company, including its annual and interim reports, preliminary results announcements and any other formal announcement relating to its financial performance, particularly focusing upon any significant financial reporting issues, significant adjustments resulting from the audit, the going concern assumption and major judgements which they contain. The committee shall, if practical and prior to the submission to the board for approval, also review summary financial statements and any financial information of a price-sensitive nature⁸; and
- (b) and challenge where necessary:
 - i. the consistency and appropriateness of accounting policies both on a year-on-year basis and across the Company and the Group;
 - ii. the methods used to account for significant or unusual transactions where different approaches are possible;
 - iii. whether the Company has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditors;
 - iv. the clarity of disclosure in the Company's financial reports and the context in which statements are made; and
 - v. all material information presented with the financial statements, such as the operating and financial review and the corporate governance statement (insofar as it relates to the audit and risk management).

⁶ Matters Reserved for the Board 8.1 & 8.2

⁷ Combined Code C.3.3

⁸ Combined Code C.3.2

- (c) annually, the external auditors independence and objectivity, taking into account relevant UK professional and regulatory requirements and also guidance from recognised bodies of good standing and the relationship with the auditors as a whole, including the provision of any non-audit services and the auditors' compliance with applicable UK ethical guidance relating to the rotation of audit partners⁹;
- (d) annually, the external auditors, their qualifications, expertise and resources and the effectiveness of the audit process which shall include a report from the external auditor on their own internal quality procedures.
- (e) regularly, with the external auditors, including once without management present, and once at the planning stage before the audit and once after the audit at the reporting stage to:
 - i. consider the annual audit plan and ensure that it is consistent with the scope of the audit engagement,
 - ii. examine the findings of the audit with the external auditors, which shall include but not be limited to the following:
 - a discussion of any major issues which arose during the audit; and
 - any accounting and audit judgements;
 - levels of errors identified during the audit; and
 - the appropriateness of management's responsiveness to the findings and recommendations of the external auditors.
 - iii. assess the effectiveness of the audit;
 - iv. consider any representation letter(s) requested by the external auditors before they are signed by management; and
 - v. consider the management letter and management's response to the auditors' findings and recommendations.
- (f) with the Director of Internal Audit at least once a year, without the management being present, to discuss their remit and any issues that have arisen out of the internal audits, together with any other issues that the Director believes the committee should be apprised of¹⁰;
- (g) assess the annual internal audit plan;

⁹ Combined Code C.3.2/C.3.6

¹⁰ ICSA best practice (Smith 2.10)

- (h) annually, the effectiveness of the Company's internal controls (including financial, operational and compliance controls) and risk management systems as well as the policies and procedures for preventing and detecting fraud¹¹;
- (i) promptly, all reports on the Company from the internal auditors;
- (j) ,monitor management's responsiveness to the findings and recommendations of the internal auditor; and
- (k) at least annually, the committee's terms of reference and the effectiveness of the committee and to report to the Board in respect thereof, including any recommendations¹².

8.3 To approve:

- (a) the appointment and removal of the Director of the Internal Audit function;
- (b) implement a policy on the supply of non-audit services by the external auditor, taking into account any relevant ethical guidance on the matter from recognised bodies of good standing;
- (c) the Company's arrangements for its employees to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters and ensure that such arrangements allow proportionate and independent investigation of such matters and appropriate follow up action¹³;
- (d) a statement for inclusion in the Annual Report on its duties and activities¹⁴;
- (e) a statement for inclusion in the Annual Report concerning internal controls and risk management¹⁵; and
- (f) the report on the frequency of, and attendance by members at, committee meetings in the Annual Report.

8.4 To recommend to the Board:

- (a) approval of Interim Results, Preliminary Results and Annual Report and Accounts¹⁶;

¹¹ Combined Code C.3.5

¹² Combined Code C.6.1

¹³ Combined Code C.3.4

¹⁴ Combined Code C.3.3

¹⁵ Matters Reserved for the Board 8.5

¹⁶ Matters Reserved for the Board 7.2

- (b) for approval at the AGM, the appointment, re-appointment and removal of the Company's external auditors. The committee shall oversee the selection process for new auditors and if auditors resign the committee shall investigate the issues and circumstances leading to this and decide whether any action is required¹⁷;
- (c) the external auditor's remuneration, whether fees for audit or non-audit services and that the level of fees is appropriate to enable an adequate audit to be conducted;
- (d) the external auditor's terms of engagement, including any engagement letter issued at the start of each audit (ensuring that it has been updated to reflect changes in the circumstances arising since the previous year) and the scope of the audit;
- (e) a policy on the employment of former employees of the Company's auditors and monitoring the implementation of such policy; and
- (f) any proposals it deems appropriate on any area within its remit where action or improvement is needed.

8.5 To have regard to the duties of the Board of directors in respect of Section 172 of the Companies Act 2006 in all of its recommendations to the board.

9 Decisions of the Committee

Any decisions of the committee shall be taken on a simple majority basis. The chairman shall have a casting vote in the event of equality of voting.

¹⁷ Combined Code C.3.2/C.3.6