

SOUTH EAST WATER LIMITED (Registration no 2679874)

**TERMS OF REFERENCE OF THE
AUDIT AND RISK COMMITTEE**

1. Objectives

The main objective of the Committee is to assist the Board in reviewing any matters of significance affecting financial reporting including:

- 1.1. Exercising oversight over the accuracy and completeness of financial statements and advising the Board as to whether they are fair balanced and understandable.
- 1.2. Making informed decisions regarding accounting policies, practices and disclosures.
- 1.3. Reviewing the scope and results of external audits and assessing whether an internal audit function is needed.
- 1.4. Assessing the adequacy of the internal control framework.

In addition, the committee is responsible for monitoring compliance with the risk management process agreed by the Board.

2. Membership

- 2.1. The committee shall consist of not less than three members. A majority of the members of the committee shall be independent non-executive directors. One member shall be a shareholder representative. The chairman of the Board may be a member but shall not chair the committee. Members of the committee shall be appointed by the Board, on the recommendation of the nominations committee, and in consultation with the chairman of the committee.
- 2.2. At least one member of the committee shall have recent and relevant financial experience, and preferably hold a professional qualification from one of the professional accountancy bodies. The independent non-executive directors on the committee shall have the requisite financial knowledge and experience to provide appropriate challenge.
- 2.3. The chairman of the committee shall be appointed by the Board, from amongst the independent non-executive directors. In the absence of the committee chairman and/or an appointed deputy, the remaining members present shall elect one of themselves to chair the meeting.
- 2.4. Appointments shall be for a period of up to three years, extendable by no more than two additional three-year periods, so long as members continue

to be independent.

3. Secretary

The chairman of the committee or his or her nominee shall act as the secretary of the committee.

4. Quorum

The quorum necessary for the transaction of business shall be two members.

5. Attendance at meetings

- 5.1. Only members of the committee have the right to attend committee meetings. However, the finance director and external audit partner will be invited to attend meetings of the committee on a regular basis and other non-members may be invited to attend all or part of any meeting as and when appropriate.
- 5.2. There should be at least one meeting a year, or part thereof, where the external auditors, and the internal auditor if any has been appointed, attend without management present.

6. Frequency of Meetings

- 6.1. The committee shall meet at least three times a year at appropriate intervals in the company's financial reporting and audit cycle and otherwise as required.
- 6.2. Outside of the formal meeting programme, the committee chairman will maintain a dialogue with key individuals involved in the company's governance, including the Board chairman, the managing director, the finance director and the external audit partner.

7. Notice of Meetings

- 7.1. Meetings of the committee shall be convened by the committee chairman (or a secretary appointed by the committee chairman in accordance with clause 3.1) as the chairman consider is necessary or at the request of the external audit partner.
- 7.2. 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, any other person required to attend and all other non-executive directors, no later than [five] working days before the date of the meeting. Supporting papers shall be sent to committee members and to other attendees as appropriate, at the same time.

8. Minutes of Meetings

- 8.1. The secretary shall minute the proceedings and decisions of all meetings of the committee, including recording the names of those present and in attendance.
- 8.2. Draft minutes of committee meetings shall be circulated promptly to all members of the committee. Once approved, minutes should be circulated to all other members of the Board, unless it would be inappropriate to do so in the opinion of the committee chairman.

9. Duties

The committee should carry out the duties below for South East Water Limited and its major subsidiary undertakings (and reference below to the company shall include references to major subsidiary undertakings).

9.1. Financial Reporting

- 9.1.1. The committee shall monitor the integrity of the financial statements of the company, including its annual and half-yearly reports, interim management statements, and formal announcements relating to its financial performance, reviewing and reporting to the Board on significant financial reporting issues and judgements which they contain having regard to matters communicated to it by the auditor.
- 9.1.2. In particular, the committee shall review and challenge where necessary:
 - a) the consistency of, and any changes to, significant accounting policies both on a year on year basis and across the company/group;
 - b) the methods used to account for significant or unusual transactions where different approaches are possible;
 - c) whether the company has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditor;
 - d) the clarity and completeness of disclosure in the company's financial reports and the context in which statements are made;
 - e) all material information presented with the financial statements, such as the business review and the corporate governance statements relating to the audit and to risk management.
- 9.1.3. Where the committee is not satisfied with any aspect of the proposed financial reporting by the company, it shall report its views to the Board.

9.2. **Narrative Reporting**

Where requested by the Board, the committee should 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.

9.3. **Internal Controls and Risk Management Systems**

The committee shall:

- 9.3.1. keep under review the adequacy and effectiveness of the Company's internal controls and risk management systems; and
- 9.3.2. review and approve the statements to be included in any statutory or regulatory reports concerning internal controls and risk management unless reviewed by the Board as a whole;
- 9.3.3. review the risk management strategy and processes approved by the Board ensuring both qualitative and quantitative metrics are used, reviewing regularly the parameters used in these measures and the methodology adopted;
- 9.3.4. review the company's ability to identify and manage new risk types;
- 9.3.5. ensure the Board is receiving regular and sufficient reports on internal controls from management;
- 9.3.6. ensure that effective risk management controls are in place and are embedded into normal management and governance processes including, inter alia, an organisation-wide risk register and continuous monitoring of the most significant risks;
- 9.3.7. ensure that there are clear reporting lines for all issues associated with risk management;
- 9.3.8. review the adequacy of the structures, processes and responsibilities for identifying and managing key risk facing the organisation;
- 9.3.9. review company's policies for ensuring that there is compliance with relevant regulatory, legal and code of conduct requirements (including the Instrument of Appointment, the UK Corporate Governance Code, Ofwat's Regulatory Accounting Guidelines and other relevant publications);
- 9.3.10. review the operational effectiveness of policies and procedures; and
- 9.3.11. ensure that appropriate audit work is undertaken on risk management.

9.4. **Compliance, whistleblowing and fraud**

The committee shall:

- 9.4.1. review the company's systems and controls for the prevention and detection of fraud and bribery and receive reports on non-compliance;
- 9.4.2. review arrangements by which employees and contractors may, in confidence, raise concerns about possible improprieties in financial reporting or other matters. These arrangements should allow proportionate and independent investigation of such matters and appropriate follow up action.

9.5. **Internal Audit**

The committee shall review the need for an internal audit function on an annual basis.

9.6. **External Audit**

The committee shall:

- 9.6.1. consider and make recommendations to the Board, to be put to shareholders for approval at any AGM if required, in relation to the appointment, re-appointment or removal of the company's external auditor;
- 9.6.2. ensure that the audit services contract is put out to tender at least once every ten years to enable the committee to compare the quality and effectiveness of the services provided by the incumbent auditor with those of other audit firms; and in respect of such tender oversee the selection process and ensure that all tendering firms have such access as is necessary to information and individuals during the duration of the tendering process;
- 9.6.3. if an auditor resigns, investigate the issues leading to this and decide whether any action is required;
- 9.6.4. oversee the relationship with the external auditor including:
 - a) recommendations on their remuneration, including both fees for audit and non-audit services, and that the level of fees is appropriate to enable an effective and high quality audit to be conducted;
 - b) approval of their terms of engagement, including any engagement letter issued at the start of each audit and the scope of the audit;

- c) assessing annually their independence and objectivity taking into account relevant UK professional and regulatory requirements and the relationship with the auditor as a whole, including the provision of any non-audit services;
 - d) satisfying itself that there are no relationships between the auditor and the company which could adversely affect the auditor's independence and objectivity;
 - e) agreeing with the Board a policy on the employment of former employees of the company's auditor, and monitoring the implementation of this policy;
 - f) monitoring the auditor's compliance with relevant ethical and professional guidance on 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 related requirements;
 - g) assessing annually the qualifications, expertise and resources of the auditor and the effectiveness of the audit process, including a report from the external auditor on their own internal quality procedures;
 - h) evaluating the risks to the quality and effectiveness of the financial reporting process and consideration of the need to include the risk of the withdrawal of their auditor from the market in that evaluation.
- 9.6.5. meet regularly with the external auditor, including once at the planning stage before the audit and once after the audit at the reporting stage, and at least once a year without management being present, to discuss the auditor's remit and any issues arising from the audit;
- 9.6.6. review and approve the annual audit plan and ensure that it is consistent with the scope of the audit engagement, having regard to the seniority, expertise and experience of the audit team; and
- 9.6.7. review the findings of the audit with the external auditor, including:
- a) a discussion of any major issues which arose during the audit,
 - b) key accounting and audit judgements,
 - c) levels of errors identified during the audit; and
 - d) the effectiveness of the audit process.

The committee shall also:

- 9.6.8. review any representation letter(s), management letter(s) and management's response to the auditor's findings and recommendations requested by the external auditor before they are signed by management;
- 9.6.9. develop and implement policy on the supply of non-audit services by the external auditor to avoid any threat to auditor objectivity and independence, taking into account any relevant ethical guidance on the matter.

10. Reporting Responsibilities

- 10.1. The committee shall formally report to the Board on how it has discharged its responsibilities.
- 10.2. The committee shall include within the annual report a description of the work of the committee in how it has discharged its responsibilities. The report shall include an explanation of how the committee has addressed the effectiveness of the external audit process, the significant issues that the committee considered in relation to the financial statements and how these issues were addressed, having regard to matters communicated to it by the auditor, and all other information requirements set out in the UK Corporate Governance Code.

11. Other Matters

The Committee shall:

- 11.1. have access to sufficient resources in order to carry out its duties, including access to the company secretariat for assistance as required;
- 11.2. 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;
- 11.3. give due consideration to laws and regulations as appropriate;
- 11.4. be responsible for co-ordination of the internal and external auditors if appropriate;
- 11.5. oversee any investigation of activities which are within its terms of reference;
- 11.6. work and liaise as necessary with all other Board committees; and
- 11.7. arrange for periodic reviews of its own performance.

12. Authority

The committee is authorised to:

- 12.1. investigate any activity within its terms of reference;
- 12.2. seek any information it requires from any employee of the company in order to perform its duties;
- 12.3. call any employee to be questioned at a meeting of the Committee as and when required;
- 12.4. obtain, at the company's expense, independent legal, accounting or other professional advice on any matter it believes necessary to do so and such advisors may attend meetings as necessary;
- 12.5. 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.