

## Audit Committee report

### Membership and process

The Committee comprises Jamie Dundas (as Chairman), Tim Barker, Mike Grasby (appointed 17 April 2008) and David Lindsell (appointed 1 December 2008), all of whom are independent non-executive directors, appointed by the Board. Charles Berry was a member of the Committee until 17 April, when he was replaced by Mike Grasby.

The biographical notes of the members of the Committee are set out on pages 36 and 37. The Board is satisfied that the membership of the Committee meets the requirement for recent and relevant financial experience. The Company Secretary acts as Secretary to the Committee.

The Committee met on four occasions in 2008, and the members' attendance record is set out on page 44. The Chairman of the Committee reports the Committee's deliberations to the following Board meeting and, once agreed, the minutes of each meeting of the Committee are circulated to all members of the Board.

### Role

The Committee assists the Board to fulfil its oversight responsibilities. Its primary functions are to:

- monitor the integrity of the financial statements and other information provided to shareholders;
- review significant financial reporting issues and judgements contained in the financial statements;
- review the systems of internal control and risk management;
- maintain an appropriate relationship with the Group's external auditors and review the effectiveness and objectivity of the external audit process; and
- monitor and review the effectiveness of the internal audit function (which is provided by Grant Thornton UK LLP, a leading firm of accountants), review all internal audit reports and review and monitor management's responses to the findings and recommendations of the internal audit function.

The terms of reference for the Committee are reviewed annually by the Committee and then by the Board. A copy of the terms of reference is available on the Group's website at [www.draxgroup.plc.uk](http://www.draxgroup.plc.uk).

### Attendance at meetings

The Chairman of the Board, the Chief Executive, the Finance Director, the Financial Controller and the internal and external auditors are normally invited by the Chairman of the Committee to attend meetings of the Committee. In undertaking its duties, the Committee has access to the services of the Finance Director and the Company Secretary and their resources, as well as access to external professional advice.

### Programme of work

During the year, the Committee undertook its duties in accordance with an agreed annual work plan of which the main features were:

- at meetings in February and July 2008, the Committee reviewed the Group's Preliminary Results Announcement and Annual Report and Accounts, and the Half Year Results Announcement and Report respectively. On each occasion, the Committee both received reports from the external auditors identifying any accounting or judgemental issues requiring its attention and also satisfied itself of the independence and objectivity of the external auditors;
- at each meeting, the Committee received reports from the internal audit function on the progress of their programme for the year, reviewed new internal audit reports and monitored progress with the implementation of internal control recommendations. In April 2008, the Committee reviewed both the arrangements for the provision of the internal audit function and the performance of the current provider, Grant Thornton UK LLP, before deciding to continue the outsourcing arrangement with that firm and then setting the internal audit programme for the coming year;
- in April 2008, the Committee undertook a detailed review of the management letter covering the external auditors' findings in respect of the prior financial year and also reviewed the performance of the external auditors;
- at meetings in April and December 2008, the Committee reviewed the Company's risk register and in December 2008 it undertook a review of the effectiveness of the system of internal controls; and
- during the year, the Committee met four times in the absence of management with the external auditors and three times with the internal auditors. No matters of concern were drawn to the Committee's attention at any of these meetings. The Committee's understanding with both the external and internal auditors is that, if they should at any time become aware of any matters occasioning them material concern, they will immediately draw it to the Committee's attention via the Chairman. Nothing was subject to this procedure in the course of the year.

The nature of the Group's activities, and the markets in which we operate, are such that from time to time there is a need to consider carefully certain complex accounting issues and make subjective judgements. During the year, the Committee reviewed the Group's accounting for unrealised gains and losses under derivative contracts, and the methodology through which we determine appropriate actuarial assumptions for our defined benefit pension scheme. The Committee also considered the subjective judgements which are made in connection with the Group's tax accounting, the methodology for calculating the weighted average cost of coal stocks, and the remaining useful economic life of the Drax Power Station.

On each occasion, the Committee concluded that the relevant accounting standards were being properly applied, and that the judgements taken were reasonable and appropriate to the circumstances.

## Independence of the audit

In July 2008, the Committee considered and adopted an enhanced Auditor Independence Policy. In accordance with the Policy, the Committee annually reviews the quality and cost effectiveness of the external audit and the independence and objectivity of the external auditor.

The provisions of the Policy include:

- seeking confirmation that the auditors are, in their professional judgement, independent of the Group and obtaining from them an account of all relationships which may affect the firm's independence and the objectivity of the audit partner and staff;
- a policy on the employment by the Group of former employees of the external auditors, the essence of which is to require a period of two years to elapse between the cessation of an individual's association with the auditors and appointment to any financial reporting oversight role within the Group; and
- a policy governing the engagement of the auditors to conduct non-audit work under which:
  - the auditors may not be engaged to provide certain categories of work, including those where they may be required to audit their own work or make management decisions, or where the auditors would act in an advocacy role for the Company;
  - there is a clear process of approval for engaging the auditors to conduct other categories of non-audit work, subject to financial limits;
  - all engagements of the auditors to conduct non-audit work are reported to the next meeting of the Committee; and
  - the balance between the fees paid to the external auditors for audit and non-audit work is monitored by the Committee.

Details of the amounts paid to the external auditors during the year for audit and other services are set out in the Notes to the consolidated financial statements on pages 65 to 89.

## Internal audit

Under an outsourcing arrangement, Grant Thornton UK LLP undertakes the Group's internal audit function. Regular reports are provided to the Audit Committee regarding the audit programme and reviews undertaken. Recommendations are made to management for process improvements as appropriate. Topics dealt with by internal audit reports reviewed by the Committee during 2008 included: information technology; financial reporting; budgeting; revenue; contract management; procurement; expenditure; human resources and payroll; and treasury. The Committee is of the opinion that, because of the nature of the Group's business, a higher quality of service is available through outsourcing the function than would be possible through the employment of internal audit staff.

## External auditors

Deloitte LLP were appointed auditors of the Company in 2005 and have been reappointed at each subsequent Annual General Meeting. They previously acted as auditors to the Drax group of companies prior to the listing of the Company in December 2005.

Having reviewed their performance during the year and satisfied itself of their continuing independence and objectivity within the context of applicable regulatory requirements and professional standards, the Committee has invited the Board to recommend the reappointment of Deloitte LLP as auditors at the forthcoming Annual General Meeting and a resolution to that effect appears in the Notice of Meeting.

The Chairman of the Committee, independent of management, maintains regular and direct contact with both the internal and external auditors.

This report was reviewed and approved by the Board on 2 March 2009.

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**Jamie Dundas**  
Chairman, Audit Committee

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