INTERNAL CONTROL

INTERNAL CONTROL MECHANISMS OF THE ENTITY, INCLUDING THE ADMINISTRATIVE AND ACCOUNTING PROCEDURES.

Banco Santander, S.A. (hereinafter Banco Santander, the Bank or the entity, together with its subsidiaries, Santander Group) follows a risk management and control model based on three lines of defence.

The business functions or activities that assume or generate exposure to a risk are the first line of defence thereof. The assumption or generation of risk in the first line of defence should be adjusted to the appetite and the limits defined. In order to carry out its role, the first line of defence should be equipped with resources in order to be able to identify, measure, address and report the risks assumed.

The second line of defence is formed by the risk control and oversight function and the compliance function. This second line of defence safeguards the effective control of risks and ensures that they are managed in accordance with the risk appetite level defined.

Internal audit, as third line of defence and in its work as the final control layer, regularly checks that the policies, methods and procedures are adequate and verifies their effective implementation.

The risk control function, the compliance function and the internal audit function have the sufficient level of separation and independence, between one another and with respect to those that they control and supervise, for the performance of their responsibilities, and they have access to the board of directors and/or its committees through their heads.

The internal control and risk management system over financial reporting at the company

This section describes key aspects of the internal control and risk management systems in place at Grupo Santander with respect to the financial reporting process, specifically addressing the following aspects:

- Control environment
- Risk assessment in financial reporting
- Control activities
- Information and communication
- Monitoring
1. Banco Santander control environment

1.1. The bodies and/or functions responsible for: (i) the existence and regular updating of a suitable, effective ICFR; (ii) its implementation; and (iii) its monitoring.

The board of directors of Banco Santander is ultimately responsible for the internal control and risk management systems. In accordance with article 16.4.e) of the Rules and Regulations of the Board of Directors, this function is entrusted to the audit committee, which must:

“(e) Supervise the financial reporting system and the internal control systems. In particular, the audit committee shall:

(i) Supervise the process of preparing and presenting the required financial information relating to the Company and the Group, as well as its integrity, reviewing compliance with regulatory requirements, the proper demarcation of the Group’s scope of consolidation and the correct application of accounting standards;

(ii) Supervise the effectiveness of the internal control systems, reviewing them periodically, so that the principal risks are identified, managed and properly disclosed; and

(iii) Discuss with the external auditor any significant weaknesses detected in the internal control system during the course of the audit.”

In addition, article 34.2 of the Rules and Regulations of the Board of Directors establishes that the board will adopt any measures required to ensure that the quarterly, half-yearly, and any other financial information that is made available to the markets is prepared in accordance with the same principles, standards and professional practices used to prepare the annual financial statements and is as reliable as such financial statements. To this end, such information shall be reviewed by the audit committee before dissemination thereof.

Moreover, the financial accounting and control units in each of the countries in which the Group operates (each of which is headed by a controller) and the corporate internal control department, which reports to the operational risk control area, are responsible for the existence, maintenance and implementation of an appropriate ICFR structure. Section 1.2 below provides further information on the roles of the controllers and the corporate internal control department.

The general code of conduct¹ sets out the main ethical principles and regulations on behaviour for all Santander Group employees. Chapter VIII of Title IV of the Code of Conduct (section 35) sets out obligations relating to the appropriate design of ICFR with regard to the Group’s accounting obligations. A number of internal control systems are in place to ensure that ICFR is implemented correctly. These are described in section 36.

¹ The complete text of Grupo Santander’s General Code of Conduct can be found on the corporate website (www.santander.com).
These sections state.

35. Accounting obligations

1. Reliability and strictness shall be applied in the drawing-up of the Group’s financial information, ensuring that:
   i. The transactions, facts and other events contained in the financial information actually exist and have been recorded at the appropriate time.
   ii. The information reflects all transactions, facts and other events in which the institution is an affected party.
   iii. Transactions, facts and other events are recorded and valued according to applicable regulations.
   iv. Transactions, facts and other events are classified, presented and divulged in the financial information in accordance with applicable regulations.
   v. The financial information reflects, as of the respective date, the rights and obligations through the respective assets and liabilities, in accordance with applicable regulations.

2. The financial information includes all information of an accounting and economic nature which the Group presents to securities markets and files with supervisory bodies. It therefore includes the annual financial report, the half-yearly financial report and intermediate statements, both individual and consolidated, and the prospectuses drawn up by the Group for the issuances of financial instruments.

36. Internal controls

1. All the internal control procedures established by the Group to guarantee the correct entry of transactions and their appropriate reflection in the financial information published by the Group shall be observed.

2. On preparing financial information, the areas of the Group responsible for each activity, process and sub-process shall certify that they have observed the controls established by the Group and that the information supplied is correct.

3. The audit committee will supervise the financial information presentation process, the effectiveness of internal controls and the internal audit and risk management systems.

The General Code of Conduct allocates responsibility for these obligations to management and other employees at their corresponding levels.
1.2. The existence or otherwise of the following components, especially in connection with the financial reporting process:

- The departments and/or mechanisms in charge of: (i) the design and review of the organisational structure; (ii) defining clear lines of responsibility and authority, with an appropriate distribution of tasks and functions; and (iii) deploying procedures so this structure is communicated effectively throughout the entity.

The Group, through the corporate organisation division and the organisation units for each country/entity or business (within the area of expertise of the human resources, organisation and costs division), defines, implements and maintains the organisational structures, catalogue of job positions and size of the units. Specifically, the corporate organisation division is responsible for defining and documenting the corporate model for managing structures and staff, which serves as the framework manual across the Group; it is similarly responsible for communicating this framework model to all Group entities.

The organisational function delegated to the countries/entities/businesses is designed to:

- optimise and align the organisational structures to the strategy defined by the corresponding corporate divisions and the Group’s strategic targets;
- define the job map in the units under its remit as a core tool for organising how the structure works and facilitating the management of its human resources.

The business/support areas channel any initiatives relating to their organisational structures through the aforementioned organisation units. These units are tasked with analysing/reviewing and, where appropriate, inputting the opportune structural modifications into the corporate IT tools. In addition, the organisation units are responsible for identifying and defining the main functions attributed to each structural unit.

The purpose of this is to try to ensure, among other things, that the organisational structure provides a solid model of internal control over financial reporting.

With respect to the specific process of preparing its financial information, the Group has defined clear lines of responsibility and authority. The process entails exhaustive planning, including, among other things, the distribution of tasks and functions, the required timeline and the various reviews to be performed by each manager. To this end, and as indicated above, the Group has financial accounting and control units in each of its operating markets; these are headed up by a controller whose duties include the following:

- Integrating the corporate policies defined at the Group level into their management, adapting them to local requirements.
- Ensuring that the organisational structures in place are conducive to due performance of the tasks assigned, including a suitable hierarchical-functional structure.
- Deploying critical procedures (control models), leveraging the Group’s corporate IT tools to this end.
- Implementing the corporate accounting and management information systems, adapting them to each entity’s specific needs as required.

In order to preserve their independence, the controllers report to their country heads and to the Group’s financial accounting and control division.
In addition, to encourage the existence of adequate documentation in the Group’s internal control model, there is a corporate internal control department, that reports to the corporate operational risk control area, which is committed to spreading a common methodology of internal control model documentation and the criteria for assessing control and processes. To ensure that the documentation is kept up-to-date, to adapt it to organisational and legislative changes and provide the audit committee with the conclusions on the internal control model assessment process. Likewise, internal control departments exist in every business unit that reports to this department.

- **Code of conduct, approving body, dissemination and instruction, principles and values covered (stating whether it makes specific reference to record keeping and financial reporting), body in charge of investigating breaches and proposing corrective or disciplinary action.**

The Group’s General Code of Conduct is approved by the board of directors, setting out behavioural guidelines relating to accounting and financial information requirements, among other matters.

This code is binding for all members of the Group’s governance bodies and all employees of Banco Santander, S.A. and Grupo Santander companies, who acknowledge as much when they join the Group, notwithstanding the fact that some of these individuals are also bound by the Code of Conduct in Securities Markets and other codes of conduct specific to the area or business in which they work.

The Group provides all its employees with e-learning courses on the aforementioned General Code of Conduct. Moreover, the compliance department is available to address any queries with respect to its application.

Title V, Chapter I of the General Code of Conduct sets out the functions of the Group’s governance bodies, units and areas with competences for compliance with the code, in addition to the compliance area.

The irregularities committee, consisting of representatives from various parts of the Group, is responsible for imposing disciplinary measures for breaches of the General Code of Conduct and proposing corrective actions.

Title V, Chapter II, section 57 sets out the consequences of breaches, which may “lead to labour-offence sanctions, notwithstanding any administrative or criminal sanctions that may also result from such breach”.

- ‘Whistle-blowing’ channel, for the reporting to the audit committee of any irregularities of a financial or accounting nature, as well as breaches of the code of conduct.
conduct and malpractice within the organisation, stating whether reports made through this channel are confidential.

Article 16.4.g of the Rules and Regulations of the Board of Directors stipulates that the audit committee is responsible for “becoming apprised of and, if applicable, responding to the initiatives, suggestions or complaints put forward or raised by the shareholders regarding the area of authority of this committee and which are submitted thereto by the office of the general secretary of the Company. The committee shall also: (i) receive, deal with and keep a record of the claims received by the Bank on matters related to the process for generating financial information, auditing and internal controls, and (ii) establish and supervise a mechanism whereby Group employees may communicate, confidentially and anonymously, potentially significant irregularities as to matters within its area of authority, especially of a financial and accounting nature.”

No such communications have been received during the last three fiscal years.

The procedure for communicating such claims to the audit committee is regulated by internal regulations that establish that such communications, whether from employees or others, must be sent in writing to the Bank’s registered office.

The following measures are in place to ensure the confidentiality of communications prior to their examination by the audit committee:

- The personal details and the sender and their contact details are not required in such communications.

- Only certain persons from the office of the general secretary and human resources may review the communication, so as to determine whether it deals with accounting or audit matters and forward it to the accounting committee or the head of the relevant area or department as appropriate, who will report to the committee.

- **Training and refresher courses for personnel involved in preparing and reviewing financial information or evaluating ICFR, which address, at least, accounting rules, auditing, internal control and risk management.**

Group employees involved in preparing and reviewing its financial information participate in training programmes and regular refresher courses which are specifically designed to provide them with the knowledge required to allow them to discharge their duties properly.

The training and refresher courses are mostly promoted by the financial accounting and control division itself and are designed and overseen together with the corporate learning and career development unit which is in turn part of the general secretary’s office and human resources division and is responsible for coordinating and imparting training across the Group.

These training initiatives take the form of a mixture of e-learning and onsite sessions, all of which are monitored and overseen by the aforementioned corporate unit in order to
guarantee they are duly taken and that the concepts taught have been properly assimilated.

With respect to the training received concerning financial information preparation and reviews, the secretary’s office and human resources division, in coordination with the financial accounting and control division, among others, has provided the employees involved in preparing and reviewing the financial information with courses on the following topics: risk analysis and management, accounting and financial statement analysis, the business, banking and financial environment, financial management, costs and budgeting, numerical skills, calculations and statistics and financial statement auditing, among other matters directly and indirectly related to the financial information process.

In 2015, 56,561 employees from the Group’s entities in the various countries in which it operates were involved in such training, involving over 351,000 training hours at the Corporate Centre in Spain and remotely (e-learning). In addition, each country develops its own training programme based on that developed by the parent.

2. Risk assessment in financial reporting

2.1. The main characteristics of the risk identification process, including risks of error or fraud, stating whether:

- The process exists and is documented.

- The process covers all financial reporting objectives, (existence and occurrence; completeness; valuation; presentation, disclosure and comparability; and rights and obligations), is updated and with what frequency.

- A specific process is in place to define the scope of consolidation, with reference to the possible existence of complex corporate structures, special purpose vehicles, holding companies, etc.

- The process addresses other types of risk (operational, technological, financial, legal, reputational, environmental, etc.) insofar as they may affect the financial statements.

- Which of the company’s governing bodies is responsible for overseeing the process.

Grupo Santander’s internal control over financial reporting model (hereinafter, the ICFR model) encompasses all of the processes and procedures put in place to ensure reasonable assurance that the control targets set at the corporate level will be met.

The Group’s ICFR model complies with the most stringent international standards and specifically complies with the guidelines established by the Committee of Sponsoring Organizations of the Tradeway Commission (COSO) in its most recent framework published in 2013, which addresses control targets in terms of corporate strategy, operations effectiveness and efficiency, financial information reliability and compliance with applicable rules and regulations.
ICFR documentation is implemented at the main Group companies using standard and uniform methodology such that it ensures inclusion of the appropriate controls and covers all material financial information risk factors.

The risk identification process takes into account all classes of risk (particularly those included in the recommendations issued by the Basel Risk Committee). Its scope is greater than the totality of risks directly related to the preparation of the Group’s financial information.

The identification of potential risks that must be covered by ICFR is based on the knowledge and understanding that management have of the business and its operating processes, taking into account both criteria of relative importance and qualitative criteria associated with the type, complexity or the structure of the business itself.

In addition, for each risk event identified, the model assigns the potential risk of error or fraud in the issuance of the financial information, i.e., potential errors in terms of: i) the existence of the assets, liabilities and transactions as of the corresponding date; ii) the fact that the assets are Group goods or rights and the liabilities Group obligations; iii) proper and timely recognition and correct measurement of its assets, liabilities and transactions; and iv) the correct application of the accounting rules and standards and adequate disclosures.

The following aspects of the Group’s ICFR model are worth highlighting:

- It is a corporate model involving the totality of the Group’s relevant organisational structure by means of a direct structure of individually-assigned lines of responsibility.
- The management of the ICFR documentation is decentralised, being delegated to the Group’s various units, while its coordination and monitoring is the duty of the corporate internal control department, which issues general criteria and guidelines to ensure uniformity and standardisation of the documentation of procedures, control validation tests, criteria for the classification of potential weaknesses and rule changes.
- It is a far-reaching model with a global scope of application, which not only documents the activities relating to generation of the consolidated financial information, its core scope of application, but also other procedures developed by each entity’s support areas which, while not generating a direct impact on the accounting process, could cause possible losses or contingencies in the case of incidents, errors, regulatory breaches and/or fraud.
- It is dynamic and updated continually to mirror the reality of the Group’s business as it evolves, the risks to which it is exposed and the controls in place to mitigate these risks.
- It generates comprehensive documentation of all the processes falling under its scope of application and includes detailed descriptions of the transactions, evaluation criteria and checks applied to the ICFR model.

All of the Group companies’ ICFR documentation is compiled into a corporate IT application which is accessed by employees of differing levels of responsibility in the evaluation and certification process of Grupo Santander’s internal control system.
The Group has a specific process for identifying the companies that should be included within its scope of consolidation. This is mainly monitored by the financial accounting and control division and the office of the general secretary and human resources.

This procedure enables the identification of not just those entities over which the Group has control through voting rights from its direct or indirect holdings, but also those over which it exercises control through other channels, such as mutual funds, securitisations and other structured vehicles. This procedure analyses whether the Group has control over the entity, has rights over or is exposed to its variable returns, and whether it has the capacity to use its power to influence the amount of such variable returns. If the procedure concludes that the Group has such control, the entity is included in the scope of consolidation, and is fully consolidated. If not, it is analysed to identify whether there is significant influence or joint control. If this is the case, the entity is included in the scope of consolidation, and consolidated using the equity method.

Finally, as stated in section 1.1 above, the audit committee is responsible for supervising the Company and Group’s regulated financial information process and internal control system.

In supervising this financial information, particular attention is paid to its integrity, compliance with regulatory requirements and accounting criteria, and the correct definition of the scope of consolidation. The internal control and risk management systems are regularly reviewed to ensure their effectiveness and adequate identification, management and reporting.

3. Control activities

3.1. Procedures for reviewing and authorising the financial information and description of ICFR to be disclosed to the markets, stating who is responsible in each case and documentation and flow charts of activities and controls (including those addressing the risk of fraud) for each type of transaction that may materially affect the financial statements, including procedures for the closing of accounts and for the separate review of critical judgements, estimates, evaluations and projections.

As already noted elsewhere in this report, the board itself has delegated in its audit committee the duty to: “supervise the process of preparing and presenting the required financial information relating to the Company and the Group, as well as its integrity, reviewing compliance with regulatory requirements, the proper demarcation of the Group’s scope of consolidation and the correct application of accounting standards” (article 16.4.(e) (i) of the Rules and Regulations of the Board of Directors).

The process of generating, reviewing and authorising financial information and the description of the ICFR is documented in a corporate tool that includes a description of the activities, processes, risks and controls associated with all transactions that could have a material impact on the financial statements. This documentation covers recurrent banking transactions and one-off operations (stock trading, property deals, etc.) and aspects related to judgements and estimates, covering the registration, assessment, presentation and disclosure of financial information. The information in the tools is updated to reflect changes in the way of carrying out, reviewing and authorising procedures for generating financial information.
The audit committee also has the duty to “report to the board, in advance of its adoption of the corresponding decisions, regarding: (i) The financial information that the Company must periodically make public, ensuring that such information is prepared in accordance with the same principles and practices applicable to the annual accounts” (article 16.4. (f) (i) of the Rules and Regulations of the Board of Directors).

The most significant aspects of the accounting close process and the review of the material judgements, estimates, measurements and projections used are as follows:

- the impairment losses on certain assets;
- the assumptions used to calculate the value of liabilities and commitments relating to post-employment benefits and other obligations;
- the useful lives of property, plant and equipment and intangible assets;
- the measurement of goodwill;
- provisions and contingent consideration liabilities;
- the fair value of certain unlisted securities; and
- the recoverability of deferred tax assets.

The Group’s chief accounting officer presents the Group’s financial information to the audit committee on a quarterly basis, at least, providing explanations of the main criteria employed for estimates, valuations and value judgements.

The board of directors is responsible for approving the financial information that the Bank is obliged to publish, in accordance with article 3.2 c) of its Rules and Regulations.

The information provided to directors prior to board meetings, including information on value judgements, estimates and forecasts relating to the financial information, is prepared specifically for the purposes of these meetings.

To verify that the ICFR model is working properly and check the effectiveness of the established controls, processes and activities, the Group has in place an evaluation and certification process which starts with an evaluation of the control activities by the staff responsible for them. Depending on the conclusions, the next step is to certify the subprocesses, processes and activities related to the generation of financial information so that, having analysed all such certifications, the chief executive officer, the chief financial officer and the controller can rule on the effectiveness of the ICFR model.

In 2015, the Group performed two evaluation processes:

- Evaluation of the effectiveness of the controls during the first half of the year in order to identify any potential incidents and remedy them before year end.
- Annual evaluation of the effectiveness of the controls and processes.
The corporate internal control department prepares a report spelling out the conclusions reached as a result of the certification process conducted by the units, taking the following aspects into consideration:

- A list of the certifications obtained at all levels.
- Any additional certifications considered necessary.
- Specific certification of all significant outsourced services.
- The ICFR model design and operation tests performed by those responsible for its maintenance and/or independent experts.

This report also itemises any incidents unearthed throughout the certification process by any of the parties involved, indicating whether these incidents have been properly resolved or, to the contrary, the plans in place to bring them to a satisfactory conclusion.

The conclusions of these evaluation processes are presented to the audit committee by the Operational Risk Control division, following a presentation in the risk control committee.

Lastly, on the basis of this report, the Group’s chief accounting officer (CAO), chief financial officer (CFO) and chief executive officer (CEO) rule on the effectiveness of the ICFR model in terms of preventing or detecting errors which could have a material impact on the consolidated financial information.

3.2. Internal control policies and procedures for IT systems (including secure access, control of changes, system operation, continuity and segregation of duties) giving support to key company processes regarding the preparation and publication of financial information.

The technology and operations division issues corporate IT policies.

For internal control purposes, the following policies are of particular importance.

The Group’s IT systems which are directly or indirectly related to the financial statements are configured to ensure the correct preparation and publication of financial information at all times by means of a specific internal control protocol.

To this end, the Bank has internal policies and procedures, which are duly updated and distributed, relating to systems security and access to the IT applications and systems based on roles and in accordance with the duties and clearances assigned to each unit/post so as to ensure proper separation of powers.

The Group’s internal policies establish that access to all systems that store or process data shall be strictly controlled, and that the level of access control required is determined by potential impact on the business. Access rights are assigned by Group experts in this area (known as authorised signatures), by roles and functions. In addition, to ensure compliance, the user and profile maintenance control and review processes in which responsible personnel in each area are involved ensure that information is only accessed by persons who need it for their work.
The Group’s methodology is designed to ensure that any new software developments and the updating and maintenance of existing programmes go through a definition-development-testing cycle that guarantees that financial information is handled reliably.

In this way, once software developments have been completed on the basis of the defined requirements (detailed documentation of the processes to be implemented), these developments are subjected to exhaustive testing by a specialist ‘software lab’.

The Corporate Certification Office (CCO) is then responsible for the complete testing cycle of the software in a pre-production environment, prior to its final implementation. The CCO manages and coordinates this whole cycle, which includes: technical and functional testing, performance testing, user acceptance testing, and pilot and prototype testing as defined by the entities, prior to making the applications available to all end users.

Underpinned by corporate methodology, the Group guarantees the existence of business continuity plans that ensure on-going performance of key functions in the event of disasters or other events that could halt or interrupt business operations.

These plans catalogue the measures, which translate into specific initiatives, designed to mitigate the scale and severity of IT incidents and to ensure that operations are up and running again as quickly and with as little fallout as possible.

To this end, the Group has highly-automated back-up systems to ensure the continuity of the most critical systems with little or no human intervention thanks to parallel redundant systems, high-availability systems and redundant communication lines.

In addition, there are specific force majeure risk mitigation strategies in place, such as virtual data processing centres, back-up power suppliers and offsite storage facilities.

3.3. Internal control policies and procedures for overseeing the management of outsourced activities, and of the appraisal, calculation or valuation services commissioned from independent experts, when these may materially affect the financial statements.

With regard to suppliers belonging to the Group, policies and procedures have been put in place to ensure coverage of the risks associated with such outsourcing.

The relevant processes include the following:

- The performance of tasks relating to the initiation, recording, processing, settlement, reporting and accounting of asset valuations and transactions.
- The provision of IT support in its various manifestations: software development, infrastructure maintenance, incident management, IT security and IT processing.
- The provision of other material support services not directly related to the generation of financial information: supplier management, property management, HR management, etc.

The main control procedures in place to ensure adequate coverage of the risks intrinsic to these processes are:
- Relations among Group companies are documented in contracts which detail exhaustively the type and level of service provided.

- All of the Group’s service providers document and validate the processes and controls related to the services they provide.

- Entities to which activities are outsourced document and validate their controls in order to ensure that the material risks associated with the outsourced services are kept within reasonable levels.

The Group assesses its estimates in-house. Whenever it considers it advisable to hire the services of a third party to help with specific matters, it does so having verified their expertise and independence, for which procedures are in place, and having validated their methods and the reasonableness of the assumptions made.

Furthermore, the Group has signed service level agreements and put in place controls to ensure the integrity and quality of information for external suppliers providing significant services that might impact the financial statements (mainly the management of foreclosed property and management of non-performing loans).

4. Information and communication

4.1. A specific function in charge of defining and maintaining accounting policies (accounting policies area or department) and settling doubts or disputes over their interpretation, which is in regular communication with the team in charge of operations, and a manual of accounting policies regularly updated and communicated to all the company’s operating units.

The financial accounting and control division includes the financial regulation and accounting processes area, the head of which reports directly to the controller and has the following exclusive responsibilities:

- Defining the accounting treatment of the operations that constitute the Bank’s business in keeping with their economic substance and the regulations governing the financial system.

- Defining and updating the Group’s accounting policies and resolving any questions or conflicts deriving from their interpretation.

- Enhancing and standardising the Group’s accounting practices.

- Assisting and advising the professionals responsible for new IT developments with respect to accounting requirements and ways of presenting information for internal consumption and external distribution and on how to maintain these systems as they relate to accounting issues.

The accounting policies are set out in the Grupo Santander accounting principles and policies and applicable measurement bases manual. In addition, any new accounting developments and the most relevant interpretations of the accounting standards in force prepared in the financial regulation and accounting processes area are reported on a monthly basis. These documents are also stored in the accounting regulation library (IAS-KEY).

The financial accounting and control division has put in place procedures to ensure it has all the information it needs to update the audit plan to cover the issue of new products.
and regulatory and accounting changes that make it necessary to adapt the plan and accounting principles and policies.

The Group entities, through the heads of their operations or accounting units, maintain an on-going and fluid dialogue with the financial regulation and accounting processes area and with the other areas of the financial accounting and control division.

4.2. **Mechanisms in standard format for the capture and preparation of financial information, which are applied and used in all units within the entity or group, and support its main financial statements and accompanying notes as well as disclosures concerning ICFR.**

The Group’s computer applications are configured in a management model which, using an IT system structure appropriate for a bank, is divided into several ‘layers’ supplying different kinds of services, including:

- General IT systems: these provide information to division/business unit heads.
- Management systems: these produce information for business monitoring and control purposes.
- Structural systems: these support the data shared and used by all the applications and services. These systems include all those related to the accounting and financial information.

All these systems are designed and developed in accordance with the following IT architecture:

- General software architecture, which defines the design patterns and principles for all systems.
- Technical architecture, including the mechanisms used in the model for design outsourcing, tool encapsulation and task automation.

One of the overriding purposes of this model is to provide the Group’s IT systems with the right software infrastructure to manage all the transactions performed and their subsequent entry into the corresponding accounting registers, with the resources needed to enable access to and consultation of the various levels of supporting data.

The software applications do not generate accounting entries per se; they are based on a model centred on the transaction itself and a complementary model of accounting templates that specifies the accounting entries and movements to be made for the said transaction. These accounting entries and movements are designed, authorised and maintained by the financial accounting and control division.

The applications execute all the transactions performed in a given day across various distribution channels (branches, internet, telephone banking, e-banking, etc.) into the ‘daily transaction register’ (DGO for its acronym in Spanish).

The DGO generates the transaction accounting entries and movements on the basis of the information contained in the accounting template, uploading it directly into the application named *accounting infrastructure.*
This application carries out the other processes necessary to generate financial information, including: capturing and balancing the movements received, consolidating and reconciling with application balances, cross-checking the software and accounting information for accuracy, complying with the accounting allocation structural model, managing and storing auxiliary accounting data and making accounting entries for saving in the accounting system itself.

Some applications do not use this process. These rely instead on their own account assistants who upload the general accounting data directly by means of account movements, so that the definition of these accounting entries resides in the applications themselves.

In order to control this process, before inputting the movements into the general accounting system, the accounting information is uploaded into a verification system which performs a number of controls and tests.

This accounting infrastructure and the aforementioned structural systems generate the processes needed to generate, disclose and store all the financial information required of a financial institution for regulatory and internal purposes, all of which under the guidance, supervision and control of the financial accounting and control division.

To minimise the attendant operational risks and optimise the quality of the information produced in the consolidation process, the Group has developed two IT tools which it uses in the financial statement consolidation process.

The first channels information flows between the units and the financial accounting and control division, while the second performs the consolidation proper on the basis of the information provided by the former.

Each month, all of the entities within the Group’s scope of consolidation report their financial statements, in keeping with the Group’s audit plan.

The Group’s audit plan, which is included in the consolidation application, generally contains the disclosure needed to comply with the disclosure requirements imposed on the Group by Spanish and international authorities.

The consolidation application includes a module that standardises the accounting criteria applied so that the units make the accounting adjustments needed to make their financial statements consistent with the accounting criteria followed by the Group.

The next step, which is automated and standardised, is to convert the financial statements of the entities that do not operate in euros into the Group’s functional currency.

The financial statements of the entities comprising the scope of consolidation are subsequently aggregated.

The consolidation process identifies intragroup items, ensuring they are correctly eliminated. In addition, in order to ensure the quality and comprehensiveness of the information, the consolidation application is configured to make investment-equity
elimination adjustments and to eliminate intragroup transactions, which are generated automatically in keeping with the system settings and checks.

Lastly, the consolidation application includes another module (the annex module) which allows all units to upload the accounting and non-accounting information not specified in the aforementioned audit plan and which the Group deems opportune for the purpose of complying with applicable disclosure requirements.

This entire process is highly automated and includes automatic controls to enable the detection of incidents in the consolidation process. The financial accounting and control division also performs additional oversight and analytical controls.

5. Monitoring

A discussion procedure whereby the auditor (pursuant to TAS), the internal audit function and other experts can report any significant internal control weaknesses encountered during their review of the financial statements or other assignments, to the company’s senior management and its audit committee or board of directors. State also whether the entity has an action plan to correct or mitigate the weaknesses found.

As stipulated in the Bylaws and the Rules and Regulations of the Board of Directors, the audit committee is officially tasked with overseeing the financial information process and the internal control systems.

The audit committee deals with any possible control deficiencies that might affect the reliability and accuracy of the financial statements. To this end it can call in the various areas of the Group involved to provide the necessary information and clarifications. The committee also takes stock of the potential impact of any flaws detected in the financial information.

Article 16.4.e) of the Rules and Regulations of the Board of Directors defines a duty of the audit committee as being to:

**(e) Supervise the financial reporting system and the internal control systems. In particular, the audit committee shall: (…)**

**(iii) Discuss with the external auditor any significant weaknesses detected in the internal control system during the course of the audit.”**

Moreover, article 16.4.d) of the Rules and Regulations of the Board of Directors establishes that the supervision duties of the audit committee with regard to the internal audit function include, and, in particular, “**(v) receive periodic information regarding the activities thereof; and (vi) verify that senior management and the board take into account the conclusions and recommendations set forth in its reports”**.

As part of its supervision work, the audit committee assesses the results of the work of the internal audit division, and can take action as necessary to correct any effects identified on the financial information.
6. External auditor’s report

The information relating to the internal control over financial reporting (ICFR) is assessed by the external auditor, which issues an opinion on the same and on the effectiveness of the ICFR system with respect to the financial information included in the Group’s consolidated financial statements for the year ended 31 December 2015.

The auditor’s report on the ICFR system is included as an appendix to the 2015 consolidated financial statements.
Internal audit

As noted above, internal audit is the third line of defense, independent of the others. Internal audit has a Charter of the Function approved by the Board of Directors of Banco Santander, S.A. which establishes its mission, scope and principles of action, structure, dependency and governance, and main responsibilities.

Considerations indicated below are valid both for Banco Santander, S.A. as the parent company of Group Santander (in later the Group), as for the following subsidiaries covered by internal audit of Banco Santander, S.A.: Santander Investment, S.A., Santander Securities Services, S.A., Banco de Albacete, S.A. and Open Bank, S.A.

1. Mission

Internal audit is a permanent function, independent of any other functions or units, whose objective is to provide the board of directors and the senior management with independent assurance on the quality and effectiveness of internal control, risk management (current or emerging) and governance processes and systems, thereby helping to protect the company’s value, solvency and reputation. To such ends, internal audit evaluates:

- the effectiveness and efficiency of these processes and systems;
- compliance with applicable laws and regulations, and with the requirements from supervisors;
- the reliability and integrity of financial and operational information;
- and asset integrity.

2. Scope of action

Internal audit’s scope of action embraces:

- all Group entities under effective control;
- separated assets (such as investment funds) managed by the entities mentioned in the previous section;
- any entity (or separated asset) not included in the previous sections but with an agreement in place to implement the Group’s internal audit function.

The subjectively defined scope set out in the preceding sections invariably includes the activities, businesses and processes implemented (whether directly or through outsourcing), the current organisation and, as the case may be, the commercial networks.

Additionally, and also to further the mission explained, internal audit may conduct audits of any other investees not included under the preceding points when the Group has reserved itself this right as shareholder.

3. Action principles

Internal audit will perform its duties following these principles:

- Independence, objectivity and impartiality.

All internal audit opinions will be based on an objective analysis of the facts, without any kind of influence, pressure or interest.
Internal audit will offer advice and consultancy services and will also perform special projects provided these:

i. do not compromise or undermine its other works.

ii. relate to specific and limited processes or topics.

iii. are requested or approved by the board of directors, the audit committee or any other governing body.

In any case, whether working on these projects or whether carrying out its normal duties, internal audit will not be in charge of the design, implementation or execution of control mechanisms. In this regard, the necessary measures will be taken to ensure the independence and objectivity of internal audit.

- Integrity, ethical conduct and confidentiality in respect of all information compiled and of the final conclusions obtained. The auditors’ work will be performed under the principles and rules of conduct set out in the Group’s codes of conduct and the Internal Audit Code of Ethics, all of which should be acknowledged and accepted with the signature of all internal audit members.

In addition, internal audit will establish the necessary procedures to prevent conflicts of interest that may disrupt performance of its functions and responsibilities.

- Auditors' professional competence and qualification, with continuous training to be provided.

- Quality work based on reasoned conclusions, documented and supported by audit tests conducted under uniform criteria through suitable shared methodologies and tools, as well as the required due of professional care.

- Geared towards creating value, generating relevant and reliable reports while supporting the management teams of audited units with the aim of collaborating and offering improvement measures.

- Suitable levels of collaboration with other Group control systems and bodies.

- Suitable levels of mutual collaboration with external auditors and other assurance providers working within the organisation, arranging periodical meetings and sharing the results of review processes and audit reports issued.

- Fluid relation with supervisors.

- Respect for international audit standards, especially the “International Standards for the Professional Practice of Internal Auditing” of 'The Institute of Internal Auditors’ and the principles established by the Bank for International Settlements in Basel on the matter.

4. Units, organisational structure and governance

Internal audit shall report to the audit committee and shall respond to requests for information that it receives therefrom in the performance of its duties. Notwithstanding the foregoing, as an independent unit, shall periodically report to the board of directors and, in any event, at least two times per year, and shall also have direct access to the board when it deems it appropriate.

The Group CAE is in charge of the Group internal audit function and is appointed by the board of directors, upon a proposal from the audit committee.
Internal audit will be organised with the necessary flexibility to adapt to the Group’s structure and situation at any time and to meet its objectives with the utmost efficiency and effectiveness. In order to adapt accordingly, internal audit will include the following:

- A unit at the corporate centre to cover at least its needs and of those units, businesses and regions without a permanent local internal audit unit. This unit will lead the audit function across the entire Group.

- Permanent local units in those countries where the Group’s presence warrants the existence of such units or where specific regulations require them. The units will be integrated into the organisational structure of the main retail & commercial banks, remaining fully independent of all other functions or units, and will report to the competent local governing body.

A Chief Audit Executive will be in charge of each local unit. The CAE will be appointed by the competent local governing body with the involvement of the Group CAE, in accordance with the Group-Subsidiaries Governance Model and the corresponding procedures.

5. Responsibilities

At Group level, the Group CAE will be responsible for:

- Proposing a suitable function Charter to the board of directors, for its approval and subsequent implementation. The framework should define the global function of internal audit and the way it should be carried out. The CAE shall also propose any changes that may be required due to periodic reviews of the framework.

- Designing and implementing suitable methodology that envisages the different aspects of the audit work and identifies material risks existing within the Group.

- Implementing an Audit Plan based on an assessment of risks existing within the Group to ensure the adequate coordination of all the local plans and to meet their needs. The expectations of the senior management, the board of directors and other involved parties will be duly taken into account. Internal audit local units will be in charge of designing their individual plans, which will be integrated into the Group Audit Plan. The Group CAE may request at any time that additional audits be included in these plans, or include work that affects the units in question into the plan of the corporate centre.

The aforementioned Audit Plan must be laid before the senior management, and the audit committee for its approval before it is submitted to the board at least once a year.

- Implementing the different activities included in the Audit Plan and preparing and distributing the reports envisaged under the plan.

- Communicating the audit conclusions and recommendations to the audited parties, establishing a schedule for implementing the recommendations and monitoring the work to ensure that the recommendations are implemented.

Local units shall report the results of their reviews to the internal audit unit at the corporate centre, along with the suggested recommendations, the extent to which they have been implemented and any other relevant aspect that may arise.

- Carrying out periodic assessments of the sufficiency of the resources in place to carry out the function.

- Periodically reporting to the audit committee on the implementation of the approved Audit Plan, including any relevant deviations, if applicable, and the most relevant conclusions of
the works conducted. The Group CAE shall provide the committee with all necessary information.

- Reporting to the board of directors on the activities performed by internal audit under its plan, the main conclusions reached and any other issues regarding its function.
- Informing the senior management, the audit committee, or the board of directors of any situations that should warrant special attention.
- Carrying out all audit works, special works and assignments and preparing all reports requested by the board of directors or the audit committee in the terms described in this Charter.
- Standing before the audit committee at least once a year to confirm that it has acted independently and that the works carried out have not been compromised by any factor that could have affected the independence or objectivity of internal audit. Otherwise, it shall explain why exactly it has not been able to act independently or objectively.
- Developing and maintaining a quality assurance and continuous improvement program that includes all aspects of internal audit and revises their effectiveness that should be evaluated by an external qualified team at least once every five years. The results of the internal and external assessments will be laid before the audit committee at least once a year.
- Reporting to local Internal Audit units on any aspects that might interest them (lessons learned, best practices, etc.) to improve the function.
- Developing and implementing a training plan for internal auditors.

The Group CAE may rely on a committee to aid it in its functions and responsibilities under the terms of this corporate framework.

6. Staff

At year-end 2015, internal audit employed 1,059 people, all dedicated exclusively to this service. Of these, 241 were based in the Corporate Centre and 818 in local units situated in the principal geographic (129 in Santander Sapin) areas in which the Group is present, all of whom exclusively work in that location.

7. Coverage of the internal control system

In 2015, the effectiveness and functioning of the main elements of the internal control system and controls on information systems in the units analysed were assessed.

8. Evaluation by the Banco Santander, S.A. audit committee of internal audit

The audit committee supervises the Group’s internal audit function and, specifically: “(i) Propose the selection, appointment and withdrawal of the officer responsible for internal audit; (ii) Approve the proposed guidance and the annual working plan of internal audit submitted to the board, ensuring that internal audit activities are primarily focused on the Company’s significant risks, and review the annual activities report; (iii) Ensure the independence and effectiveness of the internal audit function; (iv) Propose the budget for this service, including the physical and human resources needed for the performance of its duties; (v) Receive periodic information regarding the activities thereof; and (vi) Verify that senior management and the board take into account the conclusions and recommendations set forth in its reports.”

At its meeting of 20 January 2016, the audit committee favourably assessed the adequacy and effectiveness of the function in implementing its mission.
For greater detail on the aspects discussed above, you may consult the annual corporate governance report and the auditors' and annual financial report, both available on the Bank's corporate website (www.santander.com).