

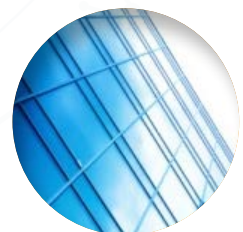
2016
Annual Audit
Committee
Report



Done and said



360°



In accordance with the Principles of Good Corporate Governance for Listed Companies, the Board of Directors of Gas Natural SDG, S.A., in its meeting of 23 June 2000, approved the regulations for the formation and operation of the Audit and Control Committee of Gas Natural SDG, S.A. These were subsequently included in the Articles of Association by agreement of the General Meeting of Shareholders of 23 June 2003, pursuant to the provisions of the Financial System Reform Act, Law 44/2002 of 22 November.

The Board of Directors of the company, in its meeting of 24 March 2004, approved the Organisation and Operation Regulations of the Board of Directors and of its Committees, which provided a complement to the tasks, operation and competence of the Audit and Control Committee as established in the aforementioned Articles of Association. These Regulations have been amended and updated by the Board of Directors at its meetings on 23 February 2007, December 18 2007, 25 February 2011, 30 September 2011, 30 November 2012, 27 February 2015 and 21 September 2016.

In accordance with the foregoing Articles of Association and Regulations, the Audit Committee shall consist of a minimum of three and a maximum of seven Directors, appointed by the Board of Directors from among the Non-executive Directors and at least one of them shall be appointed taking into account their knowledge and experience in accounting, auditing or both. Its members shall leave their post when they do so in their capacity as Directors, when agreed by the Board of Directors, or after a period of three years from their appointment. They can be re-elected.

The Board of Directors shall elect the Chairman of the Committee, who shall not have a casting vote and shall be replaced in accordance with the Articles of Association (Art. 51 bis) and legislation. He/she may be re-elected following the term of one year after his/her dismissal. The Secretary of the Committee shall be the same as the Secretary of the Board of Directors.

The Committee shall hold meetings whenever necessary in order to issue its reports, and will be convened by its Chairman on his own initiative or upon request of two of its members. At least four meetings per year must be held. The Committee may invite to its meetings any executive or employee it deems appropriate.

On 31 December 2016 the Audit Committee comprised the following Directors appointed by the Board of Directors:

- > Chairman: Mr Ramón Adell Ramón (Independent Director).
- > Board Director: Mr Enrique Alcántara-García Irazoqui¹ (Dominical Member).
- > Board Director: Mr Xabier Añoveros Trías de Bes¹ (Independent Member).
- > Board Director: Mrs Cristina Garmendia Mendizábal¹ (Independent Member).
- > Board Director: Mrs Helena Herrero Starkie¹ (Independent Member).
- > Board Director: Mr Rajaram Rao¹ (Dominical Member).
- > Board Director: Mr Luis Suárez de Lezo Mantilla (Dominical Member).

The post of Secretary of the Committee is held by Mr Manuel García Cobaleda, Secretary of the Board of Directors of Gas Natural SDG, S.A.

Pursuant to Article 51 bis of the Articles of Association and Article 32 of the Board Regulations, the Audit Committee has the powers set out in legislation and those that are commissioned by the Board of Directors, whether of a general or specific nature.

¹ They were appointed Members of the Audit Committee at the meeting of the Board of Directors on 21 September, 2016.

Article 529 *quaterdecies* of the Corporate Enterprises Act specifies that the Audit Committee shall have at least the following duties:

- a) **Informing the General Meeting of Shareholders on issues that arise with regard to those matters within the competence of the Committee** and, in particular, with regard to the results of the audit, explaining how this has contributed to the integrity of financial reporting and the function that the Committee has carried out in that process.
- b) **Supervising the efficacy of the company's internal control, Internal Auditing and risk management systems, as well as discussing with the accounts auditor any significant weaknesses of the internal control system detected during the audit. All this must be performed without jeopardising the auditor's independence.** To this end, and where appropriate, recommendations or proposals may be forwarded to the governing body along with the corresponding deadline for follow-up.
- c) **Supervising the process of compiling and submitting the compulsory financial information** and presenting recommendations or proposals to the Board of Directors targeted at safeguarding its integrity.
- d) **Forwarding proposals for selection, appointment, re-election and replacement of the accounts auditors to the Board of Directors,** taking responsibility for the screening process, pursuant to the provisions set out in Articles 16 section 2, 3 and 5, and 17 section 5 of Regulation (EU) 537/2014 of 16 April. Furthermore, setting the contractual conditions for the auditor and receiving regular information from the auditor with regard to performance of the audit plan, and guaranteeing the auditor's independence in the performance of its duties.
- e) **Establishing the appropriate relationships with the external auditor to receive information on those issues that could jeopardise their independence,** to be scrutinised by the Committee, and any others related to the accounts auditing procedure. Furthermore, its functions include the authorisation of services other than those that are banned, under the terms set out in Article 5 section 4, and 6 section 2.b) of Regulation (EU) 537/2014 of 16 April, and the provisions set out in section 3, chapter IV, heading I, Law 22/2015 of 20 July, on Accounts Auditing, concerning the structure of independence, as well as those other communications set out in accounts auditing legislation and audit standards. Under all circumstances, every year the Committee must receive the declaration of the auditor's independence with regard to the entity or entities directly or indirectly related to the company, as well as detailed and individualised information on any additional services rendered and the corresponding fees received by the external auditor or by the persons or entities related to this party, pursuant to the provisions set down in accounts auditing regulations.
- f) **Every year, before issuing the Audit Report, providing a report that gives an opinion on the independence of the accounts auditors** or audit firm. In all cases, this report must contain a reasoned assessment of the provision of each and every one of the additional services referred to above, considered on an individual basis and as a whole, separate from the legal auditing and with regard to the structure of independence or with regard to accounts auditing regulations.
- g) **Informing the Board of Directors beforehand with regard to all issues provided for under Law, the Articles of Association and the Board Regulations, and in particular concerning:**
 1. **The financial reporting that the company must regularly disclose;**
 2. **The creation or acquisition of shares in entities with special purposes or domiciled in countries or territories that are considered tax havens and**
 3. **Related-party transactions.**

Through a resolution of the Board of Directors of 27 November 2015, and pursuant to the 2015 Good Corporate Governance Recommendations from the National Securities Market Commission (CNMV), the Audit Committee was commissioned with the following duties:

- > **Drawing up the report on the external auditor's independence.**
- > **Drawing up the report on performance of the Audit Committee.**
- > **Drawing up the report on related-party transactions.**

The three reports referred to above shall be published on the company's website sufficiently prior to the General Meeting of Shareholders.

- > **Ensuring that the Board of Directors seeks to present the accounts to the General Meeting of Shareholders without reservation or exception in the Audit Report** and, in whatsoever exceptional case, both the Chairman of the Audit Committee and the external auditors should clearly explain to Shareholders the content and scope of said reservations or exceptions.
- > **In relation to the control and reporting systems:**
 - **Supervising the preparation and completeness of the financial information concerning the company** and, if appropriate, the group, checking due compliance with the governing regulations, the proper delimitation of the consolidation criteria and the correct application of accounting criteria.

- **Ensuring independence of the unit that assumes the Internal Audit function;** approving the work plans and guidelines, making sure that its activities are mainly focused on relevant risks for the company; receiving periodic information on its activities; and verifying that senior management takes into consideration the conclusions and recommendations of its reports. **Making proposals to the Chairman of the Board of Directors with regard to the selection, appointment, re-election and removal from office of the party responsible for the Internal Audit service, and proposing the budget for that service. The final decision lies with the Chairman of the Board of Directors**

- **Setting up and supervising a mechanism that enables employees to communicate any significant irregularities, especially those related to finance and bookkeeping, and to do so in a confidential manner and, if considered suitable, anonymously.**

> **In relation to the external auditor:**

- **In the case of the resignation of the external auditor, it should examine the circumstances leading to said resignation.**
- **Ensure that the remuneration of the external auditor does not compromise its quality or its independence.**
- **Ensure that company notifies the change of auditor to the CNMV as a relevant event and attaches a declaration on the possible**

existence of disagreements with the outgoing auditor and, if there are any disagreements, the content thereof.

- **Ensure that the external auditor holds an annual meeting with the full Board of Directors to report on the work carried out and the evolution of the accounting situation and of the company's risks.**
- **Ensure that the company and the external auditor observe current standards regarding non-auditing services, the limits to the external auditor's business concentration and, in general, the other standards established to guarantee the independence of external auditors.**

- > **Calling any of the company's employees or managers, and also have them appear without the presence of any other executive.**
- > **Analysing and reporting to the Board of Directors with regard to the economic conditions and the accounting impact and, more particularly, where appropriate, on the exchange ratio, with regard to structural and corporate modification operations which, because of their nature or amount, are of particular relevance. Transactions shall be considered to have such relevance when the net value exceeds 25% of the assets shown on the last approved balance sheet of the company.**

- > **With regard to supervision of compliance with the corporate governance rules, the codes of conduct and the corporate social responsibility policy.**
- **The supervision of compliance with the internal codes of conduct and the corporate governance rules of the company.**
 - **The supervision of the communication strategy and relations with shareholders and investors, including the small and medium shareholders.**
 - **Regular assessment of the appropriateness of the company's corporate government system, to ensure that it complies with its mission of fostering social interest and takes into consideration, as appropriate, the legitimate interests of remaining stakeholders.**
 - **The assessment of everything concerning non-financial risks of the company, including operational, technological, legal, social, environmental, political and reputational risks.**

In addition, the Internal Code of Conduct in issues concerning the Securities Market sets out in Article 7.7 that it is the responsibility of the Internal Audit, Compliance and Internal Control Department to verify compliance by the Economic-Financial Department of the provisions set out in the code as well as the General Treasury Stock Policy introduced by the Board of Directors. The Internal Audit, Compliance and Internal Control Department reports on this issue to the Committee every year. The General Treasury Stock Policy sets out the recommendations issued by the CNMV in July 2013 with regard to the criteria to be followed by listed companies in discretionary operations with treasury stock.

The functions and activities performed by the Audit Committee of Gas Natural SDG, S.A., duly comply with the legal requirements introduced through Law 31/2014 of 3 December, which amends the Corporate Enterprises Act to improve corporate governance.

By the same token, the functions and activities of the Committee duly comply with the Good Corporate Governance recommendations published by the CNMV, included in the Unified Code on Good Corporate Governance of Listed Companies of 19 May 2006, approved on 22 May 2006 (Conthe Code), updated in 2013 and 2015 (Rodriguez Code) and the document published in June 2010 on Internal Control System on Financial Reporting (SCIIF) at listed companies.

It should be noted that Law 31/2014 of 3 December was published, in the Official Gazette of 4 December 2014, amending the Corporate Enterprises Act for the improvement of corporate governance. According to the Preliminary Recitals of the aforesaid law, Good Corporate Governance is an essential factor for generating value for companies, improving economic efficiency and enhancing investor confidence. During 2015, to adapt to the new laws, the company proceeded, in all matters that it considered necessary, to amend its internal rules and regulations (Articles of Association, General Meeting Regulations and the Organisation and Operation Regulations of the Board of Directors and of its Committees).

The sphere of activity of the Audit Committee extends to:

- > Gas Natural SDG, S.A.
- > Companies in which Gas Natural SDG, S.A. holds a majority interest.
- > Other entities and companies for which Gas Natural SDG, S.A. has in some form the effective control or responsibility for management or operation.

During 2016, the activities of the Audit Committee included the study, reporting, support and proposals to the Board of Directors in respect of its monitoring tasks, by means of a periodic supervision of compliance with the procedure for drafting economic and financial information (SCIIF), the Crime Prevention Internal Control Model, the effectiveness of the Internal Control Regulations of the company in the other areas (regulations, laws, policies, codes, accounting procedures and internal control, etc.), the procedure for risk identification and assessment, the accounts auditing procedure and independence of the external auditor, and compliance with

the Code of Ethics, the Regulations of the Board of Directors and of its Committees, the established policies in matters of corporate governance and corporate responsibility, the health, safety and environment policies, the related-party transactions and the compliance with the Treasury Stock Policy of the company.

These activities were carried out within the framework of their competence and by means of the information and documentation provided through the Internal Audit, Compliance and Internal Control Area, the external auditor (PricewaterhouseCoopers), the Economic-Financial Area, the Legal Services Area and the Secretariat of the Board of Directors. Furthermore, different members of the company's management team attended the Committee's meetings over the year.

During the period between 1 January 2016 and 7 February 2017 (the date on which the Audit Committee proposed to the Board of Directors of Gas Natural SDG, S.A. the drawing up of the 2016 Consolidated and Individual Annual Accounts), nine meetings of the Audit Committee were held with an attendance of 97,67%.

The meetings of the Audit Committee held during that period and the matters addressed therein are summarised below:

28 January 2016

Agenda

- > Economic Information as of 31 December 2015.
- > 2015 Annual Financial Report that covers the Consolidated and Individual Annual Accounts, the Management Report and the selected financial information, prior to the approval and declaration of responsibility for the content thereof by the Board of Directors, together with the draft version of the External Audit Report.
- > Final conclusions of the external audit of the 2015 Consolidated and Individual Annual Accounts of the companies in Gas Natural Fenosa.
- > Proposal to the Board of Directors for submission to the General Meeting of Shareholders of the appointment of the external financial auditors of Gas Natural SDG, S.A., Subsidiary Companies and Consolidated Group for the year 2016 (Art. 32.2, paragraph 2 of the Regulation of the Board of Directors).
- > Quarterly report as of 31 December 2015 on the contracts signed with the External Auditor.
- > Report on the tax situation of the group.
- > Information on the treasury stock transactions in Fourth Quarter 2015.

> Committee reports:

- 2015 Annual Report on the independence of the external auditors (Law 12/2010 of 30 July).
- Report on quality and performance of the Audit and Control Committee in 2015.
- 2015 Annual Report on related-party transactions.

> Reports of the Secretary of the Board of Directors:

- 2015 Annual Report on compliance of the Internal Code of Conduct in matters relating to the Securities Market.
- 2015 Annual Report on compliance of the Board Regulations and of its Committees.
- Annual Corporate Governance Report 2015.

> Miscellaneous:

- Monitoring of legislation on corporate governance.
- Others.

> Approval of the minutes of the meeting.

25 February 2016

Agenda

- > Update on the major disputes and litigations.
- > Activities of the Code of Ethics Committee and communications received through the complaints channel.
- > Conclusions on the 2015 annual review of compliance with the General Treasury Policy.
- > 2015 Annual Report on the functions and activities of the Audit Committee.
- > 2016 Internal Audit Plan for approval of the Audit Committee.
- > 2016 Budget Proposal of the Internal Audit Department.
- > Related-party transactions.
- > Miscellaneous:
 - Monitoring of legislation on corporate governance.
 - Others.
- > Approval of the minutes of the meeting.

29 April 2016

Agenda

- > Economic Information as of 31 March 2016.
- > Intermediate management declaration – First Quarter 2016.
- > Quarterly report on the contracts signed with the External Auditor.
- > Information on the treasury stock transactions in First Quarter 2016.
- > Miscellaneous:
 - Monitoring of legislation on corporate governance.
 - Others.
- > Approval of the minutes of the meeting.

28 June 2016

Agenda

- > 2016 Corporate Risk Map of Gas Natural Fenosa
- > Evaluation of the SCIIF.
- > Evolution of the 2016 Internal Audit Plan.
- > Information on the treasury stock transactions in Second Quarter 2016.
- > Proposals for hiring the External Auditor for services other than the audit
- > Miscellaneous:
 - Monitoring of legislation on corporate governance.
 - Others.
- > Approval of the minutes of the meeting.

21 July 2016

Agenda

- > Economic Information as of 30 June 2016 and the provision of the Half Yearly Financial Report with the interim consolidated financial statements, the Interim Management Report and the selected financial information, prior to the approval and declaration of responsibility for the content thereof by the Board of Directors, together with the draft version of the External Audit Report.
- > Conclusions of the external audit of the Half Yearly Financial Report of Gas Natural Fenosa as of 30 June 2016.
- > Planning and schedule of the External Audit of the 2016 Annual Accounts.
- > Quarterly report as of 30 June 2016 on the contracts signed with the External Auditor.
- > Presentation on access procedures, updating user profiles and segregation of duties on the computer systems.
- > Related-party transactions.
- > Miscellaneous:
 - Monitoring of legislation on corporate governance.
 - Others.
- > Approval of the minutes of the meeting.

27 October 2016

Agenda

- > Economic Information as of 30 September 2016.
- > Intermediate management declaration – Third Quarter 2016.
- > Quarterly report as of 30 September 2016 on the contracts signed with the External Auditor.
- > Safety, Health and Environment Policies of Gas Natural Fenosa and main activity indicators 2016.
- > Third Quarter 2016 activities of the Code of Ethics Committee and communications received through the complaints channel.
- > Information on the treasury stock transactions in Third Quarter 2016.
- > Related-party transactions.
- > Miscellaneous:
 - Monitoring of legislation on corporate governance.
 - Others.
- > Approval of the minutes of the meeting.

24 November 2016

Agenda

- > Presentation by the firms Deloitte, Ernst & Young and KPMG of tenders for the provision of the services of auditing annual accounts for the years 2018, 2019 and 2020.
- > Proposal to the Board of Directors for the recruitment of Accounts Auditor for the years 2018, 2019 and 2020.
- > Proposals for hiring the External Auditor for services other than the audit.
- > Proposed schedule and topics to be addressed in the Audit Committee during the year 2017.
- > Miscellaneous:
 - Monitoring of legislation on corporate governance.
 - Others.
- > Approval of the minutes of the meeting.

10 de enero de 2017

Agenda

- > Preliminary conclusions of the external audit of the 2016 Consolidated Annual Accounts of the companies in Gas Natural Fenosa.
- > Update on disputes and lawsuits 2016.
- > Main activities of the Compliance Evaluation Committee.
- > Conclusions of the monitoring carried out by the independent expert of the 2016 Crime Prevention Model.
- > Evolution of the 2016 Internal Audit Plan.
- > Information and review on the treasury stock transactions in Fourth Quarter 2016.
- > Proposals for hiring the External Auditor for services other than the audit.
- > Reports of the Audit Committee:
 - 2016 Annual Report on the quality and efficiency of the operation of the Audit Committee.

- > Reports of the Secretary of the Committee:
 - 2016 Annual Report on compliance of the Internal Code of Conduct in matters relating to the Securities Market.
 - 2016 Annual Report on compliance of the Board Regulations and of its Committees.
- > Miscellaneous:
 - Monitoring of legislation on corporate governance.
 - Others.
- > Approval of the minutes of the meeting.

07 February 2017

Agenda

- > Economic Information as of 31 December 2016.
- > 2016 Annual Financial Report that covers the Consolidated and Individual Annual Accounts, the Management Report and the selected financial information, prior to the approval and declaration of responsibility for the content thereof by the Board of Directors, together with the draft version of the External Audit Report.
- > Final conclusions of the external audit of the 2016 Consolidated Annual Accounts of the companies in Gas Natural Fenosa.
- > Proposal to the Board of Directors for submission to the General Meeting of Shareholders of the appointment of the external financial auditors of Gas Natural SDG, S.A., Subsidiary Companies and Consolidated Group for the year 2017 (Art. 32.2, of the Regulation of the Board of Directors).
- > Quarterly report as of 31 December 2016 on the contracts signed with the External Auditor.
- > Report on the tax situation of the group.
- > Third Quarter 2016 main activities of the Code of Ethics Committee and communications received through the complaints channel.
- > Proposed 2017 Internal Audit Plan for approval of the Audit Committee.
- > 2017 Budget Proposal of the Internal Audit Department.

> Reports of the Audit Committee:

- 2016 Annual Report on the functions and activities of the Audit Committee.
- 2016 Annual Report on the independence of the accounts auditor (Article 529 of the Corporate Enterprises Act).
- 2016 Annual Report on related-party transactions.

> Reports of the Secretary of the Committee:

- Annual Corporate Governance Report 2016.

> Miscellaneous:

- Monitoring of legislation on corporate governance.
- Others.

> Approval of the minutes of the meeting.

The main aspects addressed in the Committee meetings were as follows:

Secretary of the Board: legislation on corporate governance in listed companies

One of the Committee's activities was the monitoring, through the Secretariat of the Board, of the legislation published during recent financial years relating to listed companies.

Likewise, the Committee Secretary submitted the status of the main solved and in-progress lawsuits in the group and the 2015 and 2016 Corporate Governance Reports and several favourable reports on compliance with the Regulations of the Board of Directors and of its Committees and its Internal Code of Conduct in issues concerning the Securities Market. It duly confirmed that, in the case of the Audit Committee, this operated with expected normality during 2016, fully exercising its terms of reference without any interference and with complete respect with regard to both current legislation as well as to the organisational and performance rules of the Board Regulations.

Internal Auditing: supervision of operational risks and effectiveness of internal control

The Internal Audit function was established in Gas Natural Fenosa as a means of independent and objective assessment and for this reason the Internal Audit Area reports to the Audit Committee of Gas Natural SDG, S.A.

Its main purpose is to ensure the supervision and continuous assessment of the effectiveness of the Internal Control System, including the SCIIF and the Crime Prevention Model, in all fields of Gas Natural Fenosa, providing a methodical and stringent approach for process monitoring and improvement, and for the assessment of operational risks and controls relating thereto. All of the foregoing is designed to achieve compliance with the Strategic Objectives of Gas Natural Fenosa and to assist the Audit Committee and the top-tier management of the group in the fields of management, control and corporate governance.

In accordance with the terms recommended in the COSO Report (Committee of Sponsoring Organisations of the Treadway Commission), the Internal Control System in Gas Natural Fenosa was established as a procedure to be carried out by the Board of Directors, top-tier management and the remainder of the organisation personnel, for the purpose of providing a reasonable degree of confidence in achieving objectives in the following sectors or categories:

- > Effectiveness and efficiency in operations.
- > Reliability of financial information.
- > Compliance with applicable laws and regulations.

The objectives, operating standards, powers and responsibilities of Internal Auditing, as well as the methodology for drawing up the Annual Internal Audit Plans, are set out in the Internal Auditing Standards.

The Strategic Audit Plan (with broader time frame of five years) and the Annual Internal Audit Plans are drawn up principally on the basis of the group's Strategic Plan, the risk areas included in the group's Corporate Risk Map, the SCIIF scope matrix, the main risks of the Crime Prevention Model, the assessment of the operational risks in each process (operational risk maps), the results of previous years' audits and the proposals from the Audit Committee and from top-tier management.

Internal Auditing has established a methodology for assessment of the operational risks based on the conceptual framework of the COSO Report, taking as a point of departure the type of risks defined in the Corporate Risk Map of Gas Natural Fenosa.

In accordance with the aforementioned methodology, the operational risks associated with the processes are prioritised by assessing their impact, relative importance and degree of control. Based on the results obtained in the aforementioned assessment, an action plan is designed with a view to implementing corrective measures which will mitigate residual risks identified as having greater potential impact than the established tolerable or accepted risks. The 2016 Annual Corporate Governance Report sets out the methodology for the identification and control of the group's risks.

In the performance of its activity, Internal Auditing constantly verifies compliance with all those policies, regulations and controls of processes (including those laid down in the SCIIF and in the Crime Prevention Model) to ensure they are working properly and for the purpose of preventing and identifying cases of fraud, corruption or bribery. To this end, all of the work review programmes of each of Gas Natural Fenosa procedures include a specific section targeted at verifying the correct design and operation of the foregoing policies, regulations and controls. In accordance with the Strategic Audit Plan, the Internal Control System of Gas Natural Fenosa is fully supervised by Internal Auditing for five years.

More specifically and with regard to the SCIIF, Internal Auditing is in charge of:

- > Validating the proper design of the SCIIF, based on the basic principles of the model approved by the Audit Committee.
- > Supervising the efficacy and adaptation of control policies and procedures put in place (in full over five years).
- > Revising and assessing of conclusions on compliance and effectiveness of the SCIIF resulting from the internal certifications of the business and corporate units in charge of the controls (in full over five years).
- > Assessing and communicating the results obtained in the process of supervising the SCIIF and the controls of the SCIIF processes.

As a consequence of the coming into force on 23 December 2010 of Organic Law 5/2010, which amends Organic Law 10/1995 of 23 November, governing the Penal Code, the criminal responsibility of artificial persons in cases in which they do not exercise due control over the systems of individuals subject to their authority was introduced in Spain.

In previous years, the Crime Prevention Model was designed and implemented. This policy addresses internal control systems established in the group for eliminating or mitigating criminal risks. The design and implementation of the model were supervised by the Audit Committee. Once it is operational, the Compliance Unit is responsible for the management and maintenance of the model.

On 1 July 2015, Organic Law 1/2015 of 30 March, came into force. This modified the foregoing Organic Law 10/1995 of 23 November, of the Penal Code, incorporating new items with regard to the internal organisation and control procedure of companies with regard to the prevention and detection of criminal conduct as a requirement to make it possible for full or partial exemption of the criminal responsibility of the artificial person.

The model introduced at Gas Natural Fenosa already incorporated the foregoing control procedures, and no major changes to these have therefore been necessary. From an organisational standpoint and as a legal requirement, the Board of Directors of Gas Natural SDG, S.A., formally adopted the model at its session held on 30 October 2015. At another session held on 25 September 2015, it appointed the Compliance Assessment Committee as the autonomous body responsible for supervising the model.

The Compliance Assessment Committee, made up of the Chief Financial Officer (in turn Committee Chairman), the Head of Legal Services and the Director of Internal Audit, Compliance and Internal Control, regularly reports its activities to the Audit Committee.

Internal Auditing is in charge of the annual audit of the Crime Prevention Model to be reasonably sure that the model is efficient and effective at preventing, identifying or mitigating the occurrence of legislation-typified crimes. In 2016 and previous reporting periods, this audit was carried out through an independent expert, issuing a favourable opinion for each year.

The 2016 Corporate Governance Report of Gas Natural SDG, S.A. provides greater detail on the SCIIF and of the Crime Prevention Model, with the model of supervision set up at Gas Natural Fenosa.

Internal Audit Projects have been developed via the Internal Audit Corporate Intranet. The aim of this IT application is to improve the effectiveness and efficiency of the development of the Internal Audit function in all geographic and business spheres of Gas Natural Fenosa. Furthermore, it should be pointed out that the function has been developed pursuant to International Standards for the Professional Practice of Internal Auditing, and that a number of the internal auditors are in the process of obtaining certification as Certified Internal Auditor (CIA), the only qualification recognised worldwide attesting to the excellence of the Internal Auditing services.

The development of the Internal Audit function within the group is designed to contribute to continuous improvement in the provision of auditing services, by applying policies based on the management and measurement of its quality, encouraging the creation of a qualified team of human resources, and promoting internal rotation, training, continuous assessment and professional development within the group.

The Gas Natural Fenosa Director of Internal Audit, Compliance and Internal Control attended the meetings of the Audit Committee for the purpose of presenting:

- > The Annual Internal Audit Plan for the Committee's approval.

The 2016 Audit Plan was presented in a meeting held on 25 February 2016.

- > The degree of implementation of the Internal Audit Plan.
- > The opinion of the Internal Audit on the Internal Control System and the main operational risks of the processes identified in 2016.
- > The evaluation of the effectiveness of the SCIIF and Crime Prevention Model.
- > The activities performed during the year in the role of Compliance and the Compliance Evaluation Committee.
- > The activities of the Code of Ethics Committee and communications received through the complaints channel (see specific section).
- > Presenting the proposed Reports on the Functions and Activities of the Audit Committee 2015 and 2016.
- > Presenting the conclusions on the annual review of compliance with the General Treasury Stock Policy approved by the company's Board of Directors.

The main processes revised by the Internal Auditing Area in 2016 were those concerning:

> Business processes (58% of the total audit hours):

- Gas Distribution: Reading and determination of consumption, procurement and commissioning, construction of networks, emergencies, gas distribution warehouse management, management of irregularities and fraud.
- Electricity Distribution: Electricity distribution, warehouse management, operations, service delivery, medium and low voltage development, network maintenance, reading.
- Generation: Operation, asset generation and maintenance, warehouse management.
- Retail Marketing: Management of energy customers and products, capture and procurement of energy facilities.
- Wholesale marketing and global accounts: Management of de-subscribing industrial customers, management and optimization of the logistics of gas.
- Procurement and Transportation: Purchases of GNL.
- Exploration and Production: Exploration/Production.
- Energy management: Estimation of demand and purchase of electricity retailers, CO₂ markets, generation of energy sales.

> Support and corporate processes (42% of the total audit hours):

- Customer Service: Collection, billing, management of receivables, customer service, readings and retail measures.
- Management of physical resources: Purchases inside and outside the perimeter, accreditation and monitoring of suppliers, due diligence of the counterpart.
- Management of the IT systems: Guarantee of continuity and availability of integral services, information security, integral services project management.
- Human resources management: Human resources administration and services, MBO.
- Communication Management and External Relations: Sponsorships, foundations.
- Monitoring undertakings to improvements in process auditing.
- Management of the regulatory framework.
- Review of the group's regulatory system.
- Review of the 2016 Corporate Responsibility Report.
- Review of the assessment and achievement of the 2015 efficiency projects.
- Review of the SCIIF.

- Review of the Crime Prevention Model.
- Updating of 2016 Operational Risk Map.
- Review of the compliance with the General Treasury Stock Policy.

33% of the total audit hours have been applied in the review process in the area of Spain and the remaining 67% internationally.

Likewise, given the organisational position of independence and the transverse scope of operations of the Internal Audit function, its management has led or taken part in other projects of collaboration, research or consultancy.

Auditing Area (External Audit)

The external auditor (PricewaterhouseCoopers) of the Consolidated and Individual Annual Accounts of Gas Natural Fenosa attended the meetings of the Audit Committee in order to ensure its autonomy and be informed of the conclusions reached on its work in the appropriate manner and with sufficient time (prior to the Board of Directors' formulation of the Half Yearly Financial Report and the Annual Financial Report that covers the Annual Accounts, the Management Report and the selected financial information by the Board of Directors). The external auditor specifically presented:

- > Planning of its external audit work, indicating the areas of greatest risk where the external auditor will focus its work and compliance with Technical Auditing Standards.
- > The Consolidated and Individual Annual Accounts Audit Report of Gas Natural Fenosa.
- > Limited review report on the review of the SCIIF.

- > The main conclusions of its auditing work on the half yearly and annual financial statements, including recommendations to improve the SCIIF, specifically:
 - Internal control weaknesses identified in the audit.
 - Conclusions drawn on the main opinions and estimates made by the management and which have an impact on accounts.
 - Conclusions on the companies included within the group's consolidation perimeter.
 - Conclusions on the appropriate nature of the accounting criteria applied and the sufficiency of the breakdowns given in the Annual Accounts.
- > The report and conclusions on the audit or accounting review tasks concerning the Financial Statements belonging to Gas Natural Fenosa, carried out in compliance with the regulatory and consolidation requirements of "la Caixa" and Repsol Groups.
- > The main aspects of the Amendment of the Corporate Enterprises Act to improve Corporate Governance, emphasising the responsibilities of the administrators and the Audit Committee.
- > Impact of the new Accounts Auditing Act.

In 2016, the Audit Committee established the appropriate relations with PricewaterhouseCoopers (accounts auditor) to receive information on those issues that could jeopardise its independence.

More specifically, the Audit Committee has analysed all of the service procurement proposals with the accounts auditor that took place in 2016, other than the accounts auditing service. The purpose of this is to make sure that these are not incompatible with its audit tasks, and do not therefore jeopardise its independence, pursuant to the limitations set out in Royal Legislative Decree 1/2011 of 1 July, which approves the Consolidated Text of the Accounts Auditing Act.

Furthermore, PricewaterhouseCoopers has sent written confirmation of its independence through a letter in which it declares that in 2016 it was not involved in any of the grounds for incompatibility set out in the Accounts Auditing Act.

The additional services provided by the auditors have corresponded to matters related mainly to fiscal, regulatory and business issues, and have been required as a result of their uniqueness and complexity.

The fees charged in 2016 by the audit service and related fees have totalled 4,733,633 Euros and those corresponding to additional services have totalled 233,725 Euros. The latter include services contracted in previous years for which the same assessments were conducted as those remarked on in this report, and with the same conclusions drawn.

In accordance with the provisions set out under legislation and the Regulations of the Board of Directors and of its Committees, at its meeting on 7 February 2017 the Committee issued the report on the independence of the accounts auditor for 2016. In this report it declared that, in its opinion, the Accounts Auditors had acted with complete independence in the provision of its services, both with regard to its work as the accounts auditor as well as the services provided over and above those legally required. The foregoing report has been published on the company's website.

Moreover, in its meetings of 28 January 2016 and 7 February 2017, the Audit Committee made a proposal to the Board of Directors (for subsequent submission to the General Meeting of Shareholders) for the selection and appointment of the external auditors for 2016 and 2017, respectively, pursuant to Article 264 of the Corporate Enterprises Act.

The General Meeting of Shareholders held on 4 May 2016, on the proposal of the Board of Directors, appointed the auditors for the financial year 2016, corresponding to the General Shareholders' Meeting to be held during the year 2017, as the auditors for said financial year.

On the other hand, at the meeting of the Committee held on 24 of November of 2017, the Audit Committee proposed to the Board of Directors the selection and appointment of the External Auditors for the years 2018, 2019 and 2020. Said proposal for the selection and appointment were made on the basis of the results of the open procedure for the selection during the year, which included three auditing firms of international prestige and recognition.

Economic-Financial Area

The Chief Financial Officer attended the meetings of the Audit Committee for the purpose of:

- > Presenting the financial information, the Annual Accounts and the monthly, quarterly and half yearly Financial Statements, as well as accounting or financial information required by the CNMV or any other regulatory body, ensuring transparency and accuracy of the information provided and stating the internal control systems and, where appropriate, the accounting criteria applied.
- > Reporting on the main accounting procedures and processes employed in compiling the economic and financial information and the financial statements.
- > Reporting on the companies that form part of the group's consolidation perimeter.
- > Reporting on the main risks and contingencies and their cover by means of provisions.
- > Reporting on the group's fiscal policy and the main fiscal policies applied in the Corporate Tax returns of 2015 and 2016.
- > Reporting on the procedure for selecting the external auditor for 2016 and 2017.

- > Report on the bidding process for the selection of the external auditor for the years 2018, 2019 and 2020.
- > Reporting on whether the External Audit Programme has been carried out in accordance with the contracted conditions and legal requirements.
- > Reporting on the efficiency and efficacy of the SCIIF.

For the purpose of having a tool that guarantees proper control of SCIIF management, in previous years the SAP GRC Process Control application was introduced in Spain and those countries in the international arena with greater materiality. The purpose of this was the automated integral management of the documentation, assessment and supervision of internal control. During the year 2016 it has been implemented in Holland and is scheduled to be progressively implemented in the other countries where Gas Natural Fenosa is present. These incorporations strengthen and secure the Internal Control at Gas Natural Fenosa.

The 2016 Corporate Governance Report of Gas Natural SDG, S.A. provides greater detail on the SCIIF and the model of supervision set up at Gas Natural Fenosa.

- > Reporting on how the key controls of the SCIIF are certified by the business and corporate units responsible for these, as well as the improvement action plans as a result of the certification procedure.
- > Reporting on the contracts signed with companies using the PricewaterhouseCoopers name (external auditor), in order to ensure their independence from the perspective of national regulations (Accounts Auditing Act).
- > Regular reporting on treasury stock operations.

Corporate Risk Map of Gas Natural Fenosa

The Chief Finance Officer provided information on the Risk Control Policies and Systems at Gas Natural Fenosa, as well as relevant aspects concerning the drafting, definition and conclusions of the Corporate Risk Map of Gas Natural Fenosa, emphasising the following aspects:

- > Definition and characteristics of the main risk factors.
- > New features in the 2016 Corporate Risk Map.
- > Impact variables.
- > Main measurement methodologies used for each kind of risk.
- > Qualitative, quantitative and probable severity of the risk occurring.
- > Defined controls and their effectiveness.

All of which is intended to establish basic guidelines for action in questions of risk and to reduce exposure in those activities with a greater likelihood of residual risk for the group.

The 2016 Annual Corporate Governance Report of Gas Natural SDG, S.A. details the Risk Management System of Gas Natural Fenosa.

Related-party transactions

Due to the amendment of the Articles of Association agreed by the General Meeting of Shareholders on 14 May 2015, the Audit Committee became responsible for or the analysis and report of related-party transactions. This had previously been carried out by the Appointments and Remuneration Committee.

The preliminary examination by the competent Committee of transactions to be carried out with related parties is for the purpose of reporting to the Board of Directors that the transaction in question is performed under market conditions and in line with other similar transactions.

Those transactions with related parties that form part of the company's normal trading practice, which have been carried out under market conditions and which are of scant relevance, have not been subject to the preliminary information from the Committee. This is on the understanding that the information on these transactions is not necessary to provide the true and fair view of company's equity, financial situation and profits (losses).

The Corporate Enterprises Act refers to related-party transactions and to conflicts of interest that could affect Directors, and warns of the duty to notify situations of conflict of interest and to refrain from taking part in any deliberations or votes concerning these. In related-party transactions that have been submitted for approval by the Board of Directors, following a favourable report from the competent Committee, those Directors representing the involved related-party have abstained from deliberating and voting.

The list of related-party transactions assessed by the competent Committee and reported to the Board of Directors are included in the 2016 Annual Corporate Governance Report and in the report issued by the Audit Committee on "Transactions with related-parties in 2016", published on the company's website.

Code of Ethics Committee of employees of Gas Natural Fenosa

The Code of Conduct¹ of Gas Natural Fenosa was approved on 31 March 2005 by the Board of Directors of Gas Natural SDG, S.A. and subsequently presented at the General Meeting of Shareholders on 20 April 2005.

The Code of Ethics Committee of Gas Natural Fenosa was set up in July 2005 with the main duties of:

- > Promoting the dissemination and content of the Code of Ethics.
- > Provide a communication channel to all employees for the purpose of gathering consultations and complaints of code breaches.
- > Helping to resolve conflicts linked to the application of the Code of Ethics.

To enable the Code of Ethics Committee to carry out its functions in an objective and independent manner, it is chaired by the Director of Internal Audit, Compliance and Internal Control and is made up of the representatives of different areas in monitoring compliance with the Code of Ethics.

The Code of Ethics Committee reports its activities on a quarterly basis to the Audit Committee through the Director of Internal Audit, Compliance and Internal Control.

¹ From February 2009 referred to as the Code of Ethics.

Code of Ethics Local Committees have also been set up, subordinated to the Code of Ethics Committee, in some of the countries where Gas Natural Fenosa operates (Italy, Argentina, Brazil, Colombia, Mexico, Panama, South Africa, Moldova and Chile), for the purpose of facilitating distribution of the content of the code within these spheres. The other areas are managed by the Code of Ethics Committee itself.

The Code of Ethics is available in nine different languages. Gas Natural Fenosa has reserved a specific space for the code in the Corporate Intranet, in which practical information is offered on different issues thereof.

The most important tasks carried out by the Code of Ethics Committee include the activities for disseminating the contents of the Code of Ethics and the Anti-corruption Policy, directed to all the group's employees and the supervision of the Code of Ethics consultation and complaints procedure.

This procedure corresponds to an open channel of communication between the Code of Ethics Committee and all employees of Gas Natural Fenosa to deal with the issues concerning the code. This channel enables all group employees, suppliers and collaborating companies to obtain or provide information on any issue concerning the Code of Ethics. The said Gas Natural Fenosa collectives can therefore address the Code of Ethics Committee to resolve any doubts they may have with regard to the code. They may also get in contact with the Code of Ethics Committee to provide information on conduct that is contrary to the principles of the Code of Ethics and Anti-Corruption Policy and do so in good faith, confidentially and without the fear of reprisals.

All communications between the Code of Ethics Committee and Gas Natural Fenosa employees are confidential, pursuant to the restrictions set forth in Organic Law 15/1999 of 13 December, governing the Protection of Personal Data. To this end, the Chairman of the Code of Ethics Committee is the sole member, at the initial stage, authorised to be aware of all the information from all the enquiries and complaints received from the group through said procedure. Complaints concerning fraud, auditing or faults in accounting processes or internal control are likewise sent directly to the Audit Committee. In 2016, 15% of the complaints received were related to alleged fraud, none of which had any significant impact.

Special mention must be made of the fact that the Code of Ethics Committee has proposed several updates to the contents of the code, which were finally approved by the Audit Committee and confirmed by the Board of Directors.

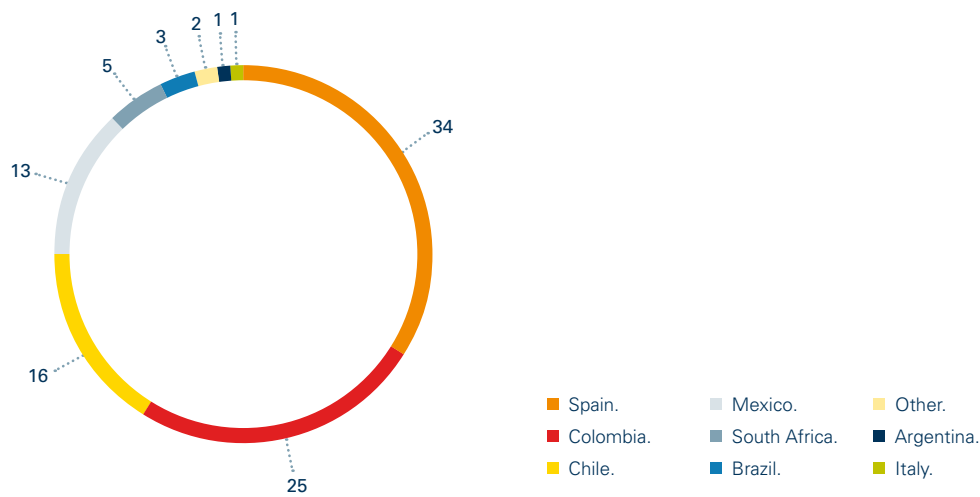
As a result of the foregoing, the Code of Ethics was amended by agreement of the Board of Directors, dated 25 January 2008, 27 February and 19 May 2009, and 27 June 2014 in order to update it and incorporate the commitments acquired by Gas Natural Fenosa regarding the good governance and corporate responsibility from 2005 (date the Code of Ethics was approved) and likewise to incorporate the best international practices in ethical and social issues and to comply with the regulatory demands derived from the integration of Gas Natural Group and Unión Fenosa. Specifically, the update carried out in the 2014 year included improvements in the areas of corruption, bribery and safety in the workplace, with the aim of adapting it to the new laws enacted (inter alia, the Reform of the Penal Code) and the implementation of the Health and Safety Model in the group.

Lastly, in previous years, the Declaration of Compliance with the Code of Ethics and Anti-Corruption Policy of Gas Natural Fenosa process was implemented, according to which all group employees must repeat their declaration of the fact that they are aware of, understand and comply with each of the guidelines for conduct provided in the Code of Ethics.

A list of the main activity indicators of the Code of Ethics Committee is given hereunder:

| | |
|-------------------------|-----|
| Received communications | 178 |
|-------------------------|-----|

Geographical origin of communications (%)



Code of Ethics chapter to which notifications refers (%)

| | 2016 |
|--|------------|
| Loyalty to the company and conflicts of interest | 30 |
| Customer relations | 14 |
| Respect for the individual | 15 |
| Corruption and bribery | 10 |
| Respect for law, human rights and ethical values | 6 |
| Professional development and equal opportunities | 6 |
| Use and protection of assets | 3 |
| Relations with collaborators and suppliers | 6 |
| Others | 10 |
| General total | 100 |

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