

## **AUDIT COMMITTEE**

### **TERMS OF REFERENCE**

#### **1. INTRODUCTION**

1.1 On June 29, 2010, the Board resolved, in accordance with the bylaws of ProPhotonix Limited (the "**Company**" and references to the Company shall include references to each member of the Group, as appropriate), to establish an audit committee of the Board.

1.2 The purpose of this document is to set out:

- (a) the duties and responsibilities of the Committee; and
- (b) the constitution of the Committee and the regulations governing proceedings of the Committee.

1.3 In this document, references to:

- (a) the "**Board**" are to the board of directors of the company from time to time;
- (b) the "**Committee**" are to the audit committee of the Board established pursuant to the resolution referred to in paragraph 1.1; and
- (c) the "**Group**" are to the Company and each of its subsidiaries from time to time.

#### **2. MEMBERSHIP**

2.1 The members of the Committee shall be appointed by the Board. All members of the Committee shall at all times be independent non-executive directors of the Company.

2.2 Appointments to the Committee shall be for a period of up to three years which may be extended for up to two further periods of three years.

2.3 The Committee shall consist of at least two members, at least one of whom shall have recent and relevant financial experience.

#### **3. CHAIRMAN**

3.1 The Board shall appoint the chairman of the Committee who shall be an independent non-executive director.

- 3.2 In the absence of the chairman of the Committee at any meeting of the Committee, the members of the Committee present shall elect one of their number to chair the meeting.

4. **SECRETARY**

The company secretary or any member of the Committee shall act as the secretary of the Committee.

5. **MEETINGS**

- 5.1 Meetings of the Committee shall be held at least three times a year at appropriate times in the reporting and audit cycle and otherwise as required.

- 5.2 Only members of the Committee are entitled as of right to attend meetings of the Committee but others (such as the chairman of the Board, the chief executive, the finance director and representatives from the risk, compliance, finance and internal audit functions (as appropriate)) may be invited by the Committee to attend for all or part of any meeting as and when the Committee considers appropriate. The external auditors shall be invited to attend meetings of the Committee on a regular basis.

6. **NOTICE**

- 6.1 Meetings of the Committee shall be summoned by the secretary of the Committee at the request of any member of the Committee any member of the Board or at the request of the external or internal auditors if they consider it necessary.

- 6.2 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 and (as appropriate) any other proposed attendee not later than five working days before the date of the meeting. Supporting papers shall be sent to members of the Committee and (as appropriate) any other proposed attendee at the same time.

7. **QUORUM**

The quorum necessary for the transaction of business at meetings of the Committee 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.

8. **VOTING**

- 8.1 Matters arising at any meeting of the Committee shall be decided by a majority of votes.
- 8.2 Each member of the Committee present at a meeting of the Committee shall have one vote on matters arising at the meeting. The chairman of the Committee shall have a casting vote on any matter in respect of which there is an equality of votes.
- 8.3 A member of the Committee shall not vote in respect of any matter being considered by the Committee in which he has, directly or indirectly, a personal interest and shall not be counted in the quorum at a meeting in relation to any matter on which he is debarred from voting.

9. **SCOPE OF DUTIES**

The Committee should carry out the duties below for the parent company, major subsidiary undertakings and the group as a whole, as appropriate.

10. **DUTIES - FINANCIAL REPORTING**

- 10.1 The Committee shall monitor the integrity of the financial statements of the Company, including its annual and interim reports, preliminary results' announcements and any other formal announcement relating to its financial performance, reviewing significant financial reporting issues and judgements which they contain. The Committee shall also review summary financial statements, significant financial returns to regulators and any financial information contained in certain other documents, such as announcements of a price sensitive nature.
- 10.2 The Committee shall review and challenge where necessary:
- (a) the consistency of, and any changes to, accounting policies both on a year on year basis and across the Company and its group;
  - (b) the methods used to account for significant or unusual transactions where different approaches are possible;
  - (c) whether the Company has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditor;
  - (d) the clarity of disclosure in the Company's financial reports and the context in which statements are made;

- (e) 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).
- 10.3 The Committee shall review the annual financial statements of the pension funds where not reviewed by the Board as a whole.

11. **DUTIES - INTERNAL CONTROLS AND RISK MANAGEMENT SYSTEMS**

The Committee shall:

- (a) keep under review the effectiveness of the company's internal controls and risk management systems; and
- (b) review and approve the statements to be included in the annual report concerning internal controls and risk management.

12. **DUTIES - WHISTLEBLOWING**

The Committee shall review the Company's arrangements for its employees to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters. The Committee shall ensure that these arrangements allow proportionate and independent investigation of such matters and appropriate follow up action. The Committee shall review the Company's procedures for detecting fraud.

13. **DUTIES - INTERNAL AUDIT**

The Committee shall:

- (a) monitor and review the effectiveness of the Company's internal audit function in the context of the Company's overall risk management system;
- (b) approve the appointment and removal of the head of the internal audit function;
- (c) consider and approve the remit of the internal audit function and ensure it has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards. The Committee shall also ensure the function has adequate standing and is free from management or other restrictions;
- (d) review and assess the annual internal audit plan;
- (e) review promptly all reports on the Company from the internal auditors;

- (f) review and monitor management's responsiveness to the findings and recommendations of the internal auditor; and
- (g) meet the head of internal audit at least once a year, without management being present, to discuss their remit and any issues arising from the internal audits carried out. In addition, the head of internal audit shall be given the right of direct access to the Chairman of the Board and to the Committee.

## 14. **EXTERNAL AUDIT**

### 14.1 The Committee shall:

- (a) consider and make recommendations to the Board, to be put to shareholders for approval at the Annual General Meeting, in relation to the appointment, re-appointment and removal of the Company's external auditor. The Committee shall oversee the selection process for new auditors and if an auditor resigns the Committee shall investigate the issues leading to this and decide whether any action is required;
- (b) oversee the relationship with the external auditor including (but not limited to):
  - (i) approval of their remuneration, whether fees for audit or non audit services and that the level of fees is appropriate to enable an adequate audit to be conducted;
  - (ii) approval of their terms of engagement, including any engagement letter issued at the start of each audit and the scope of the audit;
  - (iii) assessing annually their independence and objectivity taking into account relevant UK professional and regulatory requirements and the relationship with the auditor as a whole, including the provision of any non-audit services;
  - (iv) 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);
  - (v) agreeing with the Board a policy on the employment of former employees of the Company's auditor, then monitoring the implementation of this policy;
  - (vi) 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;

- (vii) 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;
  - (viii) seeking to ensure co-ordination with the activities of the internal audit function; and
  - (ix) considering the risk of the withdrawal of the Company's present auditor from the market;
- (c) meet regularly with the external auditor, including once at the planning stage before the audit and once after the audit at the reporting stage. 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;
  - (d) review and approve the annual audit plan and ensure that it is consistent with the scope of the audit engagement;
  - (e) review the findings of the audit with the external auditor. This shall include, but not be limited to, the following:
    - (i) a discussion of any major issues which arose during the audit;
    - (ii) any accounting and audit judgements; and
    - (iii) levels of errors identified during the audit.

14.2 The Committee shall also review the effectiveness of the audit and shall:

- (a) review any representation letter(s) requested by the external auditor before they are signed by management;
- (b) review the management letter and management's response to the auditor's findings and recommendations; and
- (c) 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.

15. **MINUTES OF MEETINGS**

15.1 The secretary of the Committee shall minute the proceedings and resolutions of all meetings of the Committee, including the names of those present and in attendance.

15.2 Minutes of meetings of the Committee shall be circulated promptly to all members of the Committee and, when finalised and agreed, to all other members of the Board.

16. **REPORTING RESPONSIBILITIES**

16.1 The chairman of the Committee shall report formally to the Board on the proceedings of the Committee following each meeting on all matters within its duties and responsibilities.

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

16.3 The Committee shall make a statement in the annual report about its activities.

16.4 The Committee shall make available these terms of reference, explaining its role and the authority delegated to it by the Board.

17. **AUTHORITY**

The Committee is authorised by the Board:

(a) to obtain, at the Company's expense, external legal or other professional advice on any matter within its terms of reference (provided that any expenses in excess of £10,000 in aggregate per annum must be approved in advance by the Board); and

(b) to seek any information it requires from any director or employee of the Company in order to perform its duties.

18. **GENERAL**

18.1 The Committee shall:

(a) have access to sufficient resources in order to carry out its duties, including access to the company secretariat for assistance as required;

- (b) be provided with appropriate and timely training, both in the form of an induction programme for new members and on an ongoing basis for all members;
  - (c) give due consideration to applicable laws and regulations, the provisions of the UK Corporate Governance Code (formerly the Combined Code), the QCA Corporate Governance Guidelines for AIM Companies and the requirements of the London Stock Exchange's AIM Rules for Companies as appropriate;
  - (d) be responsible for co-ordination of the internal and external auditors; and
  - (e) oversee any investigation of activities which are within its terms of reference and act as a court of the last resort.
- 18.2 The chairman of the Committee shall attend each Annual General Meeting of the Company prepared to respond to any shareholder questions concerning the Committee's activities.
- 18.3 The Committee shall, at least once a year, review its own performance, constitution and terms of reference to ensure it is operating at maximum effectiveness and recommend any changes it considers necessary to the Board for approval.
- 18.4 The Board may review the performance and constitution of the Committee and amend its terms of reference at any time.