

CAP-XX LIMITED

Audit Committee Terms of Reference

1. Membership

- 1.1. Members of the Committee shall be appointed by the Board. The Committee shall be made up of at least 2 members.
- 1.2. All members of the Committee shall be non-executive directors at least one of whom shall have recent and relevant financial experience.
- 1.3. Only members of the Committee have the right to attend Committee meetings. However, other individuals such as the Chief Executive may be invited to attend all or part of any meeting as and when appropriate.
- 1.4. The external auditors will be invited to attend meetings of the Committee on a regular basis.
- 1.5. Appointments to the Committee shall be for a period of up to three years, which may be extended for two further three year periods.
- 1.6. The Board shall appoint the Committee Chairman.

2. Secretary

The Company Secretary or his nominee shall act as the Secretary of the Committee.

3. Quorum

The quorum necessary for the transaction of business shall be 2 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

The Committee shall meet at least twice a year at appropriate times in the reporting and audit cycle and otherwise as required.

5. Notice of Meetings

- 5.1. Meetings of the Committee shall be summoned by the Secretary of the Committee at the request of any of its members or at the request of external or internal 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 forwarded to each member of the Committee, any other person required to attend and all other non-executive directors, no later than 5 working days before the date of the meeting. Supporting papers shall be sent to Committee members and to other attendees as appropriate, at the same time.

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 shall 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, once agreed, to all members of the Board.

7. Annual General Meeting

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

8. Duties

The Committee should carry out the duties below for the Company, major subsidiary undertakings and the Group as a whole, as appropriate.

8.1. Financial Reporting

- 8.1.1. The Committee shall monitor the integrity of the financial statements of the Company, including its annual and interim reports, preliminary results' announcements and any other formal announcement relating to its financial performance, reviewing significant financial reporting issues and judgements which they contain. The Committee shall also review summary financial statements, significant financial returns to regulators and any financial information contained in certain other documents, such as announcements of a price sensitive nature.
- 8.1.2. The Committee shall review and challenge where necessary:
 - 8.1.2.1 the consistency of, and any changes to, accounting policies both on a year on year basis and across the Company/Group;
 - 8.1.2.2 the methods used to account for significant or unusual transactions where different approaches are possible;
 - 8.1.2.3 whether the Company has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditor;
 - 8.1.2.4 the clarity of disclosure in the Company's financial reports and the context in which statements are made; and
 - 8.1.2.5 all material information presented with the financial statements, such as the operating and financial review and the corporate governance statement (insofar as it relates to the audit and risk management);

- 8.1.3. The Committee shall review the annual financial statements of the pension funds where not reviewed by the Board as a whole.

8.2. Internal Controls and Risk Management Systems

The Committee shall:

- 8.2.1. keep under review the effectiveness of the Company's internal controls and risk management systems; and
- 8.2.2. review and approve the statements to be included in the Annual Report concerning internal controls and risk management.

8.3. Whistleblowing

The Committee shall review the Company's arrangements for its 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.

8.4. Internal Audit

The Committee shall (following the appointment of internal auditors when thought appropriate by the Committee):

- 8.4.1. monitor and review the effectiveness of the Company's internal audit function in the context of the Company's overall risk management system;
- 8.4.2. approve the appointment and removal of the head of the internal audit function;
- 8.4.3. consider and approve the remit of the internal audit function and ensure it has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards. The Committee shall also ensure the function has adequate standing and is free from management or other restrictions;
- 8.4.4. review and assess the annual internal audit plan;
- 8.4.5. review promptly all reports on the company from the internal auditors;
- 8.4.6. review and monitor management's responsiveness to the findings and recommendations of the internal auditor; and
- 8.4.7. meet the head of internal audit at least once a year, without management being present, to discuss their remit and any issues arising from the internal audits carried out. In addition, the head of internal audit shall be given the right of direct access to the Chairman of the Board and to the Committee.

8.5. External Audit

The Committee shall:

- 8.5.1. consider and make recommendations to the Board, to be put to shareholders for approval at the AGM, in relation to the appointment, re-appointment and removal of the company's external auditor. The Committee shall oversee the selection process for new auditors and if an auditor resigns the Committee shall investigate the issues leading to this and decide whether any action is required;
- 8.5.2. oversee the relationship with the external auditor including (but not limited to):
 - 8.5.2.1. approval of their remuneration, whether fees for audit or non audit services and that the level of fees is appropriate to enable an adequate audit to be conducted;
 - 8.5.2.2. approval of their terms of engagement, including any engagement letter issued at the start of each audit and the scope of the audit;
 - 8.5.2.3. assessing annually their independence and objectivity taking into account relevant UK professional and regulatory requirements and the relationship with the auditor as a whole, including the provision of any non audit services;
 - 8.5.2.4. 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);
 - 8.5.2.5. agreeing with the Board a policy on the employment of former employees of the company's auditor, then monitoring the implementation of this policy;
 - 8.5.2.6. monitoring the auditor's compliance with relevant ethical and professional guidance on the rotation of audit partners, the level of fees paid by the Company compared to the overall fee income of the firm, office and partner and other related requirements; and
 - 8.5.2.7. assessing annually their qualifications, expertise and resources and the effectiveness of the audit process which shall include a report from the external auditor on their own internal quality procedures;
- 8.5.3. 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 their remit and any issues arising from the audit;
- 8.5.4. review and approve the annual audit plan and ensure that it is consistent with the scope of the audit engagement;
- 8.5.5. review the findings of the audit with the external auditor. This shall include but not be limited to, the following;

8.5.5.1. a discussion of any major issues which arose during the audit,

8.5.5.2. any accounting and audit judgements, and

8.5.5.3. levels of errors identified during the audit.

The Committee shall also:

8.5.6. review the effectiveness of the audit;

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

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

8.5.9. develop and implement a policy on the supply of non audit services by the external auditor, taking into account any relevant ethical guidance on the matter.

8.6. Reporting Responsibilities

8.6.1. The Committee Chairman shall report formally to the Board on its proceedings after each meeting on all matters within its duties and responsibilities.

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

8.6.3. The Committee shall compile a report to shareholders on its activities to be included in the company's Annual Report.

8.7. Other Matters

The Committee shall:

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

8.7.2. 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;

8.7.3. give due consideration to laws and regulations, the provisions of the Combined Code and the requirements of the AIM Rules as appropriate;

8.7.4. be responsible for co-ordination of the internal and external auditors;

8.7.5. oversee any investigation of activities which are within its terms of reference and act as a court of the last resort; and

- 8.7.6. at least once a year, review its own performance, constitution and terms of reference to ensure it is operating at maximum effectiveness and recommend any changes it considers necessary to the Board for approval.

9. Authority

The Committee is authorised:

- 9.1. to seek any information it requires from any employee of the Company in order to perform its duties;
- 9.2. to obtain, at the Company's expense, outside legal or other professional advice on any matter within its terms of reference; and
- 9.3. to call any employee to be questioned at a meeting of the Committee as and when required.

Appendix to Terms of Reference of the Audit Committee

(not forming part of the Terms of Reference)

The Combined Code on Corporate Governance (“the Combined Code”) states that:

“The Board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company’s auditors”¹.

The Combined Code goes on to say that the main role and responsibilities of the Audit Committee should be “set out in written terms of reference.”² Such statements express a clear need for an Audit Committee, the requirement for which is also supported by other influential organisations such as the Commonwealth Association for Corporate Governance and the International Corporate Governance Network.

The Guidance on Audit Committees (The Smith Report) recognises that “Audit committee arrangements need to be proportionate to the task, and will vary according to the size, complexity and risk profile of the company”³.

As with most aspects of corporate governance, the above principles make it clear that, not only should companies go through a formal process of considering their internal audit and control procedures and evaluating their relationship with their external auditor, but they must be seen to be doing so in a fair and thorough manner. It is, therefore, essential that the Audit Committee is properly constituted with a clear remit and identified authority.

The Combined Code recommends the Committee be made up of a minimum of three independent non-executive directors (although two is permissible for smaller companies⁴). The Board should satisfy itself that at least one member of the Committee has recent and relevant financial experience.

Although not a provision in the Code, the Higgs Review states as good practice, in its Non-Code Recommendations, that the Company Secretary (or his/her designee) should act as Secretary to the Committee⁵. The Smith Report states that the Company Secretary should attend the Audit Committee. It is the Company Secretary’s responsibility to ensure that the Board and its Committees are properly constituted and advised. There also needs to be a clear co-ordination between the main Board and the various Committees where the Company Secretary would normally act as a valued intermediary.

The frequency with which the Committee needs to meet will vary from company to company and may change from time to time. The Combined Code provides that the Committee should meet at least three times a year.

¹ *The Combined Code on Corporate Governance July 2003, C.3.*

² *The Combined Code on Corporate Governance July 2003, C.3.2*

³ *Audit Committees - Combined Code Guidance January 2003* 1.4 Note that references are to the original version published in January 2003. A slightly modified version of the Smith Guidance, with a different numbering sequence, was appended to the Combined Code published in July 2003.

⁴ A smaller company is defined as one which is below the FTSE 350 throughout the year immediately before the reporting year.

⁵ *Review of the role and effectiveness of non-executive directors, January 2003* para 11.30

The list of duties proposed are those which all Audit Committees should consider. The Combined Code includes a provision for a report on the Audit Committee to be included in the company's Annual Report⁶. Such report will need to disclose the following:

- Role and main responsibilities of the Audit committee;
- Composition of committee, including relevant qualifications and experience; the appointment process; and any fees paid in respect of membership;
- Number of meetings and attendance levels;
- A description of the main activities of the year to:
 - Monitor the integrity of the financial statements;
 - Review the integrity of the internal financial control and risk management systems;
 - Review the independence of the external auditors, and the provision of non audit services;
 - Describe the oversight of the external audit process, and how its effectiveness was assessed;
 - Explain the recommendation to the Board on the appointment of auditors.

The Chairman of the Committee should attend the AGM prepared to respond to any questions that may be raised by shareholders on matters within the Committee's area of responsibility⁷. The Combined Code also requires that the terms of reference of the Audit Committee, explaining its role and the authority delegated to it by the Board, be made available on request and placed on the company's website.⁸

⁶ *The Combined Code on Corporate Governance – July 2003 C.3.3 and Audit Committees - Combined Code Guidance 6.1, 6.2*

⁷ *The Combined Code on Corporate Governance – July 2003 D.2.3 and Audit Committees - Combined Code Guidance 6.3*

⁸ *The Combined Code on Corporate Governance – July 2003 C.3.3*