

## **Audit committee – Terms of Reference**

The Terms of Reference set out below are common to each of UK Asset Resolution Ltd ("UKAR"), Bradford & Bingley plc ("B&B") and Northern Rock (Asset Management) plc ("NRAM") (each, a "Company" and together, the "Group Companies" or the "Group"). Each of the Group Companies has separately resolved to adopt these Terms of Reference at a Board meeting held on 26 January 2011. Wherever any item is not applicable to any one of the Group Companies this is highlighted in the Terms of Reference.

### **1. Constitution**

The Board of Directors (the "Board") of the Company has established a committee of the Board, known as the Audit Committee (the "Committee"), with Terms of Reference as set out below.

### **2. Purpose**

The Committee shall be accountable to the Board. It shall assist the Board in meeting its responsibilities for the integrity of the Company's financial statements, including its obligations under applicable laws and regulations, for the effectiveness of the Company's (and, in the case of UKAR, the Group's) internal control systems and for monitoring the effectiveness and objectivity of the internal and external auditors.

The Audit Committee of UKAR acknowledges its oversight role in relation to the effectiveness of the internal control systems and auditing policies, of B&B and NRAM, but recognises that each of those companies have their own Audit Committees and monitor the relevant matters in accordance with these Terms of Reference.

### **3. Membership**

The Board shall appoint the Committee Chairman who shall be an independent Non-Executive Director. Members of the Committee shall be appointed by the Board, on the recommendation of the Nominations Committee in consultation with the Chairman of the Audit Committee. The Committee shall be selected from the Company's independent Non-Executive Directors, and shall, in any event, comprise no fewer than three members (including the Committee Chairman), one of whom will also be a member of the Risk Committee. At least one of the Committee members shall, in the opinion of the Board, have recent and relevant financial experience. The Chairman of the Board shall not be a member of the Committee, but may be invited to attend meetings of the Committee as appropriate. A quorum shall comprise two members of the Committee. In the absence of the Chairman, the remaining members present shall elect one of

themselves to chair the meeting. The Company Secretary or such other nominated individual as may be appointed by the Board from time to time will serve as Secretary to the Committee, and references in these Terms of Reference to the “Secretary” shall be construed as including any and all of the aforementioned persons.

Appointments to the Committee shall be for a period of up to three years, which may be extended for further periods of up to three years provided the Director still meets the criteria for membership of the Committee.

Only members of the Committee have the right to attend Committee meetings. However, the Committee may invite any Director, executive, external auditor or other person to attend any meeting(s) of the Committee as it may from time to time consider desirable to assist the Committee in the fulfilment of its duties. The following persons, whilst not members of the Committee, would normally be expected to attend each meeting of the Committee:

- Chairman of the Board
- Chief Executive
- Finance Director
- Risk Director
- Investment Director
- Head of Compliance
- Head of Internal Audit
- External Auditor

#### **4. Meetings**

The Committee shall meet as and when appropriate but not less than four times a year. Those meetings shall coincide with key dates in the Company’s financial reporting cycle, with the notice of meeting, agenda and relevant papers being sent out to each member of the Committee, any other person required to attend and all other Non-Executive Directors at least seven calendar days in advance. The Chairman of the Committee may call additional meetings to examine and consider such other matters related to its responsibilities as the Committee may consider desirable. External or internal auditors or any member of the Committee may request a meeting if they consider it necessary.

The Committee shall meet with the external auditors separately and in private at least once a year, without the presence of the Executives or the Chairman of the Board, to ensure there are no issues of concern and to discuss their remit and any issues arising from their role as external auditors.

The Committee shall meet with the Head of Internal Audit and the partner of the outsourced firm responsible for the provision of internal audit separately and in private at least once a year, without the presence of the executives or the

Chairman of the Board, to ensure there are no issues of concern and to discuss their remit and any issues arising from their role as internal auditors.

Meetings of the Committee may be held by telephone conference or similar arrangement.

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.

## **5. Authority**

The Board authorises the Audit Committee to:

- (a) investigate any activity within its Terms of Reference, and make any recommendations to the Board which it deems appropriate on any area within its remit where action or improvement is needed;
- (b) seek any information that it requires in connection with the performance of its duties from any Director or employee of the Company, with access to all books, records and facilities of the Company, and the Board directs that all Directors and all employees co-operate with any request made by the Committee;
- (c) obtain at the Company's expense appropriate external professional advice, through the Company Secretary, and if necessary invite external advisers with relevant experience to attend meetings of the Committee; and
- (d) publish in the Company's Annual Report details of any issues that cannot be resolved between the Committee and the Board.

## **6. Duties**

The Committee, in carrying out its duties under these Terms of Reference, shall:

- (a) have regard to statutory and regulatory obligations applicable to the Company, and where practicable, in accordance with the relationship framework document detailing the relationship between UKAR and UK Financial Investments Limited (acting on behalf of HM Treasury), the UK Corporate Governance Code and any other relevant corporate governance codes and/or best practice guidelines applying to companies admitted to the Official List.

## **6.1 Internal control**

- (a) in conjunction with the Risk Committee, keep under review the Company's (and, in the case of UKAR, the Group's) systems of internal control; and
- (b) review and approve the statements to be included in the Annual Report concerning internal control.

## **6.2 Financial reporting**

- (a) receive, review and discuss with management prior to their submission to the Board any interim and year-end financial statements, together with any related announcements and press releases;
- (b) receive and review representations from the Chief Executive and the Finance Director before the publication of any financial information to the effect that they have disclosed all relevant information to the Committee and to the external auditor;
- (c) receive and review a report on all known material weaknesses in internal controls over financial reporting which could adversely affect the Company's (and, in the case of UKAR, the Group's) ability to record, summarise and report financial information;
- (d) receive and review a report on all known fraud (whether material or not) that involves management or other employees who have a significant role in the Company's (and, in the case of UKAR, the Group's) internal controls over financial reporting;
- (e) inspect (and, where required, approve) any report or supervisory return which may be required to be made to the FSA and, which in the opinion of the Committee, deals with matters within its terms of reference, together with any material correspondence;
- (f) consider and report to the Board, when material, the effect of all changes in legislation, regulation and other guidance which may affect the conduct of the business of the Company (and, in the case of UKAR, the Group), its systems of control, its business risks or any other matters relating to the way in which the Directors manage the affairs of the Company (and, in the case of UKAR, the Group);
- (g) review, and challenge where necessary, the actions and judgements of management, in relation to the interim and annual financial statements before submission to the Board, paying particular attention to:

- critical accounting policies and practices, and any changes in them;
  - decisions requiring a major element of judgement;
  - the extent to which the financial statements are affected by any unusual transactions in the year and how those transactions are disclosed;
  - the clarity of any disclosures;
  - significant adjustments resulting from the audit;
  - the going concern assumption;
  - compliance with accounting standards;
  - compliance with obligations under applicable laws and regulations; and
  - management's and the external and internal auditors' reports on the effectiveness of systems for internal controls, financial reporting and risk management;
- (h) review related information that is presented with the financial statements, including operating and financial review, and corporate governance statements relating to audit and to risk management;
- (i) review the accounting policies adopted, their appropriateness, their presentation and the impact of any proposed changes;
- (j) review the extent of compliance with appropriate legislation, with accounting standards and other guidance, and the reasons for any deviations there from;
- (k) consider the major findings of material internal investigations and management's response to those findings; and
- (l) review the Company's internal financial controls and advise the Board, at least annually, on the soundness of the internal controls and risk management systems.

### **6.3 Whistleblowing**

- (a) review the arrangements by which employees and contractors may, in confidence, raise concerns about possible wrongdoing and improprieties in matters of financial reporting or other matters (including by acting as designated contact points for any member of staff who feels unable to raise their issue through any other avenue) and to ensure that these arrangements allow proportionate and independent investigation of such matters and appropriate follow up action.

#### **6.4 Internal Audit**

- (a) review the effectiveness and service provided by the internal audit function including, if relevant, reviewing and approving annually the Terms of Reference for the internal audit function and any changes to them;
- (b) review and assess the internal audit programme and where appropriate request that internal audit undertakes specific work;
- (c) monitor that the internal audit function has appropriate standing within the Company, adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards;
- (d) review and monitor management's response to any major internal audit recommendation;
- (e) approve the appointment or dismissal of the approved person for internal audit;
- (f) ensure that the approved person for internal audit has a direct reporting line to the Chairman of the Committee (with recourse directly to the Chairman of the Board) and is accountable to the Committee;
- (g) ensure co-ordination between the internal and external auditors, including, where appropriate, ensuring adequate systems for information sharing;
- (h) approve the aggregate audit and non-audit fees paid to the internal auditors;
- (i) approve the appointment, terms of reference and removal of the outsourced firm providing internal audit services; and
- (j) review reports addressed to the Committee from the internal auditor.

#### **6.5 External Audit**

- (a) 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 a new auditor and if an auditor resigns the Committee shall investigate the issues leading to this and decide whether any action is required;

- (b) at the beginning of each audit cycle, monitor that appropriate plans are in place for the audit and that the scope of the audit plans reflects the terms of the engagement letter and, following the audit, to discuss and review the findings of the external auditors;
- (c) discuss with the external auditor, before the audit commences, the nature and scope of the audit and to review the auditor's quality control procedures (including as regards access to information) and steps taken by the auditor to respond to changes in regulatory and other requirements;
- (d) approve the terms of engagement of external auditors in respect of statutory audit work, including letters of engagement;
- (e) review and monitor the independence and objectivity of the external auditor taking into account relevant UK professional and regulatory requirements and the relationship with the external auditor as a whole, including the provision of non-audit services.
- (f) assess annually the qualifications, expertise and resources of the external auditor and the effectiveness of the audit process, which shall include a report from the external auditor on their own quality procedures;
- (g) monitor compliance by the external auditor with relevant ethical and professional guidance on rotation of audit partners including monitoring the level of fees paid by the Company compared to overall fee income of the audit firm, office and partner and other related requirements;
- (h) satisfy itself that there are no relationships (such as family, employment, investment, financial or business) between the external auditor and the Company (other than in the ordinary course of business);
- (i) 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;
- (j) approve the external auditor's fees for audit and non-audit services, including pre approval of any fees and authorisations with respect to permissible non-audit services provided by the external auditor and to ensure that the provision of such non-audit services does not impair the external auditor's independence or objectivity;
- (k) monitor and review the effectiveness of the relationship between the external and internal auditors;
- (l) consider the management letter and management's response to any major external audit recommendations;

- (m) resolve disagreements between management and the external auditor regarding financial reporting;
- (n) if and when relevant, set clear hiring policies for employees or former employees of the external auditor;
- (o) review the findings of the audit with the external auditor. This shall include but not be limited to, any of the following:
  - a discussion on any major issues which arose during the audit;
  - any accounting and audit judgements;
  - levels of errors identified during the audit; and
  - the effectiveness of the audit.
- (p) review any representation letters requested by the external auditor before they are signed by management.

## **7. Other**

The Committee may form sub-committees from its membership to address specific aspects of its duties, and may delegate such of its powers to any person, firm or body as it considers necessary to assist them in carrying out work required by the Committee.

The Committee shall consider any other matters requested by the Board from time to time and oversee any investigation of activities which are within its terms of reference.

The Committee Chairman should attend the Annual General Meeting to answer shareholder questions on the Committee's activities.

## **8. Review**

The Committee will conduct an annual review of its performance, and ensure that it is provided with sufficient resources to undertake its duties including access to the Company Secretariat for assistance as required. The Committee will ensure that appropriate and timely training is provided to members on appointment and on an on-going basis, and recommend any changes it considers necessary to the Board for approval. These Terms of Reference will be reviewed annually by the Committee and any changes it considers necessary will be recommended to the Board for approval.

## **9. Reporting procedures**

The Chairman of the Committee shall be responsible for reporting to the Board. The Secretary shall minute the proceedings and decisions of all meetings of the Committee including the names of those present and in attendance. The minutes of all meetings and resolutions of the Committee shall be circulated promptly to the members of the Committee and to the Board. The Secretary will retain copies of the minutes and papers.

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

The Committee shall produce a report on its activities to be included in the Company's annual report.