

Centrica plc

**Policy on the Independence of External
Auditors**

November 2019

Contents

1 Introduction

- 1.1 Appointment of external auditors
- 1.2 Audit scope and fees
- 1.3 Rotation of audit partners and staff
- 1.4 Auditor relationships
- 1.5 Employing former employees of the external audit firm
- 1.6 Meetings between auditors and the Audit Committee

2 Independence and the provision of non-audit services

- 2.1 Audit services
- 2.2 Non-audit Services
- 2.3 Approval of the provision of non-audit services
- 2.4 Prohibited non-audit services
- 2.5 EU regulation changes
- 2.6 Auditor confirmation of independence
- 2.7 Reporting to shareholders

POLICY ON THE INDEPENDENCE OF EXTERNAL AUDITORS

1 INTRODUCTION

The Board of Centrica plc (the “Company”) is committed to ensuring that the financial statements of the Group, the Company and relevant subsidiaries have an effective and independent annual audit by its external auditors. The Board has delegated to the Audit Committee (“the Committee”) responsibility for reviewing the effectiveness of the external audit and the independence of the auditors. All companies in the Centrica plc group of companies (the “Group”) are required to conform to this policy.

This policy has been drafted in accordance with UK regulations and will be reviewed on an annual basis by the Committee.

Appointment of external auditors

The Board will make its recommendation to shareholders at the Annual General Meeting on the appointment or re-appointment of the external auditor. In reaching its recommendation, the Board will pay particular attention to the recommendation provided by the Committee.

The Committee will reach its own judgement on the appointment or re-appointment of the external auditors after conducting an assessment that takes into account all the significant, relevant factors. This should include but not be limited to relevant ethical guidance, current corporate governance best practice and the quality of service provided by the existing auditor.

In reaching its judgement on the quality of service, the Committee should understand the views of the major users of the service within the Group. However, it should reach its own, independent judgement, after considering the impact on management’s view of any matters of dispute and after discussions with the external auditor.

In reaching its judgement, the Committee should take a balanced view on the issue of pricing. Whilst the Group should always strive to obtain value for money and a competitive price in its relationships with suppliers, the Committee must also ensure that the level of fee payable in respect of the audit services is appropriate and that an effective audit can be conducted for such a fee.

With effect from the financial year ending 31 December 2017, the Group is required to adopt the provisions of the latest UK Corporate Governance rules (the EU regulation is now hard-wired into UK law). This requires that a tender process for the external group should be performed at least every 10 years) and the maximum tenure an auditor should remain in place is 20 years. The Committee will, as part of its judgement on the annual re-appointment of the external auditor, determine whether it is appropriate for the service to be put out to competitive tender.

In the event of a tender for the external audit services:

- management will propose a process that the Committee will approve;
- the tender process will be run by a steering group;
- an initial recommendation by the steering Group on appointment will be made to the Committee together with such other persons as they may agree.

1.2 Audit scope and fees

The scope of the annual audit of the financial statements will be presented to, discussed with and agreed by the Committee. The Committee will approve the proposed fees for the audit.

1.3 Rotation of audit partners and staff

For the audit of the Group's financial statements, there are two senior audit partners; the "signing" partner, who takes the lead or co-ordinating role and has primary responsibility for the audit and the issuance of the audit opinion on the Group's financial statements; and an independent review partner appointed in accordance with UK Auditing Standards, who has responsibility for reviewing key subjective decisions made during the audit process. Additionally, there may be other partners who are "key" members of the audit team as a result of their responsibilities. The signing and independent review partners should serve no more than five years continuously in either role. Other than in exceptional circumstances, and with the advance agreement of the Committee, other key partners should serve no more than seven consecutive years. No member of the audit staff should serve more than ten consecutive years in a position of managerial or partner responsibility.

The length of audit service of the partners engaged on the audit and their status of rotation should be presented to the Committee annually.

The signing partner and the independent review partner may have no active role in the audit for a period of five years from the date of their rotation following the completion of their five-year term. Any other partner rotated off audit responsibilities may not resume any partner role for a period of two years.

1.4 Auditor relationships

Relationships with auditors should be professional and respect the need for objectivity on the part of the auditor in the conduct of their audit responsibilities. Whilst it is recognised that a cordial relationship should foster open communication, which should assist the effectiveness of the audit, it is important that relationships remain business like. Reasonable levels of corporate hospitality, common in other professional relationships, are permissible.

The auditor's staff should have no financial, employment or business relationship with Centrica plc, other than in the normal course of business. Investment in the shares of Centrica plc, or any subsidiary or affiliated company, is prohibited.

1.5 Employing former employees of the external audit firm

We will agree on an ongoing basis with our external auditors which members of the audit team are categorised as the "key audit partners" and "other key team members". Key audit partners will not be offered employment by the Company or any of its subsidiary undertakings within two years of undertaking any role on the audit. Other key team members will not be offered employment by any Group company within 6 months of undertaking any role on the audit. Other audit team members who accept employment by any Group company must cease activity on the audit immediately they tender their resignation to the audit firm.

Any offer of employment to a former employee of the audit firm, within two years of the employee leaving the audit firm, must be pre-approved by the Committee where the offer is made in respect of a senior executive position. The Committee gives its Chair delegated authority to deal with such appointments at her/his discretion, between meetings. Any such interim approval should be ratified at the next meeting of the Committee.

1.6 Meetings between auditors and the Audit Committee

The auditors should raise directly with the Chair or members of the Committee any matters of concern that they have in relation to their audit responsibilities where they believe that the concerns have not been adequately addressed through the regular processes established with management. Separate meetings of the auditors and Committee members, without executive management present, will be held not less than twice a year. The auditors may also request at any time such a separate meeting with the Committee.

2 INDEPENDENCE AND THE PROVISION OF NON-AUDIT SERVICES

The services provided by the company's auditors are categorised as follows:

2.1 Audit Services

Audit services comprise the provision of statutory audit services including the audit of statutory accounts, the half year review and other services pursuant to legislation.

2.2 Non-Audit Services

Non-audit services comprise;

- *Tax services* – including tax compliance, tax consulting and tax planning (although note that it is now specifically prohibited for our auditors to provide any Tax services to us);
- *Information technology services* – including IT and other control reviews;
- *Corporate finance related services* – including due diligence and transaction support;
- *All other audit related services* – including consultation concerning financial accounting and reporting standards; comfort letters, attest services, consents and assistance with and review of documents filed with regulatory bodies, internal control reviews, forensic work, debt advisory and pension advisory work.

Non-Audit Services

The Committee has pre-approved the categories of non-audit services that may be performed by the Group's auditors. The Group Chief Accountant or Group Head of Corporate Finance must be advised by the audit firm, of all assignments undertaken by the auditors that fall within the pre-approved categories as soon as practicable. Generally, the incumbent auditor will only be engaged where there is clear evidence that another firm could not be used without adversely impacting the business. Approval must be sought from the Chief Financial Officer to engage the Group's incumbent auditor in new non-audit work.

Sections 2.3 and 2.4 below give guidance on the types of non-audit services permitted (and not permitted) for the year-ended 31 December 2017 onwards. Section 2.5 provides a summary of services specifically prohibited by the new EU regulation (which, for the avoidance of doubt, should already be covered in sections 2.3 and 2.4). Note that there is now also a 70% cap on the ratio of annual non-audit fees to (the 3 year average of) audit fees (although note this is only calculable from the 2019 year-end onwards).

2.3 Approval of the provision of non-audit services

The auditors are eligible for selection to provide non-audit services to the extent that their skills and experience make them a competitive and most appropriate supplier of these services.

The Group or Committee should not agree to the audit firm providing a service which may compromise their independence or violate any laws or regulations affecting their appointment as auditors. In considering whether to give approval the Committee should not agree to the audit firm providing a service if the result is that:

- the external auditor audits its own firm's work;

- the external auditor makes management decisions for the company;
- a mutuality of interest is created; or
- the external auditor is put in the role of advocate for the Company.

Non-audit work (including half year fee) may be undertaken by the auditors up to a cumulative annual value of £1,000,000. All new individual projects must be pre-approved by the Audit Committee or Audit Committee Chair. In exceptional circumstances incremental assurance work in excess of the annual limit of £1,000,000 could be approved by the Committee, if there was a clear business need and no viable alternative existed.

Audit related assurance services – which usually result in a certification or specific opinion on an investigation, and may include:

- Review of half yearly consolidated financial statements;
- Services relating to shareholder circulars issued in accordance with the Listing Rules of the Financial Services Authority including issuance of related comfort letters;
- Capital market debt regulatory filings including services relating to debt offering circulars including the issuance of comfort letters;
- Audit of financial statements of pension and other employee benefit plans;
- Review of internal controls and financial data related to specific operations and/or business processes including general computer controls, treasury management, tax, sustainability reviews and forensic audits/investigations;
- Issuance of comfort letters in respect of information provided to third parties including Ofgem segmental statements, British Gas light bulb, regulatory filings, and joint venture agreements;
- Discussion and review of the impact of new accounting pronouncements and accounting for acquisitions and other one-off transactions.

Non-audit related services – all tax services are now prohibited; allowed non-audit work typically includes advisory services related to corporate finance or other operational/strategic matters, such as:

Corporate finance services

- Financial and tax acquisition due diligence, completion accounts, carve out financial statements, post-deal integration planning and performance improvement and cost reduction programmes within acquired businesses.

All other services

- Advice on design and implementation of policies, controls and security arrangements, (except where this relates to the preparation and/or control of financial information or designing and implementing financial IT systems – which is prohibited);
- Advice and assistance on treasury matters and debt;
- Provision of general employee advice;
- Advice and assistance on pension matters;
- Training support;

- Legal entity rationalisation, liquidation / administration services
- Secondment of staff with the approval of the Chief Financial Officer;
- Provision of company secretarial and administration support services relating to the drafting of documents, but excluding the maintenance of registers and minutes;
- Advice and assistance on operational strategy;
- Internal/external benchmarking, offshore and outsourcing evaluations, process/best practice reviews relating to business and financial processes and administration;
- Assistance with the preparation of non-financial information, or financial information which does not form part of the statutory records, and the subsequent analysis of that information.
- iXBRL tagging (this is not considered to be a “tax service”)

No services provided by the audit firm should be the subject of a contingent fee. Other types of non-audit work may be undertaken with prior agreement on a case-by-case basis by the Committee.

In respect of each year the Committee will be presented half yearly with a list of the non-audit services provided by the auditors in that calendar year and the fees involved, for their information.

Where the provision of audit related assurance services or non-audit related services by the external auditor requires pre-approval, in respect of urgent matters, the Committee will delegate its authority to the Chair of the Committee between meetings. Such pre-approval should be ratified at the next meeting of the Committee.

2.4 Prohibited non-audit services

The following are the categories of work that may not be undertaken by the Group’s auditors in accordance with its auditor independence policy.

- All tax services
- Bookkeeping or other services related to the accounting records or financial statements of the Company and its subsidiary undertakings;
- Financial information systems design and implementation;
- Appraisal or valuation services including fairness opinions or contribution-in-kind reports, where the output is likely to be used for financial reporting purposes;
- Payroll administration services
- Actuarial services where the service will lead to a valuation likely to be included in the Group’s financial reporting;
- Internal audit services;
- Management or human resources functions which involve acting as a director, employee or officer of the Group or performing any decision-making, supervisory or ongoing monitoring function;
- Broker, dealer, investment advisor, or investment banking services;

- Legal services, under circumstances in which the person providing the service must be admitted or otherwise qualified to practice before the courts of a jurisdiction;
- Expert services for the purpose of advocating the Group's interests in litigation of regulatory or administrative investigation or proceedings;
- Recruitment of senior management or executives;
- Any other service that, locally, is prohibited through regulation.
- All services listed in section 2.5

2.5 EU regulation changes

The new EU regulation on non-audit services now applies from the 2017 year-end onwards. The regulation provides the following list of specific prohibited non audit services:

 PROHIBITED NAS Article 5(1)		
<p>A. Tax services.</p> <ul style="list-style-type: none"> i. Preparation of tax forms. ii. Payroll tax. iii. Customs duties. iv. Identification of public subsidies and tax incentives unless support from the statutory auditor or audit firm in respect of such services is required by law. v. Support regarding tax inspections by tax authorities unless support from the statutory auditor or audit firm in respect of such inspections is required by law. vi. Calculation of direct and indirect tax and deferred tax. vii. Provision of tax advice. <p>B. Services that involve playing a part in the management or decision making of the audited entity.</p>	<p>C. Bookkeeping and preparing accounting records and financial statements.</p> <p>D. Payroll services.</p> <p>E. Designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial IT systems.</p> <p>F. Valuation services, including valuations performed in connection with actuarial services or litigation support services.</p> <p>G. Legal services, with respect to:</p> <ul style="list-style-type: none"> i. the provision of general counsel; ii. negotiating on behalf of the audit entity; and iii. acting in an advocacy role in the resolution of litigation. <p>H. Services related to the audit entity's internal audit function.</p> <p>I. Services linked to the financing, capital structure and allocation, and investment strategy of the</p>	<p>audited entity, except providing assurance services in relation to the financial statements, such as the issuing of comfort letters in connection with prospectuses issued by the audited entity.</p> <p>J. Promoting, dealing in or underwriting shares in the audited entity.</p> <p>K. Human resources services with respect to:</p> <ul style="list-style-type: none"> i. management in a position to exert significant influence over the preparation of the accounting records or financial statements that are the subject of the statutory audit, where such services involve: <ul style="list-style-type: none"> a. searching for or seeking out candidates for such positions; or b. undertaking reference checks of candidates for such positions; ii. structuring the organisation design; and iii. cost control.

When compared to our previous policy, the main change is the removal of Tax Services as a permitted non-audit service.

The new EU regulation also provides a 70% cap on level of non-audit fees earned by the statutory auditor based on the average of the fees paid in the last three consecutive financial years for the statutory audit of the audited entity (including parent, subsidiary and consolidated audits). This calculation is only relevant from the 2019 year-end onwards (i.e. when a 3 year average can be calculated prospectively from 2017).

The current policy of an absolute limit of £1,000,000 is expected to be significantly below this cap level but the Group will need to check this annually.

2.6 Auditor confirmation of independence

The auditors are required each year to confirm in writing to the Committee that they have complied with the independence rules of their profession and regulations governing independence, and that they have complied with the requirements of this policy. The external auditor is required to maintain

appropriate records to provide reasonable assurance that its independence from Centrica plc is not impaired.

2.7 Report to shareholders

The Committee should produce an annual report to shareholders describing the role and responsibilities of the Committee and the actions taken by the Committee to discharge those responsibilities. Such a report should include that the Committee has reviewed the scope of the annual audit and the objectivity and independence of the auditors and is satisfied that the integrity of the audit has not been compromised and should explain to shareholders how the Committee's policy on the engagement of the external auditors to supply non-audit services provides adequate protection of auditor objectivity and independence.

The annual financial statements should disclose the amounts paid to the auditors both for audit and non-audit services, with a description of the services provided and, where thought appropriate, the reason for the services to have been provided by the auditors rather than another supplier.