

Public

Effective: 24 January 2025

Terms of Reference

Audit & Risk Committee

**These terms of reference should be read in conjunction with the terms
applicable to all Board committees**

Purpose

Monitoring effectiveness and integrity of the NESO’s financial reporting, systems of internal control and risk management, governance framework and internal and external audit processes.

Membership

At least three Non-Executive Directors. The Shareholder Director shall be a member.

At least one member shall have recent and relevant financial experience, and the Committee as a whole shall have competence relevant to the sector in which NESO operates, as determined by the Board.

The Chair of the Board should not be a member.

Quorum

Two members, one of whom must include the Shareholder Director or their alternate.

Meetings

At least four times a year.

Attendance by invitation.

Responsibilities

Internal Controls & Risk Management

1. Monitor and challenge the adequacy and effectiveness of NESO’s Risk Management Framework, including how effectively management is embedding and maintaining an appropriate risk management culture, together with first, second and third lines of defence policy.
2. At least annually, carry out a review of the adequacy and effectiveness of internal controls (including financial, operational, reporting and compliance controls).
3. Review and challenge the principal risk and control landscape and assess the effective management of risk in-line with the Board’s risk appetite and taxonomy, including regular in-depth reviews into principal risks lead by the risk owner, as determined by the Board or where, in the Committees view, further scrutiny is required.
4. Oversee the escalation of control weaknesses and issues raised by management, or in internal control, internal audit or external audit reports and any disclosures with respect to deficiencies in internal control or fraud.
5. Assess and understand mitigations proposed by management in respect of any risks associated with NESO’s internal control and reporting responsibilities, together with such emerging and other risks as it may determine fall within its scope from time to time.
6. Consider any findings and necessary disclosures relating to NESO’s internal financial control and risk management systems, including any significant deficiencies or a significant failing or material weaknesses reported to the Committee by management, or the auditors, management’s response and the conclusions of any testing or audits carried out by internal or external auditors.
7. Review the reporting of longer-term viability and modelling for risk stress testing different financial and operational events, and associated disclosures in the Annual Report and Accounts.
8. Review and challenge NESO’s control procedures for preventing and detecting fraud or bribery.
9. Consider matters of business conduct and receive reports relating to NESO’s Code of Ethics. Any significant issues must be brought to the Committee’s attention as soon as practicable.

10. Ensure that appropriate procedures are established, and evaluate the effectiveness of such procedures, for the receipt, retention, and treatment of complaints received by NESO, relating to accounting, internal accounting controls, or auditing matters of NESO.

Internal Audit

11. Approve the appointment or termination of the Head of Internal Audit. The Head of Audit is accountable to the Committee and should not be removed without the approval of the Committee.
12. Review and approve the role and mandate of internal audit.
13. The Chair of the Committee shall provide input into the annual performance assessment and objective setting process for the Head of Internal Audit.
14. Carry out an annual assessment of the effectiveness of the internal audit function, including:
 - i. Regular meetings with the Head of Internal Audit, without the presence of management, to discuss the remit and effectiveness of the function, and any issues arising from its activities. The Head of Internal Audit should have access to the Chair of the Board, the Chair of the Committee and other members of the Committee.
 - ii. Review, assess and approve the annual internal audit work plan, ensuring that it is appropriate for the current needs of NESO and aligned to key risks.
 - iii. Assess the internal audit budget and disclose whether it is satisfied that internal audit has the appropriate resources in the Annual Report and Accounts.
 - iv. Determining whether it is satisfied that the quality, experience and expertise of internal audit is appropriate for the business.
15. Receive reports on the results of the internal audit function’s work. Review the actions taken by management to implement the recommendations of internal audit and to support the effective working of the internal audit function.
16. Challenge and approve the internal audit charter to ensure its independence and effectiveness and its appropriateness to the current needs of the NESO in accordance with relevant professional standards.
17. Obtain an independent and objective external quality assessment of the internal audit function at appropriate intervals and at least every five years. Oversee and approve the appointment process for the independent assessor.

External Audit

18. Oversee and direct the tender process for the selection of the external auditors. Make recommendations to the Board, to be put to the Shareholder, on the appointment, re-appointment and removal of the external auditor.
19. If an auditor resigns the Committee shall investigate the issues leading to this and decide if any action is required.
20. Put out to tender the audit contract at least once every ten years, or sooner if required.
21. Oversee the relationship with the external auditor. The Committee shall:
 - I. Approve and challenge the external auditor’s remuneration, including both fees for audit and non-audit services, and monitor that the level of fees is appropriate to enable an effective and high-quality audit to be conducted.
 - II. Approve the external auditor’s terms of engagement, including any engagement letter issued at the start of each audit and the scope of the audit.
 - III. Meet with the external auditor at least once a year without management being present, to discuss the auditor’s remit any issues arising from the audit and any difficulties encountered during the course of the audit, including restrictions on activities or access to information and any significant disagreements with management. Assess annually the qualifications, expertise and resources of the external auditor.
 - IV. Assess annually the external auditor’s performance, independence, and objectivity; the quality of the external audit process (which shall include a report from the external auditor on its own internal quality procedures), the handling of key judgements by the external auditor, the external auditor’s response to questions from the Committee and any audit problems or difficulties and the management’s response.
 - V. Monitor and review the external auditor’s processes for maintaining independence, its compliance with relevant law, regulation, other professional requirements and the FRCs defined ethical standard, including the guidance on the rotation of audit partner and staff.
 - VI. Review with the external auditor any significant issues arising from any regulatory inspections of the external auditor, to the extent relevant to NESO, including the external auditor’s response to any identified accounting issues.
22. Develop and oversee NESO’s policy on the provision of non-audit services by the external auditor, including consideration as to whether the external audit firm is the most suitable non-audit service.

23. Recommend to the Board, and monitor the application of, a policy on the employment of current and former employees of the NESO's external auditor.
24. Ensure appropriate interaction with the activities of the internal audit team.
25. Challenge and approve the scope of the external audit plan, ensuring it is consistent with the scope of the audit engagement. Discuss with the external auditor the factors that could affect audit quality.
26. Review the findings of the audit with the external auditor including, but not limited to, any major issues which arose during the course of the audit and management's response to such issues; any accounting and audit judgements; and the levels of errors identified.
27. Review representation letters requested by the external auditor in relation to the financial reporting prior to signature by management.

Financial Reporting

28. Monitor and critically assess NESO's financial statements and financial information, including its annual report and accounts, interim results (where relevant) any significant financial returns to regulators and any other formal announcements relating to NESO's financial performance consistent with the Committee's purpose. It will focus on:
 - I. the integrity of NESO's financial reporting and related process.
 - II. the context in which the statements are made, seeking to satisfy itself that the disclosures are clear, appropriate and not misleading.
 - III. compliance with relevant legal and regulatory requirements and financial reporting standards.
 - IV. the going concern assumption and the viability statement as to NESO's ability to continue to operate and meet its liabilities, taking account of its current position and principal risks.
29. Review and challenge, where necessary, the application of, and any changes to, significant accounting policies; the methods used to account for significant or unusual transactions, where different approaches are possible; whether NESO has adopted appropriate accounting policies and made appropriate estimates and judgements, taking into account the external auditor's views on the financial statements.
30. Review and challenge all material information presented with the financial statements, including the strategic report, the corporate governance statements relating to audit and

risk management and relevant non-financial disclosures (including those related to climate and ESG related matters) which may impact the financial statements.

31. Recommend to the Board whether the annual report and accounts, taken as a whole, is fair, balanced, and understandable and provides the information necessary for the Shareholder and any relevant stakeholders to assess NESO’s position and performance, business model and strategy.

Independence

32. Oversee the duties and tasks of the Compliance Officer, as required by the licence.
33. Consider and approve as appropriate the annual report on the activities of the Compliance Officer and the fulfilment of their duties in accordance with the Licence prior to its submission to Ofgem.
34. Ensure that appropriate systems, processes and other governance arrangements necessary to maintain the impartiality of NESO employees, and the independence of the NESO business from conflict-of-interest parties are established and maintained, as required under the Licence.
35. Review and approve the Statements for submission to Ofgem, as required by the Licence, together with any subsequent revisions.

Other Matters

36. Assure themselves that management have the appropriate processes and controls in place for capital projects.
37. Annually assess and challenge the adequacy of NESO’s insurance arrangements, having regard to the nature of ‘s business and insurable risks. Make recommendations to the Board of any changes to the insurance programme.
38. Review and challenge any significant changes to general banking and treasury operations (in excess of the Executive Committee’s delegated limits) prior to consideration and approval by the Board.
39. Oversee any investigation of activities which are within its terms of reference.
40. The Chair of the Committee will be informed on a timely basis of significant matters relating to risk, compliance, ethics, controls, or financial reporting should they occur outside of the routine committee reporting cycle.

41. The Committee shall receive a regular Treasury report in respect of risk management issues and any issues in relation to banking, credit ratings, financing including financial investments and cash management, interest rate and inflation risk, liquidity management and tax.
42. Receive reports, as and when appropriate, from the business on significant areas of concern in relation to any external reporting obligations.

Reporting

43. Report to the Board on:
 - I. the significant issues that it considered in relation to the financial statements and how these issues were addressed;
 - II. significant financial reporting issues and judgements made in connection with the preparation of the financial statements, (having regard to matters communicated to it by the External Auditor) annual report and any other formal statements;
 - III. its assessment of the effectiveness of the external audit process and its recommendation on the appointment or reappointment of the External Auditor
 - IV. the outcome of the external audit, the role of the Committee in the process and how the external audit contributed to the integrity of the financial reporting; and
 - V. any other issues on which the Board has requested the Committee’s opinion.
44. Compile a report on its activities to be included in the annual report.
45. In compiling the reports referred to above, the Committee should include at least those matters that have informed its assessment of whether it is appropriate for NESO to adopt the going concern basis of accounting and the effectiveness of the process to evaluate longer-term viability of NESO. If the Board has not accepted the Committee’s recommendation on the External Auditor appointment, reappointment or removal, the annual report should include a statement explaining the Committee’s recommendation and the reasons why the Board has taken a different position.
46. The Committee shall have the right to publish in the annual report, details of any issues that cannot be resolved between the Committee and the Board.