

Audit, Risk & Assurance Committee – Terms of Reference¹

1. Membership

- 1.1 The Committee shall comprise at least 4 members. The shareholder shall have a right to nominate up to two members of the Committee². All other 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 accountancy bodies. Where possible, one member of the Committee should also be a member of the remuneration committee. The chairman of the Board shall not be a member of the Committee.
- 1.2 Members of the Committee shall be appointed by the Board³, with all appointments (subsequent to the appointment of the inaugural members of the Committee) being on the recommendation of the nomination committee and in consultation with the chair of the Committee.⁴
- 1.3 The Committee notes that the Board shall make such appointments in compliance with the Articles of Association and any rights of the shareholder to nominate a director or directors to be appointed to the Committee.
- 1.4 Only members of the Committee have the right to attend Committee meetings. However, the external auditor, the Chief Finance Officer, the Chief Executive (as Accounting Officer⁵) and the Head of Internal Audit shall attend meetings of the Committee. Other individuals (such as the chair of the Board, other directors and internal audit and finance function representatives) may be invited to attend all or part of any meeting as and when appropriate and necessary.
- 1.5 Appointments to the Committee 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.
- 1.6 The Board shall appoint the Committee chair who shall be an independent non-executive director. In the absence of the Committee chair and/or an appointed deputy at a meeting, the remaining members present shall elect one of themselves to chair the meeting.

2 Secretary

- 2.1 The Company Secretary or his/her nominee shall act as secretary to the Committee⁶ and will ensure that the Committee receives information and papers in a timely manner to enable full and proper consideration to be given to issues.

¹ Approved by the Board on 16 December 2014.

² Article 23(1) of the Articles of Association states that the shareholder may appoint the chairman of any committee. Article 23(2) states that the shareholder has the right to appoint up to two directors to be members of each Board committee. The Framework Document between the Secretary of State for Energy and Climate Change (who is also the sole shareholder) provides that one director on the remuneration committee and one director on the audit and risk committee must be a director who is a shareholder representative.

³ The UK Corporate Governance Code notes that it is useful to refresh the membership of Committees after an appropriate period.

⁴ The recommendation of the nomination committee and consultation with the chairman of the remuneration committee is a requirement of the Framework Document.

⁵ The Chief Executive has, by letter of appointment, been appointed by the Secretary of State for Energy and Climate Change as Accounting Officer. The responsibilities of the Accounting Officer include the responsibility to be satisfied that the resources authorised by Parliament are used for the purposes intended by Parliament and that all the company's funds, and any receipts, are properly accounted for; that the company's use of resources and retention of any reserves in carrying out its functions complies with the requirements of the Framework Document and the relevant legislation; and that public funds are safeguarded and used with propriety and regularity. The further (as relevant) responsibilities of the Accounting Officer are set out in chapter 3 of HM Treasury's guidance on Managing Public Monies and other government guidance.

⁶ The Company Secretary will be assisted by the Head of Internal Audit.

3 Quorum

- 3.1 The quorum necessary for the transaction of business shall be three members. 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

- 4.1 The Committee shall meet at least 3 times a year at appropriate times in the financial reporting and audit cycle, and otherwise as required.
- 4.2 Outside of the formal meetings programme, the Committee chairman, and to a lesser extent the other Committee members, will maintain a dialogue with key individuals involved in the company's governance, including the Board Chairman, the Chief Executive (including in his role as Accounting Officer), the Chief Finance Officer, the external audit lead partner and the head of internal audit.

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 and/or at the request of the external audit lead partner or head of internal audit if either considers it necessary.
- 5.2 Unless otherwise agreed by the Committee, 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 and all the other non-executive directors, no later than 7 days before the date of the meeting. Supporting papers shall be sent to Committee members and (as appropriate) to other attendees at the same time.
- 5.3 Notices, agendas and supporting papers can be sent in electronic form where the recipient has agreed to receive documents in such a way.

6 Minutes of meetings

- 6.1 The secretary (or his/her nominee) shall minute the proceedings and decisions of all meetings of the Committee, including recording the names of those present and in attendance.
- 6.2 Draft minutes of Committee meetings shall be agreed with the Committee chairman and circulated to all members of the Committee. The minutes should also be circulated to all other members of the Board or presented as part of the Board papers at a Board meeting, unless it would be inappropriate to do so in the opinion of the Committee chairman.

7 Annual General Meeting

- 7.1 The Committee chair should attend (if any) the annual general meeting to answer questions on the Committee's activities.

8 Duties

- 8.1 The Committee shall carry out the duties set out below. In carrying out its duties the Committee shall take into account the company's responsibilities relating to the safeguarding and propriety of use of public monies.

Financial Reporting

- 8.2 The Committee shall monitor the integrity of the financial statements of the company (including any

annual, half yearly or quarterly reports, interim management statements and any other formal announcement relating to its financial performance), and review and report to the Board on significant financial reporting issues and judgements which they contain having regard to matters communicated to it by the auditor.

- 8.3 In particular, the Committee shall review and challenge where necessary:
- 8.3.1 the application of, and any changes to, significant accounting policies both on a year on year basis and across the company;
 - 8.3.2 the methods used to account for significant or unusual transactions where different approaches are possible;
 - 8.3.3 whether the company has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditor;
 - 8.3.4 the clarity of disclosure in the company's financial reports and the context in which statements are made;
 - 8.3.5 all material information presented with the financial statements, such as the strategic review and corporate governance statement (insofar as relating to the audit and risk management); and
 - 8.3.6 the extent to which the company has complied with the financial reporting requirements set out in the relevant governance documents relating to the company⁷.
- 8.3A The Committee shall, prior to the Board, review any statements requiring Board approval which contain financial information where such a review prior to the Board is practicable and consistent with any prompt reporting requirements under any law or regulation.
- 8.4 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.

Accounting Officer

- 8.5 The Committee must be aware of the responsibilities of the Accounting Officer and the control framework which supports him/her in the discharge of those responsibilities (including the processes which support the Accounting Officer's compliance with the relevant requirements in chapter 3 of HM Treasury's guidance on Managing Public Monies as referred to in the Accounting Officer's appointment letter)⁸.
- 8.6 The Committee should advise the Accounting Officer and (as appropriate, the Board) on the assurance needs in relation to risk, governance, controls and the control framework which supports the Accounting Officer in the discharge of his/her responsibilities. The Committee should also advise on how well these needs are being addressed by the assurance in respect of risk, governance, controls and the control framework received from the risk management system and other systems, processes and controls.

Assurance

- 8.7 The Committee notes that the formulation of the specific assurance need is key to determining the resource that needs to be dedicated to delivery of assurance in the company. Key elements to the

⁷ These documents include the Articles of Association and the Framework Document referred to in footnote 2 and in the Accounting Officer appointment letter referred to in footnote 5.

⁸ See footnote 5.

formulation of the specific assurance need include consideration of:

- 8.7.1 the strategic outcomes and objectives which the company is charged to deliver, and the associated risks and control mechanisms;
- 8.7.2 the sources of assurance available; and
- 8.7.3 the level of confidence required in assurances, including the extent to which the range of assurance providers within the company can be relied on by internal audit in delivering its overall opinion on risk, control and governance.

Narrative reporting

- 8.8 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, provides the information necessary for the shareholder to assess the company's performance, business model and strategy and informs the Board's statement in the annual report on the matters that is required under the UK Corporate Governance Code.

Internal controls and risk management systems

- 8.9 The Committee shall:
 - 8.9.1 keep under review the adequacy and effectiveness of the company's internal financial control systems that identify, assess, manage and monitor financial risks and the internal control and risk management systems;
 - 8.9.2 review and approve the statements to be included in the annual report concerning internal controls, risk management and viability;
 - 8.9.3 review the effectiveness of the identification, assessment, reporting and mitigation of key risks and make recommendations to the Board (including in respect of the risk appetite approach); and
 - 8.9.4 if requested by the Board, be responsible for approving amendments to and updates of the company's Delegated Financial & Signing Authorities.

Compliance, whistleblowing and fraud

- 8.10 The Committee shall:
 - 8.10.1 review the adequacy and security of the company's arrangements for its employees and contractors and for energy sector generators and suppliers and (in each case) their employees 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;
 - 8.10.2 review the company's procedures for detecting fraud; and
 - 8.10.3 review the company's systems and controls for the prevention of fraud, bribery and anti-money laundering (including by the regular review of fraud risk management issues and of the implementation of policies or procedures on whistleblowing, share dealing, anti-bribery and anti-money laundering). The Committee shall receive reports on non-compliance with the foregoing.

Internal audit

8.11 The Committee shall:-

- 8.11.1 approve the appointment or termination of the head of internal audit;
- 8.11.2 review and approve the role and charter of the internal audit function, monitor and review the effectiveness of its work and annually approve the (if any) internal audit charter ensuring it is appropriate for the current needs of the organisation;
- 8.11.3 ensure the internal audit function has unrestricted scope, the necessary resources and access to information to enable it to fulfil its mandate, ensure there is open communication between different function areas and that the internal audit function evaluates the effectiveness of these functional areas as part of its internal audit plan and is equipped to perform in accordance with appropriate professional standards for internal auditors;
- 8.11.4 review and approve 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;
- 8.11.5 ensure the internal auditor has direct access to the Board Chairman and to the Committee chairman, providing independence from the executive, and accountability to the Committee;
- 8.11.6 review and assess the annual internal audit plan;
- 8.11.7 receive a report on the results of the internal auditor's work on a periodic basis;
- 8.11.8 review and monitor management's responsiveness to the internal auditor's findings and recommendations
- 8.11.9 review and monitor the actions taken by management to implement the recommendations of internal audit and to support the effective working of the internal audit function;
- 8.11.10 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; and
 - determine whether it is satisfied that the quality, experience and expertise of internal audit is appropriate for the business;
- 8.11.11 monitor and review the effectiveness of the company's internal audit function in the context of the company's overall risk management system and the work of compliance, finance and the external auditor.
- 8.11.12 consider whether an independent, third party review of processes is appropriate.

External audit

8.12 The Committee shall:

- 8.12.1 consider and make recommendations to the Board, to be put to the shareholder for approval, in relation to the appointment, re-appointment and removal of the company's external auditor;
- 8.12.2 review annually whether the audit services contract should be put out to tender to enable the

Committee to compare the quality and effectiveness of the services provided by the incumbent auditor with those of other audit firms. In respect of such tender the Committee shall 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;

8.12.3 if an external auditor resigns, investigate the issues leading to this and decide whether any action is required.

8.12.4 oversee the relationship with the external auditor including (but not limited to):

- (a) making recommendations on the external auditor's remuneration, including both fees for audit and non-audit services, and being satisfied that the level of fees is appropriate to enable an effective high quality audit to be conducted;
- (b) approving the auditor's terms of engagement, including any engagement letter issued at the start of each audit and the scope of the audit;
- (c) assessing annually the auditor's independence and objectivity taking into account any relevant UK law, regulation, the Ethical Standard relating to external auditors issued by the Financial Reporting Council from time to time and other professional requirements and the relationship with the auditor as a whole, including any threats to the auditor's independence and the safeguards applied to mitigate those threats (including in relation to the provision of any non-audit services);
- (d) 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) 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, taking into account the Ethical Standard and legal requirements, and monitoring the implementation of this policy;
- (f) monitoring the auditor's processes for maintaining independence, its compliance with relevant UK law, regulation, the Ethical Standard and other professional requirements, including the guidance on the rotation of the audit partner and staff;
- (g) monitor the level of fees paid by the company to the external auditor compared to the overall fee income of the firm, office and partner and assess these in the context of the relevant legal, professional and regulatory requirements, guidance and the Ethical Standard;
- (h) assessing annually the independence, qualifications, expertise and resources of the auditor and the effectiveness of the audit process, which shall include a report from the external auditor on its own internal quality procedures;
- (i) seek to ensure coordination of the external audit with the activities of the internal audit function; and
- (j) evaluating the risks to the quality and effectiveness of the financial reporting process in light of the external auditor's communications with the Committee;

8.12.5 meet regularly with the external auditor, including once at the planning stage before the audit and once after the audit at the reporting stage. 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;

8.12.6 8.6.15 discuss with the external auditor the factors that could affect audit quality and review and approve the annual audit plan, ensuring it is consistent with the scope of the audit engagement, having regard to the seniority, expertise and experience of the audit team;

8.12.7 review and approve the annual audit plan and ensure that it is consistent with the scope of the audit engagement, and resourced by audit staff of appropriate seniority, expertise and experience; and

8.12.8 review the findings of the audit with the external auditor. This shall include but not be limited to the following:

- a discussion of any major issues which arose during the audit;
- the auditor's explanation of how the risks to audit quality were addressed;
- key accounting and audit judgements;
- the auditor's view of their interactions with senior management;
- levels of errors identified during the audit; and
- the effectiveness of the audit.

8.13 The Committee shall also:

8.13.1 review any representation letter(s) requested by the external auditor before they are signed by management;

8.13.2 review the management letter and management's response to the auditor's findings and recommendations; and

8.13.3 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 auditor's response to questions from the committee; and

8.13.4 develop and implement a formal policy on the supply of non-audit services by the external auditor, taking into account any relevant ethical guidance on the matter. The policy shall include a requirement that the provision of non-audit services should be approved by the Committee and should specify the types of any non-audit services that are pre-approved and contain an assessment of whether non-audit services have a direct or material effect on the audited financial statements. The policy should also include consideration of the following matters:

- threats to the independence and objectivity of the external auditor and any safeguards in place;
- the nature of the non-audit services;
- whether the external audit firm is the most suitable supplier of the non-audit services;
- the fees for the non-audit services, both individually and in aggregate, relative to the audit fee.
- the criteria governing compensation

9 Reporting responsibilities

9.1 The Committee chair shall report formally to the Board on its proceedings after each Committee meeting on all matters within the Committee's duties and responsibilities and shall also formally report to the Board on how it has discharged its responsibilities. This report shall include:

- (a) the significant issues that it considered in relation to the financial statements (required under paragraph 8.2) and how these were addressed;

- (b) its assessment of the effectiveness of the external audit process (required under paragraph 8.13.3) and the approach taken to the appointment or reappointment of the external auditor, length of tenure of audit firm, when a tender was last conducted and advance notice of any retendering plans;
- (c) its recommendation on the appointment or reappointment of the external auditor; and
- (d) any other issues on which the Board has requested the Committee's opinion.

9.2 The Committee shall make whatever recommendations to the Board it deems appropriate on any area within its remit where action or improvement is needed.

9.3 The Committee shall review a report on its activities to be included in the company's annual report. The report should include an explanation of:-

9.3.1 how the Committee has addressed the effectiveness of the external audit process;

9.3.2 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

9.3.3 and all other information requirements set out in the UK Corporate Governance Code.

9.4 In compiling the reports referred to in paragraphs 9.1 and 9.3, 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. The report to shareholders need not repeat information disclosed elsewhere in the annual report and accounts, but could provide cross-references to that information.

10 Other matters

10.1 The Committee shall:

10.1.1 have access to sufficient resources in order to carry out its duties, including access to the company secretariat for assistance as required;

10.1.2 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;

10.1.3 give due consideration to laws and regulations, the provisions of the UK Corporate Governance Code and any other applicable rules, as appropriate;

10.1.4 be responsible for the coordination of the internal and external auditors;

10.1.5 oversee any investigation of activities which are within its terms of reference;

10.1.6 work and liaise as necessary with all other Board committees, taking particular account of the impact of risk management and internal controls being delegated to different committee; and

10.1.7 arrange for periodic reviews of its own performance and, at least annually, review its terms of reference to ensure it is operating at maximum effectiveness and recommend any changes it considers necessary to the Board.

11 Authority

11.1 The Committee is authorised to:

- 11.1.1 seek any information it requires from any employee of the company in order to perform its duties;
- 11.1.2 obtain, at the company's expense, independent legal, accounting or other professional advice on any matter where it believes it necessary to do so. In doing so the Committee shall take into account the requirements of the company's Procurement Policy;
- 11.1.3 call any employee to be questioned at a meeting of the Committee as and when required; and
- 11.1.4 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.