

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

(Adopted by the board on 27 April 2011)

### **Constitution**

1. There shall be a committee of the board to be known as the audit and risk committee which will act in a way which the committee considers, in good faith, to be most likely to promote the success of the Company for the benefit of its members as a whole.
2. The committee will comprise non-executive directors appointed by the Board who are determined in accordance with applicable UK corporate governance rules to be independent, at least one of whom should have recent and relevant financial experience. The committee shall consist of not less than three members. A quorum shall be two members.
3. Unless exceptional circumstances or succession planning requires otherwise, appointments should generally 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.
4. The chairman of the committee shall be appointed by the board, following consultation with the nomination committee. In the absence of the committee's chairman from any meeting, the committee will appoint one of its members to act as chairman of the committee.
5. At least one committee member should in the view of the board have recent and relevant financial experience. The other committee members should have a degree of financial literacy and experience of corporate financial matters.
6. No one other than the chairman and members of the committee is entitled to be present at a meeting of the committee but others shall attend at the invitation of the committee including but not limited to, the Chairman of the Board, the Chief Executive Officer, the Chief Financial Officer, the Head of Risk, the Head of Corporate Audit and a representative of the external auditor.
7. The company secretary (or his/her nominee) shall be the secretary to the committee and shall keep appropriate minutes of its proceedings which shall be circulated promptly to all members of the committee for approval as soon as practicable and once approved to all members of the board unless a conflict of interest exists and, if the committee so chooses, to the auditor. The secretary shall ascertain at the beginning of each meeting of the committee, the existence of any conflicts and minute them accordingly.
8. Meetings shall be held not less than three times a year and may be held in person or by telephone or videoconference, to discuss general audit matters, the interim and full year report and financial statements.
9. In the event that a member of the committee is unable to attend a regular or

ad-hoc meeting of the committee, such member may appoint an independent non-executive director to act as an alternate member of the committee and attend the meeting in his or her place. The said alternate members shall have full powers of a regular member of the committee when attending any such meeting as a substitute for any absent member.

10. The auditor, or the committee, may request a private meeting, without any executives being present, if either considers that one is necessary. In any event the committee will meet at least annually the external and internal auditors, without management, to discuss matters relating to its remit and any issues arising from the audit.

11. The committee's duties and activities during the year shall be disclosed in the annual report and financial statements.

12. The chairman of the committee shall attend the annual general meeting and shall answer questions, through the chairman of the board, on the audit committee's activities and their responsibilities.

13. Members of the committee are not expected to serve on the audit committees of more than three public companies at any one time.

### **Powers**

14. The committee is authorised by the board to undertake any activity within its terms of reference or any other activity that it is asked by the board to undertake, or any review or take any other action that it considers appropriate in the discharge of its duties. It is authorised to seek any information it requires from any employee and all employees will be directed by the board to co-operate with any request made by the committee.

15. The committee is authorised by the board to obtain outside legal or other independent professional advice and to secure the attendance of outsiders with relevant experience and expertise if it considers this necessary. This authority is subject only to the requirement that independent advice is sought at a reasonable cost commensurate with the matter under review.

### **Duties**

16. The committee's duties are:

(a) to have primary responsibility for making a recommendation to the board, for it to put to shareholders for their approval in general meeting, on the appointment, reappointment and removal of the external auditor (or auditors) and to approve the auditor's engagement letter, the audit fee and to consider the performance of the auditor and any questions of resignation by or dismissal of the auditor, the risk of the auditor withdrawing from the market and to explain the process behind that recommendation, to shareholders in the annual report and financial statements;

(b) prior to the commencement of the audit, to discuss with the external auditor the scope of the audit, keep under review the scope and results of the company's audit and its effectiveness and the independence and objectivity of the auditor, taking into account relevant UK professional and regulatory requirements and to ensure that key audit personnel are rotated at appropriate intervals;

(c) to establish policies and procedures to pre-approve the engagement of the auditor to provide any audit or non-audit services, and to keep the nature and extent of non-audit services under review, seeking to observe relevant ethical standards and, in particular, the five basic principles of auditor independence, that an auditor may not: (i) audit his own work (ii) perform management functions (iii) allow a mutuality of interest to be created (iv) develop close relationships with company personnel or (v) act as an advocate for the Company; and to recommend the audit fee to the board and pre-approve any fees in respect of non-audit services provided by the external auditors. In some cases the nature of advice may make it more timely and cost-effective to select the external auditor. Accordingly, the external auditor may also be appointed for consultancy work but only after rigorous checks to confirm it is the best provider and its appointment does not impair the external auditor's independence;

(d) to review, and challenge management where necessary, the half year and annual financial statements and any formal announcements relating to financial performance before submission to the board, focusing particularly on:

- critical accounting policies and changes in accounting policies and practices;
- major judgmental areas including material alternative accounting treatments, the ramifications of their use and the treatment preferred by the auditor;
- the clarity of disclosures;
- significant adjustments resulting from the audit;
- the going concern assumption;
- compliance with accounting standards;
- compliance with stock exchange, legal and regulatory requirements;
- appropriate compliance with best practice in the area of corporate governance; and
- other material written communications and representations between the accounting firm and management of the issuer such as any management letter, representation letter or schedule of "unadjusted" differences.

(e) to consider problems and reservations arising from any interim review or final audit and any matters the auditor may wish to raise;

(f) to review periodically the scope, remit and effectiveness of the corporate audit function, to ensure that it is adequately resourced and has appropriate standing within the company and to approve the appointment or dismissal of the director of audit and to ensure that the director of audit has direct access to the chairman of the company and the audit committee and is accountable to the audit committee;

(g) to review the effectiveness of the group's internal control systems (including financial, operational and compliance controls and risk management), to consider reports from management on its monitoring of the system of internal control, to review the company's statement on internal control systems prior to endorsement by the board; to make recommendations to the board regarding the effectiveness of the Group's internal control systems and assess the annual corporate audit plan;

(h) to review the company's statement on internal control systems prior to the endorsement by the board and to review the policies and process for identifying and assessing business risks and the management of those risks by the company;

(i) establishing that there is a robust risk management policy in place which is embedded and used within the company and that it encourages a pro-active risk management culture and includes a process for the accurate and timely monitoring of large exposures and certain risk types of critical importance within the organisation;

(j) to assist the board evaluate the company's risk appetite, tolerance and strategy;

(k) in relation to risk assessment:

- keep under review the company's risk assessment processes that inform the board's decision making, ensuring both qualitative and quantitative metrics are used
- from time to time review the parameters used in these measures and the methodology adopted

(l) consider and approve the remit of the risk management function 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 independence and has direct access to the committee;

(m) to consider the major findings of internal investigations and management's response; to review and monitor management's responsiveness to the findings and recommendations of the corporate auditor;

(n) to ensure that the board receives suitable financial information;

(o) to review the internal control and governance processes that management have in place are appropriate and sufficiently robust to ensure, so far as practical, that the information contained in the annual June Returns that the Company's subsidiary United Utilities Water PLC are required to file with Ofwat are in line with the confidence levels associated with the data contained in them and are reliable, accurate and complete;

(p) to consider other topics referred to it by the Board or to undertake any review or take any other action that the committee considers appropriate in the discharge of its duties;

(q) to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to steps to be taken;

(r) to review arrangements by which any employee or contractor of the group may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters (with a view to ensuring that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow up);

(s) to review the Company's procedures for detecting fraud and to review the Company's code of business conduct, systems and controls for the prevention of inappropriate behaviour and receive reports on non-compliance with the code;

(t) to conduct an annual review of the committee's work, effectiveness and the terms of reference and make recommendations to the Board; and

(u) to provide all new committee members with an induction programme and to provide training to committee members on an ongoing and timely basis.