



**SCOTTISH POWER LIMITED  
AUDIT & COMPLIANCE COMMITTEE  
2012 ANNUAL ACTIVITY REPORT**



## **2012 ANNUAL ACTIVITY REPORT**

Report for the fiscal year 2012 presented at the Audit & Compliance Committee (“the Committee”) meeting of 06 February 2013 for noting by the Committee. Following the Committee’s noting the Report will be submitted to the Board of Directors of Scottish Power Limited on 07 February 2013 for approval, pursuant to article 5 of the Terms of Reference of the Committee.

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## I. INTRODUCTION

In accordance with the provisions of the Articles of Association of Scottish Power Limited, the board of Directors established the Committee on 27 February 2009. The Committee is a permanent internal body and has an informative and consultative role. The Committee does not have an executive function. It has powers to gather information, carry out assessments and present proposals to the Board of Directors within the scope of its activities.

The Committee provides an additional assurance that the Board of Directors, supervises the significant risks of the Business with the utmost transparency, self-discipline and rigor. In assessing the effectiveness of the Internal Control System, the Committee contributes to the attainment of the strategic objectives of Scottish Power. While an effective Internal Control System does not, in and of itself, guarantee the achievement of such goals, it does provide an assurance that the Management of Scottish Power makes its decisions within the framework of the guidelines and standards issued by the Board of Directors.

The Committee's Terms of Reference set out the authority and responsibilities of the Committee together with its method of operation. The Terms of Reference have been prepared taking into account the fact that the sole ordinary shareholder of Scottish Power Limited is a listed company, is the parent company of the Iberdrola Group and also has an Audit and Risk Supervision Committee within its governance structure.

The Committee exercises its functions with full autonomy, notwithstanding the establishment of a framework for collaborating with and reporting on the development of its functions with the Iberdrola Audit and Risk Supervision Committee and the Internal Audit function as defined in the Regulations of the Audit and Risk Supervision Committee of Iberdrola S.A.

The Committee consists of the following members:

Member	Title	Position
<b>Rt Hon Lord MacDonald of Tradeston, CBE</b>	Non Executive Member <b>(Chairman)</b>	Independent Non Executive Director – Scottish Power Limited
<b>Juan Carlos Rebollo</b>	Executive Member	Administration and Control Director, Iberdrola S.A. and Non Independent and Non Executive Director Scottish Power Limited
<b>Professor Susan Deacon</b>	Non Executive Member	Independent Non Executive Director – Scottish Power Limited

On 02 February 2012 Rt Hon Lord MacDonald of Tradeston, CBE was appointed as Chairman of the ScottishPower Audit and Compliance Committee succeeding Juan Carlos Rebollo. Professor Susan Deacon was also appointed as a Non Executive Member on 18 July 2012, replacing José Miguel Alcolea.



On 18 July 2012 Michael Davies, Corporate Business Solicitor, was appointed as Secretary to the Committee succeeding the Head of Legal & General Secretary of Scottish Power, Marion S Venman.

## II. AUDIT AND COMPLIANCE COMMITTEE MEETINGS 2012

### a. COMMITTEE HIGHLIGHTS

	2012
<b>Number of meetings</b>	5
<b>Number of written resolutions</b>	3
<b>Reports to the Scottish Power Board of Directors</b>	12
<b>Presentations from Senior Management</b>	31
<b>Presentations from the External Auditor</b>	3

### i) Reports to the Scottish Power Limited Board of Directors

Title	2012
1. Report from the Committee to the Board on the year end 2011 financial information	2 February 2012
2. Report from the Committee to the Board on the SP ACC Annual Activity Report	2 February 2012
3. Report from the Committee to the Board on the Auditors Independence	2 February 2012
4. Report from the Committee to the Board on the PWC Evaluation of ScottishPower and Recommendations	2 February 2012
5. Report from the Committee to the Board on the Q1 2012 Financial Information	18 April 2012
6. Report from the Committee to the Board on the proposed amendments to the Audit & Compliance Committee Terms of Reference	18 July 2012
7. Report from the Committee to the Board on the Half-Year Financial Information 2012	18 July 2012
8. Report from the Committee to the Board on the Terms of Engagement – 2012 Statutory Audit	18 July 2012
9. Report from the Committee to the Board on Business Separation Compliance	18 July 2012
10. Report from the Committee to the Board on Bribery Act Compliance	18 July 2012
11. Report from the Committee to the Board on the 2012 Q3 Financial Information	10 October 2012
12. Report from the Committee to the Board on the Internal Audit Department 2013 Budget	13 December 2012

ii) Senior Management Presentations

Date	Senior Manager	Presentation
1 February 2012	Director of Finance	2011 Year End Business Performance
1 February 2012	Head of Internal Audit	SP 2011 Year End Financial Information Review SP ACC Annual Activity Report 2011 Internal Audit Activities Report 2011 Auditors Independence Report
1 February 2012	UK Risk Director	SP Risk Reporting
1 February 2012	Head of Legal and General Secretary	PWC Evaluation of SP Compliance and Group Governance System
17 April 2012	Director of Finance	Q1 Financial Performance Review
17 April 2012	Head of Internal Audit	Internal Audit Q1 Financial Information Review Management Action Monitoring and Recent Works SP Renewables 2012 Internal Audit Plan
17 July 2012	Director of Finance	2012 Half Year Financial Performance Review
17 July 2012	Head of Internal Audit	Internal Audit 2012 Half Year Financial Review Internal Audit Management Action Update Terms of Engagement Proposal – 2012 Statutory Audit Internal Audit Activities Update Half Year 2012 Business Separation Compliance Report Bribery Act Compliance Update
17 July 2012	Head of Legal and General Secretary	Liquidations Report Proposed Amendments to SP ACC Terms of Reference
17 July 2012	UK Risk Director	SP Risk Reporting
9 October 2012	Director of Finance	2012 Q3 Financial Performance Review
9 October 2012	Head of Internal Audit	Internal Audit 2012 Q3 Financial Review Management Action Monitoring and Recent Works
9 October 2012	Head of Legal and General Secretary	Report on Legal Claims and Regulatory Investigations

12 December 2012	Director of Finance	2012 Year End Business Performance
12 December 2012	Head of Internal Audit	Management Action Monitoring and Recent Works 2013 Internal Audit Budget 2013 Internal Audit Annual Plan Head of Internal Audit 2013 Objectives
12 December 2012	Audit & Compliance Committee Secretary	Calendar of Sessions for 2013

### iii) External Auditor Presentations

	Title	Date
1.	Conclusion of 2011 Statutory Audit	1 February 2012
2.	Conclusions of H1 2012	17 July 2012
3.	2012 External Audit Review - Preliminary Conclusions	12 December 2012



**b. MEETING AGENDAS**

**ii) Number of Sessions**

In 2012, the Committee held five meetings. The following tables show the business transacted at each of these meetings:

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**Session 1 – 1 February 2012**

**Financial Information Review**

- External Audit Report on 2011 Statutory Audit
- 2011 Year End Business Performance
- Internal Audit Report about Year End Financial Information & Certification Process

**Items for Discussion / Noting**

- SP ACC Annual Activity Report
- 2011 Internal Audit Annual Activity Report
- Auditors Independence Report
- SP Risk Reporting
- PwC Summary (Audit)

**Items for Approval**

- Report from the SP ACC in relation to SP's 2011 Year End Financial Information
- 

**Session 2 – 17 April 2012**

**Financial Information Review**

- Q1 Financial Performance Review
- Internal Audit Report about Q1 Financial Information Review 2012

**Items for Discussion / Noting**

- Internal Audit Management Actions Monitoring and Recent Works

**Items for Approval**

- Report from the SP ACC in relation to SP's Q1 2012 Financial Information
  - SP Renewables Audit Plan
- 

**Session 3 – 17 July 2012**

**Financial Information Review**

- External Audit Report
- 2012 Half Year Financial Performance Review
- Internal Audit Financial Review

**Items for Discussion / Noting**

- Internal Audit Management Actions
- Liquidations Report
- Proposed amendments to the SP Audit & Compliance Committee Terms of Reference

**Items for Approval**

- Report from the SP ACC in relation to SP's 2012 Half Year Financial Information
  - Terms of Engagement – 2012 Statutory Audit
  - Internal Audit Activities
  - Responsible Officer Business Separation Compliance Report
  - Bribery Act Compliance Update
  - SP Risk Reporting
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#### **Session 4 – 9 October 2012**

##### **Financial Information Review**

- 2012 Q3 Financial Performance Review
- Internal Audit Financial Review

##### **Items for Discussion / Noting**

- Litigations against the Company
- Internal Audit Management Actions Monitoring and Recent Works

##### **Items for Approval**

- Report from the SP ACC in relation to SP's 2012 Q3 Financial Information

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#### **Session 5 – 12 December 2012**

##### **Financial Information Review**

- 2012 External Audit Review – Preliminary Conclusions
- 2012 Year End Business Performance

##### **Items for Discussion / Noting**

- Internal Audit Management Actions Monitoring and Recent Works
- Head of Internal Audit Objectives
- Calendar of Sessions for 2013
- 2013 Internal Audit Budget

##### **Items for Approval**

- 2013 Internal Audit Annual Plan

Article 113 of the Scottish Power Limited Articles of Association makes provision for the use of the electronic written resolution process. Article 114 of the Articles states that the electronic written resolution process may also be used in relation to the proceedings of any Board sub committees. The Committee is a committee of the Board. In 2012, 3 written resolutions were passed as set out below:

#### **Written Resolution – 12 April 2012**

- ✚ Approval of amendments to the ACC Terms of Reference

#### **Written Resolution – 18 September 2012**

- ✚ Appointment of Ernst & Young for non audit related services (Tax R and D)

#### **Written Resolution – 20 September 2012**

- ✚ Appointment of Ernst & Young for non audit related services (Availability of Resources)

### III. MAIN ACTIVITIES

In 2012, the Committee carried out a number of planned activities in order to effectively discharge the duties entrusted to it by the Board of Directors of Scottish Power Limited.

#### a) Internal Audit

The Terms of Reference indicates that the role of the Committee is *“to oversee the independence and efficiency of the Internal Audit Department... To approve the guidelines and annual action plans established by the head of the Internal Audit Department... To propose the budget of the Internal Audit Department for its approval by the Board of Directors. To propose to the Board of Directors the appointment, re-election or cessation of the head of the Internal Audit Department.”*

The Head of Internal Audit presented a report to the Committee at its meeting on 1 February 2012, outlining compliance against the 2011 Annual Audit Plan.

On 12 December 2012, the Committee approved the 2013 Internal Audit Annual Audit Plan and proposed the annual budget for approval by the SP Board. The annual budget includes the required level of resources to deliver the annual plan, as determined by the Head of Internal Audit. The 2013 Annual Audit Plan was derived in accordance with the guidelines and general plans established by the Director of the Iberdrola Internal Audit Area, and ensures that activities are focused on Scottish Power’s risks.

#### b) Internal Monitoring and Risk Management Systems

The Terms of Reference indicates that the role of the Committee is *“To be aware of and keep under review the Company’s internal financial information process and internal risk monitoring and management systems... To ensure... that the main risks of the Company and those of any of the Company’s subsidiaries are identified, managed and adequately reported... The Committee shall ensure the establishment of measures necessary to mitigate the impact of any risks identified and introduce information and internal monitoring systems which monitor and manage such risks, including contingent liabilities or off balance-sheet risks... Maintain appropriate relationships with the Company Risk Division”*

The UK Risk Director presented papers to the Committee on 1 February 2012 providing an update on the changes to the Risk Policies for 2012, the performance against defined key limits and indicators, and the main risks in the Regulated and Liberalised businesses.

On 17 July 2012, the UK Risk Director presented a paper to the Committee on SP Risk Reporting, which included an explanation of the limits and guidelines for the Liberalised, Regulated and SP Renewables businesses and main risks within each business.

**c) Audited Accounts**

*The Terms of Reference indicates that the role of the Committee is “To propose to the Board of Directors the terms of engagement of the Company’s auditors, in accordance with the policy as established by the parent company of the Iberdrola Group... To ensure the independence of the Company’s auditors... Analyse together with the auditors, any significant weakness detected in the internal control system... To serve as a communication channel between the Board of Directors and the auditors”.*

The Head of Internal Audit presented a report to the Committee on 17 July 2012 outlining the scope of professional services in connection with the audit of the annual financial statements. The Committee received the report and proposed to the Board of Directors the Terms of Engagement of the external auditors for the 2012 Statutory Audit.

On 01 February 2012, the Head of Internal Audit presented a report to the Committee on the independence of the appointed external auditor. The Committee noted the written declaration from the external auditor ratifying its independence, and the attendance of the external auditors at three previous Committee meetings where there were no concerns expressed by the external auditors relating to its independence.

As part of the supervision of the auditing of the financial statements by the Committee, the external auditors appeared before the Committee to present the conclusions of the 2011 statutory audit, conclusion of 1H 2012 review and the preliminary conclusions of the 2012 statutory audit.

**d) Economic and Financial Information**

*The Terms of Reference indicates that the role of the Committee is “To oversee the process for the preparation of and the integrity of the financial economic information of the Company (including half year information), advising on any proposals for changes to the accounting practices and policies with the general accounting practices and policies of the parent company of the Iberdrola Group... To oversee compliance with the legal requirements and the correct application of the national and international accounting and financial information principles and practices.”*

One of the most significant activities of the Committee is the periodic submission to the Board of Directors of its reports on the approval of the year end and interim economic and financial information of Scottish Power. Through the support of the Head of Internal Audit, the Committee approved four reports for the Scottish Power Board of Directors, specifically:-

- Results to 31 December 2011 on 1 February 2012;
- Results to 31 March 2012 on 17 April 2012;
- Results to 30 June 2012 on 17 July 2012; and
- Results to 30 September 2012 on 9 October 2012.

The reports of the Committee provide an opinion to the Board of Directors on the following: changes in accounting policies and practices from those adopted in the 2011 consolidated annual accounts of the Iberdrola Group; and potential risks and sources of uncertainty in the accounting policies and practices adopted with potentially significant impact in the 2012 consolidated annual accounts.

At the Committee meetings held on 1 February 2012 and 17 July 2012, the report by the Head of Internal Audit also included an opinion on the processes relating to the preparation of the financial information for the 2011 year end and the first half of 2012 to ensure that all required reviews, guarantees and certification have been completed.

During 2012, the Director of Finance has presented to the Committee a quarterly update about performance. In addition, the external auditors “Ernst & Young” also presented their conclusions of the 2011 statutory audit, conclusion of 1H 2012 review and the preliminary conclusions of the 2012 statutory audit.

#### **e) Compliance and Good Governance**

*The Terms of Reference indicates that the role of the Committee is “ To review the status of compliance with laws, regulations and internal procedures and the scope and status of systems designed to promote Company compliance with laws, regulations and internal procedures, through review of reports from management, legal counsel and third parties as determined by the Committee”*

The Distribution and Transmission licence conditions include a number of requirements relating to separation between electricity network businesses and competitive energy activities. They also require the appointment of a Compliance Officer with specific tasks and duties including the preparation and submission of an Annual Report to the Licensee. On 17 July 2012, the Committee approved the Compliance Officers report.

**f) Irregular and Improper Financial Conduct**

*The Terms of Reference indicates that the role of the Committee is “ To establish and supervise, in coordination with the mechanisms established by the parent company of the Iberdrola Group, the channels which permit employees of the Company to communicate, confidentially and, if it is deemed appropriate, anonymously, any potentially significant irregularities, especially those which are financial or accounting in nature which they may have witnessed at the Company; and to undertake the necessary investigations regarding claims by third parties against the Company or regarding irregular or anomalous conduct.”*

On 9 October 2012, the Head of Legal & General Secretary provided a report for the Committee on the Litigations against the Company. The aim of this report is to provide the Committee with an opinion over the status of major claims and the potential legal risks affecting Scottish Power.

**g) Special Purpose Vehicles and Tax Haven Companies**

*The Terms of Reference indicates that the role of the Committee is “To inform the Board of Directors, prior to adoption of any decision on the creation or acquisition of holdings in special purpose vehicles or in entities domiciled in countries or territories which are considered tax havens, as well as any other transactions or operations of a similar nature which, due to their complexity, could undermine the transparency of the Iberdrola Group.”*

On 17 July 2012, the Head of Legal & General Secretary provided a report for the Committee summarising the changes to the Scottish Power Group structure over the period from 31 December 2010 to 31 December 2012. The report provides the Committee with the status of the project to reduce the number of companies, including dormant and tax havens as part of SP Group.

#### **IV. Outlook for 2013**

At its meeting on 12 December 2012 the Committee agreed a proposed Calendar of Sessions for 2013. This will ensure that the Committee fulfils its duties and responsibilities as defined in Article 3 of the Terms of Reference.

The proposed activities to be covered in the sessions of 2013 are set out in the table below:

<b>Audit Committee Function</b>	<b>Proposed Activities</b>
<b>Internal Audit</b>	<ul style="list-style-type: none"> <li>➤ Presentations by the Head of Internal Audit:               <ul style="list-style-type: none"> <li>○ <b>Evaluation of 2013 Internal Audit Plan</b></li> <li>○ <b>Monitoring of 2013 Internal Audit Plan</b></li> </ul> </li> </ul>
<b>Internal Monitoring and Risk Management Systems</b>	<ul style="list-style-type: none"> <li>➤ Presentations by Risk Management Director:               <ul style="list-style-type: none"> <li>○ <b>Risk Monitoring and Management Systems Update</b></li> </ul> </li> </ul>
<b>External Audit</b>	<ul style="list-style-type: none"> <li>➤ Presentations by the External Auditor:               <ul style="list-style-type: none"> <li>○ <b>Conclusions: H1 2013 Review</b></li> <li>○ <b>2013 Preliminary Conclusions</b></li> </ul> </li> <li>➤ Presentation by the Head of Internal Audit:               <ul style="list-style-type: none"> <li>➤ <b>Terms of Engagement for 2013</b></li> <li>➤ <b>Independence Report for 2012 statutory audit</b></li> </ul> </li> </ul>
<b>Economic and Financial Information</b>	<ul style="list-style-type: none"> <li>➤ Presentations by the Scottish Power Finance Director :               <ul style="list-style-type: none"> <li>○ <b>Business Performance: Q1, 1H and Q3</b></li> <li>○ <b>Closing Forecast 2012</b></li> </ul> </li> <li>➤ Presentations by the Head of Internal Audit:               <ul style="list-style-type: none"> <li>○ <b>Financial Reviews: Q1, 1H and Q3</b></li> </ul> </li> </ul>
<b>Compliance and Good Governance</b>	<ul style="list-style-type: none"> <li>➤ Scottish Power ACC Annual Report of Activities.</li> </ul>
<b>Irregular and Improper Financial Conduct</b>	<ul style="list-style-type: none"> <li>➤ Presentations by the Head of Legal &amp; General Secretary:               <ul style="list-style-type: none"> <li>○ <b>Litigations Against the Company</b></li> </ul> </li> </ul>
<b>Special Purpose Vehicles and Tax Haven Companies</b>	<ul style="list-style-type: none"> <li>➤ Presentations by the Head of Legal &amp; General Secretary:               <ul style="list-style-type: none"> <li>○ <b>Liquidations Report</b></li> </ul> </li> </ul>

**Other potential areas which may require committee attention (depending on activities in 2013) are:**

- Creation of Special Purpose Vehicles (SPV) or companies domiciled in Tax Havens;
- Consultancy Engagements with Ernst & Young; and
- Transactions between companies within the Scottish Power Group and any of the other companies forming part of the Iberdrola Group.



## V. APPENDIX

# **Terms of Reference of the Scottish Power Limited Audit and Compliance Committee**

## **Implementation of the new business and governance structure of the Iberdrola Group**

**Approved by Scottish Power Limited Board on 18 July 2012**



## **CHAPTER I.- NATURE, PURPOSE AND APPROVAL OF THE TERMS OF REFERENCE**

### **Article 1.- Nature and purpose**

1. In accordance with the provisions of the Articles of Association of Scottish Power Limited (hereinafter, the “**Company**”), the board of directors of the Company (the “**Board of Directors**”) have established the Audit and Compliance Committee (hereinafter, the “**Committee**”), a permanent internal body, having an informative and consultative role, without executive functions, with powers of information, assessment and presentation of proposals to the Board of Directors within its scope of action, which shall be governed by the Memorandum and Articles of Association of the Company and this Terms of Reference.
2. These Terms of Reference set out the principles of action and the internal operational regime of the Committee. They have been prepared taking into account that the sole ordinary shareholder of the Company is a listed company as well as the parent company of the Iberdrola Group, which also has an Audit and Risk Supervision Committee and a Corporate Social Responsibility Committee within its governance structure.

### **Article 2.- Approval, modification and regulatory ranking**

1. These Terms of Reference must be approved by a resolution of a majority of the members of the Committee and be ratified by a resolution of the Board of Directors of the Company.
2. Further to the proposal of either the chairman of the Committee or the majority of its members, these Terms of Reference may be modified by means of a resolution of the Committee, which shall submit the modifications to the Board of Directors for approval.

## **CHAPTER II.- FUNCTIONS OF THE COMMITTEE**

### **Article 3.- Functions**

3. The Committee, as well as the internal audit department of the Company (the “**Internal Audit Department**”), shall exercise their functions with full autonomy, but without prejudice to the establishment of an adequate framework for collaborating with and reporting on the development of their functions to the Audit and Risk Supervision Committee of the parent company of the Iberdrola Group (the “**Iberdrola Audit and Risk Supervision Committee**”) and its own internal auditing department (the “**Iberdrola Internal Audit Department**”).
4. The Committee shall have the following functions:
  - (a) **Internal Audit:**
    - (i) To oversee the independence and efficiency of the Internal Audit Department, ensuring that such department has sufficient resources and the professional qualifications necessary to carry out its functions optimally, and ensuring that the Basic Internal Auditing Regulations of the Iberdrola Group are complied with.
    - (ii) To approve the guidelines and the annual action plans established by the head of the Internal Audit Department, in accordance with the guidelines and general plans established by the head of the Iberdrola Internal Audit Department, but focused in the Company risks.

- (iii) To propose the budget of the Internal Audit Department, for its approval by the Board of Directors.
  - (iv) To propose to the Board of Directors the appointment, re-election or cessation of the head of the Internal Audit Department. In order to prepare any such proposal the Chairman (as defined below) shall hold any meetings necessary with the head of the Iberdrola Internal Audit Department and inform the Committee of the nature and content of any such meetings.
  - (v) To oversee the head of the Internal Audit Department, which will functionally depend on the Chairman of the Committee and hierarchically on the Chairman of the Board and which will prepare the information required for the meetings of the Committee that will attend. The head of the Internal Audit Department is, furthermore, required to inform the Committee of any incidents which may occur in the development of the annual work plan, presenting it at the end of each year with an activity report. This internal audit activity report will also be presented to the head of the Iberdrola Internal Audit Department.
  - (vi) To receive regular information on the activities carried out by the Internal Audit Department. In order to ensure the guidelines and general plans established by the parent company of the Iberdrola group are followed, the Internal Audit Department (through the head of this department) shall also maintain the necessary flow of information between himself and the head of the Iberdrola Internal Audit Department.
  - (vii) To ensure that the managers of the Company take into account the conclusions and recommendations in the reports of the Internal Audit Department. The Head of the Internal Audit Department shall be the usual point of contact between the Committee and the rest of the Company except for the risk matters. The Head of the Internal Audit Department will prepare the relevant documents for the Committee meetings within the scope of his responsibilities. The Committee may gather information and request the collaboration of any manager of the Company or of any of the Company's subsidiaries. Any such gathering of information and/or requests for collaboration shall also be notified to the chairman of the Board of Directors and to the Chief Executive Officer, if there is one, but in any case without prejudice to the provisions of Article 13.5 below.
- (b) **Internal Monitoring and Risk Management Systems:**
- (i) To be aware of and keep under review the Company's internal financial information process and internal risk monitoring and management systems and those of any of the Company's subsidiaries, ensuring that these are adequately adapted to the processes and general systems established by the parent company of the Iberdrola Group.
  - (ii) To ensure, in accordance with the general monitoring and risk management policy established by the parent company of the Iberdrola Group, that the main risks of the Company and those of any of the Company's subsidiaries are identified, managed and adequately reported, identifying, on this basis: the different types of risks which may face the Company, including financial or economics risks, contingent liabilities and other off balance-sheet risks; the level of risk of that the Company deems acceptable; the measures necessary to

mitigate the impact of any risks, should any of them materialise; and the information and internal monitoring systems which will be used to monitor and manage the aforementioned risks, including the contingent liabilities or off balance-sheet risks.

- (iii) The Committee shall ensure the establishment of measures necessary to mitigate the impact of any risks identified and introduce information and internal monitoring systems which monitor and manage such risks, including contingent liabilities or off balance-sheet risks.
- (iv) Maintain appropriate relationships with the Company Risk Division. The Company Risk Division shall be the normal body for communication with the Committee and the rest of the Company's organisation on specific matters of risk, as it is responsible for preparing the information required on these issues at meetings, with the Director of the Company Risk Division attending them if the Committee so deems appropriate, but in any case without prejudice to the provisions of Article 13.6 below.
- (v) To make, at least every six months, a report of the risks of the Company for the Board of Directors that the Chairman of the Committee, in the frame of the information and coordination of the Iberdrola Group's relationships, will make available to the Chairman of the Audit and Risk Supervision Committee of Iberdrola, S.A. in order to allow this Committee to fulfill its duties relating to the internal control of the Group as well as its risk management systems.

(c) **Audited Accounts:**

- (vi) To propose to the Board of Directors the terms of engagement of the Company's auditors, in accordance with the policy as established by the parent company of the Iberdrola Group.

For the avoidance of the doubt, the Company's auditors referred to in these Terms of Reference are the auditors which have been formally appointed in accordance with the Articles of Association of the Company.

- (vii) To ensure the independence of the Company's auditors, receiving from them information on those issues related to the audit process which may put their independence at risk, and in general, information on any other issues which may be provided for in applicable legislation and/or the relevant audit practices in force from time to time, and establishing where necessary, information channels between the Internal Audit Department and the Iberdrola Internal Audit Department. In any event, it shall receive from the Company's auditors, on an annual basis, a written confirmation of their independence in respect of the Company or entities directly or indirectly related thereto, as well as information regarding additional services of any kind provided to such entities by the said auditors or by persons or entities related thereto, pursuant to the legislation governing the audit of financial statements.
- (viii) Issue, on an annual basis and prior to the issuance of the Company's auditors' report, a report setting forth an opinion on the independence of the auditors. This report shall, in all cases, include the provision of the additional services referred to in the preceding paragraph.

- (ix) Analyse, together with the auditors, any significant weaknesses detected in the internal control system during the conduct of the audit and to review the contents of the Auditors Reports before they are issued, in order to avoid qualifications in their preparation and assess the results of each audit, overseeing the reply of the management of the Company to their recommendations.
  - (x) To serve as a communication channel between the Board of Directors and the auditors, relaying to the Board of Directors the regular information updates on the audit process and results received from the auditors.
- (d) **Economic and Financial Information:**
- (xi) To oversee the process for the preparation of and the integrity of the financial economic information of the Company (including half year information), advising on any proposals for changes to the accounting practices and policies with the general accounting practices and policies of the parent company of the Iberdrola Group. The Committee will elaborate a report for the Board of Directors on the annual, interim semi-annual and quarterly financial statements. The Chairman of the Committee will make these reports available to the Chairman of the Audit and Risk Supervision Committee of Iberdrola, S.A. in order to allow this Committee to supervise the process of preparation and submission and the integrity of the economic and financial information related to the Group.
  - (xii) To oversee compliance with the legal requirements and the correct application of the national and international accounting and financial information principles and practices which may be applicable in relation to the Annual Report and Accounts and the Director's Report of the Company.
  - (xiii) To inform the Board of Directors of the principles on which the transactions carried out between the Company and any of the other companies forming part of the Iberdrola Group, and any of the Company's subsidiaries, must respect in order to protect the interests of the Company.
- (e) **Compliance and Good Governance:**
- To review the status of compliance with laws, regulations and internal procedures and the scope and status of systems designed to promote Company compliance with laws, regulations and internal procedures, through review of reports from management, legal counsel and third parties as determined by the Committee.
- (f) **Irregular and Improper Financial Conduct:**
- a. To establish and supervise, in coordination with the mechanisms established by the parent company of the Iberdrola Group, the channels which permit employees of the Company to communicate, confidentially and, if it is deemed appropriate, anonymously, any potentially significant irregularities, especially those which are financial or accounting in nature which they may have witnessed at the Company. In doing so, the Committee shall respect applicable regulations regarding the protection of personal information and the fundamental rights of the parties involved.

- b. To undertake the necessary investigations regarding claims by third parties against the Company or regarding irregular or anomalous conduct, in accordance with the provisions of the above paragraph.

(g) **Special Purpose Vehicles and Tax Haven Companies:**

To inform the Board of Directors, prior to adoption of any decision on the creation or acquisition of holdings in special purpose vehicles or in entities domiciled in countries or territories which are considered tax havens, as well as any other transactions or operations of a similar nature which, due to their complexity, could undermine the transparency of the Iberdrola Group. The Committee shall also inform the chairman of the Iberdrola Audit and Risk Supervision Committee of the same.

5. The Committee shall similarly assume any other functions which, as the case may be, the Articles of Association of the Company or the Board of Directors attribute to it.

**Article 4.- Scope of functions. Information to the Board of Directors**

6. The functions indicated in the above Article shall extend to the Company and any and all of the Company's subsidiaries.
7. At the first meeting of the Board of Directors subsequent to any meeting(s) of the Committee the Chairman shall inform the Board of Directors of the resolutions and significant events which occurred at the meeting(s) of the Committee.

**Article 5.- Annual Report**

The Committee shall submit to the Board of Directors for its approval an Annual Report of its activities, an evaluation of the adequacy of the Committee's Terms of Reference and an evaluation of the Committee's performance during the previous year, within the three months subsequent to the end of the year. This Annual Report shall subsequently be made available to the ordinary shareholder and to the chairman of the Iberdrola Audit and Risk Supervision Committee, except the portion of the report related to Article 3.2(e) that will be made available to the Chairman of the Iberdrola SA Corporate Social Responsibility Committee.

**Article 6.- Specialist Services**

8. In order to carry out its functions, the Committee may employ, permanently or occasionally, legal advisors, accountants, technicians, financiers, salesmen or other specialists, who may attend the meetings of the Committee, as well as the meetings of the Board of Directors when required, and who may speak at the meetings but may not vote.
9. Employment of those experts shall be made in accordance with the Articles of Association.

**CHAPTER III.- FORMATION, APPOINTMENT AND CESSATION OF MEMBERS**

**Article 7.- Formation**

10. The Committee shall be formed of three (3) Directors, from among which at least one of them shall be an independent director.
11. The Committee shall have a chairman (the “**Chairman**”) and a secretary, who, in the event of absence, shall be substituted respectively by the two members who have the most seniority on the Board by length of service, on the one hand, and, on the other hand, the least seniority on the Board by length of service. In the event of equal seniority, the independent non-executive director(s) on the Board of Directors shall decide.

#### **Article 8.- Appointment**

12. The members of the Committee, as well as the Chairman, shall be appointed by the Board of Directors.
13. The Board of Directors shall attempt to ensure that the members of the Committee have the necessary experience and knowledge of accounts, audit or risk management, which is adequate for the functions they are asked to provide. It shall not be necessary for them to be experts in these areas.

#### **Article 9.- Duration**

14. The Directors sitting on the Committee shall exercise this office while their appointment as Directors of the Company continues in force, unless the Board of Directors agrees otherwise.
15. The Directors which make up the Committee, and which are re-elected as Directors of the Company in accordance with the Articles of Association, shall continue to carry out their positions on the Committee without the need for a new election, unless the Board of Directors agree otherwise.

#### **Article 10.- Cessation**

The members of the Committee shall cease in their positions:

- (a) if/when they cease to be Directors of the Company; or
- (b) by resolution of the Board of Directors.

### **CHAPTER IV.- MEETINGS OF THE COMMITTEE**

#### **Article 11.- Sessions**

16. The Committee shall meet as many times as is considered necessary in the opinion of the Chairman to comply with their undertakings, and at least four (4) times a year, or when two (2) of its members so request it.
17. The chairman of the Board of Directors and, if it exists, the Chief Executive Officer, may request informative meetings with the Committee, on an exceptional basis.

#### **Article 12.- Meeting Calls**

18. The Chairman, or the secretary of the Committee at the request of the former, may call a meeting of the Committee by means of a letter, fax, telegram, email or any other means,

addressed to each of its members, indicating the place, date and time of the meeting, as well as the agenda to be followed.

19. The calling of a meeting must be made with a minimum notice period of 48 hours, unless there is a need for an urgent meeting.
20. It shall not be necessary to call meetings of the Committee in advance when, all the members of the Committee are present and unanimously accept holding the meeting and debating the points on the agenda.

#### **Article 13.- Quorum, Attendance and Adoption of Resolutions**

21. The Committee shall be quorate when at least two (2) of its members are present or duly represented.

Any member of the Committee may delegate its representation to another member of the Committee by means of a letter, fax, telegram, email or other communication, which includes specific instructions regarding how to cast his vote, addressed to the secretary of the Committee.

22. Meetings of the Committee shall be presided over by the Chairman, which will be assisted by the secretary.
23. Resolutions shall be adopted by a majority of votes of the members of the Committee present or duly represented at the meeting. In the event of a tie, the Chairman will have a casting vote.
24. If none of the members of the Committee make any opposition, votes may be made in writing and without session as permitted by the Articles of Association of the Company.
25. At the request of the Chairman of the Committee, addressed for such purpose to the Chairman of the Board of Directors, any Director may be requested to attend the meetings thereof. The Chairman of the Committee may also request, through the Secretary of the Board of Directors, the attendance of any director, manager or employee of the Company as well as of any member of the management decision-making bodies of the companies in which the Company has an interest whose appointment has been proposed by the Company, provided that there is no legal impediment thereto.
26. Persons who are not members of the Committee may not attend meetings when the matters dealt with are outside of the scope of the powers or duties of such persons.
27. The Committee may request the presence at its meetings of both the Company's auditor as well as the auditor of any entity within the Company, provided that there is no legal impediment thereto.
28. The secretary of the Committee shall draw up the minutes of each meeting, which shall be approved at the end of the same meeting or at the start of the immediately subsequent meeting.

### **CHAPTER V.- COMPLIANCE, INTERPRETATION AND INTEGRATION OF THE REGULATIONS**

#### **Article 14.- Compliance**

29. The members of the Committee, as well as the other Directors affected, have the obligation to be aware of and comply with these Terms of Reference, for which purpose the secretary of the Board of Directors shall provide all of them with a copy.
30. Additionally, the Committee, in particular the Chairman, shall have the obligation to oversee compliance with these Terms of Reference, adopting any measures necessary for such purpose.

**Article 15.- Interpretation and Integration of the Regulation**

31. Any doubts or discrepancies as regards the interpretation of these Terms of Reference shall be resolved by a majority of the votes of the members of the Committee, and in the absence of such majority, by the Chairman, to be assisted by any persons the Board of Directors may appoint for this purpose. The interpretation and resolution of any doubts or discrepancies which may arise must be reported to the Board of Directors.
32. In the absence of any specific regulations, the provisions of the Articles of Association of the Company relating to the operation of the Board of Directors, provided they are not incompatible with its nature and function, shall be applicable to the Committee.
33. In these Terms of Reference the term “Group” shall mean a group as defined in section 1261 of the Companies Act 2006.