



General Shareholders' Meeting

Report on the Independence of the Auditor

Financial Year 2016 / 2017

REPORT ON THE INDEPENDENCE OF THE AUDITOR IN RELATION TO THE AUDIT REPORT FOR FINANCIAL YEAR 2016

INTRODUCTION

Pursuant to subsection 4.f) of section 529 *quaterdecies* of the restated text of the Companies Act (*Ley de Sociedades de Capital*) approved by *Royal Legislative Decree 1/2010 of 2 July* (the "**Companies Act**"), listed companies shall annually issue (prior to the audit report) a report that shall express an opinion as to whether the independence of the auditors is compromised. This report must contain a reasoned assessment of the provision of services other than the statutory audit by the auditor, in relation to the rules on independence or to the legal provisions regarding the auditing of accounts¹.

This power is also provided for in the Corporate Governance System of "Iberdrola, S.A." ("**Iberdrola**" or the "**Company**"), and particularly in the *Auditor Contracting and Relations Policy*. Recommendation 6.a) of the *Good Governance Code of Listed Companies* recommends that these companies publish the aforementioned independence report on their website well in advance of the annual general shareholders' meeting.

At their meeting of 8 April 2016, the shareholders acting at a General Shareholders' Meeting of the Company resolved, at the request of the Board of Directors upon a prior proposal of the Audit and Risk Supervision Committee (the "**Committee**"), to re-elect the firm "Ernst & Young, S.L." ("**Ernst & Young**" or the "**Auditor**") as auditor of the annual accounts of the Company and its consolidated group for financial year 2016.

In consideration of the foregoing, the Committee issues this report in which it states its opinion regarding the independence of the Auditor of the Company and its consolidated group for financial year 2016.

SCOPE AND WORK PERFORMED

The Committee has analysed the following information to prepare this report:

Written Statement of the Auditor regarding the Independence thereof

Pursuant to subsection 4.e) of section 529 *quaterdecies* of the *Companies Act*, Iberdrola must annually receive from the Auditor a statement of its independence regarding the entities connected to the Company. Ernst & Young must also provide a detailed and itemised breakdown of information regarding additional services of any kind provided to the Iberdrola group, including the fees received (by either Ernst & Young or its connected persons or entities), pursuant to the legal provisions governing the auditing of accounts.

In compliance with the above, on 15 February 2017, the Auditor of the Company and its consolidated group sent a letter addressed to the Committee, in which it stated the following:

"The team in charge of the audit and the audit firm, with the applicable extensions, have met the independence requirements established in the applicable legal provisions governing the activity of auditing in Spain".

This document also included various letters from the partners involved in the process of auditing the larger foreign subsidiaries (specifically: "Iberdrola México, S.A. de C.V.", "Scottish Power, Ltd." -"**Scottish Power**"-, "Iberdrola Energía, S.A." (Sociedad Unipersonal), "Avangrid, Inc." -"**Avangrid**"-); and the Spanish companies "Iberdrola Ingeniería y Construcción, S.A." (Sociedad Unipersonal) ("**Iberinco**") and "Iberdrola Inmobiliaria, S.A." (Sociedad Unipersonal).

Relationships with the auditors

During financial year 2016, Ernst & Young appeared before the Committee on twelve occasions in order to report on the items set out below:

1. at the meeting of 18 February it gave a preview of the closing of the annual financial statements for financial year 2015;

¹ The legal provision applicable to the content of this report is the restated text of the Audit Act approved by *Royal Legislative Decree 1/2011 of 1 July* (the "**Audit Act**") and its implementing regulations, given that the provisions of *Law 22/2015 of 20 July on Auditing* that govern this aspect will apply to the work of auditing the annual accounts for financial periods commencing in June 2016 (i.e. in the case of Iberdrola, the financial year that began in January 2017).

2. at the Committee meeting of 22 February, the following items appeared on the agenda: (i) report of the Board of Directors on the economic/financial information of the Company and its consolidated group for financial year 2015; (ii) proposed annual meeting with the external auditor to report on the work performed and the status of the accounting situation and risks of the Company; and (iii) difference between the fees of Ernst & Young and those proposed by the firms that are candidates for auditor for financial years 2017 to 2019;
3. at the meeting of 13 June it submitted a memorandum of recommendations on internal control resulting from the audit of the financial information for financial year 2015;
4. at the meeting of 12 July it reported on the level of progress on the Board of Directors' report on the economic/financial information of Iberdrola and its consolidated group for the first half of 2016;
5. at the meeting of 18 July it reported on the agenda item regarding the Board of Directors' report on the economic/financial information of Iberdrola and its consolidated group for the first half of 2016;
6. at the extraordinary meeting of 18 July it reported on the accounting for the merger by absorption of "Siemens Wind HoldCo, S.L." by "Gamesa Corporación Tecnológica, S.A." (the "Merger");
7. at the meeting of 13 September it participated to resolve questions of the directors regarding the accounting analysis of the significant influence that Iberdrola would have in "Gamesa Corporación Tecnológica, S.A." after the Merger;
8. at the meeting of 24 October, together with the Company's director of Administration and Control, it presented the situation regarding the internal control of the financial information of Avangrid;
9. at the meeting of 21 November, within the framework of the Committee's Training and Information Plan, it informed the directors of the most significant new accounting developments; and
10. at the meeting of 19 December it gave a preview of the closing for financial year 2016.

It is stated for the record that at these meetings, the Auditor did not report any circumstance that might have put its independence at risk.

In addition, pursuant to recommendation 42.2 d) of the *Good Governance Code of Listed Companies*, Ernst & Young appeared at the meeting of the Company's Board of Directors held on 23 February 2016 in order to report on: (i) the audit opinion; (ii) the report on independence of the auditor; (iii) the audit work performed; and (iv) the draft audit report; all with respect to the annual accounts of the Company for financial year 2015.

Protective measures that allow for detection of threats to independence

In its letter sent on 15 February, the Auditor stated the following:

"We have designed and implemented internal procedures to identify and evaluate threats that might arise from circumstances related to audited entities, including those that might entail grounds for disqualification, and, if appropriate, the application of necessary protective measures (...) As regards the aforementioned audit, no circumstances have been identified that individually or as a whole might entail a significant threat to our independence and that would therefore require the application of protective measures or that might involve grounds for disqualification."

The internal procedures implemented by the Auditor of the Company and its consolidated group to protect its independence are the following:

- a) The establishment of independence policies (such as the *Global Independence Policy* and the *Global Client Acceptance and Engagement Policy*), which contain the requirements that Ernst & Young must satisfy in this area.
- b) The sending of informational communications and the provision of courses in order to inform all partners and professionals of Ernst & Young of those services that they are prohibited from providing to their audit clients, as well as the need to obtain prior approval for certain work (including, among other measures: (i) the approval of a *Global Conduct Code*; (ii) the provision of training courses on independence policies and procedures of the Auditor; and (iii) the dissemination of independence rules through policies and practices databases).
- c) The inclusion of compliance controls (Global Internal Audit team, Global Monitoring System, Business Relationship Evaluation and Tracking, and the Global Independence Incident Report System database), in order

to review the processes that ensure the independence of the Auditor and to collect evidence allowing for verification of compliance with the independence requirement.

- d) The issuance of quarterly and annual compliance certificates, in which the partners of Ernst & Young confirm that all services other than audit for which they are responsible and that they provide to audit clients are permitted by both their own independence policies and the rules applicable to their clients.

The partners in charge of each country also issue annual confirmations, ensuring that: (i) Ernst & Young complies with its independence policy, as well as the regulations of each country; (ii) the partners and professionals have confirmed their independence and have completed courses on this topic; and (iii) in the country in question, the Auditor has implemented procedures to ensure compliance with the independence policies.

Other non-auditing services provided and fees

Pursuant to the provisions of subsection 4.f) of section 529 *quartedecies* of the *Companies Act*, the Auditor, in its letter to the Committee dated 15 February 2017, reports the following fees billed to the Company and its group in 2016:

In thousands of euros	Audit services	Audit related services	Other services	TOTAL
Iberdrola, S.A.	2,553	918	0	3,471
Subsidiaries	21,082	1,523	60	22,665
Iberdrola, S.A. and consolidated group	23,635	2,441	60	26,136

A description of these fees is included as annex I hereto and is explained below.

Audit services

Fees for audit services are 23,635 thousand euros (line 1 of annex 1), and include the statutory audit of the financial statements of Iberdrola and of its group for financial year 2016.

This engagement was approved prior to the commencement of its duties by the Auditor, for the entire period during which they were performed, and was previously reported by the Committee at its meeting of 13 June 2016.

In compliance with section 21.1 of the *Audit Act*, it is noted for the record that these fees are not influenced or determined by the provision of additional services or based on contingencies or conditions other than changes in the circumstances on which the determination of the fees are based.

Audit-related services

Fees for the provision of services relating to the audit of the Iberdrola group were 2,441 thousand euros (lines 2 to 21 of annex 1), broken down as follows:

- 1,348 thousand euros are for the limited review of the half-yearly financial statements of the Iberdrola group for the Company and its subsidiaries;
- 260 thousand euros are from the issuance of comfort letters for Iberdrola in relation to various issues of debt;
- 10 thousand euros are from the issuance of a report on agreed-upon procedures (ISRS 4400) for Iberdrola regarding taxes of the group in Spain;
- 45 thousand euros correspond to the issuance of a report on agreed-upon procedures (ISRS 4400) for the Company regarding certain tax figures of the Iberdrola group;
- 50 thousand euros are from the issuance of comfort letters in relation to various issues of debt for "Iberdrola Finanzas, S.A." (Sociedad Unipersonal);
- 36 thousand euros correspond to the issuance of comfort letters in relation to various issues of debt for "Iberdrola International B.V.";

7. 4 thousand euros are from the preparation of a report on agreed-upon procedures (ISRS 4400) regarding the status of investments and divestments made between 1 January and 31 December 2015 at the Valdecaballeros nuclear plant for "Iberdrola Generación España, S.A." (Sociedad Unipersonal) ("**Iberdrola Generación España**") and its subsidiaries;
8. 4 thousand euros are from the issuance of a report on agreed-upon procedures (ISRS 4400) regarding the status of investments and divestments made between 1 January and 31 December 2015 at the Lemoiz nuclear plant for Iberdrola Generación España, S.A. and its subsidiaries;
9. 8 thousand euros correspond to the preparation of a report on agreed-upon procedures (ISRS 4400) regarding certain financial information relating to hydroelectric plants for Iberdrola Generación España and its subsidiaries;
10. 10 thousand euros are from the issuance of a report on agreed-upon procedures (ISRS 4400) regarding certain financial information of Iberdrola Generación España in financial year 2014 for Iberdrola Generación España and its subsidiaries;
11. 5 thousand euros correspond to the issuance of a report on agreed-upon procedures (ISRS 4400) regarding subsidies for the *Life +* project for Iberdrola Generación España and its subsidiaries;
12. 128 thousand euros are from the preparation of a report on agreed-upon procedures regarding investments commissioned during financial year 2015 for "Iberdrola Redes España, S.A." (Sociedad Unipersonal) ("**Iberdrola Redes España**") and its subsidiaries;
13. 99 thousand euros are from the issuance of a report on agreed-upon procedures (ISRS 4400) regarding the inventory of electricity distribution facilities in 2015 for Iberdrola Redes España and its subsidiaries;
14. 177 thousand euros are from the preparation of a report on agreed-upon procedures (ISRS 4400) regarding the forms required by *Informational Circular 4/2015 of 22 July*, of the National Markets and Competition Commission, for Iberdrola Redes España and its subsidiaries;
15. 60 thousand euros correspond to additional fees associated with the report on agreed-upon procedures (ISRS 4400) regarding the inventory of electricity distribution facilities in 2014 for Iberdrola Redes España and its subsidiaries;
16. 10 thousand euros correspond to the issuance of a report on agreed-upon procedures (ISRS 4400) regarding certain financial information of Iberdrola and its subsidiaries at 31 December 2015 for "Iberdrola Renovables Energía, S.A." (Sociedad Unipersonal);
17. 86 thousand euros are from the preparation of various reports on agreed-upon procedures (ISRS 4400) regarding regulatory investments, required by the Brazilian regulator ANEEL (*Agência Nacional de Energia Elétrica*) for "Elektro Elektricidade e Serviços, S.A.";
18. 5 thousand euros are from the issuance of a report on agreed-upon procedures (ISRS 4400) regarding covenants for Scottish Power;
19. 28 thousand euros correspond to an audit report (ISA 800) regarding segmented consolidated information of Scottish Power; and
20. 68 thousand euros are from the preparation of comfort letters in relation to various issues of debt for Avangrid.

The engagements are for services that only the Auditor can provide and/or that it carries out pursuant to the procedures of the *International Standard on Related Services 4400* (ISRS 4400), "Engagements to Perform. Agreed-upon Procedures Regarding Financial Information", issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants and published in Spain by the Instituto de Censores Jurados de Cuentas de España (Spanish Institute of Sworn Auditors) in June 2008.

The Committee is regularly informed of these engagements by the Auditor at its appearances.

Other services

Fees deriving from the provision of services other than the above amount to 60 thousand euros and correspond to the engagement set out in line 22 of annex I. In particular, these are services relating to the documentation of transfer prices for Iberinco for financial years 2012 and 2013.

This engagement was previously authorised by the Committee at its meeting of 17 April 2013, taking into consideration the amount of the fees that would be accrued, and after reviewing: (i) the resolution of the Company's Operating Committee on 8 April 2013 reporting this engagement; and (ii) a letter sent by the Auditor dated 12 April 2013 stating that the provision of these services "does not entail any breach of the independence rules that apply to us as external auditors of the companies of the Iberdrola group audited by us".

In relation to the foregoing, it is reported that, pursuant to articles 51.5 of the *Regulations of the Board of Directors* and 23.2 of the *Regulations of the Committee*, these bodies may not propose an entity to be the Company's auditor if they have evidence that the fees that Company intends to pay it for any and all services are greater than five percent of its total domestic income during the last financial year.

In its declaration of 15 February 2016, Ernst & Young stated to the Company that:

"(...) We confirm that the fees paid by the Company to Ernst & Young, S.L. during the financial year ended 31 December 2016 for all items are not greater than five per cent of total income during the annual financial period ended 30 June 2015".

Term and rotation

Ernst & Young has been successively appointed as the Company's auditor in compliance with section 19.1 of the *Audit Act*. In particular, the shareholders acting at the Company's General Shareholders' Meeting held on 30 March 2006 approved the appointment of Ernst & Young as the auditor of the Company and its consolidated group for an initial period of three years (financial years 2006, 2007, and 2008).

The Auditor was thereafter re-elected for successive periods of one year by the shareholders at the General Shareholders' Meetings held on 20 March 2009, 26 March 2010, 27 May 2011, 22 June 2012, 22 March 2013, 28 March 2014, 27 March 2015, and 8 April 2016.

During the periods indicated above, the auditor signing the audit report was also rotated in compliance with the periods established in section 19.2 of said Act. Along these lines, the audits of the annual accounts of the Company and its consolidated group for the financial years 2006, 2007, 2008, 2009, 2010, 2011, and 2012 were signed by the Ernst & Young partner Mr Juan María Román Gonçalves. Those corresponding to financial years 2013, 2014, and 2015 were signed by the partner Mr Francisco Rahola Carral.

As regards the audit of the annual accounts of the Company and its consolidated group for 2016, this will be signed by Mr Rahola Carral, who has also signed the written declaration of the Auditor confirming the independence thereof.

Finally, by application of the provisions of *Law 22/2015 of 20 July on Auditing*, as regards the appointment, rotation, and engagement of auditors, the Board of Directors, at its meeting of 15 December 2015, after a tender led by the Audit and Risk Supervision Committee, resolved to propose to the shareholders at the Company's General Shareholders' Meeting for financial year 2017 the appointment of "KPMG Auditores, S.L." as the new auditor of the Company for financial years 2017 to 2019.

Audit teams

In compliance with article 23.6 of the *Regulations of the Committee*, the Auditor stated in its letter of 15 February that three professionals from Ernst & Young had joined Iberdrola with the status of Team Leader. Furthermore, an employee of this audit firm joined Avangrid, also with the status of Team Leader.

Given that these are professionals with short-term professional experience who held medium/low level positions of responsibility at Ernst & Young, the Committee believes that their joining with the Iberdrola group is irrelevant for purposes of the independence of the Auditor.

CONCLUSION

In light of the foregoing, the Committee finds that during financial year 2016 and the portion of financial year 2017 already passed, Ernst & Young has performed its audit work with independence from Iberdrola and its consolidated group.

The Committee issues this report on independence prior to the issuance of the audit report and pursuant to the provisions of the *Companies Act*, the Corporate Governance System of Iberdrola, and the *Good Governance Code of Listed Companies*.

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ERNST & YOUNG- SERVICES PROVIDED 2016

Nº	Company	Service Description	Amount (Thousands of euros)		
			Iberdrola, S.A.	Related entities	Total
1	Iberdrola, S.A. and subsidiaries	Audit of the companies in the IBERDROLA Group	2,553	21,082	23,635
		Total Audit services	2,553	21,082	23,635
2	Iberdrola, S.A. and subsidiaries	Limited review report of the Interim financial statements of the IBERDROLA Group	603	745	1,348
3	Iberdrola, S.A.	Comfort letters (debt emissions)	260	-	260
4	Iberdrola, S.A.	Agreed upon procedures report (ISRS 4400) on taxes of the IBERDROLA Group in Spain	10	-	10
5	Iberdrola, S.A.	Agreed upon procedures report (ISRS 4400) on certain tax amounts of the IBERDROLA Group	45	-	45
6	Iberdrola Finanzas, S.A.U.	Comfort letters (debt emissions)	-	50	50
7	Iberdrola International BV	Comfort letters (debt emissions)	-	36	36
8	Iberdrola Generación España, S.A.U. and subsidiaries	Agreed upon procedures report (ISRS 4400) on the state of the investments and divestments made between January 1st and December 31st 2015 in the Nuclear Power Plant of Valdecaballeros	-	4	4
9	Iberdrola Generación España, S.A.U. and subsidiaries	Agreed upon procedures report (ISRS 4400) on the state of the investments and divestments made between January 1st and December 31st 2015 in the Nuclear Power Plant of Lemóniz	-	4	4
10	Iberdrola Generación España, S.A.U. and subsidiaries	Agreed upon procedures report (ISRS 4400) on certain financial information related to hydraulic power plants of Iberdrola Generación, S.A.U.	-	8	8
11	Iberdrola Generación España, S.A.U. and subsidiaries	Agreed upon procedures report on certain financial information of 2014 of Iberdrola Generación S.A.U.	-	10	10
12	Iberdrola Generación España, S.A.U. and subsidiaries	Agreed upon procedures report (ISRS 4400) on the grant "Proyecto Life +"	-	5	5
13	Iberdrola Redes, S.A.U. and subsidiaries	Agreed upon procedures report (ISRS 4400) of the investments put in service in 2015	-	128	128
14	Iberdrola Redes, S.A.U. and subsidiaries	Agreed upon procedures report (ISRS 4400) for the inventory of electrical distribution of 2015	-	99	99
15	Iberdrola Redes, S.A.U. and subsidiaries	Agreed upon procedures report (ISRS 4400)- of the requirements of "Circular informativa 4/2015"	-	177	177
16	Iberdrola Redes, S.A.U. and subsidiaries	Additional fees of the Agreed upon procedures report (ISRS 4400)- Technical inventory 2014	-	60	60
17	Iberdrola Renovables Energía, S.A.U.	Agreed upon procedures report (ISRS 4400) on certain financial information of Iberdrola, S.A. and subsidiaries at December 31st, 2015	-	10	10
18	ELEKTRO	Agreed upon procedures report (ISRS 4400) on regulatory investments required by the regulator ANEEL	-	86	86
19	Scottish Power	Agreed upon procedures report (ISRS 4400) on covenants	-	5	5
20	Scottish Power	Audit report (ISA 800) on segmental consolidated information	-	28	28
21	AVANGRID	Comfort letters (debt emissions)	-	68	68
		Total audit related services	918	1,523	2,441
22	Iberdrola Ingeniería y Construcción, S.A.	Professional services related to the documentation of transfer pricing	-	60	60
		Total other services	-	60	60
		TOTAL	3,471	22,665	26,136