



Annual Report
of the **Audit
Commission**
corresponding to the 2018 fiscal year
Executive Summary



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Madrid, April 2019

Prepared by the Audit Commission for its availability to the shareholders in the
Annual General Meeting to be held in 2019.

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1 Introduction

Canal de Isabel II, S.A. is a public company in the Community of Madrid, and in which most municipalities of the region also participate, (the City of Madrid with 10% and another 110 City Councils with a 7% as a whole). The Company, as a contracting authority, is subject to the laws of public procurement, for the works, supplies and services that it needs to acquire. Likewise, it is subject to the budgetary and control regulations established for the public companies of the Community of Madrid. In its activity, it is subject to Spanish regulatory framework, on both the state and regional levels, highlighting Law 17/1984, of 20 December, on Supply and Sanitation of the Community of Madrid; as well as the Law of the Assembly of Madrid by which its creation is authorised, contained in Law 3/2008, of 29 December, on Fiscal and Administrative Measures of the Community of Madrid. Its activity is regulated, among other things, by environmental matters and in terms of the use of the state-owned hydrological resources.

The experience of Canal de Isabel II, gained over more than a century and a half, allows the company to offer added value to activities in the water sector and in geographical areas outside the Community of Madrid. The Canal de Isabel II Group offers services to 9.73 million inhabitants (6.63 in Spain and 3.10 in Latin America) and provides employment to more than 6,200 people, generating over 9,400 indirect jobs. The following companies or firms form a part of the Spanish Group: Hispanagua, S.A.; Hidráulica Santillana, S.A.; Canal de Comunicaciones Unidas, S.A.; Canal

Energía, S.A.; Canal Gestión Lanzarote, S.A.; Ocio y Deporte S.L. and Canal Extensia, S.A., which in turn, is the head of the International Group, with direct or indirect participation in the following companies: Inassa; Triple A de Barranquilla, Metroagua, Triple A Dominicana, Triple A Ecuador, Amagua, Gestuts Gestión y Servicios, Amerika T.I., ASAA, Soluciones Andinas del Agua, Emissao and Fontes da Serra, that operate in Colombia, the Dominican Republic, Ecuador, Uruguay and Brazil, which increases the complexity of the International Group.

Regarding accounting, the Company and its Spanish Group formulate the Accounts under the General Accountancy Plan. However, due to its international dimension and the fact of bond issuance, the Consolidated Accounts are also formulated under the International Accounting Standards (IFRS-EU), which is an added task in the approval process of the Accounts, but it provides a framework of reference that allows for greater comparison.

In the context of the Company's activity, and as a Commission of the Board of Directors, the Canal de Isabel II, S.A. Audit Commission, established by an agreement of the Board of Directors on 17 December 2014, has complied with the performance its duties, during the fiscal year ending on 31 December 2018, its fourth year of operation. During the 2018 fiscal year the Company passed and implemented the Canal de Isabel II 2018-2030 Strategic Plan that, following internal reflection and with different social partners, defined the following Company mission: "We care for our Community, managing everyone's water with transparency,

efficiency and sustainability”, and establishing as the company’s own values, in addition to the three foregoing, commitment, excellence and proximity. An ambitious project structured in 10 strategic lines; the objectives achieved by which will place Canal de Isabel II at the forefront in the services of the integral water cycle. The Strategic Plan has a specific strategic line, number 7, the aim of which is to enhance Transparency, Good Governance, and Commitment with different interest groups, the development of which the Commission is especially dedicated to.

During the 2018 fiscal year, significant challenges arose in the process of preparing the Individual and Consolidated Annual Accounts for the fiscal year ending 31 December 2017, in which the Directors and, among them, the members of the Audit Commission, worked to ensure that these accounts express the Company’s true and fair view of the equity, financial situation and results once the Subsequent Events occurred after the reporting period that had to be properly evaluated and that led to the need for its reformulation.

It is worth noting that in the 2018 fiscal year that the Accounts Chamber of the Community of Madrid completed the Comprehensive Audit of the Canal de Isabel II Group for the 2008 to 2015 period.

The issuance of the corresponding Report by said Controlling Body, the conclusions of which and the implementation of its recommendations will contribute to improving the management of the Company and its corporate Group.

Additionally, during the fiscal year, the Commission collaborated in the process of selecting the external auditor for the coming fiscal years (2018-2020), as provided for in the by-laws.

The Audit Commission is exclusively composed of non-executive board members with the qualification of independent board members, in line with the best practices of good governance, supporting the Board of Directors in its operations and in the decision-making processes.

The purpose of this Executive Summary is to summarise the activity of the Audit Commission during the 2018 fiscal year in compliance with its duties, in order to allow shareholders to know the activities carried out in the same, to be able to evaluate its performance and that the Commission itself can undertake improvements in its operation, in its purpose of continuous improvement.

Mr. Antonio Javier Cordero Ferrero
Chairperson of the Audit Commission

2 Rules and functions of the Audit Commission

Pursuant to Article 18 bis of the Company's By-Laws, the Audit Commission shall comprise a minimum of three non-executive directors appointed by the board of directors, of which at least two must be independent directors and one must be appointed considering his or her knowledge and experience of accountancy and/or auditing, as provided for in the technical guide 3/2017 on Audit Commissions of public interest entities issued by the Spanish National Securities Market Commission (CNMV) and whose principles and recommendations are followed by this Audit Commission.

The members of the Monitoring and Audit Commission shall appoint a President from among the independent Directors that form part thereof and these shall be replaced every four years and may be re-elected once a period of one year has elapsed since they stepped down. On 1 January 2018, the Audit Commission was formed by three independent board members, one of them being, in turn, its Chairperson.

Without prejudice to other tasks that may be entrusted to it by the Board of Directors, the Audit Commission will have as its main functions those indicated in Article 18 bis of the Company's By-Laws, in its current text, after the modifications approved by the Annual General Shareholders Meeting on 5 July 2017, for its adaptation to the current wording of Article 529 quaterdecies of Royal Legislative Decree 1/2010, of 2 July, approving the Revised Text of the Spanish Companies Act (LSC):

The Audit Commission shall have the following functions, without prejudice to any other functions that, where appropriate, the Board of Directors may delegate in this Commission:

- a) Responding to any questions raised by shareholders at their general meeting on matters which fall within its remit and, in particular, regarding the result of the audit, explaining how this has contributed to the integrity of the financial reporting and the commission's function in such process.
- b) Supervising the effectiveness of internal control at the Company, internal auditing, as the case may be, and the risk management systems, as well as discussing any significant weaknesses in the internal control system detected during the course of the audit with the auditors or audit firms, all without undermining its independence. Accordingly, and, if applicable, recommendations and proposals may be submitted to the governing body and within the relevant deadline for monitoring thereof.
- c) Supervising the process for preparation and presentation of the financial reporting required and to present recommendations or proposals to the Board of Directors aiming to safeguard its integrity.
- d) Proposing to the managing body, to be submitted to the Shareholders' Meeting, the selection, appointment, reappointment and removal of the external auditor, taking responsibility in the selection process, in line with articles 16, sections 2, 3 and 5 and 17.5 of Regulation (EU) No. 537/2014, of 16 April and the terms of the appointment and obtain information on a regular basis regarding the audit plan and the execution thereof and maintain independence while exercising its functions.
- e) Establishing the appropriate relations with the external auditor in order to regarding any such issues as may compromise their independence, for examination by the Commission, and those

of anyone else involved in the process of auditing accounts, and, when applicable, the authorisation of services other than those prohibited, in the terms set forth in Articles 5, Section 4 and 6.2.b) of the Regulation (EU) No. 537/2014 of 16 April, and as provided in the third Section of Chapter IV, title I of Law 22/2015, of 20 July on accounts auditing, on the independence such other communications as may be contemplated in the legislation governing auditing and audit standards. In any case, it will annually receive from the external auditors the statement on his independence with regard to the entity or entities directly or indirectly linked to it, together with the detailed, individualised information on any type of additional service provided and the corresponding fees received from such entities by the external auditor or by the persons or entities linked to this in accordance with that established in the legislation on account auditing.

- f) Issuing a report on a yearly basis, before the report by the accounts auditor is issued, expressing an opinion on the independence of the accounts auditors or auditing companies involved. This report will include, in any case, a reasoned opinion on the provision of each and every additional service referred to in the previous point, considered individually and as a whole, other than the legal audit and regarding the rule for independence or the account auditing regulatory policy.

g) Informing the Board of Directors, in advance, on all the issues envisaged by the Law, the Articles of Association and these Regulations, and in particular regarding:

1. Financial information that must be periodically made public by the Company,
2. the creation or acquisition of shares in entities with a special purpose or domiciled in countries or territories considered to be tax havens and
3. operations with related parties.

The provisions of letters d), e) and f) of the foregoing section shall be without prejudice to the accounts auditing regulatory standards.

The Audit Commission shall meet with the frequency determined and whenever the Chairman or two of its members call(s) a meeting. Any member of the management team or Company personnel shall attend meetings of the Audit Commission and provide cooperation and access to the information available to them whenever required.

The Commission shall have the necessary means to discharge its duties and operate independently. The decisions or recommendations of the Audit Commission shall be adopted by a majority vote.

The Board of Directors may develop the competencies and operation standards of the Audit Commission.

3 Composition of the Audit Commission and meeting attendance

3.1. Composition of the Audit Commission and member profiles

Name	Position	Condition
Mr. Antonio Javier Cordero Ferrero	Chairperson	Independent
Ms. María Antonia Otero Quintas	Board Member	Independent
Mr. Jacobo Martínez Pérez de Espinosa	Board Member	Independent

Included below is a short summary of the professional background of each member of the Audit Commission.

Mr. Antonio Javier Cordero Ferrero

He is a doctor of Business Administration and Accountancy, as well as being an economist and lawyer. He earned a Masters in Technological and Industrial Management from the EOI and is a University specialist in Business Law from the Polytechnic University of Madrid and an Accounting Expert accredited by the Register of Accounting Experts (REC).

He began his professional career in the area of Economy and Finance of the City Council of Madrid and continued it primarily in companies tied to the SEPI Group, such as Red Eléctrica, Radio Televisión

Española, Astilleros Españoles, COFIVACASA, IZAR and Navantia, in which he held numerous management positions in the economic, industrial and strategy areas.

Ms. María Antonia Otero Quintas

Telecommunications Engineer from the Polytechnic University of Madrid, she later studied the Executive Senior Management Programme at IESE and the Leading Competitive Challenges Programme at Harvard/IESE.

She has spent most of her professional career in the Telefónica Group, whose parent company Telefónica de España S.A., joined in 1979. In 1997 she changed to Telefónica Corporación, where she held various positions such as Purchasing Manager of the Group, Director of Innovation, member of the Strategy Commission, member of the Expanded Management Commission, Director of the Technology and Networks Commission and General Deputy Director of Innovation and CTO.

She was an Independent Board Member of Jazztel from 2009 to 2015, as well as a member of its Remuneration and Appointments Commission, and is currently an Independent Board Member and member of the Audit Commission of Voztelecom and Independent Board Member of Inversis Banco.

She is currently an Independent Board Member

of Unicaja Banco, S.A., and Chairperson of the Technology and Innovation Commission and Board Member of the Appointments Commission and the Risk Commission.

Mr. Jacobo Martínez Pérez de Espinosa

He is a founding partner and member of the Executive Commission of the law firm Eversheds Sutherland Nicea. He has extensive experience in labour law counsel of large companies, having also participated in numerous statutory audit processes (due diligence) and regulatory compliance programmes of several Spanish and multinational companies.

Since 2008 he has been recognised by one of the most prestigious lawyer rankings in the world, Chambers & Partners, as one of the most important lawyers in his area in Spain. Likewise, in 2015 and 2017 he was awarded the prize of 40 under Forty (Iberian Lawyer), as one of the 40 most prestigious lawyers in Spain and Portugal under 40.

He is also a university professor (Cardinal Cisneros University College), and the author of several specialised books and has collaborated with different media.

Mr. Manuel Beltrán Pedreira

During the 2018 fiscal year Mr. Manuel Beltrán Pedreira performed the functions of Secretary of the Audit Commission and Secretary not member of the Board of the Canal de Isabel II, S.A Board of Directors.

Graduate in Law from the San Pablo CEU University of Madrid. A career civil servant, he is a General Administration Manager for Local Government (TAG). Masters in Corporate Legal Consultancy at the Business Institute (Madrid), and a Masters in Local Administration at the School of Law and Economics (Madrid).

Prior to his appointment at Canal de Isabel II, he held posts and positions in the Administration and the Public Sector, holding, among others, positions

such as Counsel for the Technical Office of the Supreme Court; President and Chief Executive Officer of the State Public Company Expasa S.A. ascribed to the State Company of Industrial Participations (SEPI); Deputy Minister of the Environment and Spatial Planning and Deputy Minister of Economy and Commerce of the Community of Madrid, among others.

In July 2014 he was appointed director of the General Technical Office and Secretary of the Board of Directors of Canal de Isabel II, S.A. and continues in both positions at present.

3.2. Meeting attendance

Article 18 of the By-laws establishes that "The Audit Commission shall meet with the frequency determined and whenever the Chairperson or two of its members call(s) a meeting. Any member of the management team or Company personnel shall attend meetings of the Audit Commission and provide cooperation and access to the information available to them whenever required".

During the 2018 fiscal year, the Audit Commission carried out intense business activity, holding 13 meetings on the following dates:

- 30 January 2018
- 12 February 2018
- 27 February 2018
- 22 March 2018
- 3 of May 2018
- 24 May 2018
- 13 June 2018
- 31 July 2018
- 18 September 2018
- 10 October 2018.
- 16 October 2018.
- 21 November 2018
- 13 December 2018

The Audit Commission met 11 times in the registered offices, having been previously convened to this effect, with the Agenda defined by its Chairperson, and the Secretary- Mr. Manuel Beltrán Pedreira Furthermore, during the fiscal year 2 meetings were held in writing and without a session, in accordance with the provisions of Articles 99 and 100 of the Commercial Registry Regulations.

The attendance statistics for Audit Commission meetings, both of its members and outside invitees, or from the Company itself, are as follows:

- Board Members Audit Commission: 98,07 %*
- Chairperson of the Audit Commission: 100%
- Secretary: 100%

- Non-member Invitees of the Commission**:

- General Management: 69.23 %
- Financial Management Representatives: 76.92 %
- Internal Audit Area Representation: 46.15 %
- External Audit Representation: 53,85%
- Other external advisors: 7.69 %

**This percentage is calculated on the number of Commission Board Members, excluding the Chairperson's attendance.*

***This percentage is calculated on the total number of meetings of the fiscal year, these invitees attending 100% of the meetings that were convened.*

4 Activities carried out in 2018

As a meetings calendar, the criterion set out of convening an Audit Commission meeting prior to holding each session of the Board of Directors has been maintained, for purposes of analysing the matters of the Board's Agenda relating to its functions, as well as when the Chairperson of the Commission deems it appropriate. Furthermore, it was agreed that the Chairperson of the Company Board of Directors would be asked to include a point on the Board's Agenda to be informed of matters discussed in the previous Audit Commission session, to the effect that the Board was aware of the content and results of the sessions of said Commission, and this was done during the 2018 fiscal year.

Of the objectives set for the 2018 fiscal year, the Commission prioritised the implementation of the new Internal Audit and Compliance Functions Model, with tangible results such as the issuance of a favourable Report and elevation to the Board of Directors of the Compliance and Crime Prevention Policies in Canal de Isabel II, which were approved by the Board of Directors, as well as the creation of a Sub directorate for Compliance and a Sub directorate for Internal Audit, Risk Management and Internal Control.

Regarding Compliance, training actions on the Code of Ethics have been carried out in the Company that is applied to the same, and work has been done on the Statute of the Person Responsible for Compliance, as well as on the preparation of the Compliance and Crime Prevention Manual and in the Review and Evaluation of the Crime Prevention Model, which will be approved during the 2019 fiscal year.

In keeping with the goal of expanding these Internal Auditing and Compliance Functions to the Companies of the Group, during the 2018 fiscal year the process for the evaluation and analysis of criminal risks in the Spanish investee companies has begun: Hispanagua, S.A.U., Hidráulica Santillana, S.A.U. and Canal de Comunicaciones Unidas SAU, in relation to Article 31 bis of the Organic Law 10/1995, of 23 November, of the Criminal Code, on the criminal liability of the legal entity, whose results are expected to be presented to the Audit Commission in 2019.

Likewise, in order to extend these functions in the Latin American Companies, in the Company Canal Extensia, Holding Company of the International Group, a Head of Compliance was hired who began the implementation of an Internal Audit and Compliance Programme in the International Group. Said work continues at present.

Regarding the General Monitoring of the Incident Reporting Channel, Ethics Line, the Commission was interested in this periodic communication system and monitored its operation.

Furthermore, regarding the incorporation of non-financial risks, it should be noted that during the fiscal year a work was carried out on certain risks that the Audit Commission considered to be of special importance for the Canal de Isabel II activity, which are: Climate Change, Fiscal management, Reputational and Cybersecurity.

As regards holding meetings with regulators and other stakeholders, the objective was also met by the appearance in the Commission of the Director

General for Commerce and Consumption, under the Regional Ministry of the Economy, Finance and Employment of the Community of Madrid, which is one of the regulators of the Company in the area of Trade, Consumption and Customers, although due to scheduling conflicts, it was ultimately postponed until the beginning of the following year.

Finally, regarding the Supervision and Control of the Recommendations of the Accounts Chamber implementation, the Audit Commission analysed the recommendations made by the Accounts Chamber on the subject of Internal Audit, Risk Management and Compliance. The Commission will carry out a final review on the total implementation of the recommendations made by the Accounts Chamber in the 2019 fiscal year.

After outlining the most important actions carried out in compliance with the specific objectives set for 2018, this Executive Summary contains a synthesis of the main activities undertaken by the Audit Commission during the 2018 fiscal year, arranged according to the different duties of the same, according to the Audit Commission's various stakeholders:

4.1. External Audit

4.1.1. Relations with the external auditor

Authorisation for contracting services other than the audit

The Audit Commission supervised and authorised the sporadic hiring of services apart from the audit undertaken by the external auditor in the 2018 fiscal year.

Regarding the Individual and Consolidated Annual Accounts auditing process

Regarding the Accounts auditing process Annual and Consolidated Annual Accounts for the fiscal year ending 31 December 2017, in the performance of their duties, and in accordance with the pro-

visions of Article 18 bis e) of the By-Laws, the Audit Commission carried out an intense activity, successively, which was motivated by the occurrence of different important events, leading to the preparation, reformulation and approval of the Individual and Consolidated Accounts of Canal de Isabel II and its Group, corresponding to the fiscal year ending 31 December 2017.

Regarding the statement of the external auditor's independence

On 13 December, prior to the reformulation of the Annual Accounts, the external auditors of the Company and its Group expressed their independence as it relates to the Company and entities related to the same, directly or indirectly, before the Audit Commission. They provided detailed and individualised information on the additional services rendered of any kind and the fees received from the Company and associated parties.

The Audit Commission issued the mandatory report on the auditor's independence after completing the corresponding analysis and confirmation of the stated information.

4.1.2. New external auditor selection process

In accordance with the provisions of Article 529 quaterdecies of the Spanish Companies Act and in Article 18 bis of the Corporate By-Laws, the Audit Commission has significantly intervened in the external auditor selection process.

The General Shareholders' Meeting held on 23 November 2018, in accordance with the provisions of Articles 160 b) and 264 of the Spanish Companies Act, approved the appointment of the Company's external auditors.

4.2. Monitoring of financial information

The Audit Commission paid special attention to supervising the Individual and Consolidated Annual Accounts of the Company corresponding to the fiscal year ending 31 December 2017.

4.2.1 Establishment of a Working Group for evaluating contingencies in accordance with the available information and its impact on the Company's Financial Statements. 2017 Fiscal Year

For purposes of collaborating in the evaluation of certain contingencies in relation to events after the reporting period, the Audit Commission urged, in 2016, the creation of a Working Group so that, based on the information available, they could analyse the possible impacts of the Subsequent Events in the Annual Accounts corresponding to the 2016 fiscal year, both individually and as a consolidated entity for its subsequent presentation to the Board of Directors.

Said Working Group continued its activities for the Annual Accounts of the 2017 fiscal year.

On 13 December, the Commission ruled favourably on the Working Group's report for the Impact Analysis in the Annual Accounts corresponding to the 2017 fiscal year. Reformulation of the Annual Accounts: report updated as of the reference date - 27 November 2018 - and its elevation to the Board of Directors that approved it at its 18 December 2018 meeting.

4.2.2. Financial Management and Business Development Report, regarding the Preparation and Reformulation of the Annual Accounts corresponding to the fiscal year ending 31 December 2017

The Company's CFO and Business Development Director informed the Commission regarding the process of formulating and reformulating of the Individual and Consolidated Annual Accounts corresponding to the fiscal year ending 31 December 2017.

4.2.3 Financial Transaction relating to a Syndicated Loan to the Colombian investee Company "Sociedad de Acueducto, Alcantarillado y Aseo de Barranquilla, S.A. E.S.P. (TRIPLE A BARRANQUILLA)

On 12 February 2018, the CFO and Business Development Director of the Company and the CFO of Inassa informed the Commission of a proposal

about the structuring and participation of a syndicated loan, in favour of said investee company, for the funding of the Group and guarantee of its sustainability.

The Commission agreed to favourably report the signing of the Loan, under the terms and conditions provided for in the Term Sheet, subjecting such approval, in any case, to the prior and express authorisation to the Loan by the Autonomous Community of Madrid, and its elevation to the Board of Directors. Finally, the Audit Commission and the Company's Board of Directors do not deem it appropriate to continue with the processing of the same.

4.2.4 Financing Company Iberoamericana de Aguas y Servicios S.A. (INASSA)

In different meetings, the Commission analysed both the needs and different financing formulas of certain international companies in the Group.

4.3. Internal Audit, Internal Control and Risk Management

The Audit Commission, in consistency and continuity with what has been done in previous years, and in the performance of its duties, has acted in the following three areas:

a) Internal Audit

The Internal Audit Area reports directly to the Audit Commission, pursuant to the international framework for the practice of Internal Auditing, and reports hierarchically to the Executive Vice-President. The function of the Internal Audit follows the "2016-2018 Internal Audit Plan" that

Annual Report of the Audit Commission- Executive Summary corresponding to the 2019 fiscal year may be modified at the request of the Audit Commission, as was done in 2018.

In all the Commissions to which the Area Manager and the Head of Internal Audit were invited, they provided full information of the audits in progress, so that the members of the Commission were informed of their progress and could, when applicable, modify the priority of the audits or resources allocated.

Of the completed audits a series of recommendations and discoveries have arisen that seek to add value to and improve Canal de Isabel II's operations. The Internal Audit Area undertakes a monitoring of said recommendations and periodically reports on the status of their implementation.

b) Internal Control

During May and June 2018, four Workshop sessions were completed, which 41 people from the Organisation attended. In these sessions they analysed 62 risks, which, had a total of 61 controls. The new management was proposed of 12 risks and there was a total of 19 new controls. These sessions and their results were reported to the members of the Audit Commission.

Furthermore, it is worth noting that these controls, linked to the Organisation's main risks, are demonstrated by the testing of their effectiveness and design through the computer tool hired for this purpose.

c) Risk Management

Risk Management is a monitoring activity that seeks to remain permanently abreast of any risks that may have a bearing on the strategic targets to be met by the organisation. It reflects the values of the company and affects how risks are identified, what type of risks are acceptable, and that these are managed.

The applicable process in Canal de Isabel II in matters of Risk Management is one carried out by the Board of Directors, the General Management and certain Organisation personnel, designed to provide reasonable assurances on achieving objectives related to Canal de Isabel II operations, reporting and compliance. On the other hand, and along the lines of the methodology implemented, COSO Committee of Sponsoring Organizations of the Treadway, the Operational Risk Map and the High-Level Risk Map of the Organization were updated twice throughout 2018. The results were reported to the members of the Audit Commission.

On 18 September 2018, board members were also informed in the Commission of the participation of the Head of Internal Audit as Keynote speaker, at

the annual Internal Audit Conference of the European Commission in November 2018, on the "Risk Management in the Public Sector".

4.4. Corporate Governance and Compliance Function

Compliance Function and Model for the prevention of criminal offences

In 2018, work continued on the project to implement the compliance function of Canal de Isabel II, S.A., as good practice within the company and as a reinforcement within the Corporate Governance framework of the same.

The Audit Commission has continued to monitor the implementation of this function with special interest in the drafting of the Crime Prevention model referenced in Article 31 bis of the Criminal Code in the amendments to the same by Organic Law 5/2010 of 22 June and Organic Law 1/2015 of 30 March that establish the criminal liability of legal entities.

The Internal Audit Area reported on the most relevant and applicable existing regulations in the Organisation, as well as the overall diagnosis of the state of regulatory compliance within the company. The steps taken to implement the Crime Prevention model which brought modifications to the Criminal Code that establishes the Criminal Liability of the legal entity were also reported. The Audit Commission was made aware of, among other Activities carried out in 2018 aspects of the stages of implementation, criminal risks identified in the Company, as well as the activities to be undertaken for identifying controls.

For purposes of strengthening the Compliance Function they proposed passing two policies that reinforce the system: The Compliance Policy and the Crime Prevention Policy. The Company's Board of Directors approved the aforementioned policies in the meeting held on 28 February 2018.

Furthermore, the Compliance Function's implementation was monitored, and the participation of Canal de Isabel II, SA was authorised by means of the Head of the Internal Audit Area in the Working

Groups regarding the “Compliance Function in the Public Sector”, according to an invitation extended by the Institute of Compliance Officers.

Ethics and Compliance Commission

At the 3 May 2018 meeting, the Audit Commission was informed by the Head of the Internal Audit Area, in his capacity as Secretary of the Ethics and Compliance Commission, of said Commission’s Activities Report since its establishing, which was submitted to the members of the Audit Commission.

Said report collects, among other things, the origin, objective, functions and tasks of the Ethics and Compliance Commission.

4.5. Annual Corporate Governance Report for the 2017 Fiscal Year

The Annual Corporate Governance Report (hereinafter ACGR), is essentially regulated by the following standards (i) Article 540 of Royal Legislative Decree 1/2010, of 2 July, which approves the Revised Text of the Spanish Companies Act; (ii) Order ECC/461/2013, of 20 March, which determines the content and structure of the ACGR, the Annual Remuneration Report and other information tools of listed public limited companies, savings banks and other entities that issue securities admitted to trading in official securities markets; (iii) Circular 5/2013, of 12 June, of the National Securities Market Commission, which establishes the corporate governance annual report models of said corporations, savings banks and other entities that issue securities admitted to trading in official stock markets; and (iv) Circular 2/2018, of 12 June, of the National Market Commission of Securities, which modifies Circular 5/2013, of 12 June which establishes the ACGR models of listed public limited companies, savings banks and other entities that issue securities admitted to trading in official securities markets and Circular 4/2013, of 12 June, which establishes the annual remuneration report models of the board members of said corporations and members of the board of directors and the commission control of

savings banks that issue securities admitted to trading in securities markets.

The Audit Commission favourably reported on the ACGR for the 2017 fiscal year, approved by the Board of Directors of the Company, which on 3 April 2018, submitted it to the Spanish National Securities Market Commission and was published by means of the corresponding notification as a Relevant Fact.

4.6. Relevant Facts

The art. 6 of Order EHA/1421/2009, of 1 June, by which the Art. 82 of Law 24/1988, of 28 July, on the Securities Market, stipulates that an interlocutor must be appointed before the Spanish National Securities Market Commission in matters of disclosing Relevant Facts. The person appointed by the Board of Directors for carrying out this task as an interlocutor before the Spanish National Securities Market Commission is the Head of the Internal Audit Area, in order to effectively respond to queries or requests related to the dissemination of the disclosed Relevant facts.

Attached as Appendix I is the list of Relevant Facts reported to the Spanish National Securities Market Commission corresponding to 2018.

4.7. Operations with Related Parties

The Audit Commission’s function, among others, is to inform the Board of Directors of transactions with related parties, in accordance with Art. 18 bis g) 3. of the Corporate By-Laws, and it consequently agreed to generally inform the Board of Directors about the Management Commitments made by the Public Entity Canal de Isabel II in favour of Canal de Isabel II, S.A., as well as the Management Entrustments (now Own Means Contracts in accordance with the legal modification made by Law 9/2017, of 8 November, of Public Sector Contracts) carried out by it, in favour of its investee companies, when considering related operations in the Audit Commission’s span of control.

4.8. Other actions of Good Governance

One important element of the Compliance Function in an organisation is Personal Data Protection, especially in one such as Canal de Isabel II, S.A. that, as a provider of a public services, processes personal data including sensitive or specially protected data, such as banking data or even healthcare or union affiliation data of workers, daily. The Audit Commission was briefed on the contents, structure and main novelties of the "Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation)" (hereinafter GDPR). Furthermore, the appointment of the Canal de Isabel II, S.A. Data Protection Officer and its disclosure to the Regional Ministry of the Presidency, Justice and Spokesperson of the Government of the Community of Madrid, in response to the request made by this relation to the appointment of this figure in all companies or public entities of the Community of Madrid. Likewise, the Data Protection Officer presented a plan of the main milestones that had to be reached in order to adapt the Organisation to the new regulatory framework, as well as the initiation of a tender procedure for the contracting technical assistance that provides the necessary support and counsel in this adaptation process.

4.9. Special reference to the Report from the Accounts Chamber of the Community of Madrid on the comprehensive Audit of the Canal de Isabel II Group for the 2008 to 2015 fiscal years.

The Board of the Accounts Chamber of the Community of Madrid, in a meeting held on 29 December 2015, approved the 2016 Audits Programme, which was modified by agreement on 13 June 2016, in accordance with what was requested by the Commission on Budgets, Economy, Employment and Finance of the Assembly of Madrid, according to an agreement adopted at the session held on 16 March. Among the audits included in the programme, as a result of the aforementioned modification, is the so-called "Comprehensive audit of the Canal de Isabel II Group. 2008 to 2015 fiscal years", which was subsequently included in the programme for 2017.

The Audit, which receives the "comprehensive" qualification, according to the request formulated by the Assembly of Madrid, includes the Public Entity Canal de Isabel II and all subsidiaries.

The Audit Commission analysed the Preliminary Draft Report, the Claims under the Preliminary Draft prepared by the Company, as well as the final Comprehensive Audit Report of the Canal de Isabel II Group, 2008-2015 fiscal years, approved by the Accounts Chamber. The Audit Commission will monitor compliance with the Recommendations contained in said Report.

5 Conclusions

In the 2018 fiscal year, the Audit Commission's importance was once again proven, also in the face of adverse circumstances and in relation to extraordinary events that occurred during that fiscal year.

To summarise the Commission's activity, it is worth highlighting the following actions and compliance with the following functions of the Audit Commission as a collegiate body in accordance with the powers attributed to it in Article 18 bis of the By-Laws:

1. The Commission has supervised the operation, effectiveness and degree of implementation of the Internal Financial Information Control System.
2. It supervised the preparation and audit process for the Individual and Consolidated Annual Accounts of the Company, which included in this fiscal year a reformulation process of the Annual Accounts for the 2017 fiscal year.
3. The appropriate relations with auditors were established and their reports regarding their independence were received. The authorisation was processed for contracting additional services provided by the auditors of the Company's accounts or entities related to the same.
4. The Commission, prior to the issuance of the accounts auditing report, issued a report expressing its opinion on the independence of the external auditors, ruling on the additional services rendered.
5. The Commission also analysed the internal audits carried out by the Internal Audit Area and supervised the level of implementation of the Compliance Function.

6. During this fiscal year, the Audit Commission has exercised its new functions by significantly intervening in the process of selecting the Company's external auditors for the 2018-2020 fiscal years.

7. It also monitored the Company's Risk Management System, concerning the identification of new risks and review of those risks already defined.

8. The Commission has followed the Process for Implementing the Company's Compliance Function, and favourably ruled on the creation of the Audit and Compliance sub-directorates.

9. The Commission informed the Board of Directors of the conclusions reached in all the meetings it held, including, where appropriate, consulting, proposals and recommendations to the Board of Directors.

The Audit Commission will monitor compliance with the Recommendations contained in the Comprehensive Audit Report of the Canal de Isabel II Group, 2008-2015 fiscal years, approved by the Accounts Chamber.

Likewise, the Audit Commission considers that it has kept open, continuous and direct communication with the stakeholders involved in the processes regarding those who hold competencies. It also considers it has been adequately informed on matters that impact their functions and competencies, which has allowed it to fulfil those that both the aforementioned Corporate By-Laws and the Board of Directors of the Company have conferred on.

6 2019 Objectives

Having finished of the 2018 period, the members of the Audit Commission, in accordance with Strategic Line 7.1 (Strategic Plan for Good Governance), have agreed upon the following objectives for the new fiscal year:

- Prepare Audit Commission Regulations, approved by the Board of Directors of the Company and published on the company website.
- Hold an annual meeting in the third quarter of 2019 with the heads of the national and international Business Units.

This report was prepared by the Audit Commission on 26 April 2019, was approved by the Board of Directors on 29 April 2019 and will be reported to the General Shareholders' Meeting and published on the Company website.

- Chairperson (independent):

Mr. Antonio Javier Cordero Ferrero

- Board member (independent):

Ms. María Antonia Otero Quintas

- Board member (independent):

D. Jacobo Martínez Pérez de Espinosa

Appendix I.

Summary of Relevant Facts reported to the Spanish National Securities

Registro	Tipo(s) de hecho	Descripción
273012 20/12/2018 15:09	Convening and agreements of Meetings and General Meetings	Publication in the Official Gazette of the Commercial Registry of the convening of the General Shareholders Meeting
272787 18/12/2018 18:33	Convening and agreements of Meetings and General Meetings	Board of Directors Agreements Canal de Isabel II Limited Company held on 18 December 2018
272748 18/12/2018 10:26	Others on business and the financial situation	Legal Action in defence of their rights in INASSA
271817 23/11/2018 14:22	Convening and agreements of Meetings and General Meetings	Agreements of the Extraordinary Shareholders General Meeting held on 23 November 2018
270626 19/10/2018 09:19	Convening and agreements of Meetings and General Meetings	Publication in the Official Gazette of the Registry of the convening of the Extraordinary Shareholders General Meeting
270561 17/10/2018 13:29	Others on Corporate Governance Others on business and the financial situation	Adoption of Agreements Board of Directors
270452 11/10/2018 17:19	Composition of the Board of Directors	Legal Action in defence of their rights INASSA
267178 26/06/2018 19:43	Others on Corporate Governance	Board of Directors Agreements 26 June 2018
265165 04/05/2018 12:57	Others on Corporate Governance	Board of Directors agreement to cancel the General Shareholders Meeting
263619 03/04/2018 16:16	Annual Corporate Governance Report	The Company submits the Annual Corporate Governance Report for the 2017 fiscal year
263617 03/04/2018 14:07	Convening and agreements of Meetings and General Meetings	Publication in the Official Gazette of the Registry of the convening of the General Meeting
263521 27/03/2018 18:53	Others on Corporate Governance	Board of Directors Agreements 27 March 2018

