

D1 - AUDITOR INDEPENDENCE POLICY

Introduction

The policy provides guidance and procedures for the governance of Kelda's relationship with its external auditor. It allows the Audit Committee to satisfy itself that there are no factors which may, or may be seen to, impair the independence and objectivity of the audit process.

The Audit Committee operates in accordance with the Audit Committee - Terms of Reference (section A5) and includes duties to:

- make recommendations to the Board on the appointment of the external auditor, the audit fee, and any questions of resignation or dismissal of the external auditor
- review from time to time the cost effectiveness of the audit and the independence and objectivity of the external auditor.

This policy augments the Terms of Reference and clarifies how the independence and objectivity of the external auditor will be maintained. Although Kelda Holdings Limited is not itself an EU Public Interest Entity ('EU PIE') for the purposes of the EU Audit Regulation and Directive ('ARD') a number of entities in the group which it heads are EU PIEs. The Kelda Holdings Limited audit committee has therefore chosen to require the whole group to operate in line with the EU ARD in relation to auditor independence, and its auditors will comply with the provisions of the Financial Reporting Council's Ethical Standard 2016 as they apply to the audits of EU Public Interest Entities.

In addition, the external auditor is required to comply with the provisions of the Financial Reporting Council's Ethical Standards for Auditors, as amended from time to time.

Accountability and Access

The external auditor reports directly to the Audit Committee. The lead audit partner and other key members of the audit team have unfettered access to the Chair of the Audit Committee and to the Chairman of the Board as required. The Committee's Terms of Reference allow for the Committee to meet with the external auditors without executive directors present as deemed necessary and for members of the Committee, individually or collectively, to obtain independent professional advice at the Company's expense, in furtherance of their duties.

Appointment of the auditor

It is the duty of the Audit Committee to make recommendations to the Board on the appointment of the external auditor, the audit fee, and any questions of resignation or dismissal of the external auditor. In addition, it is the duty of the Audit Committee to review the quality and cost effectiveness of the audit and the independence and objectivity of the external auditor.

To achieve these responsibilities each year the Audit Committee considers the re-appointment of the auditor and in making any recommendation to the Board considers:

- whether the auditor has performed to the required standard
- whether the audit fee is reasonable taking into account the process by which the proposed fee has been agreed by management

- the benefit of seeking tenders for the audit, taking into account the quality and cost of the audit, and the cost and management time required to conduct a tender exercise.

In carrying out its annual review, the Audit Committee shall require the auditor to:

- disclose all relationships which may affect the firm's independence and the objectivity of the audit partner and staff
- disclose the safeguards and steps taken by the auditor in order to ensure its independence and objectivity
- confirm in writing to the Audit Committee that in its judgement, it is independent within the meaning of the relevant regulations and professional requirements; and
- disclose any gifts or hospitality which have been provided or exchanged between the Company and the auditor, unless in the case of gifts, the value is clearly insignificant and in the case of hospitality it is reasonable in terms of its frequency, nature and cost.

Audit personnel

The auditor should be required to rotate the lead audit partner and independent audit partner after a maximum of five years and to rotate any other key audit partners after a maximum of seven years, and otherwise in accordance with the FRC Ethical Standard (2016). The Audit Committee shall be consulted before the appointment of anyone who has been employed by the auditor to a senior management or Kelda board position. The external auditor shall not enter into an agreement to provide a partner or employee to work on a temporary basis for the Company or any affiliate of the Company without the prior consent of the Audit Committee.

Allocation of non-audit work

In order to ensure that the provision of non-audit services does not, and does not appear to, affect the independence and objectivity of the external auditor. The Kelda Group complies with FRC Ethical Standard (2016). It is the policy of the Audit Committee that all non-audit services shall be allocated in accordance with the following principles.

The Audit Committee does not pre-approve the provision any non-audit work by the external auditor. The allocation of each piece of non-audit work to the external auditor is to be approved in advance. The Committee shall satisfy itself that the auditor is best placed to provide the service and that a market rate has been obtained. The Committee allows the delegation of this authorisation in accordance with the following levels:

- where the fee for non-audit work is clearly trivial, £50,000 it can be approved by the Director of Finance, Regulation and Markets or Chief Executive
- where the fee of for non-audit work is not trivial but less than £125,000 it can be approved by the Director of Finance, Regulation and Markets and the Chair of the Kelda Holdings Audit Committee
- where an urgent need to allocate non audit work exists, an appointment can be made jointly by the Director of Finance, Regulation and Markets or the Chief Executive and the Chair of the Kelda Holdings Audit Committee.

The external auditor shall not be allocated any of the following categories of work:

- Tax services relating to:
 - Preparation of tax forms

- Payroll tax
- Customs duties
- Identification of public subsidies and tax incentives unless required by law
- Support regarding tax inspections by tax authorities unless required by law
- Calculation of direct and indirect tax and deferred tax
- Provision of tax advice
- Services that involve playing any part in management or decision-making of the audited entity
- Bookkeeping and preparing accounting records and financial statements
- Payroll services
- Designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information, or designing and implementing financial information technology systems
- Valuation services, including valuations performed in connection with actuarial services or litigation support services
- Legal services, with respect to provision of general counsel
- Negotiating on behalf of the audit entity
- Acting in an advocacy role in the resolution of litigation;
- Services related to the audited entity's internal audit function
- Services linked to the financing, capital structure and allocation, and investment strategy of the 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
- Promoting, dealing in, or underwriting shares in the audited entity
- Human resources services with respect to: Management in a position to exert significant influence over the preparation of accounting records or financial statements which are the subject of the audit, where such services involve:
 - Searching for or seeking out candidates for such positions; or
 - Undertaking reference checks of candidates for such positions;
 - Structuring the organisation design;
 - Cost control.

At each meeting the Audit Committee shall receive a report of the fees paid to the external auditor in all capacities, and the amounts of any future services which have been contracted, or where a written proposal has been submitted. The Audit Committee is to be provided with a cumulative fee analysis of each engagement until the engagement is closed out, re-confirmation of scope and independence and key milestones. In addition, the external auditor shall report any contingent fee arrangements for non-audit services.

From the financial year starting 1 April 2020 it has set a cap on fees for non-audit work across the Group in any one financial year of 70% of the statutory external audit fee for the whole Group. The only exception to this cap is the fee for work required by law or regulation. The cap shall be calculated by comparing the fee for non-audit work provided by the external auditor or networked firm to the Kelda Group in any one year with the average statutory audit fee, excluding fees for any audit related services such as comfort letters, over the previous three years.

Appendix 1

Auditor Independence**Authorisation of Non-audit work**

In order to ensure that the provision of non audit services does not, and does not appear to, affect the independence and objectivity of the external auditor, the Audit Committee has stipulated that non audit services shall be allocated in accordance with the Company's Auditor Independence Policy.

Accordingly I confirm that the following proposed engagement:
[details to insert]

does not fall into the following categories of non audit work:

- Tax services relating to:
 - Preparation of tax forms
 - Payroll tax
 - Customs duties
 - Identification of public subsidies and tax incentives unless required by law
 - Support regarding tax inspections by tax authorities unless required by law
 - Calculation of direct and indirect tax and deferred tax
 - Provision of tax advice
- Services that involve playing any part in management or decision-making of the audited entity
- Bookkeeping and preparing accounting records and financial statements
- Payroll services
- Designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information, or designing and implementing financial information technology systems
- Valuation services, including valuations performed in connection with actuarial services or litigation support services
- Legal services, with respect to provision of general counsel
- Negotiating on behalf of the audit entity
- Acting in an advocacy role in the resolution of litigation;
- Services related to the audited entity's internal audit function
- Services linked to the financing, capital structure and allocation, and investment strategy of the 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
- Promoting, dealing in, or underwriting shares in the audited entity
- Human resources services with respect to: Management in a position to exert significant influence over the preparation of accounting records or financial statements which are the subject of the audit, where such services involve:
 - Searching for or seeking out candidates for such positions; or
 - Undertaking reference checks of candidates for such positions;
 - Structuring the organisation design;
 - Cost control.

Authorisation is sought from:

the Audit Committee / chairman of the Audit Committee ^{*(delete as appropriate)} as the fee to be paid is greater than £50,000.

(i) I confirm that a fair tender exercise was conducted and that the Company's appointed auditor's bid is the most economically advantageous offer to the Company.*

(ii) I confirm that as a matter of urgency the Company's appointed auditor should be allocated the work.*

(*delete as appropriate)

_____ date:

GROUP FINANCE DIRECTOR*

CHIEF EXECUTIVE* ^{*(delete as appropriate)}

Approved on behalf of the Audit Committee:

_____ date:

AUDIT COMMITTEE CHAIR

Review of Audit Committee Terms of Reference and Auditor independence policy
Appendix 3: Barred non-audit services

The following non-audit services are included on the 'black list'. These are services that the auditor of a PIE cannot provide, once the new regime is implemented.

Tax services relating to:

- Preparation of tax forms*
- Payroll tax
- Customs duties

Identification of public subsidies and tax incentives unless required by law*

- Support regarding tax inspections by tax authorities unless required by law*
- Calculation of direct and indirect tax and deferred tax*
- Provision of tax advice*.

Services that involve playing any part in management or decision-making of the audited entity

Bookkeeping and preparing accounting records and financial statements

Payroll services

Designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information, or designing and implementing financial information technology systems#

Valuation services, including valuations performed in connection with actuarial services or litigation support services*

Legal services, with respect to provision of general counsel

Negotiating on behalf of the audit entity

Acting in an advocacy role in the resolution of litigation;

Services related to the audited entity's internal audit function;

Services linked to the financing, capital structure and allocation, and investment strategy of the 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

Promoting, dealing in, or underwriting shares in the audited entity

Human resources services with respect to: Management in a position to exert significant influence over the preparation of accounting records or financial statements which are the subject of the audit, where such services involve:

- Searching for or seeking out candidates for such positions; or
- Undertaking reference checks of candidates for such positions;
- Structuring the organisation design;

- Cost control.