



**Terms of Reference of the Audit Committee (“Committee”) of the Board of Directors  
 (“Board”) of Optos plc (“Company” or “Group”)**

**Constitution and Authority**

1. The Committee is established as a Committee of the Board of the Company as established in the Articles of Association of Optos plc and in accordance with The UK Corporate Governance Code (the “Code”) (June 2010).
2. The Committee’s principal responsibilities are to determine and recommend to the Board, the Group’s overall audit policy, its alignment to performance and its cost, to review, and challenge where necessary, the actions and judgments of management, in relation to the Company’s financial statements, operating and financial review, interim reports, preliminary announcements and related formal statements before submission to, and approval by, the Board, and before clearance by the auditors.
3. The Committee is authorised to undertake any activity within these terms of reference and to seek any information it properly requires in order to perform its duties from any employee of the Company or any subsidiary company of the Optos plc group. All employees are directed to co-operate with any request made by the Committee.
4. The Committee is authorised by the Board to obtain, at the Company’s expense, internal or external independent professional advice, as the Committee considers appropriate. The Secretary to the Committee maintains a register of the independent advisors who provide services to the Committee.
5. Each member of the Committee has no day-to-day involvement in running the Company and further discloses to the Committee:
  - 5.1. any personal financial interest (other than as a shareholder) in any matter to be decided by the Committee; or
  - 5.2. any potential conflict of interest from a cross-directorship or other activity; and any such member will abstain from voting on resolutions of the Committee in relation to which such interest exists and from participating in the discussions concerning such resolutions and (if so required by the Board) will resign from the Committee.

**Composition and Meetings**

6. The Committee shall be appointed by the Board on the recommendation of the Nomination Committee and shall consist of not less than three members comprised of a Chairman and at least two other members. The majority of Committee members should be independent as defined by and provided for in the Code. At least one member of the Committee, normally the Chairman, should have recent and relevant financial experience.
7. The Board shall appoint the Committee Chairman, who shall be an independent non-executive Director of the Company. The Chairman of the Board of Directors can be a member but not Chairman of the Audit Committee. In the absence of the Chairman of the Committee, the remaining members present shall elect one of their number to chair the



meeting. The Chairman of the Committee shall not be the Chairman of both the Audit Committee and the Remuneration Committee.

8. The Company's external auditors will be invited to attend meetings of the Committee on a regular basis and the Committee should have at least one meeting, or part thereof, with the external auditor without management being present.
9. Committee members will normally serve for a period of up to three years (extendable by no more than two additional three year periods) and subject to the members' retirement by rotation in accordance with the terms of the Company's Articles of Association. Wherever practical, the Chairmanship and membership of the Committee shall be regularly rotated.
10. No one other than the chairman of the Audit Committee and its members is entitled to be present at a meeting of the Audit Committee. Attendance at meetings of the Audit Committee by non-members, the Chairman of the Board (if not a member), the Chief Executive and other members of the Board shall be at the discretion of the Audit Committee. Only members of the Committee are entitled to vote at meetings of the Committee.
11. The Committee will normally appoint the Company Secretary or his or her nominee to be the Secretary to the Committee. This individual shall attend all of its meetings and shall circulate to members and all other non-executive directors (and invitees as appropriate) all information and papers in a timely manner to enable them to give full and proper consideration to the issues. The individual shall prepare minutes of the Audit Committee meetings and shall circulate them to all members of the Audit Committee and to the Chairman (if not a member), unless a conflict of interest exists.
12. Meetings are held as and when appropriate, but not less than three times per year. A timetable of business is established once per year. Any member of the Audit Committee may request a meeting if s/he considers that one is necessary or expedient.
13. The Committee may invite any person it thinks appropriate to attend all or part of any Committee meetings to present on matters of interest to the Committee or to present management proposals.
14. The quorum necessary for the transaction of business shall be two and a duly convened meeting of the Committee at which quorum is present shall be competent to exercise any or all of the authorities, powers and discretions vested in or exercisable by the Committee.

## **Duties and Responsibilities**

### **15. The duties of the Audit Committee include:**

#### **16.1 Financial Reporting**

To review, and challenge where necessary, the actions and judgements of management in relation to the Company's financial statements, operating and financial review, interim reports, preliminary announcements and related formal statements before submission to, and approval by, the Board and before clearance by the auditors, with particular attention paid to:



- 16.1.1 critical accounting policies and practices, and any changes therein;
- 16.1.2 decisions requiring a significant element of judgment;
- 16.1.3 the extent to which the financial statements are affected by any unusual transactions in the year and how they are disclosed;
- 16.1.4 the clarity of disclosures;
- 16.1.5 significant adjustments resulting from the audit;
- 16.1.6 the going concern assumption;
- 16.1.7 compliance with accounting standards;
- 16.1.8 compliance with stock exchange and other legal requirements;
- 16.1.9 reviewing the Company's statement on internal control systems prior to endorsement by the Board and to review the policies and processes for identifying and assessing business risks and management of those risks by the Company; and,
- 16.1.10 to consider other topics as may be defined by the Board.

The Committee shall keep under its review the consistency of accounting policies both on a year-to-year basis and across the Company.

## **16.2 Internal Control and Risk Management**

- 16.2.1 review the Company's procedures for whistle blowing and ensure that arrangements are in place by which staff may, in confidence, raise concerns about possible improprieties in matters regarding financial reporting, financial control or any other matters;
- 16.2.2 review the Company's internal financial controls, that is the systems established to identify, assess, manage and monitor financial risks, and the Company's internal control and risk management systems;
- 16.2.3 review reports from management on the effectiveness of the systems it has established and the conclusions of any testing carried out by internal or external auditors.

**(Note:** the Board retains responsibility for the review of the effectiveness of the system of internal control and must form its own opinion. The Company's management is responsible for the identification, assessment, and management and monitoring of risk, for developing, operating and monitoring the system of internal control and for providing assurance to the Board that it has done so.)



16.2.4 review and approve the statements included in the annual report and accounts in relation to internal control and the management of risk.

**16.3 Internal Audit**

16.3.1 consider annually whether there is a need for an internal audit function where no such function exists;

16.3.2 consider and approve the terms of reference of the internal audit function, and be advised of the planned programme of audits and the reason for any change or delay in the programme;

16.3.3 review the management of financial matters and focus upon the freedom allowed to the internal auditors and ensure that the internal audit function is adequately resourced and has appropriate standing within the Company;

16.3.4 Head of Internal Audit, if applicable, shall be given the right of direct access to the Chairman of the Committee;

16.3.5 receive a report on the results of the internal auditors' work on a periodic basis and review promptly all reports on the Company from the internal auditors;

16.3.6 review and monitor management's responsiveness to the internal auditors findings and recommendations;

16.3.7 monitor and assess the role and effectiveness of the internal audit function in the overall context of the Company's risk management system;

16.3.8 consider applications for the post of, approval and dismissal of the appointment of the Head of Internal Audit function

**16.4 External Audit**

16.4.1 oversee the Company's relations with the external auditor;

16.4.2 consider, and make recommendations on the appointment, re-appointment and removal of the external auditor as well as any questions relating to the resignation or removal of the external auditor;

16.4.3 approve the terms of engagement and the remuneration to be paid to the external auditor in respect of audit services, provided the fee having been conditionally agreed with by the Chief Financial Officer of the Company;

16.4.4 assess the qualifications, expertise and resources, effectiveness and independence of the external auditors annually, and taking the following steps:



- 16.4.4.1 seeking re-assurance that the auditors and their staff have no family, financial, employment, investment or business relationship with the Company, other than in the normal course of business;
  - 16.4.4.2 seeking from the audit firm, on an annual basis, information about policies and processes for maintaining independence and monitoring compliance with relevant requirements, including current requirements regarding the rotation of audit partners and staff;
  - 16.4.4.3 monitoring the external audit firm's compliance with applicable ethical guidance relating to the rotation of audit partners, the level of fees that the Company pays in proportion to the overall fee income of the audit firm, office and partner and other related and applicable regulatory requirements; and,
  - 16.4.4.4 agreeing with the Board and monitoring the Company's policy for the employment of former employees of the external auditor.
- 16.4.5 the Committee shall meet with the external auditors at least three times each year, once at the planning stage, where the scope of the audit and general approach with regard to the audit of areas of risk (including reliance on external audit) will be considered, and one post audit at the interim and final reporting periods, and shall ensure that any auditors, management letters and management's responses are reviewed in relation to the Company or any subsidiary of the Company.
  - 16.4.6 the Committee shall have discussions with the external auditors concerning such issues as compliance with accounting standards and any proposals which the external auditors have made vis-à-vis the company's internal auditing standards, as well as the results of the audit and any problems or reservations arising from the audit (in the absence of management where necessary);
  - 16.4.7 review with the external auditors, the findings of their work, including, any major issues that arose during the course of the audit and have subsequently been resolved and those issues that have been left unresolved; key accounting and audit judgments; levels of errors identified during the audit, obtaining explanations from management and, where necessary the external auditors, as to why certain errors might remain unadjusted;
  - 16.4.8 review the audit representation letters before consideration by the Board, giving particular consideration to matters that relate to non-standard issues;
  - 16.4.9 assess, at the end of the audit cycle, the effectiveness of the audit process by:



- 16.4.9.1 reviewing whether the auditor has met the agreed audit plan and understanding the reasons for any changes, including changes in perceived audit risks and the work undertaken by the external auditors to address those risks;
- 16.4.9.2 consideration of the robustness and perceptiveness of the auditors in their handling of the key accounting and audit judgments identified and in responding to questions from the audit committee, and in their commentary, where appropriate, on the systems of internal control; and,
- 16.4.9.3 obtain feedback about the conduct of the audit from key parties involved.
- 16.4.10 review and monitor the content of the external auditor's management letter the audit representation letters before consideration by the Board, giving particular consideration to matters that relate to non-standard issues;
- 16.4.11 review and monitor the content of the external auditor's management letter, in order to assess whether it is based on a good understanding of the Company's business, and establish whether recommendations have been acted upon and, if not, the reasons why they have not been acted upon;
- 16.4.12 develop and recommend to the Board the Company's policy in relation to the provision of non-audit services by the auditor and ensure the provision of such services does not impair the external auditor's independence or objectivity, and in particular the Audit Committee should:
  - 16.4.12.1 consider whether the skills and experience of the audit firm make it a suitable supplier of the non-audit services;
  - 16.4.12.2 consider whether there are safeguards in place to ensure that there is no threat to independence or objectivity in the conduct of the audit resulting from the provision of such services by the external auditor;
  - 16.4.12.3 consider the nature of the non-audit services, the related fee levels and the fee levels individually and in aggregate relative to the audit fee;
  - 16.4.12.4 consider the criteria that governs the compensation of the individuals performing the audit; and,
  - 16.4.12.5 set and apply a formal policy specifying the types of non-audit work: from which the external auditors are excluded; for which the external auditors can be engaged without referral to the Audit Committee; and, for which a case-by-case decision is necessary or required.

## Reporting



16. The Audit Committee shall report to the Board after each meeting on all matters within its terms of reference and shall make any recommendations to the Board it deems appropriate on any areas within its terms of reference where action or improvement is needed.
17. A summary of the Audit Committee's duties and work shall be included each year in the Company's annual report, including the process used for appointments and an explanation if external advice or open advertising has not been used, the membership of the Committee, the number of Committee meetings held and attendance over the course of the financial year.
18. The Chairman of the Audit Committee shall be available to answer questions through the Chairman of the Board on the report on the Audit Committee's activities and matters falling within its terms of reference at the Annual General Meeting of the Company.
19. The Committee shall make publicly available its terms of reference.

#### **Performance Review**

20. The Committee shall, at least once a year, consider its own performance, constitution and terms of reference to ensure that it is operating at maximum effectiveness and shall recommend any changes necessary to the Board for approval.

#### **Minutes**

21. The Secretary shall minute the proceedings and resolutions of all committee meetings, including the names of those present and in attendance.
22. The Secretary shall circulate the minutes of the meetings of the Committee to all members of the Committee and the Chairman of the Board (if not a member), unless a conflict of interest arises, and to relevant advisers.

#### **Resolution of Disagreements**

23. Where disagreements between the Committee and the Board cannot be resolved, the Committee shall report the issue to the shareholders as part of the report on its activities in the Company's annual report.

**John McNeil**  
**Company Secretary**  
**September 2010**