

# Severn Trent Plc (the “Company”)

## Audit Committee

### Terms of Reference

Approved by the Board on 20 March 2020

#### 1. Constitution

The Board of Directors (the “Board”) has established, in line with the UK Corporate Governance Code 2018 (the “Code”), a Committee of the Board, by resolution of the Board, henceforth known as the Audit Committee (the “Committee”).

#### 2. Purpose

The purpose of the Committee is to assist the Board by establishing, reviewing and monitoring the formal and transparent policies and procedures to ensure the independence and effectiveness of the internal and external audit functions, the integrity of financial and narrative reporting, the Company's internal control framework and the extent of principal risks the Group is willing to take to achieve its long-term strategic objectives, as required by the Code.

#### 3. Membership

- The Committee shall comprise at least three members. All members of the Committee shall be Independent Non-Executive Directors of the Company appointed by the Board, on the recommendation of the Nominations Committee in consultation with the Chair of the Committee, in accordance with the Company's articles of association. The Chair of the Board may not be a member of the Committee.
- The Committee as a whole shall have competence relevant to regulated and/or utilities businesses and at least one member of the Committee shall have recent and relevant financial experience and competence in accounting or audit (or both). Such individuals will have no higher degree of individual responsibility or obligation than other members.
- Appointments to the Committee shall be for an initial period of three years. The period of office may be extended for such duration as may be determined by the Board, so as long as the member continues to be an Independent Non-Executive Director.
- The Board shall appoint one of the Committee members to be the Committee Chair on the recommendation of the Nominations Committee. In the absence of the Committee Chair and/or an appointed deputy, the remaining members present shall elect one of themselves to chair the meeting.
- The Chair and Committee members shall be listed on the Company's website and each year in the Company's Annual Report and Accounts.
- Each member of the Committee shall disclose to the Committee:

- A. Any personal financial interest (other than as a shareholder) in any matter to be decided by the Committee; or
- B. Any potential conflict of interest arising from a cross directorship or other business interests.

Any such member shall abstain from voting on resolutions and participating in the discussions concerning such resolutions.

- The Committee may decide that non-committee members should attend some or all Committee meetings, or parts thereof. The Chief Financial Officer, Head of Internal Audit and external audit lead partner will be invited to attend meetings on a regular basis and others may be invited for a particular meeting or a particular agenda item as and when the Committee deems it appropriate or necessary.

#### **4. Secretary**

The Company Secretary or his or her nominee shall act as the Secretary of the Committee.

#### **5. Quorum**

- The quorum necessary for the transaction of business by the Committee will be two members, one of whom shall be the Chair of the Committee or his or her appointed deputy.
- 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, to appoint another Independent Non-Executive Director(s) to attend such meeting in consultation with the Chair of the Committee to act as that member's alternate provided that such director meets the criteria for membership of the Committee.

#### **6. Frequency of Meetings**

- Meetings shall be held at least four times per year, and at any other time as the Committee's role and responsibilities require, and otherwise as the Chair of the Committee shall require.
- There should be at least one meeting, or part of a meeting, each year which the external auditor and representatives from the internal audit function attend without management present to discuss matters relating to its remit and any issues arising from the audit.

#### **7. Notice of Meetings**

- Meetings of the Committee shall be called by the Secretary of the Committee at the request of the Committee Chair or any of its members.
- Unless otherwise agreed, notice of each meeting confirming the venue, time and date together with an agenda of items to be discussed, shall be forwarded to each member of the Committee and any other person required to attend no later than five working days before the date of the meeting, unless agreed otherwise in advance. Supporting papers shall be sent to Committee members, and to other attendees as appropriate, at the same time to enable proper consideration of matters by the Committee.

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

## **8. Minutes of Meetings**

- The Secretary shall minute the proceedings and decisions of all meetings of the Committee, including recording the names of those present and in attendance and the existence of any conflicts of interest.
- Draft minutes of Committee meetings shall be circulated promptly to all members of the Committee after a meeting. Once approved, minutes should be circulated to all other members of the Board and attendees unless the Committee Chair considers that it would be inappropriate to do so.

## **9. Annual General Meeting**

The Chair of the Committee shall attend the Annual General Meeting (AGM) and be prepared to respond to any shareholder questions on the Committee's activities.

## **10. Duties**

The Committee should carry out the duties below in respect of the Group, its major operating subsidiaries and the Group as a whole, as appropriate. In carrying out these duties, the members of the Committee must comply with their duty under section 172 of the Companies Act 2006 to act in the way they consider, in good faith, would be most likely to promote the success of the Company for the benefit of its members as a whole, whilst having regard to the interests of employees, stakeholders and other matters as required by section 172.

### **(a) Financial and Narrative Reporting**

- The Committee shall monitor the integrity of the financial statements of the Company, including its annual and half-yearly reports, interim management statements, preliminary announcements and any other formal announcement relating to its financial performance and shall review and, where appropriate, report to the Board on significant financial reporting issues and significant estimates and judgments which they contain, having regard to matters communicated by the auditor.
- The Committee will advise the Board if it is not satisfied with any aspect of the Company's proposed financial reporting. In particular, the Committee shall review and challenge where necessary:
  - A. significant accounting policies and practices, and any changes to them;
  - B. whether the Company has adopted appropriate accounting policies and made appropriate estimates and judgments, taking into account the views of the external auditor on the financial statements;
  - C. the methods used to account for significant or unusual transactions where different approaches are possible and the extent to which the financial statements are affected;
  - D. the clarity, completeness and appropriateness of disclosures in the Company's financial statements and the context in which disclosures are made;
  - E. any significant adjustments arising from the audit;
  - F. related information presented with financial statements, including, without limitation, the going concern and viability statements to be made by the Board of the Company and the related information presented with the financial statements (including the Strategic

Report and Corporate Governance statements relating to the audit and to risk management);

- G. the risks to the quality and effectiveness of the financial reporting process; and
- H. the Company's disclosure controls and procedures, including reviewing reports of the Severn Trent Disclosure Committee.

- The Committee will review the process undertaken to ensure that Directors are able to make the statement required by section 418 Companies Act 2006 in respect of relevant audit information.
- The Committee will review the contents of the Annual Report and Accounts and the process undertaken to advise the Directors whether they are able to make the statement required by Code Provision 27 that the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's position, performance, business model and strategy.

**(b) Regulatory Reporting**

In respect of Severn Trent Water Limited and Hafren Dyfrdwy Cyfyngedig, the Committee will review and challenge where necessary:

- The integrity of the processes that ensure the quality and reliability of regulatory statements and information to regulatory bodies, including the Annual Regulatory Compliance Statement and Annual Performance Report, submitted to the Office of Water Services (Ofwat); and
- The integrity of the processes that ensure compliance with the requirements of regulatory submissions to regulatory bodies.

**(c) Internal Controls and Risk Management**

The Committee shall provide assurance to the Board that the Group's control assurance processes are implemented, complete and effective. In particular:

- Keep under review the adequacy and effectiveness of the Group's internal controls and internal control and risk management systems (including the systems to identify, manage and monitor financial risks);
- Review and approve the statements to be included in the Severn Trent Plc Annual Report, prior to endorsement by the Board and external auditors, and the Annual Regulatory Compliance Statement concerning internal controls and risk management;
- Review and challenge the policies and overall process for identifying and robustly assess business risks (financial and non-financial) and managing their impact on the Group;
- Review regular reports from management, internal audit and external audit on the effectiveness of the internal control and risk management systems established and the conclusions of any testing carried out by the internal or external auditor; and
- Review the timeliness and effectiveness of corrective action taken by management.

**(d) Internal Audit**

The Committee shall:

- Monitor and review the effectiveness, independence and objectivity of the Group's internal audit function in the context of the Group's overall risk management system;
- Approve the appointment and, as necessary, the removal of the Head of the Internal Audit function;
- Consider and approve the remit of the Internal Audit function having regard to the complementary roles of the internal and external audit functions 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. The Committee shall also ensure the function has adequate standing and is free from management or other restrictions;
- Review and approve the annual internal audit plan, including any material changes to the audit plan;
- Receive and review reports addressed to the Committee from the internal auditor;
- Review and monitor management's responsiveness in remedying internal audit's findings and recommendations and any deficiencies identified by supervisory bodies related to the internal audit function;
- Meet the Head of Internal Audit at least once a year, without management being present, to discuss their remit and any issues arising from the internal audits carried out; and
- Ensure that the Head of Internal Audit has the right of direct access to the Board and to the Committee Chair and is accountable to the Committee.

**(e) External Audit**

The Committee shall consider matters relating to the appointment of the external auditor, including:

- Making recommendations to the Board, to be put to shareholders for approval at the AGM, in relation to the appointment, re-appointment and removal of the Company's external auditor;
- Making recommendations to the Board that the external audit is put out to tender at least as often as is required by applicable law, rules, regulations and best practice, and, if the Committee believes that the applicable timetable should not be complied with, seeking approval of the Board to non-compliance;
- Assessing annually the qualifications, expertise and resources of the external auditor and the outcome and effectiveness of the audit process, which shall include a report from the external auditor on their own internal quality procedures and transparency report and to include in its assessment a recommendation on whether to propose to shareholders that the external auditor should be reappointed; and
- Overseeing the relationship with the external auditor including (but not limited to):

- A. negotiation and approval of their remuneration for audit and non-audit services, including establishing whether the level of fees is appropriate to enable an effective audit to be conducted;
  - B. developing and implementing a policy on the engagement of the external auditor to supply non-audit services by the external auditor to avoid any threat to auditor objectivity and independence, taking into account applicable law, regulation and guidance and reporting to the Board on any improvement or action required.
  - C. approval of the external auditor terms of engagement, including any engagement letter issued at the start of each audit and the scope of the audit;
  - D. satisfying itself that there are no relationships (such as family, employment, investment, financial or business) between the external auditor and the Company (other than in the ordinary course of business) which could adversely affect the external auditor's independence and objectivity;
  - E. agreeing with the Board a policy on the employment of former employees of the Company's external auditor and monitoring the application of this policy;
  - F. monitoring the auditor's compliance with relevant ethical and professional requirements relating to, among other things, the rotation of audit partner, the level of fees paid by the Company compared to the overall fee income of the firm, office and partner and other regulatory requirements; and
  - G. seeking to ensure co-ordination with the activities of the internal audit function.
- Meeting regularly with the external auditor, including once at the planning stage before the audit and once after the audit at the reporting stage. The Committee shall meet the external auditor at least once a year, without management being present, to discuss the auditor's remit and any issues arising from the audit;
  - Reviewing and approving the external auditor's annual audit plan and ensuring that it is consistent with the scope of the audit engagement;
  - Reviewing the findings of the audit with the external auditor. This shall include but not be limited to, the following:
    - A. a discussion of any major issues which arose during the audit and how they have been resolved;
    - B. any accounting and audit judgments;
    - C. levels of errors identified during the audit;
    - D. the effectiveness of the audit process;
    - E. reviewing any representation letter(s) requested by the external auditor before they are signed by management; and
    - F. reviewing the management letter and management's responsiveness in remedying the external auditor's findings and recommendations.

(f) **Whistleblowing**

The Committee shall consider matters relating to whistleblowing, including:

- Overseeing the Group's whistleblowing policies and procedures, assessing their effectiveness;
- Regularly updating the Board in respect of whistleblowing matters and providing an annual report on whistleblowing to the Board, which shall include:
  - i) a review of the effectiveness of the Group's whistleblowing policies and procedures;

- ii) details of any themes identified from whistleblowing disclosures; and
  - iii) details of any corrective action required to be taken to ensure that the Company's purpose and values have been effectively embedded;
- Receiving reports on whistleblowing matters, including material instances of disclosure, at every meeting of the Committee;
  - Ensuring that management has internal arrangements in place to handle any type of whistleblowing disclosure by any person, including anonymous disclosures;
  - Reviewing the adequacy and security of the Group's whistleblowing arrangements and ensuring that these arrangements allow effective assessment and escalation of concerns;
  - Overseeing the Group's processes, systems and controls for the prevention of bribery and receive reports on non-compliance;
  - Reviewing major findings of any relevant internal investigation into control weaknesses, fraud or misconduct, and management's response to this (in the absence of management where necessary); and
  - Consideration of whether any public disclosures are needed where there have been issues with internal control procedures.

**(g) Data Protection**

The Committee shall consider matters relating to applicable data protection legislation, including overseeing the Group's policies and procedures on data protection, assessing their adequacy and effectiveness.

**11. Reporting Responsibilities**

- The Committee Chair shall report orally to the Board on its proceedings after each meeting on all matters within its duties and responsibilities and shall also report on how it has discharged its responsibilities;
- The Committee shall make whatever recommendations to the Board it deems appropriate on any area within its remit where action or improvement is needed;
- The Committee shall produce and review a report on its activities to be approved by the Board and included in the Company's Annual Report including the following matters:
  - A. a summary of the role and work of the Committee;
  - B. an explanation of how the Committee has addressed the effectiveness of the external audit process and the approach taken for the appointment or reappointment of the external auditor;
  - C. the significant issues that the Committee considered in relation to the financial statements and how these issues were addressed;
  - D. an explanation of how the Committee has assessed the independence and effectiveness of the external audit process and the approach taken to the appointment or re-appointment of the external auditor, information on the length of the current firm tenure,

- when a tender was last conducted, and any contractual obligations that restrict the Committee's choice of external auditor;
  - E. if the external auditor provides non-audit services, how auditor objectivity and independence is safeguarded; and
  - F. all other information requirements as set out in the Code and other related guidance as appropriate.
- The Committee shall make available on the Company's website its terms of reference explaining clearly its role and the authority delegated to it.

## **12. Other Matters**

The Committee shall:

- Have access to sufficient resources in order to carry out its duties, including access to the company secretariat for assistance as required;
- 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;
- Give due consideration to laws and regulations, the provisions of the Code and the requirements of the Listing Rules, Prospectus Rules and Disclosure Guidance and Transparency Rules and any other applicable rules, as appropriate;
- Be responsible for co-ordination of the internal and external auditors;
- Oversee any investigation of activities which are within its terms of reference; and
- Arrange for periodic reviews of its own performance and, at least annually, review its constitution and terms of reference to ensure it is operating at maximum effectiveness and recommend any changes it considers necessary to the Board for approval.

## **13. Authority**

The Committee is authorised:

- To seek any information it requires from any employee of the Company in order to perform its duties;
- To obtain, at the Company's expense, outside legal or other professional advice on any matter within its terms of reference. In this regard any Board policy document concerning the securing of such advice shall be adhered to by the Committee:
  - A. the Committee is exclusively responsible for establishing the selection criteria for such advisors and their appointment and terms of reference; and
  - B. the appointment and performance of such advisors shall be reviewed by the Committee on a regular basis and at least annually;
- To call any employee to be questioned at a meeting of the Committee as and when required; and
- To have the right to publish in the Company's Annual Report details of any issues that cannot be resolved between the Committee and the Board.