

Governance

Audit Committee



Baroness Noakes DBE
Chairman of the Audit Committee

The purpose of the committee is to assist the board in discharging its responsibilities for the integrity of the company's financial statements, the assessment of the effectiveness of the systems of internal controls and monitoring the effectiveness and objectivity of the internal and external auditors. The full terms of reference for the committee can be found on the company's website (www.severntrent.com) and are also available from the Company Secretary.

This report provides details of the role of the Audit Committee and the work it has undertaken during the year.

The members of the Audit Committee are Baroness Noakes DBE (Chairman), Dr Bernard Bulkin and Richard Davey whose experience and background are set out on pages 32 and 33. The board is satisfied that Baroness Noakes and Richard Davey have recent and relevant financial experience. The Chairman, Chief Executive, the Finance Director, the Director of Internal Audit, the Director of Strategy and Regulation, the Group Financial Controller, the Company Secretary and the external auditors normally attend, by invitation, all meetings of the committee. Other members of senior management are also invited to attend as appropriate to present reports. In performing its duties, the committee has access to the services of the Director of Internal Audit, the Company Secretary and external professional advisers.

Like most audit committees the committee focuses on the financial statements of the Severn Trent group which are published at the half year and year end. The regulated activities carried out by Severn Trent Water Limited result in other reporting obligations to Ofwat and these are also covered by the Audit Committee. These regulatory reporting obligations cover a comprehensive annual return on all of the Severn Trent Water's regulatory obligations, known as the June Return, and a statement which underpins the charges made by Severn Trent Water, known as the Principal Statement.

The external auditors, Deloitte LLP, make public reports on the half year accounts and on the annual reports. Deloitte also reports to Ofwat in respect of the June Return. The June Return covers many aspects which are not financial and Severn Trent Water appoints a Reporter, WS Atkins, to report to us on those aspects. The Audit Committee receives reports from Deloitte and the Reporter on their work as part of its review of the financial statements and returns.

There are four primary meetings of the committee each year and the table below, which shows the agenda items for the meetings held in 2009/10, shows how the annual cycle covers all of the regular items as well as handling specific issues.

Date	Key agenda items
May 2009	<p>Review the preliminary announcement and group accounts for year ended 31 March 2009</p> <p>Review the June Return executive summary and board overview</p> <p>Review the effectiveness of the systems of internal control</p> <p>Review the external auditors' independence, objectivity and performance, and recommendation to the board of the reappointment of Deloitte</p> <p>Review six monthly update on risks and risk management</p>
September 2009	<p>Agree the external auditors audit plan for 2009/10 and approve the auditors fee proposal</p> <p>Review the process and timeline for the 2011/12 Principal Statement</p> <p>Detailed assessment of Deloitte's performance on 2008/09 audit and approval of audit fee</p> <p>Six monthly update from Internal Audit</p> <p>Review of assurance framework for SAP programme</p>
November 2009	<p>Review six monthly update report on Enterprise Risk Management</p> <p>Financial statements for half year and interim results announcement</p> <p>Progress report on SAP programme</p>

Policy on the provision of non-audit services

The company has approved a formal policy on the provision of non-audit services aimed at safeguarding and supporting the independence and objectivity of the external auditors.

The policy sets out the approach to be taken by the group when using the services of the external auditors, including requiring that certain services provided by the external auditors are pre-approved by the Audit Committee or its Chairman.

It distinguishes between those services where an independent view is required and that should be performed by the external auditors (such as statutory and non-statutory audit and assurance work), prohibited services where the independence of the external auditors could be threatened and they must not be used, and other non-audit services where the external auditors may be used.

Non-audit services where the external auditors may be used include: non-recurring internal controls and risk management reviews (i.e. excluding outsourcing of internal audit work), advice on financial reporting and regulatory matters, due diligence on acquisitions and disposals, project assurance and advice, tax compliance services, and employee tax services.

The approval of the Audit Committee or its Chairman is always required if a non-audit service provided by the auditors is expected to cost more than £100,000 or if non-audit fees for the year would thereby exceed the amount of the audit fee.

Date	Key agenda items (continued)
March 2010	<p>Agree Internal Audit Plan 2010/11</p> <p>Review of the work of Internal Audit for 2009/10 including the fraud log</p> <p>Approve the process for the June Return 2010 submission</p> <p>Review the committee's terms of reference and 2010/11 agendas</p> <p>Preliminary review of accounting issues for the 2010 financial statements and June Return</p> <p>Review of implications of Bribery Act 2010</p> <p>Review assurance arrangements for key risks (see page 58)</p>

For 2009/10 Ofwat have introduced additional reporting requirements in relation to the split of operating costs and fixed assets between business units, as determined by Ofwat. The processes to achieve this, together with the judgments required in allocating costs and assets which are not managed in the same way as the business units are defined, have been reviewed by the Audit Committee. The Audit Committee intends to hold an additional review meeting prior to the submission of the final returns to Ofwat.

The committee receives reports from the external auditors and regularly holds discussions with both the internal and external auditors in the absence of management. The committee reports to the subsequent meeting of the board on the committee's work and the board receives a copy of the minutes of each meeting of the committee.

Internal audit

The Director of Internal Audit and his Internal Audit team are employed by Severn Trent Plc. On a day to day basis the group's Internal Audit function reports to management on the effectiveness of the company's systems of internal controls and the adequacy of these systems to manage business risk and to safeguard the group's assets and resources. This work is summarised and reported to the Audit Committee on a regular basis and is a key element of the assurance that the committee receives on the risks and controls in the group.

The plans, the level of resources and the budget of the Internal Audit function are reviewed at least annually by the Audit Committee. The Director of Internal Audit is free to raise any issues with the committee or its Chairman at any time during the year.

External auditor

Deloitte LLP (Deloitte) were appointed auditors of the company in 2005. The Audit Committee reviews the auditors effectiveness each year prior to recommending to the board that they be proposed for reappointment at the AGM. Deloitte audits all significant subsidiaries of the group.

Annually, the committee reviews information provided by the external auditors confirming their independence and objectivity within the context of applicable regulatory requirements and professional standards. This process is completed in September of each year to enable a tender process to be completed before the following AGM if necessary. The company does not have a policy of tendering the external audit at specific intervals. The auditors tenure runs from one AGM to the next and there are no contractual obligations that act to restrict the committee's choice of external auditors.

Details of the amounts paid to Deloitte for audit and non-audit services are provided in note 7 to the accounts page 76.

In accordance with the requirements for auditor independence, our lead partner is standing down after the 2009/10 audit having served five years in that capacity. Our new lead partner has observed the 2009/10 audit to ensure continuity following the changeover.

Audit Committee attendance in 2009/10

Baroness Noakes	4/4
Dr Bernard Bulkin	4/4
Richard Davey	4/4