

# Policy for the provision of non-audit services by the external auditors

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# 1. Executive Summary

This policy defines the non-audit service categories that can be provided by the group auditors subject to:

- a maximum individual engagement value of £100,000: and
- a maximum overall ratio of non-audit to audit fees of 1:1.

The categories are

- Audit related services (in addition to local statutory audit)
- Other services (under specific pre-approved headings)

Where a service value exceeds £100,000, the service requires specific pre-approval from the Audit Committee or the Audit Committee Chairman.

The policy also defines a list of categories where any request to perform services, must receive specific pre-approval from the Audit Committee or the Audit Committee Chairman.

These categories are:

- Tax services
- Services relating to IT
- Internal audit services.
- Valuation and actuarial services
- Litigation support services
- Corporate finance
- Services related to recruitment and remuneration

The group auditors are prohibited from performing certain specific services within these categories. See section 4 and Appendix 2 for more detail.

## **Operational control**

The following controls are in place in order to ensure compliance with this policy.

Where group companies wish to engage the auditors for any non-audit service, a request for pre-approval, must be sent to Group Financial Control which will review the request and confirm whether:

- the service is an approved service;
- the service value is less than £100,000

Following express approval from the Finance Director (or his delegate) the service can then be rendered.

Local Deloitte teams cannot commence work until confirmation of pre-approval is received from Deloitte Birmingham. Approval will be communicated to the Deloitte Birmingham team by Group Financial Control to allow the group auditors to confirm to local Deloitte teams that their own independence criteria are met.

## **Non-audit fee reporting**

Full analyses of all services undertaken by Deloitte will be provided annually to the Audit Committee.

## **2. Summary of regulatory and other guidance**

This policy takes account of the following regulations and guidance:

### **Combined code**

The Combined Code requires an Audit Committee to review and monitor the external auditor's independence and objectivity.

The Audit Committee must also develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account these responsibilities.

In setting policy on non-audit fees, the Audit Committee should consider a number of factors including the nature of the non-audit services, the related fee levels and the fee levels individually and in aggregate relative to the audit fee.

The Audit Committee should set and apply a formal policy specifying the types of non-audit work from which the external auditors are excluded and the types and value of work that can be engaged without referral to the Audit Committee.

### **Other**

Guidance provided by bodies in the UK with an interest in Corporate Governance such as the Pensions Investment Research Consultants Ltd (PIRC) and Institutional Shareholder Services (ISS), state the importance of monitoring the level of non-audit fees as a percentage of audit fees as a means of assessing independence issues.

The APB's Ethical Standard 5: Non-audit Services Provided to Audited Entities sets out restrictions on what services auditors can provide.

### **Companies Act**

The Companies Act requires disclosure of fees paid to the group's auditors. The Act sets out defined categories of services for which separate disclosure of fees must be made. The categories used in this paper are the same as those set out in the Act.

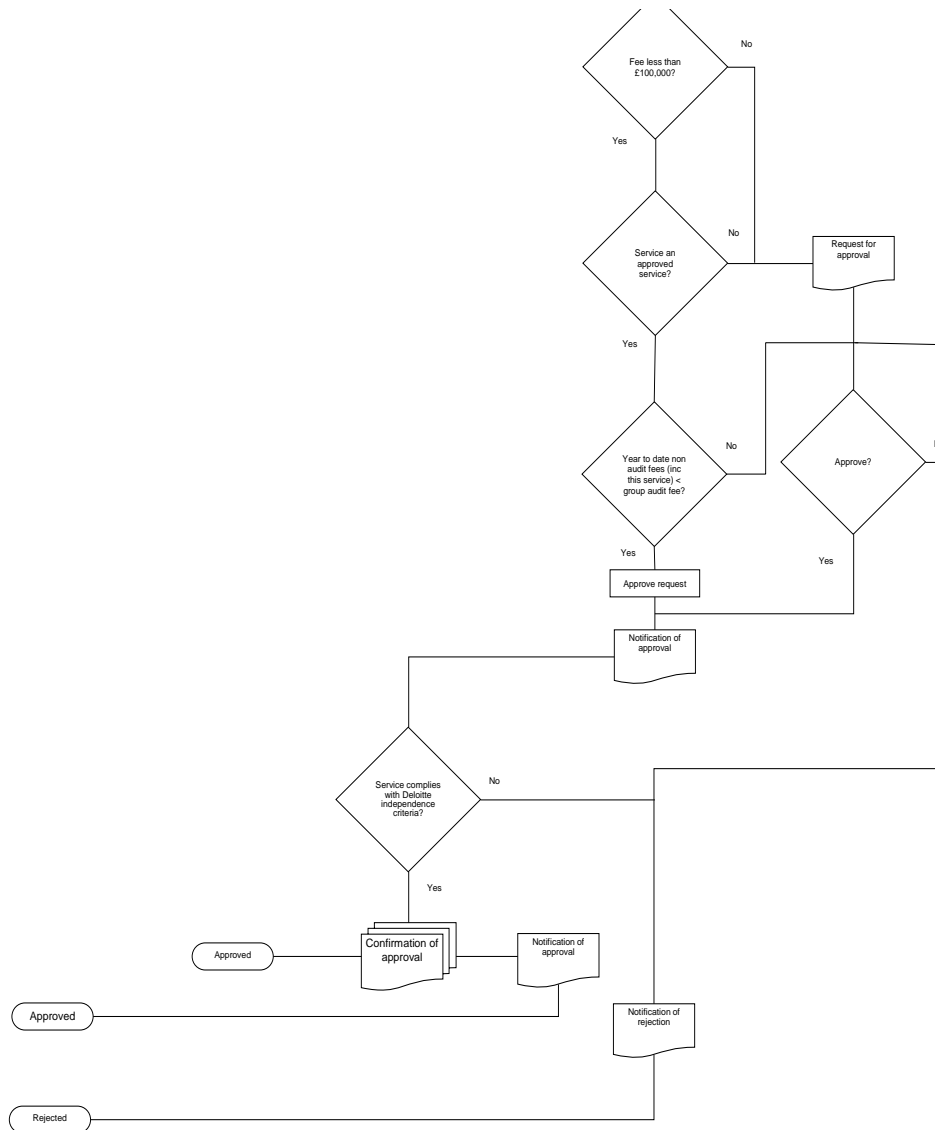
### 3. Pre-approval process

Policy	Detailed policy
<p>Audit Committee provides pre-approval for annual spending for specific categories of non-audit services</p>	<p>i) Group Financial Control receives requests for additional services from operating companies and confirms whether services have been pre-approved under the following criteria</p> <ul style="list-style-type: none"> <li>• Fee (cumulative if a request for an additional fee for an existing engagement) is not above the individual engagement limit requiring pre-approval (£100,000).</li> <li>• The engagement is a permitted service included within pre-approved service categories.</li> </ul> <p>ii) Engagement requests that do not meet all the above criteria will be either rejected or passed to the Audit Committee, or Audit Committee Chairman, as appropriate. In addition, where there is any uncertainty as to whether a particular engagement is included within a pre-approved category the request will be passed to the Audit Committee or Audit Committee Chairman.</p> <p>iii) If the proposed engagement would result in non-audit fees exceeding 100% of the audit fee for the year it will be rejected.</p> <p>iv) Approved engagements will be communicated to the Deloitte Birmingham team to allow the group auditors to confirm to local Deloitte teams and Group Financial Control that their own independence criteria are met. Local Deloitte teams cannot commence work until confirmation of approval is received from Deloitte Birmingham</p> <p>v) Once Deloitte Birmingham has confirmed that their independence criteria are not breached, Group Financial Control will send a confirmation to the local finance team that the engagement has been approved.</p> <p>vi) Audit Committee will receive a full analysis of Deloitte non-audit fees bi-annually and will be informed of each service entered into pursuant to these pre-approval policies and procedures.</p> <p>vii) The policies and procedures contained herein are reviewed by the Audit Committee on an annual basis and updated if necessary.</p>

#### 4. Scope of non-audit services that may be provided by Deloitte

Policy	Detailed policy
<p>The Audit Committee provides pre-approval for the following categories of services within the overall limits.</p> <p>The detailed policy provides additional clarity to management and auditors of the services that the auditors can perform.</p>	<p>Categories of service pre-approved are set out below. The specific services pre-approved under this policy are set out in Appendix 2</p> <p><u>Audit of the group accounts</u> The Audit Committee approves the annual audit engagement terms and the related fees.</p> <p><u>Other audit services performed pursuant to legislation</u> Audit or other attest services required by statute or regulation.</p> <p><u>Other services</u> Fraud related Corporate responsibility report reviews and environmental audits Accounting consultations not related to financial statements Review of Company responses to Financial regulators Regulatory support Audit or attest services not required by statute or regulation</p> <p>Refer to Appendix 2 for details of the permitted services for which pre-approval is has been granted and for details of prohibited services.</p>

# Appendix 1 – Flowchart of process



## Appendix 2 – pre-approved and prohibited services

Category	Services pre-approved within category	Services prohibited within this category
1 Audit of the group accounts		
Audit of the group's consolidated financial statements	Audit of the consolidation returns prepared by the group's subsidiaries  Audit of the consolidation  Work performed on the group's annual report in order to discharge the auditors' responsibilities under the Companies Act or auditing standards	None
Employee benefit plan audits	Audits of employee benefit plans required by laws or regulations.	None



<b>Category</b>	<b>Services pre-approved within category</b>	<b>Services prohibited within this category</b>
<p>2 Other audit services performed pursuant to legislation</p> <p>Audit or other attest services required by statute or regulation</p> <p>Accounting consultations on matters reflected in an entity's financial statements</p>	<p>Statutory audit opinions on local entity financial statements</p> <p>Audit opinions on STW's regulatory financial statements. Other reports to Ofwat pursuant to legislation or regulation (eg RAG5, Principal Statement).</p> <p>Comfort letters to management and/or underwriters including those relating to debt issuance (eg EMTN or Eurobond issues)</p> <p>Attestation of financial statements, financial information or extracts from the accounting records where required by legislation or regulation including the Japanese filing</p> <p>Reports on government grants, where required according to grant terms.</p> <p>Review of interim financial statements under APB Bulletin 1999/04.</p> <p>Advice on management's proposed position on accounting standards, or accounting aspects of company law, relating to current operations and/or transactions consummated in the year currently subject to audit (note that management must formulate their own accounting position before auditors begin work)</p>	<p>None</p>

Category	Services pre-approved within category	Services prohibited within this category
<b>3 Tax services</b>		
Tax compliance services	None	Preparation of tax computations for submission to the tax authorities.  Acting as an advocate in the resolution of a tax dispute.
Tax planning and related implementation advice	None	Tax planning and advisory work
<b>4 Services relating to IT</b>		
	None	Design or implementation of IT systems that form part of, or input to, the accounting systems.  Advice on selection of IT systems that form part of, or input to, the accounting systems.

Category	Services pre-approved within category	Services prohibited within this category
<b>5 Internal audit services</b>		
	None	<p>Internal audit services where the external auditor is expected to place reliance on the results of the work in the financial statements audit. Eg internal audit of the internal financial controls over significant processes or systems.</p> <p>Internal audit services that form part of the role of management, for example decisions relating to the scope of internal audit work or the design or implementation of internal control systems.</p>
<b>6 Valuation and actuarial services</b>		
	None	<p>Valuations that result in adjustments to amounts recorded in the financial statements or which are used to support amounts recorded in the financial statements.</p> <p>Advice in relation to assumptions underlying valuations that result in adjustments to amounts recorded in the financial statements or which are used to support amounts recorded in the financial statements.</p> <p>Actuarial valuation services on behalf of the company or the pension fund trustees.</p>
<b>7 Litigation support services</b>		
	None	<p>Estimation of the outcome of a legal matter that where the estimate will be used to determine an amount or disclosure in the financial statements.</p> <p>Acting as an advocate for the company or group.</p>
<b>8 Services related to recruitment and remuneration</b>		

<b>Category</b>	<b>Services pre-approved within category</b>	<b>Services prohibited within this category</b>
	None	<p>Services relating to the recruitment of a Board or STEC member or direct report to a STEC member.</p> <p>Advice relating to the quantum of the remuneration of a Board or STEC member.</p> <p>Advice relating to the measurement criteria on which the quantum of the remuneration of a Board or STEC member is determined.</p>
<b>9 Corporate Finance and Transaction Services</b>		
Due diligence assistance relating to acquisitions/disposals	None	
Due diligence other than in respect of acquisitions	None	
Other support in relation to disposals	None	Act from an advocacy perspective once a claim has been made
<b>10 Other services</b>		
Fraud related	Advice in relation to fraud risk	Assessment of alleged frauds relating to financial statements that the auditor has reported on.
Corporate responsibility reports and environmental audits	Assurance on the published Corporate Responsibility Reports or to perform other environmental audits	
Accounting advice and assistance	<p>Advice on accounting standards, or accounting aspects of company law, not effective for the entity's current year financial statements, or in relation to proposed transactions which will not be consummated and reflected in the entity's current year financial statements.</p> <p>Advice regarding the accounting for distributable reserves and calculation of permissible dividends, provided that management retain responsibility for, and post, all related accounting entries and that management perform relevant calculations of distributable reserves and dividend payments</p>	<p>Preparation of accounting entries, including current and deferred tax calculations.</p> <p>Maintaining books and records or performing specific accounting functions (eg payroll)</p>

<b>Category</b>	<b>Services pre-approved within category</b>	<b>Services prohibited within this category</b>
Review of Company responses to Financial regulators	Review and assistance with Company responses to information requests and enquiries from Financial regulators, including (but not limited to) the UK Financial Reporting Review Panel (the FRRP)	
Regulatory support	Assistance with construction and review of financial models prepared as part of discussions with regulatory bodies.	
Audit or attest services not required by statute or regulation	<p>Audits of financial statements where audit is not required by statute or regulation</p> <p>Attestation of financial statements, financial information or extracts from the accounting records other than where required by legislation or regulation.</p> <p>Audit or attest services to provide assurance to management in relation to non-financial information</p>	