

ANNUAL ACTIVITIES REPORT OF THE AUDIT AND CONTROL COMMITTEE OF EUSKALTEL, S.A. FOR FINANCIAL YEAR 2016

1. Introduction

The Audit and Control Committee of Euskaltel, S.A. (hereinafter, Euskaltel, the Euskaltel Group or the Company) is an internal informational and consultative body without executive duties, the purview of which includes information, advisory, and proposal-making powers, as follows:

- (i) internal and external audit,
- (ii) information technology and risk management systems, and
- (iii) compliance and good governance.

The main task of the Audit and Control Committee is to assist, inform and make proposals to the Board of Directors on the matters from time to time assigned thereto by both the Bylaws of the Company and by the Regulations of the Board of Directors and the Regulations of the Audit and Control Committee.

The Audit and Control Committee was permanently created by Euskaltel's Board of Directors on 19 March 2013, i.e. prior to the entry into force of Law 31/2014 of 3 December amending the Companies Act for the Improvement of Corporate Governance, which is obligatory for listed companies.

Pursuant to the provisions of articles 4 and 26 of the Regulations of the Board of Directors of the Company, using the external and internal means it deems appropriate in each case, it shall engage in an annual evaluation of the operation of its committees in view of the report that they submit thereto.

Furthermore, article 18 of the Regulations of the Audit and Control Committee provides that said Committee must report to the shareholders at the General Shareholders' Meeting on the questions raised by the shareholders thereat regarding the matters within the Committee's purview, and for such purpose must prepare an annual report on its activities, which it shall make available to the shareholders, after approval thereof by the Board of Directors, on occasion of the call to the Ordinary General Shareholders' Meeting.

This Annual Activities Report of the Audit and Control Committee of Euskaltel for financial year 2016 has been prepared as part of said process of evaluation and to be made available to the Company's shareholders in compliance with the preceding paragraph.

2. Regulatory framework

The main rules governing the actions and duties of the Audit and Control Committee are as follows:

- Section 529 *quarterdecies* of the consolidated text of the Companies Act, approved by Royal Legislative Decree 1/2010 of 2 July.
- Articles 63 and 64 of the Bylaws,

- Article 18 of the Regulations of the Board of Directors, and
- The Regulations of the Audit and Control Committee itself.

3. Principal duties and powers

The Audit and Control Committee primarily performs the following duties with respect to the Company itself as well as the subsidiaries of the Group:

- a) Report to the shareholders at the General Shareholders' Meeting on the issues raised by the shareholders that are within their purview.
- b) Monitor the effectiveness of the internal control of the Company and of its Group as well as the systems for managing risks, including tax risks.
- c) Analyse with the external auditors any possible significant weaknesses in the internal control system detected when the audit was performed.
- d) Supervise the process of preparing and presenting regulated financial information.
- e) Propose to the Board of Directors, for submission to the shareholders at the General Shareholders' Meeting, the appointment, re-election or replacement of the external auditor in accordance with applicable legal provisions, as well as the terms of engagement thereof, and regularly collect information therefrom on the audit plan and the implementation thereof, in addition to preserving its independence in the performance of its duties.
- f) Supervise the internal audit activity of the Company.
- g) Establish appropriate relations with the external auditors to receive information on those issues that might risk the independence thereof, for examination by the Committee, and any others related to the audit process, as well as such other communications as are provided for in the laws on auditing and in auditing rules.
- h) Issue, on an annual basis and prior to the issuance of the audit report, a report setting forth an opinion on the independence of the external auditors. This report must in all cases make a pronouncement regarding the provision of the additional services referred to in the preceding section, considered individually and as a whole, other than the legal audit, and in relation to the rules on independence or the legal provisions governing auditing.
- i) Provide an advance report to the Board of Directors on all of the matters provided by law, the Bylaws and the Regulations of the Board of Directors, and particularly regarding (i) the financial information that the Company must periodically publish; (ii) the creation or acquisition of interests in special purpose entities or entities domiciled in territories or countries considered to be tax havens; (iii) related-party transactions; and (iv) the financial terms and accounting impact of structural and corporate changes that the Company plans to carry out, and especially the exchange ratio for the proposed transaction.

The Audit and Control Committee shall also perform the following specific duties:

Relating to internal control and reporting systems

- Supervise the process of preparing regulated financial information relating to the Company and any group and the integrity thereof, reviewing compliance with regulatory requirements, the proper determination of the scope of consolidation, and the correct application of accounting standards.
- Analysing the annual accounts following the close of each financial year, examining the draft opinion of the external auditors, discussing with them the content of the annual accounts and the audit report, and submitting recommendations to the Board of Directors regarding the formulation of the annual accounts.
- Periodically review the internal control and risk management systems, such that the principal risks are properly identified, managed and reported.
- Endeavour to ensure the independence and efficacy of the internal audit function; propose the selection, appointment, re-election and termination of the head of the internal audit department; propose the department's budget; receive periodic reports on its activities; and verify that senior management take account of the conclusions and recommendations of its reports.
- Establish and supervise a mechanism allowing employees to report confidentially, and anonymously if deemed appropriate, potentially significant irregularities that they become aware of at the Company, especially those of a financial and accounting nature.

Relating to the external auditor

- Submit to the Board proposals for selection, appointment re-election and replacement of the external auditor, as well as of the terms of engagement thereof.
- Endeavour to ensure that the remuneration of the external auditor for its work does not compromise the quality or independence thereof.
- Ensure that the external auditor holds an annual meeting with the full Board of Directors to report thereto on the work performed and any changes in the accounting and risk situation of the Company.
- Regularly receive from the external auditor information regarding the audit plan and the results of the implementation thereof, and verify that senior management takes into account the recommendations thereof.
- Ensure the independence of the external auditor and, to that end, (i) that the Company disclose a change of auditor to the National Securities Market Commission (*Comisión Nacional del Mercado de Valores*) as a significant event and accompany therewith a declaration regarding any disagreements with the outgoing auditor and, if any, regarding the content thereof; (ii) that the Company and the auditor comply with applicable legal provisions regarding the provision of non-audit services, and (iii) in the event of the external auditors' resignation, that it examines the circumstances giving rise thereto.
- Encourage the assumption by the auditor of the consolidated group to take responsibility for auditing the companies of the group.

Relating to the risk policy and risk management

- Identify the various types of risk (operational, technological, financial, legal, reputational) facing the Company, including (among financial or economic risks) contingent liabilities and other off-balance sheet risks.
- Identify the risk level determinations that the Company deems acceptable.
- Identify the measures planned to mitigate the impact of identified risks in the event that they materialise.
- The information and internal control systems that will be used to monitor and manage the aforementioned risks, including contingent liabilities and other off-balance sheet risks.

Relating to obligations specific to listed companies

Report to the Board of Directors, prior to the latter making the corresponding decisions, on:

- The financial information that the Company must periodically make public due to its status as listed company. The Audit Committee must ensure that the half-yearly financial reports and the interim management statements are drawn up using the same accounting standards as that annual accounts and, to that end, consider the appropriateness of a limited review of the half-yearly financial reports by the external auditor.
- The creation or acquisition of equity interests in special purpose entities or entities registered in countries or territories regarded as tax havens, as well as any other transactions or operations of a similar nature that, due to their complexity, might diminish the transparency of the group.
- Related-party transactions as defined by the law from time to time in effect.
- The financial terms and accounting impact of structural and corporate changes that the Company plans to carry out, and especially the exchange ratio for the proposed transaction.

Relating to the Company's corporate governance obligations.

- Conduct a periodic review of the Company's internal corporate governance rules, and propose to the Board of Directors, for the approval thereof or for submission to the shareholders at a General Shareholders' Meeting, such amendments and updates as may contribute to the development and ongoing improvement thereof.
- Promote the Company's corporate governance strategy. Supervise compliance with legal requirements and with the internal rules of conduct and internal corporate governance rules of the Company.
- Periodically evaluate the suitability of the Company's corporate governance system, so that it may fulfil its mission of promoting the Company's interest and take account, as appropriate, of the legitimate interests of other stakeholders.

- Know, promote, guide and supervise the Company's actions on corporate social responsibility and sustainability matters, endeavouring to ensure that they are focused on the creation of value, and report thereon to the Board of Directors or to the Executive Committee, if any.
- Monitor the corporate social responsibility strategy and policies and evaluate the level of compliance therewith.
- Know, promote, guide and supervise the Company's actions on corporate social responsibility and report thereon to the Board of Directors or to the Executive Committee, if any.
- Supervise the strategy for communications and relations with shareholders and investors, including small and medium shareholders
- Supervise and evaluate the stakeholder relations processes.
- Evaluate all matters relating to the non-financial risks of the company, including operational, technological, legal, social, environmental, political and reputational risks.
- Coordinate the process of reporting non-financial and diversity-related information in accordance with applicable legal provisions and international benchmarks.
- Report on the Company's Annual Corporate Governance Report prior to the approval thereof, obtaining for such purpose the reports of the Appointments and Remuneration Committee with respect to the sections of such report that are within its purview.

4. Composition of the Committee

Pursuant to the provisions of article 6 of the Regulations thereof, the Audit and Control Committee shall be made up of a minimum of three and a maximum of five external Directors appointed by the Company's Board of Directors, a majority of whom must be independent Directors.

The Board of Directors shall endeavour to ensure that the members of the Committee and, in particular, the Chair thereof, have expertise, qualifications, and experience in the areas of accounting, audit or risk management.

As of 31 December 2016, the Audit and Control Committee is composed of four external (independent and proprietary) Directors:

Name	Committee position	Information regarding their function as director		
		Class	Date of first appointment	Date of most recent appointment
Mr Iñaki Alzaga Etxeita	Chair	Independent	31/03/2015	31/03/2015
Kartera 1, S.L., represented by Ms Alicia Vivanco González	Member	Proprietary	27/06/2016	27/06/2016
Mr José Ángel Corres Abasolo	Member	Independent	08/03/2013	27/06/2016

Ms Elisabetta Castiglioni	Member	Independent	27/06/2016	27/06/2016
---------------------------	--------	-------------	------------	------------

Mr Iñaki Alzaga Etxeita, independent Director, has been a member and has held the position of Chair of the Audit and Control Committee since 1 June 2015, and was appointed taking into account his knowledge and experience in accounting, auditing and risk management.

The independent Director Mr José Ángel Corres Abasolo was appointed as a member of the Audit and Control Committee on 24 May 2016.

The proprietary Director Kartera 1, S.L., represented by Ms Alicia Vivanco González, and the independent Director Ms Elisabetta Castiglioni, were appointed as members of the Audit and Control Committee on 26 July 2016.

During financial year 2016, the independent Directors Ms Bridget Cosgrave and Mr Richard Alden and the proprietary Director Ms Alicia Vivanco González resigned as Directors of the Company and thus as members of the Audit and Control Committee.

Ms Alicia Vivanco González held the position of Chair of the Audit and Control Committee of Euskaltel, S.A. from the creation thereof until 1 June 2015, the date on which she voluntarily resigned from said position, in order to conform the composition of the Committee to the best Good Corporate Governance practices, in order for the Audit and Control Committee to be chaired by an independent Director.

The Secretary of the Board of Directors, Mr Francisco Javier Allende Arias, who is also General Secretary of the Euskaltel Group, acts as Secretary of the Audit and Control Committee.

5. Meetings held, reports reviewed and appearances

Article 12 of its Regulations provides that Audit and Control Committee shall meet two to four times per year for the review of economic/financial information and of management that must be sent to third parties, prior to the presentation thereof, and whenever called by its Chair if appropriate for the proper performance of its duties.

In all cases, the Chair of the Committee must also call a meeting whenever the Board of Directors or the Chair thereof requests the issuance of a report or the adoption of proposals, or whenever requested by one third of the members of the Committee itself.

The Audit and Control Committee has formally met on seven occasions during financial year 2016, in addition to working and training sessions and specific meetings on particular topics, whether in person or by electronic means.

Six of the seven formal meetings were held at the registered office of Euskaltel, S.A. located at Parque Tecnológico, edificio 809, in Derio (Biscay), and one (during the month of October) was held in A Coruña.

The level of attendance at the meetings was as follows:

Number of meetings	7	
Number of possible attendees	27	100.0%
Number of physical attendees	27	100.0%

Proxies given to the Chair	n/a	n/a
Other proxies	n/a	n/a
Non-proxy attendance	n/a	n/a

The Chair and the Secretary of the Committee attended all meetings.

The dates of the meetings, the type of information used, and the guests invited to the meetings are listed below:

Date	Primary documentation analysed
24/02/2016	<ul style="list-style-type: none"> • Presentation of the conclusions of the Group's External Auditor regarding financial year 2015, including the prior drafts of the Audit Report, • Draft of the Group's consolidated Annual Accounts and those of the Companies within the Group for financial year 2015. • Drafts of annual reports on Corporate Governance and Director remuneration for financial year 2015. • Letter regarding independence of the External Auditor, • Draft report on the independence of the External Auditor, • Description of certain related-party transactions, • Report on significant holdings in the share capital, • Report on the level progress on the Internal Audit Plan for financial year 2016, • Merger by absorption of Rede Brigantium, S.L.U. • Other financial information.
26/04/2016	<ul style="list-style-type: none"> • Economic/financial information for the first quarter of financial year 2016. • Draft of the Activities Report of the Audit and Control Committee for financial year 2015. • Draft of the Related-party Transactions Report for financial year 2015, • Draft of Report on appointment of the external Auditor of the Group as auditor of the subsidiaries, • Draft of Policy on Communication with Shareholders and Institutional Investors, • Annual Internal Audit Activities Report, • Information regarding the Internal Control Over Financial Reporting (ICOFR) System, • Report on Significant Holdings.
24/05/2016	<ul style="list-style-type: none"> • Draft of Corporate Social Responsibility Policy, • Draft of 2016 - 2018 Master Corporate Social Responsibility Committee Plan, • Draft of Corporate Social Responsibility Report for financial year 2015, • Sustainability Report 2015, • Draft of Update of the Risk Management Policy,
26/07/2016	<ul style="list-style-type: none"> • Economic/financial information for the first half of financial year 2016. • Draft Report of the external auditors regarding the half-yearly information for financial year 2016, • Report on the level progress on the Internal Audit Plan for financial year 2016, • Report on significant holdings in the share capital,
26/10/2016	<ul style="list-style-type: none"> • Management Report at 30 September 2016: business data. • Economic/financial information for the third quarter of financial year 2016, • Description of related-party transactions, • Information regarding certain transactions with an effect on the financial results, • Information regarding certain companies in which the Group holds an investment, • Report on significant holdings in the Company's share capital.
21/11/2016	<ul style="list-style-type: none"> • Information regarding the Internal Control Over Financial Reporting (ICOFR) System, • Internal Audit Activities Report, • Proposed draft of the Internal Audit Action Plan for the 2017-2019 period,

	<ul style="list-style-type: none"> • Draft of structure of representational powers, • Information on interest rate hedging, • Report on significant holdings,
12/12/2016	<ul style="list-style-type: none"> • Preliminary work regarding external audit, • Information regarding the Internal Control Over Financial Reporting (ICOFR) System, • Draft of the 2017 Internal Audit Plan, • Report on significant holdings,

Both officers of the Group and advisors and external experts have attended these meetings, based on the issues addressed thereat. They include the following:

- General Manager,
- Group CFO,
- Group Internal Audit Director,
- Group Institutional Relations Director (in charge of Corporate Social Responsibility),
- External Auditors (KPMG) of the Group,
- Legal Counsel to the Board (Uría & Menéndez).

Members of the Board of Directors, including the Chair of the Board of Directors and the CEO, have likewise attended as invitees.

During the month of September 2016, the members of the Audit and Control Committee, together with the rest of the Board of Directors, participated in two training sessions specifically organised for them by Uría Menéndez regarding the following topics:

- Telecommunications Regulatory Framework, with special attention to the National Markets and Competition Commission (*Comisión Nacional de los Mercados y la Competencia*) and the Audiovisual industry.
- Capital Markets, especially inside information, conflicts of interest, and related-party transactions, and director liability.

The principal issues covered and that may have been favourably reported by the Audit and Control Committee during financial year 2016 were the following:

Financial Information and Control and Risk Management System

- Favourable report regarding the formulation of the Annual Accounts for financial year 2015 (consolidated and individual of the companies of the Group).
- Follow-up on questions regarding the Internal Control Over Financial Reporting (ICOFR) System.
- Favourable reports on the various interim (quarterly) management statements during financial year 2016.
- Monitoring of related-party transactions.
- Planning meetings and monitoring of External Audit work.
- Favourable report on various mergers, sales and corporate restructurings within the scope of consolidation.
- Favourable report on the Update of the Group's Risk Management Policy.
- Evaluation of the Group's Cyber Risks.

- Favourable report on the financial statement for the payment of dividends with a charge to financial year 2016.

Compliance and Good Governance

- Favourable report on the Annual Corporate Governance Report for financial year 2016.
- Report on the independence of the External Auditors of the Group.
- Report regarding related-party transactions with Directors and Significant Shareholders during financial year 2015.
- Periodic monitoring of significant holdings in the share capital,
- Approval of the Activities Report for financial year 2015.
- Favourable report on the 2016-2018 Master Corporate Responsibility Plan.
- Favourable report on the approval of the Group's Corporate Social Responsibility Policy.
- Favourable report on the approval of the Corporate Social Responsibility Report for financial year 2015.

Internal and External Audit

- Final meeting on the Audit of the Annual Accounts for financial year 2015 dealing in detail with the Audit Report and the principal conclusions of the External Auditor.
- Planning meeting on the Audit of the Annual Accounts for financial year 2016 with the external auditors, analysing the planning of dates, the conclusions regarding Areas of Special Attention, materiality, and regulatory changes.
- Proposed renewal of the external auditors in the case of Euskaltel, S.A. and favourable report on the appointment at various companies in which an interest is held.
- Favourable report on the fees of the external auditors for all services provided in 2016.
- Establishment of a protocol for contracting non-audit services external to the auditors of the Group.
- Periodic monitoring and update of the 2016 Internal Audit Plan.
- Approval of the principal Internal Audit Action Areas for the 2017-2019 period.
- Approval of the 2017 Internal Audit Plan.

Other issues regarding Audit and Control Committee

- Periodic monitoring of significant holdings in the share capital,
- Approval of the Activities Report of the Audit and Control Committee for financial year 2015.
- Favourable report on the amendment of certain articles of the Bylaws, of the Regulations of the Board of Directors and of the Regulations of the Audit and Control Committee.
- Favourable report on the approval of the Policy on Communication and Contacts with Shareholders, Institutional Investors and Proxy Advisors.
- Acknowledgment of certain changes in the policy on representational powers of the Group and the deployment thereof to the organisation.
- Favourable report on the creation of a specific security interest.
- Favourable report on certain recommendations in relation to the Dividend Policy.
- Favourable report on the distribution of a dividend from the results for financial year 2016.
- Monitoring of certain transactions with a significant effect on the financial results of the Group and of interest rate hedging.

* * * * *