

Centrica plc

**Policy on the Independence of External
Auditors**

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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 and Risk 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, the process will be led by the Committee:

- management will propose a process that the Committee will approve;
- the tender process will be facilitated by a steering group;
- the steering group together with such other persons as they may agree will provide detailed feedback to the Committee for decision making purposes.

The tender process will refer to and follow the FRC's Minimum Standard for Audit Committees on External Audit.

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. The key partners for material subsidiaries or components should serve no more than five years. All other members of audit staff should serve no more than seven consecutive years.

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 (with a limit of £150 per head per event), common in other professional relationships, are permissible. Costs should generally be shared

between company and auditor during the course of the year. Gifts cannot be given or received (unless wholly inconsequential).

The auditor's staff should have no financial, employment or business relationship with the Company, other than in the normal course of business. Investment in the shares of the Company, 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 after 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 their 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 and Risk 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. (This process is deemed appropriate to facilitate any "whistleblowing" type concerns.)

2 INDEPENDENCE AND THE PROVISION OF NON-AUDIT SERVICES

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

2.1 Audit and audit related assurance services

Audit and audit related assurance services comprise the provision of statutory audit services to the Group and its subsidiaries, as well as directly related services such as the Group's half year review and other attestation services pursuant to legislation and regulation. These services are typically required on an annual basis and thus do not require subsequent annual re-approval by the Committee following their initial approval.

2.2 Non-Audit Services

Non-audit services comprise any engagement in which a firm, or member of its network, provides professional services to an audited entity (or its affiliates) other than the audit of its financial statements. Examples of activities that would be considered non-audit services include:

- *Tax services* – including tax compliance, tax consulting and tax planning;
- *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, reporting accountant work, 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.

Under the FRC's revised ethical standard, all non-audit services are now prohibited from being provided by an entity's auditor unless they are specifically allowed under the standard's "whitelist".

Non-Audit Services

The Committee has pre-approved the categories of non-audit services that may be performed by the Group's auditors (essentially the "whitelist"), however the expectation is that it will only be rare instances where the auditor is engaged for non-audit services (with the exception of the Interims review or CSS audit). The Group Financial Controller 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 Committee Chair to engage the Group's incumbent auditor in any new non-audit work.

Sections 2.3 and 2.4 below give guidance on the types of non-audit services permitted by the whitelist. Section 2.5 provides examples of services not on the whitelist and consequently prohibited. Note that there is also a 70% cap on the ratio of annual non-audit fees to (the 3 year average of) audit fees (although note this only considers certain non-audit engagements in the calculation).

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 all audit related services that are not statutory or annual report audit work) may be undertaken by the auditors up to a cumulative annual value of £2,000,000. All new individual projects must be pre-approved by the Committee or Committee Chair. Recurring non-audit engagements do not require subsequent reapproval following their initial approval. In exceptional circumstances incremental allowable non-audit work in excess of the annual limit of £2,000,000 could be approved by the Committee, if there was a clear business need and no viable alternative existed (e.g. the Class 1 circular work associated with the Direct Energy disposal). This limit will be reviewed annually by the Committee in the context of inflation and any regulatory changes.

Extract from Ethical Standard:

Audit related services are:

- Reporting required by law or regulation to be provided by an auditor;
- Reviews of interim financial information;
- Reporting on regulatory returns;
- Reporting to a regulator on client assets;
- Reporting on government grants;
- Reporting on internal financial controls when required by law or regulation;
- Extended audit work that is authorised by those charged with governance performed on financial information⁴⁷ and/or financial controls where this work is integrated with the audit work and is performed on the same principal terms and conditions.

All other services are considered non-audit related services.

Non-audit related services

These services include:

- Reports, that are not ‘audit related services’, required by the competent authorities / regulators supervising the *audited entity*, where the authority / regulator has either specified the auditor to provide the service or identified to the entity that the auditor would be an appropriate choice for service provider.
- Audit and other services provided as auditor of the entity, or as *reporting accountant*, in relation to information of the *audited entity* for which it is probable that an objective, reasonable and informed third party would conclude that the understanding of the entity obtained by the auditor for the audit of the financial statements is relevant to the service, and where the nature of the service would not compromise independence. These might include, for example:
 - audit and other services relating to public reporting as *reporting accountant* on financial or other information of the *audited entity* in an investment circular or prospectus;
 - services, including private reporting, that are customarily performed by the *reporting accountant* to support statements and disclosures made by the directors, in a prospectus or investment circular or, to support confirmations provided by the sponsor or nominated advisor;
 - audit and other assurance services relating to public reporting on other information issued by the entity, such as reports on information in the front of annual reports not covered by the auditor’s report on the financial statements.

Specifically Permitted Non-audit Services (“Whitelist”)

Services required by law or regulation and exempt from the non-audit services cap:

- Reporting required by a competent authority or regulator under law or regulation for example
- Reporting to a regulator on client assets;
 - in relation to entities regulated under the Financial Services and Markets Act 2000 (FSMA), reports under s166 and s340 of FSMA;
 - Reporting to a regulator on regulatory financial statements;
 - Reporting on a Solvency and Financial Condition Report under Solvency II
- In the case of a controlled undertaking incorporated and based in a third country, reporting required by law or regulation in that jurisdiction where the auditor is permitted to undertake that engagement;
- Reporting on internal financial controls when required by law or regulation;
- Reporting on the iXBRL tagging of financial statements in accordance with the European Single Electronic Format for annual financial reports;
- Reports, required by or supplied to competent authorities / regulators supervising the audited entity, where the authority / regulator has either specified the auditor to provide the service or identified to the entity that the auditor would be an appropriate choice for service provider;

- Services which support the entity in fulfilling an obligation required by UK law or regulation, including listing requirements where: the provision of such services is time critical; the subject matter of the engagement is price sensitive; and an objective, reasonable and informed third party would conclude that the understanding of the entity obtained by the auditor for the audit of the financial statements is relevant to the service, and where the nature of the service would not compromise independence;

Services subject to the non-audit services cap:

- Reviews of interim financial information; and providing verification of interim profits not otherwise required by law or regulation;
- Where not otherwise required by law or regulation, non-audit and additional services provided as auditor of the entity, or as reporting accountant, in relation to information of the audited entity for which it is probable that an objective, reasonable and informed third party would conclude that the understanding of the entity obtained by the auditor is relevant to the service, and where the nature of the service would not compromise independence;
- Extended audit or assurance work that is authorised by those charged with governance performed on financial or performance information and/or financial or operational controls, in an entity relevant to an engagement or a third-party service provider, where this work is closely linked with the audit work;
- Additional assurance work or agreed upon procedures, authorised by those charged with governance performed on material included within or referenced from the annual report of an entity relevant to an engagement;
- Reporting on government grants;
- Reporting on covenant or loan agreements, which require independent verification, and other reporting to third parties with whom the entity relevant to an engagement has a business relationship;
- Services which have been the subject of an application to the Competent Authority in accordance with Regulation 79 of The Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 (SI 2019/177);
- Generic subscriptions providing factual updates of changes to applicable law, regulation or accounting and auditing standards.

No services provided by the audit firm should be the subject of a contingent fee.

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 Examples of 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 and the FRC's ethical standard. The list is not exhaustive.

- 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 UK regulation and Revised Ethical Standard

The UK regulations (which mirror the previous pre-Brexit EU regulations) on non-audit services provides the following list of specific prohibited non audit services, which is consistent with the FRC's ethical standard:

 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.

The UK regulations 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 £2,000,000 is expected to be significantly below this cap level but the Group will need to check this annually.

During 2020, a Revised Ethical Standard from the FRC came in force and it included a section on permitted non-audit services (the "whitelist"). Our auditors must adhere to this guidance. The Standard can be found on the internet as follows:

<https://www.frc.org.uk/getattachment/601c8b09-2c0a-4a6c-8080-30f63e50b4a2/Revised-Ethical-Standard-2019-With-Covers.pdf>

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 the Company 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 Committee undertakes an annual formal evaluation of audit quality and effectiveness, including surveying management and committee members for their observations. The output of this review is included in the annual report to shareholders.

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.