

NATIONAL GRID plc

## **AUDIT COMMITTEE TERMS OF REFERENCE**

Reference to the “Company” shall mean National Grid plc.

Reference to the “Committee” shall mean the Audit Committee.

Reference to the “Board” shall mean the Board of Directors of the Company.

### **1. Membership**

- 1.1 The Committee shall be appointed by the Board and shall comprise a Chairman and at least 2 other members on the recommendation of the Nominations Committee in consultation with the Audit Committee Chairman. Membership shall normally include at least one member of the Safety, Environment and Health Committee.
- 1.2 The Chairman and members of the Committee shall all be independent Non-executive Directors, as determined by the Board after considering UK and US law, regulation and best practice. The Chairman of the Board shall not be a member of the Committee.
- 1.3 Whilst the Committee itself is made up entirely of Non-executive Directors, other individuals such as the Chairman of the Board, Chief Executive, Finance Director, representatives of the external auditors, Director of Corporate Audit, Group Financial Controller and Group General Counsel and Company Secretary (or his/her nominee) may be invited to attend by the Committee and would normally attend each meeting. Other Executive Directors, external advisers, the Head of Global Assurance and the Global Head of Business Conduct & Ethics may be invited to attend as and when considered appropriate by the Committee and in respect of the items that are relevant to them.
- 1.4 If a regular member is unable to act due to absence, illness or any other cause, the Chairman of the Committee may appoint another independent Non-executive Director of the Company to serve as an alternate member on a short term basis.
- 1.5 The Board shall appoint the Chairman of the Committee. In the absence of the Chairman of the Committee and any appointed deputy, the remaining members present shall elect one of their number who is present to chair the meeting.
- 1.6 At least one member of the Committee shall be a financial expert with recent and relevant financial experience who ideally holds a professional qualification and who satisfies the requirements as determined by the Board, with due regard to relevant legal and best practice requirements.
- 1.7 The Committee as a whole shall have competence relevant to the sector in which the Company operates, as determined by the Board, with due regard to relevant legal and best practice requirements.

## **2. Secretary**

2.1 The Group General Counsel and Company Secretary or his/her nominee shall act as the Secretary of the Committee.

## **3. Quorum and voting**

3.1 The quorum necessary for the transaction of business shall be 2 members of the Committee. 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.

3.2 If any conflicts of interest exist with a particular member of the Committee on any particular issue then such member of the Committee shall not participate or vote on the issue that gave rise to such conflict of interest.

## **4. Meetings**

4.1 The Committee shall meet prior to publication of the full and half year Results of the Company and at such other times as the Chairman of the Committee or any of its members shall require (to coincide as appropriate with meetings of the Board). It is intended the Committee shall meet not less than 4 times per year. During the financial year it is also intended the Committee shall meet with the corporate auditors and the external auditors, without management present.

4.2 Where the Committee receives a report from the Business Separation Compliance Officer ("BSCO") that there has been a breach of:

- Paragraph 5 of Special Condition 10B of the gas transporters' licence held by National Grid Gas plc in respect of the gas national transmission system; and /or
- Paragraph 3 of Special Condition 4F of the gas transporters' licence held by National Grid Gas plc in respect of the UK gas distribution networks.

The Committee shall convene within 14 calendar days to consider what action it should recommend in response to such breach.

## **5. Notice of Meetings**

5.1 Meetings of the Committee shall be convened by the Secretary of the Committee at the request of the Chairman of the Committee, any of its members or the external or corporate 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 circulated or made available electronically to each member of the Committee and any other person required to attend no fewer than 4 working days prior to the date of the meeting to enable proper consideration of the relevant 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 should 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, following the approval of the Chairman of the Committee, to other members of the Board, the external auditors, Group General Counsel and Company Secretary, Director of Corporate Audit and Group Financial Controller.
- 6.4 The Chairman of the Committee, or in his or her absence another member of the Committee, will report orally to the Board on meetings of the Committee.

## **7. Annual General Meeting**

- 7.1 The Chairman of the Committee shall attend the Annual General Meeting (AGM) prepared to respond to any shareholder questions on the Committee's activities.

## **8. Duties**

- 8.1 The Committee should carry out the duties below for the Company, subsidiary undertakings and the group as a whole, as appropriate.

### **8.2 Internal Control, Risk and Compliance**

- 8.2.1 The Committee shall keep under review and report to the Board on its activities, on the adequacy and effectiveness of the Company's financial reporting (including if it is dissatisfied with any aspect of the proposed financial reporting by the Company), internal controls (including operational and compliance controls), and the procedures for the identification, assessment and reporting of business risks. In undertaking its review, the Committee shall consider any appropriate issues raised by corporate audit in its internal control reports and any disclosures from corporate audit with respect to deficiencies in internal controls or any fraud.
- 8.2.2 The Committee shall also review the report on the effectiveness of internal controls and risk management required to be included in the Annual Report and Accounts and any similar statement required to be included by the Company or its management in any document pursuant to applicable listing rules, legislation and best practice.
- 8.2.3 The Head of Global Assurance and the Group General Counsel and Company Secretary shall ensure the

Committee receives risk and compliance reports respectively twice per year.

- 8.2.4 The Committee shall receive reports on a regular basis from management providing information on risk management.
- 8.2.5 The Committee shall advise the Board on proposed strategic transactions as appropriate, ensuring that a due diligence appraisal of the proposition is undertaken, focusing in particular on financial risks.
- 8.2.6 The Committee shall receive a regular report from a member of the Safety, Environment and Health Committee, or a nominated representative, on the safety, environmental and health risks and material non-compliances considered by that committee.
- 8.2.7 The Committee shall consider matters of business conduct and receive reports relating to the Company's Standards of Ethical Business Conduct twice a year.
- 8.2.8 The Group General Counsel and Company Secretary shall ensure that once a year the Committee receives a report on the procedures currently in place for the prevention and detection of bribery. Details of any material non-compliance and any cases of bribery in the relevant period will be advised, with any significant issues being brought to the Committee's attention as soon as practicable. The Committee shall advise the Board on the adequacy of these procedures and any recommendations for improvements.
- 8.2.9 The Committee shall consider the Company's annual certificate of assurance and receive a report on the process from corporate audit, as appropriate.
- 8.2.10 The Committee shall review the activities of the BSCO appointed under the gas transporters licences held by National Grid Gas plc ("Licences"). This shall be by way of interim and full year reviews of the items on which National Grid Gas plc is required to report annually, pursuant to paragraphs 7 and 8 of Special Condition 10C of the NTS Licence.
- 8.2.11 The Committee shall review and recommend appropriate action in respect of any issue of National Grid Gas Board Director Non-compliance at a management board in accordance with paragraph 4.2 of these terms of reference.

### **8.3 Internal (Corporate) Audit**

- 8.3.1 The Committee shall consider applications for the post and approve the appointment of the head of internal audit (Director of Corporate Audit). The Director of Corporate Audit shall not be removed without the approval of the

Committee. The Director of Corporate Audit shall be accountable to the Committee.

- 8.3.2 The Committee shall consider and approve the terms of reference (charter) of the corporate audit function and ensure it is appropriate to the current needs of the Company. The Committee shall ensure that the corporate audit function has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with relevant professional standards.
- 8.3.3 The Committee shall review the management of corporate audit matters to ensure the scope allowed to the corporate auditors is appropriate and shall monitor and review the effectiveness of its work in the overall context of the Company's risk management system.
- 8.3.4 The Committee shall review, assess and approve the Company's annual corporate audit plan and ensure that it is aligned to the key risks of the Company.
- 8.3.5 The Committee shall review summary reports on the Company from the corporate auditors and the Head of Global Assurance dealing with key control issues, material changes to the risk profile, any significant control findings and management's responsiveness to such matters as well as other matters of specific interest to the Committee.
- 8.3.6 The Committee should ensure the Director of Corporate Audit has access to the Chairman of the Board, the Chairman of the Committee and to the other members of the Committee.
- 8.3.7 The Committee shall meet with the Director of Corporate Audit at least once each year without management being present to discuss the remit of the corporate audit function and issues arising from its activities.
- 8.3.8 The Committee shall receive a regular update from the Group Head of Audit on the process for identifying, quantifying, mitigating, measuring and responding to cyber-security risks.
- 8.3.9 The Committee shall consider, on an annual basis, whether an independent, third party review of the corporate audit function's effectiveness and processes is appropriate.

#### **8.4 External Audit**

- 8.4.1 The Committee shall consider and make recommendations to the Board, to be put to shareholders for approval at the AGM, in relation to the appointment, re-appointment, oversight and removal of the Company's external auditors. The Committee shall oversee the selection process for a new external auditor and if an auditor resigns the Committee shall investigate the issues leading to this and decide whether any action is required.

- 8.4.2 The Committee shall keep under review the relationship with the external auditors including (but not limited to):
- 8.4.2.1 the remuneration of the external auditors, the proportion of fees for non-audit services in relation to the overall fee income, and whether the level of fees is appropriate to enable an adequate audit to be conducted in line with relevant ethical and professional guidance;
  - 8.4.2.2 the terms of engagement, including any engagement letter issued at the start of each audit, and the scope of the audit.
  - 8.4.2.3 reviewing the independence and objectivity of the external auditors, including a consideration of the annual disclosure from the external auditors and the threats to their independence and the safeguards applied to mitigate those threats, taking into account relevant UK and US professional and regulatory requirements and the relationship with the auditors as a whole, including the provision of any non-audit services, the scope of any disclosed relationships or services, the appropriateness of partner rotation practices and the Company's policies regarding the employment of employees or former employees of its external auditors and shall monitor the application of these policies;
  - 8.4.2.4 undertaking (and reporting to the Board on) an annual assessment of the qualifications, expertise and resources of the external auditors; the effectiveness and adequacy of the audit process (including a report from the external auditors on their own internal quality procedures and transparency reports); evaluating the risks to the quality and effectiveness of the financial reporting process and consideration of the need to include the risk of withdrawal from the market by the external auditors;
  - 8.4.2.5 ensuring appropriate interaction with the activities of the corporate audit function; and
  - 8.4.2.6 discussions with the external auditors concerning such issues as compliance with accounting standards and any proposals which the external auditors have made in relation to the Company's corporate audit function.
- 8.4.3 The Committee shall review the external audit plan and ensure that it is consistent with the scope of the audit engagement.
- 8.4.4 The Committee shall meet with the external auditors at least once each year, normally post audit at the reporting stage, and on such other occasions as are required. Management shall not be present at these meetings.
- 8.4.5 The Committee shall review the findings of the audit with the external auditors including, but not limited to, discussing any major issues and

management's response to such issues; accounting and audit judgments; and levels of errors identified.

- 8.4.6 The Committee shall, at least annually, conduct a review of the service provided by the external auditors, report such assessment to the Board, and, subject to the outcome of this review, may consider re-tendering external audit services. However, the audit contract shall be put out to tender at least once every ten years, or sooner if required. In respect of such tender the Committee should oversee the selection process and ensure that all tendering firms have such access as is necessary to information and individuals for the duration of the tendering process.
- 8.4.7 The Committee shall review any representation letters requested by the external auditors before they are signed by management. The Committee shall review the management letter and management's response to the auditor's findings and recommendations.
- 8.4.8 The Committee shall set a policy in relation to the provision of non-audit services, taking into account relevant UK and US regulations, rules and ethical guide lines, ensuring that the provision of such services does not impair the external auditors' independence or objectivity and report to the Board on this policy. This policy shall; specify the types of non-audit service for which the use of the external auditor is pre-approved, such approval being limited to matters that are clearly trivial; and set out how the Committee assesses whether non-audit services have a direct or material effect on the audited financial statements, how it will assess and explain the estimation of the effect on the financial statements and how it will consider the external auditors' independence.

## **8.5. Financial Statements**

- 8.5.1 The Committee shall monitor the integrity of the Company's financial statements included in its results announcements, Annual Report and Accounts and any other formal documents relating to its financial performance, reviewing significant financial reporting issues and judgements which they contain.
- 8.5.2 The Committee shall review and challenge where necessary the clarity and completeness of disclosure in the Company's financial reports and the context in which statements are made including: the assumptions or qualifications in support of the going concern statement and the viability statement as to the Company's ability to continue in operation and meet its liabilities taking account of its current position and principal risks; the consistency of, and any changes to, significant accounting policies both on a year-to-year basis and across the Company; all material information presented with the financial statements, such as the strategic report and the corporate governance statements relating to audit and to risk management; the methods used to account for significant or unusual transactions where different approaches are possible; applicable accounting standards followed or reconciled in the financial statements; significant adjustments resulting from the external audit; and any other significant financial reporting judgements made by management.

## **8.6. Reporting Responsibilities**

- 8.6.1 The Committee shall make whatever recommendations to the Board it deems appropriate in order that a report to shareholders on internal controls and such other matters as may be required by law, regulation and the requirements of good governance can be included in the Company's Annual Report and Accounts and 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.
- 8.6.2 The Committee shall review results announcements and make recommendations to the Board prior to release as appropriate on significant financial reporting issues and judgement which they contain having regard to matters communicated to it by the auditor. The Committee shall also review generally with management the types of information to be disclosed and, where applicable, the type of presentation to be made, to analysts and rating agencies.
- 8.6.3 The Committee shall review the Annual Report and Accounts and any other report filed with the US Securities and Exchange Commission ("SEC") containing financial statements, and make recommendations to the Board with respect to the disclosures contained therein. The Committee shall review the financial statements with management and its external auditors, consistent with its duties.
- 8.6.4 The Committee shall ensure a report to shareholders on its activities, containing such matters as may be required by law, regulation and best practice, is included in the Annual Report and Accounts. The report will include how the Committee assessed the effectiveness of the external audit process, the significant issues the Committee considered in relation to the financial statements and how these were addressed.
- 8.6.5 Where requested by the Board, the Committee shall provide advice on whether the 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 performance, business model and strategy.
- 8.6.6 The Committee shall report to the Board on how it has discharged its responsibilities, as set out in these terms of reference, including but not limited to; the significant issues it considered in relation to the financial statements, in particular those matters that have informed the Board's assessment of whether the Company is a going concern and its consideration of the viability statement, and how these were addressed, its assessment of the effectiveness of the external audit process and its recommendation on the appointment or reappointment of the external auditor, and any other issues on which the Board has requested the Committee's opinion.

## **8.7. Other Matters**

- 8.7.1 The Committee shall assist the Board in overseeing compliance with all legal and regulatory requirements and shall give due consideration to the requirements of the UK Listing Authority's Listing, Prospectus and Disclosure and Transparency Rules, regulations made by the SEC and,



to the extent deemed appropriate, the rules of the London and New York Stock Exchanges and any other exchange on which the Company's equity securities are listed.

8.7.2 The Committee shall review any reports of, and discuss any issues raised by, the Disclosure Committee in connection with the Company's disclosures in its reports filed with the SEC and other regulatory authorities.

8.7.3 The Committee shall oversee any investigation of activities which are within its terms of reference and be responsible for resolving any disputes that may arise between the external auditors, corporate auditors and the Company.

8.7.4 The Committee should, on a regular basis but no less than annually, review its own performance, constitution and terms of reference to ensure it is operating at maximum effectiveness. The Board should also review the Audit Committee's effectiveness annually.

8.7.5 The Committee shall receive reports, as and when appropriate, from the business (either via a report from the Executive Committee, a Corporate Audit finding or the Compliance Management Report) on significant areas of concern in relation to any external reporting obligations.

## **9. Complaints and Whistle-blowing Procedures**

9.1 The Committee shall ensure that appropriate procedures are established, and shall evaluate the effectiveness of such procedures, for the receipt, retention, and treatment of complaints received by the Company relating to accounting, internal accounting controls, or auditing matters of the Company.

9.2 The Committee shall also establish procedures to ensure that submissions by Company employees and contractors arising from the Company's whistleblowing policy be treated confidentially and anonymously and are reported as appropriate to the Committee. The Committee shall ensure that these arrangements allow proportionate and independent investigation of such matters and appropriate follow up action.

## **10. Committee's Interface with Other Committees**

The Committee shall interface with:

10.1 The Finance Committee in respect of risk management issues within the Finance Committee's terms of reference and any other matters identified by the Committee for further review;

10.2 The Safety, Environment and Health Committee which shall advise the Committee on risks and significant non compliances in relation to safety, environmental and health which it has considered;

10.3 The Executive Committee with respect to business conduct matters and risk and compliance reports and matters relating to results of the Company;

- 10.4 The Disclosure Committee which shall report matters arising in connection with the Company's public disclosures and the implementation and evaluation of internal controls in respect thereto; and
- 10.5 The Global Ethics and Compliance Committee as a result of the Committee's responsibility to ensure that a whistleblowing policy is in place and its twice yearly reviews of business conduct matters.

## **11. Authority**

- 11.1 Subject to any restrictions imposed by law, the Committee is authorised by the Board to seek any information it requires from any employee of the Company in order to perform its duties and all employees are directed to cooperate with any request made by the Committee.
- 11.2 The Committee is authorised by the Board to call any member of staff to be present at a meeting of the Committee as and when required.
- 11.3 The Committee is authorised by the Board to access sufficient resources and professional advice, as is reasonable at the Company's expense, in order to carry out its duties, including access to the Company Secretariat for assistance as required.
- 11.4 Members shall be provided with training as appropriate, both in the form of an induction programme for new members and on an ongoing basis for all members.
- 11.5 The Committee shall have the right to publish in the Company's Annual Report and Accounts details of any issues that cannot be resolved between the Committee and the Board.
- 11.6 Save as expressly provided herein, the Committee shall not be entitled to sub-delegate all or any of the powers and authorities delegated to it.