



Pearson

## Pearson plc

### **Audit Committee - Charter and Terms of Reference**

These terms of reference were last reviewed in December 2015 and approved by the Board of Directors ("the Board") on 4 December 2015.

#### **1. Purpose and Primary Duty**

The Committee is established by the Board primarily for the purpose of assisting the Board's oversight of: (1) the quality and integrity of the Company's financial reporting and statements and related disclosure, (2) the Company's accounting policies and practices, (3) the external audit, including the appointment, qualification, independence and the performance of the external auditor, (4) the Company's risk management systems and internal control environment including the performance of the internal audit function (i.e. Group Internal Audit), and (5) the Company's compliance with legal and regulatory requirements in relation to financial reporting and accounting matters. The Committee shall also review significant financial returns to regulators and any financial information contained in certain other documents, such as announcements of a price sensitive nature.

#### **2. Membership and Attendance**

- 2.1. Members of the Committee shall be appointed by the Board, on the recommendation of the Nomination Committee in consultation with the Chairman of the Audit Committee. The Committee shall comprise at least three members.
- 2.2. The members of the Committee may be removed or replaced and any vacancies shall be filled by the Board upon recommendation of the Committee Chairman or Nomination Committee.
- 2.3. All members of the Committee shall be independent non-executive directors (as defined by the UK Corporate Governance Code ("the Code")). The Chairman of the Board shall not be a member of the Committee. At least one member of the Committee should have recent relevant financial knowledge, as defined by the Board. All members of the Committee shall meet the applicable independence, financial literacy and other requirements of the stock exchanges where the Company's shares are listed.
- 2.4. Care should be taken to minimise the risk of any conflict of interest that might be seen to give rise to an unacceptable influence.
- 2.5. The Board shall appoint the Committee Chairman who shall be an independent non-executive director. In the absence of the Committee Chairman and/or an appointed deputy, the remaining members in attendance at the meeting shall elect one of their number present to chair the meeting.

- 2.6. Only members of the Committee have the right to attend committee meetings. However, the Committee may ask individuals such as the Chairman, Chief Executive and any relevant senior management to attend all or part of any meeting as and when appropriate and necessary.
- 2.7. The Committee may ask the Chief Financial Officer, the SVP Internal Audit & Compliance and representative(s) of the external auditors to attend all meetings.
- 2.8. Appointments to the Committee shall be for a period of up to three years, which may be extended for two further three year periods, provided the director remains independent.

### **3. Secretary**

The Company Secretary or his/her nominee shall act as the Secretary of the Committee.

### **4. Quorum**

The quorum necessary for the transaction of business shall be two members. 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. Frequency of Meetings**

- 5.1. The Committee shall meet not less than four times a year, usually to coincide with the publication of the Company's financial statements, and at such other times as the Committee Chairman, in consultation with the Committee members, shall require. The Committee shall meet separately with representatives of management, the SVP Internal Audit & Compliance and the external auditor at least once per year.
- 5.2. Outside of the formal meeting programme, the Committee Chairman will maintain a dialogue with key individuals involved in the Company's governance, including the Chairman, Chief Executive, Chief Financial Officer, the external audit lead partner and the SVP Internal Audit & Compliance.

### **6. Agenda for Meetings**

The Committee Chairman shall develop and set the Committee's agenda, in consultation with the Company's management and, if appropriate, with the external auditors.

### **7. Notice of Meetings**

- 7.1. Meetings of the Committee shall be summoned by the Secretary of the Committee at the request of any member or at the request of the Chief Financial Officer, the SVP Internal Audit & Compliance or by the external auditors if they consider it necessary.
- 7.2. Unless otherwise agreed, notice of each meeting confirming the venue, time and date together with an agenda of items to be discussed, shall be forwarded to each member of the Committee, any other person required to attend and all other non-executive directors, no fewer than seven days prior to the date of the meeting. Supporting papers shall be sent to Committee members and to other attendees as appropriate, at the same time, unless otherwise agreed.

## **8. Minutes of Meeting**

- 8.1. The Secretary shall minute the proceedings and resolutions of all meetings of the Committee, including recording the names of those present and in attendance.
- 8.2. The Secretary should ascertain, at the beginning of each meeting, the existence of any conflicts of interest and minute them accordingly.
- 8.3. Minutes of Committee meetings shall be circulated promptly to all members of the Committee and to the Chairman and all members of the Board, unless a conflict of interest exists or it would be inappropriate to do so in the opinion of the Committee Chairman. Those in attendance shall receive minutes for the items that were discussed during their attendance.

## **9. Annual General Meeting**

The Committee Chairman, or if he is unable to attend, any other member of the Committee, shall attend the Annual General Meeting prepared to respond to any shareholder questions on the Committee's activities.

## **10. Duties**

The Committee shall carry out the duties below for the Company, major subsidiary undertakings and the group as a whole, as appropriate.

### 10.1. Internal Control, Risk Assessment and Internal Audit

- 10.1.1. The Committee shall keep under review the effectiveness of the Company's financial reporting and review and approve the statements to be made in the annual report concerning internal control policies and procedures for the identification, assessment, management and reporting of risks.
- 10.1.2. The Committee shall monitor the effectiveness of the Company's risk management and internal control systems and will at least annually review the adequacy and effectiveness of the Company's internal audit, risk management and internal control systems to satisfy itself that these are sound and provide reasonable assurance against significant loss and/or material financial misstatement. The Committee will carry out a robust assessment of the principal risks and will satisfy itself that the disclosures in the Company's financial statements relating to risk management and the internal control environment are soundly based and comply with relevant exchange listing requirements.
- 10.1.3. The Committee shall approve the appointment and dismissal of the SVP Internal Audit & Compliance.
- 10.1.4. The Committee shall consider and approve the terms of reference of the Group Internal Audit function ensuring that these allow for an effective independent internal audit function.
- 10.1.5. The Committee shall satisfy itself that the Group Internal Audit function is adequately resourced, in terms of both quality and quantity of staff and has appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards, and shall approve the annual internal audit plan. The Committee shall receive and review regular reports from the SVP Internal Audit & Compliance on the activities of the function to include, but not limited to, findings from

internal audit visits, risk management issues including significant change management projects, fraud and whistleblowing incidents. The Committee shall review and monitor management's responsiveness to the findings and recommendations of the Group Internal Audit function.

- 10.1.6. The SVP Internal Audit & Compliance shall be given the right of direct access to the Committee and Board Chairmen and to the Committee, and is accountable to the Committee, and at least once a year the Committee should meet with him/her, without management being present, to discuss their remit and any issues arising from the internal audits carried out.
- 10.1.7. The Committee shall review and assess promptly all reports on the group from the Group Internal Audit function.

#### 10.2. Whistleblowing and Fraud

- 10.2.1. The Committee shall review the group's arrangements for its employees and contractors to raise concerns, in confidence, about possible improprieties in financial reporting or other matters. The objective shall be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and appropriate follow up action.
- 10.2.2. The Committee shall review the group's policies, systems and controls for preventing and detecting fraud, bribery and corruption and receive any reports on non-compliance and shall review its code of corporate conduct/business ethics and its policies for ensuring that the group complies with the relevant regulatory and legal requirements.

#### 10.3. External Audit

- 10.3.1. The Committee shall consider and make recommendations to the Board, to be put to shareholders for approval at the AGM, for the appointment, re-appointment and removal of the Company's external auditors, the services to be provided by them, their remuneration and the terms of their engagement. Annually the Committee shall consider whether it is appropriate to recommend the reappointment of the external auditors and, if not, recommend to the Board that a tender process is initiated. The Committee shall oversee the selection process for new auditors and if an auditor resigns the Committee shall investigate the issue leading to this and decide whether any action is required. The Committee shall ensure that lead and concurring audit partners, together with other significant audit partners within the appointed firm are rotated from time to time, but no longer than once every five years, and in accordance with the rules of the stock exchanges where the Company's shares are listed.
- 10.3.2. The Committee shall ensure that the Company complies with the requirements of the Competition and Markets Authority and the UK implementation of EU Regulation 537/2014 and Directive 2014/56/EU in respect of audit firm tendering and rotation, initially by putting the statutory audit contract out to tender in time for the new firm to be appointed not later than the 2023 audit. Thereafter the Committee shall ensure that at least once every ten years the audit services contract is put out to tender, with a change of firm at least every twenty years, to comply with the regulatory requirements and to enable the Committee to compare the quality and effectiveness of the services provided by the incumbent auditor with those of other audit firms. In respect of such a

tender the Committee shall oversee the process and ensure that it complies with all applicable regulatory and legal requirements (including the UK implementation of Article 16 of the EU Regulation) and that all tendering firms have such access as is necessary to information and individuals during the tendering process.

- 10.3.3. The Committee shall meet with the external auditors at least twice each year, once at the planning stage, where the scope of the audit will be considered, and once post audit at the reporting stage, and shall ensure that any auditor's management letters and management's responses are reviewed. The Committee shall meet the external auditor at least once a year, without management being present, to discuss their remit and any issues arising from the audit.
- 10.3.4. The Committee shall review and approve the annual audit plan and ensure that it is consistent with the scope of the audit engagement.
- 10.3.5. The Committee shall review the findings of the audit with the external auditor. This shall include but not be limited to, the following: a discussion of any major issue that arose during the audit; any accounting and audit judgements; levels of errors identified during the audit; significant adjustments resulting from the audit; any material misstatements detected by the auditors that individually or in aggregate have not been corrected and the management's expectations as to why they have not been adjusted; and any possible impairments of the group's assets.
- 10.3.6. The Committee shall also review the effectiveness of the audit and review any representation letters requested by the external auditor before they are signed by management; review the management letter and management's response to the auditors findings and recommendations and develop a policy on the supply of non audit services by the external auditor, taking into account any relevant ethical guidance on the matter.
- 10.3.7. The Committee shall review the relationship with external auditors including (but not limited to):
  - a. the independence, objectivity, qualifications, experience and performance of the external auditors, taking into account relevant professional and regulatory requirements;
  - b. satisfying itself that there are no relationships (such as family, employment, investment, financial or business) between the auditor and the Company (other than in the ordinary course of business);
  - c. the Committee shall establish the policy and procedures with respect to its review and approval of the Company's external auditor's services (audit and non-audit);
  - d. discussions with the external auditors concerning such issues as compliance with accounting standards and any proposals which the external auditors have made relating to the Company's internal auditing standards;
  - e. approval of their terms of engagement, including any engagement letter issued at the start of each audit and the scope of the audit;
  - f. agreeing with the Board a policy regarding the employment of former employees of the Company's auditor, then monitoring the implementation of this policy;

- g. monitoring the auditor's compliance with relevant ethical and professional guidance on the rotation of audit partners, the level of fees paid by the Company compared to the overall fee income of the firm, office and partner and other related requirements;
- h. ensuring a proper system is in place to enable co-ordination with the activities of the Group Internal Audit function.
- i. assessing annually their qualifications, expertise and resources and the effectiveness of the audit process which shall include a report from the external auditor on their own internal quality procedures. The Committee should, at least annually, obtain and review a report by the outside auditor describing: (1) the firm's internal quality control procedures; (2) any material issues raised by the most recent internal quality control review or peer review of the audit firm, or by any investigation by governmental or professional authorities within the last five years, regarding any independent audit carried out by the firm, and any steps taken to address these issues; and (3) all relationships between the auditor and the Company; and
- j. considering the risk of the withdrawal of the Company's present auditor from the market.

10.3.8. The Committee shall review and approve the fees to be paid to the external auditor, whether fees for audit or non-audit services and shall ensure that the level of fees is appropriate to enable an adequate audit to be conducted and that there are no prohibited services.

#### 10.4. Financial Reporting

The Committee shall monitor the integrity of the financial statements of the Company, including its annual and half-yearly reports, interim management statements, preliminary results announcements and any other formal announcements relating to its financial performance, reviewing significant financial reporting issues and judgments which they contain, having regard to matters communicated to it by the external auditor, before submission to the Board. The Committee shall also review any significant financial information contained in other documents.

##### 10.4.1. General

- a. To gain an understanding of the current areas of greatest financial risk and how effectively management is managing these.
- b. To review significant accounting and reporting policies and issues, including recent professional and regulatory pronouncements, and consider their impact on the financial statements.

##### 10.4.2. Annual financial statements

- a. To review, with both management and the external auditors, the accounting principles, policies and practices adopted in the preparation of the annual financial statements of the group, and the Company's MD&A disclosures, including areas requiring major judgmental considerations, and to review any changes to these principles, policies and practices.
- b. To review and challenge whether the Company has followed appropriate accounting

standards and made appropriate estimates and judgements, taking into account the views of the external auditor.

- c. To satisfy itself that the financial statements meet all relevant statutory requirements, financial reporting standards and accounting practices and the requirements of the stock exchanges where the Company's shares are listed and that there are no unsettled issues of significance between management and the auditors which could affect the accuracy and fairness of the statements.
- d. To satisfy itself that the statements on going concern included in the financial statements and the relevant supporting assumptions are soundly based.
- e. To provide advice relating to the required viability statement under the Code, where requested by the Board, on how, taking into account the Company's position and principal risks, the prospects of the Company have been assessed, over what period and why the period is regarded as appropriate. Also to provide advice on whether there is a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the chosen period, drawing attention to any qualifications or assumptions as necessary, prior to the Directors making the related statement in the Annual Report.
- f. To hold discussions with management and the external auditors to ascertain their satisfaction with the results of the completed audit and their views of the adequacy of its scope. To review the principle points raised by the auditors in the "Management Letter" and the management response thereto; to review and discuss with the external auditors material changes to auditing standards.
- g. To review the extent to which the financial statements are affected by any unusual transactions in the year and how they are disclosed.
- h. To review the methods used to account for significant or unusual transactions where different approaches are possible.
- i. To review the clarity of the disclosures in the Company's financial report and the context in which statements are made.
- j. To review and challenge all material information presented with the financial statements, such as the business review and the corporate governance statement, insofar as it relates to the audit and risk management.
- k. To review and challenge where necessary the consistency of, and any changes to, significant accounting policies.

#### 10.4.3. Preliminary announcements and interim financial statements

To review the accounting principles, policies and practices adopted in the preparation of the preliminary and interim announcements, significant financial returns to regulators and any financial information contained in certain other documents, such as announcements of a price sensitive nature and obtain explanations from management, Group Internal Audit, and the external auditors as appropriate or required.

#### 10.4.4. Narrative reporting

Where requested by the Board, the Committee should support the Board in concluding

whether, taken as a whole, the annual report and accounts are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's performance, business model and strategy.

#### 10.5. Reporting Responsibilities

- 10.5.1. The Committee Chairman shall report formally to the Board on its proceedings after each meeting on all matters within its duties and responsibilities.
- 10.5.2. The Committee shall make whatever recommendations to the Board it deems appropriate on any area within its remit where action or improvement is needed and shall compile a report to shareholders on its activities to be included in the Company's Annual Report and Accounts. The report should include an explanation of how the Committee has addressed the effectiveness of the external audit process; the significant issues that the Committee considered in relation to the financial statements and how these issues were addressed, having regard to the matters communicated to it by the auditor; and all other information requirements set out in the Code.
- 10.5.3. In compiling the reports to the Board and shareholders referred to above, the Committee should exercise judgement in deciding which of the issues it considers in relation to the financial statements are significant, but should at least include those matters that have informed the Board's assessment of whether the Company is a going concern. The report to shareholders need not repeat information disclosed elsewhere in the annual report and accounts, but could provide cross-references to that information.

#### 10.6. Other Matters

The Committee shall:

- 10.6.1. have access to sufficient resources in order to carry out its duties, including access to the company secretariat for assistance as required;
- 10.6.2. be provided with appropriate training, as needed, in the form of an induction programme for new members and on an ongoing basis for all members;
- 10.6.3. give due consideration to laws and regulations, the provisions of the Code and the requirements of the Financial Conduct Authority's Handbook of rules and guidance, as well as the Sarbanes-Oxley Act and SEC and NYSE requirements in the US and any other applicable rules, as appropriate;
- 10.6.4. oversee any investigation of activities, which are within its charter and terms of reference and act as a court of the last resort;
- 10.6.5. review other disclosures and documents as determined by the Board;
- 10.6.6. review in general terms the information to be disclosed in the Company's full year and half year earnings releases, as well as the key messages contained in such releases;
- 10.6.7. conduct private sessions, periodically, with both Group Internal Audit and the external auditors;
- 10.6.8. at least once a year, review its own performance, constitution and charter and terms of reference to ensure it is operating at maximum effectiveness and recommend any changes it considers necessary to the Board for approval; and

10.6.9. review the Company's co-ordinated plans for business continuity and the prevention and detection of fraud, bribery and corruption.

## **11. Authority**

The Committee is authorised:

- 11.1. to seek any information it requires from any employee of the Company in order to perform its duties;
- 11.2. to obtain, at the Company's expense, outside legal or other professional advice on any matters within its charter and terms of reference;
- 11.3. to call any member of staff to be questioned at a meeting of the Committee as and when required;
- 11.4. to investigate or commission investigations into any activity within its terms of reference;
- 11.5. to delegate any of its powers to one or more of its members or the Secretary; and
- 11.6. to have the right to publish in the Company's annual report details of any issues that cannot be resolved between the Committee and the Board.