

## SOUTH WEST WATER LIMITED – AUDIT COMMITTEE

### TERMS OF REFERENCE

#### 1. Membership

- 1.1 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, in accordance with the Company's articles of association. The Committee shall be made up of at least three members.
- 1.2 All members of the Committee shall be independent non-executive directors at least one of whom shall have recent and relevant financial experience ideally with a professional qualification from one of the professional accounting bodies. The other members shall have the requisite degree of financial knowledge and experience to provide appropriate challenge. The Committee as a whole shall have competence relevant to the sector in which the company operates. The Chair of the Board shall not be a member of the Committee.
- 1.3 Only members of the Committee have the right to attend Committee meetings. However, other individuals, including the Chair of the Board, Chief Executive Officer, Group Finance Director, the Finance Director, , the Operations Director, the Group Financial Controller the Director of Risk and Assurance, Pennon, the External Auditors and other representatives from Group Finance may be invited to attend all or part of any meeting as and when appropriate and necessary.
- 1.4 The external auditors will be invited to attend meetings of the Committee on a regular basis.
- 1.5 Appointments 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.
- 1.6 The Committee Chair shall be appointed by the Board on the recommendation of the Nomination Committee from among the members of the Audit 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.
- 1.7 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 interest.

Any such member shall abstain from voting on resolutions and participating in the discussions concerning such resolutions. Except where he has a personal interest, the Committee Chair shall have a casting vote.

- 1.8 The Committee Chair and members shall be listed each year in the Company's Annual Report.

## **2. Secretary**

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

## **3. Quorum**

The quorum necessary for the transaction of business shall be two members of which at least one member shall have recent and relevant financial experience. A duly convened meeting of the Committee at which a quorum is present shall be competent to exercise all or any of the authorities, powers and discretions vested in or exercisable by the Committee.

## **4. Frequency of Meetings**

The Committee shall meet at least four times a year in person or by telephone or video conference at appropriate times in the reporting and audit cycle and otherwise as required.

## **5. Notice of Meetings**

5.1 Meetings of the Committee shall be called by the Secretary of the Committee at the request of any of its members or at the request of external or internal auditors if they consider it necessary.

5.2 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 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 and in a timely manner to enable full and proper consideration to be given to issues.

## **6. Minutes of Meetings**

6.1 The Secretary shall minute the proceedings and resolutions of all meetings of the Committee, including recording the names of those present and in attendance.

6.2 The Secretary shall ascertain, at the beginning of each meeting, the existence of any conflicts of interest and minute them accordingly.

6.3 Minutes of Committee meetings shall be circulated promptly to all members of the Committee and, once agreed, to all members of the Board unless it would be inappropriate to do so in the opinion of the Committee Chair.

## **7. Duties**

The Committee shall carry out the duties below for South West Water Limited ("the Company").

## 7.1 Financial Reporting

- 7.1.1 The Committee shall monitor the integrity of the financial statements of the Company, including its annual report and any other formal announcements relating to its financial performance, reviewing and reporting to the Board on significant financial reporting issues and judgements which they contain.
- 7.1.2 The Committee shall review and challenge where necessary:
- 7.1.2.1 the application and consistency of, and any changes to, accounting policies both on a year on year basis and across the Company;
  - 7.1.2.2 the methods used to account for significant or unusual transactions where different approaches are possible;
  - 7.1.2.3 whether the Company has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditor;
  - 7.1.2.4 the clarity and completeness of disclosure in the Company's financial reports and the context in which statements are made;
  - 7.1.2.5 all material information presented with the financial statements, such as the strategic report, directors' report and the corporate governance statement (insofar as it relates to the audit and risk management);
  - 7.1.2.6 the assumptions or qualifications in support of the going concern statement to be included in the Company's Annual Report (including any material uncertainties as to the Company's ability to continue adopting the going concern assumption);
  - 7.1.2.7 significant adjustments resulting from the audit; and
  - 7.1.2.8 report accordingly to the Board.
- 7.1.3 Where requested by the Board, provide advice on how, taking account of the Company's position and principal risks, the prospects of the Company have been assessed, over what period, and why that period is appropriate, and whether there is a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the chosen period, drawing attention to any qualifications or assumptions as necessary. This should subsequently be presented in the Annual Report.
- 7.1.4 The Committee shall monitor compliance with financial reporting and accounting standards and compliance with any other legal, governance and regulatory requirements.
- 7.1.5 The Committee will report its views to the Board where it is not satisfied with any aspect of the financial reporting by the Company.
- 7.1.6 Taking account of the Committee's findings from performing the duties set out in paragraphs 7.1.1 and 7.1.3 above the Committee shall provide advice to the Board on whether the content of the Company's Annual Report and Accounts, taken as a

whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy and whether it informs the Board's statement in the annual report on these matters as is required under the Corporate Governance Code 2018 ("the Code").

## **7.2 Regulatory Reporting**

The Committee shall review and challenge the integrity of internal control and governance processes to ensure the quality and reliability of the information provided to Ofwat, including the Company's Annual Regulatory Compliance Statement, the Annual Regulatory Performance Report and other requirements under the Company's licence.

## **7.3 Internal Controls and Risk Management Systems**

The Committee shall:

- 7.3.1 keep under review the adequacy and effectiveness of the Company's internal controls, including all material financial, operational and compliance controls and risk management systems;
- 7.3.2 review and approve the statements to be included in the Company's Annual Report concerning internal controls and risk management including the assessment of principal and emerging risks and the viability statement;
- 7.3.3 where requested by the Board, ensure that there are robust systems and processes in place to identify, assess, manage and monitor the principal risks facing the Company including those that would threaten the business model, future performance, solvency or liquidity of the Company;
- 7.3.4 review regular reports from management, internal audit, external audit and other assurance providers, as appropriate, on matters related to risk and control and review the timeliness and effectiveness management's response;
- 7.3.5 review the financial policies of Pennon Group plc ("the Group") annually.

## **7.4 Whistleblowing and Fraud**

The Committee shall:

- 7.4.1 review the policies on anti-bribery and corruption, and gifts and hospitality, and the systems and controls in place to prevent bribery and financial misconduct, and receive reports on any non-compliance with such policies, systems and controls annually.
- 7.4.2 review the Group's arrangements for the Company's employees, contractors and external parties to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters. The Committee shall ensure that these arrangements allow proportionate and independent investigation of such matters and appropriate follow up action;

- 7.4.3 review the Group's procedures for detecting fraud; and
- 7.4.4 consider the major findings of any relevant internal investigation into fraud or financial misconduct in respect of the Company and management's response.

## **7.5 Internal Audit**

The Committee shall:

- 7.5.1 monitor and review the role and effectiveness of the internal audit arrangements in the context of the Company's overall risk management system its compliance and finance functions, and the work of finance and the external auditor;
- 7.5.2 annually approve the Internal Audit Charter, confirming the remit of the internal audit function, ensuring the function has adequate resources and appropriate access to information to enable it to perform its function effectively, in accordance with the relevant professional standards, ensuring it is appropriate for the current needs of the organisation;
- 7.5.2 review and assess the annual internal audit plan to ensure it is aligned to the key risks of the business, and receive regular reports on work carried out;
- 7.5.3 review conclusions and manager responses and responsiveness to the findings and recommendations of the internal auditors;
- 7.5.4 ensure internal audit has unrestricted scope, the necessary resources and access to information to enable it to fulfil its mandate, ensure there is open communication between different functions and that the internal audit function evaluates the effectiveness of these functions as part of its internal audit plan, and ensure that the internal audit function is equipped to perform in accordance with appropriate professional standards for internal auditors;
- 7.5.5 meet the Director of Risk and Assurance at least once a year, without management being present, to discuss their remit and any issues arising from the internal audits carried out. In addition, the Director of Risk and Assurance shall be given the right of direct access to the Chair of the Board and to the Chair of the Committee providing independence from the Executive and accountability to the Committee;
- 7.5.8 carry out an annual assessment of the effectiveness of the internal audit function and as part of this assessment: meet with the head of internal audit without the presence of management to discuss the effectiveness of the function; review and assess the annual internal audit work plan; receive a report on the results of the internal auditor's work; determine whether it is satisfied that the quality, experience and expertise of internal audit is appropriate for the business; review the actions taken by management to implement the recommendations of internal audit and to support the effective working of the internal audit function; and consider whether an independent, third party review process is appropriate.

## **7.6 External Audit**

The Committee shall:

- 7.6.1 oversee the relationship between the Company and with the external auditor appointed by Pennon Group plc including (but not limited to):
  - 7.6.1.1 assessing annually their independence and objectivity taking into account relevant law, regulation, the Financial Reporting Council's Ethical Standard and other professional requirements and the Group's relationship with the auditor as a whole, including any threats to the auditor's independence and the safeguards applied to mitigate those threats including the provision of any non-audit services
  - 7.6.1.2 satisfying itself that there are no relationships (such as family, employment, investment, financial or business) between the auditor and the Company (other than in the ordinary course of business);

noting that matters relating to the tender, appointment, re-appointment and removal of the external auditor, their remuneration and terms of engagement, and the Group's policy on the supply of non-audit services by the external auditor are matters determined by the Audit Committee of Pennon Group plc.

- 7.6.2 meet 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 their remit and any issues arising from the audit;
- 7.6.3 discuss with the external auditor the factors that could affect audit quality and 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;
- 7.6.4 review the findings of the audit with the external auditor. This shall include but not be limited to, the following;
  - 7.6.4.1 a discussion of any major issues which arose during the audit,
  - 7.6.4.2 the auditor's explanation of how the risks to audit quality were addresses,
  - 7.6.4.3 key accounting and audit judgements,
  - 7.6.4.4 the auditor's view of their interaction with senior management,
  - 7.6.4.5 levels of errors identified during the audit; and
  - 7.6.4.6 any reservations that the external auditors may have and other matters that they wish to raise.

The Committee shall:

- 7.6.5 review the effectiveness of the audit process, including an assessment of the quality of the audit, the handling of key judgements, by the auditor, and the auditors' response to questions from the Committee.
- 7.6.6 review any representation letter(s) requested by the external auditor before they are signed by management giving particular consideration to matters where representation has been requested that relates to non-standard issues;

- 7.6.7 review the management letter and management's response to the auditor's findings and recommendations;
- 7.6.8 apply the Group's policy on the supply of non audit services by the external auditor and if the external auditor provides non-audit services, provide an explanation for inclusion in the Company's Annual Report of how auditor objectivity and independence is safeguarded; and
- 7.6.9 evaluate the risks to the quality and effectiveness of the financial reporting process and consider the risk of the withdrawal of the Company's present auditor from the market.

## **7.7 Treasury**

The Committee shall review periodically the Group's treasury risk management policies as they pertain to the Company.

## **7.8 Reporting Responsibilities**

- 7.8.1 The Committee Chair shall report formally to the Board on its proceedings after each meeting on all matters within its duties and how it has discharged its responsibilities.
- 7.8.2 The Committee shall make whatever recommendations to the Board it deems appropriate on any area within its remit where action or improvement is needed.
- 7.8.3 The Committee shall compile a report to shareholders on its activities to be included in the Company's Annual Report, which shall include details of the number of meetings held and attendance over the course of the year. This report shall describe the work of the Committee, including:
  - 7.8.3.1 the significant issues that it considered in relation to financial statements and how these were addressed, having regard to matters communicated to it by the external auditor;
  - 7.8.3.2 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 reappointment of the external auditor (including information on the length of tenure of the current audit firm, and when a tender was last conducted by Pennon Group plc);
  - 7.8.3.3 an explanation of how auditor independence and objectivity are safeguarded if the external auditor provides non-audit services, having regard to matters communicated to it by the auditor and all other information requirements set out in the Code.
- 7.8.4 In compiling the reports referred to in this section, the Committee should exercise judgement in deciding which of the issues it considers in relation to the financial statements are significant, but should include at least those matters that have informed the Board's assessment of whether the company is a going concern and the inputs to the Board's viability statement.

## **7.9 Other Matters**

The Committee shall:

- 7.9.1 have access to sufficient resources in order to carry out its duties, including access to the company secretariat for assistance as required;
- 7.9.2 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;
- 7.9.3 give due consideration to laws and regulations, including the provisions of the UK Corporate Governance Code;
- 7.9.4 oversee any investigation of activities which are within its terms of reference and consider other topics, as determined by the Board from time to time;
- 7.9.5 be responsible for the oversight of the coordination of the internal and external auditors.
- 7.9.6 work and liaise as necessary with all Board committees ensuring interaction between committees and with the Board is reviewed regularly, taking particular account of the impact of risk management and internal controls being delegated to different committee.
- 7.9.5 make available these terms of reference by placing them on the Company's website; and
- 7.9.6 once a year, review its own performance, 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.

## **8. Authority**

The Committee is authorised:

- 8.1 to seek any information it requires from any employee of the Company in order to perform its duties and all employees are directed by the Board to cooperate with any request made by the Committee;
- 8.2 to obtain, at the Company's expense, outside legal or other professional advice on any matter within its terms of reference and to secure the attendance of any person with relevant experience and expertise if it reasonably considers this necessary;
- 8.3 to call any employee to be questioned at a meeting of the Committee as and when required; and
- 8.4 to have the right to publish the Company's Annual Report details of any issues that cannot be resolved between the Committee and the Board.

## **9. Approval**

- 9.1 These terms of reference were approved by the Board of South West Water Limited on 24 September 2020.