

Terms of Reference of the Audit Committee

1. Scope

- 1.1 The Audit Committee responsibilities shall cover Sutton and East Surrey Water plc (the Company).

2. Membership

- 2.1 Members of the Committee shall be appointed by the Board, on the recommendation of the Nomination Committee in consultation with the Chair of the Audit Committee. All members of the Committee shall be independent non-executive directors of the Company. In accordance with the smaller company exemption under the Combined Code the Committee shall consist of at least two members.
- 2.2 One member of the Audit Committee should have recent and relevant financial experience, ideally with a professional qualification from one of the professional accountancy bodies.
- 2.3 Appointment to the Committee shall be for a period of up to three years, which may be extended for two further three-year periods, provided the director remains independent.
- 2.4 A quorum shall be two members.
- 2.5 The Chair of the Committee shall be appointed by the Board from amongst the independent non-executive directors.

3. Attendance at meetings

- 3.1 The Group Chief Executive Officer (Group CEO), Group Chief Financial Officer (Group CFO), Head of Quality and Compliance, senior finance personnel, and a representative of the external auditors shall attend meetings at the invitation of the Committee.
- 3.2 The Chair of the Board, and other Board members shall attend if invited by the Committee.
- 3.3 There should be at least one meeting a year, or part thereof, where the external auditors attend without management present.

4. Secretary

- 4.1 The Company Secretary or his/her nominee shall be secretary of the Committee.

5. Frequency of meetings

5.1 Meetings shall be held not less than twice a year and, where appropriate, should coincide with key dates in the Company's financial reporting and audit cycle.

5.2 External auditors may request a meeting if they consider that one is necessary.

6. Authority

6.1 The Committee is authorised by the Board:

- 6.1.1. to investigate any activity within its terms of reference as defined in paragraph 7;
- 6.1.2. to seek any information, it requires from any employee of the Company in order to perform its duties;
- 6.1.3. to obtain, at the Company's expense, outside legal or independent professional advice on any matter within its terms of reference; and
- 6.1.4. to call any employee or third party with relevant experience and expertise to be questioned at a meeting of the Committee as and when required.

7. Duties

The duties of the Committee shall be:

7.1 Financial reporting and Annual reporting to the Water Services Regulatory Authority

- 7.1.1. to review, and challenge where necessary, the actions and judgements of management, in relation to the Company's financial statements, operating and financial review, interim reports, preliminary announcements and related formal statements before submission to, and approval by, the Board, and before clearance by the auditors. Particular attention should be paid to:
 - critical accounting policies and practices, and any changes in them,
 - decisions requiring a significant element of judgement,
 - the extent to which the financial statements are affected by any unusual transactions in the year and how they are disclosed,
 - the clarity of disclosures,
 - significant adjustments resulting from the audit,
 - the going concern assumption,
 - compliance with accounting standards,
 - compliance with stock exchange and other legal requirements; and
- to review the content of the annual report and accounts and advise the Board on whether, taken as a whole, it is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's performance, business model and strategy; and

- 7.1.2 to consider other topics, as defined by the Board, including the risk and compliance statement, regulatory Key Performance Indicators, and other material submitted to the Water Services Regulatory Authority.

7.2 Internal control and risk management

- 7.2.1 to review the Company's procedures for the prevention of bribery, detecting fraud and whistle blowing and ensure that arrangements are in place by which staff and contractors may, in confidence, raise concerns about possible improprieties in matters of financial reporting, financial control or any other matters;
- 7.2.2 to review management's reports on the effectiveness of the systems for internal financial control, financial reporting and risk management;
- 7.2.3 to monitor the integrity of the Company's internal financial controls;
- 7.2.4 to review the statement in the annual report and accounts on the Company's internal controls and risk management framework; and
- 7.2.5 to assess the scope and effectiveness of the systems established by management to identify, assess, manage and monitor financial and non-financial risks. (Note: The Board retains responsibility for the review of the effectiveness of the system of internal control and must form its own opinion despite aspects of that review being delegated to the Audit Committee.)

7.3 Internal audit

- 7.3.1 to consider annually whether there is a need for an internal audit function where no such function exists;
- 7.3.2 to review the internal audit programme and ensure that the programme is adequately resourced and has appropriate access to information;
- 7.3.3 to ensure that the internal audit programme is accessible to the Board Chair and the Audit Committee;
- 7.3.4 to receive a report on the results of the internal audit work on a periodic basis;
- 7.3.5 to review and monitor management's responsiveness to the internal audit findings and recommendations;
- 7.3.6 to monitor and assess the role and effectiveness of the internal audit function in the overall context of the Company's risk management system;
- 7.3.7 to appoint or dismiss a head of internal audit if required.

7.4 External audit

7.4.1 to oversee the Company's relations with the external auditor;

7.4.2 to consider, and make recommendations on the appointment, reappointment and removal of the external auditor;

7.4.3 to approve the terms of engagement and the remuneration to be paid to the external auditor in respect of audit services provided;

7.4.4 to assess the qualification, expertise and resources, effectiveness and independence of the external auditors annually. Steps to consider include:

- seeking reassurance that the auditors and their staff have no family, financial, employment, investment or business relationships with the Company (other than in the normal course of business),
- seeking from the audit firm, on an annual basis, information about policies and processes for maintaining independence and monitoring compliance with relevant requirements, including current requirements regarding the rotation of audit partners and staff;
- monitoring the external audit firm's compliance with applicable ethical guidance relating to the rotation of audit partners, the level of fees that the Company pays in proportion to the overall fee income of the firm, office and partner and other related regulatory requirements,
- agreeing with the Board and monitoring the Company's policy for the employment of former employees of the external auditor;

7.4.5 to discuss with the external auditors, before the audit commences, the nature and scope of the audit;

7.4.6 to review with the external auditors the findings of their work including, any major issues that arose during the course of the audit and have subsequently been resolved and those issues that have been left unresolved; key accounting and audit judgements; levels of errors identified during the audit, obtaining explanations from management and, where necessary the external auditors, as to why certain errors might remain unadjusted;

7.4.7 to review the audit representation letters before consideration by the Board, giving particular consideration to matters that relate to non-standard issues;

7.4.8 to assess, at the end of the audit cycle, the effectiveness of the audit process by:

- reviewing whether the auditor has met the agreed audit plan and understanding the reasons for any changes, including changes in perceived audit risks and the work undertaken by the external auditors to address those risks,

- consideration of the robustness and perceptiveness of the auditors in their handling of the key accounting and audit judgements identified and in responding to questions from the Audit Committee, and in their commentary, where appropriate, on the systems of internal control,
 - obtaining feedback about the conduct of the audit from key people involved;
- 7.4.9 to review and monitor the content of the external auditor's management letter, in order to assess whether it is based on a good understanding of the Company's business and establish whether recommendations have been acted upon and, if not, the reasons why they have not been acted upon;
- 7.4.10 to develop and recommend to the Board the Company's policy in relation to the provision of non-audit services by the auditor and ensure that the provision of such services does not impair the external auditor's independence or objectivity. In doing so, the Audit Committee should:
- consider whether the skills and experience of the audit firm make it a suitable supplier of the non-audit services,
 - consider whether there are safeguards in place to ensure that there is no threat to objectivity and independence in the conduct of the audit resulting from the provision of such services by the external auditor,
 - consider the nature of the non-audit services, the related fee levels and the fee levels individually and in aggregate relative to the audit fee,
 - consider the criteria that govern the compensation of the individuals performing the audit, and
 - set and apply a formal policy specifying the types of non-audit work (a) from which the external auditors are excluded, (b) for which the external auditors can be engaged without reference to the audit committee and (c) for which a case by case decision is necessary.

8. Reporting procedures

8.1 The secretary shall circulate the minutes of meetings of the Committee to all members of the Committee and, once they are agreed, to all members of the Board. The Chair of the Committee or, as a minimum, another member of the Committee, shall attend the Board meetings at which the accounts are approved.

8.2 The Committee members shall conduct an annual review of its terms of reference and its own effectiveness and recommend any necessary changes to the Board.

8.3 The Audit Committee shall prepare a report on its role and responsibilities and the actions it has taken to discharge these responsibilities for inclusion in the annual report and accounts. Such a report should specifically include:

8.4 a summary of the role of the Audit Committee,

8.5 the names and qualifications of all members of the Audit Committee during the period,

8.6 the number of Audit Committee meetings and attendance by each member, and

8.7 the way the Audit Committee has discharged its responsibilities.