

TELEFONICA S A  
Form 6-K  
March 20, 2014  
Table of Contents

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 6-K**

**Report of Foreign Private Issuer**

**Pursuant to Rule 13a-16 or 15d-16**

**of the Securities Exchange Act of 1934**

**For the month of March, 2014**

**Commission File Number: 001-09531**

**Telefónica, S.A.**

**(Translation of registrant's name into English)**

**Districto Telefónica, Ronda de la Comunicación s/n,**

**28050 Madrid, Spain**

**3491-482 87 00**

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**(Address of principal executive offices)**

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

Form 20-F       Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Yes       No

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Yes       No

Indicate by check mark whether by furnishing the information contained in this Form, the registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

Yes       No

If  Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): N/A

**Table of Contents**

**Telefónica, S.A.**

TABLE OF CONTENTS

<b>Item</b>	<b>Sequential Page Number</b>
1. Telefónica - 2013 Annual Accounts <u>Account Auditor's Report, Annual Financial Statements and Management Report of Telefónica, S.A., all for the Fiscal Year 2013.</u> <u>Account Auditor's Report, Annual Financial Statements and Management Report of the Consolidated Group of Companies, all for the Fiscal Year 2013.</u>	

**Table of Contents**

Telefónica, S.A. hereby submits the Individual Annual Accounts of Telefónica, S.A. and the Consolidated Annual Accounts of Telefónica S.A. and its Group of Subsidiaries for 2013 financial year, that have been filed with the Spanish National Securities Market Commission (Comisión Nacional del Mercado de Valores - CNMV).

The aforesaid Annual Accounts will be submitted for approval of the next Annual General Shareholders Meeting of the Company, the dates of which will be announced due course.

Madrid, March 20<sup>th</sup>, 2014

**Table of Contents**

**AUDIT REPORT, ANNUAL FINANCIAL STATEMENTS, AND  
MANAGEMENT REPORT OF TELEFÓNICA, S.A., ALL FOR THE  
YEAR ENDED DECEMBER 31, 2013**

**Table of Contents**

Audit Report

TELEFÓNICA, S.A.

Financial Statements and Management Report

for the year ended

December 31, 2013

**Table of Contents**

*Translation of a report and financial statements originally issued in Spanish. In the event of discrepancy, the Spanish-language version prevails (See Note 23)*

**AUDIT REPORT ON THE FINANCIAL STATEMENTS**

To the Shareholders of

Telefónica, S.A.

We have audited the financial statements of Telefónica, S.A., which comprise the balance sheet at December 31, 2013, the income statement, the statement of changes in equity, the cash flow statement, and the notes thereto for the year then ended. The Company's Directors are responsible for the preparation of the financial statements in accordance with the regulatory framework for financial information applicable to the entity in Spain (identified in Note 2.a to the accompanying financial statements), and specifically in accordance with the accounting principles and criteria contained therein. Our responsibility is to express an opinion on the aforementioned financial statements taken as a whole, based upon work performed in accordance with prevailing audit regulation in Spain, which require the examination, through the performance of selective tests, of the evidence supporting the financial statements and the evaluation of whether their presentation, the accounting principles and criteria applied and the estimates made are in agreement with the applicable regulatory framework for financial information.

In our opinion, the accompanying 2013 financial statements give a true and fair view, in all material respects, of the equity and financial position of Telefónica, S.A. at December 31, 2013, and of the results of its operations and its cash flow for the year then ended, in conformity with the applicable regulatory framework for financial information in Spain, and specifically the accounting principles and criteria contained therein.

The accompanying 2013 management report contains such explanations as the Directors consider appropriate concerning the situation of the Company, the evolution of its business and other matters; however, it is not an integral part of the financial statements. We have checked that the accounting information included in the aforementioned management report agrees with the 2013 financial statements. Our work as auditors is limited to verifying the management report in accordance with the scope mentioned in this paragraph, and does not include the review of information other than that obtained from the Company's accounting records.

ERNST & YOUNG, S.L.

/s/ Ignacio Viota del Corte  
Ignacio Viota del Corte

March 19, 2014

Domicilio Social: Pl. Pablo Ruiz Picasso, 1. 28020 Madrid - Inscrita en el Registro Mercantil de Madrid al Tomo 12749, Libro 0, Folio 215, Sección 8ª, Hoja M-23123, Inscripción 116. C.I.F. B-78970506. A member firm of Ernst & Young Global Limited.

**Table of Contents**

TELEFÓNICA, S.A.

*Annual financial statements and management report for the year ended December 31, 2013*



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**Table of Contents****Index**

<u>Balance sheet at December 31</u>	4
<u>Income statements for the years ended December 31</u>	6
<u>Statements of changes in equity for the years ended December 31</u>	7
<u>Cash flow statements for the years ended December 31</u>	8
<u>Note 1. Introduction and general information</u>	9
<u>Note 2. Basis of presentation</u>	10
<u>Note 3: Proposed appropriation of profit</u>	11
<u>Note 4. Recognition and measurement accounting policies</u>	12
<u>Note 5. Intangible assets</u>	15
<u>Note 6. Property, plant and equipment</u>	16
<u>Note 7. Investment properties</u>	17
<u>Note 8. Investments in group companies and associates</u>	19
<u>Note 9. Financial investments</u>	28
<u>Note 10. Trade and other receivables</u>	32
<u>Note 11. Equity</u>	33
<u>Note 12. Financial liabilities</u>	38
<u>Note 13. Bonds and other marketable debt securities</u>	40
<u>Note 14. Interest-bearing debt and derivatives</u>	43
<u>Note 15. Payable to group companies and associates</u>	46
<u>Note 16. Derivate financial instruments and risk management policies</u>	50
<u>Note 17. Income tax</u>	61
<u>Note 18. Trade and other payables</u>	65
<u>Note 19. Revenue and expenses</u>	67
<u>Note 20. Other information</u>	74
<u>Note 21. Cash flow analysis</u>	85

---

**Table of Contents**

<u>Note 22. Events after the reporting period</u>	88
<u>Note 23. Additional note for English translation</u>	89
<u>Appendix I: Details of subsidiaries and associates at December 31, 2013</u>	90
<u>Appendix II Board of Director s Compensation</u>	95
<u>Management report 2013 (1)</u>	101
<u>Business Model</u>	101
<u>Economic results of Telefónica, S.A.</u>	103
<u>Investment activity</u>	104
<u>Share price performance</u>	107
<u>Research, development and innovation</u>	108
<u>Environment</u>	110
<u>Human Resources policies</u>	111
<u>Liquidity and financing resources</u>	113
<u>Financing</u>	113
<u>Treasury shares</u>	115
<u>Risks and uncertainties facing the Company</u>	118
<u>Trend evolution</u>	127
<u>Events after the reporting period</u>	128
<u>Annual Corporate Governance Report for Listed Companies</u>	129

**Table of Contents**

2013 Financial Statements

Telefónica, S.A.

Balance sheet at December 31

Millions of euros

	Notes	2013	2012
<b>ASSETS</b>			
<b>NON-CURRENT ASSETS</b>		<b>70,506</b>	<b>82,182</b>
<b>Intangible assets</b>	5	<b>58</b>	<b>64</b>
Software		12	15
Other intangible assets		46	49
<b>Property, plant and equipment</b>	6	<b>262</b>	<b>303</b>
Land and buildings		146	148
Plant and other PP&E items		90	115
Property, plant and equipment under construction and prepayments		26	40
<b>Investment property</b>	7	<b>399</b>	<b>410</b>
Land		65	65
Buildings		334	345
<b>Non-current investments in Group companies and associates</b>	8	<b>62,380</b>	<b>71,779</b>
Equity instruments		58,155	67,770
Loans to Group companies and associates		4,205	3,988
Other financial assets		20	21
<b>Financial investments</b>	9	<b>3,082</b>	<b>4,531</b>
Equity instruments		591	433
Loans to third parties			39
Derivatives	16	2,369	4,045
Other financial assets	9	122	14
<b>Deferred tax assets</b>	17	<b>4,325</b>	<b>5,095</b>
<b>CURRENT ASSETS</b>		<b>14,634</b>	<b>7,553</b>
<b>Net assets held for sale</b>		<b>2,302</b>	
<b>Trade and other receivables</b>	10	<b>1,122</b>	<b>1,065</b>
<b>Current investments in Group companies and associates</b>	8	<b>5,992</b>	<b>3,636</b>
Loans to Group companies and associates		5,956	3,608
Derivatives	16	10	2
Other financial assets		26	26
<b>Investments</b>	9	<b>445</b>	<b>390</b>
Loans to companies		45	9
Derivatives	16	337	282
Other financial assets		63	99
<b>Accruals</b>		<b>5</b>	<b>12</b>
<b>Cash and cash equivalents</b>		<b>4,768</b>	<b>2,450</b>

<b>TOTAL ASSETS</b>	<b>85,140</b>	<b>89,735</b>
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The accompanying Notes 1 to 23 and Appendices I and II are an integral part of these balance sheets

Telefónica, S.A. 4

**Table of Contents**

2013 Financial Statements

Millions of euros

	Notes	2013	2012
<b>Equity and liabilities</b>			
<b>EQUITY</b>		<b>22,827</b>	<b>22,978</b>
<b>CAPITAL AND RESERVES</b>		<b>23,658</b>	<b>24,383</b>
<b>Share capital</b>	11	<b>4,551</b>	<b>4,551</b>
<b>Share premium</b>	11	<b>460</b>	<b>460</b>
<b>Reserves</b>	11	<b>18,528</b>	<b>19,529</b>
Legal		984	984
Other reserves		17,544	18,545
<b>Treasury shares and own equity instruments</b>	11	<b>(545)</b>	<b>(788)</b>
<b>Profit for the year</b>	3	<b>664</b>	<b>631</b>
<b>UNREALIZED GAINS (LOSSES) RESERVE</b>	11	<b>(831)</b>	<b>(1,405)</b>
Available-for-sale financial assets		49	(34)
Hedging instruments		(880)	(1,371)
<b>NON-CURRENT LIABILITIES</b>		<b>47,154</b>	<b>50,029</b>
<b>Non-current provisions</b>		<b>213</b>	<b>187</b>
Other provisions		213	187
<b>Non-current borrowings</b>	12	<b>9,096</b>	<b>13,274</b>
Bonds and other marketable debt securities	13	177	828
Bank borrowings	14	6,079	9,232
Derivatives	16	2,677	3,130
Finance leases		75	75
Other debts		88	9
<b>Non-current borrowings from Group companies and associates</b>	15	<b>37,583</b>	<b>36,069</b>
<b>Deferred tax liabilities</b>	17	<b>262</b>	<b>499</b>
<b>CURRENT LIABILITIES</b>		<b>15,159</b>	<b>16,728</b>
<b>Current provisions</b>		<b>12</b>	<b>8</b>
<b>Current borrowings</b>	12	<b>1,869</b>	<b>2,097</b>
Bonds and other marketable debt securities	13	943	828
Bank borrowings	14	831	1,145
Derivatives	16	95	124
<b>Current borrowings from Group companies and associates</b>	15	<b>12,982</b>	<b>14,181</b>
<b>Trade and other payables</b>	18	<b>286</b>	<b>439</b>
<b>Accruals</b>		<b>10</b>	<b>3</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>85,140</b>	<b>89,735</b>

The accompanying Notes 1 to 23 and Appendices I and II are an integral part of these balance sheets



**Table of Contents**

2013 Financial Statements

Telefónica, S.A.

Income statements for the years ended December 31

Millions of euros	Notes	2013	2012
<b>Revenue</b>	19	<b>11,003</b>	<b>5,817</b>
Rendering of services to Group companies and associates		687	687
Rendering of services to non-group companies		3	3
Dividends from Group companies and associates		10,078	4,852
Interest income on loans to Group companies and associates		235	275
<b>Impairment and gains (losses) on disposal of financial instruments</b>		<b>(7,990)</b>	<b>(5,311)</b>
Impairment losses and other losses	8	(7,998)	(5,312)
Gains (losses) on disposal and other gains and losses		8	1
<b>Other operating income</b>	19	<b>84</b>	<b>120</b>
Non-core and other current operating revenue - Group companies and associates		62	95
Non-core and other current operating revenue - non-group companies		22	25
<b>Employees benefits expense</b>	19	<b>(154)</b>	<b>(141)</b>
Wages, salaries and others		(135)	(130)
Social security costs		(19)	(11)
<b>Other operational expense</b>		<b>(343)</b>	<b>(500)</b>
External services - Group companies and associates	19	(104)	(99)
External services - non-group companies	19	(225)	(389)
Taxes other than income tax		(14)	(12)
<b>Depreciation and amortization</b>	5, 6 and 7	<b>(76)</b>	<b>(63)</b>
<b>Gains (losses) on disposal of fixed assets</b>			<b>(1)</b>
<b>OPERATING PROFIT</b>		<b>2,524</b>	<b>(79)</b>
<b>Finance revenue</b>	19	<b>179</b>	<b>213</b>
From equity investments of third parties		7	17
From marketable securities and other financial instruments of third parties		172	196
<b>Finance costs</b>	19	<b>(2,712)</b>	<b>(2,268)</b>
Borrowings from Group companies and associates		(1,971)	(2,042)
Third-party borrowings		(741)	(226)
<b>Change in fair value of financial instruments</b>		<b>(38)</b>	<b>(59)</b>
Trading portfolio and other securities		6	(4)
Gain (loss) on available-for-sale financial assets recognized in the period	9 and 11	(44)	(55)
<b>Exchange rate gains (losses)</b>	19	<b>82</b>	<b>41</b>
<b>Impairment and gains (losses) on disposal of financial instruments with third-parties</b>		<b>(2)</b>	<b>(53)</b>
<b>NET FINANCIAL EXPENSE</b>		<b>(2,491)</b>	<b>(2,126)</b>
<b>PROFIT BEFORE TAX</b>	21	<b>33</b>	<b>(2,205)</b>
<b>Income tax</b>	17	<b>631</b>	<b>2,836</b>

**PROFIT FOR THE YEAR**

**664**

**631**

The accompanying Notes 1 to 23 and Appendices I and II are an integral part of these income statements

Telefónica, S.A. 6



**Table of Contents**

2013 Financial Statements

Telefónica, S.A.

Statements of changes in equity for the years ended December 31

**A) Statement of recognized income and expense**

Millions of euros	Notes	2013	2012
<b>Profit of the period</b>		<b>664</b>	<b>631</b>
<b>Total income and expense recognized directly in equity</b>	11	<b>463</b>	<b>(950)</b>
From measurement of available-for-sale financial assets		74	(46)
From cash flow hedges		588	(1,310)
Income tax impact		(199)	406
<b>Total amounts transferred to income statement</b>	11	<b>111</b>	<b>160</b>
From measurement of available-for-sale financial assets		44	55
From cash flow hedges		114	173
Income tax impact		(47)	(68)
<b>TOTAL RECOGNIZED INCOME AND EXPENSE</b>		<b>1,238</b>	<b>(159)</b>

The accompanying Notes 1 to 23 and Appendices I and II are an integral part of these statements of changes in equity.

**B) Statements of total changes in equity for the years ended December 31**

Millions of euros	Share capital	Share premium	Treasury shares and own Reserve	Profit for the year	Interim dividend	Net unrealized gains (losses) reserve	Total	
<b>Balance at December 31, 2011</b>	<b>4,564</b>	<b>460</b>	<b>22,454</b>	<b>(1,782)</b>	<b>4,910</b>	<b>(3,394)</b>	<b>(615)</b>	<b>26,597</b>
Total recognized income and expense				631		(790)	(159)	
Transactions with shareholders and owners	(13)		(4,497)	972				(3,538)

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Capital decreases	(84)		(1,237)	1,321				
Dividends paid	71		(2,907)					(2,836)
Transactions with treasury shares or own equity instruments (net)			(353)	(349)				(702)
Other movements			56	22				78
Appropriation of prior year profit (loss)			1,516		(4,910)	3,394		
<b>Balance at December 31, 2012</b>	<b>4,551</b>	<b>460</b>	<b>19,529</b>	<b>(788)</b>	<b>631</b>		<b>(1,405)</b>	<b>22,978</b>
Total recognized income and expense					664		574	1,238
Transactions with shareholders and owners			(1,680)	243				(1,437)
Capital decreases								
Dividends paid			(1,588)					(1,588)
Transactions with treasury shares or own equity instruments (net)			(92)	243				151
Other movements			48					48
Appropriation of prior year profit (loss)			631		(631)			
<b>Balance at December 31, 2013</b>	<b>4,551</b>	<b>460</b>	<b>18,528</b>	<b>(545)</b>	<b>664</b>		<b>(831)</b>	<b>22,827</b>

The accompanying Notes 1 to 23 and Appendices I and II are an integral part of these statements of changes in equity.

Telefónica, S.A. 7

**Table of Contents**

2013 Financial Statements

Telefónica, S.A.

Cash flow statements for the years ended December 31

Millions of euros	Notes	2013	2012
<b>A) CASH FLOWS FROM OPERATING ACTIVITIES</b>		<b>6,224</b>	<b>1,981</b>
<b>Profit before tax</b>		<b>33</b>	<b>(2,205)</b>
<b>Adjustments to profit:</b>		<b>226</b>	<b>2,519</b>
Depreciation and amortization	5,6 and 7	76	63
Impairment of investments in Group companies and associates	8	7,998	5,312
Change in long term provisions		(18)	145
Gains on the sale of financial assets		(8)	(1)
Losses on disposal of property, plant and equipment			1
Dividends from Group companies and associates	19	(10,078)	(4,852)
Interest income on loans to Group companies and associates	19	(235)	(275)
Net financial expense		2,491	2,126
<b>Change in working capital</b>		<b>(52)</b>	<b>(165)</b>
Trade and other receivables		(7)	45
Other current assets		11	(35)
Trade and other payables		(76)	(73)
Other current liabilities		20	(102)
<b>Other cash flows from operating activities</b>	21	<b>6,017</b>	<b>1,832</b>
Net interest paid		(1,664)	(2,007)
Dividends received		6,428	3,337
Income tax receipts		1,253	502
<b>B) CASH FLOWS (USED IN)/FROM INVESTING ACTIVITIES</b>		<b>(147)</b>	<b>1,372</b>
Payments on investments	21	(2,938)	(6,779)
Proceeds from disposals	21	2,791	8,151
<b>C) CASH FLOWS USED IN FINANCING ACTIVITIES</b>		<b>(3,736)</b>	<b>(1,663)</b>
Payments on equity instruments		(244)	(590)
Proceeds from financial liabilities	21	(1,904)	1,763
Debt issues		10,127	10,964
Repayment and redemption of debt		(12,031)	(9,201)
Dividends paid	11	(1,588)	(2,836)
<b>D) NET FOREIGN EXCHANGE DIFFERENCE</b>		<b>(23)</b>	<b>(5)</b>
<b>E) NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b>		<b>2,318</b>	<b>1,685</b>
Cash and cash equivalents at January 1		2,450	765
Cash and cash equivalents at December 31		4,768	2,450

Notes 1 to 23 and Appendices I and II are an integral part of these cash flow statements.



**Table of Contents**

2013 Financial Statements

TELEFÓNICA, S.A.

*Annual financial statements for the ended December 31, 2013*

**Note 1. Introduction and general information**

Telefónica, S.A. ( Telefónica or the Company ) is a public limited company incorporated for an indefinite period on April 19, 1924, under the corporate name of Compañía Telefónica Nacional de España, S.A. It adopted its present name in April 1998.

The Company s registered office is at Gran Vía 28, Madrid (Spain), and its Employer Identification Number (CIF) is A-28/015865.

Telefónica s basic corporate purpose, pursuant to Article 4 of its Bylaws, is the provision of all manner of public or private telecommunications services, including ancillary or complementary telecommunications services or related services. All the business activities that constitute this stated corporate purpose may be performed either in Spain or abroad and wholly or partially by the Company, either through shareholdings or equity interests in other companies or legal entities with an identical or a similar corporate purpose.

In keeping with the above, Telefónica is currently the parent company of a group that offers both fix and mobile telecommunications with the aim to turn the challenges of the new digital business into reality and being one of the most important players. The objective of the Telefónica Group is positioning as a Company with an active role in the digital business taking advantage of the opportunities of its size and industrial and strategic alliances.

The Company is taxed under the general tax regime established by the Spanish State, the Spanish Autonomous Communities and local governments, and files consolidated tax returns with most of the Spanish subsidiaries of its Group under the consolidated tax regime applicable to corporate groups.

Telefónica, S.A. 9

**Table of Contents**

2013 Financial Statements

**Note 2. Basis of presentation**

**a) True and fair view**

These financial statements have been prepared from Telefónica, S.A.'s accounting records by the Company's Directors in accordance with the accounting principles and standards contained in the Spanish GAAP in force approved by Royal Decree 1514/2007, on November 16 (PGC 2007), modified by Royal Decree 1159/2010, dated September 17, 2010 and other prevailing legislation at the date of these financial statements, to give a true and fair view of the Company's equity, financial position, results of operations and of the cash flows obtained and applied in 2013.

The accompanying financial statements for the year ended December 31, 2013 were prepared by the Company's Board of Directors at its meeting on February 26, 2014 for submission for approval at the General Shareholders' Meeting, which is expected to occur without modification.

The figures in these financial statements are expressed in millions of euros, unless indicated otherwise, and therefore may be rounded. The euro is the Company's functional currency.

**b) Comparison of information**

In 2012 and 2013 there have not been significant transactions that should be taken into account in order to ensure the comparison of information included in the Annual Financial Statements of both years.

**c) Materiality**

These financial statements do not include any information or disclosures that, not requiring presentation due to their qualitative significance, have been determined as immaterial or of no relevance pursuant to the concepts of *materiality* or *relevance* defined in the PGC 2007 conceptual framework.

**d) Use of estimates**

The financial statements have been prepared using estimates based on historical experience and other factors considered reasonable under the circumstances. The carrying value of assets and liabilities, which is not readily apparent from other sources, was established on the basis of these estimates. The Company periodically reviews these estimates.

A significant change in the facts and circumstances on which these estimates are based could have an impact on the Company's results and financial position.

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the financial statements of the following year are discussed below.

**Provisions for impairment of investments in Group companies, joint ventures and associates**

Investments in group companies, joint ventures and associates are tested for impairment at each year end to determine whether an impairment loss must be recognized in the income statement or a previously recognized impairment loss be reversed. The decision to recognize an impairment loss (or a reversal) involves estimates of the reasons for the potential impairment (or recovery), as well as the timing and amount.

There is a significant element of judgment involved in the estimates required to determine recoverable amount and the assumptions regarding the performance of these investments, since the timing and scope of future changes in the business are difficult to predict.

### **Deferred taxes**

The Company assesses the recoverability of deferred tax assets based on estimates of future earnings. The ability to recover these taxes depends ultimately on the Company's ability to generate taxable earnings over the period for which the deferred tax assets remain deductible. This analysis is based on the estimated schedule for reversing deferred tax liabilities, as well as estimates of taxable earnings, which are sourced from internal projections and are continuously updated to reflect the latest trends.

Telefónica, S.A. 10

**Table of Contents**

2013 Financial Statements

The appropriate valuation of tax assets and liabilities depends on a series of factors, including estimates as to the timing and realization of deferred tax assets and the projected tax payment schedule. Actual income tax receipts and payments could differ from the estimates made by the Company as a result of changes in tax legislation or unforeseen transactions that could affect tax balances.

**Note 3: Proposed appropriation of profit**

Telefónica, S.A. obtained 664 million euros of profit in 2013. Accordingly, the Company's Board of Directors will submit the following proposed appropriation of 2013 profit for approval at the Shareholders' Meeting:

<b>Millions of euros</b>	
<b>Proposed appropriation:</b>	
Profit for the year	664
<b>Distribution to:</b>	
Goodwill reserve (Note 11.c)	2
Voluntary reserves	662

Telefónica, S.A. 11



**Table of Contents**

2013 Financial Statements

**Note 4. Recognition and measurement accounting policies**

As stated in Note 2, the Company's financial statements have been prepared in accordance with the accounting principles and standards contained in the Código de Comercio, which are further developed in the Plan General de Contabilidad currently in force (PGC 2007), as well as any commercial regulation in force at the reporting date.

Accordingly, only the most significant accounting policies used in preparing the accompanying financial statements are set out below, in light of the nature of the Company's activities as a holding.

**a) Intangible assets**

Intangible assets are stated at acquisition or production cost, less any accumulated amortization or any accumulated impairment losses.

Intangible assets are amortized on a straight-line basis over their useful lives. The most significant items included in this caption are computer software licenses, which are generally amortized on a straight-line basis over three years.

**b) Property, plant and equipment and investment property**

Property, plant and equipment is stated at cost, net of accumulated depreciation and any accumulated impairment in value.

The Company depreciates its property, plant and equipment once the assets are in full working conditions using the straight-line method based on the assets' estimated useful lives, calculated in accordance with technical studies which are revised periodically based on technological advances and the rate of dismantling, as follows:

<b>Estimated useful life</b>	<b>Years</b>
Buildings	40
Plant and machinery	3 - 25
Other plant or equipment, furniture and fixtures	10
Other items of property, plant and equipment	4 - 10

Investment property is measured and depreciated using the same criteria described for land and buildings for own use.

**c) Impairment of non-current assets**

Non-current assets are assessed at each reporting date for indicators of impairment. Where such indicators exist, or in the case of assets which are subject to an annual impairment test, the Company estimates the asset's recoverable amount as the higher of its fair value less costs to sell and its value in use. In assessing value in use, the estimated future cash flows deriving from the use of the asset or its cash generating unit, as applicable, are discounted to their present value in the currency in which they will be generated, using a discount rate appropriate to that currency and reflecting current market assessments of the time value of money and the risks specific to the asset.

Telefónica bases the calculation of impairment on the business plans of the various companies to which the assets are allocated. The projected cash flows, based on strategic business plans, cover a period of five years. Starting with the sixth year, an expected constant growth rate is applied.

**d) Financial assets and liabilities**

Financial investments

All regular way purchases and sales of financial assets are recognized on the trade date, i.e. the date that the Company commits to purchase or sell the asset.

Investments in group companies, joint ventures and associates are classified into a category of the same name and are shown at cost less any impairment loss (see Note 4.c). Group companies are those over which the Company exercises control, either by exercising effective control or by virtue of agreements with the other shareholders. Joint ventures are companies which are jointly controlled with third parties. Associates are companies in which there is significant influence, but not control or joint control with third parties. Telefónica assesses the existence of significant influence not only in terms of percentage ownership but also in qualitative terms such as presence on the board of directors, involvement in decision-making, the exchange of management personnel, and access to technical information.

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**Table of Contents**

2013 Financial Statements

Financial investments which the Company intends to hold for an unspecified period of time and could be sold at any time to meet specific liquidity requirements or in response to interest rate movements and which have not been included in the other categories of financial assets defined in the PGC 2007 are classified as available-for-sale. These investments are recorded under Non-current assets, unless it is probable and feasible that they will be sold within 12 months.

Derivative financial instruments and hedge accounting

When Telefónica chooses not to apply hedge accounting criteria but economic hedging, gains or losses resulting from changes in the fair value of derivatives are taken directly to the income statement.

**e) Revenue and expenses**

Revenue and expenses are recognized on the income statement based on an accruals basis; i.e. when the goods or services represented by them take place, regardless of when actual payment or collection occurs.

The income obtained by the Company in dividends received from Group companies and associates, and from the interest accrued on loans and credits given to them, are included in revenue in compliance with the provisions of consultation No. 2 of BOICAC 79, published on September 30, 2009.

**f) Related party transactions**

In mergers and spin-offs of businesses involving the parent company and its direct or indirect subsidiary, in cases of non-monetary contributions of businesses between Group companies, and in cases of dividends, the contributed assets are valued, in general, at their pre-transaction carrying amount in the individual financial statements, given that the Telefónica Group does not prepare its consolidated financial statements in accordance with the Standards on Preparing Consolidated Financial Statements (Spanish NOFCAC ).

In these same operations, companies may also opt to use the consolidated values under International Financial Reporting Standards (IFRS) as adopted by the European Union, providing that the consolidated figures do not differ from those obtained under the NOFCAC. Lastly, the Company may also opt to use the values resulting from a reconciliation to the NOFCAC. Any accounting difference is taken to reserves.

**g) Financial guarantees**

The Company has provided guarantees to a number of subsidiaries to secure their transactions with third parties (see Note 20.a). Where financial guarantees provided have a counterguarantee on the Company's balance sheet, the value of the counterguarantee is estimated to be equal to the guarantee given, with no additional liability recognized as a result.

Guarantees provided for which there is no item on the Company's balance sheet acting as a counterguarantee are initially measured at fair value which, unless there is evidence to the contrary, is the same as the premium received plus the present value of any premiums receivable. After initial recognition, these are subsequently measured at the higher of:

- i) The amount resulting from the application of the rules for measuring provisions and contingencies.
- ii) The amount initially recognized less, when applicable, any amounts taken to the income statement corresponding to accrued income.

Telefónica, S.A. 13

**Table of Contents**

2013 Financial Statements

**h) Consolidated data**

As required under prevailing legislation, the Company has prepared separate consolidated annual financial statements, drawn up in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The balances of the main headings of the Telefónica Group's consolidated financial statements for 2013 and 2012 are as follows:

<b>Millions of euros</b>		
<b>Item</b>	<b>2013</b>	<b>2012</b>
Total assets	118,862	129,773
Equity:		
Attributable to equity holders of the parent	21,185	20,461
Attributable to minority interests	6,297	7,200
Revenue from operations	57,061	62,356
Profit for the year:		
Attributable to equity holders of the parent	4,593	3,928
Attributable to minority interests	376	475

Telefónica, S.A. 14

**Table of Contents**

2013 Financial Statements

**Note 5. Intangible assets**

The movements in the items composing intangible assets and the related accumulated amortization in 2013 and 2012 are as follows:

**2013**

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
<b>INTANGIBLE ASSETS, GROSS</b>	<b>331</b>	<b>7</b>	<b>(78)</b>	<b>1</b>	<b>261</b>
Software	184	4	(69)	1	120
Other intangible assets	147	3	(9)		141
<b>ACCUMULATED AMORTIZATION</b>	<b>(267)</b>	<b>(13)</b>	<b>77</b>		<b>(203)</b>
Software	(169)	(8)	69		(108)
Other intangible assets	(98)	(5)	8		(95)
<b>Net carrying amount</b>	<b>64</b>	<b>(6)</b>	<b>(1)</b>	<b>1</b>	<b>58</b>

**2012**

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
<b>INTANGIBLE ASSETS, GROSS</b>	<b>320</b>	<b>15</b>	<b>(7)</b>	<b>3</b>	<b>331</b>
Software	173	11	(2)	2	184
Other intangible assets	147	4	(5)	1	147
<b>ACCUMULATED AMORTIZATION</b>	<b>(252)</b>	<b>(17)</b>	<b>2</b>		<b>(267)</b>
Software	(162)	(8)	1		(169)
Other intangible assets	(90)	(9)	1		(98)
<b>Net carrying amount</b>	<b>68</b>	<b>(2)</b>	<b>(5)</b>	<b>3</b>	<b>64</b>

At December 31, 2013 and 2012 commitments exist to acquire intangible assets amounting to 0.1 and 1 million euros, respectively.

At December 31, 2013 and 2012, the Company had 157 million euros and 223 million euros, respectively, of fully amortized intangible assets.

Telefónica, S.A. 15

**Table of Contents**

2013 Financial Statements

**Note 6. Property, plant and equipment**

The movements in the items composing property, plant and equipment and the related accumulated depreciation in 2013 and 2012 are as follows:

**2013**

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
<b>PROPERTY, PLANT AND EQUIPMENT, GROSS</b>	<b>592</b>	<b>11</b>	<b>(35)</b>	<b>(1)</b>	<b>567</b>
Land and buildings	227		(17)	18	228
Plant and other PP&E items	325	4	(18)	2	313
Property, plant and equipment under construction and prepayments	40	7		(21)	26
<b>ACCUMULATED DEPRECIATION</b>	<b>(289)</b>	<b>(52)</b>	<b>36</b>		<b>(305)</b>
Buildings	(79)	(21)	18		(82)
Plant and other PP&E items	(210)	(31)	18		(223)
<b>Net carrying amount</b>	<b>303</b>	<b>(41)</b>	<b>1</b>	<b>(1)</b>	<b>262</b>

**2012**

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
<b>PROPERTY, PLANT AND EQUIPMENT, GROSS</b>	<b>594</b>	<b>7</b>	<b>(4)</b>	<b>(5)</b>	<b>592</b>
Land and buildings	228			(1)	227
Plant and other PP&E items	323	3	(2)	1	325
Property, plant and equipment under construction and prepayments	43	4	(2)	(5)	40
<b>ACCUMULATED DEPRECIATION</b>	<b>(256)</b>	<b>(37)</b>	<b>2</b>	<b>2</b>	<b>(289)</b>
Buildings	(74)	(5)			(79)
Plant and other PP&E items	(182)	(32)	2	2	(210)
<b>Net carrying amount</b>	<b>338</b>	<b>(30)</b>	<b>(2)</b>	<b>(3)</b>	<b>303</b>

Firm commitments to acquire property, plant and equipment at December 31, 2013 and 2012 amounted to 0.7 million euros and 1 million euros, respectively.

At December 31, 2013 and 2012, the Company had 47 million euros and 42 million euros, respectively, of fully depreciated items of property, plant and equipment.

Telefónica, S.A. has taken out insurance policies with appropriate limits to cover the potential risks which could affect its property, plant and equipment.

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Property, plant and equipment includes the net carrying amount of the land and buildings occupied by Telefónica, S.A. at its Distrito Telefónica headquarters, amounting to 76 million euros and 78 million euros at the 2013 and 2012 year-ends, respectively. Also included is the net carrying amount of the remaining assets (mainly plant and property) of 63 and 88 million euros at December 31, 2013 and 2012, respectively. The land and buildings rented to other Group Companies have been included as Investment properties in Note 7.

Telefónica, S.A. 16



**Table of Contents**

2013 Financial Statements

**Note 7. Investment properties**

The movements in the items composing investment properties in 2013 and 2012 and the related accumulated depreciation are as follows:

**2013**

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
<b>INVESTMENT PROPERTIES, GROSS</b>	<b>470</b>				<b>470</b>
Land	65				65
Buildings	405				405
<b>ACCUMULATED DEPRECIATION</b>	<b>(60)</b>	<b>(11)</b>			<b>(71)</b>
Buildings	(60)	(11)			(71)
<b>Net carrying amount</b>	<b>410</b>	<b>(11)</b>			<b>399</b>

**2012**

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
<b>INVESTMENT PROPERTIES, GROSS</b>	<b>474</b>		<b>(4)</b>		<b>470</b>
Land	65				65
Buildings	409		(4)		405
<b>ACCUMULATED DEPRECIATION</b>	<b>(51)</b>	<b>(9)</b>			<b>(60)</b>
Buildings	(51)	(9)			(60)
<b>Net carrying amount</b>	<b>423</b>	<b>(9)</b>	<b>(4)</b>		<b>410</b>

In January 2011, the Telefónica Group completed the move to Diagonal 00 building, its new corporate headquarters in Barcelona. The building has been accounted for as an asset acquired under a finance lease. It is accordingly shown under Additions in the table of 2011 at the present value of the rental payments, 88 million euros. 100% of this space is rented to Telefónica Group companies under 15-year non-cancellable lease contracts that can be renewed for up to 50 years at the discretion of Telefónica. The maturity calendar of the future minimum payments is as follows:

Millions of euros	Future minimum payments	
	2013	2012
Up to one year	5	5
Between one and five years	21	21
Over 5 years	44	49

**Total****70****75**

In addition to the Diagonal 00 building mentioned above, Investment properties mainly includes the value of land and buildings leased by Telefónica, S.A. to other Group companies at the Distrito Telefónica head offices in Madrid.

In 2013, the Company has buildings with a total area of 330,044 square meters leased to several Telefónica Group and other companies, equivalent to an occupancy rate of 92.72% of the buildings it has earmarked for lease. In 2012, it had a total of 332,291 square meters leased, equivalent to an occupancy rate of 93.45% of the buildings earmarked for lease.

Telefónica, S.A. 17

**Table of Contents**

2013 Financial Statements

Total income from leased buildings in 2013 (see Note 19.1) amounted to 52 million euros (50 million euros in 2012). Future minimum rentals receivable under non-cancellable leases are as follows:

<b>Millions of euros</b>	<b>2013 Future minimum recoveries</b>	<b>2012 Future minimum recoveries</b>
Up to one year	51	51
Between one and five years	30	83
Over 5 years	1	
<b>Total</b>	<b>82</b>	<b>134</b>

The lease contracts held with subsidiaries occupying Distrito Telefónica were renewed in 2011, for a non-cancellable period of three years. The figures also include non-cancellable lease revenue from Diagonal 00, the contracts for which expire in June 2016.

The main contracts of operating leases in which Telefónica, S.A. acts as lessee and there is no sub-lease are described in Note 19.5.

Telefónica, S.A. 18

**Table of Contents**

2013 Financial Statements

**Note 8. Investments in group companies and associates**

**8.1.** The movements in the items composing investments in Group companies, joint ventures and associates in 2013 and 2012 are as follows:

**2013**

Millions of euros	Opening balance	Additions	Disposals	Exchange Transfers	Exchange losses	Hedges of a net investment	Dividends	Closing balance	Fair value
Equity instruments (Net) (1)	67,770	(6,275)	(142)	(2,553)		(575)	(70)	58,155	133,297
Equity instruments (Cost)	82,532	1,723	(195)	(3,308)		(575)	(70)	80,107	
Impairment losses	(14,762)	(7,998)	53	755				(21,952)	
Loans to Group companies and associates	3,988	2,146	(1,664)	(269)	4			4,205	4,281
Other financial assets	21		(1)					20	20
<b>Total non-current investment in Group companies and associates</b>	<b>71,779</b>	<b>(4,129)</b>	<b>(1,807)</b>	<b>(2,822)</b>	<b>4</b>	<b>(575)</b>	<b>(70)</b>	<b>62,380</b>	<b>137,598</b>
Loans to Group companies and associates	3,608	5,774	(3,692)	269	(3)			5,956	5,956
Derivates	2	44	(36)					10	10
Other financial assets	26							26	26
<b>Total current investments in Group companies and associates</b>	<b>3,636</b>	<b>5,818</b>	<b>(3,728)</b>	<b>269</b>	<b>(3)</b>			<b>5,992</b>	<b>5,992</b>

(1) Fair value at December 31, 2013 of Group companies and associates quoted in an active market (Telefónica Brasil, S.A.) was calculated taking the listing of the investments on the last day of the year; the rest of the shareholdings are stated at the value of discounted cash flows based on those entities' business plans.

**2012**

Millions of euros	Opening balance	Additions	Disposals	Transfers	Exchange losses	Dividends	Hedges of a net investment	Closing balance	Fair value
Equity instruments (Net) (1)	77,396	(2,439)	(7,311)	27		(30)	127	67,770	128,574
Equity instruments (Cost)	86,956	2,873	(7,421)	27		(30)	127	82,532	
Impairment losses	(9,560)	(5,312)	110					(14,762)	
Loans to Group companies and associates	1,618	786	(9)	1,593				3,988	4,051
Other financial assets	22	21		(22)				21	21
<b>Total non-current investment in Group companies and associates</b>	<b>79,036</b>	<b>(1,632)</b>	<b>(7,320)</b>	<b>1,598</b>		<b>(30)</b>	<b>127</b>	<b>71,779</b>	<b>132,646</b>
Loans to Group companies and associates	3,390	3,249	(1,479)	(1,620)	68			3,608	3,624
Derivates	57	4	(59)					2	2
Other financial assets	31	10	(37)	22				26	26
<b>Total current investments in Group companies and associates</b>	<b>3,478</b>	<b>3,263</b>	<b>(1,575)</b>	<b>(1,598)</b>	<b>68</b>			<b>3,636</b>	<b>3,652</b>

- (1) Fair value at December 31, 2012 of Group companies and associates quoted in an active market (Telefónica Brasil, S.A. and Telefónica Czech Republic, a.s.) was calculated taking the listing of the investments on the last day of the year; the rest of the shareholdings are stated at the value of discounted cash flows based on those entities' business plans.

**Table of Contents**

2013 Financial Statements

The most significant transactions occurred in 2013 and 2012 as well as their accounting impacts are described below:

**2013**

On April 29, 2013, Telefónica, S.A. signed an agreement with Corporación Multi Inversiones ( CMI ) to incorporate jointly a Spanish company to manage the Group's investments in Guatemala, El Salvador, Nicaragua and Panama.

The resulting company, Telefónica Centroamérica Inversiones, S.L. ( TCI ) was incorporated through the initial contribution by Telefónica, S.A. of its entire shareholdings in Guatemala and El Salvador, along with 31.85% of its interest in Telefónica Móviles Panamá, S.A. at its net carrying amount equivalent to 633 million euros. The new company was incorporated and the corresponding contributions made on June 7, 2013 (see Note 8.4.).

On August 2, 2013 and having obtained the necessary regulatory authorisations, TCI's capital was increased in 500 million US dollars (equivalent to 377 million euros on the payment date), subscribed in full by TLK Investments, C.V. (a company part of the CMI group), thereby completing the operation. Consequently, TLK Investments, C.V. holds a 40% interest in TCI and Telefónica, S.A. the remaining 60%. On the same date, Telefónica, S.A. sold the remainder of its stake in Telefónica Móviles Panamá, S.A. (24.5%) for 83 million euros.

On November 5, 2013, Telefónica announced that it had reached an agreement to sell 65.9% of the capital of Telefónica Czech Republic, a.s. ( Telefónica Czech Republic ) to PPF Group N.V.I. ( PPF ) for, approximately, 306 Czech crowns/share (around 2,467 million euros at the agreement date). This consideration is to be settled in two tranches:

- (i) 2,063 million euros in cash on completion of the sale; and
- (ii) 404 million euros in cash as a deferred payment over four years.

Subsequent to the transaction, Telefónica will hold a stake of 4.9% in Telefónica Czech Republic. This transaction is described in Note 20 c.

At the date of the agreement, Telefónica, S.A. measured its stake in Telefónica Czech Republic at its total market value, recognising a provision for its investment portfolio of 643 million euros under the *Impairment losses and gains (losses) on disposal of financial instruments* heading of the income statement.

The agreed price for the stake being sold, updated at year end exchange rates, has been reclassified to the *Non-current assets held for sale* (see Note 20 c.) until the pertinent authorisations were received from the regulators (which had not been received at reporting date, see Note 22). The market value of the 4.9% stake that it is retained totaling 178 million euros has been reclassified to the *Equity instruments* heading under non-current financial assets (see Note 9.3). The aforementioned reclassifications are presented under *Transfers* in the table of movements for 2013.

On September 24, 2013, Telefónica and the other shareholders of the Italian company Telco, S.p.A. (which holds a 22.4% stake with voting rights of Telecom Italia, S.p.A.) reached an agreement whereby Telefónica, S.A. subscribed

and paid out a share capital increase in Telco, S.p.A., through a cash contribution of 324 million euros, in exchange for shares with voting rights in Telco, S.p.A.. As a result of this capital increase, the interest held by Telefónica in the voting share capital of Telco, S.p.A. remains unchanged (i.e. 46.18 %, as Telefónica currently holds), although its interest in the total share capital of Telco, S.p.A. is increased to 66% (See Note 20.c.). This amount is recognised as Additions of equity instruments in the accompanying table of movements.

## 2012

In April, 2012, Telefónica Móviles Colombia, S.A. (a company fully owned by the Telefónica Group), the Colombian government (hereinafter the Government ) and Colombia Telecomunicaciones, S.A. ESP (a company 52% owned by Telefónica Group and 48% by the Government) reached a final agreement to restructure their wireline and wireless businesses in Colombia. The agreement led to the merger between Colombia Telecomunicaciones, S.A. ESP and Telefónica Móviles Colombia, S.A., resulting in Telefónica holding 70% of the share capital of the resulting company and the Government the remaining 30%, based on the valuations of the companies used to determine said shareholdings. Telefónica, S.A. held a direct shareholding of 49.42% in Telefónica Móviles Colombia, S.A., holding 18.51% of the merged company after the merger. This transaction did not alter the cost of the investment held by the Company.

Telefónica started to reorganize its business in Latin America during 2012. As part of this process, on October 10, 2012 and November 7, 2012 two new companies, Telefónica América, S.A. and Telefónica Latinoamérica Holding, S.L., were incorporated, both of which are jointly controlled by Telefónica, S.A. and Telefónica Internacional, S.A.U. On December 13, 2012, Telefónica Latinoamérica Holding, S.L. performed two consecutive capital increases. In the first, Telefónica, S.A. contributed its

Telefónica, S.A. 20

**Table of Contents**

2013 Financial Statements

shareholding in Latin American Cellular Holdings, B.V. at its carrying amount of 1,749 million euros. In the second, Telefónica Internacional, S.A.U. contributed 100 million euros in cash. Telefónica, S.A. held 94.59% in this company subsequent to the capital increase. This shareholding contribution is not shown in the table of movements attached. In addition, on December 18, 2012, Telefónica, S.A. sold its non-controlling interest in Telefónica de Perú, S.A.A. to Telefónica Latinoamérica Holding, S.L. for 4 million euros. The share transfer was performed at the price quoted on the Peruvian stock market of 2.3 PEN per share, and gave rise to gains of 1 million euros, recognized under the income statement caption "Gains (losses) on disposal and other gains and losses". This transaction is recognized under "Others" in the "Disposals of investments" table in section b) of this Note.

Telefónica has also commenced the reorganization of its subsidiaries in Chile. During the first quarter of 2012, Inversiones Telefónica Móviles Holding, Ltd. distributed a dividend in kind comprising the shareholding in Inversiones Telefónica Fija, S.A. at its net carrying amount totaling 67 million euros. This contribution is reflected as an addition in the table of movements for 2012. Meanwhile, on November 19, 2012, Telefónica Chile Holdings, B.V. was incorporated with share capital of 1 euro. On December 10, 2012, it increased its share capital, which was subscribed by the Company in exchange for the Company's shareholding in Inversiones Telefónica Fija, S.A. Finally, on December 24, 2012, Telefónica Chile Holdings, B.V. increased its share capital, subscribed in full by Telefónica, S.A. for 405 million euros, paid in cash. This capital increase involving a shareholding contribution is not shown in the table of movements attached, whereas that involving the cash payment is shown under "Additions".

**Other movements**

Movement in "Transfers" in both 2013 and 2012 mainly includes the reclassification between long-term and current loans in accordance with the loan maturity schedule.

The column headed "Dividends" sets out the amounts of dividends paid out by Group companies and associates in respect of earnings generated prior to the effective date of the corresponding shareholding. Dividends comprise those distributed by Telefónica Czech Republic, a.s. totalling 101 million euros in 2013 (30 million euros in 2012), O2 Europe Ltd. totalling 286 million euros (no dividend distribution in 2012) and Panamá Cellular Holdings, B.V. totalling 186 million euros.

In 2013 and 2012, Telefónica, S.A. bought and sold the following shareholdings:

**a) Acquisitions of investments and capital increases (Additions):****Millions of euros**

<b>Companies</b>	<b>2013</b>	<b>2012</b>
Telfin Ireland, Ltd.		1,081
Telfisa Global, B.V.	7	703
Telefónica Chile Holdings, B.V.		405
Telco, S.p.A.	324	277



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Telefónica Móviles México, S.A. de C.V.	1,170	97
Telefónica de Costa Rica, S.A.	38	74
Other companies	184	236
<b>Total</b>	<b>1,723</b>	<b>2,873</b>

Telefónica, S.A. 21

**Table of Contents**

2013 Financial Statements

**2013**

On February 11, June 19 and August 29, 2013, Telefónica Móviles México, S.A. de C.V. increased its share capital by 2,173 million Mexican pesos (127 million euros), 2,435 million Mexican pesos (143 million euros) and 3,000 million Mexican pesos (170 million euros), which was fully subscribed by Telefónica, S.A.

On April 19, 2013, Telefónica, S.A. authorised the capitalisation of part of the loans it had extended to its subsidiary Telefónica Móviles México, S.A. de C.V. amounting to 11,697 million Mexican pesos (730 million euros).

The agreement reached to increase the stake in Telco, S.p.A. is described in this Note.

**2012**

On September 11 and 13, 2012, the Company completed two capital increases in Telfin Ireland, Ltd. totalling 1,005 million euros. In September 2012, the share capital of Telfisa Global, B.V. was increased by 703 million euros.

On November 22, 2012, Telfin Ireland, Ltd increased its capital again by 76 million euros, subscribed by the Company. The object of this transaction was funding the financing need of the European affiliates.

The amount for Telefónica Chile Holdings, B.V. relates to the capital increase carried out on December 24, 2012 subscribed in full by Telefónica, S.A. as explained in the previous chapter.

On May 31, 2012 the Board of Directors of Telefónica, S.A. ratified the refinancing proposal that Telco, S.p.A. had submitted for approval by its partners. This refinancing involved increasing share capital by 277 million euros and subscribing a bond of 208 million euros, as well as renewing the existing bond of 600 million euros (see Note 8.5).

In April 2012, Telefónica, S.A. subscribed various share capital increases in Telefónica Móviles México, S.A. de C.V. totalling 1,668 million Mexican pesos (97 million euros) in order to provide the subsidiary with the funds needed to fulfill payment obligation and requirements.

**b) Disposals of investments and capital decreases:****Millions of euros**

<b>Companies</b>	<b>2013</b>	<b>2012</b>
<b>Subsidiaries:</b>		
Telefónica O2 Europe, Ltd.		5,729
Telefónica de España, S.A.U.		731
Inversiones Telefónica Móviles Holding, S.A. (Chile)		652
Telefónica Czech Republic, a.s.		114

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Telefónica Móviles Puerto Rico, Inc.		110
Telefónica Móviles Panamá, S.A.	130	
Other companies	65	85
<b>Total Subsidiaries:</b>	<b>195</b>	<b>7,421</b>

Telefónica, S.A. 22

---

**Table of Contents**

2013 Financial Statements

**2013**

The disposal of Telefónica Móviles Panamá, S.A. forms part of the partial sale described at the start of this Note.

**2012**

On December 5, Telefónica O2 Europe, Ltd resolved to pay back contributions totaling 5,729 million to its parent. This consideration was collected in December 2012.

On March 27, 2012, it was resolved at the Ordinary General Shareholders Meeting of Telefónica de España, S.A.U. to distribute dividends of 221 million euros and repay contributions of 731 million euros. The dividends are recognized as revenues in the income statement (see Note 19.1.) and the repayment of contributions is recognized under Disposals in the accompanying table of movements. These considerations were collected in 2012.

On November 12, 2012, it was resolved at the Extraordinary Shareholders Meeting of Inversiones Telefónica Móviles Holding, S.A. to reduce share capital by repaying contributions totaling 652 million euros. This consideration was collected in December 2012.

On May 25, 2012, it was resolved at the Ordinary General Shareholders Meeting of Telefónica Czech Republic, a.s. to reduce share capital by 4,187 million Czech crowns. Once the transaction had been approved by the state authorities, it was recognized by Telefónica, S.A. in November 2012, having an impact of 114 million euros, which was repaid by the subsidiary in December 2012.

On July 18, 2012, the State Department of Puerto Rico ratified the winding up of Telefónica Móviles Puerto Rico, Inc. The investment amounted to 110 million euros and was provisioned for in full at the time of its liquidation; therefore this event has not had an impact in the income statement.

**8.2. Assessment of impairment of investments in group companies, joint ventures and associates**

At each year end, the Company re-estimates the future cash flows derived from its investments in Group companies and associates. The estimate is made based on the discounted cash flows to be received from each subsidiary in its functional currency, net of the liabilities associated with each investment (mainly net borrowings and provisions) and translated to euros at the official closing rate of each currency at December 31, 2013.

As a result of these estimations and the effect of the net investment hedge in 2013, an impairment provision of 7,998 million euros was recognized (5,312 million euros in 2012). This amount derives mainly from the following companies:

(a) write down recognized for Telefónica Europe, plc. (2,423 million euros in 2013 and 3,682 million euros in 2012), less 70 million euros for the effect of the net investment hedge (82 million euros in 2012).

(b) write down of 2,948 million euros for Telefónica Brasil, S.A. (69 million euros in 2012) and 915 million euros for Sao Paulo Telecomunicações, S.A. (34 million euros in 2012).

(c) write down of 359 million euros for Telco, S.p.A. (1,305 million euros in 2012), the owner of a stake in Telecom Italia. After the adjustment registered, the investment in Telecom Italia, S.p.A. through Telco, S.p.A. is valued at 1 euro per share (1.2 euros per share at December 31, 2012).

(d) write down recognised by Telefónica Czech Republic of 643 million euros explained at the beginning of this Note.

(e) write down of 211 million euros for Telefónica México, S.A. de C.V. (32 million euros in 2012).

The write down of Telefónica Europe, plc. is mainly due to the net impact of the fluctuation in the pound sterling exchange rate (decrease of 2.15%), the impact of the 1,309 million-euro dividend distribution in 2013 and, as a minor effect, the changes in the present value of the expected turnover of the subsidiary. The estimate of Gross Domestic Product (GDP) growth in United Kingdom, prepared by International Monetary Fund and analysts, has been downgraded by 0.3% since the one elaborated 18 months ago. This change in expectations, as well as the higher competitive pressure, has been reflected in the decrease of Operating Income before Depreciation and Amortization (OIBDA) used to calculate future cash flows. The decrease in average OIBDA margin used in 2013 compared to 2012 has been 4.4. p.p.

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**Table of Contents**

2013 Financial Statements

The write down of the stake in Telefónica Brasil, S.A. and Sao Paulo Telecomunicações, S.A. results from the fluctuation in the Brazilian real exchange rate (decrease of 16.5%), changes in the present value of the expected turnover of the subsidiary, and the 655 million-euro dividend distribution, including dividends received from Sao Paulo Telecomunicações. The effect of the changes in the macroeconomic scenario has been significantly important in Brazil. The estimate of GDP growth in the country, prepared by International Monetary Fund and analysts, has been downgraded by half since the one elaborated 18 months ago (estimate of 5.7% at the end of 2013 since 11.3% in June 2012). This change in expectations has been reflected in the decrease of Operating Income before Depreciation and Amortization (OIBDA) used to calculate future cash flows. The decrease in average OIBDA margin used in 2013 compared to 2012 has been 2.75 p.p.

**8.3. The detail of subsidiaries and associates is shown in Appendix I.****8.4. Transactions protected for tax purposes**

Transactions carried out in 2013 that qualify for special tax treatment, as defined in Articles 83 or 94, as applicable, of Chapter VIII of Title VII of Legislative Royal Decree 4/2004 of March 5 approving the Revised Spanish Corporate Income Tax Law, are detailed in the following paragraphs. Transactions qualify for special tax treatment carried out in prior years are disclosed in the financial statements for those years.

On May 23, 2013, Telefónica, S.A. performed a share with the Dutch company Guatemala Cellular Holdings, B.V., involving contributing to the latter its 99.99% shareholding in the Guatemalan company TCG Holdings, S.A. This transaction is treated as a share exchange for tax purposes pursuant to Art. 83.3 of Legislative Royal Decree 4/2004 of March 5.

The carrying amount of the shares delivered was 237 million euros, the same as the value recognized for the shares received by way of payment.

On June 7, 2013, Telefónica, S.A. incorporated Telefónica Centroamérica Inversiones, S. L, through a non-monetary contribution of the following shareholdings: a) 99.99% of Telefónica El Salvador Holding, Sociedad Anónima de Capital Variable from El Salvador, whose carrying amount recognized in the financial statements was 161 million euros; b) 92.83% of Guatemala Cellular Holdings, B.V. from Holland, whose carrying amount totaled 302 million euros, and; c) 31.85% of the Panamanian company Telefónica Móviles Panamá, S.A., the carrying amount of which was 170 million euros. The carrying amount of the shares received by way of payment was 633 million euros.

This transaction is treated for tax purposes as a contribution in kind as per Art. 94 of Legislative Royal Decree 4/2004 of March 5.

These transactions form part of the restructuring of the Telefónica Group in Central America, whose purpose is, inter alia, to streamline and reorganize the investment in this region by centralizing assets in a holding company which unlocks synergies, makes better use of investments, etc. in partnership with a third party, CMI.

On July 26, 2013, exercising the powers conferred on them by shareholders in the Extraordinary Meeting, the representatives of the sole stakeholder of Telefónica de España, S.A.U., Telefónica Soluciones Sectoriales, S.A.U. and

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Telefónica Cable, S.A.U., resolved to approve the takeover of Telefónica Soluciones Sectoriales, S.A.U. and Telefónica Cable, S.A.U. by Telefónica de España, S.A.U., and the subsequent winding-up of Telefónica Soluciones Sectoriales, S.A.U. and Telefónica Cable, S.A.U., and transfer en bloc of their assets and liabilities to Telefónica de España, S.A.U., which will also acquire all their rights and obligations by universal succession.

The takeover merger deed was filed in the Madrid Companies Register on October 2, 2013, with economic effect on January 1, 2013. All the disclosures specified in article 93 of the revised Spanish Income Tax Law are included in the notes to the financial statements of Telefónica de España, S.A.U., as the absorbing company.

Telefónica, S.A. 24

**Table of Contents**

2013 Financial Statements

8.5. The breakdown and maturity of loans to Group companies and associates in 2013 and 2012 are follows:

**2013**

Millions of euros

Company	2014	2015	2016	2017	2018	2019 and Final balance, subsequent current and years non-current	
Telefónica Móviles España, S.A.U.	130		638		400		1,168
Telefónica Móviles México, S.A. de C.V.	171	648					819
Telefónica de Contenidos, S.A.U.		419					419
Telefónica de España, S.A.U.	200			165			365
Telefónica Global Technology, S.A.U.	1	1	68			139	209
Telco, S.p.A.	33	1,225					1,258
Telefónica Emisiones, S.A.U.	223	122					345
Compañía de Inversiones y Teleservicios, S.A.U.	449						449
Telefónica Internacional, S.A.U.	4,530						4,530
Other companies	219	31	219			130	599
<b>Total</b>	<b>5,956</b>	<b>2,446</b>	<b>925</b>	<b>165</b>	<b>400</b>	<b>269</b>	<b>10,161</b>

**2012**

Millions of euros

Company	2013	2014	2015	2016	2017	2018 and Final balance, subsequent current and years non-current	
Telefónica Móviles España, S.A.U.	971						971
Telefónica Móviles México, S.A. de C.V.	82	1,367					1,449
Telefónica de Contenidos, S.A.U.	72	1,142	79				1,293
Telefónica de España, S.A.U.	384						384
Telefónica Global Technology, S.A.U.	5	5	1	14	14	139	178
Telco, S.p.A.	19	808					827
Telefónica Emisiones, S.A.U.	268	197	56				521
Telefónica Europe, B.V.	84					18	102
Telefónica Internacional, S.A.U.	1,588						1,588
Otras	135	39	46	6	6	51	283



<b>Total</b>	<b>3,608</b>	<b>3,558</b>	<b>182</b>	<b>20</b>	<b>20</b>	<b>208</b>	<b>7,596</b>
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Telefónica, S.A. 25

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**Table of Contents**

2013 Financial Statements

The main loans granted to Group and associated companies are described below:

The financing extended to Telefónica Móviles España, S.A.U. in 2013 consists of two loans for 638 million euros and 400 million euros, with maturity date in 2016 and 2018, respectively, and formalised in 2013 to enable this company to meet its payment obligations. These credits have 4 million euros of accrued interest receivable.

The financing awarded to this subsidiary in 2012 comprised three loans of 81 million euros, 95 million euros and 462 million euros formalised in 2012, whose purpose was to provide the subsidiary with the funds required to pay for the spectrum capacity acquired. These loans matured in 2013 and were cancelled; recognised as disposals in the table of movements for 2013.

Moreover, 126 million euros of taxes are receivable from this subsidiary for its tax expense declared in the consolidated tax return (333 million euros in 2012).

At December 31, 2013, the debt with Telefónica Móviles México, S.A. de C.V. amounts to 11,696.57 million Mexican pesos, equivalent to 648 million euros (23,393 million Mexican pesos, equivalent to 1,367 million euros in 2012). This consideration is recognised as non-current pursuant to the expected collection date at the reporting date. In 2013, half the nominal debt outstanding at the 2012 year end was capitalised, totaling 730 million euros and this movement has been recognised under Disposals in the table of movements for 2013. This transaction is described in section a) of this Note.

At December 31, 2013, accrued interest receivable totals 171 million euros (82 million euros in 2012), which forms part of the current balance receivable.

At December 31, 2013, the debt with Telefónica de Contenidos, S.A.U. is broken down as follows:

- a) A 340 million-euro participating loan awarded in 2013 and maturity date in February 2015, all of which has been drawn down. This loan replaces a previous participating loan of 1,142 million euros which has been settled in 2013. Interest on this loan is calculated according to the performance of Telefónica de Contenidos, S.A.U. At December 31, 2013, no accrued interest is receivable (70 million euros in 2012), which forms part of the current balance receivable.
- b) A 79 million-euro participating loan extended in 2005 and maturing in 2015; and

- c) There are no tax receivables from this subsidiary, in connection with the consolidated tax group in 2013 (this balance was 2 million euros in 2012).

The 2013 balance for Telefónica de España, S.A.U. consists of a 165 million euros line of credit granted to the subsidiary in 2013. There is also a balance of 200 million euros comprising tax receivables from the subsidiary for its tax expense declared in the consolidated tax return (384 million euros in 2012).

At December 31, 2013, the debt with Telefónica Global Technology, S.A.U. ( TGT ) comprises the following:

- a) A credit facility signed on January 19, 2010 for 19 million euros with an outstanding balance at December 31, 2013 of 5 million euros (10 million euros in 2012).
- b) A number of long-term financing agreements under participating loans which bear interest based on the business performance of the company, with an outstanding balance at December 31, 2013 of 207 million euros (168 million euros in 2012). This amount includes a contract amounting to 53 million euros signed in 2013, 40 million euros of which had been drawn down at the 2013 year end.

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**Table of Contents**

2013 Financial Statements

On April 24, 2013, Telco, S.p.A.'s Board of Directors approved the issue of bonds totalling 1,750 million euros and maturing on February 28, 2015. Telefónica, S.A. and the other stakeholders resolved to subscribe their respective allocations on a pro-rata basis, with Telefónica, S.A.'s contribution amounting to 808 million euros. This new issue enabled Telco, S.p.A. to cancel the bonds issued on May 28, 2012 for the same amount, without Telefónica, S.A. and the other stakeholders having to make any cash outlays.

Pursuant to the agreement reached by Telefónica and the other stakeholders of Telco, S.p.A., on September 24, 2013, Telefónica, S.A. acquired 23.8% of the non-convertible bonds described above from the remaining stakeholders in exchange for 39,021,411 treasury shares, representing 0.9% of its share capital. (see Note 11.1.a.). This amount of 417 million euros is recognised as Additions of loans to Group companies and associates in the accompanying table of movements.

Accrued interest receivable at December 31, 2013 amounted to 33 million euros, which forms part of current receivables (19 million euros in 2012).

The buying back policy of Telefónica Emisiones S.A.U. bonds continued during 2013, reaching a total of 333 million euros (508 million euros at the 2012 year end). Accrued interest receivable amounts to 12 million euros at the 2013 year end (13 million euros at the 2012 year end).

In 2013, the shareholders of Compañía de Inversiones y Teleservicios, S.A.U. agreed in a general meeting to distribute a dividend of 440 million euros against unrestricted reserves. This consideration is recognised as a current receivable at year end, and falls due in the near term.

In 2013, the shareholders of Telefónica Internacional, S.A.U. agreed in a general meeting to distribute a dividend of 4,500 million euros against unrestricted reserves, which had yet to be collected at the end of the reporting period and matures in the near term.

In December 2012, the shareholders of Telefónica Internacional, S.A.U. agreed in a general meeting to distribute a dividend of 1,500 million euros, collected in 2013, against unrestricted reserves. This amount is recognized under current receivables in the table of movements for 2012.

The Company has also extended 355 million euros (814 million euros in 2012) of loans in connection with the taxation of Telefónica, S.A. as the head of the tax group pursuant to the consolidated tax regime applicable to corporate groups (see Note 17). The most significant amounts have already been disclosed through this Note. All these amounts fall due in the short term.

Disposals of current loans to group companies and associates includes the cancellation of balances receivable from subsidiaries on account of their membership of Telefónica, S.A.'s tax group against debts held by these same subsidiaries totaling 827 million euros (665 million euros in 2012).

Total accrued interest receivable at December 31, 2013 included under Current loans to group companies and associates amounted to 222 million euros (191 million euros in 2012).

**8.6. Other financial assets with Group companies and associates**

This includes rights to collect amounts from other Group companies related to share-based payment plans involving Telefónica, S.A. shares offered by subsidiaries to their employees maturing in 2014, 2015 and 2016 (see Note 19.3).

Telefónica, S.A. 27

**Table of Contents**

2013 Financial Statements

**Note 9. Financial investments**

9.1. The breakdown of Financial investments at December 31, 2013 and 2012 is as follows:

**2013**

Millions of euros	Assets at fair value					Assets at amortized cost					Total fair value		
	Available-for-sale financial assets	Financial assets held for trading	Derivatives	Subtotal assets at fair value	Level 1 quoted prices	Level 2: other direct inputs	Level 3: observable market data	Loans	Other financial assets	Subtotal amortized cost		Subtotal liabilities at fair value	Total carrying amount
<b>Non-current financial investments</b>	<b>591</b>	<b>1,699</b>	<b>778</b>	<b>3,068</b>	<b>699</b>	<b>2,369</b>		<b>13</b>	<b>1</b>	<b>14</b>	<b>14</b>	<b>3,082</b>	<b>3,082</b>
Equity instruments	591			591	591							591	591
Derivatives (Note 16)		1,591	778	2,369		2,369						2,369	2,369
Loans to third parties and other financial assets		108		108	108			13	1	14	14	122	122
<b>Current financial investments</b>		<b>323</b>	<b>14</b>	<b>337</b>		<b>337</b>		<b>45</b>	<b>63</b>	<b>108</b>	<b>108</b>	<b>445</b>	<b>445</b>
Loans to third parties								45	63	108	108	108	108
Derivatives (Note 16)		323	14	337		337						337	337
<b>Total financial investments</b>	<b>591</b>	<b>2,022</b>	<b>792</b>	<b>3,405</b>	<b>699</b>	<b>2,706</b>		<b>58</b>	<b>64</b>	<b>122</b>	<b>122</b>	<b>3,527</b>	<b>3,527</b>

Telefónica, S.A. 28

**Table of Contents**

2013 Financial Statements

2012

	Assets at fair value				Assets at amortized cost				Subtotal assets at amortized cost	Subtotal liabilities at fair value	Total carrying amount	Total fair value
	Available-for-sale financial assets	Financial assets held for trading	Hedges	Subtotal assets at fair value	Other financial assets	Loans and receivables	Intangible assets	Other				
Millions of euros	433	2,093	1,952	4,478	433	4,045	39	14	53	53	4,531	4,531
<b>Non-current financial investments</b>	<b>433</b>	<b>2,093</b>	<b>1,952</b>	<b>4,478</b>	<b>433</b>	<b>4,045</b>	<b>39</b>	<b>14</b>	<b>53</b>	<b>53</b>	<b>4,531</b>	<b>4,531</b>
Equity instruments	433			433	433						433	433
Derivatives (Note 16)		2,093	1,952	4,045		4,045					4,045	4,045
Loans to third parties and other financial assets							39	14	53	53	53	53
<b>Current financial investments</b>		<b>222</b>	<b>60</b>	<b>282</b>		<b>282</b>	<b>9</b>	<b>99</b>	<b>108</b>	<b>108</b>	<b>390</b>	<b>390</b>
Loans to third parties							9	99	108	108	108	108
Derivatives (Note 16)		222	60	282		282					282	282
<b>Total financial investments</b>	<b>433</b>	<b>2,315</b>	<b>2,012</b>	<b>4,760</b>	<b>433</b>	<b>4,327</b>	<b>48</b>	<b>113</b>	<b>161</b>	<b>161</b>	<b>4,921</b>	<b>4,921</b>

Derivatives are measured using the valuation techniques and models normally used in the market, based on money-market curves and volatility prices available in the market.

The calculation of the fair values of the Company's financial debt instruments required an estimate for each currency of a credit spread curve using the prices of the Company's bonds and credit derivatives.





**Table of Contents**

2013 Financial Statements

**9.2 Held-for-trading financial assets and hedges**

These two categories include the fair value of outstanding derivative financial instruments at December 31, 2013 and 2012 (see Note 16).

**9.3 Available-for-sale financial assets.**

This category mainly includes the fair value of investments in listed companies (equity instruments) over which the Company does not have significant control or influence. The movement of items composing this category at December 31, 2013 and 2012 are as follows:

**December 31, 2013**

Millions of euros	Opening balance	Additions	Disposals	Other movements	Fair value adjustments	Closing balance
Banco Bilbao Vizcaya Argentaria, S.A.	316			(10)	76	382
Telefónica Czech Republic, a.s.				178	(12)	166
Portugal Telecom, SGPS, S.A.	84		(84)			
Other companies	33				10	43
<b>Total</b>	<b>433</b>		<b>(84)</b>	<b>168</b>	<b>74</b>	<b>591</b>

**December 31, 2012**

Millions of euros	Opening balance	Additions	Disposals	Other movements	Fair value adjustments	Closing balance
Banco Bilbao Vizcaya Argentaria, S.A.	327			(11)		316
Portugal Telecom, SGPS, S.A.	193		(76)		(33)	84
Other companies	36	47	(35)		(15)	33
<b>Total</b>	<b>556</b>	<b>47</b>	<b>(111)</b>	<b>(11)</b>	<b>(48)</b>	<b>433</b>

As a consequence of the transaction described in Note 8.1, the Company reclassified to this caption the remaining 4.9% investment in Telefónica Czech Republic, a.s. for an amount of 178 million euros. The change in value due to exchange-rate fluctuations and market share prices has been recognised with a counterpart in equity, net of its tax effect.

In 2010, Telefónica entered into three equity swap contracts for Portugal Telecom, SGPS, S.A. shares with a number of financial institutions. In 2013 and 2012, 23 million shares and 21 million shares were sold, respectively, fully canceling all the three contracts. These transactions are shown under Disposals in the tables above while the impact on the income statement amounts to 33 million euros (34 million euros in 2012), recognized under Gain (loss) on available-for-sale financial assets recognized in the period .

At 2013 year end, the Company has analysed the fair value of its investment in Banco Bilbao Vizcaya Argentaria, S.A. As a result of this review, the participation has been revalued in 76 million euros. This impact, net of tax effect, is registered in the Equity of the Company (Note 11.2.). The effect, recorded both in 2013 and 2012 under other movements , relates to the sale of rights to scrip dividends that the bank distributed in both years.

At December 31, 2013 Telefónica, S.A. s investment in Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) represents 0.76% of that company s share capital.

Amper, S.A. and Zon Multimedia Serviços de Telecomunicações e Multimedia, SGPS, S.A. were sold off in 2012. The 21 million euro loss on these transactions was recognized under Gain (loss) on available-for-sale financial assets recognized in the period .

**Table of Contents**

2013 Financial Statements

**9.4 Other financial assets and loans to third parties**

The breakdown of investments included in this category at December 31, 2013 and 2012 is as follows:

Millions of euros	2013	2012
<b>Other non-current financial assets</b>		
Loans to third parties		39
Guarantees given	13	13
Other non-current financial assets	109	1
<b>Other current financial assets:</b>		
Loans to third parties	45	9
Other financial investments	63	99
<b>Total</b>	<b>230</b>	<b>161</b>

**9.4.1 Loans to third parties**

Non-current loans to third parties included in 2012 the cost of the financial instrument arranged to partially cover share-based payment schemes involving Telefónica, S.A. shares (Manager and Senior Executive Options Remuneration Plan Performance & Investment Plan (PIP)) for 37 million euros, which will mature in 2014 (see Note 19.3). In 2013 the concept has been transferred to Current loans to third parties.

**9.4.2. Other non-current financial assets**

In November 2013, Telefónica, S.A. acquired on the market a bond convertible into Telecom Italia, S.p.A. shares, with a nominal value of 103 million euros. At year end, the bond was priced at 105% its nominal value, and the 5 million-euro impact of this difference was recognised in the profit and loss account under Fair value of financial instruments .

Telefónica, S.A. 31

**Table of Contents**

2013 Financial Statements

**Note 10. Trade and other receivables**

The breakdown of Trade and other receivables at December 31, 2013 and 2012 is as follows:

<b>Millions of euros</b>	<b>2013</b>	<b>2012</b>
Trade receivables	20	22
Trade receivables from Group companies and associates	425	413
Other receivables	16	19
Employee benefits payable	1	1
Tax receivables (Note 17)	660	610
<b>Total</b>	<b>1,122</b>	<b>1,065</b>

Trade receivables from Group companies and associates mainly includes amounts receivable from subsidiaries for the impact of the rights to use the Telefónica brand and the monthly office rental fees (see Note 7).

Trade receivables and Trade receivables from Group companies and associates in 2013 and 2012 include balances in foreign currency equivalent to 242 million and 134 million euros, respectively. In December 2013, there were receivables in US dollars equivalent to 218 million euros (105 million euros in 2012) and Czech crowns equivalent to 24 million euros (29 million euros in 2012).

These balances gave rise to exchange losses in the income statement of approximately 11 million euros in 2013 (3 million euros of exchange losses in 2012).

Telefónica, S.A. 32

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**Table of Contents**

2013 Financial Statements

**Note 11. Equity****11.1 Capital and reserves****a) Share capital**

At December 31, 2013, Telefónica, S.A.'s share capital amounted to 4,551,024,586 euros and consisted of 4,551,024,586 fully paid ordinary shares of a single series, per value of 1 euro, all recorded by the book-entry system and traded on the Spanish electronic trading system ( Continuous Market ), where they form part of the Ibex 35 Index, on the four Spanish Stock Exchanges (Madrid, Barcelona, Valencia and Bilbao) and listed on the New York, London, Buenos Aires and Lima Stock Exchanges.

On May 25, 2012, the deed of capital reduction through the cancellation of 84,209,363 treasury shares previously acquired by Telefónica, S.A. was executed. As a result, article 5 of the Corporate Bylaws relating to the amount of share capital was amended accordingly to show 4,479,787,122 euros. At the same time, a reserve was recorded for the cancelled shares described in the section on Retained earnings .

On June 8, 2012, a share capital increase of 71,237,464 euros was involved, during which 71,237,464 ordinary shares with a par value of 1 euro each were issued, with a charge to reserves, as part of the scrip dividend shareholder remuneration deal. Share capital amounts to 4,551,024,586 euros subsequent to this increase.

With respect to authorizations given regarding share capital, on May 18, 2011, authorization was given at the Annual Shareholders Meeting of Telefónica, S.A. for the Board of Directors, at its discretion and in accordance with the Company's needs, to increase the Company's capital, at one or several times, within a maximum period of five years from that date, up to a maximum increase of 2,281,998,242.50 euros, equivalent to half of Telefónica, S.A.'s share capital at that date, by issuing and placing new shares, of any type permitted by the Law, with a fixed or variable premium, and, in all cases, in exchange for cash, and expressly considering the possibility that the new shares may not be fully subscribed. The Board of Directors was also empowered to exclude, partially or fully, pre-emptive subscription rights under the terms of Section 506 of the Spanish Enterprises Act.

In addition, on June 2, 2010, shareholders voted to authorize the acquisition by the Board of Directors of Telefónica, S.A. treasury shares, up to the limits and pursuant to the terms and conditions established at the Shareholders Meeting, within a maximum period of five years from that date. However, it specified that in no circumstances could the par value of the shares acquired, added to that of the treasury shares already held by Telefónica, S.A. and by any of its controlled subsidiaries, exceed the maximum legal percentage at any time (currently 10% of Telefónica, S.A.'s share capital).

In addition, at the May 31, 2013 Shareholders Meeting, authorization was given for the Board of Directors to issue fixed-income securities and preferred shares at one or several times within a maximum period of five years from that date. These securities may be in the form of debentures, bonds, promissory notes or any other kind of fixed-income security, plain or, in the case of debentures and bonds, convertible into shares of the Company and/or exchangeable for shares of any of the Group companies. They may also be preferred shares. The total maximum amount of the securities issuable agreed under this authorization is 25,000 million euros or the equivalent in another currency. For

promissory notes, the outstanding balance of promissory notes issued under this authorization will be calculated for purposes of the aforementioned limit. As at December 31, 2013, the Board of Directors had not exercised these powers, being approved the programs to issue corporate promissory notes for 2014 in January of this same year.

Telefónica, S.A. 33

**Table of Contents**

2013 Financial Statements

At December 31, 2013 and 2012, Telefónica, S.A. held the following treasury shares:

	Number of shares	Euros per share		Market value (1)	%
		Acquisition price	Trading price		
Treasury shares at 13/12/31	29,411,832	11.69	11.84	348	0.64627%

(1) Millions of euros

	Number of shares	Euros per share		Market value (1)	%
		Acquisition price	Trading price		
Treasury shares at 12/12/31	47,847,809	10.57	10.19	488	1.05136%

(1) Millions of euros

The movement in treasury shares of Telefónica, S.A. in 2013 and 2012 is as follows:

	Number of shares
<b>Treasury shares at 11/12/31</b>	<b>84,209,363</b>
Acquisitions	126,489,372
Delivery GESP share plan	(2,071,606)
Disposals	(76,569,957)
Share redemption	(84,209,363)
<b>Treasury shares at 12/12/31</b>	<b>47,847,809</b>
Acquisitions	113,154,549
Disposals	(131,590,526)
<b>Treasury shares at 13/12/31</b>	<b>29,411,832</b>

Furthermore, at December 31, 2012, one Telefónica, S.A. share was held by Telefónica Móviles Argentina, S.A. This share has been sold during 2013.

**Acquisitions**

The amount paid to acquire treasury shares in 2013 and 2012 was 1,216 million euros and 1,346 million euros, respectively.

**Disposals**

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On May 25, 2012, pursuant to the resolutions adopted in the General Shareholders Meeting of May 14, capital was reduced by redeeming 84,209,363 treasury shares, thereby reducing treasury shares by 1,321 million euros.

Treasury shares sold in 2013 and 2012 amounted to 1,423 million euros and 801 million euros, respectively. The main transactions during 2013 and 2012 were as follows:

On March 26, 2013 Telefónica, S.A. reached an agreement with qualified and professional investors whereby the Company disposed of all the treasury shares it held (90,067,896 shares) at a price of 10.80 euros per share.

On September 24, 2013 Telefónica, S.A. acquired the remaining shareholders of Telco, S.p.A. 23.8% of the non-convertible bonds issued in 2013 by Telco, S.p.A. The payment of this transaction consisted of the transmission of 39,021,411 treasury shares of the Company (Note 8.5.)

In addition to these disposals, on July 27, 2012, 2,071,606 shares were delivered to Group employees when the first phase of the Global Employee Share Plan ( the GESP ) matured.

Telefónica, S.A. 34



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**Table of Contents**

2013 Financial Statements

In November 2012, Telefónica submitted an offer to purchase and cancel the preference shares that it had indirectly issued in 2002 through its subsidiary Telefónica Finance USA, LLC totaling 2,000 million euros. The offer involved acquiring these shares at their par value, subject unconditionally and irrevocably to the simultaneous reinvestment in Telefónica, S.A. shares and the subscription of newly issued plain-vanilla bonds, in the following percentage:

- a) 40% of the amount in treasury shares of Telefónica, S.A.
- b) 60% of the amount shall be used to subscribe a bond issue with a face value of 600 euros, issued at par, the characteristics of which are described in Note 13.

97% of the holders of the preference shares accepted the offer, and therefore 76,365,929 treasury shares with a carrying amount of 815 million euros (exchange value of 776 million euros) were handed over, which are included under Disposals in 2012.

**Other equity instruments**

At December 31, 2013, Telefónica held 134 million call options on treasury shares subject to physical delivery at a fix price (178 million options on treasury shares at December 31, 2012) which are presented as a reduction in equity under the caption treasury share instruments . They are valued at the amount of premium paid, and upon maturity if the call options are exercised the premium is reclassified as treasury shares together with the price paid. If they are not exercised upon maturity their value is recognized directly in reserves.

The Company also has a derivative on Telefónica shares, to be settled by offset, which has increased from 28 million shares in 2012 to 30 million shares in 2013, and is recognized under Derivatives (financial liabilities, current) on the balance sheet. In 2012, the fair value of this derivative was recognized under Derivatives (financial assets, current).

Telefónica, S.A. 35

---

**Table of Contents**

2013 Financial Statements

**b) Legal reserve**

According to the text of the Corporate Enterprises Act, companies must transfer 10% of profit for the year to a legal reserve until this reserve reaches at least 20% of share capital. The legal reserve can be used to increase capital by the amount exceeding 10% of the increased share capital amount. Except for this purpose, until the legal reserve exceeds the limit of 20% of share capital, it can only be used to offset losses, if there are no other reserves available. At December 31, 2013, the Company had duly set aside this reserve.

**c) Other reserves**

Other reserves includes:

The Revaluation reserve which arose as a result of the revaluation made pursuant to Royal Decree-Law 7/1996 dated June 7. The revaluation reserve may be used, free of tax, to offset any losses incurred in the future and to increase capital. From January 1, 2007, it may be allocated to unrestricted reserves, provided that the capital gain has been realized. The capital gain will be deemed to have been realized in respect of the portion on which the depreciation has been recorded for accounting purposes or when the revalued assets have been transferred or derecognized. In this respect, at the end of 2013, an amount of 7 million euros corresponding to revaluations reserves subsequently considered unrestricted has been reclassified to Other reserves (10 million euros in 2012). The balance of this reserve at December 31, 2013 and 2012 was 109 million euros and 116 million euros, respectively.

Reserve for cancelled share capital: In accordance with Section 335.c) of the Corporate Enterprises Act and to render null and void the right of opposition provided for in Section 334 of the same Act, whenever the Company decreases capital it records a reserve for cancelled share capital for an amount equal to the par value of the cancelled shares, which can only be used if the same requirements as those applicable to the reduction of share capital are met. In 2012, a reserve for cancelled share capital amounting to 84 million euros was recorded, the same amount as the capital reduction made in the year. The cumulative amount of the reserve for cancelled share capital at December 31, 2013 and 2012 was 582 million euros.

Pursuant to the provisions of Royal Decree 1514/2007, since 2008, after the distribution of profits for each year, the Company sets aside a non-distributable reserve of 2 million euros for goodwill amortization. The balance of this reserve at December 31, 2013 was 9 million euros. The proposed appropriation of 2013 profit (see Note 3) includes an allocation of 2 million euros to this restricted reserve.

In addition to the restricted reserves explained above, Other reserves includes unrestricted reserves from gains obtained by the Company in prior years.

**d) Dividends**

**Dividends paid in 2013**

Approval was given at the General Shareholders Meeting of May 31, 2013 to pay a gross 0.35 dividend per outstanding share carrying dividend rights, with a charge to unrestricted reserves. The dividend was paid on November 6, 2013 and the total amount paid was 1,588 million euros.

***Dividends paid in 2012***

Approval was given at the General Shareholders Meeting of May 14, 2012 to pay a gross 0.53 euro dividend per share outstanding with a charge to unrestricted reserves. The dividend was paid on May 18, 2012 and the total amount paid was 2,346 million euros.

In addition, approval at the same meeting was given to pay a scrip dividend consisting of the assignment of free allotment rights with an irrevocable purchase obligation on the Company, and a subsequent capital increase by means of the issue of new shares to fulfill said allotments.

At the close of the trading period for these rights, the holders of 37.68% of the Company's shares had accepted the Company's irrevocable commitment to buy. These rights were repurchased and cancelled by the Company for the amount of 490 million euros.

**Table of Contents**

2013 Financial Statements

62.32% of shareholders with allotment rights opted for the right to receive new Telefónica shares. A capital increase was required to fulfill said allotments, by means of the issue of 71,237,464 new shares with a nominal value of one euro each, which were delivered to the shareholders who held the rights thereto.

**11.2 Unrealized gains (losses) reserve**

The movements in the items composing Unrealized gains (losses) reserve in 2013 and 2012 are as follows:

**2013**

Millions of euros	Opening balance	Valuation at market value	Tax effect of additions	Amounts transferred to		Closing balance
				income statement	Tax effect of transfers	
Available-for-sale financial assets (Note 9.3)	(34)	74	(22)	44	(13)	49
Cash flow hedges (Note 16)	(1,371)	588	(177)	114	(34)	(880)
<b>Total</b>	<b>(1,405)</b>	<b>662</b>	<b>(199)</b>	<b>158</b>	<b>(47)</b>	<b>(831)</b>

**2012**

Millions of euros	Opening balance	Valuation at market value	Tax effect of additions	Amounts transferred to		Closing balance
				income statement	Tax effect of transfers	
Available-for-sale financial assets (Note 9.3)	(40)	(46)	14	55	(17)	(34)
Cash flow hedges (Note 16)	(575)	(1,310)	393	173	(52)	(1,371)
<b>Total</b>	<b>(615)</b>	<b>(1,356)</b>	<b>407</b>	<b>228</b>	<b>(69)</b>	<b>(1,405)</b>

Telefónica, S.A. 37

**Table of Contents**

2013 Financial Statements

**Note 12. Financial liabilities**

The breakdown of Financial liabilities at December 31, 2013 and 2012 is as follows:

**2013**

Millions of euros	LIABILITIES AT FAIR VALUE				LIABILITIES AT AMORTIZED COST				
	Financial liabilities held for trading	Hedges	Subtotal financial liabilities at fair value quoted	Level 1 market inputs	Level 2: observable market data	Level 3: estimates not based on other directly observable market data	Subtotal liabilities at fair value	TOTAL CARRYING AMOUNT	TOTAL FAIR VALUE
<b>Non-current financial liabilities</b>	<b>1,223</b>	<b>1,454</b>	<b>2,677</b>	<b>2,677</b>	<b>44,002</b>	<b>48,226</b>	<b>46,679</b>	<b>50,903</b>	
Payable to Group companies and associates					37,583	41,748	37,583	41,748	
Bank borrowings					6,079	6,167	6,079	6,167	
Bonds and other marketable debt securities					177	148	177	148	
Derivatives (Note 16)	1,223	1,454	2,677	2,677			2,677	2,677	
Other financial liabilities					163	163	163	163	
<b>Current financial liabilities</b>	<b>91</b>	<b>4</b>	<b>95</b>	<b>95</b>	<b>14,756</b>	<b>14,724</b>	<b>14,851</b>	<b>14,819</b>	
Payable to Group companies and associates					12,982	13,000	12,982	13,000	
Bank borrowings					831	763	831	763	
Bonds and other marketable debt securities					943	961	943	961	
Derivatives (Note 16)	91	4	95	95			95	95	
Other financial liabilities									
<b>Total financial liabilities</b>	<b>1,314</b>	<b>1,458</b>	<b>2,772</b>	<b>2,772</b>	<b>58,758</b>	<b>62,950</b>	<b>61,530</b>	<b>65,722</b>	



**Table of Contents**

2013 Financial Statements

2012

**LIABILITIES AT FAIR VALUE**  
**MEASUREMENT HIERARCHY AT AMORTIZED COST**

Level 3:

Level 2: Estimates  
Estimates not  
based on  
other

Millions of euros	Financial liabilities held for trading	Hedges	Subtotal financial liabilities fair value	Level 1: market prices	Level 2: directly observable market data	Level 3: Estimates not based on other trade and payables	Subtotal liabilities at fair value	TOTAL CARRYING AMOUNT	TOTAL FAIR VALUE
<b>Non-current financial liabilities</b>	<b>1,638</b>	<b>1,492</b>	<b>3,130</b>	<b>3,130</b>		<b>46,213</b>	<b>49,439</b>	<b>49,343</b>	<b>52,569</b>
Payable to Group companies and associates						36,069	38,511	36,069	38,511
Bank borrowings						9,232	9,676	9,232	9,676
Bonds and other marketable debt securities						828	1,168	828	1,168
Derivatives (Note 16)	1,638	1,492	3,130	3,130				3,130	3,130
Other financial liabilities						84	84	84	84
<b>Current financial liabilities</b>	<b>116</b>	<b>8</b>	<b>124</b>	<b>124</b>		<b>16,154</b>	<b>16,088</b>	<b>16,278</b>	<b>16,212</b>
Payable to Group companies and associates						14,181	14,230	14,181	14,230
Bank borrowings						1,145	1,028	1,145	1,028
Bonds and other marketable debt securities						828	830	828	830
Derivatives (Note 16)	116	8	124	124				124	124
Other financial liabilities									
	<b>1,754</b>	<b>1,500</b>	<b>3,254</b>	<b>3,254</b>		<b>62,367</b>	<b>65,527</b>	<b>65,621</b>	<b>68,781</b>

**Total financial  
liabilities**

Derivatives are measured using the valuation techniques and models normally used in the market, based on money-market curves and volatility prices available in the market.

The calculation of the fair values of the Company's financial debt instruments required an estimate for each currency of a credit spread curve using the prices of the Company's bonds and credit derivatives.

Telefónica, S.A. 39



**Table of Contents**

2013 Financial Statements

**Note 13. Bonds and other marketable debt securities**

**13.1** The balances and movements in issues of debentures, bonds and commercial paper at December 31, 2013 and 2012 are as follows:

**2013**

Millions of euros	Non-convertible debentures and bonds	Other marketable debt securities	Total
<b>Opening balance</b>	<b>1,328</b>	<b>328</b>	<b>1,656</b>
Additions		34	34
Depreciation and amortization	(583)		(583)
Revaluation and other movements	16	(3)	13
<b>Closing balance</b>	<b>761</b>	<b>359</b>	<b>1,120</b>
Details of maturities:			
Non-current	177		177
Current	584	359	943

**2012**

Millions of euros	Non-convertible debentures and bonds	Other marketable debt securities	Total
<b>Opening balance</b>	<b>170</b>	<b>87</b>	<b>257</b>
Additions	1,165	332	1,497
Depreciation and amortization		(87)	(87)
Revaluation and other movements	(7)	(4)	(11)
<b>Closing balance</b>	<b>1,328</b>	<b>328</b>	<b>1,656</b>
Details of maturities:			
Non-current	828		828
Current	500	328	828

Telefónica, S.A. 40

**Table of Contents**

2013 Financial Statements

Maturities of the nominal amounts of debenture and bond issues at December 31, 2013 and 2012 are as follows:

**2013**

Name	Interest rate	% interest rate	Maturity				Subsequent years	TOTAL
			2014 (1)	2015	2016	2017		
<b>DEBENTURES AND BONDS:</b>								
JULY 99	ZERO COUPON (**)	6.39%					73	73
MARCH 00	FLOATING	2.065% (*)		50				50
NOVEMBER 12	FIX	4.18%	582					582
<b>Total issues</b>			<b>582</b>	<b>50</b>			<b>73</b>	<b>705</b>

(\*) The applicable interest rate (floating, set annually) is the sterling 10-year swap rate multiplied by 1.0225.

(\*\*) Issues of zero-coupon debentures and bonds are shown in the table above at amortized cost.

(1) The figures include a maturity of 582 million with an option of with an option of early repayment and no contractual obligation to be repaid.

**2012**

Name	Interest rate	% interest rate	Maturity				Subsequent years	TOTAL
			2013 (1)	2014	2015 (1)	2016		
<b>DEBENTURES AND BONDS:</b>								
JULY 99	ZERO COUPON (**)	6.39%					69	69
MARCH 00	FLOATING	2.411% (*)			50			50
NOVEMBER 12	FIX	4.18%	500		500		164	1,164
<b>Total issues</b>			<b>500</b>		<b>550</b>		<b>233</b>	<b>1,283</b>

(\*) The applicable interest rate (floating, set annually) is the sterling 10-year swap rate multiplied by 1.0225.

(\*\*) Issues of zero-coupon debentures and bonds are shown in the table above at amortized cost.

(1)

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For 2013 and 2015 the figures include a maturity of 500 million in both years, without a contractual obligation for these maturities, based on expectations of improvements in financial market conditions.

**13.2.** The detail of the maturities and redemption values of zero-coupon debentures and bonds at December 31, 2013 and 2012 is as follows:

<b>Issue</b>	<b>Redemption date</b>	<b>Redemption rate</b>	<b>Redemption value</b>
<b>DEBENTURES AND BONDS:</b>			
JULY 99	2029/21/07	637.639%	191
<b>Total</b>			<b>191</b>

The remaining debentures and bonds have been measured at amortized cost at the year end.

Telefónica, S.A. 41

**Table of Contents**

2013 Financial Statements

**13.3** At December 31, 2013, Telefónica, S.A. had a corporate promissory note program registered with the CNMV, with the following features:

<b>Millions of euros</b>	<b>Amount</b>	<b>Placement system</b>	<b>Nominal amount of the Promissory notes</b>	<b>Terms of the Promissory notes</b>	<b>Placement</b>
	500 million; can be increased to 2,000 million	Auctions	100,000 euros	1, 2, 3, 6, 12, 18 and 25 months Between 7 and	Competitive auctions
		Tailored	100,000 euros	750 days	Specific transactions

At December 31, 2013 the outstanding balance on this promissory note program was 361 million euros (332 million euros in 2012).

**13.4** The average interest rate during 2013 on debentures and bonds outstanding during the year was 4.61% (4.56% in 2012) and the average interest rate on corporate promissory notes was 1.38% (2.37% in 2012).

Telefónica, S.A. 42

**Table of Contents**

2013 Financial Statements

**Note 14. Interest-bearing debt and derivatives**

14.1 The balances at December 31, 2013 and 2012 are as follows:

**December 31, 2013****Millions of euros**

Item	Current	Non-current	Total
Loans with financial entities	831	6,079	6,910
Derivative financial liabilities (Note 16)	95	2,677	2,772
<b>Total</b>	<b>926</b>	<b>8,756</b>	<b>9,682</b>

**December 31, 2012****Millions of euros**

Item	Current	Non-current	Total
Loans with financial entities	1,145	9,232	10,377
Derivative financial liabilities (Note 16)	124	3,130	3,254
<b>Total</b>	<b>1,269</b>	<b>12,362</b>	<b>13,631</b>

14.2 The nominal values of the main interest-bearing debts at December 31, 2013 and 2012 are as follows:

Description	Value Date	Maturity Date	Currency	Limit 12/31/13 (millions)	Balance (million of euros)
Syndicated facility *	04/21/06	04/21/17	EUR	700	700
ECA structured facility *	02/12/10	11/30/19	USD	296	215
Syndicated loan Tranche A2 **	07/28/10	07/28/14	EUR	2,000	2,000
Syndicated loan Tranche A3	07/28/10	07/28/16	EUR	2,000	2,000
ECA structured facility *	05/03/11	07/30/21	USD	341	247
Bilateral Loan	02/27/12	02/27/15	EUR	200	200
Syndicated loan Tranche D2	03/02/12	12/14/15	EUR	923	923
Vendor Loan *	02/21/13	02/21/16	EUR	206	206
Vendor Loan*	02/22/13	01/31/23	USD	1,001	336

\* Facilities with amortization schedule.

\*\* 1,400 million euros under Tranche A2 were refinanced with forward start facilities dated 02/22/2013 (available from 07/28/2014).

<b>Description</b>	<b>Value Date</b>	<b>Maturity Date</b>	<b>Currency</b>	<b>Limit 12/31/12 (millions)</b>	<b>Balance (million of euros)</b>
Syndicated loan**	04/21/06	04/21/17	EUR	700	700
ECAS structured facility**	02/12/10	11/30/19	USD	351	266
Syndicated loan Tranche A1	07/28/10	07/28/13	EUR	1,000	1,000
Syndicated loan Tranche A2	07/28/10	07/28/14	EUR	2,000	2,000
Syndicated loan Tranche A3	07/28/10	07/28/16	EUR	2,000	2,000
Syndicated loan Tranche B	07/28/10	07/28/15	EUR	3,000	3,000
ECAS structured facility**	05/03/11	07/30/21	USD	370	135
Bilateral loan	02/27/12	02/27/15	EUR	200	200
Syndicated loan Tranche D2*	12/14/12	12/14/15	EUR	923	923

\* Limit in Pounds sterling converted to euros at 12/14/2012

\*\* These credit facilities have a repayment schedule

**Table of Contents**

2013 Financial Statements

**14.3** Maturities of balances at December 31, 2013 and 2012 are as follows:

**December 31, 2013**

Millions of euros	Maturity					Subsequent years	Closing balance
	2014	2015	2016	2017	2018		
<b>Items</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>years</b>	<b>balance</b>
Loans with financial entities	831	1,228	2,317	1,360	1,064	110	6,910
Derivative financial liabilities (Note 16)	95	215	290	290	562	1,320	2,772
<b>Total</b>	<b>926</b>	<b>1,443</b>	<b>2,607</b>	<b>1,650</b>	<b>1,626</b>	<b>1,430</b>	<b>9,682</b>

**December 31, 2012**

Millions of euros	Maturity					Subsequent years	Closing balance
	2013	2014	2015	2016	2017		
<b>Items</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>years</b>	<b>balance</b>
Loans with financial entities	1,145	2,097	4,518	2,056	408	153	10,377
Derivative financial liabilities (Note 16)	124	171	342	246	371	2,000	3,254
<b>Total</b>	<b>1,269</b>	<b>2,268</b>	<b>4,860</b>	<b>2,302</b>	<b>779</b>	<b>2,153</b>	<b>13,631</b>

**14.4** On February 21, 2013, Telefónica, S.A. entered into a financing agreement for the purchase of goods and services to providers in an aggregate principal amount of 206 million euros maturing in 2016. At December 31, 2013, this facility has been drawn in full.

On February 22, 2013, Telefónica, S.A. refinanced 1,400 million euros of tranche A2 (originally amounting to 2,000 million euros and scheduled to mature on July 28, 2014) of the 8,000 million euros syndicated loan, originally dated on July 28, 2010. This refinancing was divided in two tranches: a syndicated credit facility amounting to 700 million euros maturing in 2017 (tranche A2A) and another syndicated credit facility amounting to 700 million euros maturing in 2018 (tranche A2B).

On February 22, 2013, Telefónica, S.A. signed a financing agreement for the purchase of goods and services to providers for 1,001 million US dollars (approximately 726 million euros) with an outstanding balance at December 31, 2013 amounting to 463 million US dollars (equivalent to 336 million euros) which matures on 2023.

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On July 28, 2013 tranche A1 of Telefónica, S.A. syndicated loan agreement arranged on July 28, 2010 fell due. At December 31, 2012 the outstanding balance was 1,000 million euros and was repaid during 2013.

On August 1, 2013, Telefónica, S.A. entered into a long-term credit facility for an aggregate amount of 734 million US dollars (equivalent to 532 million euros) at a fixed rate with the guarantee of the Finnish Export Credits Guarantee Board (Finnvera) which matures in 2023. No amounts had been drawn down on this credit facility at December 31, 2013.

During 2013, Telefónica, S.A. has reduced the principal amount outstanding under tranche B of its 8,000 million euros syndicated credit facility dated July 28, 2010 by 3,000 million euros. At December 31, 2013, this tranche B was fully available.

During 2013, Telefónica, S.A. drew down an aggregate principal amount of 192 million US dollars (approximately 139 million euros) of the financing agreement signed on May 3, 2011 with the guarantee of Finnish export agency (Finnvera). At December 31, 2013, the outstanding nominal principal on this financing agreement was 341 million US dollars (approximately 247 million euros).

Telefónica, S.A. 44



**Table of Contents**

2013 Financial Statements

**14.5 Average interest on loans and borrowings**

The average interest rate in 2013 on loans and borrowings denominated in euros was 1.323% and 2.51% for foreign-currency loans and receivables.

The average interest rate in 2012 on loans and borrowings denominated in euros was 2.918% and 2.341% for foreign-currency loans and receivables.

**14.6 Unused credit facilities**

The balances of loans and borrowings relate only to amounts drawn down.

At December 31, 2013 and 2012, Telefónica had undrawn credit facilities amounting to 8,873 million euros and 5,255 million euros, respectively.

Financing arranged by Telefónica, S.A. at December 31, 2013 and 2012 is not subject to compliance with any financial covenants.

Telefónica, S.A. 45

**Table of Contents**

2013 Financial Statements

**Note 15. Payable to group companies and associates****15.1 The breakdown at December 31, 2013 and 2012 is as follows:****December 31, 2013**

<b>Millions of euros</b>	<b>Non-current</b>	<b>Current</b>	<b>Total</b>
Loans	37,273	12,622	49,895
Trade payables to Group companies and associates	53	164	217
Derivatives (Note 16)		16	16
Payable to subsidiaries due to taxation on a consolidated basis	257	180	437
<b>Total</b>	<b>37,583</b>	<b>12,982</b>	<b>50,565</b>

**December 31, 2012**

<b>Millions of euros</b>	<b>Non-current</b>	<b>Current</b>	<b>Total</b>
Loans	35,757	13,779	49,536
Trade payables to Group companies and associates	56	132	188
Derivatives (Note 16)		20	20
Payable to subsidiaries due to taxation on a consolidated basis	256	250	506
<b>Total</b>	<b>36,069</b>	<b>14,181</b>	<b>50,250</b>

Telefónica, S.A. 46

**Table of Contents**

2013 Financial Statements

The maturity of these loans at the 2013 and 2012 year ends is as follows:

**December 31, 2013**

<b>Company (Millions of euros)</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>Final balance, 2018 and subsequent years</b>	<b>Final balance, current and non-current</b>
Telefónica Emisiones, S.A.U.	4,987	2,966	5,971	3,999	3,576	14,431	35,930
Telefónica Europe, B.V.	1,095	797		160	1,116	3,707	6,875
Telfisa Global, B.V.	3,455						3,455
Telefónica Finanzas, S.A.U.	3,085	475	75				3,635
<b>Total</b>	<b>12,622</b>	<b>4,238</b>	<b>6,046</b>	<b>4,159</b>	<b>4,692</b>	<b>18,138</b>	<b>49,895</b>

**December 31, 2012**

<b>Company (Millions of euros)</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>Final balance, 2017 and subsequent years</b>	<b>Final balance, current and non-current</b>
Telefónica Emisiones, S.A.U.	4,263	4,357	3,458	6,296	4,036	14,267	36,677
Telefónica Europe, B.V.	2,470		795		156	1,842	5,263
Telfisa Global, B.V.	1,822						1,822
Telefónica Finanzas, S.A.U.	5,224		475	75			5,774
Others							
<b>Total</b>	<b>13,779</b>	<b>4,357</b>	<b>4,728</b>	<b>6,371</b>	<b>4,192</b>	<b>16,109</b>	<b>49,536</b>

Financing raised by Telefónica, S.A. through its subsidiary Telefónica Europe, B.V. at December 31, 2013 was 6,875 million euros (5,263 million euros at the 2012 year end). This financing entails a number of loans paying market interest rates calculated on a Euribor plus spread basis, with an average interest rate in 2013 of 3.90% (3.52% in 2012), bonds amounting 1,406 million euros (2,947 million euros in 2012), undated deeply subordinated securities amounting 2,466 million euros and commercial paper amounting 919 million euros (768 million euros in 2012).

The main source of this financing was the funds obtained through the following transactions:

On September 18, 2013, Telefónica Europe, B.V. issued undated deeply subordinated reset rate guaranteed securities, with the subordinated guarantee of Telefónica, S.A., one of them for an aggregate nominal amount of 1,125 million euros subject to a call option exercisable by the Issuer from the fifth anniversary of the issuance date and the other for an aggregate nominal amount of 625 million euros subject to a call option exercisable by the Issuer from the eighth anniversary of the issuance date. The main terms and conditions of the loan granted to Telefónica, S.A., with the proceeds received from each of the issuances are as follows:

The issuance price was established at 100% of the face value of the loan, in an amount of 1,750 million euros, with long term maturity. For the purpose of calculation on interest rate, this loan is divided into two tranches. The first tranche, related with the amortizing securities nominal amount from the fifth anniversary of the issuance date (1,125 million euros), will accrue interest at an annual rate of 6.532% as from the issuance date (inclusive) up to September 18, 2018. From September 18, 2018 (inclusive), the loan will accrue a fixed interest rate equal to the applicable 5 year swap rate plus a margin of: (i) 5.07% per year as from September 18, 2018 up to September 18, 2023 (not inclusive); (ii) 5.320% per year as from September 18, 2023 up to September 18, 2038 (not inclusive); and (iii) 6.070% per year as from September 18, 2038 (inclusive).

The second tranche, related with to the amortizing securities nominal amount from the eighth anniversary of the issuance date (625 million euros), will accrue interest at an annual rate of 7.657% as from the issuance date (inclusive) up to September 18, 2021. From September 18, 2021 (inclusive), the loan will accrue a fixed interest rate equal to the applicable 8 year swap rate plus a margin of: (i) 5.618% per year as from September 18, 2021 up to September 18, 2023 (not inclusive); (ii) 5.868% per year as from September 18, 2023 up to September 18, 2041 (not inclusive); and (iii) 6.618% per year as from September 18, 2041 (inclusive).

Telefónica, S.A. 47

**Table of Contents**

2013 Financial Statements

On November 26, 2013, Telefónica Europe, B.V. issued undated deeply subordinated reset rate guaranteed securities, with the subordinated guarantee of Telefónica, S.A., for an aggregate nominal amount of pound sterling 600 million (approximately 720 million euros) and subject to a call option exercisable by the Issuer from the seventh anniversary of the issuance date. The main terms and conditions of the loan granted to Telefónica, S.A., with the proceeds received from each of this issuance is as follows:

The issuance price was established at 100% of the face value of the loan, in an amount of 600 million pounds sterling (approximately 720 million euros), with long-term maturity. This loan will accrue interest at an annual rate of 6.782% as from the issuance date (inclusive) up to November 26, 2020. From November 26, 2020 (inclusive), it will accrue a fixed rate of interest equal to the applicable 5 year swap rate resettable every five years plus a margin of:

(i) 4.490% per year as from November 26, 2020 up to November 26, 2025 (not inclusive); (ii) 4.740% per year as from November 26, 2025 up to November 26, 2040 (not inclusive); and (iii) 5.490% per year as from November 26, 2040 (inclusive).

On December 13, 2013, the Tranche E of the syndicated loan facility arranged by Telefónica Europe, B.V. on October 31, 2005 matured as scheduled. The outstanding balance upon maturity was 100 million pounds sterling (approximately 120 million euros). On the same date, there was a merge of the following syndicated loan facilities: i) Tranche E1 for 756 million euros available as from March 2, 2012 and maturing on March 2, 2017; and ii) Tranche E2 for 1,469 million pounds sterling (this syndicated loan facility was redenominated into euros on December 13, 2013) available as from December 13, 2013 and maturing on March 2, 2017. As a result of this, there was a new tranche E2 for 2,523 million euros. At December 31, 2013 the outstanding balance of this new tranche was 120 million euros.

During 2013, Telefónica Europe, B.V. drew down an aggregate principal amount of 844 million US dollars (approximately 612 million euros) of the financing agreement with suppliers signed on August 28, 2012 for 1,200 million US dollars maturing in 2023.

Financing raised by Telefónica, S.A. through Telefónica Emisiones, S.A.U. at December 31, 2013 was 35,930 million euros (36,677 million euros in 2012). This financing is arranged as loans from these companies on the same terms as those of the issuance programs. The average interest rate in 2013 was 5.09% (5.16% in 2012). The financing arranged includes, as a related cost, the fees or premiums taken to the income statement for the period corresponding to the financing based on the corresponding effective interest rates. Telefónica Emisiones, S.A.U. raised financing in 2013 mainly by tapping the European and US capital markets, issuing the following bonds totaling 4,883 million euros (5,148 million euros in 2012):

Description	Issue date	Maturity date	Amount (nominal)	Currency of	
				issue	Coupon
EMTN bonds	01/22/13	01/23/23	1,500,000,000	EUR	3.987%
	03/27/13	03/26/21	1,000,000,000	EUR	3.961%
	05/29/13	05/29/19	750,000,000	EUR	2.736%

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	10/23/13	10/23/20	225,000,000	CHF	2.595%
SHELF bond	04/29/13	04/27/18	1,250,000,000	USD	3.192%
	04/29/13	04/27/23	750,000,000	USD	4.570%

Part of the amount owed by Telefónica, S.A. to Telefónica Emisiones, S.A.U. and to Telefónica Europe, B.V. includes restatements to amortized cost at December 31, 2013 and 2012 as a result of fair value interest rate and exchange rate hedges.

Meanwhile, at December 31, 2013, Telefónica, S.A. had raised financing from Telefónica Finanzas, S.A.U., in charge of the integrated cash management of the companies comprising the Telefónica Group in Spain, amounting to 3,635 million euros (5,774 million euros at December 31, 2012) in a series of loans bearing interest at market rates.

Telfisa Global, B.V. centralizes and handles cash management and flows for the Telefónica Group in Latin America, the United States and Europe. The balance payable to this subsidiary is formalized through several Deposit Agreements accruing interest at market rates and amounting to 3,455 million euros in 2013 and 1,822 million euros in 2012.

Loans to Group companies under current assets include accrued interest receivable at December 31, 2013 of 1,281 million euros (878 million euros in 2012).

Telefónica, S.A. 48

**Table of Contents**

2013 Financial Statements

**15.2** The balance of Payable to subsidiaries due to taxation on a consolidated basis was 437 million euros and 506 million euros at December 31, 2013 and 2012, respectively. This basically includes payables to Group companies for their contribution of taxable income (tax losses) to the tax group headed by Telefónica, S.A. (see Note 17). The current- or non-current classification is based on the Company's projection of maturities.

The main amounts are those relating to Telefónica Internacional, S.A.U. for 104 million euros (322 million euros in 2012), Telefónica Móviles España, S.A.U. for 116 million euros (123 million euros in 2012) and Latin American Cellular Holdings, S.L for 154 million euros. This company has been aggregated to the Tax Group in 2013 and therefore had not amounts in 2012.

Telefónica, S.A. 49

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**Table of Contents**

2013 Financial Statements

**Note 16. Derivate financial instruments and risk management policies****a) Derivative financial instruments**

During 2013, the Group continued to use derivatives to limit interest and exchange rate risk on otherwise unhedged positions, and to adapt its debt structure to market conditions.

At December 31, 2013, the total outstanding balance of derivatives transactions was 139,000 million euros (121,514 million euros in 2012), of which 109,390 million euros related to interest rate risk and 29,610 million euros to foreign currency risk. In 2012, 96,532 million euros related to interest rate risk and 24,982 million euros to foreign currency risk.

It should be noted that at December 31, 2013, Telefónica, S.A. had transactions with financial institutions to hedge exchange rate risk for other Telefónica Group companies amounting to 1,429 million euros (507 million euros in 2012). At year-end 2013 and 2012, the Company had no transactions to hedge interest rate risk for other Group companies. These external trades are matched by intra-group hedges with identical terms and maturities between Telefónica, S.A. and Group companies, and therefore involve no risk for the Company. External derivatives not backed by identical intragroup transactions consist of hedges on net investment and future acquisitions that, by their nature, cannot be transferred to Group companies and/or transactions to hedge financing raised by Telefónica, S.A. as parent company of the Telefónica Group, which are transferred to Group subsidiaries in the form of financing rather than via derivative transactions.

Telefónica, S.A. 50



**Table of Contents**

2013 Financial Statements

The breakdown of Telefónica, S.A.'s interest rate and exchange rate derivatives at December 31, 2013, their notional amounts at year end and the expected maturity schedule is as follows:

**2013**

Millions of euros Type of risk	Value in Euros	Telefónica receives		Telefónica pays	
		Carrying	Currency	Carrying	Currency
<b>Euro interest rate swaps</b>	<b>81,956</b>				
Fixed to fixed	95	95	EUR	95	EUR
Fixed to floating	37,829	37,862	EUR	37,829	EUR
Floating to fixed	43,982	43,982	EUR	43,982	EUR
Floating to floating	50	50	EUR	50	EUR
<b>Foreign currency interest rate swaps</b>	<b>25,254</b>				
Fixed to floating					
GBPGBP	4,966	4,140	GBP	4,140	GBP
JPYJPY	117	17,000	JPY	17,000	JPY
USDUSD	15,362	21,186	USD	21,186	USD
CHFCHF	509	625	CHF	625	CHF
CZKCZK	46	1,250	CZK	1,250	CZK
Floating to fixed					
GBPGBP	2,629	2,192	GBP	2,192	GBP
USDUSD	1,579	2,177	USD	2,177	USD
CZKCZK	46	1,250	CZK	1,250	CZK
<b>Exchange rate swaps</b>	<b>14,941</b>				
Fixed to fixed					
EURBRL	278	354	EUR	896	BRL
EURCLP	53	50	EUR	37,800	CLP
EURCZK	570	631	EUR	15,641	CZK
Fixed to floating					
JPYEUR	95	15,000	JPY	95	EUR
Floating to floating					
EURCZK	150	162	EUR	4,114	CZK
EURGBP	485	588	EUR	405	GBP
GBPEUR	829	700	GBP	829	EUR
JPYEUR	167	17,000	JPY	167	EUR
USDEUR	11,799	15,738	USD	11,799	EUR
CHFEUR	515	625	CHF	515	EUR
<b>Forwards</b>	<b>12,319</b>				
CLPEUR	54	40,200	CLP	54	EUR
BRLEUR	5	19	BRL	5	EUR

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EURBRL	149	147	EUR	481	BRL
EURCZK	952	952	EUR	26,100	CZK
EURGBP	3,520	3,493	EUR	2,935	GBP
EURMXN	173	174	EUR	3,119	MXN
EURUSD	2,175	2,214	EUR	2,999	USD
GBPEUR	3,640	3,068	GBP	3,640	EUR
GBPUSD	45	38	GBP	61	USD
EURCLP	5	5	EUR	3,332	CLP
USDBRL	13	18	USD	43	BRL
USDCLP	4	5	USD	2,643	CLP
USDCOP	1	1	USD	2,896	COP
USDEUR	1,565	2,113	USD	1,565	EUR
USDGBP	15	20	USD	12	GBP
USDPEN	1	2	USD	5	PEN
EURPEN	1	1	EUR	5	PEN
EURCOP	1	1	EUR	2,260	COP
<b>Subtotal</b>		<b>134,470</b>			

Telefónica, S.A. 51

**Table of Contents**

2013 Financial Statements

Millions of euros		Value in euros	Notional	Currency
<b>Notional amounts of structured products with options</b>				
<b>Interest rate options Caps &amp; Floors</b>		<b>2,180</b>		
<b>Caps&amp;Floors</b>		<b>2,180</b>	<b>2,180</b>	<b>EUR</b>
USD		30	42	USD
EUR		1,250	1,250	EUR
GBP		900	544	GBP
<b>Currency options</b>		<b>2,350</b>		
EURUSD		797	797	EUR
USDEUR		1,553	3,422	USD
<b>Subtotal</b>		<b>4,530</b>		
<b>TOTAL</b>		<b>139,000</b>		

The breakdown by average maturity is as follows:

Millions of euros		Notional	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
<b>Hedged underlying item</b>						
<b>With underlying instrument</b>						
<b>Promissory notes</b>	<b>540</b>	<b>281</b>			<b>59</b>	<b>200</b>
<b>Loans</b>	<b>19,935</b>	<b>696</b>	<b>4,983</b>	<b>6,367</b>	<b>7,889</b>	
in national currency	10,100		3,200	3,050	3,850	
in foreign currencies	9,835	696	1,783	3,317	4,039	
<b>Debentures and bonds MtM</b>	<b>78,758</b>	<b>4,058</b>	<b>22,830</b>	<b>17,409</b>	<b>34,461</b>	
in national currency	35,629	2,605	6,638	12,139	14,247	
in foreign currencies	43,129	1,453	16,192	5,270	20,214	
<b>Other underlying*</b>	<b>39,767</b>	<b>19,555</b>	<b>4,410</b>	<b>8,597</b>	<b>7,205</b>	
Swaps	1,050	375	628	47		
Currency options	3,360	1,010	78	2,272		
Forward	10,674	10,674				
IRS	24,683	7,496	3,704	6,278	7,205	
<b>Total</b>	<b>139,000</b>	<b>24,590</b>	<b>32,223</b>	<b>32,432</b>	<b>49,755</b>	

(\*) Most of these transactions are related to economic hedges of investments, assets and liabilities of subsidiaries, and provisions for restructuring plans.



**Table of Contents**

2013 Financial Statements

The breakdown of Telefónica, S.A.'s derivatives in 2012, their notional amounts at year end and the expected maturity schedule is as follows:

**2012**

Millions of euros Type of risk	Value in Euros	Telefónica receives		Telefónica pays	
		Carrying	Currency	Carrying	Currency
<b>Euro interest rate swaps</b>	<b>72,164</b>				
Fixed to fixed	55	55	EUR	55	EUR
Fixed to floating	24,380	24,380	EUR	24,380	EUR
Floating to fixed	47,679	47,679	EUR	47,679	EUR
Floating to floating	50	50	EUR	50	EUR
<b>Foreign currency interest rate swaps</b>	<b>22,157</b>				
Fixed to floating					
CHFCHF	331	400	CHF	400	CHF
CZKCZK	50	1,250	CZK	1,250	CZK
GBPGBP	3,498	2,855	GBP	2,855	GBP
JPYJPY	150	17,000	JPY	17,000	JPY
USDUSD	14,364	18,951	USD	18,951	USD
Floating to fixed					
CZKCZK	50	1,250	CZK	1,250	CZK
GBPGBP	1,445	1,180	GBP	1,180	GBP
USDUSD	2,269	2,994	USD	2,994	USD
<b>Exchange rate swaps</b>	<b>13,719</b>				
Fixed to fixed					
EURBRL	203	222	EUR	546	BRL
EURCLP	60	50	EUR	37,800	CLP
EURCZK	622	631	EUR	15,641	CZK
Fixed to floating					
USDEUR	95	132	USD	95	EUR
Floating to floating					
CHFEUR	332	400	CHF	332	EUR
EURCZK	327	322	EUR	8,228	CZK
EURGBP	496	588	EUR	405	GBP
GBPEUR	829	700	GBP	829	EUR
JPYEUR	167	17,000	JPY	167	EUR
USDEUR	10,588	14,196	USD	10,588	EUR
<b>Forwards</b>	<b>7,399</b>				
ARSUSD	14	110	ARS	19	USD
CLPEUR	64	40,428	CLP	64	EUR

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CZKEUR	115	2,906	CZK	115	EUR	
EURBRL	18	18	EUR	49	BRL	
EURCOP	1	1	EUR	3,100	COP	
EURCZK	541	550	EUR	13,612	CZK	
EURGBP	1,345	1,356	EUR	1,098	GBP	
EURPEN			EUR	1	PEN	
EURMXN	80	81	EUR	1,361	MXN	
EURUSD	2,092	2,137	EUR	2,760	USD	
GBPEUR	1,904	1,539	GBP	1,904	EUR	
GBPUSD	45	36	GBP	59	USD	
USDARS		17	19	USD	110	ARS
USDBRL		27	34	USD	71	BRL
USDCLP		5	6	USD	2,964	CLP
<b>USDCOP</b>		<b>1</b>	<b>2</b>	<b>USD</b>	<b>2,796</b>	<b>COP</b>
USDEUR		1,101	1,443	USD	1,101	EUR
USDGBP		28	37	USD	23	GBP
USDPEN		1	1	USD	2	PEN
<b>Spot</b>		<b>111</b>				
CZKEUR		106	2,672	CZK	106	EUR
EURGBP		5	5	EUR	3	GBP
<b>Subtotal</b>		<b>115,550</b>				

Telefónica, S.A. 53

**Table of Contents**

2013 Financial Statements

**Millions of euros**

<b>Notional amounts of structured products with options</b>	<b>Value in Euros</b>		<b>Notional</b>	<b>Currency</b>
<b>Interest rate options Caps &amp; Floors</b>	<b>2,211</b>			
<b>Caps&amp;Floors</b>	<b>2,211</b>	<b>2,211</b>		<b>EUR</b>
USD	42	54		USD
EUR	1,250	1,250		EUR
GBP	919	750		GBP
<b>Currency options</b>	<b>3,753</b>			
GBP/EUR	640	522		GBP
USD/EUR	3,113	4,107		USD
<b>Subtotal</b>	<b>5,964</b>			
<b>TOTAL</b>	<b>121,514</b>			

The breakdown by average maturity is as follows:

**Millions of euros**

<b>Hedged underlying item</b>	<b>Notional</b>	<b>Up to 1 year</b>	<b>From 1 to 3 years</b>	<b>From 3 to 5 years</b>	<b>Over 5 years</b>
<b>With underlying instrument</b>					
<b>Promissory notes</b>	<b>540</b>		<b>280</b>	<b>60</b>	<b>200</b>
<b>Loans</b>	<b>18,005</b>	<b>2,592</b>	<b>3,555</b>	<b>1,480</b>	<b>10,378</b>
in national currency	13,170	1,900	2,750	850	7,670
in foreign currencies	4,835	692	805	630	2,708
<b>Debentures and bonds MtM</b>	<b>73,604</b>	<b>11,474</b>	<b>12,171</b>	<b>21,736</b>	<b>28,223</b>
in national currency	29,475	6,315	6,701	7,839	8,620
in foreign currencies	44,129	5,159	5,470	13,897	19,603
<b>Without underlying*</b>	<b>29,365</b>	<b>16,617</b>	<b>4,472</b>	<b>5,054</b>	<b>3,222</b>
Swaps	1,212	164	457	591	
Currency options	3,754	2,035	161	1,438	120
Forward	7,772	7,772			
IRS	16,627	6,646	3,854	3,025	3,102
<b>Total</b>	<b>121,514</b>	<b>30,683</b>	<b>20,478</b>	<b>28,330</b>	<b>42,023</b>

(\*) Most of these transactions are related to economic hedges of investments, assets and liabilities of subsidiaries, and provisions for restructuring plans.

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The debentures and bonds hedged relate to both those issued by Telefónica, S.A. and intragroup loans on the same terms as the issues of Telefónica Europe, B.V. and Telefónica Emisiones, S.A.U.

Telefónica, S.A. 54



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**Table of Contents**

2013 Financial Statements

The fair value of Telefónica, S.A.'s derivatives portfolio with external counterparties at December 31, 2013 was equivalent to a net liability of 66 million euros (net asset of 1,073 million euros in 2012).

***b) Risk management policy***

Telefónica, S.A. is exposed to various financial market risks as a result of: (i) its ordinary business activity, (ii) debt incurred to finance its business, (iii) its investments in companies, and (iv) other financial instruments related to the above commitments.

The main market risks affecting Telefónica are as follows:

**Exchange rate risk**

Foreign currency risk primarily arises in connection with: (i) Telefónica's international presence, through its investments and businesses in countries that use currencies other than the euro (primarily in Latin America, but also in the United Kingdom and the Czech Republic), and (ii) debt denominated in currencies other than that of the country where the business is conducted or the home country of the company incurring such debt.

**Interest rate risk**

Interest rate risk arises primarily in connection with changes in interest rates affecting (i) financial expenses on floating rate debt (or short-term debt likely to be renewed), due to changes in interest rates and (ii) the value of non-current liabilities at fixed interest rates.

**Share price risk**

Share price risk arises primarily from changes in the value of the equity investments (that may be bought, sold or otherwise involved in transactions), from changes in the value of derivatives associated with such investments, from changes in the value of treasury shares and from equity derivatives.

**Other risks**

Telefónica, S.A. is also exposed to liquidity risk if a mismatch arises between its financing needs (operating and financial expense, investment, debt redemptions and dividend commitments) and its sources of finance (revenues, divestments, credit lines from financial institutions and capital market operations). The cost of finance could also be affected by movements in the credit spreads (over benchmark rates) demanded by lenders.

Finally, Telefónica is exposed to country risk (which overlaps with market and liquidity risks). This refers to the possible decline in the value of assets, cash flows generated or cash flows returned to the parent company as a result of political, economic or social instability in the countries where Telefónica, S.A. operates, especially in Latin America.

**Risk management**

Telefónica, S.A. actively manages these risks through the use of derivatives (primarily on exchange rates, interest rates and share prices) and by incurring debt in local currencies, where appropriate, with a view to stabilizing cash flows, the income statement and investments. In this way, Telefónica attempts to protect its solvency, facilitate financial planning and take advantage of investment opportunities.

Telefónica manages its exchange rate risk and interest rate risk in terms of net debt and net financial debt as calculated by them. Telefónica believes that these parameters are more appropriate to understanding its debt position. Net debt and net financial debt take into account the impact of the Group's cash balance and cash equivalents including derivatives positions with a positive value linked to liabilities. Neither net debt nor net financial debt as calculated by Telefónica should be considered an alternative to gross financial debt (the sum of current and non-current interest-bearing debt) as a measure of liquidity.

*Exchange rate risk*

The fundamental objective of the exchange rate risk management policy is that, in event of depreciation in foreign currencies relative to the euro, any potential losses in the value of the cash flows generated by the businesses in such currencies, caused by depreciation in exchange rates of a foreign currency relative to the euro, are offset (to some extent) by savings from the reduction in the euro value of debt denominated in such currencies and/or synthetic debt in such currencies. The degree of exchange rate hedging employed varies depending on the type of investment.

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**Table of Contents**

2013 Financial Statements

Telefónica aims to protect itself against declines in Latin American currencies relative to the euro affecting our asset values through, so it occasionally takes out dollar-denominated debt, incurred either in Spain (where such debt is associated with an investment as long as it is considered to be an effective hedge) or in the country itself, where the market for local currency financing or hedges may be inadequate or non-existent.

At December 31, 2013, pound sterling-denominated net debt was approximately 2.31 times the value of our 2013 operating income before depreciation and amortization (OIBDA) from the Telefónica Europe business unit in the United Kingdom. Telefónica's aim is to maintain a similar proportion of pound sterling-denominated net debt to OIBDA as the Telefónica net debt to OIBDA ratio, on a consolidated basis, in order to help them to reduce its sensitivity to changes in the pound sterling to euro exchange rate. Debt denominated in pound sterling as of December 31, 2013 amounts to 3,342 million euros, higher than 2,629 million as of December 31, 2012.

Until the agreement for the sale of Telefónica Czech Republic, a.s., the risk-management objective to protect the investment in the Czech Republic was similar to that described for the investment in the UK, where the amount of Czech crown-denominated debt is proportional to the OIBDA of the Telefónica Europe business unit in the Czech Republic. Czech crown-denominated net debt at December 31, 2013 was 2.65 times OIBDA in Czech crown (2.1 times in 2012) on a consolidated basis and 3.85 times (2.97 times in 2012) on a proportional basis. This ratio is substantially higher than the objective of 2 times OIBDA because once the sale of the company was decided and agreed (as described in Note 8), the objective was changed in order to reflect the new situation of this asset in the Group portfolio. Accordingly the price in CZK of this sale was totally hedged.

Exchange rate risk is managed by seeking to minimize the negative impact of any remaining exchange rate exposure on the income statement, regardless of whether there are open positions. Such open position exposure can arise for any of three reasons: (i) a thin market for local derivatives or difficulty in sourcing local currency finance which makes it impossible to arrange a low-cost hedge (as in Argentina and Venezuela), (ii) financing through intra-group loans, where the accounting treatment of exchange rate risk is different from that for financing through capital contributions, and (iii) as the result of a deliberate policy decision, to avoid the high cost of hedges that are not warranted by expectations or high risk of depreciation.

As Telefónica's direct exposure is counterbalanced by the positions held in subsidiaries, the Company analyses its foreign currency risk exposure at the Group level. To illustrate the sensitivity of exchange gains or losses to variability in exchange rates, assuming the exchange rate position affecting the income statement at the end of 2013 were constant during 2014 and Latin American currencies depreciated against the dollar and the rest of the currencies against the euro by 10%, Telefónica estimates that consolidated exchange losses recorded for 2014 would be a negative 42 million euros. For Telefónica, S.A., assuming only financing arranged with external counterparties, the same change would lead to a decrease in finance costs of 78 million euros. Nonetheless, Telefónica manages its exposure on a dynamic basis to mitigate their impact.

*Interest rate risk*

The Telefónica Group's financial expenses are exposed to changes in interest rates. In 2013, the rates applied to the largest amount of short-term debt were mainly based on the Euribor, the Czech crown Pribor, the Brazilian SELIC, the dollar Libor and the Colombian UVR. Telefónica manages its interest rate risk by entering into derivative financial

instruments, primarily swaps and interest rate options.

Telefónica analyzes its exposure to changes in interest rates at the Telefónica Group level. The table illustrates the sensitivity of finance costs and the balance sheet to variability in interest rates at Group and Telefónica, S.A. level.

To calculate the sensitivity of the income statement, a 100 basis point rise in interest rates in all currencies in which there are financial positions at December 31, 2013 has been assumed, as well as a 100 basis point decrease in all currencies (EUR, GBP, USD, etc.) in order to avoid negative rates. The constant position equivalent to that prevailing at the end of 2012 has also been assumed.

To calculate the sensitivity of equity to variability in interest rates, a 100 basis point increase in interest rates in all currencies and terms in which there are financial positions at December 31, 2013 was assumed, as well as a 100 basis point decrease in all currencies and terms (except those below 1% in order to avoid negative rates). Cash flow hedge positions were also considered as they are the only positions where changes in market value due to interest-rate fluctuations are recognized in equity.

Telefónica, S.A. 56

**Table of Contents**

2013 Financial Statements

In both cases, only transactions with external counterparties have been considered.

	<b>Impacto en Resultado Consolidado (*)</b>	<b>Impacto PyG Telefónica, S.A. (*)</b>	<b>Impacto en Patrimonio Consolidado</b>	<b>Impacto en Patrimonio Telefónica, S.A.</b>
+100bp	(118)	(45)	741	741
-100bp	55	29	(632)	(632)

(\*) Impact on results of 100 bp change in all currencies, except the pound sterling, the dollar, the euro and the czech crown.

*Share price risk*

The Telefónica Group is exposed to changes in the value of equity investments that may be bought, sold or otherwise involved in transactions, from changes in the value of derivatives associated with such investments, from treasury shares and from equity derivatives.

According to the Telefónica, S.A. share option plan, Performance & Investment Plan (PIP) (see Note 19) the shares to be delivered to employees under such plan may be either the parent company treasury shares, acquired by them or any of its Group companies; or newly-issued shares. The possibility of delivering shares to beneficiaries of the plan in the future, in accordance with relative total shareholders' return, implies a risk since there could be an obligation to hand over a maximum number of shares at the end of each phase, whose acquisition (in the event of acquisition in the market) in the future could imply a higher cash outflow than required on the start date of each phase if the share price is above the corresponding price on the phase start date. In the event that new shares are issued for delivery to the beneficiaries of the plan, there would be a dilutive effect for ordinary shareholders as a result of the higher number of shares delivered under such plan outstanding.

To reduce the risk associated with variations in share price under these plans, Telefónica has acquired instruments that replicate the risk profile of some of these plans as explained in Note 19.

The second Global Employee Share Plan was launched in 2012 as approved in the 2011 Ordinary General Shareholders' Meeting (see details of the plan in Note 19).

In addition, the Group may use part of the treasury shares of Telefónica, S.A. held at year end to cover shares deliverable under the PIP or Global Employee Share Plan. The net asset value of the treasury shares could increase or decrease depending on variations in Telefónica, S.A.'s share price.

*Liquidity risk*

The Telefónica Group seeks to match the schedule for its debt maturity payments to its capacity to generate cash flows to meet these maturities, while allowing for some flexibility. In practice, this has been translated into two key principles:

1. The Telefónica Group's average maturity of net financial debt is intended to stay above 6 years, or be restored above that threshold in a reasonable period of time if it eventually falls below it. This principle is considered as a guideline when managing debt and access to credit markets, but not a rigid requirement. When calculating the average maturity for the net financial debt and part of the undrawn credit lines can be considered as offsetting the shorter debt maturities, and extension options on some financing facilities may be considered as exercised, for calculation purposes.
2. The Telefónica Group must be able to pay all commitments over the next 12 months without accessing new borrowing or tapping the capital markets (although drawing upon firm credit lines arranged with banks), assuming budget projections are met.

Telefónica, S.A. 57

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**Table of Contents**

2013 Financial Statements

*Country risk*

The Telefónica Group managed or mitigated country risk by pursuing two lines of action (in addition to its normal business practices):

Partly matching assets to liabilities (those not guaranteed by the parent company) in the Telefónica Group's Latin American companies such that any potential asset impairment would be accompanied by a reduction in liabilities; and,

Repatriating funds generated in Latin America that are not required for the pursuit of new, profitable business development opportunities in the region.

*Credit risk*

As a general rule, the Telefónica Group trades in derivatives with creditworthy counterparties. Therefore, Telefónica, S.A. generally trades with credit entities whose senior debt ratings are of at least A-. In Spain, where most of the Group's derivatives portfolio is held, there are netting agreements with financial institutions, with debtor or creditor positions offset in case of bankruptcy, limiting the risk to the net position. In addition, since Lehman went bankrupt, the credit ratings of rating agencies have proved to be less effective as a credit risk management tool. Therefore, the 5-year CDS (Credit Default Swap) of credit institutions has been added. This way, the CDS of all the counterparties with which Telefónica S.A. operates is monitored at all times in order to assess the maximum allowable CDS for operating at any given time. Transactions are generally only carried out with counterparties whose CDS is below the threshold.

For other subsidiaries, particularly those in Latin America, given the stable sovereign rating provides a ceiling and is below A, trades are with local financial entities whose rating by local standards is considered to be of high creditworthiness.

Meanwhile, with credit risk arising from cash and cash equivalents, the Telefónica Group places its cash surpluses in high quality and highly liquid money-market assets. These placements are regulated by a general framework, revised annually. Counterparties are chosen according to criteria of liquidity, solvency and diversification based on the conditions of the market and countries where the Group operates. The general framework sets: (i) the maximum amounts to be invested by counterparty based on its rating (long-term debt rating); (ii) the maximum tenor of the investment, set at 180 days; and (iii) the instruments in which the surpluses may be invested (money-market instruments).

The Telefónica Group considers credit risk management as a key element to achieve its business and customer base sustainable growth targets in a manner that is consistent with Telefónica Corporate Risk Management Policy.

This management approach relies on the continuous monitoring of the risk assumed and the resources necessary to optimize the risk-reward balance to grant the adequate separation between the risk ownership areas and risk

management areas. Customer-financing products and those debtors that could cause a material impact on the Group's financial statements are subject to specific management practices to mitigate exposure to credit risk, according to the segment and risk profile of the customer.

Uniform policies, procedures, delegation of authority and management practices are established in all Group companies, taking into account benchmark risk management techniques but adapted to the local characteristics of each market. This commercial credit risk management model is embedded into the Group's decision-making processes, both from a strategic and, especially, day-to-day operating perspective, where credit risk assessment guides the available products and services for the different customer profiles.

Telefónica's maximum exposure to credit risk is initially represented by the carrying amounts of the assets (see Notes 8 and 9) and the guarantees given by Telefónica.

Telefónica, S.A. provides operating guarantees granted by external counterparties, which are offered during its normal commercial activity. At December 31, 2013, these guarantees amounted to approximately 114 million euros.

#### *Capital management*

Telefónica's corporate finance department, which is in charge of Telefónica's capital management, takes into consideration several factors when determining Telefónica's capital structure, with the aim of ensuring sustainability of the business and maximizing the value to shareholders.



**Table of Contents**

2013 Financial Statements

Telefónica monitors its cost of capital with a goal of optimizing its capital structure. In order to do this, Telefónica monitors the financial markets and updates to standard industry approaches for calculating weighted average cost of capital, or WACC. Telefónica also uses a net financial debt ratio below 2.35x OIBDA in the medium term (excluding items of a non-recurring or exceptional nature), enabling to obtain and maintain the desired credit rating over the medium term, and with which the Telefónica Group can match the potential cash flow generation with the alternative uses that could arise at all times.

These general principles are refined by other considerations and the application of specific variables, such as country risk in the broadest sense, or the volatility in cash flow generation, when determining the Telefónica Group's financial structure.

Telefónica's derivatives policy emphasizes the following points:

Derivatives based on a clearly identified underlying.

Matching of the underlying to one side of the derivative.

Matching the company contracting the derivative and the company that owns the underlying.

Ability to measure the derivative's fair value using the valuation systems available to the Telefónica Group.

Sale of options only when there is an underlying exposure.

Hedge accounting

Hedges can be of three types:

Fair value hedges

Cash flow hedges, which can be set at any value of the risk to be hedged (primarily interest rate and foreign currency) or for a defined range through options.

Hedges of net investment in a foreign operation.

Hedges can comprise a combination of different derivatives. There is no reason to suppose management of accounting hedges will be static, with an unchanging hedging relationship lasting right through to maturity. Hedging relationships may change to allow appropriate management that serves our stated principles of stabilizing cash flows, stabilizing net financial income/expense and protecting our share capital. The designation of hedges may therefore be cancelled, before maturity, because of a change in the underlying, a change in perceived risk on the underlying or a change in market view. Derivatives included in these hedges may be reassigned to new hedges where they meet the effectiveness test and the new hedge is well documented. To gauge the efficiency of transactions defined as accounting hedges, we analyze the extent to which the changes in the fair value or in the cash flows attributable to the hedged item would offset the changes in fair value or cash flows attributable to the hedged risk using a linear regression model for both forward- and backward-looking analysis.

Risk management guidelines are issued by the Corporate Finance Department. This department may allow exceptions to this policy where these can be justified, normally when the market is too thin for the volume of transactions required or on clearly limited and small risks.

In 2013 the Company recognized a loss of 0.15 million euros for the ineffective part of cash flow hedges (0.25 million euros in 2012).

**Table of Contents**

2013 Financial Statements

The breakdown of the Company's derivatives with counterparties not belonging to the Telefónica Group at December 31, 2013 and 2012 by type of hedge, their fair value at year end and the expected maturity schedule is as follows:

**2013**

Millions of euros	Fair value (**)	Notional amount maturities (*)				
		2013	2014	2015	Subsequent years	Total
<b>Derivatives</b>						
<b>Interest rate hedges</b>	<b>438</b>	<b>(3,460)</b>	<b>2,155</b>	<b>1,053</b>	<b>(1,590)</b>	<b>(1,842)</b>
Cash flow hedges	752	(3,230)	2,150		8,420	7,340
Fair value hedges	(314)	(230)	5	1,053	(10,010)	(9,182)
<b>Exchange rate hedges</b>	<b>361</b>	<b>70</b>	<b>1,564</b>	<b>3,157</b>	<b>4,726</b>	<b>9,517</b>
Cash flow hedges	361	70	1,564	3,157	4,726	9,517
<b>Interest and exchange rate hedges</b>	<b>(22)</b>	<b>(405)</b>	<b>(221)</b>	<b>549</b>	<b>2,812</b>	<b>2,735</b>
Cash flow hedges	(22)	(405)	(221)	549	2,812	2,735
<b>Hedge of net investment</b>	<b>(111)</b>	<b>(273)</b>		<b>(588)</b>		<b>(861)</b>
<b>Derivatives not designated as hedges</b>	<b>(600)</b>	<b>374</b>	<b>(225)</b>	<b>(1,273)</b>	<b>(1,989)</b>	<b>(3,113)</b>
Interest rate	(356)	2,354	(141)	(710)	(1,941)	(438)
Exchange rate	(244)	(1,980)	(84)	(563)	(48)	(2,675)

(\*) For interest rate hedges, the positive amount is in terms of fixed payment. For foreign currency hedges, a positive amount means payment in functional vs. foreign currency.

(\*\*) Positive amounts indicate payables.

**2012**

Millions of euros	Fair value (**)	Notional amount maturities (*)				
		2012	2013	2014	Subsequent years	Total
<b>Derivatives</b>						
<b>Interest rate hedges</b>	<b>341</b>	<b>(932)</b>	<b>(836)</b>	<b>2,555</b>	<b>3,601</b>	<b>4,388</b>
Cash flow hedges	1,389	(936)	(350)	2,550	7,730	8,994
Fair value hedges	(1,048)	4	(486)	5	(4,129)	(4,606)
<b>Exchange rate hedges</b>	<b>(487)</b>	<b>1,456</b>	<b>(153)</b>	<b>1,564</b>	<b>6,364</b>	<b>9,231</b>
Cash flow hedges	(487)	1,456	(153)	1,564	6,364	9,231
<b>Interest and exchange rate hedges</b>	<b>(251)</b>	<b>(69)</b>	<b>72</b>	<b>72</b>	<b>2,437</b>	<b>2,512</b>
Cash flow hedges	(251)	(69)	72	72	2,437	2,512
<b>Hedge of net investment</b>	<b>(115)</b>	<b>(822)</b>	<b>(230)</b>	<b>(162)</b>	<b>(989)</b>	<b>(2,203)</b>
<b>Derivatives not designated as hedges</b>	<b>(561)</b>	<b>10,588</b>	<b>(63)</b>	<b>(467)</b>	<b>(1,628)</b>	<b>8,430</b>

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Interest rate	(389)	8,612	(13)	(545)	(2,133)	5,921
Exchange rate	(172)	1,976	(50)	78	505	2,509

(\* ) For interest rate hedges, the positive amount is in terms of fixed payment. For foreign currency hedges, a positive amount means payment in functional vs. foreign currency.

(\*\*) Positive amounts indicate payables.

Telefónica, S.A. 60

**Table of Contents**

2013 Financial Statements

**Note 17. Income tax**

Pursuant to a Ministerial Order dated December 27, 1989, since 1990 Telefónica, S.A. has filed consolidated tax returns with certain Group companies. The consolidated tax group in 2013 comprised 51 companies; with respect to the previous year, Latin American Cellular Holding, S.L. was included and Telefónica Cable, S.A and Telefónica Soluciones Sectoriales, S.A. ceased forming part of the Tax Group, as a result of the merger with Telefónica de España S.A.U. in 2013.

Tax balances are as follows:

Millions of euros	2013	2012
<b>Tax receivables:</b>	<b>4,985</b>	<b>5,705</b>
<b>Deferred tax assets:</b>	<b>4,325</b>	<b>5,095</b>
Deferred income tax (income)	3,115	3,634
Long-term tax loss carryforwards	1,203	1,170
Deductions	7	291
<b>Current tax receivables (Note 10):</b>	<b>660</b>	<b>610</b>
Withholdings	21	1
Corporate income tax payable	617	584
VAT and Canary Islands general indirect tax refundable	22	25
<b>Tax payable:</b>	<b>304</b>	<b>618</b>
<b>Deferred tax liabilities:</b>	<b>262</b>	<b>499</b>
<b>Current payables to public administrations (Note 18):</b>	<b>42</b>	<b>119</b>
Personnel income tax withholdings	4	3
Corporate income tax payable	13	89
Withholding on investment income, VAT and other	24	26
Social security	1	1

The tax group had unused tax loss carryforwards at December 31, 2013 amounting to 9,785 million euros. These losses must be applied within 18 years, according to the following estimated schedule.

2012/12/31	Total	Less than 1 year	More than 1 year
Tax loss carryforwards	9,785	342	9,443

Following completion in 2012 of the inspection by the tax authorities (see Note 17.3), and considering the rulings on the tax assessments signed in disagreement by the Company, the Company restated its tax credits based on the business plans of the companies in the tax group and the best estimate of taxable income, over a period of time that is in line with the situation. Consequently, tax credits of 458 million euros at year-end 2012 were recognized.

In 2013, tax credits of the Tax Group have been analyzed with the same criteria used in the previous year. As a consequence of this review, a 190 million euros negative income tax has been registered.

Total tax credits based on the taxable income recognized in the balance sheet at December 2013 therefore amount to 1.203 million euros (1,170 million euros in 2012).

As of December 2013, non-registered taxable income amounts to 5,775 million euros.

During 2013, Telefónica, S.A., as head of the Telefónica tax group, made payments on account of 2013 income tax amounting to 436 million euros (247 million euros in 2012).

Telefónica, S.A. 61

**Table of Contents**

2013 Financial Statements

**17.1 Movement in deferred tax assets and liabilities**

The balances and movements in Deferred tax assets and Deferred tax liabilities for Telefónica, S.A. at December 31, 2013 and 2012 are as follows:

**2013**

Millions of euros	Tax credits	Temporary differences, assets	Deductions	Total deferred tax assets	Deferred tax liabilities
<b>Opening balance</b>	<b>1,170</b>	<b>3,634</b>	<b>291</b>	<b>5,095</b>	<b>499</b>
Arising in the year	190	744	9	943	41
Reversal		(1,215)		(1,215)	(268)
Transfers to the tax group's net position	(157)	(48)	(293)	(498)	(29)
Other movements					19
<b>Closing balance</b>	<b>1,203</b>	<b>3,115</b>	<b>7</b>	<b>4,325</b>	<b>262</b>

**2012**

Millions of euros	Tax credits	Temporary differences, assets	Deductions	Total deferred tax assets	Deferred tax liabilities
<b>Opening balance</b>	<b>723</b>	<b>1,765</b>	<b>117</b>	<b>2,605</b>	<b>474</b>
Arising in the year	458	1,936	2	2,396	166
Reversal	(11)	(34)		(45)	(156)
Transfers to the tax group's net position		(33)	172	139	
Other movements					15
<b>Closing balance</b>	<b>1,170</b>	<b>3,634</b>	<b>291</b>	<b>5,095</b>	<b>499</b>

The main items for which Telefónica, S.A. recognizes temporary differences in assets and liabilities are the effects of impairment losses on some of its assets, principally investments in subsidiaries (see Note 8).

Law 16/2013 of October 29, 2013, modifies the tax treatment of impairment losses on investments, which are no longer deductible as from January 1, 2013 and it includes new conditions which must be taken into account in order to calculate the tax value of investments. The reversal movements of the charts above are according to these considerations.

Deferred tax assets include the amount the Company expects to regain in a period shorter than stipulated in the tax regulation.

Deferred tax liabilities include 47 million euros corresponding to the tax amortization of goodwill generated on acquiring stakes in the Brazilian subsidiaries of Brasilcel, N.V. No impact has been recognized in profit and loss, pending the final decisions on the court and administrative proceedings relating to this matter, which at year-end remained open.

In accordance with article 12.3 of the revised Spanish Income Tax Law ( TRLIS ), revoked by Law 16/2013 of October 29, as well as with transitional provision 29 of that law, a negative adjustment of 790 million euros was provisionally included in the Company's taxable income declared at 2012 year end, in connection with the decline in value of investees. At December 31, 2012, inclusion of 3,861 million euros was pending for reversal of the adjustment in future periods.

In 2012, the negative variation in equity of investees for which a provision was made amounts to 589 million euros, primarily in respect of the Brazilian and Mexican companies.



**Table of Contents**

2013 Financial Statements

**17.2 Reconciliation of accounting profit to taxable income and income tax expense to income tax payable.**

The calculation of the income tax expense and income tax payable for 2013 and 2012 is as follows.

Millions of euros	2013	2012
Accounting profit before tax	33	(2,205)
Permanent differences	(4,787)	(5,017)
Temporary differences:	3,243	4,619
Arising in the year	2,690	4,782
Arising in prior years	553	(163)
<b>Tax result</b>	<b>(1,511)</b>	<b>(2,603)</b>
Gross tax payable	(454)	(781)
Tax credits capitalized	(9)	(2)
<b>Corporate income tax refundable</b>	<b>(462)</b>	<b>(783)</b>
Temporary differences for tax valuation	(973)	(1,386)
Other effects	778	(714)
Corporate income tax accrued in Spain	(657)	(2,883)
Foreign taxes	27	48
<b>Income tax</b>	<b>(631)</b>	<b>(2,836)</b>
Current income tax	(429)	(851)
Deferred income tax	(202)	(1,985)

The permanent differences relate mainly to changes in investment in Group Companies write-down provisions recorded by the Tax Group companies included in the consolidated corporate income tax return, dividends received and investment write downs with no deferred asset registered.

In addition, they include as a permanent difference the decrease in income tax expense derived from the tax amortization of financial goodwill for foreign shareholding acquisitions made before December 21, 2007. In 2013, this adjustment came to 28 million euros. This impact has been lessened as a result of the entry into force of Law 9/2011 of August 19, 2011 and Law 16/2013 of October 29, 2013, which reduced the deductible portion of goodwill amortization under article 12.5 TRLIS (Corporate Income Tax Act) from 5% to 1% for 2011, 2012, 2013, 2014 and 2015. The effect is temporary: the 4% not amortized over those five years (20% in total) will be recovered by extending the deduction period from the original 20 years to 25 years.

Temporary differences mainly refer to adjustment made to Tax result due to accruals or reversals of non-deductible investment write downs.

In 2013 and 2012, the Company capitalized 9 million euros and 2 million euros, respectively, of deductions. The cumulative amount at year end principally reflects tax deductions for export activities and donations to non-profit organizations (approximately 7 million euros). In 2013, 324 million euros deductions were offset during the year as the final declaration of 2013 (See Note 17.1.).

The caption other effects includes mainly the effects related to the above mentioned Law 16/2013 of October 29, 2013 and the register of tax credits.

### **17.3 Tax inspections and tax-related lawsuits**

On December 12, 2012, the National Court of Justice issued a ruling on the tax inspection for 2001 to 2004, accepting the tax losses incurred by the Group in relation to the transfer of certain interests in TeleSudeste, Telefónica Móviles México and Lycos as tax deductible. The other allegations were rejected, and the Company has filed an appeal with the Supreme Court on December 28.

Also in 2012, the tax inspections for all taxes for the years 2005 to 2007 were completed, with the Company signing consent forms for an income tax payment of 135 million euros and non-consent forms for the items which the Company contests. The tax assessment for which a non-consent form was signed did not require payment of any tax because it only proposed a reduction in unused tax loss carryforwards. An appeal was filed with the Large Taxpayers Central Office of the Spanish State Tax Agency requesting this tax assessment to be reversed, although no decision on the appeal has been issued to date.

At 2013 year end, it is not expected that the final outcome of these assessments and lawsuits, in progress or pending will require any additional significant liabilities to be recognized in Telefónica, S.A.'s financial statements.

Telefónica, S.A. 63

**Table of Contents**

2013 Financial Statements

In July 2013, new inspections of various companies in the 24/90 tax group, of which Telefónica, S.A. is the parent, were initiated. The taxes and periods subject to review are corporate income tax for the years 2008 to 2011, VAT, tax withholdings and payments on account in respect of personal income tax, tax on investment income, property tax and non-resident income tax for the second half of 2009 and the years 2010 and 2011. It is not expected that these inspections in progress will result in the need of recognizing any additional significant liabilities in Telefónica's financial statements.

Telefónica, S.A. 64

**Table of Contents**

2013 Financial Statements

**Note 18. Trade and other payables**

The breakdown of Trade and other payables is as follows:

Million of euros	2013	2012
Suppliers	131	162
Other payables	113	158
Current income tax liabilities (Note 17)	13	89
Other payables to public administrations (Note 17)	29	30
<b>Total</b>	<b>286</b>	<b>439</b>

**Trade payables**

In performance of Telefónica's irrevocable undertaking of 2010 to give Fundación Telefónica a total of 280 million euros, in 2013 the Company made cash payments in the amount of 53 million euros (62 million in 2012).

**Information on deferred payments to third parties. (Third additional provision, Information requirement of Law 15/2010 of 5 July).**

Telefónica, S.A. has adapted its internal processes and payment schedules to the provisions of Law 15/2010, establishing measures against late payment in commercial transactions. Engagement conditions with commercial suppliers in 2013 and 2012 included payment periods of up to 60 and 75 days, respectively, as laid down in said law.

For reasons of efficiency and in line with general practice in the business, the Company has set payment schedules, whereby payments are made on set days. Invoices falling due between two payment days are settled on the following payment date in the schedule. This is not deemed to be a deferred payment.

Information on contracts entered into after Law 15/2010 took effect that exceed the maximum period established in this law is shown in the table below.

Payments to Spanish suppliers in 2013 and 2012 surpassing the legal limit were due to circumstances or incidents beyond the payment policies, mainly the closing of agreements with suppliers over the delivery of goods or the rendering of services, or occasional processing issues.

**2013**

Millions of euros	Amount	%
Payments made on time	298	98

Other	8	2
<b>Total payments to commercial suppliers</b>	<b>306</b>	<b>100</b>
Weighted average maturity exceeded (days)	17	
Deferrals at year-end that exceed the limit	2	

2012

Millions of euros	Amount	%
Payments made on time	332	95
Other	17	5
<b>Total payments to commercial suppliers</b>	<b>349</b>	<b>100</b>
Weighted average maturity exceeded (days)	32	
Deferrals at year-end that exceed the limit	4	

Telefónica, S.A. 65

**Table of Contents**

2013 Financial Statements

At the date of authorization for issue of these financial statements, Telefónica had processed the outstanding payments, except in cases where an agreement with suppliers was being handled.

Telefónica, S.A. 66

**Table of Contents**

2013 Financial Statements

**Note 19. Revenue and expenses****19.1 Revenue****a) Rendering of services**

Telefónica, S.A. has contracts for the right to use the Telefónica brand with Group companies which use the license. The amount each subsidiary must recognize as a cost for use of the license is stipulated in the contract as a percentage of income obtained by the licensor. In 2013 and 2012, Rendering of services to Group companies and associates included 609 million euros and 603 million euros, respectively, for this item.

Telefónica, S.A. has signed contracts to provide management support services to Telefónica de España, S.A.U, Telefónica Móviles España, S.A.U., Telefónica O2 Holding, Ltd. and Telefónica Internacional, S.A.U. Revenue received for this concept in 2013 and 2012 amounted to 16 million euros and 23 million euros, in each case, recognized under Rendering of services to Group companies and associates .

Revenues also include property rental income amounting to 52 and 50 million euros in 2013 and 2012, respectively, mainly from the lease of office space in Distrito Telefónica to several Telefónica Group companies (see Note 7).

**b) Dividends from Group companies and associates**

The detail of the main amounts recognized in 2013 and 2012 is as follows:

Millions of euros	2013	2012
Telefónica Internacional, S.A.U.	4,500	1,500
Telefónica de España, S.A.U.	1,600	221
Telefónica Europe, plc.	1,309	575
Telefónica Móviles España, S.A.U.	1,081	1,435
Telefónica Brasil, S.A. (previously Telecomunicações de Sao Paulo)	495	307
Compañía Inversiones y Teleservicios, S.A.U.	440	10
Sao Paulo Telecomunicações	160	44
Telefónica Czech Republic, a.s.	158	213
Telefónica Móviles Argentina, S.A. y Telefónica Móviles Argentina Holding, S.A.	89	140
Telefónica Gestión de Servicios Compartidos España, S.A.U.	55	
Inversiones Telefónica Móviles Holding, Ltd. (Chile)		189
Ohter companies	191	218
<b>Total</b>	<b>10,078</b>	<b>4,852</b>





**Table of Contents**

2013 Financial Statements

**c) Interest income on loans to Group companies and associates**

This heading includes the return obtained on loans made to subsidiaries to carry out their business (see Note 8.5). The breakdown of the main amounts is as follows:

Millions of euros	2013	2012
Telefónica Móviles México, S.A. de C.V.	100	104
Telefónica de España, S.A.U.		34
Telefónica de Contenidos, S.A.U.	56	75
Other companies	79	62
<b>Total</b>	<b>235</b>	<b>275</b>

**19.2** Non-core and other current operating revenues Group companies relates to revenues on centralized services that Telefónica, S.A., as head of the Group, provides to its subsidiaries. Telefónica, S.A. bears the full cost of these services and then charges each individual subsidiary for the applicable portion.

**19.3 Personnel expenses and employee benefits**

The breakdown of Personnel expenses is as follows:

Millions of euros	2013	2013
Wages, salaries and other personnel expenses	135	130
Pension plans	(1)	(6)
Social security costs	20	17
<b>Total</b>	<b>154</b>	<b>141</b>

In 2013, Wages, salaries and other personnel expenses includes 11 million euros of compensation payable during the year (8 million euros in 2012).

Telefónica has reached an agreement with its staff to provide an Occupational Pension Plan pursuant to Legislative Royal Decree 1/2002, of November 29, approving the revised Pension Plans and Funds Law. The features of this plan are as follows:

Defined contribution of 4.51% of the participating employees base salary. The defined contributions of employees transferred to Telefónica from other Group companies with different defined contributions (e.g.

6.87% in the case of Telefónica de España, S.A.U.) will be maintained.

Mandatory contribution by participants of a minimum of 2.2% of their base salary.

Individual and financial capitalization systems.

This fund was outsourced to Telefónica subsidiary, Fonditel Entidad Gestora de Fondos de Pensiones, S.A., which has added the pension fund assets to its Fonditel B fund.

At December 31, 2013, 1,833 employees had signed up for the plan (1,709 employees in 2012). This figure includes both employees contributing and those who have ceased to contribute to the plan, as provided for in Royal Decree 304/2004 approving the regulations for Pension Plans and Funds. The cost for the Company amounted to 4 million euros in 2013 (3 million euros in 2012).

In 2006, a Pension Plan for Senior Executives, wholly funded by the Company, was created and complements the previous plan and involves additional defined contributions at a certain percentage of the executive's fixed remuneration, based on professional category, plus some extraordinary contributions depending on the circumstances of each executive, payable in accordance with the terms of the plan.

Telefónica, S.A. 68

**Table of Contents**

2013 Financial Statements

Telefónica, S.A. has recorded costs related to the contributions to this executive plan of 8 million euros in both 2013 and 2012.

In 2013 and 2012, some executives left this Pension Plan for Senior Executives, leading to the recovery of the cost of the contributions corresponding to these executives amounting to 12 million euros and 17 million euros, respectively.

No provision was made for this plan as it has been fully externalized.

The share-based payment plans are the following:

***Telefónica, S.A. share plan: Performance Share Plan (PSP).***

At the General Shareholders Meeting of Telefónica, S.A. on June 21, 2006, its shareholders approved the introduction of a long-term incentive plan for managers and senior executives of Telefónica, S.A. and other Telefónica Group companies. Under this plan, selected participants who met the qualifying requirements were given a certain number of Telefónica, S.A. shares as a form of variable compensation. The term of the plan is six years and it is divided into five phases.

June 30, 2012 marked the maturity date of the fourth phase of the plan. This phase had a maximum of 6,356,597 shares (of which 1,552,382 shares corresponded to Telefónica, S.A. executives) assigned on July 1<sup>st</sup>, 2009 with a fair value of 8.41 euros per share. As of maturity date, the requirements of the plan had not been fulfilled and therefore no shares were awarded.

For this same phase of the plan, Telefónica, S.A. acquired an instrument from a financial institution with the same features of the plan. The cost of the financial instrument was 36 million euros, equivalent to 8.41 euros per option. The instrument was cancelled with a charge to distributable reserves when this phase of the plan expired.

June 30, 2013 marked the maturity date of the fifth and last phase of the plan, and no shares have been awarded, pursuant to the general requirements of the plan. This phase had the following maximum number of shares assigned:

	<b>Number of shares</b>	<b>Unit fair value</b>	<b>End date</b>
5rd phase July 1, 2010	5,025,657	9.08	June 30, 2013

Of this amount, the maximum number of shares corresponding to Telefónica, S.A. managers and executives was 1,249,407.

The amount incurred in 2013 related to this concept has been 2 million euros (13 million euros in 2012) with a counterpart of Equity, net of tax effects.

***Long-term incentive plan based on Telefónica, S.A. shares: Performance and Investment Plan***

At the General Shareholders Meeting held on May 18, 2011, a new long-term share-based incentive plan called Performance and Investment Plan (the Plan or PIP) was approved for Telefónica Group directors and executive officers. This plan will take effect following completion of the Performance Share Plan.

Under this Plan, a certain number of shares of Telefónica, S.A. will be delivered to participants selected by the Company who have opted to take part in the scheme and meet the requirements and conditions stipulated to this end. The plan includes an additional condition regarding compliance by all or part of the Participants with a target investment and holding period of Telefónica, S.A. shares through each phase ( Co-Investment ).

The term of the plan is five years and it is divided into three phases.

**Table of Contents**

2013 Financial Statements

The three allocations of shares under this plan were made on July 1, 2011, July 1, 2012 and July 1, 2013, respectively. The maximum number of shares assigned (including the amount of co-investment) under the plan for the three phases is as follows:

	No. of shares assigned	No. of shares assigned at 12/31/12	Unit fair value	End date
1st phase July 1, 2011	5,545,628	4,984,670	8.28	June 30, 2014
2nd phase July 1, 2012	7,347,282	6,868,684	5.87	June 30, 2015
3rd phase July 1, 2013	7,020,473	7,004,547	6.40	June 30, 2016

From the total number of shares assigned, 1,713,318, 2,349,916 and 2,212,215 shares were assigned to employees of Telefónica, S.A. in phases 1, 2 and 3, respectively.

For the first phase of the Plan, Telefónica, S.A. acquired an instrument from a financial institution with the same features of the plan (see Note 9.4.1).

**Telefónica, S.A. share plan: Global Employee Share Plan (GESP)**

In addition to PSP and PIP share plans, during 2011 to 2013 period there have been two other incentive plans based on Telefónica, S.A. shares. The expense incurred under these plans is not significant either considered on a standalone basis or considering both plans together. These shared-base plans are two editions of Global Employee Share Plan which was available for all the employees of the Telefónica Group, with some exceptions. The first edition ended in 2011 and the second will finish in 2014.

**19.4 Average number of employees in 2013 and 2012 and number of employees at year-end:****2013**

Professional category	Employees at 13/31/12			Average no. of employees in 2013		
	Females	Males	Total	Females	Males	Total
General managers and chairmen		1	1		1	1
Directors	58	103	161	55	101	156
Managers	96	108	204	87	100	187
Project Managers	140	132	272	132	125	257
University graduates and experts	88	69	157	83	63	146
Administration, clerks, advisors	151	8	159	145	10	155
<b>Total</b>	<b>533</b>	<b>421</b>	<b>954</b>	<b>502</b>	<b>400</b>	<b>902</b>

**2012**

<b>Professional category</b>	<b>Employees at 12/31/12</b>			<b>Average no. of employees in 2012</b>		
	<b>Females</b>	<b>Males</b>	<b>Total</b>	<b>Females</b>	<b>Males</b>	<b>Total</b>
General managers and chairmen		1	1		4	4
Directors	44	74	118	43	94	137
Managers	69	69	138	76	90	166
Project Managers	108	99	207	112	110	222
University graduates and experts	65	53	118	70	51	121
Administration, clerks, advisors	122	12	134	126	14	140
<b>Total</b>	<b>408</b>	<b>308</b>	<b>716</b>	<b>427</b>	<b>363</b>	<b>790</b>

The increase in 2013 headcount is due to the concentration in the Headquarters of some activities that had previously been developed in the different regions of the Telefónica Group.

Telefónica, S.A. 70

**Table of Contents**

2013 Financial Statements

**19.5 External services.**

The items composing Finance revenue are as follows:

Millions of euros	2013	2012
Rent	11	11
Independent professional services	169	148
Marketing and advertising	80	87
Other expenses	69	242
<b>Total</b>	<b>329</b>	<b>488</b>

On December 19, 2007, Telefónica, S.A. signed a rental contract with a view to establishing the headquarters of the Telefónica Corporate University. The contract included construction and refurbishment of certain facilities by the lessor. On October 31, 2008, some of the facilities were partially accepted and thus the lease period commenced. The lease period is for 15 years (until 2023), renewable for another five.

Future minimum rentals payable under non-cancellable operating leases without penalization at December 31, 2013 and 2012 are as follows:

Millions of euros	Total	From 1 to 3			
		Up to 1 year	years	From 3 to 5 years	Over 5 years
<b>Future minimum rentals 2013</b>	<b>53</b>	5	10	11	27
<b>Future minimum rentals 2012</b>	<b>52</b>	5	9	10	28

Telefónica, S.A. 71

**Table of Contents**

2013 Financial Statements

**19.6 Finance revenue**

The items composing Finance revenue are as follows:

Millions of euros	2013	2012
Dividends from other companies	7	17
Other finance revenue	172	196
<b>Total</b>	<b>179</b>	<b>213</b>

**19.7 Finance costs**

The breakdown of Finance costs is as follows:

Millions of euros	2013	2012
Interest on borrowings from Group companies and associates	1,971	2,042
Finance costs payable to third parties and gains (losses) on interest rates of financial hedges	741	226
<b>Total</b>	<b>2,712</b>	<b>2,268</b>

The breakdown by Group company of debt interest expenses is as follows:

Millions of euros	2013	2012
Telefónica Europe, B.V.	238	388
Telefónica Emisiones, S.A.U.	1,712	1,607
Other companies	21	47
<b>Total</b>	<b>1,971</b>	<b>2,042</b>

Other companies includes financial costs with Telefónica Finanzas, S.A.U. and Telfisa Global, B.V. related to current payables for specific cash needs.

The amount included as Finance costs payable to third parties and gain (losses) on interest rate of financial hedges refers to fair value effects in the valuation of derivative instruments described in Note 16.

**19.8 Exchange differences:**



The breakdown of exchange losses recognized in the income statement is as follows:

<b>Millions of euros</b>	<b>2013</b>	<b>2012</b>
On current operations	37	16
On loans and borrowings	813	414
On derivatives	769	927
On other items	8	15
<b>Total</b>	<b>1,627</b>	<b>1,372</b>

Telefónica, S.A. 72

**Table of Contents**

2013 Financial Statements

The breakdown of exchange gains recognized in the income statement is as follows:

<b>Millions of euros</b>	<b>2013</b>	<b>2012</b>
On current operations	22	35
On loans and borrowings	270	173
On derivatives	1,197	1,073
On other items	56	50
<b>Total</b>	<b>1,545</b>	<b>1,331</b>

The change in exchange gains and losses is basically due to the fluctuations in the main currencies the Company works with which have been significantly weakened against euro in 2013: Brazilian real weakening by 16.54% (9.98% in 2012), Czech crown weakening by 8.33% (strengthening by 2.62% in 2012), US dollar weakening by 4.33% (strengthening of 1.93% in 2012), and the pound sterling weakening by 2.11% (strengthening by 2.35% in 2012). These impacts are offset by the hedges contracted to mitigate exchange rate fluctuations.

Telefónica, S.A. 73

**Table of Contents**

2013 Financial Statements

**Note 20. Other information****a) Financial guarantees**

At December 31, 2013, Telefónica, S.A. had provided financial guarantees for its subsidiaries and investees to secure their transactions with third parties amounting to 42,535 million euros (40,812 million euros at 2012 year-end). These guarantees are measured as indicated in Note 4.g).

<b>Millions of euros</b>		
<b>Nominal Amount</b>	<b>2013</b>	<b>2012</b>
Debentures and bonds	38,780	37,719
Loans and other payables	2,776	2,266
Other marketable debt securities	979	827
<b>Total</b>	<b>42,535</b>	<b>40,812</b>

The debentures and bonds in circulation at December 31, 2013 issued by Telefónica Emisiones, S.A.U., Telefónica Europe, B.V. and Telefónica Finanzas México, S.A. de C.V. were guaranteed by Telefónica, S.A. The nominal amount guaranteed was equivalent to 38,780 million euros at December 31, 2013 (37,719 million euros at December 31, 2012). During 2013, Telefónica Emisiones, S.A.U. issued debt instruments on capital markets for an equivalent of 4,883 million euros (5,148 million euros in 2012); while Telefónica Europe, B.V. issued three undated subordinated securities by an equivalent to 2,466 million euros and Telefónica Emisiones, S.A.U. bonds by an amount equivalent to 3,354 million euros (618 million euros in 2012) and Telefónica Europe, B.V. by 1,500 million euros.

The main loans and other debts guaranteed by Telefónica, S.A. at December 31, 2013 are: a line of credit entered into with China Development Bank on January 5, 2012 by Telefónica Europe, B.V., whose outstanding principal at December 31, 2013 was 375 million US dollars (equivalent to 272 million euros); a syndicated loan granted on March 2, 2012 to Telefónica Europe, B.V. by various institutions, whose outstanding principal at December 31, 2012 was equivalent to 801 million euros (same amount in 2012); and credit facilities obtained by Telefónica Finanzas, S.A. from the European Investment Bank, whose outstanding principal at December 31, 2013 was equivalent to 707 million euros (766 million euros at December 31, 2012). On December 13, 2013, there was a merge of the following syndicated loan facilities: i) Tranche E1 for 756 million euros available as from March 2, 2012 and maturing on March 2, 2017; and ii) Tranche E2 for 1,469 million pounds sterling (this syndicated loan facility was redenominated into euros on December 13, 2013) available as from December 13, 2013 and maturing on March 2, 2017. As a result of this redenomination and conversion there was a new tranche E1 for 2,522 million euros with an outstanding balance at December 31, 2013 amounted to 100 million pounds sterling (equivalent to 123 million euros). During 2013, 1,500 million euros bond issued on October 31, 2004 by Telefónica Europe, B.V. fell due and approximately 52 million euros was complied by Telefónica Finanzas, S.A.U. according to the repayment schedule of the financings.

Other marketable debt securities includes the guarantee of Telefónica, S.A. relating to the commercial paper issue program of Telefónica Europe, B.V. The outstanding balance of commercial paper in circulation issued through this program at December 31, 2013 was 720 million euros (769million euros at December 31, 2012). This caption also includes the remaining guarantee for preferred shares issued by Telefónica Finance USA, LLC, the redemption value of which amounts to 59 million euros (59 million euros at December 31, 2012).

Telefónica, S.A. provides operating guarantees granted by external counterparties, which are offered during its normal commercial activity. At December 31, 2012, these guarantees amounted to approximately 114 million euros.

**b) Litigation**

Telefónica and its Group companies are party to several lawsuits or proceedings that are currently in progress in the law courts and administrative and arbitration bodies of the various countries in which the Telefónica Group is present.

Telefónica, S.A. 74

**Table of Contents**

2013 Financial Statements

Considering the reports of the Company's legal advisors regarding these proceedings, it is reasonable to assume that this litigation or cases will not materially affect the financial position or solvency of Telefónica Group, regardless of the outcome.

Among unresolved cases or those underway in 2013 (see Note 17 for details of tax-related cases), the following are of special note:

**Contentious proceedings in connection with the merger between Terra Networks, S.A. and Telefónica**

On September 26, 2006, Telefónica was notified of the claim filed by former shareholders of Terra Networks, S.A. (Campoaguas, S.L., Panabeni, S.L. and others) alleging breach of contract in respect of the terms and conditions set forth in the Prospectus of the Initial Public Offering of shares of Terra Networks, S.A. dated October 29, 1999. The court rejected this claim and ordered the plaintiffs to pay court costs by a ruling issued on September 21, 2009. The plaintiffs appealed this ruling on December 4, 2009 and Telefónica was notified of such appeal on June 16, 2010. Telefónica opposed to the appeal in January 2011. On April 23, 2013, Telefónica was notified a ruling of the Madrid Regional Court dismissing in its entirety the appeal filed by the plaintiffs against the first instance ruling handed down in 2009, confirming the rulings of the decision under appeal and ordering appellants to pay court costs. The ruling became firm on May 29, 2013, with no further appeals possible.

**Appeal against the European Commission Ruling of July 4, 2007 against Telefónica de España's broadband pricing policy**

On July 9, 2007, Telefónica was notified of the Decision issued by the European Commission (the "EC") imposing on Telefónica and Telefónica de España, S.A.U. (Telefónica de España) a fine of approximately 152 million euros for breach of the former Article 82 of the Treaty Establishing the European Community for not charging equitable prices to whole and retail broadband access services. The court ruled in favour of the EC accusing Telefónica of applying a margin squeeze between the prices it charged competitors to provide regional and national wholesale broadband services and its retail broadband prices using ADSL technology between September 2001 and December 2006.

On September 10, 2007, Telefónica and Telefónica de España, S.A.U. filed an appeal to overturn the decision before the General Court of the European Union. The Kingdom of Spain, as an interested party, also lodged an appeal to overturn the decision. Meanwhile, France Telecom and the Spanish Association of Bank Users (AUSBANC) filed requests to intervene, which the General Court admitted.

In October 2007, Telefónica, S.A. presented a guarantee for an indefinite period of time to secure the principal and interest.

A hearing was held on May 23, 2011, at which Telefónica presented its case. On March 29, 2012 the General Court ruled rejecting the appeal by Telefónica and Telefónica de España, confirming the sanction imposed by the EC. On June 13, 2012, an appeal against this ruling was lodged before the European Court of Justice.

On September 26, 2013 the Attorney General presented its conclusions to the Court stating of a possible breach of the principle of non-discrimination with respect to the sanction and a defective application of the principle of full

jurisdiction by the General Court, requesting the return of the lawsuit to the instance.

**Appeal against the Decision of the European Commission dated January 23, 2013 to sanction Telefónica for the infringement of Article 101 of the Treaty on the functioning of the European Union**

On January 19, 2011, the EC initiated formal proceedings to investigate whether Telefónica, S.A. and Portugal Telecom SGPS, S.A. ( Portugal Telecom ) had infringed on European Union anti-trust laws with respect to a clause contained in the sale and purchase agreement of Portugal Telecom 's ownership interest in Brasilcel, N.V., a joint venture in which both were venturers and owner of brazilian company Vivo.

On January 23, 2013, the EC passed a ruling on the formal proceedings. The ruling imposed a fine on Telefónica of 67 million euros, as the EC ruled that Telefónica and Portugal Telecom committed an infraction as stipulated in Article 101 of the Treaty on the Functioning of the European Union ( TFUE ) for having entered into the agreement set forth in Clause Nine of the sale and purchase agreement of Portugal Telecom 's ownership interest of Brasilcel, N.V.

On April 9, 2013, Telefónica filed an appeal for annulment of this ruling with the European Union General Court. On August 6, 2013, the General Court notified Telefónica of the response issued by the European Commission, in which the EC reaffirmed the main arguments of its ruling and, specially, that Clause Nine is a competition restriction. On September 30, 2013, Telefónica filed its reply. On December 18, 2013, the European Commission filed its appeal.

Telefónica, S.A. 75

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**Table of Contents**

2013 Financial Statements

**c) Commitments****Atento**

As a result of the sale agreement of Atento by Telefónica, announced on October 12, 2012 and ratified on December 12, 2012, both companies have signed a Master Service Agreement which regulates Atento's relationship with the Telefónica Group as a service provider for a period of nine years.

By virtue of this Agreement, Atento become Telefónica's preferred Contact Centre and Customer Relationship Management (CRM) service provider, stipulating annual commitments in terms of turnover which updates in line with inflation and deflation that vary from country to country, pursuant to the volume of services Atento has been providing to the entire Group.

In the case of an eventual failure to meet the annual turnover commitments that could result in a compensation, which would be calculated based on the difference between the actual amount of turnover and the predetermined commitment, applying a percentage based on the Contract Centre's business margin to the final calculation.

Lastly, the Master Agreement sets forth a reciprocal arrangement, whereby Atento assumes similar commitments to subscribe its telecommunications services to Telefónica.

**Agreement for the acquisition of E-Plus**

Telefónica and its German listed subsidiary Telefónica Deutschland Holding AG (hereinafter, "Telefónica Deutschland"), entered into an agreement on July 23 (amended on August 26, 2013) with the Dutch company Koninklijke KPN NV (hereinafter, "KPN") under which Telefónica Deutschland committed itself to acquire the shares of the German subsidiary of KPN, E-Plus Mobilfunk GmbH & Co. KG (hereinafter, "E-Plus"), receiving KPN, as consideration, 24.9% of Telefónica Deutschland and 3,700 million euros.

Telefónica committed to subsequently acquire from KPN, 4.4% of Telefónica Deutschland for a total amount of 1,300 million euros, consequently, after the aforementioned acquisition, KPN's stake in Telefónica Deutschland would be reduced to 20.5%.

Telefónica also committed to subscribe the proportional corresponding share in the capital increase approved by Telefónica Deutschland in the Extraordinary General Meeting held on February, 11, 2014, to finance the cash consideration of the transaction.

The closing of this transaction is subject to certain conditions of which only the relevant authorization from the Competition Authority remains.

**Agreement with the shareholders of Telco, S.p.A**

On September 24, 2013, Telefónica and the remaining shareholders of the Italian company Telco, S.p.A. (which holds a capital stake of 22.4% of the voting share capital of Telecom Italia, S.p.A.) reached an Agreement by virtue of which:

Telefónica subscribed for and paid out a capital increase in Telco, S.p.A., through the contribution of 324 million euros in cash, receiving in return non-voting shares of Telco, S.p.A. As a result of this capital increase, the interest held by Telefónica in the voting share capital of Telco, S.p.A. remained unchanged (i.e. 46.18%), although its interest in the total share capital of Telco, S.p.A. has increased to 66%. The current governance structure at Telco, S.p.A. remained unaffected, including the obligation by Telefónica of abstaining from participating or influencing in any decisions which could affect the markets in which both, Telefónica and Telecom Italia, S.p.A., are present.

Subject to receiving any required anti-trust and telecommunications approvals (including in Brazil and Argentina), Telefónica will subscribe for and pay out a second capital increase in Telco, S.p.A., through the contribution of 117 million euros in cash and will receive in return non-voting shares of Telco, S.p.A. As a result of this second capital increase, the interest of Telefónica in the voting share capital of Telco, S.p.A. will remain unchanged (i.e. 46.18%), although its interest in the total share capital will be then increased to 70%.

Telefónica, S.A. 76



**Table of Contents**

2013 Financial Statements

Starting from January 1, 2014, subject to receiving any required anti-trust and telecommunications approvals (including in Brazil and Argentina), Telefónica may convert all or a portion of its non-voting shares in Telco, S.p.A. into voting shares in Telco, S.p.A., representing no more than 64.9% of the voting share capital of Telco, S.p.A.

The Italian shareholders of Telco, S.p.A. have granted Telefónica a call option to acquire all of their shares in Telco, S.p.A., whose exercise is subject to receiving any required anti-trust and telecommunications approvals (including in Brazil and Argentina). The call option may be exercised by Telefónica starting from January 1, 2014 while the Shareholders Agreement remains in effect, except (i) between June 1, 2014 and June 30, 2014 and between January 15, 2015 and February 15, 2015, and (ii) during certain periods, if the Italian shareholders of Telco, S.p.A. request the demerger of Telco, S.p.A.

At the date of the authorization of these financial statements the approvals that are necessary for the implementation of the transactions contemplated in the Agreement dated September 24, 2013, and subscribed between Telefónica and the remaining shareholders of the Italian company Telco S.p.A. have not been obtained yet.

On December 4, 2013, the Brazilian Antitrust Regulator, Conselho Administrativo de Defesa Econômica (CADE) announced, the two following decisions:

1. To approve, with the restrictions mentioned below, the acquisition by Telefónica of the entire participation held by Portugal Telecom, SGPS S.A., and PT Móveis - Serviços de Telecomunicações, SGPS, S.A., (the PT Companies ) in Brasilcel N.V., which controlled the Brazilian mobile company, Vivo Participações S.A.

It must be noted that such transaction was approved by ANATEL (Brazilian Telecommunications Regulation Authority) and the closing (which did not require CADES' prior approval at the time), occurred immediately after such ANATEL's approval, on September 27, 2010.

The above mentioned decision has been granted by CADE conditional on:

- (a) The entry of a new shareholder in Vivo, sharing with Telefónica the control of Vivo in conditions identical to those that were applicable to the PT Companies when they had a participation in Brasilcel N.V., or
- (b) That Telefónica ceases to have any direct or indirect financial interest in TIM Participações S.A.

2. To impose on Telefónica a fine of 15 million Brazilian Reais, for having allegedly breached the spirit and the goal of the agreement signed between Telefónica and CADE (as a condition to the approval of

Telefónica's original acquisition of an interest in Telecom Italia in 2007), due to the subscription of non-voting shares of Telco on a recent capital increases. This decision also requires Telefónica to divest such non-voting shares of Telco S.p.A

The timing for the accomplishment of the conditions and obligations imposed by CADE on both decisions was classified by CADE as confidential and reserved information.

On December 13, 2013, Telefónica S.A. announced, in relation to the two Decisions adopted by CADE on its December 4, 2013 session, that the company considers that the remedies imposed were unreasonable and therefore, is further analyzing the possibility of initiating the appropriate legal actions.

In line with such course of action, and to reinforce our strong commitment with the previous obligations undertaken by Telefónica to remain separate from Telecom Italia's Brazilian businesses, Telefónica S.A, highlighted in the aforementioned announcement, that Mr. César Alierta Izuel and Mr. Julio Linares López have decided to resign, with immediate effect, from their positions as Directors of Telecom Italia; and Mr. Julio Linares has decided to resign, with immediate effect, from his position in the slate submitted by Telco S.p.A. for the potential re-election of the Board of Directors of Telecom Italia in the Shareholders Meeting of the aforementioned company, called for December 20, 2013.

For the same reasons, Telefónica S.A., indicated that, without prejudice of any of the rights recognized in Telco, S.p.A. Shareholder's Agreement, has decided for the time being not to avail of its right to appoint two Directors in the Board of Directors of Telecom Italia.

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**Table of Contents**

2013 Financial Statements

**Agreement for the sale of a stake in Telefónica Czech Republic, A.S**

As explained in Note 8, on November 5th, 2013, Telefónica reached an agreement with PPF Group N.V. (hereinafter PPF) to sell 65.9% of Telefónica Czech Republic, a.s. (hereinafter Telefónica Czech Republic) for an amount of, approximately, 306 Czech Crowns per share in cash (approximately 2,467 million euros at the date of the agreement).

The agreement stated that aforementioned consideration was to be paid in two tranches:

(i) 2,063 million euros in cash up front at closing of the transaction; and

(ii) 404 million euros in cash as deferred payments over a 4 year period.

Additionally, Telefónica received an amount of 260 million euros corresponding to the distribution to shareholders approved by the General Shareholders Meeting of Telefónica Czech Republic, paid on November 11th, 2013.

As a result of this transaction, Telefónica will hold a 4.9% equity stake in Telefónica Czech Republic. In addition, Telefónica will remain as a Company's industrial and commercial partner for 4 years:

Telefónica Czech Republic will be renamed but will continue using the O2 brand for up to four years.

The Company will become part of Telefónica's Business Partners Program.

In connection with this transaction, PPF will launch a Mandatory Tender Offer. Telefónica will maintain its 4.9% but may dispose of the shares upon completion, subject to certain restrictions.

Furthermore, the agreement establishes a put/call option structure in relation to the Telefónica Czech Republic shares which Telefónica holds after 4 years. In addition, the agreement includes tag along/drag along clauses.

Transaction was completed on January 28, 2014, after obtaining the relevant regulatory authorization (See Note 22).

Telefónica, S.A. 78

**Table of Contents**

2013 Financial Statements

**d) Directors and senior executives compensations and other benefits****Board of Directors compensation**

The compensation of Telefónica members of the Board of Directors is governed by Article 35 of the Bylaws, which states that the compensation amount that the Company may pay to all of its Directors as remuneration and attendance fees shall be fixed by the shareholders at the General Shareholders Meeting. The Board of Directors shall determine the exact amount to be paid within such limit and the distribution thereof among the directors. This compensation, as established in said article of the Bylaws, is compatible with other professional or employment compensation accruing to the Directors by reason of any executive or advisory duties that they perform for the Company, other than the supervision and collective decision-making duties inherent in their capacity as Directors.

Accordingly, the shareholders, at the Annual General Shareholders Meeting held on April 11, 2003, set the maximum gross annual amount to be paid to the Board of Directors at 6 million euros, including a fixed payment and fees for attending meetings of the Board of Directors Advisory or Control Committees. Total compensation paid to Telefónica's Directors for discharging their duties in 2013 amounted to 3,516,669 euros in fixed compensation and attendance fees.

The compensation of Telefónica, S.A. directors in their capacity as members of the Board of Directors, the Executive Commission and/or the Advisory and Control Committees consists of a fixed amount payable monthly, and fees for attending the meetings of the Board's Advisory or Control Committees. Executive Directors other than the Chairman do not receive any amounts for their directorships, but only the corresponding amounts for discharging their executive duties as stipulated in their respective contracts.

It is hereby stated that the Company's Board of Directors, at its meeting of July 25, 2012, agreed to a 20% reduction of the amounts that the Board members receive for discharging their duties.

The tables below presents the fixed amounts established in 2013 for membership to Telefónica's Board of Directors, Executive Commission and Advisory or Control Committees and the attendance fees of the Advisory or Control Committees.

**Compensation of members of the Board of Directors and Board Committees**

<b>Amounts in euros</b>			
<b>Position</b>	<b>Board of Directors</b>	<b>Executive Committees</b>	<b>Advisory or Control Committees (*)</b>
Chairman	240,000	80,000	22,400
Vice Chairman	200,000	80,000	
Executive			
Proprietary	120,000	80,000	11,200
Independent	120,000	80,000	11,200
Other external	120,000	80,000	11,200

(\*) In addition, the amounts paid for attendance to each of the Advisory or Control Committee s meetings is 1,000 euros.

**Individual breakdown**

Annex II provides a detail by individual, by compensation item, of the compensation and benefits paid by Telefónica, S.A. and other companies of the Telefónica Group to members of the Company s Board of Directors in 2013.

Telefónica, S.A. 79

**Table of Contents**

2013 Financial Statements

**e) Detail of equity investments, positions held and duties performed in companies engaging in an activity that is similar or complementary to that of the Company**

Pursuant to Section 229 of the consolidated Corporate Enterprises Act, introduced by Royal Legislative Decree 1/2010 of July 2, details are given below of (i) the direct and indirect interests held by members of the Board of Directors of Telefónica, S.A., and by persons related thereto as set out in Section 231 of the consolidated Corporate Enterprises Act and (ii) the positions or duties carried out by those individuals, both of the foregoing in respect to companies with the same, analogous, or similar corporate purpose as that of Telefónica, S.A.

<b>Name</b>	<b>Activity performed</b>	<b>Company</b>	<b>Position or functions</b>	<b>Stake (%) (*)</b>
Mr. Isidro Fainé Casas	Telecommunications	Abertis Infraestructuras, S.A.	Vice Chairman 1º	< 0.01%
Mr. Isidro Fainé Casas	Telecommunications	Telecom Italia, S.p.A.		< 0.01% (**)
Mr. Carlos Colomer Casellas	Telecommunications	Abertis Infraestructuras, S.A.	Director	
Mr. Luiz Fernando Furlán	Telecommunications	Abertis Infraestructuras, S.A.	Advisory Board Member	

(\*) Shareholding of less than 0.01% of share capital indicated by <0.01% .

(\*\*) Shareholding of the total number of ordinary shares.

Information on Board member Chang Xiaobing, Executive Chairman of China Unicom (Hong Kong) Limited, is not included in this section given that:

In accordance with Article 33 of the Company's Bylaws, whereby (...) the following shall not be deemed to be in a situation of effective competition with the Company, even if they have the same or a similar or complementary corporate purpose: (...) companies with which Telefónica, S.A. maintains a strategic alliance , Mr. Xiaobing's interests are not in conflict with those of Telefónica, S.A.

Mr. Xiaobing holds no stakes in the capital of the companies in which he is a Board member (Section 229 of the Corporate Enterprises Act).

In addition, for information purposes, details are provided below on the positions or duties performed by members of the Board of Directors of Telefónica, S.A. in those companies whose activity is identical, similar or complementary to the corporate purpose of the Company, of any Telefónica Group company, or of any company in which Telefónica, S.A. or any of its Group companies holds a significant interest whereby it is entitled to board representation in those companies or in Telefónica, S.A.



**Table of Contents**

2013 Financial Statements

<b>Name</b>	<b>Company</b>	<b>Position or functions</b>
Mr. César Alierta Izuel	China Unicom (Hong Kong) Limited	Director
Mr. Alfonso Ferrari Herrero	Telefónica Chile, S.A. Telefónica del Perú, S.A.A.	Acting Director Director
Mr. Francisco Javier de Paz Mancho	Telefónica Brasil, S.A. Telefónica de Argentina, S.A.	Director Director
Mr. José Fernando de Almansa Moreno-Barreda	Telefónica Brasil, S.A. Telefónica Móviles México, S.A. de C.V.	Director Director
Mr. Gonzalo Hinojosa Fernández de Angulo	Telefónica del Perú, S.A.A.	Director
Mr. Luiz Fernando Furlán	Telefónica Brasil, S.A.	Director
Ms. María Eva Castillo Sanz	Telefónica Czech Republic, a.s. Telefónica Europe, Plc. Telefónica Deutschland Holding, A.G. Tuenti Technologies, S.L.	Chairwoman of Supervisory Board (1) Chairwoman Chairwoman of Supervisory Board Chairwoman
Mr. Santiago Fernández Valbuena	Telefónica Internacional, S.A. Telefónica América, S.A. Telefónica Brasil, S.A. Telefónica Móviles México, S.A. de C.V. Colombia Telecomunicaciones, S.A., E.S.P. Telefónica Chile, S.A. Telefónica Capital, S.A.	Chairman Chairman Vice Chairman Vice Chairman Director Acting Director Sole Director
Mr. Chang Xiaobing	China United Network Communications Group Company Limited China United Network Communications Corporation Limited China Unicom (Hong Kong) Limited China United Network Communication Limited	Chairman Chairman Chairman Executive Chairman Chairman

(1)



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On January 29, 2014, Ms. Eva Castillo Sanz resigned from the position of Chairwoman of the Supervisory Board of Telefónica Czech Republic, a.s.

Telefónica, S.A. 81

**Table of Contents**

2013 Financial Statements

**f) Related-party transactions***Significant shareholders*

The main transactions between Telefónica, S.A. and its significant shareholders always concluded at arm's length are as follows: The figures refer to Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) and subsidiaries pertaining to its consolidated group and Caja de Ahorros y Pensiones de Barcelona, (la Caixa) and subsidiaries pertaining to its consolidated group: Their stake in Telefónica as of December 31, 2013 is 6.89% y 5.43%, respectively.

<b>Millions of euros</b>		
<b>2013</b>	<b>BBVA</b>	<b>la Caixa</b>
Financial expenses	2	1
Receipt of services	3	2
<b>Total expenses</b>	<b>5</b>	<b>3</b>
Financial revenues	8	8
Dividends received (1)	14	
<b>Total revenues</b>	<b>22</b>	<b>8</b>
Financing transactions	1,568	1,671
Guarantees granted		
Time deposits	310	214
Dividends distributed	108	89
Derivatives (Nocional) (2)	12,268	1,200

(1) As of December 31, 2013 Telefónica holds 0.76% investment in BBVA (See Note 9.3.).

(2) See the policies of derivative instruments of the Group in Note 16.

<b>Millions of euros</b>		
<b>2012</b>	<b>BBVA</b>	<b>la Caixa</b>
Financial expenses	5	5
Receipt of services	28	25
<b>Total expenses</b>	<b>33</b>	<b>30</b>
Financial revenues	4	2
Dividends received	16	

<b>Total revenues</b>	<b>20</b>	<b>2</b>
Financing transactions	449	385
Guarantees granted		10
Time deposits	622	618
Dividends distributed	286	135
Derivatives (Nocional)	12,905	2,661

*Group companies and Associates*

Telefónica, S.A. is a holding company for various investments in companies in Latin, Spain and the rest of Europe which do business in the telecommunications, media and entertainment sectors.

The balances and transactions between the Company and these subsidiaries (Group and Associated Companies) at December 31, 2013 and 2012 are detailed in the notes to these individual financial statements.

Telefónica, S.A. 82

**Table of Contents**

2013 Financial Statements

*Directors and senior executives*

During the financial year to which these accompanying annual financial statements refer, the Directors and senior executives did not perform any transactions with Telefónica or any Telefónica Group company other than those in the Group's normal trading activity and business.

Compensation and other benefits paid to members of the Board of Directors and senior executives, as well as the detail of the equity interests and positions held and duties performed in companies engaging in an activity that is identical, similar or complementary to that of the Company are detailed in Note 20.d and Appendix II to these financial statements.

Certain Directors of Telefónica, S.A.'s Board that are also Directors in the Board of Abertis Infraestructuras, S.A., which is the holding company of de Abertis Group (See Note 20.e.). In 2013, Telefónica has reached an agreement with Abertis, through its subsidiary Abertis Tower, S.A. Pursuant to this agreement, Telefónica Móviles España, S.A.U. has sold 690 mobile telephone towers with a profit of 70 million euros. In addition, Abertis Tower, S.A. has rented to Telefónica Móviles España, S.A.U. some space in the previously mentioned infrastructures to locate its telecommunication equipments.

On December 28, 2012 Telefónica de Contenidos, S.A.U. (a subsidiary 100% of Telefónica, S.A.) signed an agreement with Abertis (through its subsidiary Abertis Telecom, S.A.) to sell 23,343 shares of Hispasat, S.A. for an amount of 68 million euros.

**g) Auditors fees**

The fees accrued in 2013 and 2012 to the various member firms of the EY international organization (previously Ernst & Young), to which Ernst & Young, S.L. (the auditors of Telefónica, S.A. in 2013 and 2012) belongs, amounted to 3.19 million euros and 3.15 million euros, respectively, broken down as follows.

<b>Millions of euros</b>	<b>2013</b>	<b>2012</b>
Audit services	2.90	2.53
Audit-related services	0.29	0.62
<b>Total</b>	<b>3.19</b>	<b>3.15</b>

Ernst & Young, S.L. has not provided the Company with tax advice or other services except as disclosed above.

**h) Environmental matters**

Telefónica has an integrated Green ICT and Environment strategy with three common goals. The first concerns environmental risk management, the second promoting internal eco-efficiency, and the third unlocking business opportunities to offer end-to-end telecommunications services that support a low-carbon economy.

The Group has an Environmental Policy covering all its companies, as well as a Global Environmental Management System to ensure compliance with local environmental laws and continuously improve management processes. The Climate Change and Energy Efficiency Office is also responsible for rolling out processes to boost energy efficiency and shrink the Group's carbon footprint.

**Table of Contents**

2013 Financial Statements

**i) Trade and other guarantees**

The Company is required to issue trade guarantees and deposits for concession and spectrum tender bids and in the ordinary course of its business. No significant additional liabilities in the accompanying financial statements are expected to arise from guarantees and deposits issued (see Note 20 a.).

Telefónica, S.A. 84

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**Table of Contents**

2013 Financial Statements

**Note 21. Cash flow analysis****Cash flows from/(used in) operating activities**

The net result before tax in 2013 amounted to 33 million euros (see the income statement), adjusted by items recognized in the income statement that did not require an inflow or outflow of cash in the year.

These adjustments relate mainly to:

Impairments to investments in Group companies, associates and other investments of 7,998 million euros (impairment in 2012 of 5,312 million euros).

Declared dividends as income in 2012 for 10,078 million euros (4,852 million euros in 2012), interest accrued on loans granted to subsidiaries of 235 million euros (275 million euros in 2012) and a net financial expense of 2,491 million euros (2,126 million euros in 2012), adjusted initially to include only movements related to cash inflows or outflows during the year under Other cash flows from operating activities.

Other cash flows from operating activities amounted to 6,017 million euros (1,832 million euros in 2012). The main items included are:

a) Net interest paid:

Payments of net interest and other financial expenses amounted to 1,664 million euros (2,007 million euros in 2012), including:

Net payments to external credit entities of 174 million euros (190 million euros in 2012), and

Interest and hedges paid to Group companies of 1,838 million euros (1,817 million euros in 2012). The main payments in 2013 were to Telefónica Emisiones, S.A.U., for 1,677 million euros, and to Telefónica Europe, B.V., for 273 million euros. The interest paid figure is partially offset by the interest received from Telefónica de Contenidos, S.A.U. amounting to 125 million euros.

b) Dividends received:

The main receipts relate to:

<b>Millions of euros</b>	<b>2013</b>	<b>2012</b>
Telefónica de España, S.A.U.	1,600	221
Telefónica Móviles España, S.A.U.	1,080	1,435
Telefónica Europe, plc.	1,309	574
Telefónica Czech Republic, a.s.	147	212
Telefónica Internacional, S.A.U.	1,500	
Telefónica Brasil, S.A. (Telesp)	398	347
Grupo Telefónica Móviles Argentina	89	112
Sao Paulo Telecomunicações	141	51
Otros cobros de dividendos	164	385
<b>Total</b>	<b>6,428</b>	<b>3,337</b>

In addition to the dividends recognized as income in 2013 (see Note 19.1) and collected in the same period, this caption also includes dividends from 2012 collected in 2013.



**Table of Contents**

2013 Financial Statements

- c) Income tax collected: Telefónica, S.A. is the parent of its consolidated Tax Group (see Note 17) and therefore it is liable for filing income tax with the Spanish Treasury. It subsequently informs companies included in the Tax Group of the amounts payable by them. Payments of totaling 436 million euros were made in 2013 (247 million in 2012), as disclosed in Note 17. In this regard, the main amounts passed on to subsidiaries of the tax group were as follows:

Telefónica Móviles España, S.A.U.: collection of 648 million euros, corresponding to: 311 million euros for the 2012 income tax settlement, 326 million in payments of account of 2013 income tax and 11 million euros of the third payment of account of 2012 income tax that has been paid in 2013, net of the effect of 1998 to 2000 tax settlements. In 2012, rebilling amounted to 360 million euros mainly due to payments on account of the 2011 income tax settlement.

Telefónica de España, S.A.U.: collection of 931 million euros, corresponding to: 362 million euros for the 2012 income tax settlement, 531 million in payments of account of 2013 income tax and 38 million euros of the third payment of account of 2012 income tax that has been paid in 2013, net of the effect of 1998 to 2000 tax settlements. In 2012, rebilling amounted to 573 million euros corresponding to: 382 million euros for the 2011 income tax settlement, 25 million euros for the 2005 to 2007 tax settlements, and 166 million in payments of account of 2012 income tax.

**Cash flows from/(used in) investing activities**

Payments on investments under Cash flows from/(used in) investing activities included a total payment of 2,938 million euros (6,779 million euros in 2012). The main transactions to which these payments refer are as follows:

Capital increases: the main disbursements correspond to Telefónica México, S.A. de C.V. amounting to 440 million euros and Telco, S.p.A. amounting to 324 million euros. These capital increases, as well as other minor disbursements of this same concept are disclosed fully in Note 8.1.a.

1,038 million euro loans awarded and paid out in 2013 to Telefónica Móviles España, S.A.U., 158 million euro loan awarded and paid to Telefónica Digital Holding, S.A. and a credit awarded and paid to Telefónica de España, S.A.U. totaling 165 million euros, all described in Note 8.5.

Buyback of debentures and bonds issued by Telefónica Emisiones, S.A.U. and Telefónica Europe, B.V. totaling 98 million euros.

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Acquisition of a convertible debenture issued by Telecom Italia, S.p.A. amounting to 103 million euros as described in Note 9.4.2.

Proceeds from disposals totaling 2,791 million euros in 2013 (8,151 million euros in 2012) includes:

Repayment of contributions through share capital reductions or share premiums by O2 Europe Ltd amounting to 286 million euros, Panamá Cellular Holdings, B.V. with 186 million euros and Telefónica Czech Republic, a.s. with 100 million euros.

Repayments of a loan granted by Telefónica, S.A. to Telefónica de Contenidos, S.A.U. amounting to 1,142 million euros and maturity date in 2013. The loan was substituted by a credit amounting to 340 million euros. The funds have been received by the net amount and it has been shown as proceed from disposals (See Note 8.5.)

The proceed from the sale to Telefónica Centroamérica Inversiones, S.L. of the 24.5% investment in Telefónica Móviles Panamá, S.A. amounting to 83 million euros (Nota 8.1.).

Repayment in 2013 of a loan granted and paid to Telefónica Móviles España, S.A.U. in 2012 amounting to 638 million euros.

The proceeds from the maturity of debentures and bonds issued by Telefónica Emisiones, S.A.U. and Telefónica Europe, B.V. totaling 337 million euros.

In 2012, Proceeds from disposals primarily included repayment of loans granted by the Company to subsidiaries, the most significant amounts of which were received from Telefónica de España, S.A.U. (681 million euros). It was also included the repayment of contributions through share capital reductions or share premiums by subsidiaries: O2 Europe Ltd (5,729 million euros) and Telefónica de España, S.A.U. (731 million euros).

Telefónica, S.A. 86

**Table of Contents**

2013 Financial Statements

**Cash flows from/(used in) financing activities**

This caption includes the following items:

- i. Payments for equity instruments of 244 million euros (590 million euros in 2012), relating to the net amount of treasury shares acquired in 2013.
- ii. Proceeds from financial liabilities:
  - a) Debt issues: The main collections comprising this heading are as follows:

Millions of euros	2013	2012
8bn syndicated loan		915
Bilateral credit (Note 14.2)		200
EKN credit facility (Note 14.2)	407	200
Telefónica Emisiones, S.A.U. (Note 15)	4,352	5,148
Telefónica Europe, B.V. (Note 15)	3,078	2,604
Preferred shares TFinance (Note 14)		1,165
Telfisa Global, B.V. financing (Note 15)	1,633	
Commercial paper issued by Telefónica Europe, B.V.	153	
Commercial paper (Note 13)	31	244
Other collections	473	489
<b>Total</b>	<b>10,127</b>	<b>10,964</b>

- b) Prepayments and redemption of debt: The main payments comprising this heading are as follows:

Millions of euros	2013	2012
Preferred shares bonds (Note 13)	582	
8bn syndicated loan (Note 14)	4,000	915
Telefónica Europe, B.V.	1,500	4,508
Telefónica Finanzas, S.A.U.	2,081	1,544
Telefónica Emisiones, S.A.U. (Note 15)	3,594	620
Telfisa Global, B.V. financing (Note 15)		510

Net movement in floating-rate credit facilities		423
Other payments	274	681
<b>Total</b>	<b>12,031</b>	<b>9,201</b>

The commercial paper transactions with Telefónica Europe, B.V. are stated at their net balance as recognized for the purposes of the cash flow statement, being high-turnover transactions where the interval between purchase and maturity never exceeds six months.

The financing obtained by the Company from Telefónica Finanzas, S.A.U. and Telfisa Global, B.V. relates to the Group's integrated cash management (see Note 15). These amounts are stated net in the cash flow statement as new issues or redemptions on the basis of whether or not at year-end they represent current investment of surplus cash or financed balances payable.

- iii. Payments of dividends for 1,588 million euros (2,836 million euros in 2012) as described in Note 11.1. d).

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**Table of Contents**

2013 Financial Statements

**Note 22. Events after the reporting period**

The following events regarding the Company took place between the reporting date and the date of preparation of the accompanying financial statements:

**Financing**

On January 31, 2014, Telefónica Emisiones, S.A.U. redeemed 296 million pounds sterling (equivalent to 355 million euros) of its notes, issued on December 28, 2006. The notes were guaranteed by Telefónica S.A.

On February 3, 2014, Telefónica Emisiones, S.A.U. redeemed 2,000 million euros of its notes, issued on February 3, 2009. The notes were guaranteed by Telefónica S.A.

On February 7, 2014, Telefónica Emisiones, S.A.U. redeemed 1,500 million euros of its notes, issued on February 7, 2007. The notes were guaranteed by Telefónica S.A.

On February 7, 2014, Telefónica, S.A. made an early repayment for 923 million euros of its syndicated loan (Tranche D2) dated March 2, 2012 (scheduled to mature originally on December 14, 2015).

On February 7, 2014, Telefónica Europe, B.V. made an early repayment for 801 million euros of its syndicated loan (Tranche D1) dated March 2, 2012 (scheduled to mature originally on December 14, 2015).

On February 18, 2014, Telefónica, S.A. signed a 3,000 million euros syndicated revolving credit facility maturing on February 18, 2019. This agreement would enter into effect on February 25, 2014 cancelling the 3,000 million syndicated credit facility signed on July 28, 2010 (scheduled to mature originally in 2015).

**Sale of Telefónica Czech Republic, a.s.**

On January 28, 2014 Telefónica announced that, after obtaining the relevant regulatory approval, the transaction for the sale of a 65.9% stake of Telefónica Czech Republic, a.s. to PPF Group, N.V., has been completed (see Note 20.c. and 8.5.)

**Telefónica new organization structure**

On February 26, 2014, the Board of Directors of Telefónica, S.A. has approved the implementation of a new organizational structure completely focused on clients and that incorporates the digital offering as the main focus for commercial policies. The structure gives greater visibility to local operations, bringing them closer to the corporate

decision-making centre, simplifying the global structure and strengthening the transverse areas to improve flexibility and agility in decision makings.

Within this framework, Telefónica has created the role of the Chief Commercial Digital Officer, who will be responsible for fostering revenue growth. On the cost side, the Company has strengthened the role of the Chief Global Resources Officer. Both Officers will report directly to the Chief Operating Officer (COO), as will the local business CEOs for Spain, Brazil, Germany and the United Kingdom, in addition to the Latin American Unit, now without Brazil.

The new model integrates the activities carried out to date by Telefónica Digital, Telefónica Europe and Telefónica Latam into the Global Corporate Centre, thus simplifying the organization.

**Table of Contents**

2013 Financial Statements

**Note 23. Additional note for English translation**

These annual financial statements were originally prepared in Spanish and were authorized for issue by the Company's Directors in the meeting held on February 26, 2014. In the event of a discrepancy, the Spanish-language version prevails.

Telefónica, S.A. 89

**Table of Contents**

2013 Financial Statements

Appendix I: Details of subsidiaries and associates at December 31, 2013

MILLIONS OF EUROS	% OWNERSHIP		INCOME (LOSS)				Gross carrying amount	
	Direct	Indirect	Capital	Reserves	Dividends	From operations		For the year
<b>Telefónica Europe plc (UNITED KINGDOM)</b> Wireless communications services operator Wellington Street, Slough, SL1 1YP	100.00%		13	14,405	1,309	(12)	1,288	25,310
<b>Telefónica Internacional, S.A.U. (SPAIN)</b> Investment in the telecommunications industry abroad Gran Vía, 28 - 28013 Madrid	100.00%		2,839	3,022	4,500	(155)	797	8,132
<b>Telefónica Móviles España, S.A.U. (SPAIN)</b> Wireless communications services provider Plaza de la Independencia, 6 - Pta. 5 - 28001 Madrid	100.00%		423	498	1,081	1,393	994	5,775
<b>Telfin Ireland Limited (IRELAND)</b> Intragroup financing 28/29 Sir John Rogerson's Quay, Dublin 2	100.00%			4,726			130	4,491
<b>O2 (Europe) Ltd. (UNITED KINGDOM)</b> Holding company Wellington Street, Slough, SL1 1YP	100.00%		1,239	5,952		(1,458)	(1,177)	2,764
<b>Telefónica Móviles México, S.A. de C.V. (MEXICO) (1)</b> Holding company Prolongación Paseo de la Reforma 1200 Col. Cruz Manca, México D.F. CP.05349	100.00%		4,313	(2,738)		(115)	(205)	4,061
<b>Telefónica de España, S.A.U. (SPAIN)</b> Telecommunications service provider in Spain Gran Vía, 28 - 28013 Madrid	100.00%		1,024	1,484	1,600	2,739	2,030	2,303
<b>Telefónica de Contenidos, S.A.U. (SPAIN)</b>	100.00%		1,865	(1,623)		86	25	2,242



Organization and operation of multimedia  
service-related activities and businesses  
Don Ramón de la Cruz, 84 4ª Pta.- 28006  
Madrid

<b>Telefónica Datacorp, S.A.U. (SPAIN)</b> Holding company Gran Via, 28 - 28013 Madrid	100.00%	700	136		(3)	(2)	1,343
<b>Telfisa Global, B.V. (NETHERLANDS)</b> Integrated cash management, consulting and financial support for Group companies Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX - Amsterdam	100.00%		721		(3)	6	712
<b>Ecuador Cellular Holdings, B.V. (NETHERLANDS)</b> Holding company Strawinskylaan 3105, Atium 7th, Amsterdam	100.00%,		533	77		62	581
<b>Telefónica Chile Holdings B.V. (NETHERLANDS)</b> Holding company Herikerbergwebr 238, 1101CM 23393, 1100DW - Amsterdam Zuidoost (Netherlands)	100.00%		1,464				473
<b>Compañía de Inversiones y Teleservicios, S.A. (SPAIN)</b> Holding company C/ Santiago de Compostela, 94 - 28035 Madrid	100.00%	24	87	440		6	256
<b>Panamá Cellular Holdings, B.V. (NETHERLANDS)</b> Holding company Strawinskylaan 3105, Atium 7th, Amsterdam	100.00%		85		(93)	(83)	52

Telefónica, S.A. 90

**Table of Contents**

2013 Financial Statements

MILLIONS OF EUROS	% OWNERSHIP		INCOME (LOSS)				Gross For the carrying amount	
	Direct	Indirect	Capital	Reserve	Dividend	From operations		
<b>NAME AND CORPORATE PURPOSE</b>								
<b>Telefónica de Costa Rica TC, S.A. (COSTA RICA)</b>	100.00%		239	(77)		(41)	(43)	239
Holding company Plaza Roble, Edificio Los Balcones 4to. Piso, San José								
<b>Telefónica Global Technology, S.A. (SPAIN)</b>	100.00%		16	95		(2)	(6)	178
Global management and operation of IT systems Gran Vía, 28 - 28013 Madrid								
<b>Telefónica Capital, S.A. (SPAIN)</b>	100.00%		7	126		(1)	3	110
Finance company Gran Via, 28 - 28013 Madrid								
<b>Seguros de Vida y Pensiones Antares, S.A. (SPAIN)</b>	100.00%		51	60	12	2	10	69
Life insurance, pensions and health insurance Ronda de la Comunicación, s/n Distrito Telefónica Edificio Oeste 1, planta 9- 28050 Madrid								
<b>Telefónica Digital Holdings, S.L. (SPAIN)</b>	100.00%		9	102		(121)	(128)	149
Holding company Ronda de la Comunicación, s/n Distrito Telefónica Edificio Central - 28050 Madrid								
<b>Taetel, S.L. (SPAIN)</b>	100.00%		28	12	1			28
Acquisition, ownership and disposal of shares and stakes in other companies Gran Via, 28 - 28013 Madrid								
<b>Telefónica Gestión de Servicios Compartidos España, S.A. (SPAIN)</b>	100.00%		8	(8)	55	10	28	24
Management and administrative services rendered Gran Via, 28 - 28013 Madrid								
<b>Lotca Servicios Integrales, S.L. (SPAIN)</b>	100.00%		17	(6)			(1)	17
Holding and operation of aircraft and aircraft leases Gran Via, 28 - 28013 Madrid								
<b>Telefónica Ingeniería de Seguridad, S.A. (SPAIN)</b>	100.00%		7			(8)	(9)	15
Security services and systems Condesa de Venadito, 1 - 28027 Madrid								

<b>Comet, Compañía Española de Tecnología, S.A. (SPAIN)</b>	100.00%	5	4				14
Promotion of business initiatives and holding of real estate assets Villanueva, 2 duplicado planta 1ª Oficina 23 - 28001 Madrid							
<b>Telefónica Finanzas, S.A.U. (TELFISA) (SPAIN)</b>	100.00%	3	58	(2)	11		13
Integrated cash management, consulting and financial support for Group companies Gran Vía, 30 - 4ª Plta. - 28013 Madrid							
<b>Centro de Investigación y Experimentación de la Realidad Virtual, S.L. (SPAIN)</b>	100.00%						10
Design of communications products Vía de Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta. Pozuelo de Alarcón - 28224 Madrid							
<b>Telefónica International Wholesale Services II, S.L. (SPAIN)</b>	100.00%		(61)	(59)	(41)		9
Telecommunications service provider and operator Ronda de la Comunicación, s/n 28050 Madrid							
<b>Telefónica Investigación y Desarrollo, S.A.U. (TIDSA) (SPAIN)</b>	100.00%	6	11	48	6	10	6
Telecommunications research activities and projects Telecomunicaciones Ronda de la Comunicación, s/n 28050 Madrid							

Telefónica, S.A. 91

**Table of Contents**

2013 Financial Statements

MILLIONS OF EUROS	% OWNERSHIP		INCOME (LOSS)					Gross From For the carrying year amount
	Direct	Indirect	Capital Reserve	Dividends	Operations			
<b>Telefónica Luxembourg Holding S.à.r.L. (LUXEMBOURG)</b> Holding company 26, rue Louvingny, L-1946- Luxembourg	100.00%		3	76				4
<b>Venturini España, S.A. (SPAIN)</b> Property leasing Avda. de la Industria, 17 Tres Cantos - 28760 Madrid	100.00%		3	2				4
<b>Fisatel Mexico, S.A. de C.V. (MEXICO)</b> Integrated cash management, consulting and financial support for Group companies Boulevard Manuel Avila Camacho, 24 - 16 <sup>a</sup> Plta. - Lomas de Chapultepec - 11000 Mexico D.F.	100.00%		57	(2)	2	(1)	1	57
<b>Terra Networks Marocs S.A.R.L.</b> Dormant Company 332 Boulevard Brahim Roudani, Casablanca	100.00%							
<b>Telefónica Participaciones, S.A (SPAIN)</b> Integrated cash management, consulting and financial support for Group Companies Gran Via, 28 - 28013 Madrid	100.00%							
<b>Telefónica Emisiones, S.A.. (SPAIN)</b> Integrated cash management, consulting and financial support for Group Companies Gran Via, 28 - 28013 Madrid	100.00%			5		(3)		
<b>Telefónica Europe, B.V. (NETHERLANDS)</b> Fund raising in capital markets Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX Amsterdam	100.00%			5	2	(1)	1	
<b>Telefónica Internacional USA Inc. (EE.UU.)</b> Financial advisory services 1221 Brickell Avenue suite 600 - 33131 Miami Florida	100.00%			1				
<b>Telefónica Global Applications, S.L. (SPAIN)</b> Holding company	100.00%					(7)	(5)	

Ronda de la Comunicación, s/n 28050 Madrid								
<b>Telefónica Latinoamérica Holding, S.L. (SPAIN)</b>	94.59%	5.41%	185	1,661		82	1,749	
Holding company Ronda de la Comunicación, s/n Distrito Telefónica - 28050 Madrid								
<b>Telefónica International Wholesale Services, S.L. (SPAIN)</b>	92.51%	7.49%	230	56		66	50	213
International services provider Gran Vía, 28 - 28013 Madrid								
<b>Corporation Real Time Team, S.L. (SPAIN)</b>	87.96%	12.04%						12
Internet design, advertising and consulting Claudio Coello, 32, 1º ext. Madrid								
<b>Telefónica Móviles Argentina Holding, S.A. (ARGENTINA)</b>	75.00%	25.00%	298	434	89	481	275	856
Holding company Ing Enrique Butty 240, piso 20-Capital Federal-Argentina								

Telefónica, S.A. 92

Table of Contents

2013 Financial Statements

MILLIONS OF EUROS	% OWNERSHIP		INCOME (LOSS)					Gross carrying amount
	Direct	Indirect	Capital	Reserve	Dividend	From operations	For the year	
<b>Telefónica International Wholesale Services America, S.A. (URUGUAY)</b> Provision of high bandwidth communications services Luis A. de Herrera, 1248 Piso 4 Montevideo	74.36%	25.64%	562	(433)		(55)	(46)	325
<b>Telefónica Centroamérica Inversiones, S.L (SPAIN)</b> Holding company Distrito Telefónica. Avda. Ronda Comunicación, s/n. - 28050 Madrid	60.00%		1	1,010			(1)	638
<b>Comtel Comunicaciones Telefónicas, S.A. (VENEZUELA)</b> Holding company Torre Edicampo, Avda. Francisco de Miranda, Caracas 1010	65,14%	34,86%		(61)		(59)	(41)	
<b>Telefónica América, S.A (SPAIN).</b> Inversión, administración y gestión de empresas en el sector de las telecomunicaciones Distrito Telefónica. Avda. Ronda Comunicación, s/n. - 28050 Madrid	50.00%	50.00%						
<b>Aliança Atlântica Holding B.V. (NETHERLANDS)</b> Portfolio company Strawinskylaan 1725 1077 XX Amsterdam	50.00%	43.99%	40	2				22
<b>Sao Paulo Telecomunicacoes Participações, Ltda (BRAZIL)</b> Holding company Rua Martiniano de Carvalho, 851 20º andar, parte, Sao Paolo	44.72%	55.28%	3,813	(208)	160	(13)	212	3,092
<b>Telefónica Móviles del Uruguay, S.A. (URUGUAY)</b> Wireless communications and services operator Constituyente 1467 Piso 23, Montevideo 11200	32.00%	68.00%	10	292		85	88	13
<b>Telefónica Brasil, S.A. (BRAZIL) (1)(*)</b>	24.68%	49.28%	15,217	(1,506)	495	1,702	1,297	9,823

Wireline telephony operator in Sao Paulo  
Sao Paulo

**Colombia Telecomunicaciones, S.A. ESP**

**(COLOMBIA) (1)** 18.51% 51.49% 485 (1,300) 136 (113) 272

Wireless operator  
Calle 100, N° 7-33, Piso 15,  
Bogotá, Colombia

**Pléyade Peninsular, Correduría de****Seguros y Reaseguros del grupo**

**Telefónica, S.A. (SPAIN)** 16.67% 83.33% 1 5 5

Distribution, promotion or preparation of  
insurance contracts, operating as a broker  
Distrito Telefónica, Avda. Ronda de la  
Comunicación, s/n Edificio Oeste 1 28050  
Madrid

**Telefónica Móviles Argentina, S.A.**

**(SPAIN)** 15.40% 84.60% N/D N/D N/D N/D N/D 139

Wireless communications and services  
operator  
Ing Enrique Butty 240, piso 20-Capital  
Federal-Argentina

**Telefónica Gestión de Servicios**

**Compartidos, S.A. (ARGENTINA)** 4,99% 95,00% 2 4 3

Management and administrative services  
rendered  
Av. Ing. Huergo 723 PB - Buenos Aires

**Inversiones Telefónica Móviles Holding,**

**Ltd. (CHILE))** 3,11% 96,89% 461 (22) (1) 130 89

Holding company  
Miraflores, 130 - 12° - Santiago de Chile

Telefónica, S.A. 93

Table of Contents

2013 Financial Statements

MILLIONS OF EUROS	% OWNERSHIP		INCOME (LOSS)				Gross From For the carrying operations year amount
	Direct	Indirect	Capital Reserves	Dividends			
<b>Telefónica de Argentina, S.A. (1)</b> <b>(ARGENTINA)</b> Telecommunications service provider Av. Ingeniero Huergo, 723, PB - Buenos Aires	1.80%	98.20%	185	215	118	58	23
<b>Telefónica Venezolana, C.A.</b> <b>(VENEZUELA) (1)</b> Wireless operator Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060	0.09%	99.91%	587	1,029	1,100	585	123
<b>Telefónica Factoring España, S.A.</b> <b>(SPAIN)</b> Factoring Pedro Teixeira, 8 - 28020 Madrid	50.00%		5	2	9	9	3
<b>Telco, S.p.A. (ITALY)</b> Holding company Galleria del Corso, 2 - Milan	66,00%		1,785	(726)	(1)	(182)	2,916
<b>Telefónica Factoring México, S.A. de C.V. SOFOM ENR (MEXICO)</b> Factoring México D.F.	40.50%	9.50%	2			1	1
<b>Telefónica Factoring Perú, S.A.C. (PERÚ)</b> Factoring Ciudad de Lima	40.50%	9.50%	1	1		1	1
<b>Telefónica Factoring Colombia, S.A. (COLOMBIA)</b> Factoring Bogotá	40.50%	9.50%	1	1	2	1	1
<b>Telefónica Factoring Chile, S.A. (CHILE)</b> Factoring Ciudad y Comuna de Santiago.	40.50%	9.50%			1	1	
<b>Telefónica Factoring Do Brasil, Ltd. (BRASIL)</b> Factoring Avda. Paulista, 1106 Sao Paulo	40.00%	10.00%	1	(1)	(3)	10	1
<b>Jubii Europe N.V. (NETHERLANDS) (*)</b>	32.10%		N/D	N/D	N/D	N/D	13



Internet portal - In liquidation

Richard Holkade 36, 2033 PZ Haarlem

PAISES BAJOS

<b>Torre de Collçerola, S.A. (SPAIN)</b>	30.40%		6					2
Operation of telecommunications and technical assistance and consulting services.								
Ctra. Vallvidrera-Tibidabo, s/nº - 08017 Barcelona								
<b>Other investments</b>	N/D	N/D	N/D	N/D	206	N/D		339
<b>Total group companies and associates</b>					<b>10,078</b>			<b>80,107</b>

(1) Consolidated data.

(\*) Companies listed on international stock exchanges at December 31, 2013.

Telefónica, S.A. 94

**Table of Contents**

2013 Financial Statements

## Appendix II Board of Directors Compensation

**TELEFÓNICA, S.A.**

(Euros)

<b>Director</b>	<b>Wage / Compensation<sup>1</sup></b>	<b>Fixed payment<sup>2</sup></b>	<b>Attendance fees<sup>3</sup></b>	<b>Short term variable compensation<sup>4</sup></b>	<b>Fixed payments Board Committees<sup>5</sup></b>	<b>Other items<sup>6</sup></b>	<b>Total</b>
Mr. César Alierta Izuel	2,230,800	240,000		3,497,448	80,000	204,655	6,252,903
Mr. Isidro Fainé Casas		200,000			80,000	8,000	288,000
Mr. José María Abril Pérez		200,000	8,000		95,867		303,867
Mr. Julio Linares López		200,000	7,000		19,600		226,600
Mr. José María Alvarez-Pallete López	1,923,100			1,626,713		128,330	3,678,143
Mr. Fernando de Almansa Moreno-Barreda		120,000	17,000		38,267	8,000	183,267
Ms. Eva Castillo Sanz	1,264,000			323,647		49,741	1,637,388
Mr. Carlos Colomer Casellas		120,000	25,000		139,733	8,000	292,733
Mr. Peter Erskine		120,000	29,000		124,800		273,800
Mr. Santiago Fernández Valbuena							
Mr. Alfonso Ferrari Herrero		120,000	44,000		163,067	8,000	335,067
Mr. Luiz Fernando Furlán		120,000			4,667		124,667
Mr. Gonzalo Hinojosa Fernández de Angulo		120,000	44,000		159,334	8,000	331,334
Mr. Pablo Isla Álvarez de Tejera		120,000	9,000		35,467		164,467
Mr. Antonio Massanell Lavilla		120,000	17,000		56,000	8,000	201,000
Mr. Ignacio Moreno Martínez		120,000	9,000		19,600		148,600
Mr. Javier de Paz Mancho		120,000	13,000		118,267		251,267
Mr. Chang Xiaobing		120,000					120,000

- 1 **Wage:** Non-variable compensation accrued by the Director for discharging executive duties.
- 2 **Fixed Payment:** Cash compensation with a predefined payment frequency, accruable or not over time and accrued by the Director for membership to the Board of Directors, irrespective of affective attendance by the Director at Board Meetings.
- 3 **Attendance fees:** Amounts payable for attendance to meetings of the Advisory or Control Committees, and the various Regional Advisory Committees in Spain (Valencia, Andalusia and Catalonia)
- 4 **Short-term variable compensation:** Variable amount linked to the performance or achievement of individual or group objectives (quantitative or qualitative) for a period equal to or up to a year, corresponding to 2012 and paid in 2013. It is stated Ms. Eva Castillo Sanz was appointed Chairwoman of Telefónica Europe on September 17, 2012, date of commencement, therefore, of her executive duties within Telefónica Group. Concerning the bonus referred to 2013, to be paid during 2014, the Executive Directors will perceive the following amounts: Mr. César Alierta Izuel 3,050,000 Euros, Mr. José María Álvarez-Pallete López 2,900,000 Euros and Mrs. Eva Castillo Sanz 1,463,712 Euros.
- 5 **Fixed Payment Board Committees:** Cash compensation with a predefined payment frequency, accruable or not over time and accrued by the Director for membership to the Executive Committee or Advisory or Control Committees of Telefónica, S.A., irrespective of effective attendance to meetings of said Committees.
- 6 **Other items:** Includes, inter alia, amounts paid for membership of the Regional Advisory Committees in Spain (Valencia, Andalusia and Catalonia) and other in-kind compensation (such as general medical insurance and dental coverage), paid by Telefónica, S.A .

**Table of Contents**

2013 Financial Statements

In addition, to detail the amounts included in the preceding table, the following table presents the specific compensation paid to Directors of Telefónica for membership of the various Advisory or Control Committees in 2013, including both fixed payments and fees for attending meetings:

**TELEFÓNICA, S.A. ADVISORY OR CONTROL COMMITTEES**

(Euros)

<b>Director</b>	<b>Audit and Control</b>	<b>Nominations and Corporate Governance</b>	<b>Human Resources, Reputation and Corporate Responsibility</b>	<b>Regulation</b>	<b>Service Quality and Customer Service</b>	<b>International Affairs<sup>1</sup></b>	<b>Innovation</b>	<b>Strategy</b>	<b>Institutional Affairs<sup>1</sup></b>	<b>TOTAL 2013</b>
Mr. César Alierta Izuel										
Mr. Isidro Fainé Casas										
Mr. José María Abril Pérez						5,667	18,200			23,867
Mr. Julio Linares López								9,533	17,067	26,600
Mr. José María Álvarez-Pallete López										
Mr. José Fernando de Almansa Moreno-Barreda				14,200		10,334		20,200	10,533	55,267
Ms. Eva Castillo Sanz										
Mr. Carlos Colomer Casellas	19,933	18,200			13,200		33,400			84,733
Mr. Peter Erskine		22,200					20,200	31,400		73,800
Mr. Santiago Fernández Valbuena										
Mr. Alfonso Ferrari Herrero	21,200	33,400	6,667	14,200	14,200	5,667		20,200	11,533	127,067

Mr. Luiz Fernando Furlán						4,667			4,667
Mr. Gonzalo Hinojosa Fernández de Angulo	24,933	22,200	6,667	17,933	13,200	5,667	21,200	11,533	123,334
Mr. Pablo Isla Álvarez de Tejera		20,200	4,667	14,933	4,667				44,467
Mr. Antonio Massanell Lavilla	19,200		4,667		25,400		15,200	8,533	73,000
Mr. Ignacio Moreno Martínez	10,533			9,533	8,533				28,600
Mr. Francisco Javier de Paz Mancho			11,333	14,200	8,533	5,667		11,533	51,267
Mr. Chang Xiaobing									

- 1 The Human Resources, Reputation and Corporate Responsibility Committee and International Affairs Committee were disbanded on May 31, 2013. The Institutional Affairs Committee was established on the same date.

**Table of Contents**

2013 Financial Statements

On the other hand, the following table presents an individual breakdown of the amounts received from other Telefónica Group companies other than Telefónica, S.A., by Company's Directors for discharging executive duties or for membership of the companies' governing bodies and/or Advisory Boards of such companies:

**OTHER TELEFÓNICA GROUP COMPANIES**

(Euros)

<b>Director</b>	<b>Wage / Compensation<sup>1</sup></b>	<b>Fixed payment<sup>2</sup></b>	<b>Attendance fees<sup>3</sup></b>	<b>Short term variable compensation<sup>4</sup></b>	<b>Fixed payments Board Committees<sup>5</sup></b>	<b>Other items<sup>6</sup></b>	<b>Total</b>
Mr. César Alierta Izuel							
Mr. Isidro Fainé Casas							
Mr. José María Abril Pérez							
Mr. Julio Linares López						300,000	300,000
Mr. José María Álvarez-Pallete López							
Mr. José Fernando de Almansa Moreno-Barreda						120,000	283,427
Ms. Eva Castillo Sanz			163,427				38,353
Mr. Carlos Colomer Casellas						70,000	70,000
Mr. Peter Erskine						74,202	74,202
Mr. Santiago Fernández Valbuena	1,287,446					198,267	2,846,131
Mr. Alfonso Ferrari Herrero						120,000	195,531
Mr. Luiz Fernando Furlán						160,000	255,324
Mr. Gonzalo Hinojosa Fernández de Angulo						90,000	111,876
Mr. Pablo Isla Álvarez de Tejera							
Mr. Antonio Massanell Lavilla						60,000	60,000
Mr. Ignacio Moreno Martínez							
Mr. Francisco Javier de Paz Mancho						120,000	248,248
Mr. Chang Xiaobing			128,248				

- 1 **Wage:** Non-variable compensation accrued by the Director for discharging executive duties of any Telefónica Group company.
- 2 **Fixed Payment:** Cash compensation with a predefined payment frequency, accruable or not over time and accrued by the Director for membership to the Board of Directors, irrespective of affective attendance by the Director at Board Meetings of any Telefónica Group company.
- 3 **Attendance fees:** Amounts payable for attendance to meetings of the Board of Directors or similar bodies of any Telefónica Group company.
- 4 **Short-term variable compensation (bonus):** Variable amount linked to the performance or achievement of individual or group objectives (quantitative or qualitative) and commensurate with other compensation or any other reference in euros for a period of up to a year referred to 2012 and paid during 2013 by any Telefónica Group Company. Concerning the bonus referred to 2013, the amount that will perceive the Executive Director Mr. Santiago Fernández Valbuena is 1,441,424 Euros.
- 5 **Fixed Payment Board Committees:** Cash compensation with a predefined payment frequency, accruable or not over time and accrued by the Director for membership to the Executive Committee or Advisory or Control Committees of Telefónica, S.A., irrespective of effective attendance to meetings of said Committees.
- 6 **Other items:** Includes, *inter alia*, amounts paid for membership of Regional and Business Advisory Committees (Europe, Latam and Digital) and other in-kind compensation (such as general medical insurance and dental coverage), paid by any Telefónica Group Company.

**Table of Contents**

2013 Financial Statements

Furthermore, as explained in the Compensation policy section, Executive Directors receive a series of employee benefits. The following table presents a breakdown of contributions made in 2013 by the Company to long-term savings schemes (Pension Plans and Pension Plan for Senior Executives):

**LONG-TERM SAVINGS SCHEMES**

(Euros)

<b>Director</b>	<b>Contributions 2013 by the Company</b>
Mr. César Alierta Izuel	1,023,193
Mr. José María Álvarez-Pallete López	550,436
Ms. Eva Castillo Sanz	393,796
Mr. Santiago Fernández Valbuena	142,559

The following table presents a breakdown of the long-term savings schemes, comprising contributions to Pension Plans and the Pension Plan:

(Euros)

<b>Director</b>	<b>Contributions to Pension Plans</b>	<b>Contributions to Benefits Plan<sup>1</sup></b>
Mr. César Alierta Izuel	8,402	1,014,791
Mr. José María Álvarez-Pallete López	9,468	540,968
Ms. Eva Castillo Sanz	8,402	385,394
Mr. Santiago Fernández Valbuena	115,031	27,528

1 Contributions to the Pension Plan for Executives set up in 2006, funded exclusively by the Company to complement the existing Pension Plan. It entails defined contributions equivalent to a certain percentage of the Director's fixed remuneration in accordance with their professional category within the Telefónica Group's organization.

Life insurance premiums paid in 2013 are as follow:

**LIFE INSURANCE PREMIUMS**

(Euros)

<b>Director</b>	<b>Life insurance premiums</b>
Mr. César Alierta Izuel	103,858



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Mr. José María Álvarez-Pallete López	39,842
Ms. Eva Castillo Sanz	19,802
Mr. Santiago Fernández Valbuena	3,028

Regarding share-based payment plans (those exclusively for Executive Directors), there were two long-term variable compensation plans in place in 2013:

The Performance Share Plan (PSP) approved at the General Shareholders Meeting of June 21, 2006, whose fifth and final phase began in 2010 and ended in July 2013.

It is hereby stated that regarding the fifth phase of this Plan (2010-2013), the general terms for the delivery of shares were not met. Therefore, no shares were delivered to Executive Directors.

Telefónica, S.A. 98

**Table of Contents**

2013 Financial Statements

The so-called Performance & Investment Plan ( PIP ) approved at the General Shareholders Meeting of May 18, 2011 whose first phase began in 2011 and will end in July 2014, second phase began in 2012 and will end in July 2015, and third phase began in 2013 and will end in July 2016. It is hereby stated that the number of shares assigned and the maximum possible number of shares to be received by the Directors of Telefónica for discharging executive duties in each phase, if the co-investment requirement established in the Plan and the maximum target TSR established for each phase are met, are as follows:

**First phase / 2011-2014**

<b>Directors</b>	<b>Theoretical shares assigned</b>	<b>Maximum number of shares*</b>
Mr. César Alierta Izuel	249,917	390,496
Mr. Julio Linares López	149,950	234,298
Mr. José María Álvarez-Pallete López	79,519	124,249
Mr. Santiago Fernández Valbuena	79,519	124,249

\* Maximum possible number of shares to be received if the co-investment requirement and maximum target TSR are met.

**Second phase / 2012-2015**

<b>Directors</b>	<b>Theoretical shares assigned</b>	<b>Maximum number of shares*</b>
Mr. César Alierta Izuel	324,417	506,901
Mr. Julio Linares López(1)	13,878	21,686
Mr. José María Álvarez-Pallete López	188,131	293,955
Ms. Eva Castillo Sanz	95,864	149,787
Mr. Santiago Fernández Valbuena	103,223	161,287

(1) The number of shares assigned to Mr. Linares was calculated in proportion to the time he discharged executive duties as Chief Operating Officer COO- (from July 1, 2012 to September 17, 2012) during the second phase of the Plan.

\* Maximum possible number of shares to be received if the co-investment requirement and maximum target TSR are met.

**Third phase / 2013-2016**

<b>Directors</b>	<b>Theoretical shares assigned</b>	<b>Maximum number of shares*</b>
Mr. César Alierta Izuel	324,000	506,250
Mr. José María Álvarez-Pallete López	192,000	300,000
Ms. Eva Castillo Sanz	104,000	162,500
Mr. Santiago Fernández Valbuena	104,000	162,500

\* Maximum possible number of shares to be received if the co-investment requirement and maximum target TSR are met.

In addition, to reinforce Telefónica's status as a global employer, with a common remuneration culture throughout the Company, to encourage all Group employees to take an equity interest, and to motivate employees and boost their loyalty, at the Company's General Shareholders Meeting of June 23, 2009, shareholders approved the introduction of a Telefónica, S.A. share incentive plan, the Global Employee Share Plan ( GESP ) for all employees of the Group worldwide (including executives and Executives Directors).

Under this plan, employees that meet the qualifying requirements are offered the possibility of acquiring Telefónica, S.A. shares, for a period of up to 12 months (the acquisition period), with this company assuming the obligation of giving participants a certain number of shares free of charge. The maximum sum each employee can assign to this plan is 1,200 euros, while the minimum is 300 euros. Employees who remain at the Telefónica Group and retain their shares for an additional year after the acquisition period (the consolidation period) will be entitled to receive one free share per share acquired and retained until the end of the consolidation period.

During the first phase of this Plan (2010-2012), Directors participating, as they discharged executive duties in the Group, acquired a total of 604 shares (including free shares received under the general terms and conditions of the Plan).

Later, for the second phase of the Plan (2012-2014), approved at the General Shareholders Meeting of May 18, 2011, the Executive Directors that decides to take part contributing the maximum (i.e. 100 euros a month, over 12 months), had acquired a total of 328 shares.

It should be noted that the external Directors do not receive and did not receive in 2013 any compensation in the form of pensions or life insurance, nor do they participate in the share-based payment plans linked to Telefónica's share price.

In addition, the Company does not grant and did not grant in 2013 any advances, loans or credits to the Directors, or to its top executives, thus complying with the requirements of the U.S.A. Sarbanes-Oxley Act, which is applicable to Telefónica as a listed company in that market.

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**Table of Contents**

2013 Financial Statements

**Senior executives compensation**

Meanwhile, the Executives considered as Senior Executives<sup>(1)</sup> of the Company in 2013, excluding those that are also members of the Board of Directors, received a total, in 2013, of 9,709,715 euros.

In addition, the contributions by the Telefónica Group in 2013 with respect to the Benefits Plan for Senior Executives described in Note on Revenue and Expenses for these Executives amounted to 1,179,905 euros. Contribution to the Pension Plan amounted to 411,287 euros and compensation in kind (including life and other insurance premiums such as general medical and dental insurance) to 118,031 euros.

Also, it is hereby stated that regarding the fifth phase of the Performance Share Plan (PSP) (2010-2013), the general terms for the delivery of shares were not met. Therefore, no shares were delivered to the Executives.

Regarding the above mentioned Performance and Investment Plan (PIP) approved at the General Shareholders Meeting of May 18, 2011, a total of 422,344 shares were assigned to the Executives considered Senior Executives of the Company in the first phase (2011-2014), 623,589 shares in the second phase (2012-2015), and 650,000 shares in the third phase (2013-2016).

Finally, regarding the first phase of the Global Employee Share Plan (GESP) (2010-2012), Executives participating acquired a total of 872 shares (including free shares received under the general terms and conditions of the Plan). Regarding the second phase of the Global Employee Share Plan (GESP) (2012-2014), the Executives taking part and contributing the maximum (i.e. 100 euros a month, over 12 months), have acquired a total of 443 shares.

- (1) For these purposes, Senior Executives are understood to be individuals who perform senior management functions reporting directly to the management bodies, or their executive committees or CEOs, including the person in charge of the internal audit.

Telefónica, S.A. 100

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**Table of Contents**

2013 Financial Statements

Management report 2013 <sup>(1)</sup>**Business Model**

The Telefónica Group is one of the world's leading mobile and fixed communications services providers. Its strategy is to become a leader in the new digital world and transform the possibilities it brings into reality.

Telefónica aim is to reinforce its position as an active player in the digital world capable of seizing all the opportunities afforded by its global scale and its industrial and strategic alliances.

Telefónica has a regional and integrated management model. The current organizational structure was defined in 2011 and its implementation continued through 2013. The different operations of the Telefónica Group, are organized around two geographic regions, Europe and Latin America, together with other Global Units. Telefónica Europe comprised, at year-end, the Spain, United Kingdom, Germany, Czech Republic, Slovakia and Ireland operations. Latin America includes operations in Brazil, Argentina, Peru, Chile Venezuela and Central America (El Salvador, Guatemala, Nicaragua, Panama and Costa Rica), Colombia, Mexico, Ecuador and Uruguay. Telefónica Digital is a global business division of Telefónica. Its mission is to seize the opportunities within the digital world and deliver new growth for Telefónica through research and development, venture capital, global partnerships and digital services.

Telefónica Global Resources is a global unit that aims to support the profitability and sustainability of the business by leveraging economies of scale, as well as by driving Telefónica's transformation into a fully global company. Its goal is to maximize Telefónica's economies of scale while seeking greater efficiencies for the company, through, among other strategies, simplification, standardization, rationalization and consolidation, global procurement and the management of Telefónica's non-strategic assets.

In 2013, with the aim of strengthening direct contact with both retail and corporate clients in order to accelerate the transformation of the company into a digital telecommunications company, the Global Chief Marketing Officer position was created, which oversees all the related commercial areas, encompassing product, service, channels, handset and pricing policies, as well as advertising and brand strategies. Furthermore, Telefónica Global Solutions unit is facing the increasing complexity of enterprise market is increasingly adopting digital solutions.

Telefónica Europe and Telefónica Latin America's aim is to generate sustainable growth through available means and the support of the Telefónica Group. In this report two differentiated segments are presented: Telefónica Europe (T. Europe) and Telefónica Latin America (T. Latin America).

The Telefónica's Group strategy aims to:

Improve the customer experience in order to continue increasing accesses.

Lead growth:

Drive forward the penetration of smart phones in all markets in order to raise the rate of growth of mobile data by monetizing their increasingly widespread use.

Defend our competitive positioning, and leverage our customer knowledge.

Develop the growth opportunities that have arisen in an increasingly digital context, such as media, financial services, cloud, security, advertising, M2M, e-Health, etc.

Capture the opportunity in the business areas.

Continue working on the transformation of the Group's operating model:

Increase the modernization of networks in markets where we operate through technological advances and the acquisition of spectrum.

Maximize the benefits of economies of scale to increase efficiency.

**Table of Contents**

2013 Financial Statements

Simplify the operative model.

Reduce legacy cost, especially legacy network costs.

In addition, Telefónica maintains an industrial alliance with Telecom Italia, S.p.A and a strategic alliance with China Unicom in which the Group holds a 5% stake. Furthermore, in order to unlock the value of Telefónica's scale, the Partners program was created in 2011, and now includes five operators (Bouygues, Etisalat, Sunrise, Megafon and O2 CZ). The Partners Program is an initiative that makes available to selected operators and under commercial terms a host of services that allows partners to leverage on Telefónica's scale and to cooperate on key business topics (roaming, services to multinationals, procurement, devices, etc.).

Elsewhere, in 2013 Telefónica Europe's portfolio was restructured through a sale agreement of operations in the Czech Republic, which was closed in January 2014 after obtaining regulatory approval, and in Ireland, pending regulatory approval, and with the announcement of the acquisition of E-Plus by Telefónica Germany to form the leading operator in the European market.

Non-controlling interests are split into two groups. The first group consists of subsidiaries listed in a regulated market such as Telefónica Brasil or Telefónica Deutschland, the shareholder bases of which are quite dispersed and for which Telefónica protects non-controlling interests in compliance with the regulations of the market in which they are listed. The second group consist of subsidiaries with significant non-controlling interests with which agreements are entered into to guarantee their rights as non-controlling interests are protected, and (in certain cases such as Colombia Telecomunicaciones) where specific commitments also exist through corporate actions (see Note 21.b).

The Company has a governance system, which applies to Telefónica's entire structure. Pursuant to the Company's commitment to its shareholders, the Board of Directors, supported by its Committees, manages the Company's business in accordance with the corporate governance rules laid down primarily in the Corporate By-laws, Regulation of the General Shareholders' Meeting, and Regulation of the Board of Directors.

Telefónica's Board of Directors consists of 18 directors and is responsible for overseeing and controlling the Company's activity. It has sole powers regarding general strategy and policies on corporate governance, corporate social responsibility, remuneration of the Board and senior management, shareholder remuneration, and strategic investments.

In order to strengthen the corporate governance of the Company, the board of directors of Telefónica, S.A. has eight committees (including the Executive Commission) which are charged with examining and overseeing areas of particular relevance. Pursuant to its regulation, the Board also confers responsibility for day-to-day management of the businesses on Telefónica's executive bodies (primarily through the Executive Committee) and management team.

Telefónica, S.A. 102

---

**Table of Contents**

2013 Financial Statements

**Economic results of Telefónica, S.A.**

Telefónica, S.A. obtained net profit of 664 million euros in 2013. Highlights of the 2013 income statement include:

Revenue from operations, amounting to 11,003 million euros has increased significantly year on year, primarily due to the higher amount of dividends received from Group companies and associates. The most significant variation comes from Telefónica Internacional, S.A.U. with 4,500 million euros (1,500 million euros in 2012) and Telefónica Europe, plc. with 1,309 million euros (575 million euros in 2012).

The figure of Impairment and gains (losses) on disposal of financial instruments amounting to 7,990 million euros has increased considerably compared to 2012 due to impairment charges recognized to investments in Telefónica Brasil, S.A. and Sao Paulo Telecomunicações, S.A. totalling 3,863 million euros (in 2012 the write down was 103 million euros). Related with the decrease in this investment value it must be highlighted the Brazilian real devaluation of 17% since 2012.

Net financial expense totaled 2,491 million euros in 2013, compared to 2,216 million euros in 2012. This was mainly due to finance costs with Group companies and associates, of which the largest came from Telefónica Europe, B.V. amounting to 238 million euros (388 million euros in 2012) and Telefónica Emisiones, S.A.U. totaling 1,712 million euros (1,607 million euros in 2012).

Telefónica, S.A. 103



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**Table of Contents**

2013 Financial Statements

**Investment activity****2013**

On April 29, 2013, Telefónica, S.A. signed an agreement with Corporación Multi Inversiones ( CMI ) to incorporate jointly a Spanish company to manage the Group's assets in Guatemala, El Salvador, Nicaragua and Panama.

The resulting company, Telefónica Centroamérica Inversiones, S.L. ( TCI ) was incorporated through the initial contribution by Telefónica, S.A. of its entire shareholdings in Guatemala and El Salvador, along with 31.85% of its interest in Telefónica Móviles Panamá, S.A. at its net carrying amount equivalent to 633 million euros. The new company was incorporated and the corresponding contributions made on June 7, 2013.

On August 2, 2013 and having obtained the necessary regulatory authorisations, TCI's capital was increased in 500 million US dollars (equivalent to 377 million euros on the payment date), subscribed in full by TLK Investments, C.V., thereby completing the operation. Consequently, TLK Investments, C.V. holds a 40% interest in TCI and Telefónica, S.A. the remaining 60%. On the same date, Telefónica, S.A. sold the remainder of its stake in Telefónica Móviles Panamá, S.A. (24.5%) for 83 million euros.

On November 5, 2013, Telefónica announced that it had reached an agreement to sell 65.9% of the capital of Telefónica Czech Republic, a.s. ( Telefónica Czech Republic ) to PPF Group N.V.I. ( PPF ) for, approximately, 306 Czech crowns/share (around 2,467 million euros at the agreement date). This consideration shall be settled in two tranches:

(i) 2,063 million euros in cash on completion of the sale; and

(ii) 404 million euros in cash as a deferred payment over four years.

Subsequent to the transaction, Telefónica will hold a stake of 4.9% in Telefónica Czech Republic.

At the date of the agreement, Telefónica, S.A. measured its stake in Telefónica Czech Republic at its total market value, recognising a provision for its investment portfolio of 643 million euros under the *Impairment losses and gains (losses) on disposal of financial instruments* heading of the income statement.

The agreed price for the stake being sold, updated at year end exchange rates, has been reclassified to the *Non-current assets held for sale* heading for 2,302 million euros until the pertinent authorisations were received from the regulators (which had not been received at the date of these financial statements). The market value of the 4.9% stake that it is retaining totaling 178 million euros has been reclassified to the *Equity instruments* heading under non-current financial assets.

On September 24, 2013, Telefónica and the other shareholders of the Italian company Telco, S.p.A. (which holds a 22.4% stake with voting rights of Telecom Italia, S.p.A.) reached an agreement whereby Telefónica, S.A. subscribed

and paid out a share capital increase in Telco, S.p.A., through a cash contribution of 324 million euros, in exchange for shares with voting rights in Telco, S.p.A. As a result of this capital increase, the interest held by Telefónica in the voting share capital of Telco, S.p.A. remains unchanged (i.e. 46.18 %, as Telefónica currently holds), although its interest in the total share capital of Telco, S.p.A. is increased to 66%.

## 2012

In April, 2012, Telefónica Móviles Colombia, S.A. (a company fully owned by the Telefónica Group), the Colombian government (hereinafter the Government ) and Colombia Telecomunicaciones, S.A. ESP (a company 52% owned by Telefónica Group and 48% by the Government) reached a final agreement to restructure their wireline and wireless businesses in Colombia. The agreement led to the merger between Colombia Telecomunicaciones, S.A. ESP and Telefónica Móviles Colombia, S.A., resulting in Telefónica holding 70% of the share capital of the resulting company and the Government the remaining 30%, based on the valuations of the companies used to determine said shareholdings Telefónica, S.A. held a direct shareholding of 49.42% in Telefónica Móviles Colombia, S.A., holding 18.51% of the merged company after the merger. This transaction did not alter the cost of the investment held by the Company.

Telefónica, S.A. 104

**Table of Contents**

2013 Financial Statements

Telefónica started to reorganize its business in Latin America during 2012. As part of this process, on October 10, 2012 and November 7, 2012 two new companies – Telefónica América, S.A. and Telefónica Latinoamérica Holding, S.L. – were incorporated, both of which are jointly controlled by Telefónica, S.A. and Telefónica Internacional, S.A.U. On December 13, 2012, Telefónica Latinoamérica Holding, S.L. performed two consecutive capital increases. In the first, Telefónica, S.A. contributed its shareholding in Latin American Cellular Holdings, B.V. at its carrying amount of 1,749 million euros. In the second, Telefónica Internacional, S.A.U. contributed 100 million euros in cash. Telefónica, S.A. held 94.59% in this company subsequent to the capital increase. In addition, on December 18, 2012, Telefónica, S.A. sold its non-controlling interest in Telefónica de Perú, S.A.A. to Telefónica Latinoamérica Holding, S.L. for 4 million euros. The share transfer was performed at the price quoted on the Peruvian stock market of 2.3 PEN per share, and gave rise to gains of 1 million euros, recognized under the income statement caption Gains (losses) on disposal and other gains and losses .

Telefónica also commenced the reorganization of its subsidiaries in Chile. During the first quarter of 2012, Inversiones Telefónica Móviles Holding, Ltd. distributed a dividend in kind comprising the shareholding in Inversiones Telefónica Fija, S.A. at its net carrying amount totaling 67 million euros. Meanwhile, on November 19, 2012, Telefónica Chile Holdings, B.V. was incorporated with share capital of 1 euro. On December 10, 2012, it increased its share capital, which was subscribed by the Company in exchange for the Company's shareholding in Inversiones Telefónica Fija, S.A. Finally, on December 24, 2012, Telefónica Chile Holdings, B.V. increased its share capital, subscribed in full by Telefónica, S.A. for 405 million euros, paid in cash.

In April 2012, Telefónica, S.A. subscribed to various share capital increases in Telefónica Móviles México, S.A. de C.V. totaling 1,668 million Mexican pesos (97 million euros) in order to provide the subsidiary with the funds needed to pay for the spectrum licenses acquired in 2011.

On May 31, 2012 the Board of Directors of Telefónica, S.A. ratified the refinancing proposal that Telco, S.p.A. had submitted for approval by its partners. This refinancing involved increasing share capital by 277 million euros and subscribing a bond of 208 million euros, as well as renewing the existing bond of 600 million euros

**Impairment provisions in investments**

At each year end, the Company re-estimates the future cash flows derived from its investments in Group companies and associates. The estimate is made based on the discounted cash flows to be received from each subsidiary in its functional currency, net of the liabilities associated with each investment (mainly net borrowings and provisions) and translated to euros at the official closing rate of each currency at December 31, 2013.

As a result of these estimations and the effect of the net investment hedge in 2013, an impairment provision of 7,998 million euros was recognized (5,312 million euros in 2012). This amount derives mainly from the following companies:

(a) write down recognized for Telefónica Europe, plc. (2,423 million euros in 2013 and 3,682 million euros in 2012), less 70 million euros (82 million euros in 2012) for the effect of the net investment hedge.

(b) write down of 2,947 million euros for Telefónica Brasil, S.A. (69 million euros in 2012) and 916 million euros (34 million euros in 2012) for Sao Paulo Telecomunicações, S.A.

(c) write down of 359 million euros for Telco, S.p.A. (1,305 million euros in 2012), the holding company of Telecom Italia. After the adjustment registered, the investment in Telecom Italia, S.p.A. through Telco, S.p.A. is valued at 1 euro per share (1.2 euros per share at December 31, 2012).

(d) write down recognised by Telefónica Czech Republic of 643 million euros (no impairment registered in 2012) explained at the beginning of this Note.

(e) write down of 211 million euros for Telefónica México, S.A. de C.V. (32 million euros in 2012).

The write down of Telefónica Europe, plc. is mainly due to the net impact of the fluctuation in the pound sterling exchange rate (decrease of 2.1%), the impact of the 1,309 million-euro dividend distribution in 2013 and, as a minor effect, the changes in the present value of the expected turnover of the subsidiary. The estimate of GDP growth in United Kingdom, prepared by International Monetary Fund and analysts, has been downgraded by 0.3% since the one elaborated 18 months ago. This change in expectations, as well as the tighter competitive pressure, has been reflected in the decrease of Operating Income before Depreciation and Amortization (OIBDA) used to calculate future cash flows. The decrease in average OIBDA margin used in 2013 compared to 2012 has been 4.4. p.p.

**Table of Contents**

2013 Financial Statements

The write down of the stake in Telefónica Brasil, S.A. and Sao Paulo Telecomunicações, S.A. results from the fluctuation in the Brazilian real exchange rate (decrease of 16.5%), changes in the present value of the expected turnover of the subsidiary, and the 655 million-euro dividend distribution, including dividends received from Sao Paulo Telecomunicações. The effect of the changes in the macroeconomic scenario has been significantly important in Brazil. The estimate of GDP growth in the country, prepared by International Monetary Fund and analysts, has been downgraded by half since the one elaborated 18 months ago (estimate of 5.7% at the end of 2013 since 11.3% in June 2012). This change in expectations, has been reflected in the decrease of Operating Income before Depreciation and Amortization (OIBDA) used to calculate future cash flows. The decrease in average OIBDA margin used in 2013 compared to 2012 has been 2.75 p.p.

Telefónica, S.A. 106

**Table of Contents**

2013 Financial Statements

**Share price performance**

The main European markets were up in 2013 (EStoxx-50: +17.9%) for the first time in three consecutive years, off the back of fewer concerns about the eurozone crisis, greater confidence among investors in the efforts being made by periphery states to cut their debt levels, and how the US has managed its stimulus packages. The DAX outperformed the rest of Europe climbing 25.5%, followed by the Ibex-35 (+21.4%), the CAC-40 (+18.0%), the FTSEMIB (+16.6%) and the FTSE-100 (+14.4%).

The Spanish ten-year bond yield closed 2013 at 4.1% (5.2% in 2012), while the risk premium steadily fell over the year to 218.3 basis points at year end (388.7 basis points at year-end 2012).

Against this backdrop, Telefónica shares rose by 16.1% to 11.84 euros per share at year-end 2013. Meanwhile, the European sector benchmark index (DJ Stoxx 600 Telecommunications) rebounded by 32.1%, outperforming the market in general thanks to a rise in corporate actions in the telecommunications sector, expectations about the sector's consolidation and a more favourable regulatory environment, and a re-rating of the sector due to a widening of the EV/EBITDA multiple. It is noteworthy that the operators enjoying the greatest upticks in share price were those directly or indirectly affected by corporate actions: BT (+64.2%); Vodafone (+53.4%); Deutsche Telekom (+44.6%); Telenor (+28.9%); Orange (+7.9%); Telecom Italia (+5.6%); KPN (+4.0%) and Telefónica Deutschland (+3.9%). In contrast, PT shares slumped by 15.7%.

The total return on Telefónica shares in 2013 was 19.6% (including the dividends distributed throughout 2013), compared to a negative performance over the last three years (-17.8% in 2012; -12.1% in 2011; -6.4% in 2010).

At the 2013 year end, Telefónica featured among the world's ten largest telecommunications company by market cap (53,861 million euros vs. 46,375 million euros in 2012).

Daily trading volume in Telefónica shares on Spain's continuous market was 35.8 million shares in 2013 (42.9 million shares in 2012).

Telefónica, S.A. 107

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**Table of Contents**

2013 Financial Statements

**Research, development and innovation**

Telefónica remains firmly committed to technological innovation as an essential tool for achieving competitive advantages, anticipating market trends and differentiating its products. By introducing new technologies and developing new products and business processes, we seek to become a more effective, efficient and customer-oriented Group.

Telefónica has developed an open innovation model for the management of technological innovation to boost the application of technical research in the development of new commercial products and services. Telefónica focuses on certain applied research and development (R&D) priorities that are aligned with its strategy. Open innovation initiatives driving this model include the creation of a venture capital fund and involvement in business collaboration forums, among others. The model also promotes the use of knowledge developed at technology centers, universities and start-ups, among other sources, and encourages innovation in conjunction with other agents (e.g. customers, universities, public administrations, suppliers, content providers and other companies), making them technological partners. Telefónica believes it cannot rely solely on acquired technology to differentiate its products from those of its competitors and to improve its market positioning. It is also important to encourage R&D initiatives in an effort to achieve this differentiation and make inroads in other innovation activities. The Group's R&D policy is geared towards:

developing new products and services in order to win market share;

boosting customer loyalty;

increasing revenue;

enhancing innovation management;

improving business practices;

increasing the quality of infrastructure services to improve customer service and reduce costs;

promoting global products;

supporting open innovation; and

creating value from the technology generated.

In 2013, the technological innovation projects undertaken focused on sustainable innovation, process efficiency, creation of new revenue streams, customer satisfaction, consolidation of operations in new markets and technological leadership.

Technical innovation activities are a key part of Telefónica's strategy of creating value through latest-generation network communications and services.

In 2013, projects were undertaken to promote greater access to information technology, new services focused on new internet business models, advanced user interfaces, TV distribution, multimedia content and other broadband services. These initiatives, among others, were undertaken based on our objective of rapidly identifying emerging technologies that could have a relevant impact on our businesses and pilot testing these technologies in new services, applications and platform prototypes.

Most of our R&D activities are carried out by Telefónica Investigación y Desarrollo, S.A.U. (Telefónica I+D), a wholly-owned subsidiary, which works mainly for the lines of business. In its operations, Telefónica I+D receives the assistance of other companies and universities. Telefónica I+D's mission is centered on enhancing the Company's competitive positioning by leveraging technological innovation and product development. Telefónica I+D undertakes experimental and applied research and new product development with the overriding goal of broadening the range of services offered and reducing operating costs.



**Table of Contents**

2013 Financial Statements

Telefónica I+D's technological innovation activities focus on certain areas:

Telefónica I+D works on new networks, primarily in collaboration with Telefónica's Global Resources team. These activities are related with radio access technologies and fiber; network virtualization technologies, in line with the technology trend known as software defined networks (SDN); and network optimization and zero touch developments making networks more flexible and moldable and able to adapt dynamically to new digital consumer and service requirements.

R&D activities to develop new products and services are conducted as part of Telefónica Digital's strategy. Indeed, Telefónica I+D has been the origin of many activities and products of Telefónica Digital. These activities include the following:

Natural P2P communication of the future, using the Internet, Web 2.0 and smartphones.

Video and multimedia services (combining text, audio, images and video) offering a user experience in all connected devices.

Advanced solutions in emerging ITC businesses such as cloud computing, security, financial services or e-health.

M2M (machine-to-machine) service management associated with energy efficiency and mobility and with the Internet of Things and their adoption in the urban and industrial scenario, and as a service creation enabler.

Making use of user communication profiles to exploit opportunities to operate different products and business models (marketing campaigns, target marketing, contextual services, churn reduction, cross-selling, etc.) Telefónica I+D also boasts scientific work groups with a more medium- to long-term focus and aim to look into opportunities relating to new networks and services and solutions to the technological challenges that arise.

At December 31, 2013, Telefónica I+D had 689 employees (667 employees in 2012).

Total I+D expense for 2013 amounted to 1,046 million euros, down 2.4% from the 1,071 million euros incurred in 2012. This expense represents 1.8% and 1.7% of the Group's consolidated revenue for 2013 and 2012, respectively. These figures were calculated using guidelines of the Organization for Economic Co-operation and Development (OECD).

In 2013, Telefónica registered 82 patents (87 patents in 2012), 70 of which were registered with the Spanish Patent and Trademark Office and (OEPM for its initials in Spanish) and 12 with the United States Patent and Trademark Office (USPTO). Of the patents pending with the OEPM, 57 European (EP) applications, and 13 international (PCT)

applications.

Telefónica, S.A. 109

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**Table of Contents**

2013 Financial Statements

**Environment****Objectives and policies related to environmental management and the control of environmental risks.**

Telefónica has an integrated Green ICT and Environmental strategy, with three converging objectives. The first is focused on the management of environmental risks, the second on the promotion of internal eco-efficiency, and the third on taking advantage of business opportunities, to provide integrated telecommunications services that promote a low carbon economy.

The Group maintains an Environmental Policy applicable to all the companies and a Global Environmental Management System that ensures compliance with local environmental legislation and continually improves management processes. Our business operations are not by nature particularly harmful to the environment, but we have a massive geographical deployment which makes it essential that environmental management is based on standardised procedures.

Currently over 60% of the Group companies, which represent 70% of global billing, have Environmental Management Systems in accordance with ISO 14001 and certified by an external entity.

**Guidelines**

Telefónica's activities are regulated, in environmental matters, by local laws, especially in activities related to our network infrastructure. These activities entail obtaining environmental permits for operations, waste management, noise control, and the monitoring of electromagnetic fields.

In addition, Telefónica extended its environmental control over suppliers and contractors to ensure correct environmental management. To this end, in addition to incorporating environmental clauses in all the contracts, environmental educational initiatives are carried out, along with audits to monitor the supply chain.

**Main initiatives aimed at improving environmental quality and management results**

Among the main initiatives carried out by the Group to effectively manage the environmental aspects of its operations, is the optimal selection of sites for the rollout of the network, promoting the sharing of infrastructure with other operators over 30,000 sites in 2013, and the development of technical evaluations to reduce the visual impact of antennas.

The waste generated during the construction and maintenance of the network, is managed by qualified managers, in compliance with environmental legislation and prioritising the following points in order set out below: reduction, reuse and recycle. On average, the waste management processes for reusing and recycling generate revenues for the company of around 80 million euros annually.

The Telefónica Climate Change and Energy Efficiency Office is responsible for the energy efficiency processes and the reduction of the carbon footprint. 85% of the Group's CO<sub>2</sub> emissions come from the networks, for which reason Telefónica has a structured corporate governance model and an energy manager in each country to ensure the correct

management of energy and carbon. Telefónica has corporate objectives for the reduction of energy and emissions. 30% of electricity consumption in the network in 2015 and 30% of the CO2 in 2020; both for customer equivalent access.

Despite the intensive programmes to rollout the network, thanks to the energy efficiency activities, the electricity consumption of the Group's network grew an average of 1% annually since 2010. Similarly, the Group's CO2 emissions remained practically stable in the last 3 years.

Consequently, the Group's employees are a fundamental pillar in the company's environmental performance, and therefore the different companies develop specific training programmes and initiatives to raise awareness.

**Table of Contents**

2013 Financial Statements

**Human Resources**

**Social objectives and policies**

At Telefónica people are important and are the core of the business, representing one of the Group's greatest assets. The aim is to build capacities in people, the culture and the organisation in order to become a Digital Telco.

Our vision is based on three main pillars:

To construct and develop people's capacity and ensure the company's diversity strategy in its recruiting, empowering the best professionals and future leaders.

To accelerate the transformation of Telefónica, raising awareness regarding the necessity and urgency of this transformation.

To encourage the productivity of employees with a headcount that is more adapted to the business and ensures the correct management of the company's simplification process.

Telefónica faces a great transformation in order to continue as a leader in the new digital environment. Therefore, human resources policies have been rolled out to create a work environment in which each professional contributes the best they have to offer. As a result of these policies, in the Global Climate and Commitment index that was carried out in the final months of the year, Telefónica, S.A. reached 76%, with a participation percentage of 72.5% of the people invited. Among the aspects where the Company made the greatest progress, we would highlight the leadership of employees' immediate managers and the pride of belonging to the group.

**Employee training**

Telefónica employees have access to a wide range of training options thanks to the opportunities that the Company makes available to all its professionals. These opportunities are structured using different tools, through both on-site training and online training via the a+ platform.

The Universitas Telefónica campus is the nexus where Telefónica's culture and values flourish. In 2013 the number of employees receiving training through this channel increased over 60% with respect to the previous year. The strategic programmes, events, as well as the off-shore Universitas that involve on-site training in places away from the campus, have increased.

The Social Learning model with the A+ platform has consolidated, with over 47,000 students and over 380,000 accesses in the corporate schools, doubling the number of students who benefited from its educational initiatives the previous year.

In 2013, over 37,900 training initiatives were carried out. For the Company, managing knowledge is a priority. In 2013, the cost of training amounted to over 1.4 million euros, 21.6% higher than the previous year.

### **Equality in Diversity at Telefónica**

Diversity is a key value at Telefónica. The work of men and women of different nationalities, cultures, ethnic groups, histories, generations and abilities make the Group's growth possible. The company makes an effort to offer employees the same opportunities, without losing sight of the fact that each worker is unique. Telefónica believes that equality opens the way for enrichment and professional development, something that positively impacts innovation and efficiency and, therefore increases the quality of the services provided to customers.

The headcount distribution by gender and professional scales has been disclosed in Note 19.4.

Telefónica has a *Women in Leadership* programme that seeks to establish a solid network of female leaders that extends throughout Telefónica's European companies. These initiatives seek to promote female talent among the leaders in the sector.

**Table of Contents**

2013 Financial Statements

Telefónica is committed to society and makes important investments in innovation related to social innovation and initiatives in favour of the disabled. Among other initiatives, we would highlight the *Telefónica Ability Awards* which recognise the companies or institutions that have incorporated the disabled into their value chains, and developed sustainable business models that integrate solutions, products, and services that meet the needs of disabled people and promote their incorporation into society.

**Occupational health and safety**

One of Telefónica's priorities is to offer its staff the best possible working conditions at their place of work or when they are on the move.

As per its Business Principles, Telefónica ensures staff work in a safe environment. Appropriate mechanisms are therefore in place to avoid workplace accidents, injuries and illness associated with professional activities by fully complying with prevailing regulations, implementing safe working procedures, providing training and managing occupational risks.

The Occupational Risk Management System ensures worker health and safety is at the heart of all Telefónica's processes and services; offering an end-to-end model for rolling out joint action, procedures and policies. This system enables Telefónica to identify and disseminate practices that are proven to have an impact on staff welfare and therefore on reducing accident rates.

Telefónica, S.A. 112

**Table of Contents**

2013 Financial Statements

**Liquidity and capital resources****Financing**

In 2013, Telefónica's financing activity was intense, executing operations through bond and loan markets for an amount over 12,000 million equivalent euros. The financing activity was mainly focused on refinancing in advance debt maturing in 2014 and beyond and on smoothing the debt maturity profile at the Holding level for the following years while strengthening the liquidity position. Therefore, as of December 31st, the Company maintained a comfortable liquidity position to meet its upcoming debt maturities.

Telefónica, S.A., has a fully and unconditionally guaranteed the following issues by Telefónica Emisiones, S.A.U. during 2013:

Description	Issue date	Maturity date	Amount (nominal)	Currency of issue	Coupon
EMTN bonds	22/01/2013	23/01/2023	1,500,000,000	EUR	3.987%
	27/03/2013	26/03/2021	1,000,000,000	EUR	3.961%
	29/05/2013	29/05/2019	750,000,000	EUR	2.736%
	23/10/2013	23/10/2020	225,000,000	CHF	2.595%
SHELF bond	29/04/2013	27/04/2018	1,250,000,000	USD	3.192%
	29/04/2013	27/04/2023	750,000,000	USD	4.570%

The main financing transactions undertaken by Telefónica, S.A. in the banking market in 2013 are as follows:

Item	Limit	Currency	Nominal (millions)		
			of euros)	Arrangement Date	Maturity date
Vendor Financing (2)	206	EUR	206	02/21/2013	02/21/2016
Vendor Financing (2)	1,001	USD	336	02/22/2013	01/31/2023
Syndicated loan Tranche A2A (FSF) (1)	700	EUR		02/22/2013	02/22/2017
Syndicated loan Tranche A2B (FSF) (1)	700	EUR		02/22/2013	02/22/2018
ECAs structured facility (2)	734	USD		08/01/2013	08/01/2023

(1) 1,400 million euros under Tranche A2 were refinanced with forward start facilities dated 02/22/2013 (available from 07/28/2014).

(2) Facilities with amortization schedule.

**Available funds**



At December 31, 2013, available funds from undrawn lines of credit in different financial institutions totaled 8,873 million euros. Out of this figure, around 7,979 million euros have a maturity longer than 12 months. Additionally, cash and cash equivalents as of December 31, 2013 amount to 4,768 million euros.

Additional information on sources of liquidity and undrawn lines of credit available to the Company, on liquidity risk management, on the Company's debt levels, and on capital management is provided in Notes 13, 14, 15 and 16 of this financial statements.

### **Contractual commitments**

Note 19.5 to this financial statements provides information on firm commitments giving rise to future cash outflows and associated with operating leases, primarily.

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**Table of Contents**

2013 Financial Statements

**Credit risk management**

The Telefónica Group considers managing commercial credit risk is crucial to meeting its sustainable business and customer base growth targets in a manner that is consistent with its risk-management policy.

This management approach relies on the continuous monitoring of the risk assumed and the resources necessary to optimize the risk-reward balance to grant the adequate separation between the risk ownership areas and the risk management areas. Customer financing products and those debtors that could cause a material impact on the Group's financial statements are subject to specific management practices to mitigate exposure to credit risk according to the segment and risk profile of the customer (which include, particularly in the case of distributors and resellers, applications for deposits, guarantees and credit insurance as one of the key variables used to set the maximum threshold or acceptable limit for each of these parties).

All Group companies adopt policies, authorization guidelines, and homogeneous management practices, in consideration of the particularities of each market and best international practices, including:

Using statistical/expert models for accepting customers that can be used to forecast and manage the probabilities of default associated with such arrangements.

Tools for continually monitoring and rating the solvency and payment behavior of existing customers.

Internal and external collection processes aimed at optimizing debt recovery through measures that vary depending on a customer's profile and the length of time in default.

Ongoing controls over and evaluation of exposure to credit risk by specific local and group committees. This commercial credit risk management model is embedded into the Group's decision-making processes, both from a strategic and, especially, a day-to-day operating perspective, where credit risk assessment guides the product and service offering available for the different credit profiles.

**Credit rating**

Telefónica, S.A.'s long-term issuer default rating is currently BBB+/negative outlook from Fitch, Baa2/negative outlook from Moody's and BBB/negative outlook from Standard & Poor's. The most recent updates on these ratings were issued by Standard and Poor's on November 21, 2013, Moody's on July 25, 2013, and Fitch on July 23, 2013. The only change in the long-term issuer default rating and outlook for Telefónica, S.A. during 2013 was that the Japanese rating agency, JCR, withdrew from assigning the Company a rating on October 31, 2013.

In 2013, among the measures taken to help to protect the credit rating it is noteworthy the intensive financing activity to extend average debt maturity and accumulate liquidity; cash retained in the Company by not paying out dividends in the first half-year and restating the November 2013 dividend; net disposals of treasury shares; agreements to sell

Group companies (the Czech Republic and Ireland operators); and the issuance of undated deeply subordinated securities ( hybrids ), which also enabled the Company to agree the acquisition of E-Plus, with no negative impact in the solvency.

### **Dividend policy**

Telefónica, S.A.'s dividend policy is revised yearly based on the Group's earnings, cash generation, solvency, liquidity, flexibility to make strategic investments, and shareholder and investor expectations. Given circumstances in 2013, it was resolved to pay a cash dividend of 0.35 euros per share in November 2013, and the Board announced its intention to take corporate actions to approve another cash dividend of 0.40 euros per share in the second quarter of 2014.

The 2014 dividend policy will be announced in the report on fourth quarter 2013 earnings.

In May 2012, Telefónica launched a scrip dividend issue to allow shareholders to choose to receive new shares in place of a cash dividend (which may be replaced by selling the associated subscription rights to the Company at a pre-established price), while enabling the Company to reduce its debt, depending on the take-up rate of the conversion.

Telefónica, S.A. 114

**Table of Contents**

2013 Financial Statements

**Treasury shares**

Telefónica has performed, and may consider performing, transactions with treasury shares and financial instruments or contracts that confer the right to acquire treasury shares or assets whose underlying is Company shares.

Treasury share transactions will always be for legitimate purposes, including:

Undertaking treasury share acquisitions approved by the Board of Directors or pursuant to General Shareholders Meeting resolutions.

Honoring previous legitimate commitments assumed.

Covering requirements for shares to allocate to employees and management under stock option plans.

Other purposes in accordance with prevailing legislation. In the past, treasury shares purchased on the stock market were exchanged for other shares-securities (as in the case of preferred capital securities), swapped for stakes in other companies (e.g. China Unicom or Telco S.p.A.), or acquired to reduce the number of shares in circulation (by redeeming the shares acquired), thereby boosting earnings per share.

Treasury share transactions will not be performed in any event based on privileged information or in order to intervene in free price formation. In particular, any of the conduct referred to in Articles 83.ter.1 of the Spanish Securities Market Law and 2 of Royal Decree 1333/2005 of November 11 implementing the Spanish Securities Market Law, with regards to market abuse will be avoided.

At December 31, 2013 and 2012, Telefónica, S.A. held the following treasury shares:

	Number of shares	Euros per share		Market value (1)	%
		Acquisition price	Trading price		
Treasury shares at 13/12/31	29,411,832	11.69	11.84	348	0.64627%

(1) Millions of euros

Euros per share  
Trading price Market value (1) %

	<b>Number of shares</b>	<b>Acquisition price</b>			
Treasury shares at 12/12/31	47,847,809	10.57	10.19	488	1.05136%

(1) Millions of euros

The movement in treasury shares of Telefónica, S.A. in 2013 and 2012 is as follows:

	<b>Number of shares</b>
<b>Treasury shares at 11/12/31</b>	<b>84,209,363</b>
Acquisitions	126,489,372
Delivery GESP share plan	(2,071,606)
Disposals	(76,569,957)
Share redemption	(84,209,363)
<b>Treasury shares at 12/12/31</b>	<b>47,847,809</b>
Acquisitions	113,154,549
Disposals	(131,590,526)
<b>Treasury shares at 13/12/31</b>	<b>29,411,832</b>

Furthermore, at December 31, 2012, one Telefónica, S.A. share was held by Telefónica Móviles Argentina, S.A. This share has been sold during 2013.

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**Table of Contents**

2013 Financial Statements

**Acquisitions**

The amount paid to acquire treasury shares in 2013 and 2012 was 1,216 million euros and 1,346 million euros, respectively.

**Disposals**

On May 25, 2012, pursuant to the resolutions adopted in the General Shareholders Meeting of May 14, capital was reduced by redeeming 84,209,363 treasury shares, thereby reducing treasury shares by 1,321 million euros.

Treasury shares sold in 2013 and 2012 amounted to 1,423 million euros and 801 million euros, respectively. The main transactions during 2013 and 2012 were as follows:

On March 26, 2013 Telefónica, S.A. reached an agreement with qualified and professional investors whereby the Company disposed of all the treasury shares it held (90,067,896 shares) at a price of 10.80 euros per share.

On September 24, 2013 Telefónica, S.A. acquired the remaining shareholders of Telco, S.p.A. 23.8% of the non-convertible bonds issued in 2013 by Telco, S.p.A. The payment of this transaction consisted of the transmission of 39,021,411 treasury shares of the Company.

In addition to these disposals, on July 27, 2012, 2,071,606 shares were delivered to Group employees when the first phase of the Global Employee Share Plan ( the GESP ) matured.

In November 2012, Telefónica submitted an offer to purchase and cancel the preference shares that it had indirectly issued in 2002 through its subsidiary Telefónica Finance USA, LLC totaling 2,000 million euros. The offer involved acquiring these shares at their par value, subject unconditionally and irrevocably to the simultaneous reinvestment in Telefónica, S.A. shares and the subscription of newly issued plain-vanilla bonds, in the following percentage:

a) 40% of the amount in treasury shares of Telefónica, S.A.

b) 60% of the amount shall be used to subscribe a bond issue with a face value of 600 euros, issued at par. 97% of the holders of the preference shares accepted the offer, and therefore 76,365,929 treasury shares with a carrying amount of 815 million euros (exchange value of 776 million euros) were handed over, which are included under Disposals in 2012.

**Other equity instruments**

At December 31, 2013, Telefónica held 134 million call options on treasury shares subject to physical delivery at a fix price (178 million call options on treasury shares at December 31, 2012) which are presented as a reduction in equity under the caption treasury share instruments . They are valued at the amount of premium paid, and upon maturity if the

call options are exercised the premium is reclassified as treasury shares together with the price paid. If they are not exercised upon maturity their value is recognized directly in equity.

The Company also has a derivative on Telefónica shares, to be settled by offset, which has increased from 28 million shares in 2012 to 30 million shares in 2013, and is recognized under Derivatives (financial liabilities, current) on the balance sheet. In 2012, the fair value of this derivative was recognized under Derivatives (financial assets, current).

Lastly, details of the applicable conditions and time periods governing any resolutions of the General Shareholders Meeting to purchase and/or transfer treasury shares are provided hereon.

At Telefónica's Ordinary General Shareholders Meeting held on June 2, 2010, the shareholders granted the Board of Directors authorization (with express powers to delegate duties to the Executive Commission, Executive Chairman, Chief Operating Officer, or any other individual to which the Board of Directors confers powers for the same purpose) for the derivative acquisition by Telefónica, S.A. either directly or through any of the subsidiaries of which it is the controlling company at any time and as many times as it deems appropriate, of fully-paid treasury shares through purchase and sale, exchange or any other legal transaction.

The minimum price or consideration for the acquisition shall be equal to the par value of the treasury shares acquired, and the maximum acquisition price or consideration for the acquisition shall be equal to the listing price of the treasury shares acquired by the Company on an official secondary market at the time of the acquisition.

Telefónica, S.A. 116

**Table of Contents**

2013 Financial Statements

Such authorization is granted for 5 years as from the date of the General Shareholders Meeting and is expressly subject to the limitation that the par value of the treasury shares acquired pursuant to this authorization added to those already held by Telefónica, S.A. and any of its controlled subsidiaries shall at no time exceed the maximum amount permitted by the Law (currently 10% of Telefónica, S.A.'s share capital).

The aforesaid authorization granted to acquire treasury shares may be used in whole or in part to acquire shares of Telefónica, S.A. that it must deliver or transfer to directors or employees of the Company or of Group companies, directly or as a result of the exercise by them of option rights, all within the framework of duly approved compensation systems linked to the trading price of the Company's shares.

Telefónica, S.A. 117



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**Table of Contents**

2013 Financial Statements

**Risks and uncertainties facing the Company**

The Telefónica Group's business is conditioned by a series of intrinsic risk factors that affect exclusively the Group, as well as a series of external factors that are common to businesses of the same sector. The main risks and uncertainties facing the Company which could affect its business, financial position, reputation, corporate image and brand and its results, must be considered jointly with the information in the financial statements of 2013, and are as follows:

**Group-related risks****Worsening of the economic and political environment could negatively affect business.**

Telefónica's international presence enables the diversification of its activities across countries and regions, but entails the need of considering various legislations, as well as the political and economic environments of the countries in which it operates. Any adverse developments or even just uncertainties in this regard, or possible exchange-rate or sovereign-risk fluctuations may adversely affect the business, financial position, cash flows and/or the performance of some of the Group's economic and financial parameters.

With respect to the economic environment, the Telefónica Group's business is impacted by overall economic conditions in each of the countries in which it operates. Economic conditions may adversely affect the level of demand of existing and prospective customers, as they may no longer deem critical the services offered by the Group. The main macroeconomic factors that could have an adverse impact on consumption and, accordingly, on the level of demand for our services and finally, on Telefónica Group's results, are: the shortage of credit in an environment of adjustment of banks' balance sheets; the evolution of the labor market; the worsening of consumer confidence, with an increase in saving rates as an immediate consequence; or the needs for greater fiscal adjustment, which would negatively impact on the household income levels and corporate investments, expenses and revenues.

This economic risk might be significant in some European countries which are on the road to recovery but are rebounding more slowly due to financial imbalances that must continue to be corrected. According to the European Economic and Financial Affairs Council, the European economy is expected to have shrunk by -0.4% in 2013 and will only grow 1.1% in 2014, assuming, therefore, that private consumption growth may be weak in certain cases. In this region, Telefónica Group generated 47% of the Group's total revenues in 2013 (including 22.7% in Spain, 11.7% in the UK and 8.6% in Germany).

Also, the impact of the sovereign debt crisis and the rating downgrades in certain Euro Area countries should be taken into account. Any additional deterioration in the sovereign debt markets, doubts about developments in European projects (e.g. implementation of the banking union project, the results of the European elections or progress towards fiscal integration), as well as further credit restrictions by the banking sector could have an adverse effect on the Telefónica's ability to access funding and/or liquidity which could have a significant adverse effect on the Group's businesses, financial position, results of operations and cash flows. In addition, the Group's business may be affected by other possible effects from the economic crisis, including a possible insolvency of key customers and suppliers.



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**Table of Contents**

2013 Financial Statements

In Latin America, the most important challenge is the exchange-rate risk in Venezuela and Argentina (with a sustained accelerated depreciation of the peso against the U.S. dollar), given the negative impact that a higher than expected depreciation in their currencies could have on cash flows from both countries. The economic outlook for the entire region suggests that growth rates will remain stable at around 3%, supported by solid domestic demand fundamentals. International scenario, despite being not so favorable as in the past periods, it will remain to have a relatively benign impact on the region, except for potential periods of volatility linked to the evolution of the developed financial markets (especially long-term interest rates in the United States affected by the U.S. Federal Reserve's intervention that are not discounted in the market), a greater than envisaged economic slowdown in Asia (a key region for Latin America), and the slow progress being made with structural reforms projects in the majority of these countries which limits potentially higher growth rates. The most significant internal macroeconomic risk factors in the region would be the very high inflation rates in Venezuela and Argentina that could lead to economic stagnation in these countries, the delicate situation of Venezuela's public finance, and the deterioration in the external accounts of countries such as Argentina, Brazil, Chile and Peru; though with very different funding outlooks for the latter three (favorable) than the first.

In relation to the political environment, the Group's investments and operations in Latin America could be affected by a series of risks related to economic, political and social factors in these countries, collectively denominated country risk. On this point, approximately 15% of our revenues in the telephony business are generated in countries that do not have investment grade status (in order of importance Venezuela, Argentina, Ecuador, Guatemala, Nicaragua, El Salvador and Costa Rica), and other countries are only one notch away from losing this threshold. Also note that despite clear improvements in Brazil, recent announcements by the ratings agencies considering a possible downgrading of its credit rating could, depending on the extent of the downgrading, result in strong exchange-rate volatility due to an outflow of investments, especially strong in fixed-income.

Among the factors included in the concept of country risk, we highlight:

government regulation or administrative policies may change unexpectedly, including changes that modify the terms and conditions of licenses and concessions and their renewal (or delay their approvals) which could negatively affect the Group's interests in such countries;

abrupt exchange-rate fluctuations mainly due to situations of high levels of inflation and twin deficits (in public finance and external sector) with the resulting exchange-rate overvaluation. This movement could lead to a strong exchange-rate depreciation in the context of a floating exchange rate regime, to a significant devaluation off the back of abandoning fixed exchange rates regimes, or to the introduction of varying degrees of restrictions on capital movement. For example, in Venezuela, the official U.S. dollar to Bolivar fuerte exchange rate is established by the Central Bank of Venezuela and the Minister of Finance, with an alternative market for attracting foreign currency through SICAD's fortnightly auctions. Additionally, the acquisition of foreign currencies by Venezuelan or Argentinian companies (in some cases) to pay foreign debt or dividends is subject to the pre-authorization of the relevant authorities. Also, the Argentinean peso is following a sustained accelerated depreciation against the U.S. dollar;

governments may expropriate or nationalize assets, or make adverse tax decisions, or increase their participation in the economy and in companies;

economic-financial downturns, political instability and civil disturbances may negatively affect the Telefónica Group's operations in such countries; and

maximum profit margins limits may be imposed in order to limit the prices of goods and services through the analysis of cost structures. Thus, in Venezuela, a maximum profit margin has been introduced that will be set annually by the Superintendence for the defense of socio-economic rights.

**The Group's financial condition and results of operations may be adversely affected if it does not effectively manage its exposure to foreign currency exchange rates, interest rates or financial investment risks.**

At December 31, 2013, 71% of the Group's net debt (in nominal terms) had its interest rates fixed over a year, while 23% was denominated in a currency other than the euro.

To illustrate the sensitivity of financial expenses to a change in short-term interest rates at December 31, 2013: (i) a 100 basis points increase in interest rates in all currencies in which Telefónica has a financial position at that date would lead to an increase in financial expenses of 118 million euros, (ii) whereas a 100 basis points decrease in interest rates in all currencies except the euro, U.S. dollar and the pound sterling (these to zero rates in order to avoid negative rates), would lead to a reduction in financial expenses of 55 million euros. These calculations were made assuming a constant currency and balance position equivalent to the position at that date and bearing in mind the derivative financial instruments arranged.

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**Table of Contents**

2013 Financial Statements

According to the Group's calculations, the impact on results and specifically changes in the value of a 10% depreciation of Latin American currencies against the U.S. dollar and a 10% depreciation of the rest of the currencies against the euro would result in exchange losses of 42 million euros, primarily due to the weakening of the Venezuelan bolivar and, to a lesser extent, the Argentinean peso. These calculations had been made assuming a constant currency position with an impact on profit or loss at December 31, 2013 including derivative instruments in place.

The Telefónica Group uses a variety of strategies to manage this risk, mainly through the use of financial derivatives, which themselves are also exposed to risk, including counterparty risk. Furthermore, the Group's risk management strategies may not achieve the desired effect, which could adversely affect the Group's business, financial condition, results of operations and cash flows.

**Existing or worsening conditions in the financial markets may limit the Group's ability to finance, and consequently, the ability to carry out its business plan.**

The performance, expansion and improvement of the Telefónica Group's networks, the development and distribution of the Telefónica Group's services and products, the development and implementation of the Company's strategic plan, as well as the development and implementation of new technologies or the renewal of licenses require a substantial amount of financing.

The performance of financial markets in terms of liquidity, cost of credit, access and volatility, continues to be overshadowed by persisting uncertainty regarding certain factors such as the pace of economic recovery, the health of the international banking system and the concerns regarding the burgeoning deficits of some European countries. The worsening international financial market credit conditions caused by some of these factors could make it more difficult and more expensive to refinance existing financial debt or arrange new debt if necessary, and more difficult and costly to raise funds from our shareholders, and may negatively affect the Group's liquidity. At December 31, 2013, gross financial debt scheduled to mature in 2014 amounted to 9,214 million euros (which includes: (i) the net position of derivative financial instruments, certain current payables and (ii) 582 million euros of notes with an option of early repayment and no contractual obligation to be repaid), and gross financial debt scheduled to mature in 2015 amounted to 6,802 million euros. Despite having covered gross debt maturities of 2014 and 2015 by available cash and lines of credit at December 31, 2013, possible difficulties to maintain the current safety margin, or the risk that this could be significantly and unexpectedly exhausted, could force Telefónica to use resources allocated for other investments or commitments for payment of its financial debt, which could have a negative effect on the Group's businesses, financial position, results of operations or cash flows.

Although the Group maintains liquidity coverage on 24-month maturities, obtaining financing on the international capital markets could also be restricted, in terms of access and cost, if Telefónica's credit ratings are revised downwards, either due to lower solvency or operating performance, or as a result of a downgrade in the rating for Spanish sovereign risk by rating agencies. Any of these situations could have a negative impact on our ability to deal with our debt maturities.

Moreover, market conditions could make it harder to renew existing undrawn credit lines, 10% of which, at December 31, 2013, initially mature prior to December 31, 2014.

**Risks related to the Group's industry**

**The Group operates in a highly regulated industry which requires government concessions for the provision of a large part of its services and the use of spectrum, which is a scarce and costly resource.**

The telecommunications sector is subject to laws and regulations in different countries, and additionally, many of the services provided require the granting of a license, concession or official approval, which usually requires certain obligations and investments to be made, such as those relating to spectrum availability. Among the main risks of this nature are the spectrum and licenses/concessions, rates, universal service regulation, fiber networks, privacy, functional separation of businesses and network neutrality.

Thus, as the Group provides most of its services under licenses, authorizations or concessions, it is vulnerable to administrative bodies decisions, such as economic fines for serious breaches in the provision of services and, eventually, revocation or failure to renew these licenses, authorizations or concessions or the granting of new licenses to competitors for the provisions of services in a specific market.

Telefónica, S.A. 120

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**Table of Contents**

2013 Financial Statements

The Telefónica Group pursues its license renewal in the terms referred in their respective contractual conditions, though it cannot guarantee that it will always complete this process successfully or under the most beneficial terms for the Group. In many cases complying with certain obligations is required, including, among others, minimum specified quality standards, service and coverage conditions and capital investment. Failure to comply with these obligations could result in the imposition of fines, revision of the contractual terms, or even the revocation of the license, authorization or concession. Additionally, the Telefónica Group could be affected by regulatory actions carried out by the antitrust authorities. These authorizations could prohibit certain actions, such as new acquisitions or specific practices, create obligations or lead to heavy fines. Any such measures implemented by the competition authorities could result in economic and/or reputational loss for the Group, in addition to a loss of market share and/or in harm to the future growth of certain businesses.

*Regulation of spectrum and government concessions:*

The Digital Single Market packaged of measures is currently being amended by the European Parliament to include important measures affecting, *inter alia*, spectrum regulation. Although these measures are not yet final, they could have significant implications as they include new provisions on secondary markets, criteria to apply at auctions, renewals and terms of licensees, etc.

In 2015/2016, in Germany, it is expected that frequencies in the 900/1800 MHz band licenses, expiring at the end of 2016, will be renewed. The German regulator has adopted a proposal decision envisaging an auction of spectrum in the 900 MHz, 1800 MHz, 700 MHz and 1500 MHz bands. Furthermore, it is proposed, for operators holding 900 MHz GSM band licenses, the reservation of 2X5 MHz in this band. The aforementioned reservation entails a 99% population coverage obligation. Moreover, European and National regulators are reviewing the implications of the merger of Telefónica Germany and E-Plus, and any potential remedies or conditions. Remedies could affect the spectrum finally available. In Spain, it is expected that the previously auctioned frequencies in the 800 MHz band from the digital dividend, will be allocated on January 1, 2015. For its part, in the UK a tax rate increase for the use of the spectrum in 900 and 1800 MHz band is under discussion, which outcome is uncertain.

Main allocation criteria for the 700 MHz band (Digital Dividend II) will be defined in coming years in Europe. This could involve facing new cash outflow ahead of schedule (most likely scenario is currently seen as to have this spectrum between 2018 and 2021).

In Latin America, spectrum auctions will take place entailing potential outflows to obtain new licenses or to meet the coverage requirements associated with these licenses. Specifically, the following procedures are in progress or expected to take place in 2014:

Brazil. Auction of the 700 MHz band. Allocation of frequencies in the 700 MHz band for fixed-line and mobile telephone and broadband services has being approved. However, the allocation process requires television channels currently occupying this band to be migrated and Anatel to complete its analysis regarding spectrum interference between mobile and television services.

Chile. Auction of the 700 MHz band.

Ecuador. Negotiations underway to obtain additional frequencies in the 1900 MHz band.

El Salvador. The auction of one block in the 1900 MHz band and another in the AWS band had been postponed, although this issue might be resolved in the coming months.

Venezuela. Auction in the AWS band (1710-2170 MHz frequencies) and in the 2.5 GHz band, has been suspended.

On the other hand, negotiations to renew 850 MHz/1900 MHz licenses in Colombia (where a legal action regarding the reversion of assets at the end of the license terms is in place) and 850/1900 MHz licenses in Panama are under way. In Peru, an application for partial renewal of the concessions for the provision of the fixed-line service for another five years has been made, although assurance has been given that the concession will remain in force until November 2027. Also, a new law has also been enacted establishing mobile virtual network operator (MVNOs) and Rural Mobile Infrastructure Operators (RMIOs) in the Peruvian market. In Mexico, it is envisaged, in development of the constitutional reform enacted due to the Pact for Mexico political initiative, the creation of a wholesale network publicly owned which will offer wholesale services in the 700 MHz band, the funding and the marketing model of this project have not been determined at present



**Table of Contents**

2013 Financial Statements

On the other hand, Telefónica UK was awarded two 10 MHz blocks of spectrum in the 800 MHz band in 2013 to roll out a national 4G network. In Spain, the following license extensions have been granted: in the 900 MHz band, 4 MHz from July 2025 to December 2030 and 1 MHz from February 2015 to December 2030, likewise, in the 1800 MHz band a 20 MHz license has been extended from 2028 to December 2030. Moreover, in 2013, Telefónica also obtained spectrum licenses in Uruguay (2x5 MHz in the 1900 MHz band), Colombia (30 MHz in the AWS band) and Peru (20+20 MHz in the 1700 MHz band). In 2013 Telefónica Brazil requested the amendment of the Terms of its Authorization for the L band in order to relocate the blocks of radiofrequencies. Currently, the L band is located in the 3G radiofrequencies (1.9/2.1GHz). The notice of the L band provided for such relocation and the request ensured a more efficient use of the spectrum for Telefónica Brazil. CAPEX associated with the new spectrum in 2013 amounted to 1,224 million euros.

In 2012, Telefónica Ireland was awarded spectrum in the 800, 900 and 1800 MHz bands. In Brazil, Telefónica was awarded a block of the 2500 MHz X band (20+20 MHz), including the 450 MHz band in certain states. In the spectrum auction, Telefónica Brazil had to compensate the former licensees of this bandwidth, used for multichannel multipoint distribution services. The other operators also awarded spectrum shall, in turn, compensate Telefónica Brazil. Part of these compensation requirements is being legally contested. In Venezuela, the concession agreement between Telefónica Venezolana and the Regulator for an additional 20 MHz in the 1900 MHz band was executed. Telefónica Móviles Chile, S.A. was awarded radiofrequencies for 4G technology in the 2.6 GHz band (2x20 MHz), and in Nicaragua Telefónica was granted 36 MHz in the 700 MHz band.

The Company's failure to obtain sufficient or appropriate spectrum capacity in the jurisdictions discussed above or any others in which it operates or its capacity to assume the related costs, could have an adverse impact its ability to launch and provide new services and on the Company's ability to maintain the quality of existing services, which may adversely affect the Group's financial condition, results of operations and cash flows.

*Regulation of wholesale and retail charges:*

In terms of roaming, the regulated Eurotariffs will be reduced in July 2014, as per the Regulation approved in 2012. The structural roaming solutions which could lead to a price decrease in the intra-european roaming services, will also take effect in July 2014. Furthermore, the packet of Digital Single Market measures mentioned above also includes a proposal to eliminate European Union roaming charges in July 2016 as well as international charges.

The decreases in wholesale mobile network termination rates in Europe are also noteworthy. In the UK, wholesale mobile network termination rates will be reduced to 0.845 pence/minute from April 1, 2014 (representing a 0.3% reduction compared to the current rates), while the termination rate in Germany was set at 0.0179 euro/minute as from December 31, 2013 (3.24% lower than the previous termination rates). The European Commission has requested that the German regulator withdraw or amend its latest decision on mobile termination rates. There is a risk that the European Commission will initiate infringement proceedings, against Germany, and rates may be further reduced. In Spain, the schedule for reducing mobile network termination rates has reached the target rate (0.0109 euro/minute) in July 2013, representing close to 61% lower than the wholesale prices in force until that date. As from July 2013, the target price reached will remain in force until new target prices are set. The Spanish regulator has yet to make its decision on this matter. Based on a High Court ruling in Ireland, a mobile termination rate of 2.60 euro cents was provisionally imposed (more favorable than the figure initially proposed by the regulator), applicable from July 1,

2013 (representing 29.35% lower the previous termination rates). The Irish regulator is also developing a more adverse cost model based on long-run incremental cost (LRIC) price calculation, which is expected to be announced in July 2014.

Also, in Latin America, there are moves to review mobile termination rates leading to these being reduced. Thus, for example, developments in Mexico are among the most relevant, where the declaration of dominant operators in the telecommunications market is expected to lead to asymmetric regulatory measures that must be set. The Company's competitive position may benefit to a greater or lesser extent depending on the scope of these measures. Telefónica México has filed an administrative appeal against the 2011 resolutions of the Federal Telecommunications Commission of México (Cofetel) regarding mobile network termination rates (representing a 61% reduction compared to the previous rates). As of today, no ruling has been made on this appeal. Once these appeals have been concluded, the rates applied may be further reduced retroactively. As of today, Cofetel has not approved the termination rates for 2012, 2013, or 2014.

In Brazil, in October 2011, the regulator (Anatel) approved the fixed-mobile rate adjustment Regulation, which provides a progressive reduction of these rates until 2014 through a reduction factor, which will be deducted from the inflation, and implying a reduction of approximately 29% in 2012-2014. However, the Plano Geral de Metas de Competição (PGMC) of the end of 2012 extended application of the reduction to 2015 and amended the rates for 2014 and 2015 (75% of the 2013 rate in 2014 and 50% of the 2013 rate in 2015). A draft law has been prepared in Brazil to abolish the basic telephony service monthly fee. Price protection practices (reimbursement of price differences of a product to customers if this falls within a relative short period of time) may also have a negative effect, both in economic and image terms.

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**Table of Contents**

2013 Financial Statements

In Chile, a process to set new fixed-line termination charges is ongoing. A Tariff Decree has been passed for mobile networks covering the 2014-2019 five-year period. The new Tariff Decree entered into effect on January 25, 2014 and implies a reduction of 73.4% with respect to the previous rates. In Ecuador the rate-related risks also concern a reduction in rural and urban telephony charges, a reimbursement of top-up balances, as well as rounding to the nearest minute.

The implementation of the Enabling Act (Ley Habilitante) in Venezuela also confers full powers to the President to implement price controls measures, and it is therefore expected that it will not be possible to raise Movistar retail rates in line with high Venezuela inflation. In relation to mobile termination rates with the national operator of reference, these have been reduced 6% compared to the previous rates.

In Peru, the previously applicable rate was reduced by 24.24% in October 2013.

In Colombia, a decision was adopted establishing a gradual reduction for termination mobile rates. Regarding the termination model for time, the reduction for 2014 is 19.8% and 24.6% for 2015. For the capacity model the reduction will be 10.9% for 2014 and 12.3% for 2015. In relation with fix networks (for extended local networks) the reduction will be 50% for 2014 and 100% for 2015.

*Regulation of universal services:*

The European Commission on its formal obligation to review the Universal Service Directive will launch a public consultation whose objective will be to modify the scope of their obligations and include, at a European level, far higher broadband speeds than are currently provided. Depending on the terms set forth in the new regulation, implementation at a local level could lead to higher costs for both the universal service provider and the operators forced to finance the Universal Service.

The regulator in Brazil has modified the universal service targets. This represents a risk on the Company's positive balance resulted from the fulfilment of 2003 universal service targets, whose implementation was less costly than the initially established targets, leaving a positive balance for the Company.

The new requirements that cause this positive balance could apply until 2025, and extend beyond on issues such as, for example, rural telephony services and the expansion of the backhaul network. Rural telephony services are another risk in Brazil given the obligations arising from the switched fixed-line telephone services model and the obligations to provide mobile coverage in certain rural areas of the country.

*Regulation of fiber networks:*

It is expected that in 2014, Spanish National Competition Authority (Comisión Nacional de los Mercados y la Competencia) will study broadband market regulation in Spain. This could increase Telefónica's regulatory obligations in Spain, especially wholesale market obligations concerning access to fiber networks, and its pricing.

*Regulations on privacy:*

In Europe, a new Data Protection Regulation is in the pipeline before the end of the current European legislative term (spring 2014). This could lead to certain critical provisions laid down in the current draft of the Regulation (presently under debate) being worded in such a way that stops or hinders Telefónica from launching some services, that focus on the processing of personal data.

*Regulation of functional separation:*

The new principles established in Europe's common regulatory framework, adopted in 2009 and transposed in the national legislation of each Member State in which Telefónica operated during 2011 and 2012 could result in greater regulatory pressure on the local competitive environment. Specifically, this framework supports the possibility of national regulators, in specific cases and under exceptional conditions, forcing operators with significant market power and vertically-integrated operators to separate their wholesale and retail businesses at a functional level. They would therefore be required to offer equal wholesale terms to third-party operators that acquire these products.

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**Table of Contents**

2013 Financial Statements

*Regulation of network neutrality:*

In Europe, application of the current regulatory framework means that it is likely that during 2014, the Body of European Regulators for Electronic Communications (BEREC) and national regulators will strengthen their supervision of operators with regard to blocking of access, discrimination of applications or Internet service quality. The European Parliament and the Council are simultaneously debating the draft of the European Digital Market Regulation proposed by the European Commission, in particular concerning network neutrality, network management or differentiation of Internet access service characteristics. All of them are aspects of great importance that have a direct impact on potential business models that can be developed in the future.

Presently we have countries where net neutrality has already been ruled, such as Chile and Colombia. But it is a live issue and with varying degree of development in the rest of the countries. In Germany, the Economy Minister published a draft law on June 20, 2013 to regulate neutrality, especially with regard to blocking and discrimination of content and Internet services. The text is pending approval by parliament in 2014 after the new government was sworn in during December 2013.

In Brazil, the Civil Rights Framework for Internet Governance is being debated by Congress and is expected to be approved in the first quarter of 2014. It includes policies on the Internet such as network neutrality. Activities regarding net neutrality have been, as of today, focused in supervision of the quality of the services: in October 2011, Anatel approved the regulations of the Service Quality of Multimedia Communication Service (includes fixed internet) and Personal Mobile Service (including mobile internet). Aforementioned regulations, regulates the measurement made from independent entities on quality delivered and perceived by ISPs to customers.

If changes to regulation such as those described above, or otherwise, occur in the various jurisdictions where the Telefónica Group operates, it could have a material adverse effect on our business and results of operations.

**Customers' perceptions of services offered by the Company may put it at a disadvantage compared to competitors' offerings.**

Customers' perceptions of the services and products offered are critical to operating in highly-competitive markets. The ability to predict and respond to the changing needs and demands of customers affects the Company's competitive position relative to other technology sector companies, and its ability to extract the value generated during this process of transformation. Failure to do so appropriately could have an adverse impact on the Group's financial condition, results of operations and cash flows.

**Company may not be able to adequately foresee and respond to technological changes and sector trends.**

In a sector characterized by rapid technological change, it is essential to be able to offer the products and services demanded by the market, and consider the impacts of changes in the life cycle of technical assets, finely adjust margins, and select the right investments to make.

The Telefónica Group operates in markets that are highly competitive and subject to constant technological development. Therefore, as a consequence of both characteristics, it is subject to the effects of actions by competitors

in these markets and to its ability to anticipate and adapt to constant technological changes taking place in the industry.

To compete effectively in these markets, the Telefónica Group needs to successfully market its products and services and respond to both commercial actions by competitors and other competitive factors affecting these markets, anticipating and adapting promptly to technological changes, changes in consumer preferences and general economic, political and social conditions. Failure to do so appropriately could have an adverse impact on the Group's financial condition, results of operations and cash flows.

New products and technologies arise constantly, while the development can render obsolete the products and services the Telefónica Group offers and the technology it uses. This means that Telefónica must invest in the development of new products, technology and services so it can continue to compete effectively with current or future competitors, and which may result in the decrease of the Group's profits and revenue margins. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are deriving from mobile internet and connectivity services that are being launched. Research and development costs amounted to 1,046 million euros and 1,071 million euros in 2013 and 2012, respectively, representing 1.8% and 1.7% of the Group's consolidated revenue, respectively. One technology that telecommunications operators, including Telefónica (in Spain and Latin America), are focused on is the new FTTx-type network, which offers broadband access using optical fiber with superior services, e.g. internet speed of up to 100MB or HD television services. However, substantial investment is required to deploy these networks, which entails fully or partially substituting copper loop access with optic fiber. An increasing demand for the capabilities offered by these new networks to end users exist, however, the high level of the investments requires a continuous analysis of the return on investment.

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**Table of Contents**

2013 Financial Statements

The explosion of the digital market, and entry of new players in the communications market, such as Mobile Virtual Network Operators (MVNOs), internet companies or device manufacturers, may cause the loss of value of certain assets, and affect its ability to generate income. Therefore, it is necessary to update the business model, encouraging the pursuit of incomes and additional efficiencies to the more traditional. Failure to do so appropriately could have an adverse impact on the Group's financial condition, results of operations and cash flows.

In addition, the ability of the Telefónica Group's IT systems (operational and backup) to respond the Company's operating requirements is a key factor to be taken into account with respect to the commercial development, customer satisfaction and business efficiency.

**The Company depends on the suppliers.**

The existence of critical suppliers in the supply chain, especially in areas such as network infrastructure, information systems or handsets, with a high concentration in a small number of suppliers, poses risks that may affect the operation, and may cause contingencies or damages to the Company's image in the event that inappropriate practices were produced by a participant in the supply chain.

As of December 31, 2013, the Telefónica Group depends on 8 handset suppliers and 12 network infrastructure suppliers, which together accounted for 80% of orders. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own shortages and business requirements.

If these suppliers fail to deliver products and services to the Telefónica Group on a timely basis, it could jeopardize network deployment and expansion plans, which in some cases could adversely affect the Telefónica Group's ability to satisfy its license terms and requirements or have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

**Unanticipated network interruptions can lead to quality loss or the interruption of the service.**

Unanticipated network interruptions as a result of system failures, including those due to network, hardware or software or cyber-attacks, which affect the quality of or cause an interruption in the Telefónica Group's service, could lead to customer dissatisfaction, reduced revenues and traffic, costly repairs, penalties or other measures imposed by regulatory authorities and could harm the Telefónica Group's image and reputation.

Telefónica attempts to mitigate these risks through a number of measures, including backup systems and protective systems such as firewalls, virus scanners and other physical and logical security. However, these measures are not always effective. Although the Telefónica Group has insurance policies to cover this type of incidents and risks, these policies may not be sufficient to cover all possible monetary losses, although the claims and loss in revenue caused by service interruptions to date have been covered by these policies.

**The telecommunications industry may be affected by the possible effects of electromagnetic fields, emitted by mobile devices and base stations, may have on human health.**

In some countries, there is a concern regarding potential effects of electromagnetic fields, emitted by mobile devices and base stations, on human health. This public concern has caused certain governments and administrations to take measures that have hindered the deployment of the infrastructures necessary to ensure quality of service, and affected the deployment criteria of new networks and digital services such as smart meters development.

There is a consensus between various expert groups and public health agencies, including the World Health Organization (WHO), who claim that at the moment there have not been established risks for exposure to low frequency signals in mobile communications. The scientific community is still investigating this issue especially on mobile devices. Exposure limits for radio frequency suggested in the guidelines of the Protection of Non-Ionizing Radiation Protection Committee (ICNIRP) have been internationally recognized. The mobile industry has adopted these exposure limits and works to request authorities worldwide to adopt these standards.

Society's worries about radiofrequency emissions may discourage the use of mobile devices and new digital services, which could cause the public authorities to implement measures restricting where transmitters and cell sites can be located and how they operate, and the use of our mobile telephones, the massive deployment of smart meters and other products using mobile technology. This could lead to the Company being unable to expand or improve its mobile network.



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**Table of Contents**

2013 Financial Statements

The adoption of new measures by governments or administrations or other regulatory interventions in this respect, and any future assessment on the adverse impact of electromagnetic fields on health, may negatively affect the business, financial conditions, results and cash flows of Telefónica Group.

**Possible regulatory, business, economic or political changes could lead to asset impairment.**

The Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future expected cash flows, including, in some cases synergies allowed for in acquisition cost. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and recognize impairment losses in goodwill, intangible assets or fixed assets. Although the recognition of impairments of property, plant and equipment, intangible assets and financial assets results in a non-cash charge on the income statement, it could adversely affect the results of the Telefónica Group's operations. In this respect, the Telefónica Group has experienced impairment losses on certain of its investments, affecting the results of the year in which they were made. Thus, with respect to the investment in Telco, S.p.A., it has been made value adjustments in fiscal years 2012 and 2013 resulted in 1.277 million euros and 267 million euros, respectively. Also in 2012, the revision of the value of Telefónica operations in Ireland, resulted in a negative impact of 527 million euros.

**Our networks carry and store huge volumes of confidential, personal and corporate data, and our Internet access and hosting services may lead to claims for illegal or illicit use of the Internet.**

Our networks carry and store huge volumes of confidential, personal and business data, both voice and data traffic. We store increasing quantities and types of customer data in both business and consumer segments. Despite our best efforts to prevent it, Telefónica may be found liable for the loss, transfer, or inappropriate modification of the customer data or general public data stored on its servers or transmitted through its networks which could involve many people and have an impact on the Company's reputation, or lead to legal claims and liabilities that are difficult to measure in advance.

Our Internet access and hosting servers could lead to claims for illegal or unlawful use of the Internet. Telefónica, like other telecommunications providers, may be held liable for the loss, transfer or inappropriate modification of the customer data stored on its servers or carried by its networks.

In most countries in which Telefónica operates, the provision of its internet access and hosting services (including the operation of websites with shelf-generated content) are regulated under a limited liability regime applicable to the content that it makes available to the public as a technical service provider, particularly content protected by copyright or similar laws. However, regulatory changes have been introduced imposing additional obligations on access providers (such as blocking access to a website) as part of the struggle against some illegal or illicit uses of the internet, notably in Europe.

**Telefónica and Telefónica Group companies are party to lawsuits, tax claims, antitrust and other legal proceedings.**

Telefónica and Telefónica Group companies are party to lawsuits, tax claims and other legal proceedings in the ordinary course of their businesses, the financial outcome of which is unpredictable. An adverse outcome or settlement in these or other proceedings could result in significant costs and may have a material adverse effect on the Group's business, financial condition, results of operations, reputation and cash flows. In particular, regarding tax and antitrust claims, Telefónica Group has open judicial procedures in Peru concerning the clearance of previous years income tax, which contentious-administrative appeal is currently on its way; as well as in Brazil CADE's (Conselho Administrativo de Defesa Econômica) as regards the acquisition of a 50% stake in VIVO and tax open procedures, primarily relating to the CIMS (tax on telecommunication services).

Telefónica, S.A. 126

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**Table of Contents**

2013 Financial Statements

**Trend evolution**

Telefónica is an integrated diversified telecommunications group that offers a wide range of services, mainly in Europe and Latin America. Its core business is the provision of fixed and mobile telephony, broadband, internet, data, pay TV and value added services, among others. The Group's operations in 25 countries, managed through a regional organization geared towards certain businesses in global units, enable it to leverage the strong local positioning, as well as the advantages afforded by the scale, two features that have been reinforced by the opportunities arising from the Group's holdings in and strategic alliances with China Unicom and Telecom Italia.

As a multinational telecommunications company that operates in regulated markets, Telefónica is subject to different laws and regulations in each of the jurisdictions in which it provides services. Telefónica expects the regulatory landscape to continue to change in Europe as a consequence of the revised regulations resulting from the implementation of the review of the common regulatory framework currently in place in the European Union. In addition, Telefónica may also face pressure from regulatory initiatives in some European countries regarding tariffs, the reform of rights of spectrum use and allocation, issues related to the quality of service, and the regulatory treatment of new broadband infrastructure deployments.

Telefónica faces intense competition in the vast majority of the markets it operates in, and is therefore subject to the effects of actions taken by its competitors. The intensity of the competition may deepen, which could have an impact on tariff structures, consumption, market share and commercial activity and negatively affect the number of customers, revenues and profitability.

However, Telefónica believes that it is in a strong competitive position in most of the markets where it operates, which it expects to help enable it to continue taking advantage of the growth opportunities that arise in these markets, such as by boosting both fixed and mobile broadband services and by furthering the development of services beyond connectivity, information technology services and related businesses. In this respect, Telefónica seeks to lead the industry by anticipating trends in the new digital environment.

Telefónica embarked on a restructuring in September 2011 with the aim of reinforcing its growth story, actively participating in the digital world and capturing the most of the opportunities afforded by its scale and industrial alliances. This new organization gave rise to two cross-cutting areas, Telefónica Digital and Telefónica Global Resources, in addition to the Telefónica Europe and Telefónica Latin America business segments. This structure was designed to bolster Telefónica's place in the digital world, enabling it to tap any growth opportunities arising in this environment, drive innovation, strengthen the product and services portfolio and maximize the advantages afforded by its global customer bases in an increasingly connected world. In addition, the creation of a Global Resources operating unit supports the profitability and sustainability of the business by leveraging economies of scale and driving Telefónica's transformation into a fully global company. Telefónica Europe's and Telefónica Latin America's objective is to shore up the results of the business and generate sustainable growth through available capacity, backed by the global corporation. During 2013, with the objective of increasing its direct contact with customers, both residential and business, and in the context of accelerating the transformation of the company into a digital telecommunications company, Telefónica created the position of Chief Marketing Officer at the global level, bringing together all the commercial areas, policies products, services, channels, handsets and prices, as those relating to advertising and brand. In addition, Telefónica Global Solutions, was integrated into Telefónica Global Resources, and addresses the growing

complexity of a business market that is increasingly adopting digital solutions.

In Europe, customers remain at the core of the Group's strategy and management priorities in the region in order to provide a high level of customer satisfaction with our services. With the objective of offering our customers the best value, we aim to boost the transformation of our network with higher investment in fiber and LTE and we will try to accelerate digital services growth. In such a competitive market such as presently prevails, we will dedicate our efforts on reinforcing our market positioning. Another objective in coming years is to improve operating efficiency, for which we are rolling out several local and regional initiatives, such as network sharing agreements, with the support of Telefónica Global Resources.

In Latin America, Telefónica's strategy is based on a regional model that captures growth and efficiency of scale without losing sight of the local management of the client. The mobile business will continue to play a key role as a driver of regional growth and we will continue further enhancing the capacity and coverage of our networks, in order to keep and attract high-value customers, especially in the contract segment and boosting the penetration of mobile internet.

Regarding the fixed telephony business, we will encourage the increase of broadband speed and expand the supply of bundled services. Meanwhile, we will further advance efficiency, in operational and commercial terms, and attempt to achieve further synergies by implementing global, regional and local projects.

In summary, in the context of intense competition and regulatory pressure on pricing, Telefónica aims to continue strengthening its business model to make it more efficient and capture the synergies arising from the integrated approach of businesses, processes and technologies, while focusing even more on the client and staying ahead of trends in the new digital world.

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**Table of Contents**

2013 Financial Statements

**Events after the reporting period**

The following events regarding the Company took place between the reporting date and the date of preparation of the accompanying financial statements:

**Financing**

On January 31, 2014, Telefónica Emisiones, S.A.U. redeemed 296 million pounds sterling (equivalent to 355 million euros) of its notes, issued on December 28, 2006. The notes were guaranteed by Telefónica S.A.

On February 3, 2014, Telefónica Emisiones, S.A.U. redeemed 2,000 million euros of its notes, issued on February 3, 2009. The notes were guaranteed by Telefónica S.A.

On February 7, 2014, Telefónica Emisiones, S.A.U. redeemed 1,500 million euros of its notes, issued on February 7, 2007. The notes were guaranteed by Telefónica S.A.

On February 7, 2014, Telefónica, S.A. made an early repayment for 923 million euros of its syndicated loan (Tranche D2) dated March 2, 2012 (scheduled to mature originally on December 14, 2015).

On February 7, 2014, Telefónica Europe, B.V. made an early repayment for 801 million euros of its syndicated loan (Tranche D1) dated March 2, 2012 (scheduled to mature originally on December 14, 2015).

On February 18, 2014, Telefónica, S.A. signed a 3,000 million euros syndicated revolving credit facility maturing on February 18, 2019. This agreement would enter into effect on February 25, 2014 cancelling the 3,000 million syndicated credit facility signed on July 28, 2010 (scheduled to mature originally in 2015).

**Sale of Telefónica Czech Republic, a.s.**

On January 28, 2014 Telefónica announced that, after obtaining the relevant regulatory approval, the transaction for the sale of a 65.9% stake of Telefónica Czech Republic, a.s. to PPF Group, N.V., has been completed (see Note 20.c. and 8.5.)

**Telefónica new organization structure**

On February 26, 2014, the Board of Directors of Telefónica, S.A. has approved the implementation of a new organizational structure completely focused on clients and that incorporates the digital offering as the main focus for commercial policies. The structure gives greater visibility to local operations, bringing them closer to the corporate

decision-making centre, simplifying the global structure and strengthening the transverse areas to improve flexibility and agility in decision makings.

Within this framework, Telefónica has created the role of the Chief Commercial Digital Officer, who will be responsible for fostering revenue growth. On the cost side, the Company has strengthened the role of the Chief Global Resources Officer. Both Officers will report directly to the Chief Operating Officer (COO), as will the local business CEOs for Spain, Brazil, Germany and the United Kingdom, in addition to the Latin American Unit, now without Brazil.

The new model integrates the activities carried out to date by Telefónica Digital, Telefónica Europe and Telefónica Latam into the Global Corporate Centre, thus simplifying the organization.

**Table of Contents**

2013 Financial Statements

**Annual Corporate Governance Report for Listed Companies**

## A. Ownership structure

## A.1. Complete the following table on the company's share capital:

Date of last modification	Share capital ( )	Number of shares	Number of voting rights
08-06-2012	4,551,024,586.00	4,551,024,586	4,551,024,586

Indicate whether different types of shares exist with different associated rights:

No

## A.2. List the direct and indirect holders of significant ownership interests in your organization at year-end, excluding directors:

Name or corporate name of shareholder	Number of direct voting rights	Number of indirect voting rights		
		Name or corporate name of direct shareholder	Number of voting rights	% of total voting rights
Banco Bilbao Vizcaya Argentaria, S.A.				6.893
Banco Bilbao Vizcaya Argentaria, S.A.	313,681,635			6.893
		BBVA Seguros, S.A. de Seguros y Reaseguros	25,498	0.000
Caja de Ahorros y Pensiones de Barcelona, la Caixa				5.427
Caja de Ahorros y Pensiones de Barcelona, la Caixa	0			0.000
		Caixabank, S.A.	246,251,707	5.411
		VidaCaixa, S.A. de Seguros y Reaseguros	42,940	0.000
		Compañía Andaluza de Rentas e Inversiones, S.A.	682,500	0.015
Blackrock, Inc.				3.895
		Blackrock Investment Management (UK)	177,257,649	3.895

Indicate the most significant movements in the shareholder structure during the year:

<b>Name or corporate name of shareholder</b>	<b>Date of transaction</b>	<b>Description of transaction</b>
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		Telefónica, S.A. 129
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**Table of Contents**

2013 Financial Statements

**A.3. Complete the following tables on company directors holding voting rights through company shares:**

Name or corporate name of director	Number of direct voting rights	Number of indirect voting rights	
		Name or corporate name of direct shareholder	Number of % of total voting rights
Mr. César Alierta Izuel	4,419,548		0.097
Mr. Isidro Fainé Casas	508,875		0 0.011
Mr. José María Abril Pérez	94,586		108,386 0.004
Mr. Julio Linares López	418,946		1,887 0.009
Mr. José María Álvarez-Pallete López	325,841		0 0.007
Mr. Alfonso Ferrari Herrero	586,352		19,499 0.013
Mr. Antonio Massanell Lavilla	2,346		0 0.000
Mr. Carlos Colomer Casellas	49,360		63,190 0.002
Mr. Francisco Javier de Paz Mancho	55,273		0 0.001
Mr. Gonzalo Hinojosa Fernández de Angulo	87,725		447,474 0.012
Mr. Ignacio Moreno Martínez	12,713		0 0.000
Mr. José Fernando de Almansa Moreno-Barreda	19,449		0 0.000
Mr. Luiz Fernando Furlán	34,035		0 0.001
Ms. Eva Castillo Sanz	97,089		0 0.002
Mr. Pablo Isla Álvarez de Tejera	8,816		0 0.000
Mr. Peter Erskine	71,081		0 0.002
Mr. Santiago Fernández Valbuena	506,042		50,000 0.012
<b>% of total voting rights held by the Board of Directors</b>			0,176

Complete the following tables on share options held by directors:

Name or corporate name of director	Number of direct voting rights		Number of indirect voting rights		% of total voting rights
	Number of voting rights	Direct shareholder	Number of voting rights	Equivalent number of shares	
Mr. César Alierta Izuel	100,000		0	10,000,000	0.002
Mr. César Alierta Izuel 2	898,334		0	1,403,647	0.020
Mr. Julio Linares López	163,828		0	255,983	0.004
Mr. José María Álvarez-Pallete López	459,650		0	658,204	0.010
Ms. Eva Castillo Sanz	199,864		0	312,287	0.004
Mr. Santiago Fernández Valbuena	286,742		0	448,036	0.006



**Table of Contents**

2013 Financial Statements

**A.4. Indicate, as applicable, any family, commercial, contractual or corporate relationships between owners of significant shareholdings, insofar as these are known by the company, unless they are insignificant or arise from ordinary trading or exchange activities:**

Name or company name of related party	Type of relationship	Brief description
---------------------------------------	----------------------	-------------------

**A.5. Indicate, as applicable, any commercial, contractual or corporate relationships between owners of significant shareholdings, and the company and/or its group, unless they are insignificant or arise from ordinary trading or exchange activities:**

Name or company name of related party	Type of relationship	Brief description
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Joint shareholding with Telefónica Móviles España, S.A.U. in Mobipay España, S.A.
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Joint shareholding of Banco Bilbao Vizcaya Argentaria, S.A. (or any of its Group Companies), with Telefónica, S.A. and with Caixabank, S.A., in Telefónica Factoring España, S.A., Telefónica Factoring Perú, S.A.C., Telefónica Factoring Colombia, S.A., Telefónica Factoring do Brasil, Ltda., Telefónica Factoring México, S.A. de C.V., SOFOM, E.N.R., and Telefónica Factoring Chile, S.A.
Caja de Ahorros y Pensiones de Barcelona, La Caixa	Corporate	Joint shareholding of Caixabank, S.A. with Telefónica, S.A. and with Banco Bilbao Vizcaya Argentaria, S.A. (or any of its Group Companies), in Telefónica Factoring España, S.A., Telefónica Factoring Perú, S.A.C., Telefónica Factoring Colombia, S.A., Telefónica Factoring do Brasil, Ltda., Telefónica Factoring México, S.A. de C.V., SOFOM, E.N.R., and Telefónica Factoring Chile, S.A.
Caja de Ahorros y Pensiones de Barcelona, La Caixa	Corporate	Joint shareholding of Caixa Card 1 Establecimiento Financiero de Crédito, S.A.U. with Telefónica Digital España, S.L., and with Banco Santander, S.A., in Ecosistema Virtual para la Promoción del Comercio, S.L.



**Table of Contents**

2013 Financial Statements

**A.6. Indicate whether any shareholders agreements have been notified to the company pursuant to Articles 530 and 531 of the Corporate Enterprises Act (*Ley de Sociedades de Capital*, hereinafter LSC in Spanish). Provide a brief description and list the shareholders bound by the agreement, as applicable:**

Yes

**Shareholders bound by agreement**

China Unicom (Hong Kong) Limited  
Telefónica, S.A.

**% of share capital affected**

0.87

**Brief description of the agreement:**

In accordance with the provisions of Article 112, Section 2 of the Securities Market Act 24/1988, of July 28 (currently replaced by Article 531 Section 1 of the revised text of the Corporate Enterprises Act approved by Royal Decree-Law 1/2010, of 2 July), on October 22, 2009, the Company notified the Spanish Securities Market Commission (*Comisión Nacional del Mercado de Valores*, CNMV in Spanish) in writing that on September 6, 2009 Telefónica had entered into a mutual share exchange agreement with China Unicom (Hong Kong) Limited, whose clauses 8.3 and 9.2 are considered a shareholder agreement as per Article 530 of the Corporate Enterprises Act. By virtue of these clauses, Telefónica may not, while the strategic partnership agreement is in force, offer, issue or sell a significant number of its shares or any convertible security or security that confers the right to subscribe or acquire a significant number of shares of Telefónica, S.A. to any of the main competitors of China Unicom (Hong Kong) Limited. In addition, China Unicom (Hong Kong) Limited undertook not to sell, use or transfer, directly or indirectly, for a period of one year its share in Telefónica's voting share capital (excluding intragroup transfers). This undertaking was rendered null and void when the aforementioned period of one year had elapsed.

At the same time, both parties also assumed similar obligations with respect to the share capital of China Unicom (Hong Kong) Limited.

This mutual share exchange agreement, which includes the shareholder agreement, was filed with the Madrid Mercantile Registry on November 24, 2009.

On January 23, 2011, Telefónica, S.A. and China Unicom (Hong Kong) Limited ( China Unicom ) signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. Telefónica agreed to acquire through its subsidiary Telefónica Internacional, S.A.U. a number of China Unicom shares to the value of 500 million US dollars from third parties, within nine months from the agreement date. In recognition of China Unicom's stake in Telefónica, the latter commits to proposing the appointment of a board member nominated by China Unicom in the next General Shareholders Meeting, in accordance with prevailing legislation and the Company's By-laws. The General Shareholders Meeting held on May 18, 2011 duly approved the appointment of China Unicom's nominee, Mr. Chang Xiaobing, as member of the Board of Directors.

China Unicom completed the acquisition of Telefónica shares on January 28, 2011, giving it ownership of 1.37% of the Company's capital.

The Telefónica Group purchased China Unicom shares during 2011 to the amount of 358 million euros. At December 31, 2011, the Telefónica Group held a 9.57% stake in the company.

On June 10, 2012, Telefónica, S.A. through its wholly-owned subsidiary Telefónica Internacional, S.A.U., and China United Network Communications Group Company Limited, through a wholly-owned subsidiary, signed an agreement for the purchase by the latter of 1,073,777,121 shares in China Unicom (Hong Kong) Limited owned by Telefónica, equivalent to 4.56% of its total capital.

After securing the requisite regulatory authorizations, the sales transaction was completed on July 30, 2012.

Telefónica, S.A. 132

**Table of Contents**

2013 Financial Statements

Subsequent to the transaction, Telefónica and China Unicom remain firmly committed to their strategic partnership.

Telefónica agreed not to sell the shares it holds directly and indirectly in China Unicom for a period of 12 months as from the date of the agreement.

Telefónica will also continue to enjoy representation on China Unicom's board of directors, while Telefónica's Board of Directors will continue to include a representative of China Unicom.

**Indicate whether the company is aware of the existence of any concerted actions among its shareholders. Give a brief description as applicable:**

No

Shareholders involved in concerted action	% of share capital affected	Brief description of the concerted action
[Redacted]		

**Expressly indicate any amendments to or termination of such agreements or concerted actions during the year:**

**A.7. Indicate whether any individuals or bodies corporate currently exercise control or could exercise control over the company in accordance with Article 4 of the Spanish Securities Market Act (Ley del Mercado de Valores). If so, identify:**

No

**Name or corporate name**

**Remarks**

**Table of Contents**

2013 Financial Statements

**A.8. Complete the following tables on the company's treasury shares:**

At year end:

Number of shares held directly	Number of shares held indirectly (* )	% of total share capital
29,411,832	0	0.646

(\*) Through:

Name or corporate name of direct shareholder	Number of shares held directly

**Total****Give details of any significant changes during the year, in accordance with Royal Decree 1362/2007:**

Date of notification	Total number of direct shares acquired	Total number of indirect shares acquired	% of total share capital
11/02/2013	48,534,363	0	1.066
25/07/2013	49,692,373	0	1.092

**A.9. Give details of the applicable conditions and time periods governing any resolutions of the General Shareholders Meeting authorizing the Board of Directors to repurchase or transfer the treasury shares:**

At Telefónica's Ordinary General Shareholders Meeting held on June 2, 2010, the shareholders resolved to renew the authorization granted at the General Shareholders Meeting of June 23, 2009, for the derivative acquisition of treasury stock, either directly or through Group companies, in the terms literally transcribed below:

To authorize, pursuant to the provisions of Section 75 et seq. of the Spanish Companies Act (*Ley de Sociedades Anónimas*, hereinafter LSA in Spanish), the derivative acquisition by Telefónica, S.A. either directly or through any of the subsidiaries of which it is the controlling company at any time and as many times as it deems appropriate, of its own fully-paid shares through purchase and sale, exchange or any other legal transaction.

The minimum price or consideration for the acquisition shall be equal to the par value of the shares of its own stock acquired, and the maximum acquisition price or consideration for the acquisition shall be equal to the listing price of



the shares of its own stock acquired by the Company on an official secondary market at the time of the acquisition.

Such authorization is granted for a period of 5 years as from the date of this General Shareholders Meeting and is expressly subject to the limitation that the par value of the Company's own shares acquired pursuant to this authorization added to those already held by Telefónica, S.A. and any of its controlled subsidiaries shall at no time exceed the maximum amount permitted by the Law at any time, and the limitations on the acquisition of the Company's own shares established by the regulatory Authorities of the markets on which the shares of Telefónica, S.A. are traded shall also be observed.

It is expressly stated for the record that the authorization granted to acquire shares of its own stock may be used in whole or in part to acquire shares of Telefónica, S.A. that it must deliver or transfer to directors or employees of the Company or of companies of its Group, directly or as a result of the exercise by them of option rights, all within the framework of duly approved compensation systems referencing the listing price of the Company's shares.

To authorize the Board of Directors, as broadly as possible, to exercise the authorization granted by this resolution and to implement the other provisions contained therein; such powers may be delegated by the Board of Directors to the Executive Commission, the Executive Chairman of the Board of Directors, the Chief Operating Officer or any other person expressly authorized by the Board of Directors for such purpose.

Telefónica, S.A. 134

**Table of Contents**

2013 Financial Statements

To deprive of effect, to the extent of the unused amount, the authorization granted under Item IV on the Agenda by the Ordinary General Shareholders Meeting of the Company on June 23, 2009.

**A.10. Indicate, as applicable, any restrictions on the transfer of securities and/or any restrictions on voting rights. In particular, indicate any type of restrictions that could impose obstacles to the takeover of the company by means of share purchases on the market:**

**Yes**

**Description of the restrictions**

In accordance with Article 26 of the Corporate By-laws, no shareholder may cast a number of votes in excess of 10 percent of the total voting capital existing at any time, regardless of the number of shares held by such shareholder and in full compliance with mandatory requirements of law. In determining the maximum number of votes that each shareholder may cast, only the shares held by each such shareholder shall be computed. It does not include additional votes cast on behalf of other shareholders who may have appointed them as proxy, who are themselves likewise restricted by the 10 percent voting ceiling.

The 10 percent limit described above also applies to the number of votes that can be cast either jointly or separately by two or more legal entity shareholders belonging to the same corporate group and to the number of votes that may be cast altogether by an individual or legal entity shareholder and any entity or entities that they directly or indirectly control and which are also shareholders.

For the purposes of the provisions contained in the preceding paragraph, the provisions of Section 18 of the current Corporate Enterprises Act shall apply in order to decide whether or not a group of entities exists and to examine the situations of control indicated above.

In relation to the above and in accordance with the provisions of Article 527 of the Corporate Enterprises Act, any clauses in the By-laws of listed corporations that directly or indirectly restrict the number of shares that may be cast by a single shareholder by shareholders belonging to the same group or by any parties acting together with the aforementioned, will be rendered null and void when, subsequent to a takeover bid, the buyer has a stake equal to or over 70 percent of share capital which confers voting rights, unless the buyer was not subject to neutralization measures to prevent a takeover bid or had not adapted these measures accordingly.

**A.11. Indicate whether the General Shareholders Meeting has agreed to take neutralization measures to prevent a public takeover bid by virtue of the provisions of Act 6/2007.**

**No**

If applicable, explain the measures adopted and the terms under which these restrictions may be lifted:

**A.12. Indicate whether the company has issued securities not traded in a regulated market of the European Union.**

**Yes**

If so, identify the various classes of shares and, for each class of shares, the rights and obligations they confer.

The shares of Telefónica, S.A. are traded on the Spanish Continuous Markets, as well as on the markets of New York, London, Lima and Buenos Aires, and all share the same characteristics, rights and obligations.

Telefónica, S.A. 135

**Table of Contents**

2013 Financial Statements

On the stock markets of New York and Lima, Telefónica, S.A. s shares are traded via American Depositary Shares (ADSs), with each ADS representing one share in the Company.

Telefónica, S.A. 136

**Table of Contents**

2013 Financial Statements

**B. General Shareholders Meeting**

**B.1. Indicate the quorum required for constitution of the General Shareholders Meeting established in the company's By-laws. Describe how it differs from the system of minimum quorums established in the Corporate Enterprises Act (Ley de Sociedades de Capital, hereinafter LSC in Spanish).**

No

	<b>Quorum % other than that established in Article 193 of the LSC for general cases</b>	<b>Quorum % other than that established in Article 194 of the LSC for the special cases described in Article 194</b>
Quorum required for first call	0	0
Quorum required for second call	0	0

**Description of the differences**

**B.2. Indicate and, as applicable, describe any differences between the company's system of adopting corporate resolutions and the framework established in the LSC:**

No

Describe how they differ from the rules established in the LSC.

**B.3. Indicate the rules governing amendments to the company's By-laws. In particular, indicate the majorities required to amend the By-laws and, if applicable, the rules for protecting shareholders rights when changing the By-laws.**

The Articles of Association and the Rules of Procedure of the Telefónica General Meeting of Shareholders award the General Meeting of Shareholders the power to amend the Articles of Association (articles 15 and 5, respectively),

referring otherwise to the applicable legal provisions.

The procedure to amend the Articles of Association is set down in articles 285 and thereafter in the Capital Enterprises Act, and requires approval by the General Meeting of Shareholders with the majorities foreseen in articles 194 and 201 of the aforementioned Act. In particular, the General Meeting is held to deliberate amendments to the Articles of Association, including capital increases and decreases, eliminating or limiting the right to first refusal to buy shares, and the transformation, merger, spin-off and global conveyance of assets and liabilities and transferring the registered office abroad. At the first meeting, these decisions require the attendance of shareholders or representatives of shareholders representing at least fifty percent of the subscribed capital with voting rights. If there is not a sufficient quorum, a General Meeting will be held where the attendance of at least 25 percent of the subscribed stock capital with voting rights. Where the shareholders in attendance represent less than fifty percent of the subscribed capital with voting rights, the decisions referred to in the paragraph above may only be validly adopted with the vote in favour of at least two thirds of the capital presented or represented at the Meeting.

Pursuant to the provisions of article 286 of the Capital Enterprises Act, in the event the Articles of Association are amended, the Directors or, where applicable, the partners tabling the proposal must write the full text of their proposal amendment, and a written report to justify the change, which must be made available to the shareholders for the General Meeting called to deliberate on said amendment.

Furthermore, and pursuant to article 287 of the Capital Enterprises Act, the announcement of a meeting of the General Assembly should explicitly state with due clarity the points to be amended, and mention the right of all partners to examine the full text of the proposal amendment and the report at the company's headquarters, and to request the delivery or sending of said documents free of charge.

**Table of Contents**

2013 Financial Statements

Article 291 of the Capital Enterprises Act set out that where changes to the Articles of Association involve new obligations for the partners the affected parties must give their consent to the decision. Equally, if the amendment directly or indirectly affects a class of shareholders, or part thereof, the provisions of article 293 of the aforementioned Act must be applied.

The General Assembly voting procedure on proposals is governed by Telefónica's internal regulations (in particular, article 23 of the Rules of Procedure of the General Assembly). This states, i.a., that each substantially independent article of group of articles shall be voted on separately.

**B.4. Indicate the attendance figures for the General Shareholders Meetings held during the year:**

Date of general meeting	Attendance data				Total
	% attending in person	% by proxy	% remote voting Electronic means	Other	
31/05/2013	7.126	47.349	0.009	0.587	54.475
14/05/2012	16.240	38.040	0.004	0.310	54.280

**B.5. Indicate whether the bylaws impose any minimum requirement on the number of shares required to attend the General Shareholders Meetings:**

Yes

**Number of shares required to attend the General Shareholders Meetings**

300

**B.6. Indicate whether decisions involving a fundamental corporate change ( subsidiarization , acquisitions/disposals of key operating assets, operations that effectively entail the company's liquidation) must be submitted to the General Shareholders Meeting for approval or ratification even when not expressly required under company law.**

Yes

Both Article 15 of the Company's By-laws and Article 5 of the Regulations for the General Shareholders Meeting expressly define the following powers among those conferred on the general Shareholders Meeting:

The transformation of the Company into a holding company through subsidiarization or by entrusting subsidiaries with the conduct of core activities theretofore carried out by the Company itself.

The acquisition or disposal of essential operating assets, when this entails an effective amendment of the corporate purpose.

Transactions, the effect of which is tantamount to liquidating the Company and, especially, the approval of the final balance sheet upon liquidation.

**B.7. Indicate the address and mode of accessing corporate governance content on your company's website as well as other information on General Meetings which must be made available to shareholders on the website.**

Telefónica complies with applicable legislation and best practices in terms of the content of its website concerning Corporate Governance. In this respect, it fulfills both the technical requirements for access to the Company's website and the requirements on the content thereof (including information on the General Shareholders' Meetings) through direct access from the homepage of Telefónica, S.A. ([www.telefonica.com](http://www.telefonica.com)) in the section Shareholders and Investors ([www.telefonica.com/accionistaseinversores](http://www.telefonica.com/accionistaseinversores)), which includes not only all of the information that is legally required, but also information that the Company considers to be of interest.

All the available information included on the Telefónica website, except for certain specific documents, is available in two languages: Spanish and English.



**Table of Contents**

2013 Financial Statements

## C. Company management structure

**C.1. Board of Directors**

## C.1.1. List the maximum and minimum number of directors included in the bylaws:

<b>Maximum number of directors</b>	20
<b>Minimum number of directors</b>	5

## C.1.2. Complete the following table with board members details:

<b>Name or corporate name of director</b>	<b>Position on the Representative board</b>	<b>Date of first appointment</b>	<b>Date of last appointment</b>	<b>Election procedure</b>
Mr. César Alierta Izuel	Chairman	29/01/1997	14/05/2012	Vote at General Shareholders Meeting
Mr. Isidro Fainé Casas	Vice Chairman	26/01/1994	18/05/2011	Vote at General Shareholders Meeting
Mr. José María Abril Pérez	Vice Chairman	25/07/2007	31/05/2013	Vote at General Shareholders Meeting
Mr. Julio Linares López	Vice Chairman	21/12/2005	18/05/2011	Vote at General Shareholders Meeting
Mr. José María Álvarez-Pallete López	Chief Executive Officer	26/07/2006	14/05/2012	Vote at General Shareholders Meeting
Mr. Alfonso Ferrari Herrero	Director	28/03/2001	18/05/2011	Vote at General Shareholders Meeting
Mr. Antonio Massanell Lavilla	Director	21/04/1995	18/05/2011	Vote at General Shareholders Meeting
Mr. Carlos Colomer Casellas	Director	28/03/2001	18/05/2011	Vote at General Shareholders Meeting
Mr. Chang Xiaobing	Director	18/05/2011	18/05/2011	Vote at General Shareholders Meeting
Mr. Francisco Javier de Paz Mancho	Director	19/12/2007	31/05/2013	Vote at General Shareholders Meeting
Mr. Gonzalo Hinojosa Fernández de Angulo	Director	12/04/2002	14/05/2012	Vote at General Shareholders Meeting
Mr. Ignacio Moreno Martínez	Director	14/12/2011	14/05/2012	Vote at General Shareholders Meeting
	Director	26/02/2003	31/05/2013	

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Mr. José Fernando de Almansa Moreno-Barreda				Vote at General Shareholders Meeting
Mr. Luiz Fernando Furlán	Director	23/01/2008	31/05/2013	Vote at General Shareholders Meeting
Ms. Eva Castillo Sanz	Director	23/01/2008	31/05/2013	Vote at General Shareholders Meeting
Mr. Pablo Isla Álvarez de Tejera	Director	12/04/2002	14/05/2012	Vote at General Shareholders Meeting
Mr. Peter Erskine	Director	25/01/2006	18/05/2011	Vote at General Shareholders Meeting
Mr. Santiago Fernández Valbuena	Director	17/09/2012	31/05/2013	Vote at General Shareholders Meeting

**Total number of directors**

18

Indicate any board members who left during this period:

Name or corporate name of director	Type of directorship at time of leaving	Leaving date
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Telefónica, S.A. 139

**Table of Contents**

2013 Financial Statements

C.1.3. Complete the following tables on board members and their respective categories:

**EXECUTIVE DIRECTORS**

<b>Name or corporate name of director</b>	<b>Committee proposing appointment</b>	<b>Post held in the company</b>
Mr. César Alierta Izuel	Nominating, Compensation and Corporate Governance Committee	Executive Chairman
Mr. José María Álvarez-Pallete López	Nominating, Compensation and Corporate Governance Committee	Chief Operating Officer (COO.)
Ms. Eva Castillo Sanz	Nominating, Compensation and Corporate Governance Committee	Chairwoman Telefónica Europe
Mr. Santiago Fernández Valbuena	Nominating, Compensation and Corporate Governance Committee	Chairman Telefónica Latin America
<b>Total number of executive directors</b>		<b>4</b>
<b>% of the board</b>		<b>22.222</b>

**EXTERNAL PROPRIETARY DIRECTORS**

<b>Name or corporate name of director</b>	<b>Committee proposing appointment</b>	<b>Name or corporate name of significant shareholder represented or proposing appointment</b>
Mr. Isidro Fainé Casas	Nominating, Compensation and Corporate Governance Committee	Caja de Ahorros y Pensiones de Barcelona, la Caixa
Mr. José María Abril Pérez	Nominating, Compensation and Corporate Governance Committee	Banco Bilbao Vizcaya Argentaria, S.A.
Mr. Antonio Massanell Lavilla	Nominating, Compensation and	Caja de Ahorros y Pensiones de Barcelona, la Caixa

	Corporate Governance Committee	
Mr. Chang Xiaobing	Nominating, Compensation and Corporate Governance Committee	China Unicom (Hong Kong) Limited
Mr. Ignacio Moreno Martínez	Nominating, Compensation and Corporate Governance Committee	Banco Bilbao Vizcaya Argentaria, S.A.
<b>Total number of proprietary directors</b>		<b>5</b>
<b>% of the board</b>		<b>27.778</b>

**Table of Contents**

2013 Financial Statements

**INDEPENDENT EXTERNAL DIRECTORS**

<b>Name or corporate name of director</b>	<b>Profile</b>
Mr. Alfonso Ferrari Herrero	Industrial Engineer. Formerly Executive Chairman of Beta Capital, S.A. and senior manager at Banco Urquijo.
Mr. Carlos Colomer Casellas	Graduate in Economics. Was Chairman of the Colomer Group until 2013.
Mr. Francisco Javier de Paz Mancho	Graduate in Information and Advertising. Law Studies. IESE Business Management Program. Formerly Chairman of the State- owned company MERCASA.
Mr. Gonzalo Hinojosa Fernández de Angulo	Industrial Engineer. Formerly Chairman and CEO of Cortefiel Group.
Mr. Luiz Fernando Furlán	Degrees in chemical engineering and business administration, specializing in financial administration. From 2003 to 2007 he was Minister of Development, Industry and Foreign Trade of Brazil.
Mr. Pablo Isla Álvarez de Tejera	Law Graduate. Member of the Body of State Lawyers (on sabbatical). Chairman and CEO of Inditex, S.A.
Mr. Peter Erskine	Psychology Graduate. Was General manager of Telefónica Europe until 2007. Currently Chairman of Ladbrokes, Plc.
Mr. José Fernando de Almansa Moreno-Barreda	Law Graduate. Joined the diplomatic corps in 1974 and was appointed by His Majesty the King [Juan Carlos I] as Chief of the Royal Household in 1993, with the rank of Minister, and is currently Personal Adviser to His Majesty the King.

<b>Total number of independent directors</b>	<b>8</b>
----------------------------------------------	----------

<b>% of the board</b>	<b>44.444</b>
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List any independent directors who receive from the company or group any amount or payment other than standard director remuneration or who maintain or have maintained during the period in question a business relationship with the company or any group company, either in their own name or as a significant shareholder, director or senior manager of an entity which maintains or has maintained the said relationship.

**No**

If applicable, include a statement from the board detailing the reasons why the said director may carry on their duties as an independent director.

Name or corporate name of director	Description of the relationship	Reasons
------------------------------------	---------------------------------	---------

**Other External Directors**

Name or corporate name of director	Committee notifying or proposing appointment
Mr. Julio Linares López	Nominating, Compensation and Corporate Governance Committee
<b>Total number of Other External Directors</b>	1
<b>% of the board</b>	5.556

Telefónica, S.A. 141

**Table of Contents**

2013 Financial Statements

List the reasons why these cannot be considered proprietary or independent directors and detail their relationships with the company, its executives or shareholders.

Name or corporate name of director	Reasons	Company, executive or shareholder with whom the relationship is maintained
Mr. Julio Linares López	On September 17, 2012, Mr. Julio Linares López resigned from his post as COO of Telefónica, S.A. and his managerial post in the Telefónica Group and therefore went from being an Executive Director to being classified in the Other External Directors category.	Telefónica, S.A.

List any changes in the category of each director which have occurred during the year.

Name or corporate name of director	Date of change	Previous classification	Current classification
Mr. José Fernando de Almansa Moreno-Barreda	26/06/2013	Other External	Independent

C.1.4. Complete the following table on the number of female directors over the past four years and their category:

	Number of female directors				% of total directors of each type			
	Year t	Year t-1	Year t-2	Year t-3	Year t	Year t-1	Year t-2	Year t-3
	<b>Executive</b>	1	1	0	0	25	25	0
<b>Proprietary</b>	0	0	0	0	0	0	0	0
<b>Independent</b>	0	0	1	1	0	0	12.5	12.5
<b>Other External</b>	0	0	0	0		0	0	
<b>Total:</b>	1	1	1	1	25	25	12.5	12.5

C.1.5. Explain the measures, if applicable, which have been adopted to ensure that there is a sufficient number of female directors on the board to guarantee an even balance between men and women.

Explanation of measures

The search for women who meet the necessary professional profile is a question of principle and, in this regard, it is clear that Telefónica has taken this concern on board. In this regard, it should be noted that, on January 23, 2008, the Board of Directors unanimously agreed to coopt, at the proposal of the Nominating, Compensation and Corporate Governance Committee, Ms. Eva Castillo Sanz as an Independent Director of Telefónica. This appointment was ratified by the Ordinary General Shareholders Meeting of Telefónica held on April 22, 2008, and she was thus appointed as a Member of the Board of the Company for a term of five years. On September 17, 2012, Ms. Eva Castillo Sanz was appointed as Chairwoman of Telefónica Europe, and therefore changed from being an Independent Director to an Executive Director.

Likewise, on December 19, 2007, the Board of Directors unanimously agreed, following a recommendation from the Nominating, Compensation and Corporate Governance Committee, to appoint Ms. María Luz Medrano Aranguren as the Deputy Secretary General and Secretary to the Board of Directors of Telefónica.

Article 10.3 of the Regulations of the Board of Directors stipulates that the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that the candidates chosen are persons of recognized caliber, qualifications and experience, who are willing to devote a sufficient portion of their time to the Company, and shall take extreme care in the selection of the persons to be appointed as Independent Directors.

Therefore, the selection procedure described above is based exclusively on the personal merits of the candidates ( recognized caliber, qualifications and experience ) and their ability to dedicate themselves to the functions of members of the Board, so there is no implicit bias capable of impeding the selection of women directors, if, within the potential candidates, there are women candidates who meet the professional profile sought at each moment.



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**Table of Contents**

2013 Financial Statements

C.1.6. Explain the measures taken, if applicable, by the Nomination Committee to ensure that the selection processes are not subject to implicit bias that would make it difficult to select female directors, and whether the company makes a conscious effort to search for female candidates who have the required profile.

Explanation of measures

In accordance with Article 10.3 of the Board Regulations, the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that the candidates chosen are persons of recognized caliber, qualifications and experience, who are willing to devote a sufficient portion of their time to the Company, and shall take extreme care in the selection of the persons to be appointed as independent Directors.

When, despite the measures taken, there are few or no female directors, explain the reasons:

Explanation of reasons

All the measures and processes agreed and adopted by the Board of Directors and the Nominating, Compensation and Corporate Governance Committee to ensure the number of females on the Board guarantees an even balance and to ensure that the selection processes are not subject to implicit bias that would make it difficult to select female directors have been implemented and initiated by the Company. No circumstance arose however during 2013 requiring the current composition of the Board of Directors to be altered.

C.1.7. Explain how shareholders with significant holdings are represented on the board.

As stated in Section C.1.3 of this Annual Corporate Governance Report, at December 31, 2013, the group of External Directors of Telefónica, S.A. was composed of 14 members (of a total of 18 Board members), of whom five are Proprietary Directors, eight are Independent Directors and one falls under the Other External Directors category.

Of the five Proprietary Directors, two act in representation of Caja de Ahorros y Pensiones de Barcelona ( la Caixa ), which holds 5.43% of the capital of Telefónica, S.A., two act in representation of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), which holds 6.89% of the capital, and one acts in representation of China Unicom (Hong Kong) Limited (China Unicom) which holds a 1.41% stake.

Telefónica, S.A. 143

**Table of Contents**

2013 Financial Statements

- C.1.8. Explain, when applicable, the reasons why proprietary directors have been appointed upon the request of shareholders who hold less than 5% of the share capital:

**Name or corporate name of shareholder****Reasons**

As explained in Section A.6 of this report, on January 23, 2011, expanding on their existing strategic alliance, Telefónica, S.A. and China Unicom (Hong Kong) Limited ( China Unicom ) signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. Telefónica also agreed to propose the appointment of a board member nominated by China Unicom in the next General Shareholders Meeting, in accordance with prevailing legislation and the Company s By-laws.

The General Shareholders Meeting held on May 18, 2011 approved the appointment of China Unicom s nominee, Mr. Chang Xiaobing, as member of the Board of Directors in accordance with the addendum to the Strategic Partnership Agreement signed in January 2011. This commitment to China Unicom is a consequence of the Strategic Partnership, which is intended to strengthen Telefónica s position in the global communications market.

China Unicom (Hong Kong) Limited

Provide details of any rejections of formal requests for board representation from shareholders whose equity interest is equal to or greater than that of other shareholders who have successfully requested the appointment of proprietary directors. If so, explain why these requests have not been entertained:

**No**

- C.1.9. Indicate whether any director has resigned from office before their term of office has expired, whether that director has given the board his/her reasons and through which channel. If made in writing to the whole board, list below the reasons given by that director:

**No**

**Name of director**

**Reasons for resignation**

Telefónica, S.A. 144

**Table of Contents**

2013 Financial Statements

C.1.10. Indicate what powers, if any, have been delegated to the Chief Executive Officer:

**Name or corporate name of director****Brief description**

	<p>The Chairman of the Company, as the Executive Chairman, has been expressly delegated all the powers of the Board of Directors, except those that cannot be delegated by Law, by the Corporate By-laws, or by the Regulations of the Board of Directors which establishes, in Article 5.4, the competencies that the Board of Directors reserves itself, and may not delegate.</p>
Mr. César Alierta Izuel Executive Chairman (Chief Executive Officer)	<p>Article 5.4 specifically stipulates that the Board of Directors reserves the power to: (i) approve the general policies and strategies of the Company; (ii) evaluate the performance of the Board of Directors, its Committees and the Chairman; (iii) appoint Senior Executives, as well as determine the remuneration of Directors and Senior Executives; and (iv) decide on strategic investments.</p>
Mr. José María Álvarez-Pallete López Chief Operating Officer	<p>The Chief Operating Officer (COO) has been delegated those powers of the Board of Directors related to the management of the business and the performance of the highest executive functions over all the Company's business areas, except those which cannot be delegated by Law, under the Corporate By-laws or according to the Regulations of the Board of Directors.</p>

Telefónica, S.A. 145

**Table of Contents**

2013 Financial Statements

C.1.11. List the directors, if any, who hold office as directors or executives in other companies belonging to the listed company's group:

<b>Name or corporate name of director</b>	<b>Corporate name of the group company</b>	<b>Post</b>
Mr. Alfonso Ferrari Herrero	Telefónica Chile, S.A.	Acting Director
	Telefónica del Perú, S.A.A.	Director
Mr. Francisco Javier de Paz Mancho	Telefónica Brasil, S.A.	Director
	Telefónica de Argentina, S.A.	Director
Mr. Gonzalo Hinojosa Fernández de Angulo	Telefónica del Perú, S.A.A.	Director
	Telefónica Brasil, S.A.	Director
Mr. José Fernando de Almansa Moreno-Barreda	Telefónica Móviles México, S.A. de C.V.	Director
Mr. Luiz Fernando Furlán	Telefónica Brasil, S.A.	Director
Ms. Eva Castillo Sanz	Telefónica Czech Republic, A.S.	Chairman of Supervisory Board
	Telefónica Deutschland Holding, A.G.	Chairman of Supervisory Board
	Telefónica Europe, Plc.	Chairman and CEO
	Tuenti Technologies, S.L.	Chairwoman
Mr. Santiago Fernández Valbuena	Colombia Telecomunicaciones, S.A. Esp	Director
	Telefónica América, S.A.	Chairwoman
	Telefónica Brasil, S.A.	Vice Chairwoman
	Telefónica Capital, S.A.	Sole Director
	Telefónica Chile, S.A.	Acting Director
	Telefónica Internacional, S.A.U.	Chairwoman
	Telefónica Móviles México, S.A. de C.V.	Vice Chairman

Telefónica, S.A. 146

**Table of Contents**

2013 Financial Statements

C.1.12. List any company board members who sit on the boards of directors of other non-group companies that are listed on official securities markets in Spain, insofar as these have been disclosed to the company.

<b>Name or corporate name of director</b>	<b>Name of listed company</b>	<b>Post</b>
Mr. César Alierta Izuel	International Consolidated Airlines Group, S.A. ( IAG )	Director
Mr. Isidro Fainé Casas	Caixabank, S.A.	Chairman
	Abertis Infraestructuras, S.A.	First Vice Chairman
	Repsol, S.A.	First Vice Chairman
	Banco Português de Investimento, S.A. (BPI)	Director
Mr. Carlos Colomer Casellas	The Bank of East Asia	Director
	Abertis Infraestructuras, S.A.	Director
	Inversiones Mobiliarias Urquiola, S.A. SICAV	Chairman
Ms. Eva Castillo Sanz	Ahorro Bursatil, S.A. SICAV	Chairman
	Bankia, S.A.	Director
Mr. Pablo Isla Alvarez de Tejera	Inditex, S.A.	Chairman- CEO
Mr. Luiz Fernando Furlán	Brasil Foods, S.A. (BRF)	Director
	AGCO Corporation	Director
Mr. Ignacio Moreno Martínez	Secuoya, Grupo de Comunicación, S.A.	Director
Mr. Santiago Fernández Valbuena	Ferrovial, S.A.	Director
Mr. Peter Erskine	Ladbroke's, Plc	Chairman
Mr. Antonio Massanell Lavilla	Boursorama, S.A.	Director
Mr. Chang Xiaobing	China United Network Communications Limited	Chairman
	China Unicom (Hong Kong) Limited	Chairman and CEO

C.1.13. Indicate and, where appropriate, explain whether the company has established rules about the number of boards on which its directors may sit:

**Yes**

**Explanation of rules**

The Regulations of the Board of Directors (Article 28.2) establish as one of the obligations of the Directors that they must devote the time and efforts required to perform their duties and, to such end, shall report to the Nominating, Compensation and Corporate Governance Committee on their other professional obligations if they might interfere with the performance of their duties as Directors.



**Table of Contents**

2013 Financial Statements

C.1.14. Indicate the company's general policies and strategies that are reserved for approval by the Board of Directors in plenary session:

<b>Investment and financing policy</b>	Yes
<b>Design of the structure of the corporate group</b>	Yes
<b>Corporate governance policy</b>	Yes
<b>Corporate social responsibility policy</b>	Yes
<b>Strategic or business plans, management targets and annual budgets</b>	Yes
<b>Remuneration and evaluation of senior officers</b>	Yes
<b>Risk control and management, and the periodic monitoring of internal information and control systems</b>	Yes
<b>Dividend policy, as well as the policies and limits applying to treasury stock</b>	Yes

C.1.15. List the total remuneration paid to the Board of Directors in the year:

<b>Board remuneration (thousands of euros)</b>	23,453
<b>Amount of total remuneration corresponding to accumulated pension rights (thousands of euros)</b>	1,263
<b>Total board remuneration (thousands of euros)</b>	24,716

C.1.16. List any members of senior management who are not executive directors and indicate total remuneration paid to them during the year:

<b>Name or corporate name</b>	<b>Position(s)</b>
Mr. Guillermo Ansaldo Lutz	General Manager of Global Resources
Mr. Matthew Key	Chairman Telefónica Digital
Mr. Eduardo Navarro de Carvalho	Director of Strategies and Partnerships
Mr. Ramiro Sánchez de Lerín García-Ovies	General Secretary and of the Board of Directors
Mr. Ángel Vilá Boix	General Manager of Finance and Corporate Development
Mr. Ignacio Cuesta Martín-Gil	Director Internal Audit



**Total remuneration received by senior management (in thousands of euros)**

12,130

Telefónica, S.A. 148

**Table of Contents**

2013 Financial Statements

C.1.17. List, if applicable, the identity of those directors who are likewise members of the boards of directors of companies that own significant holdings and/or group companies:

<b>Name or corporate name of director</b>	<b>Name or corporate name of significant shareholder</b>	<b>Post</b>
Mr. Isidro Fainé Casas	Caja de Ahorros y Pensiones de Barcelona, la Caixa	Chairman of Criteria Caixaholding, S.A. Chairman of Caja de Ahorros y Pensiones de Barcelona, la Caixa Chairman of Caixabank, S.A.
Mr. Antonio Massanell Lavilla	Caja de Ahorros y Pensiones de Barcelona, la Caixa	Director of Bousorama, S.A. Chairman of Barcelona Digital Technological Centre Director of Mediterranea Beach & Golf Community, S.A.
Mr. José Fernando de Almansa Moreno-Barreda	Banco Bilbao Vizcaya Argentaria, S.A.	Acting Director of Grupo Financiero BBVA Bancomer, S.A. de C.V. Acting Director of BBVA Bancomer, S.A.

List, if appropriate, any relevant relationships, other than those included under the previous heading, that link members of the Board of Directors with significant shareholders and/or their group companies.

<b>Name or company name of director with relationship</b>	<b>Name or company name of significant shareholder with relationship</b>	<b>Description of relationship</b>
Mr. Antonio Massanell Lavilla	Caja de Ahorros y Pensiones de Barcelona, la Caixa	General Manager of Caixabank, S.A.
Mr. José María Abril Pérez	Banco Bilbao Vizcaya Argentaria, S.A.	Early retirement. Formerly General Manager of Wholesale and Investment Banking
Mr. Ignacio Moreno Martínez	Banco Bilbao Vizcaya Argentaria, S.A.	Formerly General Manager of Chairman's Office

Telefónica, S.A. 149

**Table of Contents**

2013 Financial Statements

C.1.18. Indicate whether any changes have been made to the board regulations during the year.

**Yes**

**Description of amendments**

At its meeting held on June 26, 2013, Telefónica, S.A.'s Board of Directors approved the partial modification of the Regulations of the Board of Directors and a new revised text thereof, for the primary purpose of: i) improving its regulation in accordance with best practices; ii) including the latest legislative changes; and iii) revising its entire wording to systemize and standardize the content and expression thereof in line with the Corporate By-laws and Rules for the General Shareholders Meeting (previously amended by the Company's Ordinary General Shareholders Meeting on May 31, 2013). Consequently, the articles thereof were reworked and renumbered.

In particular, the amendments to the Regulations of the Board of Directors introduced in June 2013 were as follows:

- 1.- Addition of a new Article 17 to include the post of Lead Independent Director to improve good corporate governance, reflecting the amendments to the By-laws.
- 2.- Amendment to articles 17, 18, 20 and 21 (which became articles 18, 19, 21 and 22, respectively), to incorporate the improvements approved to the Company Statutes as regards the functioning of the Board of Directors and its Committees. First, article 17 was amended (now article 18) to include the option of a meeting of the Board of Directors being called by a group of at least one third of its members, a power provided for under the Law and which, after the changes made by the last Ordinary General Meeting of Shareholders, held in 2012, was already included in the Company Statutes. Equally, in line with the amendments proposed to the Company Statutes, minor changes were made to articles 18 and 20 (now articles 19 and 21) to specify the majorities needed to pass decisions in the Board of Directors and Executive Committee, respectively, and to introduce flexibility, in article 21 (now article 22) regarding the composition of the Audit and Control Committee by deleting the maximum number of members.
- 3.- Amendment to articles 19 and 22 (now articles 20 and 23, respectively) and deletion of articles 24 and 26 to change the structure of the Committees of the Board of Directors and make improvements to the rules of procedure governing the Committee on Appointments, Remuneration and Good Governance. With the overall aim of improving the functioning of the Board of Directors and, in particular, to rationalise how many committees it has and strengthen their role, the structure of the Committees of the Board of Directors was reorganised, eliminating the International Affairs Committee and the Committee on Human Resources, Reputation and Corporate Responsibility, and boosting the role of the Committee on Appointments, Remuneration and Good Governance. With respect to the latter, after incorporating its rules of procedure into the Company Statutes and establishing it as a statutory body, thus placing it on the same level as the Audit and Control Committee, its powers on reputation and corporate responsibility were expanded to include those previously held by the Committee on Human Resources, Reputation and Corporate Responsibility. A full list of its powers was drawn up, adding the Secretary and Vice-Secretary to the Board and the Independent Coordinator Member to the list of posts whose appointment is subject to the opinion of or proposal by this Committee.
4. - Amendment to Article 36 (which was renumbered Article 35) to include a specific reference to the publication of the Report on Directors Compensation on the corporate website.

5. - A new revised text to introduce technical improvements and standardize its wording and renumber the chapters, titles and articles in order.

These modifications were notified to the Spanish Securities Market Commission and inscribed in the Mercantile Register of Madrid on July 25, 2013.

C.1.19. Indicate the procedures for appointing, re-electing, appraising and removing directors. List the competent bodies and the processes and criteria to be followed for each procedure.

#### **Selection and appointment**

Telefónica's Bylaws state that the Board of Directors shall be composed of a minimum of five members and a maximum of twenty, to be appointed at the General Shareholders Meeting. The Board of Directors may, in accordance with the Corporate Enterprises Act and the Company Bylaws, provisionally co-opt Directors to fill any vacancies.

To this effect the Board of Directors shall have the power to fill, on an interim basis, any vacancies that may occur therein, by appointing, in such manner as is legally allowed, the persons who are to fill such vacancies until the holding of the next General Shareholders Meeting.

Also, in all cases, proposed appointments of Directors must follow the procedures set out in the Company's Bylaws and Regulations of the Board of Directors and be preceded by the appropriate favorable report by the Nominating, Compensation and Corporate Governance Committee and in the case of independent Directors, by the corresponding proposal by the Committee.

Therefore, in exercise of the powers delegated to it, the Nominating, Compensation and Corporate Governance Committee must report, based on criteria of objectivity and the best interests of the Company, on proposals to appoint, re-appoint or remove Company Directors, taking into account the skills, knowledge and experience required of candidates to fill the vacancies.

In line with the provisions of its Regulations, the Board of Directors, exercising the right to fill vacancies by interim appointment and to propose appointments to the shareholders at the General Shareholders Meeting, shall ensure that, in the composition of the Board of Directors, external or non-executive Directors represent an ample majority over executive Directors. Similarly, the Board shall ensure that the total number of independent Directors represents at least one third of the total number of Board members.

Similarly the nature of each Director shall be explained by the Board of Directors to the shareholders at the General Shareholders Meeting at which the appointment thereof must be made or ratified. Furthermore, such nature shall be reviewed annually by the Board after verification by the Nominating, Compensation and Corporate Governance Committee, and reported in the Annual Corporate Governance Report.

In any case, and in the event of re-election or ratification of Directors by the General Shareholders Meeting, the report of the Nominating, Compensation and Corporate Governance Committee, or in the case of independent Directors, the proposal of said Committee, will contain an assessment of the work and effective time devoted to the post during the last period in which it was held by the proposed Director.

Lastly, both the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that those proposed for the post of Director should be persons of recognized caliber, qualifications and experience, who are willing to devote the time and effort necessary to carrying out their functions, and shall take extreme care in the selection of persons to be appointed as independent Directors.

### **Re-election**

Directors are appointed for a period of five years, and may be re-elected for one or more subsequent five-year periods.

As with appointments, proposals for the reappointment of Directors must be preceded by the corresponding report by the Nominating, Compensation and Corporate Governance Committee, and in the case of independent Directors, by the corresponding proposal by the Committee.

### **Evaluation**

In accordance with the Regulations of the Board of Directors, the latter reserves expressly the duty to approve on a regular basis its functioning and the functioning of its Committees, it being the duty of the Nominating, Compensation and Corporate Governance Committee to organize and coordinate, together with the Chairman of the Board of Directors, the regular assessment of said Body.

In accordance with the above, it should be noted that the Board of Directors and its Committees carry out a periodic evaluation of the operation of the Board of Directors and of the Committees thereof in order to determine the opinion of Directors regarding the workings of these bodies and to establish any proposals for improvements to ensure the optimum working of the company's governing bodies.

### **Removal or dismissal**

Directors shall cease to hold office when the term for which they were appointed expires, or when so resolved by the shareholders at the General Shareholders Meeting in the exercise of the powers legally granted to them.

The Board of Directors shall not propose the removal of any independent Director prior to the end of the Bylaw-mandated period for which they have been appointed, unless there are due grounds therefore acknowledged by the Board after a report from the Nominating, Compensation and Corporate Governance Committee. Specifically, due grounds shall be deemed to exist when the Director has failed to perform the duties inherent to his position.

The removal of independent Directors may also be proposed as a result of Takeover Bids, mergers or other similar corporate transactions that represent a change in the structure of the Company's capital.

C.1.20. Indicate whether the board has evaluated its performance during the year:

**Yes**

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**Table of Contents**

2013 Financial Statements

Explain, if applicable, to what extent this evaluation has prompted significant changes in its internal organization and the procedures applicable to its activities:

**Description of amendments**

In a meeting on February 26, 2013 the Nominating, Compensation and Corporate Governance Committee revised and analyzed the results of Telefónica, S.A.'s evaluation of the performance in 2012 of the Board of Directors and its Committees and of the Company's General Meeting, concluding that, on the whole, they were highly satisfied with the organization and activities of these governing bodies.

Furthermore, and as a result of this evaluation, certain improvement points were identified. In view of this and after an exhaustive examination and analysis of the results obtained, the Board followed the Nominating, Compensation and Corporate Governance Committee's proposal and approved the suggested improvements described hereon in order to optimize the operation of the Company's governing bodies:

Continue to work towards ensuring the earliest possible submission of the documentation and information needed to examine and analyze in advance matters tabled for discussion at Board meetings.

Assess the analysis of the Company's current corporate governance structure, insofar as it relates to the Board Committees, for the purpose of proposing appropriate improvement measures.

Once the Board Library (electronic repository of Board documentation) has been set up, continue to optimize the use of electronic media.

Oversee all necessary measures in order to ensure the General Shareholders' Meetings of the Company are conducted normally.

C.1.21. Indicate the cases in which directors must resign.

In accordance with Article 12 of the Regulations of the Board of Directors, Directors must tender their resignation to the Board of Directors and formalize such resignation in the following cases:

- a) When they cease to hold the executive positions to which their appointment as Directors is linked, or when the reasons for which they were appointed no longer exist.

- b) When they are affected by any of the cases of incompatibility or prohibition established by Law.
  - c) When they are severely reprimanded by the Nominating, Compensation and Corporate Governance Committee for having failed to fulfill any of their obligations as Directors.
  - d) When their remaining on the Board might affect the Company's credit or reputation in the market or otherwise jeopardize its interests.
- The conditions listed above under Recommendation C.1.19 Removal above must also be taken into consideration.

C.1.22. Indicate whether the duties of chief executive officer fall upon the Chairman of the Board of Directors. If so, describe the measures taken to limit the risk of powers being concentrated in a single person:

**Yes**

**Measures for limiting risk**

The Company's Articles of Association (article 32) and the Rules of Procedure of the Board of Directors (article 17) cover and regulate the role of the Lead Director, whose functions and tasks include the following:

- a) To coordinate the work of External Directors appointed by the Company to defend the interests of all company shareholders and represent the concerns of said Directors;
- b) To request the Chairman of the Board of Directors call a meeting of the Board when appropriate under Good Governance practices;

**Table of Contents**

2013 Financial Statements

- c) Consequently, to request the inclusion of certain matters on the Agenda of meetings of the Board of Directors;
- d) To direct the Board of Directors when it evaluates the Chairman of the Board.

Mr. Alfonso Ferrari Herrero was appointed as Lead Director by the Board of Directors in its meeting of May 31, 2013.

At its meeting on the 17th of September 2012 the Company Board of Directors agreed to appoint Mr. José María Álvarez Pallete-López as Chief Operating Officer of Telefónica, S.A., reporting directly to the Chairman and with responsibilities for all of the Business Units in Telefónica Group. Between the 19th of December 2007 and the 17th of September 2012, the Chief Operating Officer of the Company was Mr. Julio Linares López.

Equally, pursuant to the provisions of article 28 of the Rules of Procedure of the Board of Directors, any Member of the Board can urge that a meeting of the Board of Directors be called when he deems necessary, or request the inclusion on the Agenda of any matters he considers pertinent.

Otherwise, as per the Rules of Procedure of the Board of Directors, the Chairman must at all times act in accordance with the guidelines set by the General Meeting of Shareholders and the Board of Directors.

In the same manner, all decisions of particular importance to the Company are submitted for prior approval to the Board of Directors or the Executive Committee, depending on the case in question.

It also states that the Board of Directors has exclusive competence over certain matters, such as: general policy and strategies; evaluation of the Board, its Committees and its Chairman, appointment of Senior Managers; remuneration of Board Members and Senior Managers; and strategic investments.

Additionally, reports and proposals from certain Committees of the Board of Directors are required to take some decisions.

Finally, it is important to highlight that the Chairman does not have a casting vote on the Board of Directors. Indicate, and if necessary, explain whether rules have been established that enable any of the independent directors to convene board meetings or include new items on the agenda, to coordinate and voice the concerns of external directors and oversee the evaluation by the Board of Directors.

**Yes**





**Table of Contents**

2013 Financial Statements

**Explanation of rules**

Subsequent to the Ordinary General Shareholders Meeting on May 31, 2013, the Company's By-laws (Article 32) and, since June 2013, the Regulations of the Board of Directors (Article 17), set forth and regulate the position of Lead Director (*Consejero Independiente Coordinador*), the duties and tasks of which include:

- a) Coordinating the work of the External Directors appointed by the Company, in defense of the interests of all shareholders of the Company, and hearing the concerns of such directors.
- b) Requesting the Chairman of the Board of Directors call a meeting of the Board of Directors when appropriate in accordance with good governance rules.
- c) In said instances, requesting the inclusion of certain items on the agenda for meetings of the Board of Directors.
- d) Directing the evaluation by the Board of Directors of its Chairman.

In its meeting of May 31, 2013, the Board also appointed the Chairman of the Nominating, Compensation and Corporate Governance Committee, Mr. Alfonso Ferrari Herrero, as Lead Director.

C.1.23. Are qualified majorities, other than legal majorities, required for any type of decisions?:

**No**

If applicable, describe the differences.

**Description of differences**

C.1.24. Indicate whether there are any specific requirements, apart from those relating to the directors, to be appointed Chairman.

**Yes**

Telefónica, S.A. 153

**Table of Contents**

2013 Financial Statements

**Description of requirements**

In order for a Director to be appointed Chairman, said Director must have served on the Board for at least three years prior to any such appointment. However, such length of service shall not be required if the appointment is made with the favorable vote of at least 85 percent of the members of the Board of Directors.

C.1.25. Indicate whether the Chairman has the casting vote:

**No**

**Matters where the Chairman has the casting vote**

C.1.26. Indicate whether the bylaws or the regulations of the Board of Directors set any age limit for directors:

**No**

**Age limit for Chairman**

0

**Age limit for CEO**

0

**Age limit for directors**

0

C.1.27. Indicate whether the bylaws or the regulations of the Board of Directors set a limited term of office for independent directors:

**No**

**Maximum number of years in office**

C.1.28. Indicate whether the bylaws or board regulations stipulate specific rules on appointing a proxy to the board, the procedures thereof and, in particular, the maximum number of proxy appointments a director may hold. Also indicate whether only one director of the same category may be appointed as a proxy. If so, give brief details:

In accordance with Article 19 of the Regulations of the Board of Directors, Directors must attend meetings of the Board in person, and when unable to do so in exceptional cases, they shall endeavor to ensure that the proxy they grant to another member of the Board includes, as far as is practicable, appropriate instructions. Such proxies may be

granted by letter or any other means that, in the Chairman's opinion, ensures the certainty and validity of the proxy granted.

Article 34.4 of the By-laws also establishes that all Directors who are absent may grant a proxy in writing to another Director who is in attendance, with the right to speak and to vote, at the meeting or session to which the proxy refers. The Director granting the proxy shall endeavor, to the extent possible, to include voting instructions in the proxy document.

Telefónica, S.A. 154

**Table of Contents**

2013 Financial Statements

C.1.29. Indicate the number of board meetings held during the year and how many times the board has met without the Chairman's attendance. Attendance will also include proxies appointed with specific instructions.

<b>Number of board meetings</b>	<b>14</b>
<b>Number of Board meetings held without the Chairman's attendance</b>	<b>1</b>

Indicate the number of meetings of the various board committees held during the year:

<b>Number of meetings of the Executive or Delegated Committee</b>	<b>19</b>
<b>Number of meetings of the Audit and Compliance Committee</b>	<b>10</b>
<b>Number of meetings of the Nomination and Remuneration Committee</b>	<b>11</b>
<b>Number of meetings of the Nomination Committee</b>	<b>0</b>
<b>Number of meetings of the Remuneration Committee</b>	<b>0</b>
<b>Number of meetings of the Regulation Committee</b>	<b>3</b>
<b>Number of meetings of the Service Quality and Customer Service Committee</b>	<b>3</b>
<b>Number of meetings of the Institutional Affairs Committee</b>	<b>6</b>
<b>Number of meetings of the Strategy Committee</b>	<b>10</b>
<b>Number of meetings of the Innovation Committee</b>	<b>11</b>

C.1.30. Indicate the number of board meetings held during the year with all members in attendance. Attendance will also include proxies appointed with specific instructions:

<b>Directors' attendance</b>	<b>8</b>
<b>% of attendances of the total votes cast during the year</b>	<b>97.62</b>

C.1.31. Indicate whether the consolidated and individual financial statements submitted for authorization by the board are certified previously:

**No**

Identify, where applicable, the person(s) who certified the company's individual and consolidated financial statements prior to their authorization for issue by the board:

**Name**

**Position**

C.1.32. Explain the mechanisms, if any, established by the Board of Directors to prevent the individual and consolidated financial statements it prepares from being laid before the General Shareholders Meeting with a qualified Audit Report.

Through the Audit and Control Committee, the Board of Directors plays an essential role in supervising the preparation of the Company's financial information, controlling and coordinating the various players that participate in this process.

To achieve this objective, the Audit and Control Committee's work addresses the following basic issues:

- 1) Supervising the process of preparing and submitting regulated financial information. With respect thereto, it shall be responsible for supervising the preparation and completeness of the financial information relating to the Company and the Group, reviewing compliance with regulatory requirements, the proper determination of the scope of consolidation, and the correct application of accounting standards, informing the Board of Directors thereof.
- 2) Monitoring the effectiveness of the Company's internal control and risk management systems, and to discuss with the auditors significant weaknesses in the internal control system detected during the audit. With respect thereto, it shall be responsible for proposing to the Board of Directors a risk control and management policy.

**Table of Contents**

2013 Financial Statements

- 3) Establishing and maintaining appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the Auditor's independence, as well as any other matters relating to the audit procedure, and such other communications as may be provided for in auditing legislation and in technical auditing regulations.
- 4) In any event, the Audit and Control Committee must receive, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as information regarding additional services of any kind provided to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of prevailing regulations.
- 5) Issuing on an annual basis, prior to the issuance of the audit report, a report stating an opinion regarding the independence of the Auditor. This report must in all cases include an opinion on the provision of the additional services referred to in the previous paragraph.
- 6) Supervising internal audit, in particular:
  - a) To ensure the independence and efficiency of the internal audit function;
  - b) To propose the selection, appointment and removal of the person responsible for internal audit;
  - c) To propose the budget for such service;
  - d) To review the internal audit work plan and its annual activities report;
  - e) To receive periodic information on its activities; and
  - f) To verify that the senior executive officers take into account the conclusions and recommendations of its reports.

The Audit and Control Committee verifies both the periodical financial information and the Annual Financial Statements, ensuring that all financial information is drawn up according to the same professional principles and practices. To this effect, the Audit and Control Committee meets whenever appropriate, holding ten (10) meetings in 2013.

Furthermore, the External Auditor participates regularly in the Audit and Control Committee meetings, when called to do so by the Committee, to explain and clarify different aspects of the audit reports and other aspects of its work. Additionally and when requested by the Committee, other members of the management of the Company and its subsidiaries have attended Committee meetings to explain specific matters that are directly within their scope of competence. In particular, managers from the finance, as well as those in charge of internal audit, have attended these meetings. The members of the Committee have held separate meetings with each of these when it was deemed necessary to closely monitor the preparation of the Company's financial information.

The above notwithstanding, Article 40 of the Regulations of the Board of Directors establishes that the Board of Directors shall endeavor to prepare the final financial statements in a manner that will give no for the Auditor to qualify its opinion. However, whenever the Board considers that it should maintain its standards, it shall publicly explain the contents and scope of the discrepancies.

C.1.33. Is the Secretary of the board also a director?

**No**



**Table of Contents**

2013 Financial Statements

C.1.34. Explain the procedures for appointing and removing the Secretary of the board, indicating whether their appointment and removal have been notified by the Nomination Committee and approved by the board in plenary session.

**Appointment and removal procedure**

In accordance with Article 15 of the Regulations of the Board of Directors, the Board of Directors, upon the proposal of the Chairman, and after a report from the Nominating, Compensation and Corporate Governance Committee, shall appoint a Secretary to the Board, and shall follow the same procedure for approving his/her removal.

**Does the Nomination Committee propose appointments?** Yes

**Does the Nomination Committee advise on dismissals?** Yes

**Do appointments have to be approved by the board in plenary session?** Yes

**Do dismissals have to be approved by the board in plenary session?** Yes

Is the Secretary of the board entrusted in particular with the function of overseeing corporate governance recommendations?

**Yes**

**Remarks**

The Secretary to the Board shall, at all times, attend to the formal and substantive legality of the Board's actions, and the conformance thereof to the Corporate By-laws, the Regulations for the General Shareholders' Meeting and of the Board, and ensure that these actions are in line with the corporate governance recommendations assumed by the Company at any given time (Article 15 of the Regulations of the Board).

C.1.35. Indicate and explain, where applicable, the mechanisms implemented by the company to preserve the independence of the auditor, financial analysts, investment banks and rating agencies.

With regards to the independence of the External Auditor of the Company, Article 40 of the Regulations of the Board of Directors establishes that the Board shall, through the Audit and Control Committee, establish a stable and professional relationship with the Company's Auditor, strictly respecting the independence thereof.

The Audit and Control Committee has a fundamental responsibility, as specified in Article 22 of the Regulations of the Board, to establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the Auditor's independence, as well as any other matters relating to the audit procedure, and such other communications as may be provided for in auditing legislation and in technical auditing regulations.

In any event, the Audit and Control Committee must receive, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as information

regarding additional services of any kind provided to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of prevailing legislation.

The Committee must also issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion regarding the independence of the External Auditor. This report must in all cases include an opinion on the provision of the additional services referred to in the previous paragraph.

In addition, in accordance with Article 22 of the Regulations of the Board of Directors, it is the Audit and Control Committee that proposes to the Board of Directors, for submission to the shareholders at the General Shareholders Meeting, the appointment of the Auditor as well as, if necessary, the appropriate terms for the hiring thereof, the scope of its professional engagement and the revocation or non- renewal of its appointment.

Likewise, the External Auditor has direct access to the Audit and Control Committee and participates regularly in its meetings, in the absence of the Company's management team when this is deemed necessary. To this effect, and in keeping with US legislation on this matter, the External Auditor must inform the Audit and Control Committee at least once a year on the most significant generally accepted auditing policies and practices followed in the preparation of the Company's financial and accounting information affecting key elements in the financial statements which may have been discussed with the management team, and of all relevant communications between the Auditor and the Company's management team.

**Table of Contents**

2013 Financial Statements

In accordance with internal company regulations and in line with the requirements imposed by US legislation, the engagement of any service from the Company's External Auditors must always have the prior approval of the Audit and Control Committee. Moreover, the engagement of non-audit services must be done in strict compliance with the Auditing Act (*Ley de Auditoría de Cuentas*) and the Sarbanes-Oxley Act published in the United States and subsequent regulations. For this purpose, and prior to the engagement of the Auditors, the Audit and Control Committee studies the content of the work to be performed, evaluating any situations that may jeopardize the External Auditor's independence, and specifically supervises the percentage the fees paid for such services represent in the total revenue of the auditing firm. In this respect, the Company reports the fees paid to the External Auditor, including those paid for non-audit services, in its Notes to the Financial Statements, in accordance with prevailing legislation.

C.1.36. Indicate whether the company has changed its external audit firm during the year. If so, identify the incoming audit firm and the outgoing auditor:

No

Explain any disagreements with the outgoing auditor and the reasons for the same.

No

**Explanation of the disagreements**

C.1.37. Indicate whether the audit firm performs other non-audit work for the company and/or its group. If so, state the amount of fees paid for such work and the percentage they represent of the fees invoiced to the company and/or its group.

No

	Company	Group	Total
<b>Amount of non-audit work (in thousands )</b>	0	0	0
<b>Amount of non-audit work as a % of the total amount billed by the audit firm</b>	0.000	0.000	0.000

C.1.38. Indicate whether the audit report on the previous year's financial statements is qualified or includes reservations. Indicate the reasons given by the Chairman of the Audit Committee to explain the content and scope of those reservations or qualifications.

No

**Explanation of reasons**

C.1.39. Indicate the number of consecutive years during which the current audit firm has been auditing the financial statements of the company and/or its group. Likewise, indicate how many years the current firm has been auditing the accounts as a percentage of the total number of years over which the financial statements have been audited:

	<b>Company</b>	<b>Group</b>
<b>Number of consecutive years</b>	9	9
	<b>Company</b>	<b>Group</b>
<b>Number of years audited by current audit firm/Number of years the company's financial statements have been audited (%)</b>	29.0	39.1

Telefónica, S.A. 158

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**Table of Contents**

2013 Financial Statements

C.1.40. Indicate and give details of any procedures through which directors may receive external advice:

**Yes**

**Procedures**

Article 27 of the Regulations of the Board of Directors stipulates that in order to receive assistance in the performance of their duties, the Directors or any of the Committees of the Board may request that legal, accounting, financial or other experts be retained at the Company's expense. The engagement must necessarily be related to specific problems of a certain significance and complexity that arise in the performance of their duties.

The decision to retain such services must be communicated to the Chairman of the Board of Directors and shall be formalized through the Secretary to the Board, unless the Board of Directors does not consider such engagement to be necessary or appropriate.

C.1.41. Indicate whether there are procedures for directors to receive the information they need in sufficient time to prepare for meetings of the governing bodies:

**Yes**

**Procedures**

The Company adopts the measures necessary to ensure that the Directors receive the necessary information, specially drawn up and geared to preparing the meetings of the Board and its Committees, sufficiently in advance. Under no circumstances shall such a requirement not be fulfilled, on the grounds of the importance or the confidential nature of the information, apart from in absolutely exceptional cases.

In this regard, at the beginning of each year the Board of Directors and its Committees set the calendar of ordinary meetings to be held during the year. The calendar may be amended by resolution of the Board itself, or by decision of the Chairman, in which case the Directors shall be made aware of the amendment as soon as practicable.

Also, and in accordance with Recommendation 18 of the Unified Good Governance Code (2013 revised version), at the beginning of the year the Board and its Committees prepare an Action Plan detailing the activities to be carried out and their timing for each year, as per their assigned powers and duties.

Likewise, all the meetings of the Board and the Board Committees have a pre-established agenda, which is communicated at least three days prior to the date scheduled for the meeting together with the call for the session. For the same purpose, the Directors are sent the documentation related to the agenda of the meetings sufficiently in advance. Such information is subsequently supplemented with the written documentation and presentations handed out to the Directors at the meeting.

To provide all the information and clarifications necessary in relation to certain points deliberated, the Group's senior executive officers attend nearly all the Board and Committee meetings to explain the matters within their

competencies.

Furthermore, and as a general rule, the Regulations of the Board of Directors expressly establish that Directors are granted the broadest powers to obtain information about all aspects of the Company, to examine its books, records, documents and other data regarding corporate transactions. Exercising of this right to receive information shall be channeled through the Chairman or Secretary to the Board of Directors, who shall respond to the requests made by the Directors, providing them with the requested information directly or offering them the proper contacts at the appropriate level of the organization.

C.1.42. Indicate and, where appropriate, give details of whether the company has established rules obliging directors to inform the board of any circumstances that might harm the organization's name or reputation, tendering their resignation as the case may be:

**Yes**

Telefónica, S.A. 159

**Table of Contents**

2013 Financial Statements

**Details of rules**

In accordance with Article 12 of the Regulations of the Board of Directors, Directors must tender their resignation to the Board of Directors and formalize such resignation when their remaining on the Board might affect the Company's credit or reputation in the market or otherwise jeopardizes its interests.

Likewise, Article 31.h) of the Regulations establishes that Directors must report to the Board any circumstances related to them that might damage the credit or reputation of the Company as soon as possible.

C.1.43. Indicate whether any director has notified the company that they have been indicted or tried for any of the offences stated in Article 213 of the LSC.

**No**

**Name of director****Criminal proceedings****Remarks**

Indicate whether the Board of Directors has examined this matter. If so, provide a justified explanation of the decision taken as to whether or not the director should continue to hold office or, if applicable, detail the actions taken or to be taken by the board.

**No**

**Decision/action taken****Justified explanation**

C.1.44. List the significant agreements entered into by the company which come into force, are amended or terminate in the event of a change of control of the company due to a takeover bid, and their effects.

1. - On 22nd of February 2013, Telefónica, S.A., the service provider, and a group of credit entities, as lenders, with Citibank International Plc as the agent bank, signed a syndicated loan contract worth 1.4 billion euros (the Financing Contract ).

Pursuant to the Financing Contract, in the event of a change in control of Telefónica, S.A., the lenders may, in certain circumstances, require early cancellation of the Financing Contract.

To determine whether a change in control has occurred for these purposes, the Financing Contract will adhere to the usual criteria in this sort of agreements, such as taking control of the majority of the voting rights, or the appointment of the majority of the members of the governing body or of the company's financial and operational policies.

2.- On April 29, 2013, Telefónica, S.A. and TLK Investment, CV (a company forming part of the Guatemalan business group Corporación Multi-Inversiones) ( CMI ) signed an agreement to establish a joint venture between Telefónica and CMI, Telefónica Centroamérica Inversiones, S.L.U. ( TCI ). Telefónica contributed its assets in Central America (excluding assets in Costa Rica) and CMI made a monetary contribution of 500,000,000 US dollars. As a result of these contributions, Telefónica holds 60% and CMI 40% of TCI 's share capital. This arrangement was completed on August 2, 2013.

Telefónica and CMI also entered into a Shareholders ' Pact in TCI, which includes a change of control clause stipulating that if there was a change of control of CMI or Telefónica, the other party would be fully entitled to: (i) exercise the right to acquire (call option) the entire stake held in TCI by the shareholder over which control has changed at the date control changed; or (ii) exercise the right to sell (put option) the entire stake the former held in TCI to the latter. In both cases, the purchase price of the stake shall be TCI 's market value calculated by an independent expert.

For the purposes of the Shareholders ' Pact, a change of control shall be: (i) in the case of CMI, when the last natural person or corporate body controlling CMI ceases to do so; and (ii) for Telefónica, when a natural person or corporate body not controlling Telefónica assumes control. In both instances, ' control ' shall be as specified in the International Financing Reporting Standards (IFRS).

Telefónica, S.A. 160



**Table of Contents**

2013 Financial Statements

C.1.45. Identify, in aggregate form and provide detailed information on agreements between the company and its officers, executives and employees that provide indemnities for the event of resignation, unfair dismissal or termination as a result of a takeover bid or other.

Number of beneficiaries	55
Type of beneficiary	
Executive Directors, Senior Executive Officers and other Employees	
Description of the resolution	

With regard to Executive Directors and the conditions for termination of their contracts, since 2006, in line with typical market practices, the Company policy applicable to Executive Directors provides for compensation equivalent to two years' worth of remuneration, calculated based on the last fixed payment and the arithmetical average of the total for the last two annual variable payments, in the event their contract is terminated for reasons attributable to the Company or objective circumstances, such as a change in control of the Company. Otherwise, if the contract is terminated because of a failure attributable to the Executive Director, he is entitled to no compensation whatsoever.

Contracts signed since 2006 (for Executive Directors) have followed these compensation rules.

In the case of contracts signed before 2006, the compensation due to Executive Directors, pursuant to their contracts, does not follow the policy outlined above, but rather is based on the Director's personal and professional circumstances and when he signed the contract. In these cases, the financial compensation agreed to for contract termination, where applicable, may be up to a maximum of four times annual remuneration depending on the time the Director has been with the Company. Each annual payment includes the last fixed payment and the arithmetical average of the sum of the two last variable annual payments under the contract.

As regards the Company's Senior Management (excluding Executive Directors), their contracts recognise an entitlement to financial compensation, as indicated below, in the event they are terminated for a reason attributable to the Company and, in certain cases, for objective circumstances such as a change in control of the Company. Otherwise, if the contract is terminated because of a failure attributable to the Senior Manager, he is entitled to no compensation whatsoever. However, it should be noted that, in certain cases, the compensation to which the Senior Manager is entitled, depending on his contract, is not governed by these general rules but instead by his personal and professional circumstances and when he signed his contract. The financial compensation agreed for termination of the contract, where applicable, consists of a maximum of three annual payments plus one more depending on length of service with the Company. The annual payment includes the last fixed payment and the arithmetical average of the sum of the last two variable annual payments under the contract.

Employment contracts that link employees to the Company under a standard employment relationship do not contain a compensation clause for termination of the contract. As such, the employee is entitled, where applicable, to the compensation established under employment legislation. Notwithstanding the above, certain Company employees, depending on their level and length of service, their personal and professional circumstances and when they signed their contracts, have a recognised contractual entitlement to receive compensation, in some cases, under the same conditions as set out in the paragraph above, generally consisting of one and a half annual payments. This annual

payment includes the last fixed payment and the arithmetical average of the sum of the last two variable annual payments under the contract.

Indicate whether these agreements must be reported to and/or authorized by the governing bodies of the company or its group:

	<b>Board of Directors</b>	<b>General Shareholders Meeting</b>
<b>Body authorizing clauses</b>	Yes	No
<b>Is the General Shareholders Meeting informed of such clauses?</b>		Yes

Telefónica, S.A. 161

**Table of Contents**

2013 Financial Statements

**C.2. Board committees**

C.2.1. Give details of all the board committees, their members and the proportion of proprietary and independent directors.

**EXECUTIVE OR DELEGATE COMMITTEE****EXECUTIVE COMMISSION**

<b>Name</b>	<b>Post</b>	<b>Type</b>
Mr. César Alierta Izuel	Chairman	Executive
Mr. Isidro Fainé Casas	Vice Chairman	Proprietary
Mr. José María Abril Pérez	Vice Chairman	Proprietary
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Carlos Colomer Casellas	Member	Independent
Mr. Francisco Javier de Paz Mancho	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. José María Álvarez-Pallete López	Member	Executive
Mr. Peter Erskine	Member	Independent

<b>% of executive directors</b>	22.22
<b>% of proprietary directors</b>	22.22
<b>% of independent directors</b>	55.55
<b>% of Other External Directors</b>	0.00

**AUDIT AND CONTROL COMMITTEE**

<b>Name</b>	<b>Post</b>	<b>Type</b>
Mr. Carlos Colomer Casellas	Chairman	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Antonio Massanell Lavilla	Member	Proprietary
Mr. Ignacio Moreno Martínez	Member	Proprietary

<b>% of executive directors</b>	0.00
<b>% of proprietary directors</b>	40.00
<b>% of independent directors</b>	60.00
<b>% of Other External Directors</b>	0.00

**NOMINATING, COMPENSATION AND CORPORATE GOVERNANCE COMMITTEE**

<b>Name</b>	<b>Position</b>	<b>Type</b>
Mr. Alfonso Ferrari Herrero	Chairman	Independent
Mr. Carlos Colomer Casellas	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. Pablo Isla Álvarez de Tejera	Member	Independent
Mr. Peter Erskine	Member	Independent

Telefónica, S.A. 162

**Table of Contents**

2013 Financial Statements

<b>% of executive directors</b>	0.00
<b>% of proprietary directors</b>	0.00
<b>% of independent directors</b>	100.00
<b>% of Other External Directors</b>	0.00

**REGULATION COMMITTEE**

<b>Name</b>	<b>Position</b>	<b>Type</b>
Mr. Gonzalo Hinojosa Fernández de Angulo	Chairman	Independent
Mr. Pablo Isla Álvarez de Tejera	Member	Independent
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Francisco Javier de Paz Mancho	Member	Independent
Mr. José Fernando de Almansa Moreno-Barreda	Member	Independent
Ms. Eva Castillo Sanz	Member	Executive
Mr. Ignacio Moreno Martínez	Member	Proprietary

<b>% of executive directors</b>	14.29
<b>% of proprietary directors</b>	14.29
<b>% of independent directors</b>	71.43
<b>% of Other External Directors</b>	0.00

**SERVICE QUALITY AND CUSTOMER SERVICE COMMITTEE**

<b>Name</b>	<b>Position</b>	<b>Type</b>
Mr. Antonio Massanell Lavilla	Chairman	Proprietary
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Carlos Colomer Casellas	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Ms. Eva Castillo Sanz	Member	Executive
Mr. Ignacio Moreno Martínez	Member	Proprietary
Mr. Francisco Javier de Paz Mancho	Member	Independent

<b>% of executive directors</b>	14.29
<b>% of proprietary directors</b>	28.57
<b>% of independent directors</b>	57.14
<b>% of Other External Directors</b>	0.00

**INSTITUTIONAL AFFAIRS COMMITTEE**

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<b>Name</b>	<b>Post</b>	<b>Type</b>
Mr. Julio Linares López	Chairman	Other External
Mr. José Fernando de Almansa Moreno-Barreda	Member	Independent
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. Antonio Massanell Lavilla	Member	Proprietary
Mr. Francisco Javier de Paz Mancho	Member	Independent

<b>% of executive directors</b>	0.00
<b>% of proprietary directors</b>	16.67
<b>% of independent directors</b>	66.66
<b>% of Other External Directors</b>	16.67

Telefónica, S.A. 163

**Table of Contents**

2013 Financial Statements

**STRATEGY COMMITTEE**

<b>Name</b>	<b>Position</b>	<b>Type</b>
Mr. Peter Erskine	Chairman	Independent
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. José Fernando de Almansa Moreno-Barreda	Member	Independent
Ms. Eva Castillo Sanz	Member	Executive
Mr. Julio Linares López	Member	Other External

<b>% executive directors</b>	16.67
<b>% proprietary directors</b>	0.00
<b>% independent directors</b>	66.66
<b>% of Other External Directors</b>	16.67

**INNOVATION COMMITTEE**

<b>Name</b>	<b>Position</b>	<b>Type</b>
Mr. Carlos Colomer Casellas	Chairman	Independent
Mr. Antonio Massanell Lavilla	Member	Proprietary
Mr. José María Abril Pérez	Member	Proprietary
Mr. Peter Erskine	Member	Independent
Mr. Julio Linares López	Member	Other External

<b>% executive directors</b>	0.00
<b>% proprietary directors</b>	40.00
<b>% independent directors</b>	40.00
<b>% of Other External Directors</b>	20.00

Telefónica, S.A. 164

**Table of Contents**

2013 Financial Statements

C.2.2. Complete the following table on the number of female directors on the various board committees over the past four years.

	Number of female directors							
	Year t		Year t-1		Year t-2		Year t-3	
	Number	%	Number	%	Number	%	Number	%
Executive Committee	0		0		0		0	
Audit Committee	0		0		0		0	
Nomination and Remuneration Committee	0		0		0		0	
Nomination Committee								
Remuneration Committee								
Regulation Committee	1	(14.29)	1	(20.00)	1	(16.67)	1	(20.00)
Service Quality and Customer Service Committee	1	(14.29)	1	(16.67)	1	(16.67)	1	(16.67)
Institutional Affairs Committee	0		N/A		N/A		N/A	
Strategy Committee	1	(16.67)	1	(20.00)	1	(20.00)	1	(20.00)
Innovation Committee	0		0		0		0	

C.2.3. Indicate whether the Audit Committee is responsible for the following:

<b>To supervise the preparation process, monitoring the integrity of financial information on the company and, if applicable, the group, and revising compliance with regulatory requirements, the adequate boundaries of the scope of consolidation and correct application of accounting principles.</b>	Yes
<b>To regularly review internal control and risk management systems, so main risks are correctly identified, managed and notified.</b>	Yes
<b>To safeguard the independence and efficacy of the internal audit function; propose the selection, appointment, reappointment and removal of the head of internal audit; propose the department s budget; receive regular report-backs on its activities; and verify that senior management are acting on the findings and recommendations of its reports.</b>	Yes
<b>To establish and supervise a mechanism whereby staff can report, confidentially and, if necessary, anonymously, any irregularities they detect in the course of their duties, in particular financial or accounting irregularities, with potentially serious implications for the firm.</b>	Yes
<b>To submit to the board proposals for the selection, appointment, reappointment and removal of the External Auditor, and the engagement conditions.</b>	Yes
<b>To receive regular information from the External Auditor on the progress and findings of the audit program and check that senior management are acting on its recommendations.</b>	Yes
<b>To ensure the independence of the External Auditor.</b>	Yes



C.2.4. Describe the organizational and operational rules and the responsibilities attributed to each of the board committees.

**Audit and Control Committee.**

Pursuant to the provisions of Article 39 of the Corporate By-laws of Telefónica, S.A., Article 22 of the Regulations of the Board of Directors regulates the Audit and Control Committee in the following terms:

**a) Composition.**

The Audit and Control Committee shall consist of such a number of members as the Board of Directors determines at any given time, who shall in no case be less than three and shall be appointed by the Board of Directors. All members thereof must be external or non-executive Directors, and at least one of them must be an Independent Director. When appointing such members, the Board of Directors shall take into account the appointees' knowledge and experience in matters of accounting, auditing or both, as well as in risk management.

The Chairman of the Audit and Control Committee, who shall in all events be an independent Director, shall be appointed from among its members, and shall be replaced every four years; he may be re-elected after the passage of one year from the date when he ceased to hold office.

Telefónica, S.A. 165

**Table of Contents**

2013 Financial Statements

**b) Duties.**

Without prejudice to any other tasks that the Board of Directors may assign thereto, the primary duty of the Audit and Control Committee shall be to support the Board of Directors in its supervisory duties. Specifically, it shall have at least the following powers and duties:

- 1) To report, through its Chairman, to the shareholders at the General Shareholders Meeting on issues raised therein in connection with matters within its purview.
- 2) To propose to the Board of Directors, for submission to the shareholders at the General Shareholders Meeting, the appointment of the Auditor mentioned in Article 264 of the Corporate Enterprises Act, as well as, where appropriate, terms for the hiring thereof, the scope of its professional engagement and the revocation or renewal of its appointment.
- 3) To supervise internal audit and, in particular:
  - a) To ensure the independence and efficiency of the internal audit function;
  - b) To propose the selection, appointment and removal of the person responsible for internal audit;
  - c) To propose the budget for such service;
  - d) To review the internal audit work plan and its annual activities report;
  - e) To receive periodic information on its activities; and
  - f) To verify that the senior executive officers take into account the conclusions and recommendations of its reports.
- 4) To supervise the process of preparing and submitting regulated financial information. With respect thereto, it shall be responsible for supervising the process of preparation and the completeness of the financial information relating to the Company and the Group, reviewing compliance with regulatory requirements, the proper

determination of the scope of consolidation, and the correct application of accounting standards, informing the Board of Directors thereof.

- 5) To supervise the effectiveness of the Company's internal control system and risk management systems, and to discuss with the Auditor significant weaknesses in the internal control system detected during the audit. With respect thereto, it shall be responsible for proposing to the Board of Directors a risk control and management policy, which shall identify at least the following:
  - a) The types of risk (operational, technological, financial, legal and reputational) facing the Company;
  - b) The risk level that the Company deems acceptable; the measures to mitigate the impact of the identified risks, should they materialize; and
  - c) The control and information systems to be used to control and manage the above-mentioned risks.
- 6) To establish and supervise a system that allows employees to confidentially and anonymously report potentially significant irregularities, particularly any financial and accounting irregularities detected within the Company.
- 7) To establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the independence thereof, as well as any other matters relating to the audit procedure, and such other communications as may be provided for in auditing legislation and in technical auditing regulations.

In any event, the Audit and Control Committee must receive, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as information regarding additional services of any kind provided to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of prevailing legislation.
- 8) To issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion regarding the independence of the Auditor. This report must in all cases include an opinion on the provision of the additional services referred to in point 7) above.

**Table of Contents**

2013 Financial Statements

**c) Operation.**

The Audit and Control Committee shall meet at least once every quarter and as often as appropriate, when called by its Chairman.

In the performance of its duties, the Audit and Control Committee may require that the Company's Auditor and the person responsible for internal audit, and any employee or senior executive officer of the Company, attend its meetings.

**d) Action Plan and Report.**

As with the Board and its Committees, at the beginning of each year and in accordance with Article 20 b) 3. of the Regulations of the Board of Directors, the Audit and Control Committee shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

The Committee also draws up an internal Activities Report summarizing the main activities and actions taken during the year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 20 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues dealt with by the Audit and Control Committee.

**Service Quality and Customer Service Committee.**

**a) Composition.**

The Service Quality and Customer Service Committee shall consist of such a number of members, all of them Directors, as the Board of Directors determines at any given time, who shall in no case be less than three and the majority of whom must be External Directors.

The Chairman of the Service Quality and Customer Service Committee shall be appointed from among its members.

**b) Duties.**

Without prejudice to any other duties that the Board of Directors may assign thereto, the Service Quality and Customer Service Committee shall have at least the following duties:

- 1) To periodically examine, review and monitor the quality indices of the principal services provided by the companies of the Telefónica Group.

- 2) To evaluate levels of customer service provided by the companies of the Group to their customers.  
c) Action Plan and Report.

As with the Board and the rest of its Committees, at the beginning of each year and in accordance with Article 20 b) 3. of the Regulations of the Board of Directors, the Service Quality and Customer Service Committee shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

The Committee also draws up an internal Activities Report summarizing the main activities and actions taken during the year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 20 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues dealt with by the Service Quality and Customer Services Committee.

Telefónica, S.A. 167

**Table of Contents**

2013 Financial Statements

**Strategy Committee**

**a) Composition.**

The Board of Directors shall determine the number of members of this Committee.

The Chairman of the Strategy Committee shall be appointed from among its members.

**b) Duties.**

Without prejudice to any other tasks that the Board of Directors may assign thereto, the primary duty of the Strategy Committee shall be to support the Board of Directors in the analysis and follow-up of the global strategy policy of the Telefónica Group.

**c) Action Plan and Report.**

As with the Board and the rest of its Committees, at the beginning of each year and in accordance with Article 20 b) 3. of the Regulations of the Board of Directors, the Strategy Committee shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

The Committee also draws up an internal Activities Report summarizing the main activities and actions taken during the year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 20 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues dealt with by the Strategy Committee.

Telefónica, S.A. 168

**Table of Contents**

2013 Financial Statements

**Innovation Committee**

**a) Composition.**

The Board of Directors shall determine the number of members of this Committee.

The Chairman of the Innovation Committee shall be appointed from among its members.

**b) Duties.**

The Innovation Committee is primarily responsible for advising and assisting in all matters regarding innovation. Its main object is to perform an examination, analysis and periodic monitoring of the Company's innovation projects, to provide guidance and to help ensure its implementation and development across the Group.

**c) Action Plan and Report.**

As with the Board and the rest of its Committees, at the beginning of each year and in accordance with Article 20 b) 3. of the Regulations of the Board of Directors, the Innovation Committee shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

The Committee also draws up an internal Activities Report summarizing the main activities and actions taken during the year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 20 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues dealt with by the Innovation Committee.

**Nominating, Compensation and Corporate Governance Committee**

**a) Composition.**

The Nominating, Compensation and Corporate Governance Committee shall consist of such a number of members as the Board of Directors determines at any given time, who shall in no case be less than three and shall be appointed by the Board of Directors. All members thereof must be external or non-executive Directors and the majority of them must be Independent Directors.

The Chairman of the Nominating, Compensation and Corporate Governance Committee, who shall in all events be an Independent Director, shall be appointed from among its members.

**b) Duties.**

Notwithstanding other duties entrusted it by the Board of Directors, the Nominating, Compensation and Corporate Governance Committee shall have the following duties:

- 1) To report, following standards of objectivity and conformity to the corporate interest, on the proposals for the appointment, re-election and removal of Directors and senior executives of the Company and its subsidiaries, as well as the Secretary and, if applicable, the Deputy Secretary of the respective Board of Directors, and evaluate the qualifications, knowledge and experience required of candidates to fill vacancies.
- 2) To report on the proposals for appointment of the members of the Executive Commission and of the other Committees of the Board of Directors, as well as the respective Secretary and, if applicable, the respective Deputy Secretary.
- 3) To propose to the Board of Directors the appointment of the Lead Director from among the Independent Directors.
- 4) Together with the Chairman of the Board of Directors, to organize and coordinate a periodic assessment of the Board of Directors pursuant to Article 13.3 of the Regulations of the Board.
- 5) To inform on the periodic assessment of the performance of the Chairman of the Board of Directors.

Telefónica, S.A. 169



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**Table of Contents**

2013 Financial Statements

- 6) To examine or organize, in such manner as is deemed fit, the succession of the Chairman of the Board of Directors and, if applicable, to make proposals to the Board of Directors so that such succession occurs in an orderly and well-planned manner.
  - 7) To propose to the Board of Directors, within the framework established in the Corporate By-laws, the compensation for the Directors and review it periodically to ensure that it is in keeping with the tasks performed by them, as provided in Article 34 of the Regulations of the Board.
  - 8) To propose to the Board of Directors, within the framework established in the By-Laws, the extent and amount of the compensation, rights and remuneration of a financial nature of the Chairman of the Board of Directors, the Executive Directors and the senior executives of the Company, as well as the basic terms of their contracts, for purposes of contractual implementation thereof.
  - 9) To prepare and propose to the Board of Directors an annual report regarding the Director compensation policy.
  - 10) To supervise compliance with the Company's internal rules of conduct and the corporate governance rules thereof in effect from time to time.
  - 11) To exercise such other powers and perform such other duties as are assigned to such Committee in these Regulations.
- c) Operation.

In addition to the meetings provided for in the annual schedule, the Nominating, Compensation and Corporate Governance Committee shall meet whenever the Board of Directors of the Company or the Chairman of the Board of Directors requests the issuance of a report or the making of a proposal within the scope of its powers and duties, provided that, in the opinion of the Chairman of the Committee, it is appropriate for the proper implementation of its duties.

**d) Action Plan and Report.**

As with the Board and the rest of its Committees, at the beginning of each year and in accordance with Article 20 b) 3. of the Regulations of the Board of Directors, the Nominating, Compensation and Corporate Governance Committee shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

The Committee also draws up an internal Activities Report summarizing the main activities and actions taken during the year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 20 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues dealt with by the Nominating, Compensation and Corporate Governance Committee.

### **Regulation Committee**

#### **a) Composition.**

The Regulation Committee shall consist of such a number of members, all of them Directors, as the Board of Directors determines at any given time, who shall in no case be less than three and the majority of whom must be external Directors.

The Chairman of the Regulation Committee shall be appointed from among its members.

#### **b) Duties.**

Notwithstanding other duties entrusted to it by the Board of Directors, the Regulation Committee shall have at least the following functions:

- 1) To monitor on a permanent basis the principal regulatory matters and issues affecting the Group at any time, through the study, review and discussion thereof.
- 2) To act as a communication and information channel on regulatory matters between the management team and the Board of Directors and, where appropriate, to advise the Board of Directors of those matters deemed significant to the Company or to any of the companies of the Group in respect of which it is necessary or appropriate to make a decision or adopt a particular strategy.

**Table of Contents**

2013 Financial Statements

**c) Action Plan and Report.**

As with the Board and the rest of its Committees, at the beginning of each year and in accordance with Article 20 b) 3.of the Regulations of the Board of Directors, the Regulation Committee shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

The Committee also draws up an internal Activities Report summarizing the main activities and actions taken during the year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 20 b) 3.of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues dealt with by the Regulation Committee.

**Institutional Affairs Committee**

**a) Composition.**

The Board of Directors shall determine the number of members of this Committee.

The Chairman of the Institutional Affairs Committee shall be appointed from among its members.

**b) Duties.**

Without prejudice to any other duties that the Board of Directors may assign thereto, the Institutional Affairs Committee's main duty shall be to examine and analyze matters and issues relating to the Telefónica Group's institutional relations.

**c) Action Plan and Report.**

As with the Board and the rest of its Committees, at the beginning of each year and in accordance with Article 20 b) 3.of the Regulations of the Board of Directors, the Institutional Affairs Committee shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

The Committee also draws up an internal Activities Report summarizing the main activities and actions taken during the year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 20 b) 3.of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues dealt with by the Institutional Affairs Committee.

**Executive Commission**

**a) Composition.**

The Executive Commission shall consist of the Chairman of the Board of Directors, once appointed as a member of the Executive Commission, and not less than three or more than ten Directors appointed by the Board of Directors.

The Board of Directors shall seek to have External Directors constitute a majority over the Executive Directors.

In all cases, the affirmative vote of at least two-thirds of the members of the Board of Directors shall be required in order for the appointment or re-appointment of the members of the Executive Commission to be valid.

**b) Duties.**

The Board of Directors, always subject to the legal provisions in force, has delegated all its powers to an Executive Commission, except those that cannot be delegated by Law, by the Corporate By-laws, or by the Regulations of the Board of Directors.

**Table of Contents**

2013 Financial Statements

The Executive Commission provides the Board of Directors with a greater efficiency and effectiveness in the executions of its tasks, since it meets more often.

**c) Operation.**

The Executive Commission shall meet whenever called by the Chairman, and shall normally meet every fifteen days.

The Chairman and Secretary to the Board of Directors shall act as the Chairman and Secretary to the Executive Commission. One or more Vice Chairmen and a Deputy Secretary may also be appointed.

A valid quorum of the Executive Commission shall exist with the presence, in person or by proxy, of more than one-half of its members.

Resolutions shall be adopted by a majority of the Directors attending the meeting (in person or by proxy), and in the case of a tie, the Chairman shall cast the deciding vote.

**d) Relationship with the Board of Directors.**

The Executive Commission shall report to the Board in a timely manner on the matters dealt with and the decisions adopted at the meetings thereof, with a copy of the minutes of such meetings made available to the members of the Board (Article 21.C of the Regulations of the Board of Directors).

C.2.5. Indicate, as appropriate, whether there are any regulations governing the board committees. If so, indicate where they can be consulted, and whether any amendments have been made during the year. Also indicate whether an annual report on the activities of each committee has been prepared voluntarily.

**Audit and Control Committee**

The organization and operation of the Board of Directors Committees are governed by the Regulations of the Board of Directors. In addition, the Audit and Control Committee is specifically regulated in Article 39 of the Corporate By-laws. These documents are available for consultation on the Company's website.

As mentioned in Section C.2.4 above, the Board Committees draw up an internal Activities Report summarizing the main activities and actions taken during the year detailing the issues discussed at their meetings and highlighting certain aspects regarding their powers and duties, composition and operation.

**Service Quality and Customer Service Committee**

The organization and operation of the Board of Directors Committees are governed by the Regulations of the Board of Directors. This document is available for consultation on the Company's website.

As mentioned in Section C.2.4 above, the Board Committees draw up an internal Activities Report summarizing the main activities and actions taken during the year detailing the issues discussed at their meetings and highlighting certain aspects regarding their powers and duties, composition and operation.

### **Strategy Committee**

The organization and operation of the Board of Directors Committees are governed by the Regulations of the Board of Directors. This document is available for consultation on the Company's website.

As mentioned in Section C.2.4 above, the Board Committees draw up an internal Activities Report summarizing the main activities and actions taken during the year detailing the issues discussed at their meetings and highlighting certain aspects regarding their powers and duties, composition and operation.

**Table of Contents**

2013 Financial Statements

**Innovation Committee**

The organization and operation of the Board of Directors Committees are governed by the Regulations of the Board of Directors. This document is available for consultation on the Company's website.

As mentioned in Section C.2.4 above, the Board Committees draw up an internal Activities Report summarizing the main activities and actions taken during the year detailing the issues discussed at their meetings and highlighting certain aspects regarding their powers and duties, composition and operation.

**Nominating, Compensation and Corporate Governance Committee**

The organization and operation of the Board of Directors Committees are governed by the Regulations of the Board of Directors. In addition, the Nominating, Compensation and Corporate Governance Committee is specifically regulated in Article 40 of the Corporate By-laws. These documents are available for consultation on the Company's website.

As mentioned in Section C.2.4 above, the Board Committees draw up an internal Activities Report summarizing the main activities and actions taken during the year detailing the issues discussed at their meetings and highlighting certain aspects regarding their powers and duties, composition and operation.

**Regulation Committee**

The organization and operation of the Board of Directors Committees are governed by the Regulations of the Board of Directors. This document is available for consultation on the Company's website.

As mentioned in Section C.2.4 above, the Board Committees draw up an internal Activities Report summarizing the main activities and actions taken during the year detailing the issues discussed at their meetings and highlighting certain aspects regarding their powers and duties, composition and operation.

**Institutional Affairs Committee**

The organization and operation of the Board of Directors Committees are governed by the Regulations of the Board of Directors. This document is available for consultation on the Company's website.

As mentioned in Section C.2.4 above, the Board Committees draw up an internal Activities Report summarizing the main activities and actions taken during the year detailing the issues discussed at their meetings and highlighting certain aspects regarding their powers and duties, composition and operation.

**Executive Commission**

The organization and operation of the Board of Directors Committees are governed by the Regulations of the Board of Directors. The Executive Commission is also regulated by Article 38 of the Corporate By-laws. These documents are available for consultation on the Company's website.

It should be highlighted that upon modifying the Rules of Procedure of the Board of Directors, approved by that body on the 31st of May 2013, the Committees on Human Resources, Reputation and Corporate Responsibility and International Affairs, which until then had be explicitly recognised in the regulation, and the Committee on Institutional Affairs was created.

C.2.6. Indicate whether the composition of the Executive Committee reflects the participation within the board of the different types of directors.

**Yes**

Telefónica, S.A. 173



**Table of Contents**

2013 Financial Statements

D. Related-party and intragroup transactions

**D.1. Identify the competent body and explain, if applicable, the procedures for approving related-party or intragroup transactions.**

**Competent body**

Board of Directors

**Procedures**

As per Article 5 of the Regulations of the Board of Directors, the Board reserves the power to approve, inter alia, transactions entered into by the Company with related parties.

In this regard, and pursuant to Article 38 of the Regulations of the Board of Directors, the Board of Directors shall examine the transactions that the Company enters into, either directly or indirectly, with Directors, with significant shareholders or shareholders represented on the Board of Directors, or with persons related thereto.

The performance of such transactions shall require the authorization of the Board of Directors, on the recommendation of the Nominating, Compensation and Corporate Governance Committee, unless they are transactions or operations that form part of the customary or ordinary activity of the parties involved that are performed on an arm's-length basis and in insignificant amounts for the Company.

The transactions referred to in the preceding sub-section shall be assessed from the point of view of equal treatment of shareholders and the arm's-length basis of the transaction, and shall be included in the Annual Corporate Governance Report and in the periodic public information of the Company upon the terms provided by law.

**Explain if the authority to approve related-party transactions has been delegated to another body or person**

The powers to approve transactions entered into by the Company with related parties, may be adopted, by the Executive Commission in urgent cases and subsequently ratified by the Board of Directors (pursuant to Article 5.4.C of the Regulations of the Board of Directors).

Telefónica, S.A. 174

**Table of Contents**

2013 Financial Statements

**D.2. List any relevant transactions, by virtue of their amount or importance, between the company or its group of companies and the company's significant shareholders:**

<b>or corporate name of significant shareholder</b>	<b>Name or corporate name of the company or its group company</b>	<b>Nature of the relationship</b>	<b>Type of transaction</b>	<b>Amount (Thousands of euros)</b>
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Gain from sale or disposal of assets	
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Financing agreements: loans and capital contributions (lender)	58
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance leases (lessor)	4
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Other expenses	
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Sale of goods (finished or in progress)	5
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Guarantees and deposits received	383
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance agreements, loans and capital contributions (borrower)	50
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Commitments acquired	32
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Receipt of services	15
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance income	26
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Services rendered	68
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance costs	42
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Other income	62
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Leases	
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Repayment or cancellation of loans and finance leases (lessor)	12
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Cancelled	
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	commitments/guarantees	68
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Other transactions	1,083
Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Other transactions	209
Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Guarantees and deposits received	67
Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Financing agreements: loans and capital contributions (lender)	1,567
Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance income	8
Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual		309

				Financing agreements: loans and capital contributions (borrower)	
Bilbao Vizcaya Argentaria, S.A.		Telefónica, S.A.	Contractual	Receipt of services	2
Bilbao Vizcaya Argentaria, S.A.		Telefónica, S.A.	Contractual	Dividends and other distributed earnings	108
Bilbao Vizcaya Argentaria, S.A.		Telefónica, S.A.	Contractual	Dividends received	14
Bilbao Vizcaya Argentaria, S.A.		Telefónica, S.A.	Contractual	Finance costs	2
Bilbao Vizcaya Argentaria, S.A.		Telefónica, S.A.	Contractual	Other transactions	12,268
e Ahorros y Pensiones de Barcelona,	la Caixa	Rest of Telefónica Group	Contractual	Leases	
e Ahorros y Pensiones de Barcelona,	la Caixa	Rest of Telefónica Group	Contractual	Services rendered	77
e Ahorros y Pensiones de Barcelona,	la Caixa	Rest of Telefónica Group	Contractual	Other expenses	
e Ahorros y Pensiones de Barcelona,	la Caixa	Rest of Telefónica Group	Contractual	Commitments acquired	69
e Ahorros y Pensiones de Barcelona,	la Caixa	Rest of Telefónica Group	Contractual	Guarantees and deposits received	118
e Ahorros y Pensiones de Barcelona,	la Caixa	Rest of Telefónica Group	Contractual	Receipt of services	54
e Ahorros y Pensiones de Barcelona,	la Caixa	Rest of Telefónica Group	Contractual	Finance income	
e Ahorros y Pensiones de Barcelona,	la Caixa	Rest of Telefónica Group	Contractual	Finance costs	

Telefónica, S.A. 175

**Table of Contents**

2013 Financial Statements

Caja de Ahorros y Pensiones de Barcelona, la Caixa	la	Rest of Telefónica Group	Contractual	Sale of goods (finished or in progress)	3,045
Caja de Ahorros y Pensiones de Barcelona, la Caixa	la	Rest of Telefónica Group	Contractual	Finance agreements, loans and capital contributions (borrower)	(55)
Caja de Ahorros y Pensiones de Barcelona, la Caixa	la	Rest of Telefónica Group	Contractual	Other transactions	53
Caja de Ahorros y Pensiones de Barcelona, la Caixa	la	Telefónica, S.A.	Contractual	Finance income	8,096
Caja de Ahorros y Pensiones de Barcelona, la Caixa	la	Telefónica, S.A.	Contractual	Other transactions	1,199,868
Caja de Ahorros y Pensiones de Barcelona, la Caixa	la	Telefónica, S.A.	Contractual	Financing agreements: loans and capital contributions (lender)	1,670,634
Caja de Ahorros y Pensiones de Barcelona, la Caixa	la	Telefónica, S.A.	Contractual	Dividends and other distributed earnings	88,650
Caja de Ahorros y Pensiones de Barcelona, la Caixa	la	Telefónica, S.A.	Contractual	Guarantees and deposits received	15,070
Caja de Ahorros y Pensiones de Barcelona, la Caixa	la	Telefónica, S.A.	Contractual	Finance costs	1,284
Caja de Ahorros y Pensiones de Barcelona, la Caixa	la	Telefónica, S.A.	Contractual	Receipt of services	2,413
Caja de Ahorros y Pensiones de Barcelona, la Caixa	la	Telefónica, S.A.	Contractual	Finance agreements, loans and capital contributions (borrower)	214,275

Telefónica, S.A. 176

**Table of Contents**

2013 Financial Statements

- D.3. List any relevant transactions, by virtue of their amount or importance, between the company or its group of companies and the company's managers or directors:**

Name or corporate name of director or senior manager	Name or corporate name of related party	Relationship	Type of transaction	Amount (Thousands of euros)
------------------------------------------------------	-----------------------------------------	--------------	---------------------	-----------------------------

- D.4. List any relevant transactions undertaken by the company with other companies in its group that are not eliminated in the process of drawing up the consolidated financial statements and whose subject matter and terms set them apart from the company's ordinary trading activities.**

**In any case, list any intragroup transactions carried out with entities in countries or territories considered to be tax havens:**

Corporate name of the group company	Brief description of the transaction	Amount (Thousands of euros)
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- D.5. Indicate the amount from related-party transactions.**

Certain members of the Board of Directors of Telefónica, S.A. are also members of the Board of Directors of Abertis Infraestructuras, S.A., the parent company of Abertis. In 2013 Telefónica reached an agreement with Abertis via the company Abertis Tower, S.A., under which Telefónica Móviles España, S.A.U. has transferred 690 mobile telephone towers to Abertis, obtaining a capital gain of 70 million euros. Equally, an agreement was formalised for Abertis Tower, S.A. to rent certain spaces in the aforementioned infrastructure to have Telefónica Móviles España, S.A.U. install communications equipment.

Additionally, on 28 December 2012 Telefónica de Contenidos, S.A.U. (a 100% Telefónica, S.A. owned subsidiary) formalised the transfer to Abertis (via its subsidiary Abertis Telecom, S.A.) of 23,343 shares in Hispasat, S.A. for 68 million euros. In April 2013 Telefónica de Contenidos, S.A. completed the sale to Eutelsat Services & Beteiligungen, GmbH of its remaining shares in Hispasat, S.A., consisting of 19,359 shares for a total price of 56 million euros.

- D.6. List the mechanisms established to detect, determine and resolve any possible conflicts of interest between the company and/or its group, and its directors, management or significant shareholders.**

Company policy establishes the following principles governing possible conflicts of interest that may affect Directors, senior executives or significant shareholders:

With respect to Directors, Article 31 of the Regulations of the Board of Directors establishes that Directors shall inform the Board of Directors of any situation of direct or indirect conflict they may have with the interest of the Company. In the event of conflict, the Director affected shall refrain from participating in the deliberation to which the conflict refers.

Moreover, and in accordance with the provisions set out in the Regulations of the Board, Directors shall refrain from participating in votes that affect matters in which they or persons related to them have a direct or indirect interest.

Likewise, the aforementioned Regulations establish that Directors shall not directly or indirectly enter into professional or commercial transactions with the Company or with any of the companies of the Group, if such transactions are unrelated to the ordinary course of business of the Company or not performed on an arm's length basis, unless the Board of Directors is informed thereof in advance and, on the recommendation of the Nominating, Compensation and Corporate Governance Committee, it approves the transaction upon the affirmative vote of at least 90% of the Directors (present in person or by proxy).

Telefónica, S.A. 177

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**Table of Contents**

2013 Financial Statements

Directors must also report with respect to themselves as well as the persons related thereto: (a) the direct or indirect interests held by them and (b) the offices held or duties performed at any company that is in a situation of actual competition with the Company.

For purposes of the provisions of this paragraph, the following shall not be deemed to be in a situation of actual competition with the Company, even if they have the same or a similar or complementary corporate purpose: (i) companies controlled thereby (within the meaning of Article 42 of the Commercial Code) and (ii) companies with which Telefónica, S.A. has established a strategic alliance. Likewise, for purposes of the provisions hereof, proprietary directors of competitor companies appointed at the request of the Company or in consideration of the Company's interest in the capital thereof shall not be deemed to be in a situation of prohibition of competition.

With regards to significant shareholders, Article 38 of the Regulations of the Board of Directors stipulates that the Board of Directors shall know the transactions that the companies enter into, either directly or indirectly, with Directors, with significant shareholders or shareholders represented on the Board, or with persons related thereto. The performance of such transactions shall require the authorization of the Board, on the recommendation of the Nominating, Compensation and Corporate Governance Committee, unless they are transactions or operations that form part of the customary or ordinary activity of the parties involved that are performed on customary market terms and in insignificant or immaterial amounts for the Company.

The transactions referred to in the preceding sub-section shall be assessed from the point of view of equal treatment of shareholders and the arm's-length basis of the transaction, and shall be included in the Annual Corporate Governance Report and in the periodic information of the Company upon the terms set forth in applicable laws and regulations.

With respect to senior executives, the Internal Code of Conduct for Securities Markets Issues sets out the general principles of conduct for the persons subject to the said regulations who are involved in a conflict of interest. The aforementioned Code includes all the Company's management personnel within the concept of affected persons. In accordance with the provisions of this Code, senior executives are obliged to (a) act at all times with loyalty to the Telefónica Group and its shareholders, regardless of their own or other interests; (b) refrain from interfering in or influencing the making of decisions that may affect individuals or entities with whom there is a conflict; and (c) refrain from receiving information classified as confidential which may affect such conflict. Furthermore, these persons are obliged to inform the Company's Regulatory Compliance function of all transactions that may potentially give rise to conflicts of interest.

Telefónica, S.A. 178

**Table of Contents**

2013 Financial Statements

**D.7. Is more than one Group Company listed in Spain?**

**No**

Identify the listed subsidiaries in Spain:

**Listed Subsidiaries**

Indicate whether they have provided detailed disclosure on the type of activity they engage in, and any business dealings between them, as well as between the subsidiary and other group companies.

**No**

**Business dealings between the parent and listed subsidiary, as well as between the subsidiary and other group companies**

Indicate the mechanisms in place to resolve possible conflicts of interest between the listed subsidiary and other group companies.

**Mechanisms to resolve any possible conflicts of interest**

Telefónica, S.A. 179



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**Table of Contents**

2013 Financial Statements

**E. Risk control and management systems****E.1. Describe the risk management system in place at the company.**

Telefónica continually monitors the most significant risks in the main companies comprising its Group. The Company therefore has a Corporate Risk Management Model based on the model established by the Treadway Commission's Committee of Sponsoring Organizations (COSO), which is used to evaluate the probability of the various risks arising and the impact thereof.

One of the features of this Model is a map prioritizing risks according to their importance, thereby facilitating their control and appropriate responses to mitigate them. In accordance with this Model, and based on best practices and benchmarks in risk management, the following four risk categories have been identified:

- Business risk: Possible loss of value or earnings as a result of strategic uncertainty or uncertainty about competitors, changes in the business, competition and market scenario, or changes in the legal framework.
- Operational risk: Possible loss of value or earnings as a result of events caused by inadequacies or failures in customer service, processes, human resources, business teams and IT systems, security, compliance with contracts, laws and regulations, or due to external factors.
- Financial risk: Possible loss of value or earnings as a result of adverse movements in financial variables and the inability of the Company to meet its obligations or convert its assets into cash.
- Global risk: Possible loss of value or earnings as a result of events that affect the entire Telefónica Group in terms of its corporate reputation and responsibility, corporate public relations, marketing strategy, brand, sponsorship and innovation.

**E.2. Identify the bodies responsible for preparing and implementing the risk management system.**

Telefónica, S.A.'s Board of Directors reserves the power to approve the general risk policy. Audit and Control Committee analyzes and evaluates risks and then proposes to the Board of Directors the risk control and management policy to be adopted, identifying the categories of risks to which the Company is exposed, the level of acceptable risk, measures to mitigate the impacts of identified risks, control systems and the reporting to be used to control and manage said risks.

As per the Group's Risk Management Policy, various local, regional and corporate units are involved in managing risks.

While all staff in the organization are responsible for contributing to the identification and management of risk following the procedures defined to implement and ensure the effectiveness of the Group's risk management processes.

**E.3. Indicate the main risks which may prevent the company from achieving its targets.**

Information on this matter is provided in Section H ( Other information of interest ) of this Annual Corporate Governance Report under Note 11 of Section E.3] .

**E.4. Identify if the company has a risk tolerance level.**

The Company has a risk or acceptable risk tolerance level that is set at corporate level. This threshold represents the extent to which it is prepared to assume a certain level of risk, insofar as it may contribute to generating value and developing the business, achieving an appropriate balance between growth, performance and risk.

Telefónica, S.A. 180

**Table of Contents**

2013 Financial Statements

The range of risks to which the Company may be exposed described below is considered when evaluating risk:

Generally, albeit mainly related to operational and business risks, tolerance thresholds are defined pursuant to the impact and probability of risk. These thresholds are revised annually based on the performance of the main financials for both the Group as a whole and the business lines and main companies therein.

The tolerance level for financial risks is set in terms of their economic impact.

A tolerance level of zero is established for global risks, principally those affecting corporate reputation and responsibility.

**E.5. Identify any risks which have occurred during the year.**

Telefónica Group reviews the value of its assets and cash generating units annual, or on a more frequent basis if the circumstances so require, in order to determine whether their book value can be supported by their expected revenue generation. In some cases this includes expected synergies included in the acquisition price. Any potential regulatory, business, financial or political changes require that modifications be made to the estimates and that the goodwill be adjusted, for either real estate or intangible assets. Although it has no impact on cash flow, acknowledging a drop in the value of assets affects the profit and loss account and may have a negative impact on operating results.

In this regard the Group has made a number of corrections to the value of some of its shares. This has had a knock-on impact on the results for the financial year when the adjustments were made. Thus, in the 2013 financial year, as set out in the Company's Financial Statements, it recorded a correction to the value of the shares held by Telco, S.p.A. in Telecom Italia, S.p.A. which, along with the contribution to the year's results, had a negative impact of 266 million euros before tax.

**E.6. Explain the response and monitoring plans for the main risks the company is exposed to.**

The Corporate Risk Management Model, which has been devised in accordance with the main international best practices and guidelines (such as COSO, the Treadway Commission's Committee of Sponsoring Organizations), involves identifying and evaluating risks to respond to and monitor them.

Given the diverse range of risks, the mechanisms for responding to risks include overarching initiatives that are developed and coordinated as standard across the Group's main operations and/or specific measures aimed at managing certain risks at company level.

Overarching measures, mainly involving the use of financial derivatives, are taken to mitigate certain financial risks such as those relating to exchange-rate and interest-rate fluctuations. The Group uses Multinational Programs for

insurance or insurance arranged locally in each country to cover operational risks, depending on the type of risk and cover required.

Telefónica, S.A. 181

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**Table of Contents**

2013 Financial Statements

**F. Internal Control and Risk Management Systems with regard to Statutory Financial Reporting (ICFR)**

Describe the mechanisms which comprise the internal control and risk management systems with regard to Statutory Financial Reporting (ICFR).

F.1. The company's control environment

Specify at least the following components with a description of their main characteristics:

F.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 Telefónica, S.A. (hereinafter Telefónica) assumes ultimate responsibility of ensuring that an adequate and effective internal control over financial reporting system (ICFRS) exists and is updated.

Pursuant to Law and the Corporate By-laws, the Board of Directors is the Company's most senior governing body and representative, and basically consists of a supervisory and control body, while the executive bodies and management team are responsible for the day-to-day management of the Company's businesses.

The By-laws and Regulations of the Board of Directors state that the primary duty of the Audit and Control Committee shall be to support the Board of Directors in its supervisory duties. Specifically, it shall have at least the following powers and duties:

To supervise the process of preparing and submitting financial information. In this regard, to supervise the process of preparation and the completeness of the financial information related to the Company and the Group, reviewing compliance with the regulatory requirements, the proper determination of the scope of consolidation, and the correct application of the accounting standards.

To supervise the effectiveness of the Company's internal control system and risk management systems, and to discuss with the Auditors significant weaknesses in the internal control system detected during the audit. With respect thereto, it shall be responsible for proposing to the Board of Directors a risk control and management policy, which shall identify at least the following types of risk (operational, technological, financial, legal and reputational) which the Company faces; the level of risk which the Company deems acceptable; the measures for mitigating the impact of the identified risks should they materialize; and the control and information systems to be employed to control and manage said risks.

To ensure the independence of the External Auditor, supervising their work and acting as a channel of communication between the Board of Directors and the External Auditor, as well as between the External Auditor and the Company's Management Team.

To supervise internal audit and, in particular: to ensure the independence and efficiency of the internal audit function; to receive periodic information on its activities; and to verify that senior executives take into account the conclusions and recommendations of its reports.

The Audit and Control Committee shall meet monthly and as often as appropriate.

In order to carry out this supervisory function, the Audit and Control Committee is assisted by all the Senior Management of the Company, including Internal Audit.

The different areas and functional units of the Telefónica Group, primarily the financial teams, also play a key role in ICFR as they are responsible for preparing, maintaining and updating the different procedures that govern their operations and identify the tasks to be carried out, as well as the persons in charge of the same.

F.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 organizational 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 company.

**Table of Contents**

2013 Financial Statements

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.

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 and malpractice within the organization, stating whether reports made through this channel are confidential.

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. The Board of Directors is responsible for designing and reviewing the Company's organizational structure, ensuring there is an adequate separation of functions and that satisfactory coordination mechanisms among the different areas are established.

Use of the Telefónica Group's economic-financial IT system is regulated in several manuals, instructions and internal rules and regulations, the most noteworthy of which are as follows:

**Corporate Regulations on the Control, Registration and Reporting of Financial and Accounting Information**, which sets out the basic principles of the Telefónica Group's financial and accounting reporting system, and the procedures and mechanisms in place to oversee this system.

**Accounting Policies and Measurement Criteria Manual**, designed to unify and standardize the accounting criteria and policies used by all the Group companies to ensure Telefónica operates as a consolidated and uniform group.

**Financial Statements Closing Process Instructions**, published annually to establish the procedures and the schedule all Telefónica Group companies must follow when reporting financial and accounting information to prepare the Group's consolidated financial information, to comply with Telefónica's legal and reporting requirements in Spain and the other countries in which its shares are listed.

**Annual calendar of financial accounting information**, applicable to all Telefónica Group companies to establish the monthly accounting-financial reporting dates at the start of each period.

The regulations also define and delimit responsibilities at each level of the organization regarding the reliability of the information published.

Regarding the Code of conduct, in December 2006, Telefónica's Board of Directors approved the unification of the Codes of Ethics of the Group's different companies in a new Code of Business Principles, to be applied as standard in all countries where the Telefónica Group operates, and for all its employees (at all levels of the organization, directors and non-directors).

The Business Principles are based on a number of general principles associated with honesty, trust, respect for the law, integrity and respect for human rights. Also, they include more specific principles aimed at ensuring the trust of the customers, professionals, shareholders, suppliers and society in general.

They expressly mention issues related to recording transactions and preparation of financial information: We will prepare financial and accounting records in an accurate and reliable manner .

This ethical code is accessible to all employees via the intranet, and procedures are in place in the Telefónica Group to update, monitor adherence to and disseminate these Business Principles.

Telefónica has an Office of Business Principles which is responsible for ensuring compliance therewith. It comprises the most senior representatives of the General Secretary s Office, Human Resources, Internal Audit and Public Affairs and other pertinent areas given their duties and responsibilities.

The Office is in charge of:

1.- Guaranteeing that Telefónica conducts business in an ethical and responsible manner, and that the Company s reputation is not tarnished.



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**Table of Contents**

2013 Financial Statements

2.- Developing the mechanisms need to ensure the Ethical Code is followed to the letter in all regions/countries/business units.

3.- Overseeing, reviewing and contemplating the implementation of the Business Principles across the entire Telefónica Group.

Training courses are provided to all employees through the online training platform to ensure these Business Principles are followed. The course involves employees signing up to the Ethical Code.

4.- Examining any matters or proposals in the Group that could represent a risk to the Business Principles and associated policies and therefore, the brand and reputation.

Telefónica also has an Internal Code of Conduct for Securities Markets Issues setting out the general guidelines and the principles of conduct for the persons involved in securities and financial instrument transactions entered into by the Company and its subsidiaries.

Regarding the Whistle-blowing channel, as specified in Article 22 of Regulations for the Board of Directors, the Audit and Control Committee's duties include: establishing and maintaining a mechanism to allow employees to confidentially and anonymously report potentially significant irregularities, particularly any financial or accounting irregularities detected within the Company .

The Telefónica Group has two whistle-blowing channels:

**SOX Whistle-blowing Channel:** This channel was approved by the Audit and Control Committee in April 2004 to fulfil the obligations laid down in the Sarbanes-Oxley Act (SOX), as a company listed on the New York Stock Exchange. It is open to all Telefónica Group employees. Any irregularities reported through the channel must only be related with accounting, internal controls over reporting and/or audit-related matters.

This channel is confidential and anonymous, since the contents of any reports are sent automatically to the Secretary of Audit and Control Committee after removing the sender's name, and the source of the message cannot be traced in any event.

Irregularities can be reported by employees using a mailbox on the public section of the Internal Audit webpage on Telefónica's intranet.

The Telefónica Audit and Control Committee receives all complaints regarding internal controls, accounting and the audit of the financial statements. All complaints of this nature will be treated and resolved by the Committee appropriately.

**Business Principles Whistle-blowing Channel:** In addition to the Business Principles ethical code, the Board of Directors approved a whistle-blowing channel for employees and other stakeholders through which professionals can notify the Company of any behavior, actions or events that could breach the Ethical Code, the Company's internal rules, or any regulations governing its activity, and jeopardize the contractual relationship between the Company and

the accused party. Questions, advice and information on compliance with the Business Principles and associated policies and rules can also be submitted through this channel.

The Principles regulating this channel are:

**Confidentiality:** data and claims made shall be treated in the strictest confidence.

**Thoroughness:** Information on potential breaches of the Business Principles shall be fully and exhaustively investigated to determine the veracity of the claim submitted.

**Respect:** The rights of the individuals involved in possible irregularities shall be respected at all times. The individuals and/or professionals involved shall be entitled to provide reasons and explanations for their actions before any assessment of the irregularities are conducted.

**Grounds:** Any decision must be adopted based on reasonable grounds, and must be proportionate to and commensurate with the irregularity and take into account any related circumstances and events.

Telefónica, S.A. 184

**Table of Contents**

2013 Financial Statements

The channel is accessible through the Business Principles webpage on Telefónica's intranet. It can also be accessed directly here: <http://principiosactuacion.intranet.Telefonica>.

Telefónica S.A.'s Office of Business Principles is responsible for the Business Principles Whistle-blowing Channel and therefore receives and disseminates each of the reports received.

Also, and with regard to employee training in financial and control issues, we would note that, in 2007, the **Telefónica Corporate University** (Universitas Telefónica) was opened to help contribute to the Telefónica Group's advancement through lifelong learning. All the University's training programs are based on developing the corporate culture, the business strategy and management and leadership skills. Personnel involved in preparing and reviewing financial information are also offered refresher courses in this area.

Likewise, Telefónica, S.A.'s Accounting Policies and Consolidation Department (operating within Telefónica, S.A.'s Corporate Finance Department) offers training plans and seminars to all personnel working in the Group's financial areas and other pertinent areas (tax, M&A, etc.), with the aim of informing them of any accounting or financial changes which are relevant to preparing consolidated financial information.

Finance personnel also attend technical sessions run by external consultancy firms and covering developments in accounting.

Finally, the Telefónica Group also has an on-line training platform which includes a finance school providing specific training and refresher courses on financial information, as well as an internal control school providing instruction on auditing, internal control and risk management.

F.2. Risk assessment in financial reporting  
Report at least:

F.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.

Finally, which of the company's governing bodies is responsible for overseeing the process. Given the vast number of processes involved in financial reporting at the Telefónica Group, a model has been developed to select the most significant processes by applying a so-called Scope Definition Model, which is documented. This model is applied to the financial information reported by subsidiaries or companies managed by Telefónica. The model selects the accounts with the largest contribution to the Group's consolidated financial information and then identifies the processes used to generate this information. Once the processes have been identified, the risks inherent in the processes affecting financial reporting are analyzed. This identification procedure covers all the financial reporting objectives of existence and occurrence, completeness, valuation, presentation, disclosure and fraud. Risk identification is carried out on an annual basis.

Telefónica also has a Risk Management Model covering four key areas of risk:

Business risks

Operational risks

Global risks

Financial risks

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**Table of Contents**

2013 Financial Statements

Financial risks include risks associated with the accuracy, completeness and publication of reporting information.

In the process of identifying the consolidation scope, the Telefónica Accounting Policies and Consolidation Department periodically monitors the changes in the Group's scope.

**F.3. Control activities**

Indicate the existence of at least the following components, and specify their main characteristics:

F.3.1. Procedures for reviewing and authorizing 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 judgments, estimates, evaluations and projections.

On March 26, 2003 the Telefónica Board approved the Regulations governing disclosure and reporting to the markets. These regulate the basic principles of operation of the financial disclosure control processes and systems which guarantee that all relevant consolidated financial information of Telefónica, S.A. is communicated to the Company's senior executives and its management team, assigning to the Internal Audit the duty of periodically assessing the functioning of these processes and systems.

Each quarter the Finance Department submits the periodic financial information to the Audit and Control Committee, highlighting the main events and accounting criteria applied and clarifying any major events which occurred during the period.

Likewise, the Telefónica Group has documented financial processes in place which stipulate common criteria for preparing financial information in all Group companies, as well as any outsourced activities.

Also, the Company follows documented procedures for preparing consolidated financial information whereby those employees responsible for the different areas are able to verify this information. In this regard, there is a Coordination and Control Committee comprising employees responsible for these areas. They are able to submit the results of their reviews in order to correctly prepare the financial information which will be presented to the Company's decision-making bodies (Audit and Control Committee and, if applicable, the Board of Directors).

Also, and pursuant to the internal regulations, the Executive Chairmen and the Finance Directors of the Group companies must submit a certificate to the Corporate Finance Department stating that they have reviewed the financial information being presented, that the financial statements give a true and fair view, in all material respects, of the financial position, results and cash position, and that there are no significant risks to the business or unhedged risks which may have a material impact on the Company's equity and financial position.

In relation to the accounting close, the Consolidation and Accounting Policies Department issues instructions setting out the calendar and contents for the financial reporting period for the preparation of the consolidated annual financial statements. These instructions are mandatory for all Telefónica consolidation subgroups and subsidiaries.

The Corporate Finance Department reviews the key judgments, estimates, valuations and forecasts to identify critical accounting policies that require the use of estimates and value judgments. In these cases, the Corporate Finance Department also establishes the necessary operational co-ordination actions with the rest of the Telefónica Group units for their specific areas of activity and knowledge before presenting them to the Audit and Control Committee. The most relevant are dealt with by the Audit and Control Committee. Senior management defines the format for presenting the annual financial statements prior to approval by the Board.

**Table of Contents**

2013 Financial Statements

Internal Audit performs a three-tier evaluation of the ICFR Model each year:

**Self-appraisal Questionnaires**

All the Group's subsidiaries complete Self-appraisal Questionnaires every year, the responses to which are certified by officers in charge of internal control over financial reporting in each company (Chief Executive Officer (CEO) and Chief Financial Officer (CFO)). These questionnaires cover those aspects of ICFR that are deemed to be minimum requirements to achieve reasonable assurance of the reliability of the financial information. A sample of responses is audited.

**General Evaluation Model**

As well as the requirement to complete the Self-appraisal Questionnaire, certain companies are subject to a direct review of their processes and controls due to the significance of their contribution to the Group's economic and financial figures (and other risk factors considered). This review is conducted using the General Evaluation Model.

The Scope Definition Model is used to order in terms of priority which companies are reviewed using the General Evaluation Model. This tool is used to identify critical accounts in each Telefónica Group company employing previously-established assumptions (primarily contribution to consolidated accounts and risk).

Once these critical accounts are identified for review, the General Evaluation Model is applied as follows:

The processes and systems associated with the critical accounts are determined.

Risks affecting the financial reporting vis-à-vis these processes are identified.

Checks and, where necessary, process controls are put in place to provide reasonable assurance that the documentation and design of controls over financial reporting are sound.

Audit tests are carried out to assess the effectiveness of the controls.

**Focused Tests**

Focused Tests are carried out to evaluate the general controls at the main Group companies. The control objectives assessed mainly relate to rules and guidelines in force across the entire Group.

F.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 Global Information Systems Department of the Telefónica Group is in charge of the information systems for all the Group's business. Within its multiple and different functions is in charge of the definition and implementation of security policies and standards for applications and infrastructures (in conjunction with the Security and Networks Department), among which is included the internal control model in the field of information technologies.

In the Telefónica Group, the Internal Network and Systems Audit team is charged with monitoring the general controls over IT systems. The processes for controlling the IT systems are grouped into 22 general control objectives, which in turn are grouped together in the following three main categories:

Management of software upgrades: the purpose of which is to provide reasonable assurance that any new developments and upgrades (urgent or routine) to software are duly authorized, tested and signed off.

Data and systems access:

Physical security: to ensure physical access to the facilities where key software is located is appropriately controlled and restricted to authorized personnel.

Logical security: to ensure only authorized personnel can access data and software (including profiles/tables, programs, operating systems, databases and other related resources).



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**Table of Contents**

2013 Financial Statements

## Operations:

Infrastructure changes, backup, scheduled tasks and incident management: to make certain that infrastructures changes (operating system and database), backups, schedules tasks and exceptions, and monitoring and incident management, are carried out correctly, and provide a reasonable safety in the applications operation.

- F.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.

If a process or part of a process is outsourced with an independent party, controls are still required to ensure the entire process is adequately controlled. Given the importance of outsourcing services and the impacts that this can have on the opinion about the effectiveness of the internal control for financial reporting ICFR, measures are taken in the Telefónica Group to demonstrate a minimum level of control in the independent party. Actions taken to achieve this objective are three-fold:

**Certification of internal control by an independent third party:** ISAE3402 and/or SSAE16 certificates.

**Implementation of specific controls:** Determined, designed, introduced and evaluated by the company.

**Direct evaluation:** An evaluation of the outsourced processes by the Internal Audit area.

When Telefónica, S.A. or any of its subsidiaries engage the services of an independent expert whose findings may materially affect the consolidated financial statements, as part of the selection process the competence, training, credentials and independence of the third party are verified directly by the area contracting the service and, if applicable, the procurement department. The finance department has control activities in place to guarantee the validity of the data, the methods used and the reasonableness of the assumptions used by the third party.

Likewise, there is an internal procedure for engaging independent experts which requires specific levels of approval.

## F.4. Information and communication

Indicate the existence of at least the following components, and specify their main characteristics:

## F.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 Accounting Policies and Consolidation Department of Telefónica, S.A. is charged with defining and updating the accounting policies used for preparing the consolidated financial information.

Thus, this area publishes IFRS (International Financial Reporting Standards) information newsletters summarizing the main changes to accounting methodology, as well as clarifications on various other related issues. These newsletters are monthly.

Also, the Telefónica Group has an Accounting Policies Manual which is annually updated. The objectives of this manual are: to align the corporate accounting principles and policies with IFRS; to maintain accounting principles and policies which ensure that the information is comparable within the Group and offers optimum management of the source of information; to improve the quality of the accounting information of the various Group companies and of the Consolidated Group by disclosing, agreeing and introducing accounting principles which are unique to the Group; and to facilitate the accounting integration of acquired and newly-created companies into the Group's accounting system by means of a reference manual.

This Manual is mandatory for all companies belonging to the Telefónica Group, and shall be applied to their reporting methods when preparing the financial statements.

**Table of Contents**

2013 Financial Statements

F.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

There is a **Compliance Manual for Consolidation Reporting** includes specific instructions on preparing the disclosures which comprise the reporting for the consolidation of the Telefónica Group's financial statements and the preparation of consolidated financial information.

Likewise, the Telefónica Group uses specific software system for the reporting of the individual financial statements at its various subsidiaries, as well as the necessary notes and disclosures for preparing the consolidated annual financial statements. This tool is also used to carry out the consolidation process and its subsequent analysis. The system is managed centrally and uses the same accounts plan.

F.5. Monitoring

Indicate the existence of at least the following components, describing their main characteristics:

F.5.1. The ICFR monitoring activities undertaken by the Audit Committee and an internal audit function whose competencies include supporting the Audit Committee in its role of monitoring the internal control system, including ICFR. Describe the scope of the ICFR assessment conducted in the year and the procedure for the person in charge to communicate its findings. State also whether the company has an action plan specifying corrective measures for any flaws detected, and whether it has taken stock of their potential impact on its financial information.

As mentioned beforehand, the Corporate By-laws and Regulations of the Board of Directors state that the primary duty of the Audit and Control Committee shall be to support the Board of Directors in its supervisory duties, with its main functions including: supervising the effectiveness of the Company's internal control system and risk management systems, and discussing with the Auditor significant weaknesses in the internal control system detected during the audit.

The Audit and Control Committee is responsible for supervising the effectiveness of the internal controls carried out by the Telefónica Group's Internal Audit function.

The Telefónica Group's Internal Audit function reports hierarchically to the General Secretary and the Board and functionally to the Audit and Control Committee. Its activities include: ensuring compliance with applicable laws, internal regulations and the principles of the Group's Code of Ethics; safeguarding the Group's assets, the efficiency and effectiveness of operations, the reliability of information, and the controlled transparency vis-à-vis third parties, and safeguarding the image of the Telefónica Group.

Internal Audit is responsible for implementing the International Standards for the Professional Practice of Internal Auditing and has been awarded a Quality Certificate from the Institute of Internal Auditors.

With regard to supervision of ICFR, Telefónica is listed on the New York Stock Exchange and is therefore subject to the regulatory requirements established by the US authorities applicable to all companies trading on this exchange.

Among these requirements is the aforementioned Sarbanes-Oxley Act and, specifically, Section 404 which stipulates that all listed companies in the US market must evaluate on an annual basis the effectiveness of their ICFR procedures and structure.

The external Auditor issued an independent evaluation on the effectiveness of the Internal Control over the financial reporting.

To fulfil this objective, the Telefónica Group uses the aforementioned ICFR Evaluation Model, while the Internal Audit function is responsible for evaluating its performance.

In April 2013, the Audit and Control Committee was informed of the findings of the ICFRS review which directly affected 30 companies, 236 material accounting items, 483 critical processes and 160 IT systems, with a total of 7,396 (3,876 process control activities reviewed and 3,520 in IT systems general monitoring).

**Table of Contents**

2013 Financial Statements

In order to assess the status of the general controls at Telefónica, the so-called "Focused Tests" have been carried out to analyze the controls established by the Company's management which are associated with the general control environment and basically apply to the general guidelines and rules covering the entire Group. A total of 25 control objectives were reviewed in the two Telefónica Group companies listed in the US market.

Also, Self-Appraisal Questionnaires have been filled out by the employees in charge of the 256 Group companies certifying their assessment of a series of basic issues related to internal control in their area of responsibility.

F.5.2. 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 explained beforehand, the unit of Internal Audit also provides support to the Audit and Control Committee in monitoring the correct functioning of the ICFR system. The system is monitored twice a year in order to offer a preliminary assessment to help resolve any major incidences in advance by establishing the corresponding action plans for the managers in charge.

The results of the final appraisal for 2013 were presented at the February 2014 meeting of the Audit and Control Committee. No material weaknesses in the ICFR structure and procedures were identified.

Each year the External Auditor issues its own opinion on the effectiveness of ICFR. At the date of this report, the External Auditor has not notified the Audit and Control Committee of the existence of any control shortcomings which constitute significant weaknesses for 2013.

Furthermore, the External Auditor participates regularly in the Audit and Control Committee meetings, when called to do so by the Committee, to explain and clarify different aspects of the audit reports and other aspects of its work, including tasks performed to guarantee the effectiveness of the system of internal control over financial reporting.

**F.6. Other relevant information****F.7. External auditor review**

State whether:

F.7.1. The ICFR information supplied to the market has been reviewed by the external auditor, in which case the corresponding report should be attached. Otherwise, explain the reasons for the absence of this review. Otherwise, explain the reasons for the absence of this review.

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The attached information on ICFR has been submitted for review by the External Auditor, whose report is attached as an appendix to this document.

Telefónica, S.A. 190

**Table of Contents**

2013 Financial Statements

G Degree of compliance with corporate governance recommendations

**Indicate the degree of the company's compliance with Corporate Governance recommendations.**

**Should the company not comply with any of the recommendations or comply only in part, include a detailed explanation of the reasons so that shareholders, investors and the market in general have enough information to assess the company's behavior. General explanations are not acceptable.**

- 1 The bylaws of listed companies should not place an upper limit on the votes that can be cast by a single shareholder, or impose other obstacles to the takeover of the company by means of share purchases on the market.**

See sections: A.10, B.1, B.2, C.1.23 and C.1.24.

**Explain**

In accordance with Article 26 of the Corporate By-laws, no shareholder may cast a number of votes in excess of 10 percent of the total voting capital existing at any time, regardless of the number of shares held by such shareholder and in full compliance with mandatory requirements of law. In determining the maximum number of votes that each shareholder may cast, only the shares held by each such shareholder shall be computed. It does not include additional votes cast on behalf of other shareholders who may have appointed them as proxy, who are themselves likewise restricted by the 10 percent voting ceiling.

The limitation established in the preceding paragraphs shall also apply to the maximum number of votes that may be collectively or individually cast by two or more shareholder companies belonging to the same group of entities, as well as to the maximum number of votes that may be cast by an individual or corporate shareholder and the entity or entities that are shareholders themselves and which are directly or indirectly controlled by such individual or corporate shareholder.

In addition, Article 30 of the Corporate By-laws stipulates that no person may be appointed as Director unless they have held, for more than three years prior to their appointment, a number of shares of the Company representing a nominal value of at least 3,000 euros, which the Director may not transfer while in office. These requirements shall not apply to those persons who, at the time of their appointment, are related to the Company under an employment or professional relationship, or when the Board of Directors resolves to waive such requirements with the favorable vote of at least 85 percent of its members.

Article 31 of the Corporate By-laws establishes that, in order for a Director to be appointed Chairman, Vice Chairman, Chief Executive Officer or member of the Executive Commission, it shall be necessary for such Director to have served on the Board for at least the three years immediately prior to any such appointment. However, such length of service shall not be required if the appointment is made with the favorable vote of at least 85 percent of the members of the Board of Directors.

The Corporate By-laws (Article 26) restrict the number of shares that may be cast by a single shareholder or by shareholders belonging to the same group in order to achieve a suitable balance and protect the position of minority shareholders, thus avoiding a potential concentration of votes among a reduced number of shareholders, which could impact on the guiding principle that the General Shareholders Meeting must act in the interest of all the shareholders. Telefónica believes guarantees that any takeover shall require, in the interest of all shareholders, an offer for one hundred percent of the capital, because, naturally, and as taught by experience, potential offerors may make their offer conditional upon the removal of the defense mechanism.

In relation to the above and in accordance with the provisions of Article 527 of the Corporate Enterprises Act, any clauses in the By-laws of listed corporations that directly or indirectly restrict the number of shares that may be cast by a single shareholder by shareholders belonging to the same group or by any parties acting together with the aforementioned, will rendered null and void when, subsequent to a takeover bid, the buyer has a stake equal to or over 70% of share capital which confers voting rights, unless the buyer was not subject to neutralization measures to prevent a takeover bid or had not adapted these measures accordingly.

Telefónica, S.A. 191



**Table of Contents**

2013 Financial Statements

In addition, the special requirements for appointment as Director (Article 30 of the Corporate By-laws) or as Chairman, Vice Chairman, Chief Executive Officer or member of the Executive Commission (Article 31 of the Corporate By-laws) are justified by the desire that access to the management decision-making body and to the most significant positions thereon is reserved to persons who have demonstrated their commitment to the Company and who, in addition, have adequate experience as members of the Board, such that continuity of the management model adopted by the Telefónica Group may be assured in the interest of all of its shareholders and stakeholders. In any event, these special requirements may be waived by broad consensus among the members of the Board of Directors, namely, with the favorable vote of at least 85 percent of its members, as provided by the aforementioned Articles of the Corporate By-laws.

**2 When a dominant and a subsidiary company are stock market listed, the two should provide detailed disclosure on:**

- a) **The type of activity they engage in, and any business dealings between them, as well as between the subsidiary and other group companies;**
- b) **The mechanisms in place to resolve possible conflicts of interest.**

See sections: D.4 and D.7

**Not applicable**

**3 Even when not expressly required under company law, any decisions involving a fundamental corporate change should be submitted to the General Shareholders Meeting for approval or ratification. In particular:**

- a) **The transformation of listed companies into holding companies through the process of subsidiarization, i.e. reallocating core activities to subsidiaries that were previously carried out by the originating firm, even though the latter retains full control of the former;**
- b) **Any acquisition or disposal of key operating assets that would effectively alter the company's corporate purpose;**
- c) **Operations that effectively add up to the company's liquidation.**

See sections: B.6

**Complies**

- 4 Detailed proposals of the resolutions to be adopted at the General Shareholders Meeting, including the information stated in Recommendation 27, should be made available at the same time as the publication of the Meeting notice.**

**Complies**

- 5 Separate votes should be taken at the General Meeting on materially separate items, so shareholders can express their preferences in each case. This rule shall apply in particular to:**

- a) The appointment or ratification of directors, with separate voting on each candidate;**
- b) Amendments to the bylaws, with votes taken on all articles or group of articles that are materially different.**

**Complies**

Telefónica, S.A. 192

---

**Table of Contents**

2013 Financial Statements

- 6. Companies should allow split votes, so financial intermediaries acting as nominees on behalf of different clients can issue their votes according to instructions.**

**Complies**

- 7. The Board of Directors should perform its duties with unity of purpose and independent judgment, according all shareholders the same treatment. It should be guided at all times by the company's best interest and, as such, strive to maximize its value over time.**

**It should likewise ensure that the company abides by the laws and regulations in its dealings with stakeholders; fulfils its obligations and contracts in good faith; respects the customs and good practices of the sectors and territories where it does business; and upholds any additional social responsibility principles it has subscribed to voluntarily.**

**Complies**

- 8 The board should see the core components of its mission as to approve the company's strategy and authorize the organizational resources to carry it forward, and to ensure that management meets the objectives set while pursuing the company's interests and corporate purpose. As such, the board in full should reserve the right to approve:**

- a) The company's general policies and strategies, and, in particular:**

**The strategic or business plan, management targets and annual budgets;**

**Investment and financing policy;**

**Design of the structure of the corporate group;**

**Corporate governance policy;**

**Corporate social responsibility policy;**

**Remuneration and evaluation of senior officers;**

**Risk control and management, and the periodic monitoring of internal information and control systems.**

**Dividend policy, as well as the policies and limits applying to treasury stock.**

See sections: C.1.14, C.1.16 and E.2

**b) The following decisions:**

**On the proposal of the company's chief executive, the appointment and removal of senior officers, and their compensation clauses.**

**Directors' remuneration, and, in the case of executive directors, the additional consideration for their management duties and other contract conditions.**

**The financial information that all listed companies must periodically disclose.**

Telefónica, S.A. 193

---

**Table of Contents**

2013 Financial Statements

**Investments or operations considered strategic by virtue of their amount or special characteristics, unless their approval corresponds to the General Shareholders Meeting;**

**The creation or acquisition of shares in special purpose vehicles or entities resident in countries or territories considered tax havens, and any other transactions or operations of a comparable nature whose complexity might impair the transparency of the group.**

- c) **Transactions which the company conducts with directors, significant shareholders, shareholders with board representation or other persons related thereto ( related-party transactions ).**

**However, board authorization need not be required for related-party transactions that simultaneously meet the following three conditions:**

- 1. They are governed by standard form contracts applied on an across-the-board basis to a large number of clients;**
- 2. They go through at market prices, generally set by the person supplying the goods or services;**
- 3. Their amount is no more than 1% of the company's annual revenues.**

**It is advisable that related-party transactions should only be approved on the basis of a favorable report from the Audit Committee or some other committee handling the same function; and that the directors involved should neither exercise nor delegate their votes, and should withdraw from the meeting room while the board deliberates and votes.**

**Ideally the above powers should not be delegated with the exception of those mentioned in b) and c), which may be delegated to the Executive Committee in urgent cases and later ratified by the full board.**

See sections: D.1 and D.6

**Complies**

- 9 In the interests of maximum effectiveness and participation, the Board of Directors should ideally comprise no fewer than five and no more than fifteen members.**

See sections: C.1.2

**Explain**

The complexity of the Telefónica Group organizational structure, given the considerable number of companies it comprises, the variety of sectors it operates in, its multinational nature, as well as its economic and business relevance,

justify the fact that the number of members of the Board is adequate to achieve an efficient and operative operation.

In addition, it is important to bear in mind the Company's large number of Board committees, which ensures the active participation of all its Directors.

**10 External directors, proprietary and independent, should occupy an ample majority of board places, while the number of executive directors should be the minimum practical bearing in mind the complexity of the corporate group and the ownership interests they control.**

See sections: A.3 y C.1.3

**Complies**

Telefónica, S.A. 194

**Table of Contents**

2013 Financial Statements

**11 That among external directors, the relation between proprietary members and independents should match the proportion between the capital represented on the board by proprietary directors and the remainder of the company's capital.**

**This proportional criterion can be relaxed so the weight of proprietary directors is greater than would strictly correspond to the total percentage of capital they represent:**

- 1. In large cap companies where few or no equity stakes attain the legal threshold for significant shareholdings, but where there are shareholders with high absolute value shareholdings.**
- 2. In companies with a plurality of shareholders represented on the board but not otherwise related.**

See sections: A.2, A.3 y C.1.3

**Explain**

The aforementioned recommendation 11 refers to the composition of the group of External Directors. As stated in Section C.1.3 of this Annual Corporate Governance Report, at 31 December 2013, the group of External Directors of Telefónica, S.A. was composed of 14 members (of a total of 18 Members), of whom five are Proprietary Directors, eight are Independent Directors and one falls under the "Other External Directors" category.

Of the five Proprietary Directors, two act in representation of Caja de Ahorros y Pensiones de Barcelona ("la Caixa"), which holds 5.427% of the capital of Telefónica, S.A., two act in representation of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), which holds 6.893% of the capital, and one acts in representation of China Unicom (Hong Kong) Limited (China Unicom) which holds a 1.41% stake.

Applying the proportional criterion established in Article 243 of the LSC regarding the total number of directors, the stakes held by "la Caixa" and BBVA are sufficient to entitle each entity to appoint a director.

Moreover, it must be taken into account that recommendation 11 stipulates that this strict proportionality criterion can be relaxed so the weight of Proprietary Directors is greater than would strictly correspond to the total percentage of capital they represent in large cap companies where few or no equity stakes attain the legal threshold for significant shareholdings, despite the considerable sums actually invested.

In this regard, Telefónica ranks among the top listed companies on Spanish stock exchanges in terms of stock market capitalization, reaching the figure of 53,861 million euros at December 31, 2013, which means a very high absolute value of the stakes of "la Caixa" and BBVA in Telefónica (that of "la Caixa" is 2,914 million euros, and that of BBVA is 3,713 million euros). This justifies the overrepresentation of these entities on the Board of Directors, rising from one member of the board each (to which they would strictly have the right in accordance with Article 243 of the Corporate Enterprises Act) to two members, i.e. permitting the appointment of just one more Proprietary Director over the strictly legal proportion.

On January 23, 2011, China Unicom and Telefónica, S.A. expanded on their existing strategic alliance and signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their

strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. In recognition of China Unicom's stake in Telefónica, approval was given at Telefónica's General Shareholders Meeting held on May 18, 2011 for the appointment of a board member named by China Unicom.

**12 The number of independent directors should represent at least one third of all board members.**

See section: C.1.3

**Complies**

Telefónica, S.A. 195



---

**Table of Contents**

2013 Financial Statements

- 13 The nature of each director should be explained to the General Meeting of Shareholders, which will make or ratify his or her appointment. Such determination should subsequently be confirmed or reviewed in each year's Annual Corporate Governance Report, after verification by the Nomination Committee. Said Report should also disclose the reasons for the appointment of proprietary directors at the urging of shareholders controlling less than 5% of capital; and explain any rejection of a formal request for a board place from shareholders whose equity stake is equal to or greater than that of others applying successfully for a proprietary directorships.**

See sections: C.1.3 y C.1.8

**Complies**

- 14 When women directors are few or non existent, the Nomination Committee should take steps to ensure that:**

**a) The process of filling board vacancies has no implicit bias against women candidates;**

**b) The company makes a conscious effort to include women with the target profile among the candidates for board places.**

See sections: C.1.2, C.1.4, C.1.5, C.1.6, C.2.2 y C.2.4

**Explain**

In fact, the search for women who meet the necessary professional profile is a question of principle and, in this regard, it is clear that Telefónica has taken this concern on board. In this regard, it should be noted that, on January 23, 2008, the Board of Directors unanimously agreed to coopt, at the proposal of the Nominating, Compensation and Corporate Governance Committee, Ms. María Eva Castillo Sanz as an Independent Director of Telefónica. This appointment was ratified by the Ordinary General Shareholders Meeting of Telefónica held on April 22, 2008, and she was thus appointed as a Member of the Board of the Company for a term of five years. On September 17, 2012, Ms. Eva Castillo Sanz was appointed as Chairwoman of Telefónica Europe, and therefore changed from being an Independent Director to an Executive Director.

Likewise, on December 19, 2007, the Board of Directors unanimously agreed, following a favorable report from the Nominating, Compensation and Corporate Governance Committee, to appoint Ms. María Luz Medrano Aranguren as the Deputy Secretary General and Secretary of the Board of Directors of Telefónica.

Article 10.3. of the Regulations of the Board of Directors stipulates that the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that the candidates chosen are persons of recognized caliber, qualifications and experience, who are willing to devote a sufficient portion of their time to the Company, and shall take extreme care in the selection of the persons to be

appointed as Independent Directors.

Therefore, the selection procedure described above is based exclusively on the personal merits of the candidates ( recognized caliber, qualifications and experience ) and their ability to dedicate themselves to the functions of members of the board, so there is no implicit bias capable of impeding the selection of women directors, if, within the potential candidates, there are women candidates who meet the professional profile sought at each moment.

- 15 The Chairman, as the person responsible for the proper operation of the Board of Directors, should ensure that directors are supplied with sufficient information in advance of board meetings, and work to procure a good level of debate and the active involvement of all members, safeguarding their rights to freely express and adopt positions; he or she should organize and coordinate regular evaluations of the board and, where appropriate, the company s chief executive, along with the chairmen of the relevant board committees.**

See sections: C.1.19 y C.1.41

**Complies**

Telefónica, S.A. 196

**Table of Contents**

2013 Financial Statements

**16 When a company's Chairman is also its chief executive, an independent director should be empowered to request the calling of board meetings or the inclusion of new business on the agenda; to coordinate and give voice to the concerns of external directors; and to lead the board's evaluation of the Chairman.**

See sections: C.1.22

**Complies**

**17 The Secretary should take care to ensure that the board's actions:**

**a) Adhere to the spirit and letter of laws and their implementing regulations, including those issued by regulatory agencies;**

**b) Comply with the company bylaws and the regulations of the General Shareholders' Meeting, the Board of Directors and others;**

**c) Are informed by those good governance recommendations of the Unified Code that the company has subscribed to.**

**In order to safeguard the independence, impartiality and professionalism of the Secretary, his or her appointment and removal should be proposed by the Nomination Committee and approved by a full board meeting; the relevant appointment and removal procedures being spelled out in the board's regulations.**

See section: C.1.34

**Complies**

**18 The board should meet with the necessary frequency to properly perform its functions, in accordance with a calendar and agendas set at the beginning of the year, to which each director may propose the addition of other items.**

See sections: C.1.29

**Complies**

**Director absences should be kept to the bare minimum and quantified in the Annual Corporate Governance Report. When directors have no choice but to delegate their vote, they should do so with instructions.**

See sections: C.1.28, C.1.29 y C.1.30

**Complies**

Telefónica, S.A. 197

**Table of Contents**

2013 Financial Statements

- 20 When directors or the Secretary express concerns about some proposal or, in the case of directors, about the company's performance, and such concerns are not resolved at the meeting, the person expressing them can request that they be recorded in the minute book.**

**Complies**

- 21 The board in full should evaluate the following points on a yearly basis:**

**a) The quality and efficiency of the board's operation;**

**b) Starting from a report submitted by the Nomination Committee, how well the Chairman and chief executive have carried out their duties;**

**c) The performance of its committees on the basis of the reports furnished by the same.**

See sections: C.1.19 y C.1.20

**Complies**

- 22 All directors should be able to exercise their right to receive any additional information they require on matters within the board's competence. Unless the bylaws or board regulations indicate otherwise, such requests should be addressed to the Chairman or Secretary.**

See sections: C.1.41

**Complies**

- 23 All directors should be entitled to call on the company for the advice and guidance they need to carry out their duties. The company should provide suitable channels for the exercise of this right, extending in special circumstances to external assistance at the company's expense.**

See sections: C.1.40

**Complies**

**Companies should organize induction programs for new directors to acquaint them rapidly with the workings of the company and its corporate governance rules. Directors should also be offered refresher programs when circumstances so advise.**

**Complies**

**25 Companies should require their directors to devote sufficient time and effort to perform their duties effectively, and, as such:**

**a) Directors should apprise the Nomination Committee of any other professional obligations, in case they might detract from the necessary dedication;**

**b) Companies should lay down rules about the number of directorships their board members can hold.**

See sections: C.1.12, C.1.13 and C.1.17

**Complies**

Telefónica, S.A. 198

---

**Table of Contents**

2013 Financial Statements

**26 The proposal for the appointment or renewal of directors which the board submits to the General Shareholders Meeting, as well as provisional appointments by the method of co-option, should be approved by the board:**

**a) On the proposal of the Nomination Committee, in the case of independent directors.**

**b) Subject to a report from the Nomination Committee in all other cases.**

See sections: C.1.3

**Complies**

**27 Companies should post the following director particulars on their websites, and keep them permanently updated:**

**a) Professional experience and background;**

**b) Directorships held in other companies, listed or otherwise;**

**c) An indication of the director's classification as executive, proprietary or independent; In the case of proprietary directors, stating the shareholder they represent or have links with.**

**d) The date of their first and subsequent appointments as a company director; and**

**e) Shares held in the company and any options on the same.**

**Complies**

**28 Proprietary directors should resign when the shareholders they represent dispose of their ownership interest in its entirety. If such shareholders reduce their stakes, thereby losing some of their entitlement to proprietary directors, the latter's number should be reduced accordingly.**

See sections: A.2, A.3 and C.1.2

**Complies**

**29 The Board of Directors should not propose the removal of independent directors before the expiry of their tenure as mandated by the bylaws, except where just cause is found by the board, based on a proposal from the Nomination Committee. In particular, just cause will be presumed when a director is in breach of his or her fiduciary duties or comes under one of the disqualifying grounds enumerated in Ministerial Order ECC/461/2013.**

**The removal of independents may also be proposed when a takeover bid, merger or similar corporate operation produces changes in the company's capital structure, in order to meet the proportionality criterion set out in Recommendation 11.**

See sections: C.1.2, C.1.9, C.1.19 and C.1.27

**Complies**

Telefónica, S.A. 199



---

**Table of Contents**

2013 Financial Statements

- 30 Companies should establish rules obliging directors to inform the board of any circumstance that might harm the organization's name or reputation, tendering their resignation as the case may be, with particular mention of any criminal charges brought against them and the progress of any subsequent trial.**

**The moment a director is indicted or tried for any of the crimes stated in article 213 of the Public Limited Companies Act, the board should examine the matter and, in view of the particular circumstances and potential harm to the company's name and reputation, decide whether or not he or she should be called on to resign. The board should also disclose all such determinations in the Annual Corporate Governance Report.**

See sections: C.1.42, C.1.43

**Complies**

- 31 All directors should express clear opposition when they feel a proposal submitted for the board's approval might damage the corporate interest. In particular, independents and other directors unaffected by the conflict of interest should challenge any decision that could go against the interests of shareholders lacking board representation.**

**When the board makes material or reiterated decisions about which a director has expressed serious reservations, then he or she must draw the pertinent conclusions. Directors resigning for such causes should set out their reasons in the letter referred to in the next Recommendation.**

**This terms of this Recommendation should also apply to the Secretary of the board, director or otherwise.**

**Complies**

- 32 Directors who give up their place before their tenure expires, through resignation or otherwise, should state their reasons in a letter to be sent to all members of the board. Irrespective of whether such resignation is filed as a significant event, the motive for the same must be explained in the Annual Corporate Governance Report.**

See sections: C.1.19

**Not applicable**

- 33 Remuneration comprising the delivery of shares in the company or other companies in the group, share options or other share-based instruments, payments linked to the company's performance or membership of pension schemes should be confined to executive directors.**

**The delivery of shares is excluded from this limitation when directors are obliged to retain them until the end of their tenure.**

**Complies**

Telefónica, S.A. 200

---

**Table of Contents**

2013 Financial Statements

- 34 External directors remuneration should sufficiently compensate them for the dedication, abilities and responsibilities that the post entails, but should not be so high as to compromise their independence.**

**Complies**

- 35 In the case of remuneration linked to company earnings, deductions should be computed for any qualifications stated in the external auditor s report.**

**Not applicable**

- 36 In the case of variable awards, remuneration policies should include technical safeguards to ensure they reflect the professional performance of the beneficiaries and not simply the general progress of the markets or the company s sector, atypical or exceptional transactions or circumstances of this kind.**

**Complies**

- 37 When the company has an Executive Committee, the breakdown of its members by director category should be similar to that of the board itself. The Secretary of the board should also act as secretary to the Executive Committee.**

See sections: C.2.1 and C.2.6.

**Complies**

- 38 The board should be kept fully informed of the business transacted and decisions made by the Executive Committee. To this end, all board members should receive a copy of the Committee s minutes.**

**Complies**

- 39 In addition to the Audit Committee mandatory under the Securities Market Act, the Board of Directors should form a committee, or two separate committees, of Nomination and Remuneration. The rules governing the make-up and operation of the Audit Committee and the committee or committees of Nomination and Remuneration should be set forth in the board regulations, and include the following:**

**a) The Board of Directors should appoint the members of such committees with regard to the knowledge, aptitudes and experience of its directors and the terms of reference of each committee; discuss their proposals and reports; and be responsible for overseeing and evaluating their work, which should be reported to the first**

**board plenary following each meeting;**

**b) These committees should be formed exclusively of external directors and have a minimum of three members. Executive directors or senior officers may also attend meetings, for information purposes, at the Committees invitation.**

**c) Committees should be chaired by an independent director.**

**d) They may engage external advisors, when they feel this is necessary for the discharge of their duties.**

**e) Meeting proceedings should be minuted and a copy of the minutes sent to all board members.**

See sections: C.2.1 and C.2.4

**Complies**

Telefónica, S.A. 201

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**Table of Contents**

2013 Financial Statements

- 40 The job of supervising compliance with internal codes of conduct and corporate governance rules should be entrusted to the Audit Committee, the Nomination Committee or, as the case may be, separate Compliance or Corporate Governance committees.**

See sections: C.2.3 and C.2.4

**Complies**

- 41 All members of the Audit Committee, particularly its chairman, should be appointed with regard to their knowledge and background in accounting, auditing and risk management matters.**

**Complies**

- 42 Listed companies should have an internal audit function, under the supervision of the Audit Committee, to ensure the proper operation of internal reporting and control systems.**

See sections: C.2.3

**Complies**

- 43 The head of internal audit should present an annual work program to the Audit Committee, report to it directly on any incidents arising during its implementation, and submit an activities report at the end of each year.**

**Complies**

- 44 Control and risk management policy should specify at least:**

**a) The different types of risk (operational, technological, financial, legal, reputational, ) the company is exposed to, with the inclusion under financial or economic risks of contingent liabilities and other off-balance sheet risks;**

**b) The determination of the risk level the company sees as acceptable;**

**c) Measures in place to mitigate the impact of risk events should they occur;**

**d) The internal reporting and control systems to be used to control and manage the above risks, including contingent liabilities and off-balance sheet risks.**

See section: E

**Complies**

**45 The Audit Committee's role should be:**

**1<sup>st</sup>. With respect to internal control and reporting systems:**

**a) Review internal control and risk management systems on a regular basis, so the main risks are properly identified, managed and disclosed.**

Telefónica, S.A. 202

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**Table of Contents**

2013 Financial Statements

**b) Monitor the independence and efficacy of the internal audit function; propose the selection, appointment, reappointment and removal of the head of internal audit; propose the department's budget; receive regular report-backs on its activities; and verify that senior management are acting on the findings and recommendations of its reports.**

**c) Establish and supervise a mechanism whereby staff can report, confidentially and, if necessary, anonymously, any irregularities they detect in the course of their duties, in particular financial or accounting irregularities, with potentially serious implications for the firm.**

**2<sup>nd</sup>. With respect of the external auditor:**

**a) Receive regular information from the external auditor on the progress and findings of the audit programme, and check that senior management are acting on its recommendations.**

**b) Monitor the independence of the external auditor, to which end:**

**i. The company should notify any change of auditor to the CNMV as a significant event, accompanied by a statement of any disagreements arising with the outgoing auditor and the reasons for the same.**

**ii. The Audit Committee will investigate the issues giving rise to the resignation of any external auditor.**

See sections: C.1.36, C.2.3, C.2.4 and E.2

**Complies**

**46 The Audit Committee should be empowered to meet with any company employee or manager, even ordering their appearance without the presence of another senior officer.**

**Complies**

**47 The Audit Committee should prepare information on the following points from Recommendation 8 for input to board decision-making:**

**a) The financial information that all listed companies must periodically disclose. The Committee should ensure that interim statements are drawn up under the same accounting principles as the annual statements and, to this end, may ask the external auditor to conduct a limited review.**

**b) The creation or acquisition of shares in special purpose vehicles or entities resident in countries or territories considered tax havens, and any other transactions or operations of a comparable nature whose complexity might impair the transparency of the group.**

**c) Related-party transactions, except where their scrutiny has been entrusted to some other supervision and control committee.**

See sections: C.2.3 and C.2.4

**Complies**

Telefónica, S.A. 203



---

**Table of Contents**

2013 Financial Statements

**48 The Board of Directors should seek to present the annual accounts to the General Shareholders Meeting without reservations or qualifications in the audit report. Should such reservations or qualifications exist, both the Chairman of the Audit Committee and the auditors should give a clear account to shareholders of their scope and content.**

See section: C.1.38

**Complies**

**49 The majority of Nomination Committee members or Nomination and Remuneration Committee members as the case may be should be independent directors.**

See sections: C.2.1

**Complies**

**50. The Remuneration Committee should have the following functions in addition to those stated in earlier recommendations:**

**a) Evaluate the balance of skills, knowledge and experience on the board, define the roles and capabilities required of the candidates to fill each vacancy, and decide the time and dedication necessary for them to properly perform their duties.**

**b) Examine or organize, in appropriate form, the succession of the chairman and chief executive, making recommendations to the board so the handover proceeds in a planned and orderly manner.**

**c) Report on the senior officer appointments and removals which the chief executive proposes to the board.**

**d) Report to the board on the gender diversity issues discussed in Recommendation 14 of this Code.**

See section: C.2.4

**Complies**

**51. The Nomination Committee should consult with the company's Chairman and chief executive, especially on matters relating to executive directors.**

**Any board member may suggest directorship candidates to the Nomination Committee for its consideration.**

**Complies**



**Table of Contents**

2013 Financial Statements

**52. The Remuneration Committee should have the following functions in addition to those stated in earlier recommendations:**

**a) Make proposals to the Board of Directors regarding:**

**i. The remuneration policy for directors and senior officers;**

**ii. The individual remuneration and other contractual conditions of executive directors.**

**iii. The standard conditions for senior officer employment contracts.**

**b) Oversee compliance with the remuneration policy set by the company.**

See section: C.2.4

**Complies**

**53. The Remuneration Committee should consult with the Chairman and chief executive, especially on matters relating to executive directors and senior officers.**

**Complies**

Telefónica, S.A. 205

**Table of Contents**

2013 Financial Statements

H Other information of interest

- i) **If you consider that there is any material aspect or principle relating to the Corporate Governance practices followed by your company that has not been addressed in this report and which is necessary to provide a more comprehensive view of the corporate governance structure and practices at the company or group, explain briefly.**

- ii) **You may include in this Section any other information, clarification or observation related to the above Sections of this report.**

**Specifically indicate whether the company is subject to corporate governance legislation from a country other than Spain and, if so, include the compulsory information to be provided when different to that required by this report.**

- iii) **The company may also state whether it voluntarily subscribes to other international, sectorial or other ethical principles or standard practices. If applicable identify the Code and date of adoption.**

GENERAL CLARIFICATION: It is hereby stated that the details contained in this report refer to the financial year ended on December 31, 2013, except in those issues in which a different date of reference is specifically mentioned.

**- Note 1 to Section A.3]**

It should be noted that the Company has an Internal Code of Conduct for Securities Markets Issues setting out, among other issues, the general operating principles for Directors and senior executives when carrying out personal trades involving securities issued by Telefónica, S.A. and financial instruments and contracts whose underlying securities or instruments are issued by the Company.

The general operating principles of this Internal Code of Conduct include transactions subject to notification, action limitations as well as the minimum holding period when acquiring securities in the Company, during which time these may not be transferred, except in the event of extraordinary situations that justify their transfer, subject to authorization by the Regulatory Compliance Committee.

**- Note 2 to Section A.3]**

On September 16, 2011, the Executive Chairman of the Company, Mr. César Alierta Izuel, notified the CNMV of the purchase of 100,000 call options granting the right to acquire 10 million shares of Telefónica, S.A. up to the maturity date on June 20, 2014, with an exercise price of 18 euros.

At the General Shareholders Meeting of Telefónica, S.A. on May 18, 2011, its shareholders approved the introduction of a long-term incentive plan for managers and senior executives of the Group (including Executive Directors) known as the Performance & Investment Plan ( PIP ). Under this plan, participants who met the qualifying requirements were awarded a certain number of Telefónica, S.A. shares as a form of variable compensation. Said General Shareholders Meeting approved the maximum number of shares to be awarded to Executive Directors subject to their meeting the Co-Investment requirement established in the Plan and the maximum target total shareholder return (TSR) established for each phase.

In accordance with the above, the amounts appearing in Section A.3. of this report under Number of direct options and Equivalent number of shares (i.e. Mr. César Alierta Izuel, 898,334-1,403,647; Mr. Julio Linares López, 163,828-255,983; Mr. José María Álvarez-Pallete López, 459,650-658,204; Ms. Eva Castillo Sanz, 199,864-312,287; and Mr. Santiago Fernández Valbuena, 286,742-448,036) relate to the theoretical number of shares assigned and the maximum possible number of shares to be received in the first, second and third phase if the co-investment requirement established in the Plan and the maximum target TSR established for each phase are met.

Telefónica, S.A. 206

**Table of Contents**

2013 Financial Statements

**- Note 3 to Section A.5.]**

The company Telefónica Consumer Finance, Establecimiento Financiero de Crédito, S.A. was incorporated in January 2013, the shareholders of which are Finconsum, Establecimiento Financiero de Crédito, S.A.U. (a Caja de Ahorros y Pensiones de Barcelona, la Caixa, Group company) and Telefónica, S.A.

**- Nota 4 to Section A.8.]**

**Gain/(loss) on treasury shares sold during the year (thousands of euros)**

44,738

**- Note 5 to Section C.1.3]**

On June 26, 2013, the Board of Directors resolved to change the status of the director Mr. José Fernando de Almansa Moreno-Barreda from Other External Director to Independent Director.

Mr. José Fernando de Almansa Moreno-Barreda was appointed as a Director of Telefónica, S.A. on February 26, 2003, as an Independent Director. In 2007 he became an Other External Director on publication of the so-called Conthe Code, since he was a CEO of the Mexican company Servicios Externos de Apoyo Empresarial, S.A. de C.V., and a director of BBVA Bancomer México, S.A. de C.V., both of which belong to the BBVA Group.

In 2008, Mr. Almansa stood down as the said CEO. Consequently, five years after resigning as CEO of the Mexican company Servicios Externos de Apoyo Empresarial, S.A. de C.V., (he continues to hold the post of Substitute Independent Director with no executive duties in BBVA Bancomer México, S.A. de C.V.), Mr. Almansa director's status changed to Independent Director.

On February 26, 2013, the Director Ms. Eva Castillo, resign in the performance of her executive role as Telefónica Europe Chairwoman, changing its status of Executive Director to Other External Director.

Also, on February 26, 2014, the Director Mr. Santiago Fernández Valbuena was appointed Strategy General Director, resigning as Telefónica Latin America Chairman.

**- Note 6 to Section C.1.11]**

On January 29, 2014, the director Ms. Eva Castillo Sanz stood down as Chairwoman of the Supervisory Board of Telefónica Czech Republic, a.s.

**- Note 7 to Section C.1.12]**

Until December 13, 2013, Mr. César Alierta Izuel and Mr. Julio Linares López were Directors of Telecom Italia, S.p.A.

**- Note 8 to Section C.1.14]**

Although the investment and financing policy is not included literally in Article 5.4. of the Regulations of the Board of Directors, in practice said policy is the exclusive competency of the Board of Directors of the Company.

Telefónica, S.A. 207

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**Table of Contents**

2013 Financial Statements

**- Note 9 to Section C.1.31]**

In accordance with US securities market regulations, the information contained in the Annual Report on form 20-F (which includes the Consolidated Annual Accounts of the Telefónica Group), filed with the Securities and Exchange Commission, is certified by the Executive Chairman of the Company and by the CFO. This certification is made after the Financial Statements have been prepared by the Board of Directors of the Company.

**- Note 10 to Section C.1.39]**

Financial year 1983 was the first audited by an External Auditor. Prior to that, the financial statements were revised by chartered accountants (*censores de cuentas*). Therefore, 1983 is the base year taken for calculating the percentage in the case of audits of the Individual Annual Accounts of Telefónica, S.A., while 1991 is the date taken for the calculation of the percentage in the case of the Consolidated Annual Accounts, as 1991 was the first year in which the Telefónica Group prepared Consolidated Annual Accounts.

**- Note 11 to Section C.2.1]**

In its meeting on May 31, 2013, the Board of Directors resolved on the recommendation of the Nominating, Compensation and Corporate Governance Committee to disband the International Affairs Committee and Human Resources, Corporate Reputation and Corporate Responsibility Committee, and establish a new Board of Directors advisory committee – the Institutional Affairs Committee.

**- Note 12 to Section D.2]**

The transactions included under Other Transactions in amounts of 12,268,365 euros and 1,083,569 euros with Banco Bilbao Vizcaya Argentaria, S.A. and 1,199,868 euros with Caja de Ahorros y Pensiones de Barcelona, la Caixa, entail transactions with derivatives.

Telefónica, S.A. 208



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**Table of Contents**

2013 Financial Statements

**- Note 13 to Section E.3]****Risks and uncertainties facing the Company**

The Telefónica Group's business is conditioned by a series of intrinsic risk factors that affect exclusively the Group, as well as a series of external factors that are common to businesses of the same sector. The main risks and uncertainties facing the Company which could affect its business, financial position, reputation, corporate image and brand and its results, must be considered jointly with the information in the financial statements of 2013, and are as follows:

**Group-related risks****Worsening of the economic and political environment could negatively affect business.**

Telefónica's international presence enables the diversification of its activities across countries and regions, but entails the need of considering various legislations, as well as the political and economic environments of the countries in which it operates. Any adverse developments or even just uncertainties in this regard, or possible exchange-rate or sovereign-risk fluctuations may adversely affect the business, financial position, cash flows and/or the performance of some of the Group's economic and financial parameters.

With respect to the economic environment, the Telefónica Group's business is impacted by overall economic conditions in each of the countries in which it operates. Economic conditions may adversely affect the level of demand of existing and prospective customers, as they may no longer deem critical the services offered by the Group. The main macroeconomic factors that could have an adverse impact on consumption and, accordingly, on the level of demand for our services and finally, on Telefónica Group's results, are: the shortage of credit in an environment of adjustment of banks' balance sheets; the evolution of the labor market; the worsening of consumer confidence, with an increase in saving rates as an immediate consequence; or the needs for greater fiscal adjustment, which would negatively impact on the household income levels and corporate investments, expenses and revenues.

This economic risk might be significant in some European countries which are on the road to recovery but are rebounding more slowly due to financial imbalances that must continue to be corrected. According to the European Economic and Financial Affairs Council, the European economy is expected to have shrunk by -0.4% in 2013 and will only grow 1.1% in 2014, assuming, therefore, that private consumption growth may be weak in certain cases. In this region, Telefónica Group generated 47% of the Group's total revenues in 2013 (including 22.7% in Spain, 11.7% in the UK and 8.6% in Germany).

Also, the impact of the sovereign debt crisis and the rating downgrades in certain Euro Area countries should be taken into account. Any additional deterioration in the sovereign debt markets, doubts about developments in European projects (e.g. implementation of the banking union project, the results of the European elections or progress towards fiscal integration), as well as further credit restrictions by the banking sector could have an adverse effect on the Telefónica's ability to access funding and/or liquidity which could have a significant adverse effect on the Group's businesses, financial position, results of operations and cash flows. In addition, the Group's business may be affected by other possible effects from the economic crisis, including a possible insolvency of key customers and suppliers.

In Latin America, the most important challenge is the exchange-rate risk in Venezuela and Argentina (with a sustained accelerated depreciation of the peso against the dollar), given the negative impact that a higher than expected depreciation in their currencies could have on cash flows from both countries. The economic outlook for the entire region suggests that growth rates will remain stable at around 3%, supported by solid domestic demand fundamentals. International scene, despite being not so favorable as in the past periods, it will remain to have a relatively benign impact on the region, except for potential periods of volatility linked to the evolution of the developed financial markets (especially long-term interest rates in the United States affected by the U.S. Federal Reserve's intervention that are not discounted in the market), a greater than envisaged economic slowdown in Asia (a key region for Latin America), and the slow progress being made with structural reforms projects in the majority of these countries which limits potentially higher growth rates. The most significant internal macroeconomic risk factors in the region would be the very high inflation rates in Venezuela and Argentina that could lead to economic stagnation in these countries, the delicate situation of Venezuela's public finance, and the deterioration in the external accounts of countries such as Argentina, Brazil, Chile and Peru; though with very different funding outlooks for the latter three (favorable) than the first.

Telefónica, S.A. 209

Table of Contents

2013 Financial Statements

In relation to the political environment, the Group's investments and operations in Latin America could be affected by a series of risks related to economic, political and social factors in these countries, collectively denominated country risk. On this point, approximately 15% of our revenues in the telephony business are generated in countries that do not have investment grade status (in order of importance Venezuela, Argentina, Ecuador, Guatemala, Nicaragua, El Salvador and Costa Rica), and other countries are only one notch away from losing this threshold. Also note that despite clear improvements in Brazil, recent announcements by the ratings agencies considering a possible downgrading of its credit rating could, depending on the extent of the downgrading, result in strong exchange-rate volatility due to an outflow of investments, especially strong in fixed-income.

Among the factors included in the concept of country risk, we highlight:

government regulation or administrative policies may change unexpectedly, including changes that modify the terms and conditions of licenses and concessions and their renewal (or delay their approvals) which could negatively affect the Group's interests in such countries;

abrupt exchange-rate fluctuations mainly due to situations of high levels of inflation and twin deficits (in public finance and external sector) with the resulting exchange-rate overvaluation. This movement could lead to a strong exchange-rate depreciation in the context of a floating exchange rate regime, to a significant devaluation off the back of abandoning fixed exchange rates regimes, or to the introduction of varying degrees of restrictions on capital movement. For example, in Venezuela, the official U.S. Dollar to Bolivar fuerte exchange rate is established by the Central Bank of Venezuela and the Minister of Finance, with an alternative market for attracting foreign currency through SICAD's fortnightly auctions. Additionally, the acquisition of foreign currencies by Venezuelan or Argentinian companies (in some cases) to pay foreign debt or dividends is subject to the pre-authorization of the relevant authorities. Also, the Argentinean peso is following a sustained accelerated depreciation against the U.S. dollar;

governments may expropriate or nationalize assets, or make adverse tax decisions, or increase their participation in the economy and in companies;

economic-financial downturns, political instability and civil disturbances may negatively affect the Telefónica Group's operations in such countries; and

maximum profit margins limits may be imposed in order to limit the prices of goods and services through the analysis of cost structures. Thus, in Venezuela, a maximum profit margin has been introduced that will be set annually by the Superintendence for the defense of socio-economic rights.

**The Group's financial condition and results of operations may be adversely affected if it does not effectively manage its exposure to foreign currency exchange rates, interest rates or financial investment risks.**

At December 31, 2013, 71% of the Group's net debt (in nominal terms) had its interest rates fixed over a year, while 23% was denominated in a currency other than the euro.

To illustrate the sensitivity of financial expenses to a change in short-term interest rates at December 31, 2013: (i) a 100 basis points increase in interest rates in all currencies in which Telefónica has a financial position at that date would lead to an increase in financial expenses of 118 million euros, (ii) whereas a 100 basis points decrease in interest rates in all currencies except the euro, dollar and the pound sterling (these to zero rates in order to avoid negative rates), would lead to a reduction in financial expenses of 55 million euros. These calculations were made assuming a constant currency and balance position equivalent to the position at that date and bearing in mind the derivative financial instruments arranged.

According to the Group's calculations, the impact on results and specifically changes in the value of a 10% depreciation of Latin American currencies against the U.S. dollar and a 10% depreciation of the rest of the currencies against the euro would result in exchange losses of 42 million euros, primarily due to the weakening of the Venezuelan bolivar and, to a lesser extent, the Argentinean peso. These calculations had been made assuming a constant currency position with an impact on profit or loss at December 31, 2013 including derivative instruments in place.

The Telefónica Group uses a variety of strategies to manage this risk, mainly through the use of financial derivatives, which themselves are also exposed to risk, including counterparty risk. Furthermore, the Group's risk management strategies may not achieve the desired effect, which could adversely affect the Group's business, financial condition, results of operations and cash flows.

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**Table of Contents**

2013 Financial Statements

**Existing or worsening conditions in the financial markets may limit the Group's ability to finance, and consequently, the ability to carry out its business plan.**

The performance, expansion and improvement of the Telefónica Group's networks, the development and distribution of the Telefónica Group's services and products, the development and implementation of the Company's strategic plan, as well as the development and implementation of new technologies or the renewal of licenses require a substantial amount of financing.

The performance of financial markets in terms of liquidity, cost of credit, access and volatility, continues to be overshadowed by persisting uncertainty regarding certain factors such as the pace of economic recovery, the health of the international banking system and the concerns regarding the burgeoning deficits of some European countries. The worsening international financial market credit conditions caused by some of these factors could make it more difficult and more expensive to refinance existing financial debt or arrange new debt if necessary, and more difficult and costly to raise funds from our shareholders, and may negatively affect the Group's liquidity. At December 31, 2013, gross financial debt scheduled to mature in 2014 amounted to 9,214 million euros (which includes: (i) the net position of derivative financial instruments, certain current payables and (ii) 582 million euros of notes with an option of early repayment and no contractual obligation to be repaid), and gross financial debt scheduled to mature in 2015 amounted to 6,802 million euros. Despite having covered gross debt maturities of 2014 and 2015 by available cash and lines of credit at December 31, 2013, possible difficulties to maintain the current safety margin, or the risk that this could be significantly and unexpectedly exhausted, could force Telefónica to use resources allocated for other investments or commitments for payment of its financial debt, which could have a negative effect on the Group's businesses, financial position, results of operations or cash flows.

Although the Group maintains liquidity coverage on 24-month maturities, obtaining financing on the international capital markets could also be restricted, in terms of access and cost, if Telefónica's credit ratings are revised downwards, either due to lower solvency or operating performance, or as a result of a downgrade in the rating for Spanish sovereign risk by rating agencies. Any of these situations could have a negative impact on our ability to deal with our debt maturities.

Moreover, market conditions could make it harder to renew existing undrawn credit lines, 10% of which, at December 31, 2013, initially mature prior to December 31, 2014.

**Risks related to the Group's industry****The Group operates in a highly regulated industry which requires government concessions for the provision of a large part of its services and the use of spectrum, which is a scarce and costly resource.**

The telecommunications sector is subject to laws and regulations in different countries, and additionally, many of the services provided require the granting of a license, concession or official approval, which usually requires certain obligations and investments to be made, such as those relating to spectrum availability. Among the main risks of this nature are the spectrum and licenses/concessions, rates, universal service regulation, fiber networks, privacy, functional separation of businesses and network neutrality.

Thus, as the Group provides most of its services under licenses, authorizations or concessions, it is vulnerable to administrative bodies decisions, such as economic fines for serious breaches in the provision of services and, eventually, revocation or failure to renew these licenses, authorizations or concessions or the granting of new licenses to competitors for the provisions of services in a specific market.

The Telefónica Group pursues its license renewal in the terms referred in their respective contractual conditions, though it cannot guarantee that it will always complete this process successfully or under the most beneficial terms for the Group. In many cases complying with certain obligations is required, including, among others, minimum specified quality standards, service and coverage conditions and capital investment. Failure to comply with these obligations could result in the imposition of fines, revision of the contractual terms, or even the revocation of the license, authorization or concession. Additionally, the Telefónica Group could be affected by regulatory actions carried out by antitrust or competition authorities. These authorizations could prohibit certain actions, such as new acquisitions or specific practices, create obligations or lead to heavy fines. Any such measures implemented by the competition authorities could result in economic and/or reputational loss for the Group, in addition to a loss of market share and/or in harm to the future growth of certain businesses.

Telefónica, S.A. 211

---

**Table of Contents**

2013 Financial Statements

*Regulation of spectrum and government concessions:*

The Digital Single Market packaged of measures is currently being amended by the European Parliament to include important measures affecting, *inter alia*, spectrum regulation. Although these measures are not yet final, they could have significant implications as they include new provisions on secondary markets, criteria to apply at auctions, renewals and terms of licensees, etc.

In 2015/2016, in Germany, it is expected that frequencies in the 900/1800 MHz band licenses, expiring at the end of 2016, will be renewed. The German regulator has adopted a proposal decision envisaging an auction of spectrum in the 900 MHz, 1800 MHz, 700 MHz and 1500 MHz bands. Furthermore, it is proposed, for operators holding 900 MHz GSM band licenses, the reservation of 2X5 MHz in this band. Aforementioned reservation entails a 99% population coverage obligation. Moreover, European and National regulators are reviewing the implications of the merger of Telefónica Germany and E-Plus, and any potential remedies or conditions. Remedies could affect the spectrum finally available. In Spain, it is expected that the previously auctioned frequencies in the 800 MHz band from the digital dividend, will be allocated on January 1, 2015. For its part, in the UK a tax rate increase for the use of the spectrum in 900 and 1800 MHz band is under discussion, the outcome is uncertain.

Main allocation criteria for the 700 MHz band (Digital Dividend II) will be defined in coming years in Europe. This could involve facing new cash outflow ahead of schedule (most likely scenario is currently seen as to have this spectrum between 2018 and 2021).

In Latin America, spectrum auctions will take place entailing potential outflows to obtain new licenses or to meet the coverage requirements associated with these licenses. Specifically, the following procedures are in progress or expected to take place in 2014:

1. Brazil. Auction of the 700 MHz band. Allocation of frequencies in the 700 MHz band for fixed-line and mobile telephone and broadband services has being approved. However, the allocation process requires television channels currently occupying this band to be migrated and Anatel to complete its analysis regarding spectrum interference between mobile and television services.
2. Chile. Auction of the 700 MHz band.
3. Ecuador. Negotiations underway to obtain additional frequencies in the 1900 MHz band.
4. El Salvador. The auction of one block in the 1900 MHz band and another in the AWS band had been postponed, although this issue might be resolved in the coming months.

5. Venezuela. Auction in the AWS band (1710-2170 MHz frequencies) and in the 2.5 GHz band, has been suspended.

On the other hand, negotiations to renew 850 MHz/1900 MHz licenses in Colombia (where a legal action regarding the reversion of assets at the end of the license terms is in place) and 850/1900 MHz licenses in Panama are under way. In Peru, an application for partial renewal of the concessions for the provision of the fixed-line service for another five years has been made, although assurance has been given that the concession will remain in force until November 2027. Also, a new law has also been enacted establishing mobile virtual network operator (MVNOs) and Rural Mobile Infrastructure Operators (RMIOs) in the Peruvian market. In Mexico, it is envisaged, in development of the constitutional reform enacted due to the Pact for Mexico political initiative, the creation of a wholesale network publicly owned which will offer wholesale services in the 700 MHz band, the funding and the marketing model of this project have not been determined at present

On the other hand, Telefónica UK was awarded two 10 MHz blocks of spectrum in the 800 MHz band in 2013 to roll out a national 4G network. In Spain, the following license extensions have been granted: in the 900 MHz band, 4 MHz from July 2025 to December 2030 and 1 MHz from February 2015 to December 2030, likewise, in the 1800 MHz band a 20 MHz license has been extended from 2028 to December 2030. Moreover, in 2013, Telefónica also obtained spectrum licenses in Uruguay (2x5 MHz in the 1900 MHz band), Colombia (30 MHz in the AWS band) and Peru (20+20 MHz in the 1700 MHz band). In 2013 Telefónica Brazil requested the amendment of the Terms of its Authorization for the L band in order to relocate the blocks of radiofrequencies. Currently, the L band is located in the 3G radiofrequencies (1.9/2.1GHz). The notice of the L band provided for such relocation and the request ensured a more efficient use of the spectrum for Telefónica Brazil. CAPEX associated with the new spectrum in 2013 amounted to 1,224 million euros.



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**Table of Contents**

2013 Financial Statements

In 2012, Telefónica Ireland was awarded spectrum in the 800, 900 and 1800 MHz bands. In Brazil, Telefónica was awarded a block of the 2500 MHz X band (20+20 MHz), including the 450 MHz band in certain states. In the spectrum auction, Telefónica Brazil had to compensate the former licensees of this bandwidth, used for multichannel multipoint distribution services. The other operators also awarded spectrum shall, in turn, compensate Telefónica Brazil. Part of these compensation requirements is being legally contested. In Venezuela, the concession agreement between Telefónica Venezolana and the Regulator for an additional 20 MHz in the 1900 MHz band was executed. Telefónica Móviles Chile, S.A. was awarded radiofrequencies for 4G technology in the 2.6 GHz band (2x20 MHz), and in Nicaragua Telefónica was granted 36 MHz in the 700 MHz band.

The Company's failure to obtain sufficient or appropriate spectrum capacity in the jurisdictions discussed above or any others in which it operates or its capacity to assume the related costs, could have an adverse impact its ability to launch and provide new services and on the Company's ability to maintain the quality of existing services, which may adversely affect the Group's financial condition, results of operations and cash flows.

*Regulation of wholesale and retail charges:*

In terms of roaming, the regulated Eurotariffs will be reduced in July 2014, as per the Regulation approved in 2012. The structural roaming solutions which could lead to a price decrease in the intra-european roaming services, will also take effect in July 2014. Furthermore, the packet of Digital Single Market measures mentioned above also includes a proposal to eliminate European Union roaming charges in July 2016 as well as international charges.

The decreases in wholesale mobile network termination rates in Europe are also noteworthy. In the UK, wholesale mobile network termination rates will be reduced to 0.845 pence/minute from April 1, 2014 (representing a 0.3% reduction compared to the current rates), while the termination rate in Germany was set at 0.0179 euro/minute as from December 31, 2013 (3.24% lower than the previous termination rates). The European Commission has requested that the German regulator withdraw or amend its latest decision on mobile termination rates. There is a risk that the European Commission will initiate infringement proceedings, against Germany, and rates may be further reduced. In Spain, the schedule for reducing mobile network termination rates has reached the target rate (0.0109 euro/minute) in July 2013, representing close to 61% lower than the wholesale prices in force until that date. As from July 2013, the target price reached will remain in force until new target prices are set. The Spanish regulator has yet to make its decision on this matter. Based on a High Court ruling in Ireland, a mobile termination rate of 2.60 euro cents was provisionally imposed (more favorable than the figure initially proposed by the regulator), applicable from July 1, 2013 (representing 29.35% lower the previous termination rates). The Irish regulator is also developing a more adverse cost model based on long-run incremental cost (LRIC) price calculation, which is expected to be announced in July 2014.

Also, in Latin America, there are moves to review mobile termination rates leading to these being reduced. Thus, for example, developments in Mexico are among the most relevant, where the declaration of dominant operators in the telecommunications market is expected to lead to asymmetric regulatory measures that must be set. The Company's competitive position may benefit to a greater or lesser extent depending on the scope of these measures. Telefónica México has filed an administrative appeal against the 2011 resolutions of the Federal Telecommunications Commission of México (Cofotel) regarding mobile network termination rates (representing a 61% reduction compared to the previous rates). As of today, no ruling has been made on this appeal. Once these appeals have been concluded,

the rates applied may be further reduced retroactively. As of today, Cofotel has not approved the termination rates for 2012, 2013, or 2014.

In Brazil, in October 2011, the regulator (Anatel) approved the fixed-mobile rate adjustment Regulation, which provides a progressive reduction of these rates until 2014 through a reduction factor, which will be deducted from the inflation, and implying a reduction of approximately 29% in 2012-2014. However, the Plano Geral de Metas de Competição (PGMC) of the end of 2012 extended application of the reduction to 2015 and amended the rates for 2014 and 2015 (75% of the 2013 rate in 2014 and 50% of the 2013 rate in 2015). A draft law has been prepared in Brazil to abolish the basic telephony service monthly fee. Price protection practices (reimbursement of price differences of a product to customers if this falls within a relative short period of time) may also have a negative effect, both in economic and image terms.

In Chile, a process to set new fixed-line termination charges is ongoing. A Tariff Decree has been passed for mobile networks covering the 2014-2019 five-year period. The new Tariff Decree entered into effect on January 25, 2014 and implies a reduction of 73.4% with respect to the previous rates. In Ecuador the rate-related risks also concern a reduction in rural and urban telephony charges, a reimbursement of top-up balances, as well as rounding to the nearest minute.

The implementation of the Enabling Act (Ley Habilitante) in Venezuela also confers full powers to the President to implement price controls measures, and it is therefore expected that it will not be possible to raise Movistar retail rates in line with high Venezuela inflation. In relation to mobile termination rates with the national operator of reference, these have been reduced 6% compared to the previous rates.

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**Table of Contents**

2013 Financial Statements

In Peru, the previously applicable rate was reduced by 24.24% in October 2013.

In Colombia, a decision was adopted establishing a gradual reduction for termination mobile rates. Regarding the termination model for time, the reduction for 2014 is 19.8% and 24.6% for 2015. For the capacity model the reduction will be 10.9% for 2014 and 12.3% for 2015. In relation with fix networks (for extended local networks) the reduction will be 50% for 2014 and 100% for 2015.

*Regulation of universal services:*

The European Commission on its formal obligation to review the Universal Service Directive will launch a public consultation whose objective will be to modify the scope of their obligations and include, at a European level, far higher broadband speeds than are currently provided. Depending on the terms set forth in the new regulation, implementation at a local level could lead to higher costs for both the universal service provider and the operators forced to finance the Universal Service.

The regulator in Brazil has modified the universal service targets. This represents a risk on the Company's positive balance resulted from the fulfilment of 2003 universal service targets, whose implementation was less costly than the initially established targets, leaving a positive balance for the Company.

The new requirements that cause this positive balance could apply until 2025, and extend beyond on issues such as, for example, rural telephony services and the expansion of the backhaul network. Rural telephony services are another risk in Brazil given the obligations arising from the switched fixed-line telephone services model and the obligations to provide mobile coverage in certain rural areas of the country.

*Regulation of fiber networks:*

It is expected that in 2014, Spanish National Competition Authority (Comisión Nacional de los Mercados y la Competencia) will study broadband market regulation in Spain. This could increase Telefónica's regulatory obligations in Spain, especially wholesale market obligations concerning access to fiber networks, and its pricing.

*Regulations on privacy:*

In Europe, a new Data Protection Regulation is in the pipeline before the end of the current European legislative term (spring 2014). This could lead to certain critical provisions laid down in the current draft of the Regulation (presently under debate) being worded in such a way that stops or hinders Telefónica from launching some services, that focus on the processing of personal data.

*Regulation of functional separation:*

The new principles established in Europe's common regulatory framework, adopted in 2009 and transposed in the national legislation of each Member State in which Telefónica operated during 2011 and 2012 could result in greater regulatory pressure on the local competitive environment. Specifically, this framework supports the possibility of national regulators, in specific cases and under exceptional conditions, forcing operators with significant market

power and vertically-integrated operators to separate their wholesale and retail businesses at a functional level. They would therefore be required to offer equal wholesale terms to third-party operators that acquire these products.

*Regulation of network neutrality:*

In Europe, application of the current regulatory framework means that it is likely that during 2014, the Body of European Regulators for Electronic Communications (BEREC) and national regulators will strengthen their supervision of operators with regard to blocking of access, discrimination of applications or Internet service quality. The European Parliament and the Council are simultaneously debating the draft of the European Digital Market Regulation proposed by the European Commission, in particular concerning network neutrality, network management or differentiation of Internet access service characteristics. All of them are aspects of great importance that have a direct impact on potential business models that can be developed in the future.

Presently we have countries where net neutrality has already been ruled, such as Chile and Colombia. But it is a live issue and with varying degree of development in the rest of the countries. In Germany, the Economy Minister published a draft law on June 20, 2013 to regulate neutrality, especially with regard to blocking and discrimination of content and Internet services. The text is pending approval by parliament in 2014 after the new government was sworn in during December 2013.

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**Table of Contents**

2013 Financial Statements

In Brazil, the Civil Rights Framework for Internet Governance is being debated by Congress and is expected to be approved in the first quarter of 2014. It includes policies on the Internet such as network neutrality. Activities regarding net neutrality have been, as of today, focused in supervision of the quality of the services: in October 2011, Anatel approved the regulations of the Service Quality of Multimedia Communication Service (includes fixed internet) and Personal Mobile Service (including mobile internet). Aforementioned regulations, regulates the measurement made from independent entities on quality delivered and perceived by ISPs to customers.

If changes to regulation such as those described above, or otherwise, occur in the various jurisdictions where the Telefónica Group operates, it could have a material adverse effect on our business and results of operations.

**Customers' perceptions of services offered by the Company may put it at a disadvantage compared to competitors' offerings.**

Customers' perceptions of the services and products offered are critical to operating in highly-competitive markets. The ability to predict and respond to the changing needs and demands of customers affects the Company's competitive position relative to other technology sector companies, and its ability to extract the value generated during this process of transformation. Failure to do so appropriately could have an adverse impact on the Group's financial condition, results of operations and cash flows.

**Company may not be able to adequately foresee and respond to technological changes and sector trends.**

In a sector characterized by rapid technological change, it is essential to be able to offer the products and services demanded by the market, and consider the impacts of changes in the life cycle of technical assets, finely adjust margins, and select the right investments to make.

The Telefónica Group operates in markets that are highly competitive and subject to constant technological development. Therefore, as a consequence of both characteristics, it is subject to the effects of actions by competitors in these markets and to its ability to anticipate and adapt to constant technological changes taking place in the industry.

To compete effectively in these markets, the Telefónica Group needs to successfully market its products and services and respond to both commercial actions by competitors and other competitive factors affecting these markets, anticipating and adapting promptly to technological changes, changes in consumer preferences and general economic, political and social conditions. Failure to do so appropriately could have an adverse impact on the Group's financial condition, results of operations and cash flows.

New products and technologies arise constantly, while the development can render obsolete the products and services the Telefónica Group offers and the technology it uses. This means that Telefónica must invest in the development of new products, technology and services so it can continue to compete effectively with current or future competitors, and which may result in the decrease of the Group's profits and revenue margins. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are deriving from mobile internet and connectivity services that are being launched. Research and development costs amounted to 1,046 million euros and 1,071 million euros in 2013 and 2012, respectively, representing 1.8% and 1.7% of the Group's consolidated revenue,

respectively. One technology that telecommunications operators, including Telefónica (in Spain and Latin America), are focused on is the new FTTx-type network, which offers broadband access using optical fiber with superior services, e.g. internet speed of up to 100MB or HD television services. However, substantial investment is required to deploy these networks, which entails fully or partially substituting copper loop access with optic fiber. An increasing demand for the capabilities offered by these new networks to end users exist, however, the high level of the investments requires a continuous analysis of the return on investment.

Telefónica, S.A. 215

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**Table of Contents**

2013 Financial Statements

The explosion of the digital market, and entry of new actors in the communications market, such as Mobile Virtual Network Operators (MVNOs), internet companies or device manufacturers, may cause the loss of value of certain assets, and affect its ability to generate income. Therefore, it is necessary to update the business model, encouraging the pursuit of incomes and additional efficiencies to the more traditional. Failure to do so appropriately could have an adverse impact on the Group's financial condition, results of operations and cash flows.

In addition, the ability of the Telefónica Group's IT systems (operational and backup) to respond the Company's operating requirements is a key factor to be taken into account with respect to the commercial development, customer satisfaction and business efficiency.

**The Company depends on the suppliers.**

The existence of critical suppliers in the supply chain, especially in areas such as network infrastructure, information systems or handsets, with a high concentration in a small number of suppliers, poses risks that may affect the operation, and may cause contingencies or damages to the Company's image in the event that inappropriate practices were produced by a participant in the supply chain.

As of December 31, 2013, the Telefónica Group depends on 8 handset suppliers and 12 network infrastructure suppliers, which together accounted for 80% of orders. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own shortages and business requirements.

If these suppliers fail to deliver products and services to the Telefónica Group on a timely basis, it could jeopardize network deployment and expansion plans, which in some cases could adversely affect the Telefónica Group's ability to satisfy its license terms and requirements or have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

**Unanticipated network interruptions can lead to quality loss or the interruption of the service.**

Unanticipated network interruptions as a result of system failures, including those due to network, hardware or software or cyber-attacks, which affect the quality of or cause an interruption in the Telefónica Group's service, could lead to customer dissatisfaction, reduced revenues and traffic, costly repairs, penalties or other measures imposed by regulatory authorities and could harm the Telefónica Group's image and reputation.

Telefónica attempts to mitigate these risks through a number of measures, including backup systems and protective systems such as firewalls, virus scanners and other physical and logical security. However, these measures are not always effective. Although the Telefónica Group has insurance policies to cover this type of incidents and risks, these policies may not be sufficient to cover all possible monetary losses, although the claims and loss in revenue caused by service interruptions to date have been covered by these policies.

**The telecommunications industry may be affected by the possible effects of electromagnetic fields, emitted by mobile devices and base stations, may have on human health.**

In some countries, there is a concern regarding potential effects of electromagnetic fields, emitted by mobile devices and base stations, on human health. This public concern has caused certain governments and administrations to take measures that have hindered the deployment of the infrastructures necessary to ensure quality of service, and affected the deployment criteria of new networks and digital services such as smart meters development.

There is a consensus between various expert groups and public health agencies, including the World Health Organization (WHO), who claim that at the moment there have not been established risks for exposure to low frequency signals in mobile communications. The scientific community is still investigating this issue especially on mobile devices. Exposure limits for radio frequency suggested in the guidelines of the Protection of Non-Ionizing Radiation Protection Committee (ICNIRP) have been internationally recognized. The mobile industry has adopted these exposure limits and works to request authorities worldwide to adopt these standards.

Society's worries about radiofrequency emissions may discourage the use of mobile devices and new digital services, which could cause the public authorities to implement measures restricting where transmitters and cell sites can be located and how they operate, and the use of our mobile telephones, the massive deployment of smart meters and other products using mobile technology. This could lead to the Company being unable to expand or improve its mobile network.



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**Table of Contents**

2013 Financial Statements

The adoption of new measures by governments or administrations or other regulatory interventions in this respect, and any future assessment on the adverse impact of electromagnetic fields on health, may negatively affect the business, financial conditions, results and cash flows of Telefónica Group.

**Possible regulatory, business, economic or political changes could lead to asset impairment.**

The Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future expected cash flows, including, in some cases synergies allowed for in acquisition cost. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and recognize impairment losses in goodwill, intangible assets or fixed assets. Although the recognition of impairments of property, plant and equipment, intangible assets and financial assets results in a non-cash charge on the income statement, it could adversely affect the results of the Telefónica Group's operations. In this respect, the Telefónica Group has experienced impairment losses on certain of its investments, affecting the results of the year in which they were made. Thus, with respect to the investment in Telco, S.p.A., it has been made value adjustments in fiscal years 2012 and 2013 resulted in 1.277 million euros and 267 million euros, respectively. Also in 2012, the revision of the value of Telefónica operations in Ireland, resulted in a negative impact of 527 million euros.

**Our networks carry and store huge volumes of confidential, personal and corporate data, and our Internet access and hosting services may lead to claims for illegal or illicit use of the Internet.**

Our networks carry and store huge volumes of confidential, personal and business data, both voice and data traffic. We store increasing quantities and types of customer data in both business and consumer segments. Despite our best efforts to prevent it, Telefónica may be found liable for the loss, transfer, or inappropriate modification of the customer data or general public data stored on its servers or transmitted through its networks which could involve many people and have an impact on the Company's reputation, or lead to legal claims and liabilities that are difficult to measure in advance.

Our Internet access and hosting servers could lead to claims for illegal or unlawful use of the Internet. Telefónica, like other telecommunications providers, may be held liable for the loss, transfer or inappropriate modification of the customer data stored on its servers or carried by its networks.

In most countries in which Telefónica operates, the provision of its internet access and hosting services (including the operation of websites with shelf-generated content) are regulated under a limited liability regime applicable to the content that it makes available to the public as a technical service provider, particularly content protected by copyright or similar laws. However, regulatory changes have been introduced imposing additional obligations on access providers (such as blocking access to a website) as part of the struggle against some illegal or illicit uses of the internet, notably in Europe.

**Telefónica and Telefónica Group companies are party to lawsuits, tax claims, antitrust and other legal proceedings.**

Telefónica and Telefónica Group companies are party to lawsuits, tax claims and other legal proceedings in the ordinary course of their businesses, the financial outcome of which is unpredictable. An adverse outcome or settlement in these or other proceedings could result in significant costs and may have a material adverse effect on the Group's business, financial condition, results of operations, reputation and cash flows. In particular, regarding tax and antitrust claims, Telefónica Group has open judicial procedures in Peru concerning the clearance of previous years income tax, which contentious-administrative appeal is currently on its way; as well as in Brazil CADE's (Conselho Administrativo de Defesa Econômica) as regards the acquisition of a 50% stake in VIVO and tax open procedures, primarily relating to the CIMS (tax on telecommunication services).

Telefónica, S.A. 217

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**Table of Contents**

2013 Financial Statements

**This annual corporate governance report was adopted by the Company's Board of Directors at its meeting held on February 26, 2014.**

**List whether any directors voted against or abstained from voting on the approval of this Report.**

**No**

<b>Name or corporate name of director</b>	<b>Reasons (voted against, abstention, non-attendance)</b>	<b>Explain the reasons</b>
		

Telefónica, S.A. 218

**Table of Contents**

*Translation of an auditor's report on the Internal Control over Financial*

*Reporting originally issued in Spanish. In the event of discrepancy,*

*the Spanish-language version prevails*

**AUDITOR'S REPORT ON THE INTERNAL CONTROL OVER FINANCIAL REPORTING**

To the Board of Directors of

Telefónica, S.A., engaged by the management

We have examined the description of the Internal Control over Financial Reporting of Telefónica, S.A. (the Parent Company) and subsidiaries (the Group) included in Section F of the Annual Corporate Governance Report for the year ended December 31, 2013. This examination included the evaluation of the effectiveness of internal control over financial reporting with respect to the financial information included in the Group's consolidated financial statements at December 31, 2013, prepared in accordance with International Financial Reporting Standards, as adopted by the European Union, and other provisions in the regulatory framework applicable to the Group. Such internal control is based on the criteria and policies defined by the Parent Company's management in accordance with the guidelines established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in its report *Internal Control - Integrated Framework* (1992).

Telefónica, S.A.'s management is responsible for maintaining effective internal control over financial reporting included in the consolidated financial statements, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on the aforementioned effectiveness of internal control over financial reporting, based on the work we have performed in accordance with the requirements of the Standard ISAE 3000 *Assurance Engagement Other than Audits or Reviews of Historical Financial Information* issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC) for the issuance of reports to obtain reasonable assurance.

The work performed to obtain reasonable assurance includes obtaining an understanding of the internal control over financial reporting with respect to the financial information included in the consolidated financial statements, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we consider necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have

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a material effect on the financial statements.

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**Table of Contents**

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements, fraud or illegal acts. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Telefónica, S.A. and subsidiaries maintained, in all material respects, effective internal control over financial reporting with respect to the financial information included in the consolidated financial statements as of December 31, 2013, based on the criteria and policies defined by the Parent Company's management in accordance with the guidelines established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in its report "Internal Control - Integrated Framework" (1992). We also have checked that the disclosures included in the accompanying description of the internal control over financial reporting at December 31, 2013 comply, in all material respects, with the requirements of Securities Market Law 24/1988 of July 28, as amended by Law 2/2011, of March 4, on Sustainable Economy, and meets the minimum content of the Annual Corporate Governance Report template required by Circular 5/2013, issued on June 12, 2013 by the Comisión Nacional del Mercado de Valores (Spanish stock market regulator).

The examination indicated in the preceding paragraphs is not subject to the Spanish Audit Law, approved by Royal Legislative Decree 1/2011 of July 1, so we do not express an audit opinion in the terms provided for in the aforementioned Law.

In addition to the aforementioned examination, we have audited, in accordance with prevailing audit regulations in Spain, the consolidated financial statements of Telefónica, S.A. and subsidiaries at December 31, 2013, prepared by the Parent Company's Directors in accordance with International Financial Reporting Standards, as adopted by the European Union, and other provisions in the regulatory framework applicable to the Group, and our report dated March 19, 2014 expressed an unqualified opinion on the aforementioned consolidated financial statements.

ERNST & YOUNG, S.L.

/s/ Ignacio Viota del Corte  
Ignacio Viota del Corte

March 19, 2014

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**Table of Contents**

**AUDIT REPORT, CONSOLIDATED ANNUAL FINANCIAL  
STATEMENTS, AND CONSOLIDATED MANAGEMENT REPORT ALL  
FOR THE YEAR ENDED DECEMBER 31, 2013**

**Table of Contents**

Audit Report

TELEFÓNICA, S.A. AND SUBSIDIARIES

Consolidated Financial Statements and

Consolidated Management Report

for the year ended

December 31, 2013



**Table of Contents**

*Translation of a report and consolidated financial statements originally issued in Spanish. In the event of discrepancy, the Spanish-language version prevails (See Note 24)*

**AUDIT REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS**

To the Shareholders of

Telefónica, S.A.

We have audited the consolidated financial statements of Telefónica, S.A. (the Parent Company) and subsidiaries (the Group), which comprise the consolidated statement of financial position at December 31, 2013, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity, the consolidated statement of cash flows, and the notes thereto for the year then ended. As indicated in Note 2 to the accompanying consolidated financial statements, the Parent Company's Directors are responsible for the preparation of the Group's consolidated financial statements in accordance with International Financial Reporting Standards, as adopted by the European Union, and other provisions in the regulatory framework applicable to the Group. Our responsibility is to express an opinion on the aforementioned consolidated financial statements taken as a whole, based upon work performed in accordance with prevailing audit regulation in Spain, which require the examination, through the performance of selective tests, of the evidence supporting the consolidated financial statements, and the evaluation of whether their presentation, the accounting principles and criteria applied and the estimates made are in agreement with the applicable regulatory framework for financial information.

In our opinion, the accompanying 2013 consolidated financial statements give a true and fair view, in all material respects, of the consolidated equity and consolidated financial position of Telefónica, S.A. and subsidiaries at December 31, 2013, and the consolidated results of their operations and their consolidated cash flows for the year then ended, in conformity with International Financial Reporting Standards, as adopted by the European Union, and other applicable provisions in the regulatory framework for financial information.

The accompanying 2013 consolidated management report contains such explanations as the Directors of Telefónica, S.A. consider appropriate concerning the situation of the Group, the evolution of its business and other matters; however, it is not an integral part of the consolidated financial statements. We have checked that the accounting information included in the aforementioned consolidated management report agrees with the 2013 consolidated financial statements. Our work as auditors is limited to verifying the consolidated management report in accordance with the scope mentioned in this paragraph, and does not include the review of information other than that obtained from the accounting records of Telefónica, S.A. and its subsidiaries.

ERNST & YOUNG, S.L.

/s/ Ignacio Viota del Corte  
Ignacio Viota del Corte

March 19, 2014

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**Table of Contents**

**2013**

*Consolidated Financial Statements (Consolidated Annual Accounts) and Consolidated Management Report for 2013*

*Telefónica, S.A. and subsidiaries composing the Telefónica Group*

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**Table of Contents****Index**

<u>Consolidated statements of financial position at December 31</u>	4
<u>Consolidated income statements for the years ended December 31</u>	5
<u>Consolidated statements of comprehensive income for the years ended December 31</u>	6
<u>Consolidated statements of changes in equity for the years ended December 31</u>	7
<u>Consolidated statements of cash flows for the years ended December 31</u>	8
<u>Note 1. Background and general information</u>	9
<u>Note 2. Basis of presentation of the consolidated financial statements</u>	10
<u>Note 3. Accounting policies</u>	16
<u>Note 4. Segment information</u>	23
<u>Note 5: Business combinations and acquisitions of non-controlling interests</u>	26
<u>Note 6. Intangible assets</u>	27
<u>Note 7. Goodwill</u>	29
<u>Note 8. Property, plant and equipment</u>	33
<u>Note 9. Associates and joint ventures</u>	35
<u>Note 10. Related parties</u>	37
<u>Note 11. Trade and other receivables</u>	39
<u>Note 12. Equity</u>	40
<u>Note 13. Financial assets and liabilities</u>	48
<u>Note 14. Trade and other payables</u>	56
<u>Note 15. Provisions</u>	58
<u>Note 16. Derivative financial instruments and risk management policies</u>	64
<u>Note 17. Income tax matters</u>	75
<u>Note 18. Revenue and expenses</u>	79
<u>Note 19. Share-based payment plans</u>	83
<u>Note 20. Cash flow analysis</u>	85
<u>Note 21. Other information</u>	88
<u>Note 22. Finance leases</u>	98
<u>Note 23. Events after the reporting period</u>	99
<u>Note 24. Additional note for English translation</u>	100
<u>Appendix I: Changes in the consolidation scope</u>	101
Table of Contents	404

<u>Appendix II: Board of Director s Compensation</u>	104
<u>Appendix III: Debentures and bonds</u>	110
<u>Appendix IV: Financial instruments</u>	115
<u>Appendix V: Interest-bearing debt</u>	124
<u>Appendix VI: Main companies comprising the Telefónica Group</u>	125
<u>Appendix VII: Key regulatory issues and concessions and licenses held by the Telefónica Group</u>	132
<u>2013 Consolidated Management Report</u>	154
<u>Business model</u>	154

**Table of Contents**

<u>Financial Results</u>	156
<u>2013 Consolidated results</u>	159
<u>Segments Discussion</u>	168
<u>Definitions</u>	202
<u>Services and products</u>	204
<u>Share price performance</u>	206
<u>Research, Development and Innovation</u>	207
<u>Human Resources</u>	209
<u>Environment</u>	211
<u>Liquidity and Capital Resources</u>	212
<u>Treasury shares</u>	215
<u>Risks and uncertainties facing the company</u>	218
<u>Risks and uncertainties facing the Company</u>	218
<u>Trend evolution</u>	227
<u>Events after the reporting period</u>	229
<u>Annual Corporate Governance Report for Listed Companies</u>	231

**Table of Contents**

2013 Consolidated Financial Statements

*Telefónica Group*

Consolidated statements of financial position at December 31

Millions of euros	NOTES	2013	2012
<b>ASSETS</b>			
<b>A) NON-CURRENT ASSETS</b>		<b>89,597</b>	<b>104,177</b>
Intangible assets	(Note 6)	18,548	22,078
Goodwill	(Note 7)	23,434	27,963
Property, plant and equipment	(Note 8)	31,040	35,021
Investments accounted for by the equity method	(Note 9)	2,424	2,468
Non-current financial assets	(Note 13)	7,775	9,339
Deferred tax assets	(Note 17)	6,376	7,308
<b>B) CURRENT ASSETS</b>		<b>29,265</b>	<b>25,596</b>
Inventories		985	1,188
Trade and other receivables	(Note 11)	9,640	10,711
Current financial assets	(Note 13)	2,117	1,872
Tax receivables	(Note 17)	1,664	1,828
Cash and cash equivalents	(Note 13)	9,977	9,847
Non-current assets held for sale	(Note 2)	4,882	150
<b>TOTAL ASSETS (A+B)</b>		<b>118,862</b>	<b>129,773</b>
	<b>NOTE</b>	<b>2013</b>	<b>2012</b>
<b>EQUITY AND LIABILITIES</b>			
<b>A) EQUITY</b>		<b>27,482</b>	<b>27,661</b>
Equity attributable to equity holders of the parent and other holders of equity instruments	(Note 12)	21,185	20,461
Equity attributable to non-controlling interests	(Note 12)	6,297	7,200
<b>B) NON-CURRENT LIABILITIES</b>		<b>62,236</b>	<b>70,601</b>
Non-current interest-bearing debt	(Note 13)	51,172	56,608
Non-current trade and other payables	(Note 14)	1,701	2,141
Deferred tax liabilities	(Note 17)	3,063	4,788
Non-current provisions	(Note 15)	6,300	7,064
<b>C) CURRENT LIABILITIES</b>		<b>29,144</b>	<b>31,511</b>
Current interest-bearing debt	(Note 13)	9,527	10,245
Current trade and other payables	(Note 14)	15,221	17,089
Current tax payables	(Note 17)	2,203	2,522
Current provisions	(Note 15)	1,271	1,651

Liabilities associated with non-current assets held for sale	(Note 2)	922	4
<b>TOTAL EQUITY AND LIABILITIES (A+B+C)</b>		<b>118,862</b>	<b>129,773</b>

The accompanying Notes 1 to 24 and Appendices I to VII are an integral part of these consolidated statements of financial position.

Telefónica, S.A. 4



**Table of Contents**

## 2013 Consolidated Financial Statements

*Telefónica Group*

Consolidated income statements for the years ended December 31

Millions of euros	NOTES	2013	2012	2011
<b>INCOME STATEMENTS</b>				
Revenues	(Note 18)	57,061	62,356	62,837
Other income	(Note 18)	1,693	2,323	2,107
Supplies		(17,041)	(18,074)	(18,256)
Personnel expenses		(7,208)	(8,569)	(11,080)
Other expenses	(Note 18)	(15,428)	(16,805)	(15,398)
<b>OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION (OIBDA)</b>		<b>19,077</b>	<b>21,231</b>	<b>20,210</b>
Depreciation and amortization	(Note 18)	(9,627)	(10,433)	(10,146)
<b>OPERATING INCOME</b>		<b>9,450</b>	<b>10,798</b>	<b>10,064</b>
<b>Share of loss of investments accounted for by the equity method</b>	(Note 9)	<b>(304)</b>	<b>(1,275)</b>	<b>(635)</b>
Finance income		933	963	827
Exchange gains		3,323	2,382	2,795
Finance costs		(3,629)	(4,025)	(3,609)
Exchange losses		(3,493)	(2,979)	(2,954)
<b>Net financial expense</b>	(Note 16)	<b>(2,866)</b>	<b>(3,659)</b>	<b>(2,941)</b>
<b>PROFIT BEFORE TAX</b>		<b>6,280</b>	<b>5,864</b>	<b>6,488</b>
Corporate income tax	(Note 17)	(1,311)	(1,461)	(301)
<b>PROFIT FOR THE YEAR</b>		<b>4,969</b>	<b>4,403</b>	<b>6,187</b>
Non-controlling interests	(Note 12)	(376)	(475)	(784)
<b>PROFIT FOR THE YEAR ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT</b>		<b>4,593</b>	<b>3,928</b>	<b>5,403</b>
<b>Basic and diluted earnings per share attributable to equity holders of the parent (euros)</b>	(Note 18)	<b>1.01</b>	<b>0.87</b>	<b>1.18</b>

The accompanying Notes 1 to 24 and Appendices I to VII are an integral part of these consolidated income statements.

**Table of Contents**

2013 Consolidated Financial Statements

*Telefónica Group*

Consolidated statements of comprehensive income for the years ended December 31

Millions of euros	2013	2012	2011
<b>CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME</b>			
<b>Profit for the year</b>	<b>4,969</b>	<b>4,403</b>	<b>6,187</b>
<b>Other comprehensive income (loss)</b>			
Gains (losses) on measurement of available-for-sale investments	32	(49)	(13)
Income tax impact	(10)	4	4
Reclassification of losses included in the income statement	51	46	3
Income tax impact	(15)	(3)	(1)
	58	(2)	(7)
Gains (losses) on hedges	831	(1,414)	(921)
Income tax impact	(247)	376	280
Reclassification of losses included in the income statement (Note 16)	121	173	210
Income tax impact	(36)	(5)	(63)
	669	(870)	(494)
Share of (loss) income recognized directly in equity of associates and others	(29)	(27)	58
Income tax impact	4	9	(9)
Reclassification of losses included in the income statement	1	4	
Income tax impact			
	(24)	(14)	49
Translation differences	(6,454)	(1,862)	(1,265)
<b>Total other comprehensive loss recognized in the period (Items that may be reclassified subsequently to profit or loss)</b>	<b>(5,751)</b>	<b>(2,748)</b>	<b>(1,717)</b>
Actuarial gains (losses) and impact of limit on assets for defined benefit pension plans	(49)	(154)	(85)
Income tax impact	1	39	28
	(48)	(115)	(57)
<b>Total other comprehensive loss recognized in the period (Items that will not be reclassified subsequently to profit or loss)</b>	<b>(48)</b>	<b>(115)</b>	<b>(57)</b>
<b>Total comprehensive (loss) income recognized in the year</b>	<b>(830)</b>	<b>1,540</b>	<b>4,413</b>

Attributable to:

<b>Equity holders of the parent and other holders of equity instruments</b>	(434)	1,652	4,002
<b>Non-controlling interests</b>	(396)	(112)	411
	<b>(830)</b>	<b>1,540</b>	<b>4,413</b>

The accompanying Notes 1 to 24 and Appendices I to VII are an integral part of these consolidated statements of comprehensive income.

Telefónica, S.A. 6

**Table of Contents**

2013 Consolidated Financial Statements

Consolidated statements of changes in equity for the years ended December 31

Millions of euros	Attributable to equity holders of the parent and other holders of equity instruments										Non-controlling interests	Total equity	
	Share capital	Share premium	Treasury Shares	Other equity instruments	Legal reserve	Retained earnings	Available-for-sale investments	Hedges	Equity of associates and Traslacion	Equity differences	Total		(Note 12)
<b>Financial position at December 31, 2012</b>	<b>4,551</b>	<b>460</b>	<b>(788)</b>		<b>984</b>	<b>19,569</b>	<b>36</b>	<b>(715)</b>	<b>(7)</b>	<b>(3,629)</b>	<b>20,461</b>	<b>7,200</b>	<b>27,661</b>
Profit for the year						4,593					4,593	376	4,969
Other comprehensive income (loss)						(48)	58	678	(24)	(5,691)	(5,027)	(772)	(5,799)
<b>Total comprehensive loss</b>						<b>4,545</b>	<b>58</b>	<b>678</b>	<b>(24)</b>	<b>(5,691)</b>	<b>(434)</b>	<b>(396)</b>	<b>(830)</b>
Dividends paid (Note 12)						(1,588)					(1,588)	(739)	(2,327)
Net movement in treasury shares (Note 12)			244			(92)					152		152
Acquisitions and disposals of non-controlling interests and business combinations (Note 5)						66				45	111	238	349
Undated Deeply Subordinated Securities (Note 12)				2,466							2,466		2,466

Other movements						17					17	(6)	11
<b>Financial position at December 31, 2013</b>	<b>4,551</b>	<b>460</b>	<b>(544)</b>	<b>2,466</b>	<b>984</b>	<b>22,517</b>	<b>94</b>	<b>(37)</b>	<b>(31)</b>	<b>(9,275)</b>	<b>21,185</b>	<b>6,297</b>	<b>27,482</b>
<b>Financial position at December 31, 2011</b>	<b>4,564</b>	<b>460</b>	<b>(1,782)</b>		<b>984</b>	<b>19,374</b>	<b>38</b>	<b>154</b>	<b>7</b>	<b>(2,163)</b>	<b>21,636</b>	<b>5,747</b>	<b>27,383</b>
Profit for the year						3,928					3,928	475	4,403
Other comprehensive income (loss)						(112)	(2)	(870)	(14)	(1,278)	(2,276)	(587)	(2,863)
<b>Total comprehensive income</b>						<b>3,816</b>	<b>(2)</b>	<b>(870)</b>	<b>(14)</b>	<b>(1,278)</b>	<b>1,652</b>	<b>(112)</b>	<b>1,540</b>