

PETROPAVLOVSK PLC (“the Company”) Audit Committee Policy on the Provision of Non-Audit Services

1. Objective

- 1.1 The purpose of this paper is to review the policy framework for the non-audit services to be provided by the external auditor of the Company and to confirm the procedures in respect of the same and the role of the Audit Committee (“the Committee”) within this process.

2 Background

- 2.1 Guidance on the use of external auditors to provide non-audit services was originally provided by the Auditing Practices Board (“APB”) in 2004 and by the Financial Reporting Council (“FRC”) through its ‘Guidance for Audit Committees’ originally published in 2005 and recently updated in 2008. The APB undertook a consultation on audit firms providing non-audit services to listed companies in October 2009 following which a Working Group (“WG”) was established by the ICAS (Institute of Chartered Accountants of Scotland) to respond to specific questions raised by the APB in its consultation. In its work, the WG issued a questionnaire to FTSE350 companies.
- 2.2 Paragraphs 4.26 to 4.34 of the FRC ‘Guidance for Audit Committees’ specifically address the need for an audit committee to consider the independence of the external auditor. In particular, if a company engages its external auditors to perform other non-audit services, there should be sufficient safeguards in place to protect the external auditor’s independence and objectivity. Shareholders and the market in general must be confident that any non-audit services provided by the external auditor are necessary and appropriate given the circumstances, and provide value for money. The Committee should therefore develop a policy for the provision of non-audit services by the external auditor for recommendation to the Board.
- 2.3 The FRC Guidance specifically recommends that the following points should be considered when developing the policy:
- whether the skills and experience of the audit firm make it a suitable supplier of the non-audit service;
 - whether there are safeguards in place to ensure that there is no significant threat to objectivity and independence in the conduct of the audit resulting from the provision of such services by the external auditor;
 - the nature of the non-audit services, the related fee levels and the fee levels individually and in aggregate relative to the audit fee; and
 - the criteria which govern the compensation of individuals performing the audit.
- 2.4 In addition, the Smith Guidance also suggests that in providing a non-audit service, external auditors should not:

- audit their own work;
 - make management decisions for the company;
 - create a mutuality of interest; or
 - find themselves in the role of advocate for the company.
- 2.5 The WG concluded that greater transparency was required in regard to the procurement of non-audit services which, together with improved disclosure, would assist stakeholders' understanding and should remove some of the negative perception that currently exists.
- 2.6 The WG recommended that the APB should not introduce a complete prohibition on audit firms providing non-audit services to their listed audit clients. However it recommended that audit committees should be required to publish policies in relation to non-audit services being provided by the external auditor.
- 2.7 Audit committees should clearly set out its policy on how any perceived conflicts of interest will be addressed in relation to the audit firm and also to members of the board of directors or other related parties.
- 2.8 It is recommended that audit committees pre-approval for all non-audit services above a set fee level and that all non-audit services of an internal audit nature or which are procured on a contingency fee basis should be subject to pre-approval by the audit committee.
- 2.9 In a further development, the APB issued a revised Ethical Standard 3: Long Association with the Audit Engagement. It amends the rotation requirements for audit engagement partners and engagement quality control review partners on listed entity audits. For the audit engagement partner, the maximum rotation period remains at five years, with a minimum of five years not involved in the audit afterwards. However, flexibility of up to an additional two years is permitted where the audit committee believes this is necessary to maintain audit quality and the extension is disclosed to shareholders. While not intended to be a default position, this is intended to permit greater flexibility than the existing provision which has been difficult to apply in practice.

3 Policy Proposal

- 3.1 In view of the recent developments in respect of the review and monitoring of non-audit services by audit committees, the following policy on the provision of non audit services by the auditors has been drafted for the audit committee's considerations.
- 3.2 It is recommended that Committee reviews and, if it agrees, approve the Policy and that it ensures that it fulfills the approval, review, reporting and disclosure requirements set out therein.



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Petropavlovsk PLC – Non-Audit Services Policy

Audit Services

The following constitutes those services that the external auditors are expected to undertake within their audit brief:

Statutory audit

The audit of the financial statements, operating & financial review and corporate governance disclosures of the Company, including its annual reports, preliminary results' announcements and any other formal announcements relating to its financial performance.

Other work as auditors or reporting accountants

While it is difficult to be precise regarding the definition of work that the external auditor may undertake as auditor or reporting accountant, it includes the following:

- Interim results and any other review of the accounts for regulatory purposes;
- Assurance work relating to compliance and corporate governance, including high level controls;
- Work in connection with listing particulars and prospectuses;
- Work in connection with any merger and acquisition transaction which falls under class 1 and requires a circular
- Work relating to capital raising i.e. debt or equity
- Any certification which is needed under loan agreement, bond covenants
- Regulatory reviews or reviews commissioned by the Audit Committee; and
- Accounting advice, recommendations concerning accounting policies and reviews of accounting standards.

Acceptable Non-Audit Services

In the absence of any discernible threat to independence, the following represents the types of additional non-audit services that the external auditors may be considered for:

- Tax advisory, including tax planning and compliance;
- Mergers & acquisitions, disposals and joint ventures;
- Completion accounts, assistance and advice;
- Secondments into non-management roles;
- Non-IT consultancy services; and
- Forensic litigation services;

Unacceptable Non-Audit Services

The following have been identified by various regulatory authorities, including the Auditing Practices Board and the Institute of Chartered Accountants of England and Wales, as presenting a high risk of conflict and auditor independence. Consequently, these services are (unless it can be clearly shown that no threat to auditor independence is created by the auditor undertaking such activity and, indeed, it is in the best interests of the Petropavlovsk Group for such work to be undertaken by the external auditor) specifically prohibited from being contracted to the external auditor:

- Work related to the maintenance of accounting records and the initial preparation of financial statements that will ultimately be subject to external audit;
- Management of, or significant involvement in, internal audit services;
- Financial information systems design and implementation;
- Actuarial services;
- Investment advice and banking services;
- Secondments to management positions that involve any decision-making;
- Advising the Remuneration Committee (other than general assistance relating to appropriate levels of disclosures and accounting advice);
- Legal services;
- Custody of assets;
- Valuation services of a public nature; and
- Any work where a mutuality of interest is created that could compromise the independence of the external auditor.

Safeguards

In order to provide safeguards to auditor independence (particularly the self-interest threat) in the provision of non-audit services the following requirements are in place:

Approvals

The Audit committee must pre-approve the provision of all non-audit services by the auditors. Engagements that fall within the Audit Services classification of services, as set out above, are considered to be pre-approved by the Audit Committee to a level of £100,000.

Audit Services engagements with expected fees in excess of this amount should be approved by the Audit Committee.

All other permitted engagements in excess of £100,000 may only be awarded to the statutory auditor with prior approval of the Audit Committee before commencement of the work.



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Where fees for non-audit services in the year exceed £500,000 in aggregate, all permitted engagements may only be awarded to the statutory auditor with prior approval of the Audit Committee before commencement of the work.

Any work related to the “Unacceptable non-audit services” need to be pre-approved by the Audit Committee, irrespective of any amount.

Where the commissioning requirements fall between Audit Committee meetings, the Chairman of the Committee may be approached for his/her approval subject to details of this approval then being circulated to other Committee members and ratification at the following meeting. Where such ratification is not forthcoming, the engagement must be terminated.

Reporting

The Audit Committee will receive a report every six months analysing fees paid for other non-audit work by the external auditors or reporting accountants, with additional commentary on assignments and on work carried out or to be done relating to safeguards of independence.

Review

The Audit Committee, in accordance with its Terms of Reference, will annually review the independence and objectivity of the external auditors, taking into account UK professional and regulatory requirements and taking into consideration all relationships between the Company and the auditor as a whole.

Disclosure

The Company will report annually on the Group’s annual expenditure with the external auditor on non-audit services and will explain how, when the external auditor provides non-audit services, auditor independence and objectivity is safeguarded and the disclosure in annual report will disclose the nature of non-audit services rendered by auditors for non audit fee.