

TELEFONICA S A
Form 6-K
February 27, 2015
Table of Contents

FORM 6-K
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Report of Foreign Private Issuer

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

of the Securities Exchange Act of 1934

For the month of February, 2015

Commission File Number: 001-09531

Telefónica, S.A.

(Translation of registrant's name into English)

Distrito Telefónica, Ronda de la Comunicación s/n,

28050 Madrid, Spain

3491-482 87 00

(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

Edgar Filing: TELEFONICA S A - Form 6-K

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

Item	Sequential Page Number
1. Telefónica - 2014 Annual Accounts	
<u>Account Auditor's Report, Annual Financial Statements and Management Report of Telefónica, S.A., all for the Fiscal Year 2014.</u>	4
<u>Account Auditor's Report, Annual Financial Statements and Management Report of the Consolidated Group of Companies, all for the Fiscal Year 2014.</u>	229

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 2014 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, February 27, 2015

Table of Contents

**AUDIT REPORT, ANNUAL FINANCIAL STATEMENTS, AND
MANAGEMENT REPORT OF TELEFÓNICA, S.A., ALL FOR THE
YEAR ENDED DECEMBER 31, 2014**

Table of Contents

Independent Audit Report

TELEFÓNICA, S.A.

Financial Statements and Management Report

for the year ended

December 31, 2014

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)*

INDEPENDENT AUDIT REPORT ON THE FINANCIAL STATEMENTS

To the Shareholders of

Telefónica, S.A

Report on the financial statements

We have audited the accompanying financial statements of Telefónica, S.A., which comprise the balance sheet at December 31, 2014, and the income statement, the statement of changes in equity, the cash flow statement, and the notes thereto for the year then ended

Directors' responsibility for the financial statements

The Directors are responsible for the preparation of the accompanying financial statements so that they give a true and fair view of the equity and financial position and the results of Telefónica, S.A., 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 for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on the accompanying financial statements based on our audit. We conducted our audit in accordance with prevailing audit regulations in Spain. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation of financial statements by the Directors of the Company in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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

Opinion

In our opinion, the accompanying 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, 2014, and its results and cash flow for the year then ended, in accordance with the applicable regulatory framework for financial information in Spain, and specifically the accounting principles and criteria contained therein.

Report on other legal and regulatory requirements

The accompanying 2014 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 2014 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

February 27, 2015

Table of Contents

2014

TELEFÓNICA, S.A.

Annual financial statements and management report for the year ended December 31, 2014

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>	42
<u>Note 15. Payable to group companies and associates</u>	45
<u>Note 16. Derivate financial instruments and risk management policies</u>	49
<u>Note 17. Income tax</u>	61
<u>Note 18. Trade and other payables</u>	65
<u>Note 19. Revenue and expenses</u>	66
<u>Note 20. Other information</u>	72
<u>Note 21. Cash flow analysis</u>	79

Table of Contents

<u>Note 22. Events after the reporting period</u>	82
<u>Note 23. Additional note for English translation</u>	83
<u>Appendix I: Details of subsidiaries and associates at December 31, 2014</u>	84
<u>Appendix II: Board of Director s Compensation</u>	89
<u>Management report 2014</u>	96
<u>Business Model</u>	96
<u>Additional information</u>	97
<u>Economic results of Telefónica, S.A.</u>	98
<u>Investment activity</u>	99
<u>Share price performance</u>	102
<u>Research, development and innovation</u>	103
<u>Environment</u>	105
<u>Human Resources</u>	106
<u>Liquidity and capital resources</u>	108
<u>Financing</u>	108
<u>Treasury shares</u>	110
<u>Risks and Uncertainties Facing the Company</u>	112
<u>Trend evolution</u>	124
<u>Events after the reporting period</u>	126
<u>Annual Corporate Governance Report for Listed Companies</u>	127

Table of Contents

Financial Statements

Telefónica, S.A.

Balance sheet at December 31

Millions of euros

	Notes	2014	2013
ASSETS			
NON-CURRENT ASSETS		73,065	70,506
Intangible assets	5	58	58
Software		13	12
Other intangible assets		45	46
Property, plant and equipment	6	225	262
Land and buildings		142	146
Plant and other PP&E items		76	90
Property, plant and equipment under construction and prepayments		7	26
Investment property	7	417	399
Land		94	65
Buildings		323	334
Non-current investments in Group companies and associates	8	62,367	62,380
Equity instruments		59,123	58,155
Loans to Group companies and associates		3,227	4,205
Other financial assets		17	20
Financial investments	9	5,709	3,082
Equity instruments		483	591
Loans to third parties		217	
Derivatives	16	4,998	2,369
Other financial assets	9	11	122
Deferred tax assets	17	4,289	4,325
CURRENT ASSETS		12,782	14,634
Net assets held for sale			2,302
Trade and other receivables	10	1,081	1,122
Current investments in Group companies and associates	8	5,168	5,992
Loans to Group companies and associates		5,031	5,956
Derivatives	16	105	10
Other financial assets		32	26
Investments	9	1,941	445
Loans to companies		1,399	45
Derivatives	16	488	337
Other financial assets		54	63
Accruals		8	5
Cash and cash equivalents		4,584	4,768

TOTAL ASSETS	85,847	85,140
---------------------	---------------	---------------

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

Telefónica, S.A. 4

Table of Contents

Financial Statements

Millions of euros

	Notes	2014	2013
Equity and liabilities			
EQUITY		23,168	22,827
CAPITAL AND RESERVES		24,232	23,658
Share capital	11	4,657	4,551
Share premium	11	460	460
Reserves	11	18,682	18,528
Legal		984	984
Other reserves		17,698	17,544
Treasury shares and own equity instruments	11	(1,587)	(545)
Profit for the year	3	2,604	664
Interim dividend	3	(1,790)	
Other equity instruments	11	1,206	
UNREALIZED GAINS (LOSSES) RESERVE	11	(1,064)	(831)
Available-for-sale financial assets		20	49
Hedging instruments		(1,084)	(880)
NON-CURRENT LIABILITIES		49,351	47,154
Non-current provisions		267	213
Non-current borrowings	12	8,069	9,096
Bonds and other marketable debt securities	13	831	177
Bank borrowings	14	4,027	6,079
Derivatives	16	3,122	2,677
Finance leases			75
Other debts		89	88
Non-current borrowings from Group companies and associates	15	40,728	37,583
Deferred tax liabilities	17	179	262
Long term deferred revenues		108	
CURRENT LIABILITIES		13,328	15,159
Current provisions		46	12
Current borrowings	12	1,201	1,869
Bonds and other marketable debt securities	13	77	943
Bank borrowings	14	759	831
Derivatives	16	365	95
Current borrowings from Group companies and associates	15	11,702	12,982
Trade and other payables	18	336	286
Accruals		43	10
TOTAL EQUITY AND LIABILITIES		85,847	85,140

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

Table of Contents

Financial Statements

Telefónica, S.A.

Income statements for the years ended December 31

Millions of euros	Notes	2014	2013
Revenue	19	8,727	11,003
Rendering of services to Group companies and associates		643	687
Rendering of services to non-group companies		3	3
Dividends from Group companies and associates		7,974	10,078
Interest income on loans to Group companies and associates		107	235
Impairment and gains (losses) on disposal of financial instruments		(3,675)	(7,990)
Impairment losses and other losses	8	(3,679)	(7,998)
Gains (losses) on disposal and other gains and losses		4	8
Other operating income	19	96	84
Non-core and other current operating revenue - Group companies and associates		25	62
Non-core and other current operating revenue - non-group companies		71	22
Employees benefits expense	19	(233)	(154)
Wages, salaries and others		(203)	(135)
Social security costs		(30)	(19)
Other operational expense		(327)	(343)
External services - Group companies and associates	19	(104)	(104)
External services - non-group companies	19	(198)	(225)
Taxes other than income tax		(25)	(14)
Depreciation and amortization	5, 6 and 7	(64)	(76)
OPERATING PROFIT		4,524	2,524
Finance revenue	19	184	179
From equity investments of third parties		4	7
From marketable securities and other financial instruments of third parties		180	172
Finance costs	19	(2,296)	(2,712)
Borrowings from Group companies and associates		(2,034)	(1,971)
Third-party borrowings		(262)	(741)
Change in fair value of financial instruments		(57)	(38)
Trading portfolio and other securities		(38)	6
Gain (loss) on available-for-sale financial assets recognized in the period	9 y 11	(19)	(44)
Exchange rate gains (losses)	19	(96)	82
Impairment and gains (losses) on disposal of financial instruments with third-parties	9.3 y 19.9	(270)	(2)
NET FINANCIAL EXPENSE		(2,535)	(2,491)
PROFIT BEFORE TAX	21	1,989	33
Income tax	17	615	631
PROFIT FOR THE YEAR		2,604	664

Edgar Filing: TELEFONICA S A - Form 6-K

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

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	2014	2013
Profit of the period		2,604	664
Total income and expense recognized directly in equity	11	(360)	463
From measurement of available-for-sale financial assets		(59)	74
From cash flow hedges		(411)	588
Income tax impact		110	(199)
Total amounts transferred to income statement	11	127	111
From measurement of available-for-sale financial assets		19	44
From cash flow hedges		163	114
Income tax impact		(55)	(47)
TOTAL RECOGNIZED INCOME AND EXPENSE		2,371	1,238

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 and Reserves	Treasury shares	Profit for the year	Interim dividends	Other net equity instruments	Net unrealized gains (losses) reserve	Total
Balance at December 31, 2012	4,551	19,989	(788)	631			(1,405)	22,978
Total recognized income and expense				664			574	1,238
Transactions with shareholders and owners		(1,680)	243					(1,437)

Edgar Filing: TELEFONICA S A - Form 6-K

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)				
Balance at December 31, 2013	4,551	18,988	(545)	664			(831)	22,827
Total recognized income and expense				2,604			(233)	2,371
Transactions with shareholders and owners	106	(485)	(1,042)		(1,790)	1,206		(2,005)
Dividends paid	106	(348)			(1,790)			(2,032)
Transactions with treasury shares or own equity instruments (net)		(113)	(1,042)					(1,155)
Other transactions with shareholders and owners		(24)				1,206		1,182
Other movements		(25)						(25)
Appropriation of prior year profit (loss)		664		(664)				
Balance at December 31, 2014	4,657	19,142	(1,587)	2,604	(1,790)	1,206	(1,064)	23,168

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

Financial Statements

Telefónica, S.A.

Cash flow statements for the years ended December 31

Millions of euros	Notes	2014	2013
A) CASH FLOWS FROM OPERATING ACTIVITIES		8,418	6,224
Profit before tax		1,989	33
Adjustments to profit:		(1,836)	226
Depreciation and amortization	5,6 and 7	64	76
Impairment of investments in Group companies and associates	8	3,679	7,998
Change in long term provisions		(29)	(18)
Gains on the sale of financial assets		(4)	
Losses on disposal of property, plant and equipment			(8)
Dividends from Group companies and associates	19	(7,974)	(10,078)
Interest income on loans to Group companies and associates	19	(107)	(235)
Net financial expense		2,535	2,491
Change in working capital		43	(52)
Trade and other receivables		35	(7)
Other current assets		(40)	11
Trade and other payables		(49)	(76)
Other current liabilities		97	20
Other cash flows from operating activities	21	8,222	6,017
Net interest paid		(1,872)	(1,664)
Dividends received		9,750	6,428
Income tax receipts		237	1,253
Other payments/proceeds from operating activities		107	
B) CASH FLOWS (USED IN)/FROM INVESTING ACTIVITIES		(3,024)	(147)
Payments on investments	21	(5,704)	(2,938)
Proceeds from disposals	21	2,680	2,791
C) CASH FLOWS USED IN FINANCING ACTIVITIES		(5,524)	(3,736)
Payments on equity instruments		(21)	(244)
Proceeds from financial liabilities	21	(3,502)	(1,904)
Debt issues		10,038	10,127
Repayment and redemption of debt		(13,540)	(12,031)
Dividends paid	21	(2,001)	(1,588)
D) NET FOREIGN EXCHANGE DIFFERENCE		(54)	(23)
E) NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		(184)	2,318
Cash and cash equivalents at January 1		4,768	2,450
Cash and cash equivalents at December 31		4,584	4,768

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

Table of Contents

Financial Statements

TELEFÓNICA, S.A.

Annual financial statements for the ended December 31, 2014

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 Telefonica 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

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 2014.

The accompanying financial statements for the year ended December 31, 2014 were prepared by the Company's Board of Directors at its meeting on February 23, 2015 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 2013 and 2014 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 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. In note 8.2 it is assessed the impairment of these investments.

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.

Telefónica, S.A. 10

Table of Contents

Financial Statements

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.

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. The information about deferred tax assets and unused tax loss carryforwards, whose effect has been registered when necessary in balance, is included in Note 17.

Note 3. Proposed appropriation of profit

Telefónica, S.A. obtained 2,604 million euros of profit in 2014. Accordingly, the Company's Board of Directors will submit the following proposed appropriation of 2014 profit for approval at the Shareholders' Meeting:

Millions of euros	
Proposed appropriation:	
Profit for the year	2,604
Distribution to:	
Goodwill reserve (Note 11.c)	2
Voluntary reserves	812
Interim Dividend	1,790

At its meeting of April 25, 2014, the Company's Board of Directors resolved to pay an interim dividend against 2014 profit of a fixed gross 0.40 euros for each of the outstanding shares carrying dividend rights. This dividend was paid in full on May 7, 2014. The total amount paid was 1,790 million euros (see Note 11.1.d).

In accordance with Article 277 of the Spanish Enterprise Law, the following table shows the provisional statement issued by the Directors to substantiate that the Company had sufficient liquidity at that time to distribute this dividend.

Millions of euros	
Liquidity statement	
Income from January 1 through March 31, 2014	3,177
Mandatory appropriation to reserves	
Distributable income	3,177
Proposed interim dividend (maximum amount)	(1,820)

Cash position

Funds available for distribution	
Cash and cash equivalents	4,135
Unused credit facilities	4,397
Proposed interim dividend (maximum amount)	(1,820)

To ensure its liquidity requirements are met throughout the following year, the Company effectively manages its liquidity risks (see Note 16).

Telefónica, S.A. 11

Table of Contents

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:

Estimated useful life	Years
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.

Telefónica, S.A. 12

Table of Contents

Estados financieros

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.

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.

Table of Contents

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 2014 and 2013 are as follows:

Millions of euros		
Item	2014	2013
Total assets	122,299	118,862
Equity:		
Attributable to equity holders of the parent	21,115	21,185
Attributable to minority interests	9,174	6,297
Revenue from operations	50,377	57,061
Profit for the year:		
Attributable to equity holders of the parent	3,001	4,593
Attributable to minority interests	251	376

Telefónica, S.A. 14

Table of Contents

Financial Statements

Note 5. Intangible assets

The movements in the items composing intangible assets and the related accumulated amortization in 2014 and 2013 are as follows:

2014

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INTANGIBLE ASSETS, GROSS	261	10		3	274
Software	120	5		4	129
Other intangible assets	141	5		(1)	145
ACCUMULATED AMORTIZATION	(203)	(13)			(216)
Software	(108)	(8)			(116)
Other intangible assets	(95)	(5)			(100)
Net carrying amount	58	(3)		3	58

2013

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

At December 31, 2014 and 2013 commitments exist to acquire intangible assets amounting to 0.7 and 0.1 million euros, respectively.

At December 31, 2014 and 2013, the Company had 175 million euros and 157 million euros, respectively, of fully amortized intangible assets.

Telefónica, S.A. 15

Table of Contents

Financial Statements

Note 6. Property, plant and equipment

The movements in the items composing property, plant and equipment and the related accumulated depreciation in 2014 and 2013 are as follows:

2014

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
PROPERTY, PLANT AND EQUIPMENT, GROSS	567	6	(13)	(3)	557
Land and buildings	228				228
Plant and other PP&E items	313	3		6	322
Property, plant and equipment under construction and prepayments	26	3	(13)	(9)	7
ACCUMULATED DEPRECIATION	(305)	(40)	13		(332)
Buildings	(82)	(17)	13		(86)
Plant and other PP&E items	(223)	(23)			(246)
Net carrying amount	262	(34)		(3)	225

2013

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
PROPERTY, PLANT AND EQUIPMENT, GROSS	592	11	(35)	(1)	567
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
ACCUMULATED DEPRECIATION	(289)	(52)	36		(305)
Buildings	(79)	(21)	18		(82)
Plant and other PP&E items	(210)	(31)	18		(223)
Net carrying amount	303	(41)	1	(1)	262

Firm commitments to acquire property, plant and equipment at December 31, 2014 and 2013 amounted to 3 million euros and 0.7 million euros, respectively.

At December 31, 2014 and 2013, the Company had 139 million euros and 47 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.

Edgar Filing: TELEFONICA S A - Form 6-K

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 74 million euros and 76 million euros at the 2014 and 2013 year-ends, respectively. Also included is the net carrying amount of the remaining assets (mainly plant and property) of 48 and 63 million euros at December 31, 2014 and 2013, 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

Financial Statements

Note 7. Investment properties

The movements in the items composing investment properties in 2014 and 2013 and the related accumulated depreciation are as follows:

2014

Millions of euros	Opening balance	Additions and allowances	Disposals Transfers	Closing balance
INVESTMENT PROPERTIES, GROSS	470	29		499
Land	65	29		94
Buildings	405			405
ACCUMULATED DEPRECIATION	(71)	(11)		(82)
Buildings	(71)	(11)		(82)
Net carrying amount	399	18		417

2013

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

As of September 4th, 2014 the Company exerted its pre-emptive rights and acquired the building of its headquarters in Barcelona, known as Diagonal 00, for 107 million euros plus transaction taxes. Until the purchase moment, the building was registered as an asset in financial leasing and the liability associated with this transaction amounted to 79.5 million euros. Having examined it, the Company has estimated that the additional investment corresponds only to a higher value of land, so in September the difference between liability and purchase cost was booked as addition under the Land caption. As a result of the transaction described, the obligation of future minimum payments under this finance lease has been canceled. The following detail shows the disclosure of the liability at 2013 year end.

Future minimum payments	2013
Millions of euros	
Up to one year	5
Between two and five years	21

Over 5 years	44
Total	70

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.

Telefónica, S.A. 17

Table of Contents

Financial Statements

In 2014, the Company has buildings with a total area of 322,039 square meters leased to several Telefónica Group and other companies, equivalent to an occupancy rate of 92.81% of the buildings it has earmarked for lease. In 2013, it had a total of 330,044 square meters leased, equivalent to an occupancy rate of 92.72% of the buildings earmarked for lease.

Total income from leased buildings in 2014 (see Note 19.1) amounted to 49 million euros (52 million euros in 2013). Future minimum rentals receivable under non-cancellable leases are as follows:

Millions of euros	2014 Future minimum recoveries	2013 Future minimum recoveries
Up to one year	48	51
Between two and five years	17	30
Over 5 years	1	1
Total	66	82

The lease contracts held with subsidiaries occupying Distrito Telefónica have been renewed in 2014 for a non-cancellable period of 12 months. The figures also include non-cancellable lease revenue from Diagonal 00, the contracts for which expire in July 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.

Table of Contents

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 2014 and 2013 are as follows:

2014

Millions of euros	Opening balance	Additions	Disposals	Transfers	Exchange losses	Hedges of a net investment	Dividends	Closing balance	Fair value
Equity instruments (Net) (1)	58,155	1,049		(227)		(2)	148	59,123	131,415
Equity instruments (Cost)	80,107	4,728		(2,976)		(2)	148	82,005	
Impairment losses	(21,952)	(3,679)		2,749				(22,882)	
Loans to Group companies and associates	4,205	801	(12)	(1,789)	22			3,227	3,335
Other financial assets	20	14		(17)				17	17
Total non-current investment in Group companies and associates	62,380	1,864	(12)	(2,033)	22	(2)	148	62,367	134,767
Loans to Group companies and associates	5,956	4,302	(5,723)	482	14			5,031	5,031
Derivates	10	311	(216)					105	105
Other financial assets	26	19	(30)	17				32	32
Total current investments in Group companies and associates	5,992	4,632	(5,969)	499	14			5,168	5,168

(1) Fair value at December 31, 2014 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.

2013

Millions of euros	Opening balance	Additions	Disposals	Transfers	Exchange losses	Dividends	Hedges of a net investment balance	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
Total non-current investment in Group companies and associates	71,779	(4,129)	(1,807)	(2,822)	4	(575)	(70)	62,380	137,598
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
Total current investments in Group companies and associates	3,636	5,818	(3,728)	269	(3)			5,992	5,992

- (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.

Table of Contents

Financial Statements

The most significant transactions occurred in 2014 and 2013 as well as their accounting impacts are described below:

2014

On January 28th, 2014 Telefónica announces that after obtaining the relevant regulatory approval, the sale transaction of the 65.9% of the capital share of Telefónica Czech Republic, a.s. to PPF Group N.V.I. has been completed. This concept was registered in 2013 balance under caption Non-current assets held for sale for an amount of 2,302 million euros.

On June 16, 2014 the three Italian shareholders of Telco, S.p.A. requested the initiation of the process of demerger (spin off) of the Company, as provided in the Shareholders Agreement. Implementation of the demerger, approved by the General Meeting of Shareholders of Telco, S.p.A. held on July 9, 2014, is subject to obtaining any required anti-trust and telecommunications approvals (including Brazil and Argentina). Once the aforementioned approvals are obtained, this decision will be implemented by transferring all the current stake of Telco, S.p.A. in Telecom Italia to four newly created companies. The share capital of each of these companies will belong in its entirety to each of the shareholders of Telco, S.p.A. and each of these companies will receive a number of shares of Telecom Italia S.p.A. proportional to the current economic stake in Telco, S.p.A. of its respective shareholder.

The application process of the aforementioned anti-trust and telecommunications approvals (including Brazil and Argentina) to proceed to the demerger (spin off) of Telco, S.p.A. has already started, once completed in Italy the corresponding corporate documents.

At a meeting on December 22, 2014, the Brazilian telecommunications regulator (ANATEL) approved the demerger on condition of suspension of Telefónica's voting rights in Telecom Italia, S.p.A. and its subsidiaries, among certain other measures. Telefónica has agreed with the aforementioned suspension of voting rights and has offered the presentation of a formal statement to ANATEL in this regard. Therefore, on the same date Telefónica ceased to have significant influence through its indirect holding in Telecom Italia, S.p.A. and reclassified this investment as an available-for-sale financial asset (see Note 9).

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.

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.

Telefónica, S.A. 20

Table of Contents

Financial Statements

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 held a stake of 4.9% in Telefónica Czech Republic until the date of the sale (see Note 9).

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, was reclassified to the *Non-current assets held for sale* until the pertinent authorisations were received from the regulators. The market value of the 4.9% stake that was retained totaling 178 million euros was reclassified to the *Equity instruments* heading under non-current financial assets (see Note 9.3). The aforementioned reclassifications were 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. remained unchanged (i.e. 46.18 %), although its interest in the total share capital of Telco, S.p.A. was increased to 66%. This amount is recognised as *Additions* of equity instruments in the accompanying table of movements.

Other movements

Movement in *Transfers* in both 2014 and 2013 mainly includes the reclassification between long-term and current loans in accordance with the loan maturity schedule, as well as the reclassification under *Loans to third parties* of the bond and not yet due accrued interest of Telco, S.p.A. (see Note 8.5).

In 2014, movement in *Transfers* in *Equity instruments* caption refers to the net book value reclassification of the investment in Telco, S.p.A. (amounting to 358 million euros) as it has been described in this Note. Offsetting this figure, it is also included the reclassification to *Long term provisions* of the negative net book value of some investments in group companies totaling 131 million euros.

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. In 2014 the amount is not

significant and in 2013, Dividends comprised those distributed by Telefónica Czech Republic, a.s. totaling 101 million euros, O2 Europe Ltd. totaling 286 million euros and Panamá Cellular Holdings, B.V. totaling 186 million euros.

Telefónica, S.A. 21

Table of Contents

Financial Statements

In 2014 and 2013, Telefónica, S.A. bought and sold the following shareholdings:

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

Companies	2014	2013
Telfin Ireland, Ltd.	3,700	
Telefónica de Contenidos, S.A.U.	400	
Telefónica Digital Holdings, S.A.U.	268	
Telefónica Finanzas México, S.A. de C.V.	138	
Telco, S.p.A.		324
Telefónica Móviles México, S.A. de C.V.	56	1,170
Other companies	166	229
Total	4,728	1,723

2014

With the object of regaining equity balance, on January 16th, 2014 Telefónica Digital Holding, S.A.U. increased its share capital totally subscribed and paid by Telefónica, S.A. amounting 31 million euros. On October 2nd, 2014 an additional capital increase was completed totaling 237 million euros also totally subscribed and paid by Telefónica, S.A. with the same objective of regaining the equity balance of the company and its affiliates.

On January 22nd, 2014 Telefónica México, S.A. de C.V. completed a share capital increase amounting to 1,000 million Mexican pesos (56 million euros) fully subscribed by Telefónica, S.A.

On March 25, 2014 Telefónica Finanzas México, S.A. de C.V. has increased its share capital by 2,500 million Mexican pesos (138 million euros) fully subscribed and paid by Telefónica, S.A.

On July 7th, 2014, and within the framework of the purchase of the shares that Promotora de Informaciones, S.A. (PRISA) owns in Distribuidora de Televisión Digital, S.A. (DTS), Telefónica de Contenidos, S.A. increased its share capital in 300 million euros totally subscribed by Telefónica, S.A. With the aim of raising the funds needed to complete the acquisition of this investment once the relevant regulatory approvals are achieved, on November 17th, the company increased its share capital in 100 million euros, fully subscribed and paid by Telefónica, S.A.

On August 1st and September 18th, Telefónica, S.A. completed two capital increases fully subscribed and paid in Telfin Ireland, Ltd totaling 2,900 million and 800 million euros, respectively, in order to provide the company with the funds needed to fulfill borrowing activities for other subsidiaries of the Telefónica Group such as Telefónica Deutschland and carry out their activities.

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.

Telefónica, S.A. 22

Table of Contents

Financial Statements

b) Disposals of investments and capital decreases:

Millions of euros		
Companies	2014	2013
Subsidiaries:		
Telefónica Móviles Panamá, S.A.		130
Other companies		65
Total Subsidiaries:		195

2013

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

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, 2014.

As a result of these estimations and the effect of the net investment hedge in 2014, an impairment provision of 3,679 million euros was recognized (7,998 million euros in 2013). This amount derives mainly from the following companies:

- (a) write down recognized for Telefónica Europe, plc. Amounting to 2,352 million euros in 2014 (2,423 million euros in 2013), increased by 148 million euros for the effect of the net investment hedge (70 million euros in 2013).
- (b) write down of 559 million euros for Telefónica Brasil, S.A. (2,948 million euros in 2013) and 176 million euros for Sao Paulo Telecomunicacoes, S.A. (915 million euros in 2013).
- (c) write down of 92 million euros for Telco, S.p.A. (359 million euros in 2013), the owner of a stake in Telecom Italia, S.p.A.
- (d) write down of 126 million euros for Telefónica México, S.A. de C.V. (211 million euros in 2013).
- (e) write down of 300 million euros for Telefónica Digital Holding, S.A.U. (166 million euros in 2013).

In 2013, a write down recognised for Telefónica Czech Republic of 643 million euros was also included.

Edgar Filing: TELEFONICA S A - Form 6-K

The write down in Telefónica Europe, plc. is mainly due to the impact of the 1,304 million-euro dividend distribution in 2014 and the changes in the present value of the expected turnover of the subsidiary. In this regard, the Operating Income Before Depreciation and Amortization (OIBDA) margin used to calculate long term cash flows is 1.7 p.p. lower compared with the same parameter used in 2013 plan.

The write down of the stake in Telefónica Brasil, S.A. and Sao Paulo Telecomunicações, S.A. in 2014 results from the changes in the macroeconomic scenario. The estimate of GDP growth in the country, prepared by Focus Economics and analysts, was estimated in 2.3% for 2014 and it has finally been 0.2% and it will be no higher than 0.7% in 2015. The change in expectations has been reflected in the decrease of OIBDA used to calculate future cash flows. The OIBDA margin used to calculate long term cash flows, has decreased 2 p.p. compared with those used in 2013.

Telefónica, S.A. 23

Table of Contents

Financial Statements

8.3. The detail of subsidiaries and associates is shown in Appendix I.

8.4. Transactions protected for tax purposes

Transaction carried out in 2014 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, is detailed in the following paragraph. Transactions qualified for special tax treatment carried out in prior years are disclosed in the financial statements for those years.

On May 14, 2014, exercising the powers conferred by shareholders in the Extraordinary Shareholders Meeting, the representative of the sole stakeholder of Telefónica Digital España, S.A.U., resolved to approve the takeover of Telefónica Global Applications, S.L., by Telefónica Digital España, S.A.U., and transfer *en bloc* of their assets and liabilities to Telefónica Digital 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 July, 9th 2014, with economic effect on January 1st, 2014.

Telefónica, S.A. 24

Table of Contents

Financial Statements

8.5. The breakdown and maturity of loans to Group companies and associates in 2014 and 2013 are follows:

2014

Millions of euros

Company	2015	2016	2017	2018	2019	2020 and subsequent years	Final balance, current and non-current
Telefónica Móviles España, S.A.U.	276	638		400			1,314
Telefónica Móviles México, S.A. de C.V.	226	654					880
Telefónica de Contenidos, S.A.U.	419						419
Telefónica de España, S.A.U.	471		165		550		1,186
Telefónica Global Technology, S.A.U.	4				21	177	202
Telefónica Digital Holding, S.A.U.		155					155
Telefónica Emisiones, S.A.U.	138						138
Telefónica Internacional, S.A.U.	3,272						3,272
Other companies	225	106	29	203	36	93	692
Total	5,031	1,553	194	603	607	270	8,258

2013

Millions of euros

Company	2014	2015	2016	2017	2018	2019 and subsequent years	Final balance, current and 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				207	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
Otras	219	31	219			130	599

Total	5,956	2,446	857	165	400	337	10,161
--------------	--------------	--------------	------------	------------	------------	------------	---------------

Telefónica, S.A. 25

Table of Contents

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 2014 and 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.

Moreover, 272 million euros of taxes are receivable from this subsidiary for its tax expense declared in the consolidated tax return (126 million euros in 2013).

At December 31, 2014, the account receivable with Telefónica Móviles México, S.A. de C.V. amounts to 11,696.57 million Mexican pesos, equivalent to 654 million euros (11,696.57 million Mexican pesos, equivalent to 648 million euros in 2013). This consideration is recognised as non-current pursuant to the expected collection date at the reporting date. In 2013, half the nominal debt outstanding 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 1 a) of this Note. At December 31, 2014, accrued interest receivable totals 226 million euros (171 million euros in 2013), which forms part of the current balance receivable.

At December 31, 2014, the account receivable 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 was settled in 2013. Interest on this loan is calculated according to the performance of Telefónica de Contenidos, S.A.U. At December 31, 2014 and 2013, no accrued interest is outstanding.
- b) A 79 million-euro participating loan extended in 2005 and maturing in 2015.

The 2014 balance for Telefónica de España, S.A.U. consists of a 550 million euros credit facility granted and drawn down in full in November 2014 and maturing in 2019, and a credit facility of 165 million euros maturing in 2017. Additionally, there is also a balance of 470 million euros comprising tax receivables from the subsidiary for its tax expense declared in the consolidated tax return (200 million euros in 2013) and accrued interest of 1 million euros.

At December 31, 2014, the account receivable from Telefónica Global Technology, S.A.U. (TGT) consists of 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, 2014 of 202 million euros (207 million euros in 2013).

T. Digital Holding, S.L.U. has a financing maturing in 2016, with an outstanding balance at December 31, 2014 of 155 million euros.

During January and February 2014, according to their maturity schedule, Telefónica Emisiones S.A.U. bonds totaling 153 million euros and 57 million pounds sterling (equivalent to 69 million euros) have been cancelled. The remaining bonds (136 million euros), with a maturity date in the first half of 2015, are booked as short term financial assets. Accrued interest receivable amounts to 2 million euros at the 2014 year end (12 million euros at the 2013 year end).

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. 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.).

Telefónica, S.A. 26

Table of Contents

Financial Statements

This amount of 417 million euros were recognised as Additions of loans to Group companies and associates in the accompanying table of movements of 2013.

On July 9, 2014, each of the Telco shareholders, among which Telefónica is one of them, agreed with Telco a shareholders loan agreement with a maturity date no later than April 30, 2015. The aggregate amount of shareholders loans made available pursuant to such loans is up to 2,550 million euros (1,683 million euros corresponding to Telefónica, S.A. according to its stake in Telco), which will enable Telco to repay in full all amounts due by Telco under its banking debt and the subordinated bond. As of December 31, 2014 there was no outstanding amount under there loans.

In 2014, the net book value of the investment in this company as well as the receivables and payables have been reclassified as third party balances in these annual accounts (see Notes 8 and 9). This movement is shown as Transfers in 2014 chart of movements.

In 2014 the General Shareholders Meeting of Telefónica Internacional, S.A.U. approved the distribution of 3,238 million euros against unrestricted reserves. The amount has been registered as short term financial receivables.

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 was book as short term financial receivable in 2013 and it has been settled in 2014.

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 was recognised as a current receivable in the table of movements for 2013, and it has been collected in December 2014.

The Company has also extended 825 million euros (355 million euros in 2013) 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 355 million euros (827 million euros in 2013).

Total accrued interest receivable at December 31, 2014 included under Current loans to group companies and associates amounted to 234 million euros (222 million euros in 2013).

8.6. Other financial assets with Group companies and associates

Edgar Filing: TELEFONICA S A - Form 6-K

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 2015, 2016 and 2017 (see Note 19.3).

Telefónica, S.A. 27

Table of Contents

Financial Statements

Note 9. Financial investments

9.1. The breakdown of Financial investments at December 31, 2014 and 2013 is as follows:

2014

	Assets at fair value				Assets at amortized cost				Subtotal assets at 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	Level 1: quoted prices in active markets	Level 2: Estimates based on Level other directly observable inputs	Level 3: Estimates based on unobservable inputs	Loans and financial assets				
Non-current financial investments	483	2,457	2,541	5,481	483	4,998	217	11	228	236	5,709	5,717
Equity instruments	483			483	483						483	483
Derivatives (Note 16)		2,457	2,541	4,998		4,998					4,998	4,998
Loans to third parties and other financial assets							217	11	228	236	228	236
Current financial investments		250	238	488		488	1,399	54	1,453	1,447	1,941	1,935
Loans to third parties							1,399	54	1,453	1,447	1,453	1,447
Derivatives (Note 16)		250	238	488		488					488	488
Total financial investments	483	2,707	2,779	5,969	483	5,486	1,616	65	1,681	1,683	7,650	7,652

Table of Contents

Financial Statements

2013

Millions of euros	Assets at fair value					Assets at amortized cost						
	Available-for-sale financial assets held	Financial assets for trading	Hedge	Subtotal assets at fair value	Measurement hierarchy Level 2: Estimates based on Level 3: other directly observable inputs	Subtotal assets at Level 1: market data	receivables	Other financial assets	Subtotal assets at amortized cost	Subtotal liabilities at fair value	Total carrying amount	Total fair value
Non-current financial investments	591	1,699	778	3,068	699	2,369	13	1	14	14	3,082	3,082
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
Current financial investments	323	14	337	337	337	45	63	108	108	445	445	
Loans to third parties							45	63	108	108	108	108
Derivatives (Note 16)		323	14	337		337					337	337
Total financial investments	591	2,022	792	3,405	699	2,706	58	64	122	122	3,527	3,527

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

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, 2014 and 2013 (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, 2014 and 2013 are as follows:

December 31, 2014

Millions of euros	Opening balance	Additions	Disposals	Other movements	Fair value adjustments	Closing balance
Banco Bilbao Vizcaya Argentaria, S.A.	382			(14)	(21)	347
Telefónica Czech Republic, a.s.	166		(160)		(6)	
Telco, S.p.A.			(270)	358	(15)	73
Other companies	43	37			(17)	63
Total	591	37	(430)	344	(59)	483

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
Total	433		(84)	168	74	591

The impacts shown in the column Fair value adjustments on both years include the fair value adjustment, net of tax effect of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA). These impacts are registered in the Equity of the Company (Note 11.2.). The effect, recorded both in 2014 and 2013 under other movements, relates to the sale of rights to scrip dividends that the bank distributed in both years.

At December 31, 2014 Telefónica, S.A.'s investment in BBVA represents 0.72% of that company's share capital.

The investment in Telefónica Czech Republic, a.s., reclassified by the Company under this caption in 2013, has been sold in October 2014 for an amount of 160 million euros. The result of the transaction has been recognised as financial result of the Company.

As a result of the loss of significant influence in its indirect investment in Telecom Italia, S.p.A., as reported at the beginning of Note 8, in December 2014 the net carrying amount of the investment in Telco, S.p.A. has been registered under this caption, being previously recognized as associated company. At this same moment, the Company has reviewed the value of this investment, booking it at the quoted price of Telecom Italia's shares (0.89 euro per share) minus Telco's debt. As a result of the valuation, 270 million euros of Financial Expense, third parties has been registered (See Note 19.7).

Telefónica, S.A. 30

Table of Contents

Financial Statements

In October 2013 the contracts of Equity Swap over Portugal Telecom, SPGS, S.A. shares were fully cancelled. These transactions are shown under Disposals in the 2013 table above while the impact on the income statement amounted to 33 million euros financial expense in 2013, recognized under Gain (loss) on available-for-sale financial assets recognized in the period .

9.4 Other financial assets and loans to third parties

The breakdown of investments included in this category at December 31, 2014 and 2013 is as follows:

Millions of euros	2014	2013
Other non-current financial assets:		
Loans to third parties	217	
Guarantees given	11	13
Other non-current financial assets		109
Other current financial assets:		
Loans to third parties	1,399	45
Other current financial assets	54	63
Total	1,681	230

9.4.1 Loans to third parties

Current loans to third parties included in 2013 the cost of the financial instrument arranged to partially cover share-based payment schemes involving Telefónica, S.A. shares (Performance & Investment Plan PIP) for 37 million euros. (see Note 19.3).

The full amount within non-current loans in 2014 is the deferred account receivable generated from the sale of Telefónica Czech Republic, a.s. completed on January 28, 2014. This same item amounts to 86 million euros as current loans. The sale agreement contemplates a payment schedule that extends to January 2018.

Additionally, the principal plus the outstanding receivable interests of the bonds of Telco, S.p.A., amounting 1,307 million euros, have been recognised as non-current loans to third parties. In 2013 they appeared as loans to associates (see Note 8) and after considering this investment as available-for-sale it has been classified under loans to third parties. In this regard, the interest accrued on these bonds during 2014 is included under finance revenue, as described in Note 19.6.

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 . On June 20, 2014 the sale of this financial asset was completed and the result of the transaction was recognised under the same caption in the profit and loss account.

Telefónica, S.A. 31

Table of Contents

Financial Statements

Note 10. Trade and other receivables

The breakdown of Trade and other receivables at December 31, 2014 and 2013 is as follows:

Millions of euros	2014	2013
Trade receivables	2	20
Trade receivables from Group companies and associates	422	425
Other receivables	1	16
Employee benefits receivable	2	1
Tax receivables (Note 17)	654	660
Total	1,081	1,122

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 2014 and 2013 include balances in foreign currency equivalent to 267 million and 242 million euros, respectively. In December 2014, there were receivables in US dollars equivalent to 267 million euros (218 million euros in 2013). In addition, in December 2013, there were Czech crowns equivalent to 24 million euros.

These balances gave rise to exchange losses in the income statement of approximately 2 million euros in 2014 (11 million euros of exchange losses in 2013).

Telefónica, S.A. 32

Table of Contents

Financial Statements

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

At December 31, 2014, Telefónica, S.A.'s share capital amounted to 4,657,204,330 euros and consisted of 4,657,204,330 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 London and Buenos Aires Stock Exchanges, and on the New York and Lima Stock Exchanges, through ADSs, American Depositary Shares.

On December 9, 2014, the deed of a share capital increase of 106,179,744 euros was involved, during which 106,179,744 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 4,657,204,330 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.

Furthermore, 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 30, 2014 Shareholders Meeting, authorization was given for the Board of Directors to issue debentures, bonds, notes and other fixed-income securities and hybrid instruments, including 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, or debt instruments of similar category or hybrid instruments whatever may be the forms admitted in law, plain or, in the case of debentures, bonds and hybrid instruments convertible into shares of the Company and/or exchangeable for shares of any of the Group companies, or any other company. This delegation also includes warrants or other similar securities that might give the right to directly or indirectly subscribe or acquire shares of the Company, whether newly issued or outstanding, and which may be paid for by physical delivery or by offset. The aggregated amount of the issuance(s) of securities approved under this delegation of powers may not exceed, at any given time, the sum of 25,000 million 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. Also for purposes of the foregoing limit, in the case of warrants, the sum of the premiums and exercise prices of the warrants for each issuance that is approved under this delegation shall be taken into account.

Table of Contents

Financial Statements

At December 31, 2014 and 2013, Telefónica, S.A. held the following treasury shares:

	Number of shares	Euros per share		Market value (1)	%
		Acquisition price	Trading price		
Treasury shares at 12/31/14	128,227,971	11.68	11.92	1,528	2.75332%

(1) Millions of euros

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

(1) Millions of euros

The movement in treasury shares of Telefónica, S.A. in 2014 and 2013 is as follows:

	Number of shares
Treasury shares at 12/31/12	47,847,809
Acquisitions	113,154,549
Disposals	(131,590,526)
Treasury shares at 12/31/13	29,411,832
Acquisitions	100,723,415
Disposals	(129,177)
GESP share plan delivery	(1,778,099)
Treasury shares at 12/31/14	128,227,971

Acquisitions

The amount of the acquisitions of treasury shares in 2014 and 2013 was 1,176 million euros and 1,216 million euros, respectively.

Disposals

Treasury shares sold in 2014 and 2013 amounted to 1 million euros and 1,423 million euros, respectively. The main transactions 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 November 28, 2014, 1,778,099 shares were delivered to Group employees when the second phase of the Global Employee Share Plan (the GESP) matured.

Options on treasury shares

At December 31, 2014, Telefónica held 76 million call options on treasury shares (134 million options in 2013) subject to physical delivery at a fix price which are presented as a reduction in equity under the caption

Telefónica, S.A. 34

Table of Contents

Financial Statements

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 instrument, to be settled by offset, on a nominal value equivalent to 32 million of Telefónica shares, recognized under Current interest-bearing debt in the accompanying balance sheet (derivative instrument on 30 million shares in 2013, recognized under Current interest-bearing debt).

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, 2014, 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 2014, an amount of 8 million euros corresponding to revaluations reserves subsequently considered unrestricted has been reclassified to Other reserves (7 million euros in 2013). The balance of this reserve at December 31, 2014 and 2013 was 101 million euros and 109 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, 2014 and 2013 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, 2014 was 10 million euros. The proposed appropriation of 2014 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 2014

The Board of Directors at its meeting of April 25th, 2014 approved the payment of an interim dividend of 0.4 euros per share outstanding. The dividend was paid on May 7th, 2014 and the total amount paid was 1,790 million euros.

Telefónica, S.A. 35

Table of Contents

Financial Statements

The Executive Commission of Telefonica, S.A. Board of Directors, at its meeting held on November 14, 2014, agreed to carry out the execution of the free-of-charge capital increase, related to the shareholders compensation by means of a scrip dividend, approved by the Annual General Shareholder's Meeting held on May 30, 2014.

After this approval, each shareholder received one free allotment right for each Telefónica Share held. Such free allotment rights were traded on the continuous Market in Spain during a period of fifteen calendar days.

Once this trading period ended, the shareholders of 15.8% of the free-of-charge allotment rights have accepted the purchase commitment assumed by Telefónica, S.A. Cash payment to these shareholders was carried into effect on December 8, 2014, assuming an impact on equity of 242 million euros.

The shareholders of 84.2% of the free-of-charge allotment rights were entitled, therefore, to receive new shares of Telefónica, S.A. Nevertheless, Telefónica, S.A. has waived the subscription of new shares that correspond to the treasury shares, so the final number of shares issued in the capital increase was 106,179,744 shares with a nominal value of 1 euro each.

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.

e) Other equity instruments

On September 24, 2014, Telefónica Participaciones, S.A.U., issued 1,500 million euros of bonds necessarily convertible into new and/or existing shares of Telefónica, S.A. at a nominal fixed interest rate of 4.9%, due on September 25, 2017, guaranteed by Telefónica, S.A. The notes could be converted at the option of the noteholders or the issuer at anytime from the 41st day after the Issue Date up to the 25th trading day prior to the Maturity Date. The minimum conversion price of the notes will be equal to 11.9 euros per share and the maximum conversion price will be equal to 14.5775 euros per share, resulting in a premium equal to 22.5% over the minimum conversion price.

On the same date, Telefónica, S.A. issued bonds with the same amount and characteristics of the previously detailed bond and a derivative instrument (warrant) in order to hedge the conversion price of the bonds. These bonds were wholly acquired by Telefónica Participaciones, S.A.U. In the balance sheet of Telefónica, S.A. the present value of the coupons has been recorded as debt amounting 215 million euros (217 million euros as of December 31st, 2014 as seen in Note 15), the warrant has been accounted as long term liabilities to group companies (see Note 15) and the remaining amount of 1,206 million euros has been recorded as other net equity instruments .

Table of Contents

Financial Statements

11.2 Unrealized gains (losses) reserve

The movements in the items composing Unrealized gains (losses) reserve in 2014 and 2013 are as follows:

2014

Millions of euros	Opening balance	Valuation at market value	Tax effect of additions	Amounts transferred to income statement	Tax effect of transfers	Closing balance
Available-for-sale financial assets (Note 9.3)	49	(59)	17	19	(6)	20
Cash flow hedges (Note 16)	(880)	(411)	93	163	(49)	(1,084)
Total	(831)	(470)	110	182	(55)	(1,064)

2013

Millions of euros	Opening balance	Valuation at market value	Tax effect of additions	Amounts transferred to income statement	Tax effect of transfers	Closing balance
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)
Total	(1,405)	662	(199)	158	(47)	(831)

Telefónica, S.A. 37

Table of Contents

Financial Statements

Note 12. Financial liabilities

The breakdown of Financial liabilities at December 31, 2014 and 2013 is as follows:

2014

Millions of euros	LIABILITIES AT FAIR VALUE				LIABILITIES AT AMORTIZED COST				
	Financial liabilities held for trading	Hedges	Subtotal financial liabilities at fair value	Level 1: quoted prices	Level 2: observable inputs	Level 3: estimates based on other directly observable market data	Subtotal liabilities at fair value	TOTAL CARRYING AMOUNT	TOTAL FAIR VALUE
Non-current financial liabilities	2,322	800	3,122	3,122		45,675	50,313	48,797	53,435
Payable to Group companies and associates						40,728	45,287	40,728	45,287
Bank borrowings						4,027	4,070	4,027	4,070
Bonds and other marketable debt securities						831	867	831	867
Derivatives (Note 16)	2,322	800	3,122	3,122				3,122	3,122
Other financial liabilities						89	89	89	89
Current financial liabilities	264	101	365	365		12,538	11,930	12,903	12,295
Payable to Group companies and associates						11,702	11,107	11,702	11,107
Bank borrowings						759	760	759	760
Bonds and other marketable debt securities						77	63	77	63
Derivatives (Note 16)	264	101	365	365				365	365
Total financial liabilities	2,586	901	3,487	3,487		58,213	62,243	61,700	65,730

Table of Contents

Financial Statements

2013

	LIABILITIES AT FAIR VALUE MEASUREMENT HIERARCHY				LIABILITIES AT AMORTIZED COST					
	Financial liabilities held for trading	Hedges	Subtotal financial liabilities at fair value	Level 1 quoted prices inputs	Level 2 observable market data	Level 3 Estimates not based on other directly observable market data	Trade and other payables	Subtotal liabilities at fair value	TOTAL CARRYING AMOUNT	TOTAL FAIR VALUE
Millions of euros										
Non-current financial liabilities	1,223	1,454	2,677	2,677	44,002	48,226	46,679	50,903		
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		
Current financial liabilities	91	4	95	95	14,756	14,724	14,851	14,819		
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										
Total financial liabilities	1,314	1,458	2,772	2,772	58,758	62,950	61,530	65,722		

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

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, 2014 and 2013 are as follows:

2014

Millions of euros	Non-convertible debentures and bonds	Other marketable debt securities	Total
Opening balance	761	359	1,120
Additions	750	6	756
Depreciation and amortization	(613)	(361)	(974)
Revaluation and other movements	4	2	6
Closing balance	902	6	908
Details of maturities:			
Non-current	831		831
Current	71	6	77

2013

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

The additions shown in the table of movements for 2014 in the column Non-convertible debentures and bonds relate to Telefónica's bond issuance made on July 24, 2014 amounting to 750 million euros. The bonds are mandatorily exchangeable into ordinary shares of Telecom Italia, S.p.A, maturing on July 24, 2017. The bonds may be exchanged in advance of the transfer of the shares, except under certain circumstances where the company may opt to redeem the bonds in cash. As a result of this transaction, Telefónica, S.A., after the Telco, S.p.A. demerger and the later transfer of the underlying shares of the bonds, would reduce its stake in Telecom Italia, S.p.A, which would be between 8.3% and 9.4% in Telecom Italia, S.p.A, current voting share capital.

Table of Contents

Financial Statements

Maturities of the nominal amounts of debenture and bond issues at December 31, 2014 and 2013 are as follows:

2014

Name	Interest rate	% interest rate	Maturity					Subsequent years	TOTAL
			2015	2016	2017	2018	2019		
DEBENTURES AND BONDS:									
MARCH 00	FLOATING	2.80% (*)	50						50
Bonds exchangeable into Telecom Italia shares	FIXED	6.00%			750				750
Total issues			50		750				800

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

2013

Name	Interest rate	% interest rate	Maturity					Subsequent years	TOTAL
			2014 (1)	2015	2016	2017	2018		
DEBENTURES AND BONDS:									
JULY 99	ZERO COUPON (**)	6.39%						73	73
MARCH 00	FLOATING	2.065% (*)		50					50
NOVEMBER 12	FIX	4.18%	582						582
Total issues			582	50				73	705

(*) 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) For 2014 the figures include a maturity of 582 million euros, without a contractual obligation for these maturities. Zero-coupon bonds issued in July 99 have been redeemed in July 2014, and accordingly, the closing balance of this concept is zero in 2014 annual accounts.

13.2 At December 31, 2014, Telefónica, S.A. had a corporate promissory note program registered with the CNMV, with the following features:

Millions of euros	Nominal amount of the			
	Amount	Placement system	Promissory notes	Terms of the Promissory notes
500 million; can be increased to 2,000 million	Auctions	100,000 euros	60, 90, 180, 365, 540 and 731 days	Competitive auctions
	Tailored	100,000 euros	Between 3 and 731 days	Specific transactions

At December 31, 2014 the outstanding balance on this promissory note program was 6 million euros (359 million euros in 2013).

13.3 The average interest rate during 2014 on debentures and bonds outstanding during the year was 5.15% (4.61% in 2013) and the average interest rate on corporate promissory notes was 0.43% (1.38% in 2013).

Table of Contents

Financial Statements

Note 14. Interest-bearing debt and derivatives

14.1 The balances at December 31, 2014 and 2013 are as follows:

December 31, 2014**Millions of euros**

Item	Current	Non-current	Total
Loans with financial entities	759	4,027	4,786
Derivative financial liabilities (Note 16)	365	3,122	3,487
Total	1,124	7,149	8,273

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
Total	926	8,756	9,682

14.2 The nominal values of the main interest-bearing debts at December 31, 2014 and 2013 are as follows:

Description	Value Date	Maturity Date	Currency	Limit 12/31/14 (millions)	Balance (million of euros)
Syndicated loan (1) *	04/21/06	04/21/17	EUR	700	700
Syndicated loan Tranche A3	07/28/10	07/28/16	EUR	328	328
Bilateral loan on supplies*	02/22/13	01/31/23	USD	905	571
Bilateral	06/26/14	06/26/17	EUR	2,000	2,000

* Facilities with amortization schedule.

(1) 350 million euros are scheduled to mature on 04/21/15

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).

Telefónica, S.A. 42

Table of Contents

Financial Statements

14.3 Maturities of balances at December 31, 2014 and 2013 are as follows:

December 31, 2014

Millions of euros	Maturity					Subsequent years	Closing balance
	2015	2016	2017	2018	2019		
Items							
Loans with financial entities	759	508	2,531	232	427	329	4,786
Derivative financial liabilities (Note 16)	365	147	345	476	357	1,797	3,487
Total	1,124	655	2,876	708	784	2,126	8,273

December 31, 2013

Millions of euros	Maturity					Subsequent years	Closing balance
	2014	2015	2016	2017	2018		
Items							
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
Total	926	1,443	2,607	1,650	1,626	1,430	9,682

14.4 Interest-bearing debt arranged or repaid in 2014 mainly includes the following:

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 and originally scheduled to mature 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 euros syndicated credit facility (Tranche B) signed on July 28, 2010 (originally scheduled to mature in 2015). At December 31, 2014 there was no outstanding amount under this facility and therefore is not mentioned in the table of 14.2 chapter.

On June 26, 2014, Telefónica, S.A. signed a 2,000 million euros bilateral loan maturing on June 26, 2017. At the same date it was fully disbursed.

During 2014, Telefónica, S.A. made an early repayment for 1,672 million euros of its syndicated loan (tranche A3) dated July 28, 2010 and scheduled to mature originally on July 28, 2016. As of December 31, 2014 the outstanding balance of this financing was 328 million euros (2,000 million euros in 2013).

During 2014, Telefónica, S.A. repaid in full its syndicated loan (tranche A2) dated July 28, 2010 totaling 2,000 million euros and scheduled to mature originally on July 28, 2014. At the same time, its *forward start facilities* (Tranche A2A and A2B) dated February 22, 2013 and available as of July 28, 2014 were fully canceled.

During 2014, Telefónica, S.A. drew down an aggregate principal amount of 310 million US dollars (255 million euros) of its bilateral loan on supplies of 1,001 million US dollars (825 million euros) with an outstanding balance at December 31, 2014 amounted to 694 million US dollars (571 million euros).

14.5 Average interest on loans and borrowings

The average interest rate in 2014 on loans and borrowings denominated in euros was 1.048% and 2.250% for foreign-currency loans and receivables.

Table of Contents

Financial Statements

The average interest rate in 2013 on loans and borrowings denominated in euros was 1.323% and 2.510% 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, 2014 and 2013, Telefónica had undrawn credit facilities amounting to 7,445 million euros and 8,873 million euros, respectively.

Financing arranged by Telefónica, S.A. at December 31, 2014 and 2013 is not subject to compliance with financial ratios (covenants).

Telefónica, S.A. 44

Table of Contents

Financial Statements

Note 15. Payable to group companies and associates**15.1 The breakdown at December 31, 2014 and 2013 is as follows:****December 31, 2014**

Millions of euros	Non-current	Current	Total
Loans	40,415	11,265	51,680
Trade payables to Group companies and associates	21	152	173
Derivatives (Note 16)	107	12	119
Payable to subsidiaries due to taxation on a consolidated basis	185	273	458
Total	40,728	11,702	52,430

December 31, 2013

Millions of euros	Non-current	Current	Total
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
Total	37,583	12,982	50,565

Telefónica, S.A. 45

Table of Contents

Financial Statements

The maturity of these loans at the 2014 and 2013 year ends is as follows:

December 31, 2014

Company (Millions of euros)	2015	2016	2017	2018	2019	2020 and subsequent years	Final balance, current and non-current
Telefónica Emisiones, S.A.U.	3,962	6,391	4,774	3,786	3,347	14,897	37,157
Telefónica Europe, B.V.	1,451			1,104	847	5,035	8,437
Telfisa Global, B.V.	3,913						3,913
Telefónica Finanzas, S.A.U.	1,837	75					1,912
Others	102		142			17	261
Total	11,265	6,466	4,916	4,890	4,194	19,949	51,680

December 31, 2013

Company (Millions of euros)	2014	2015	2016	2017	2018	2019 and subsequent years	Final balance, current and non-current
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
Total	12,622	4,238	6,046	4,159	4,692	18,138	49,895

Financing raised by Telefónica, S.A. through its subsidiary Telefónica Europe, B.V. at December 31, 2014 was 8,437 million euros (6,875 million euros in 2013). This financing entails a number of loans paying market interest rates calculated on a Euribor plus spread basis, with an average interest rate in 2014 of 5.00% (3.90% in 2013). The main source of this financing was the funds obtained through the issuance of undated deeply subordinated reset rate guaranteed securities amounting 5,120 million euros (2,466 million euros in 2013), bonds and debentures amounting 1,530 million euros (1,406 million euros in 2013) and commercial paper amounting 496 million euros (919 million euros in 2013).

The main transactions made in 2014 were following:

On March 31, 2014, 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 750 million euros subject to a call option exercisable by the Issuer from the sixth anniversary of the issuance date and the other for an aggregate nominal amount of 1,000 million euros subject to a call option exercisable by the Issuer from the tenth 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 sixth anniversary of the issuance date (750 million euros), will accrue interest at an annual rate of 5.032% as from the issuance date (inclusive) up to March 31, 2020. From March 31, 2020 (inclusive), the loan will accrue a fixed interest rate equal to the applicable 6 year swap rate plus a margin of: (i) 3.836% per year as from March 31, 2020 up to March 31, 2024 (not inclusive); (ii) 4.086% per year as from March 31, 2024 up to March 31, 2040 (not inclusive); and (iii) 4.836% per

Telefónica, S.A. 46

Table of Contents

Financial Statements

year as from March 31, 2040 (inclusive). The second tranche, related with to the amortizing securities nominal amount from the tenth anniversary of the issuance date (1,000 million euros), will accrue interest at an annual rate of 5.907% as from the issuance date (inclusive) up to March 31, 2024. From March 31, 2024 (inclusive), the loan will accrue a fixed interest rate equal to the applicable 10 year swap rate plus a margin of: (i) 4.333% per year as from March 31, 2024 up to March 31, 2044 (not inclusive); (ii) 5.083% per year as from March 31, 2044 (inclusive).

On December 4, 2014, 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 850 million euros and subject to a call option exercisable by the Issuer from the fifth 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 850 million euros, with long-term maturity. This loan will accrue interest at an annual rate of 4.232% as from the issuance date (inclusive) up to December 4, 2019. From December 4, 2019 (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) 3.838% per year as from December 4, 2019 up to December 4, 2024 (not inclusive); (ii) 4.088% per year as from December 4, 2024 up to December 4, 2039 (not inclusive); and (iii) 4.838% per year as from December 4, 2039 (inclusive).

Financing raised by Telefónica, S.A. through Telefónica Emisiones, S.A.U. at December 31, 2014 was 37,157 million euros (35,930 million euros in 2013). This financing is arranged as loans from these companies on the same terms as those of the issuance programs. The average interest rate in 2014 was 4.69% (5.09% in 2013). 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 2014 mainly by tapping the European and US capital markets, issuing the following bonds totaling 2,962 million euros (4,883 million euros in 2013):

Description	Issue date	Maturity date	Amount in		Coupon	
			millions of euros (nominal)	Currency of issue		
Telefónica Emisiones, S.A.U.						
EMTN bonds	03/26/14	03/26/16	200	EUR	200	Euribor 3M + 0.65%
	04/10/14	04/10/17	200	EUR	200	Euribor 3M + 0.75%
	05/27/14	05/27/22	1,250	EUR	1,250	2.242%
	06/04/14	04/10/17(*)	100	EUR	100	Euribor 3M + 0.75%
	10/17/14	10/17/29	800	EUR	800	2.932%
SHELF bond	06/23/14	06/23/17	500	USD	412	Libor 3M + 0.65%

(*) Retap bond of the 200 million euros issuance dated on 04/10/14.

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, 2014 and 2013 as a result of fair value interest rate and exchange rate hedges.

Meanwhile, at December 31, 2014, 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 1,912 million euros (3,635 million euros at December 31, 2013) 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

Telefónica, S.A. 47

Table of Contents

Financial Statements

Deposit Agreements accruing interest at market rates and amounting to 3,913 million euros in 2014 (3,455 million euros in 2013).

Financing raised by Telefónica, S.A. through Telefónica Participaciones, S.A.U. at December 31, 2014 totals 217 million euros and it has been shown as Others in 2014 chart of movements. This financing corresponds to the actual value of the interests from a bond issuance launched on September 24, 2014 by Telefónica, S.A. and fully subscribed by Telefónica Participaciones, S.A.U. with an average interest rate of 4.90% (see Note 11 e). The nominal value of the previously mentioned issuance (1,500 million euros) of bonds necessarily convertible into treasury shares has been booked as Other equity instruments .

Loans to Group companies under current assets include accrued interest receivable at December 31, 2014 of 917 million euros (1,281 million euros in 2013).

15.2 The balance of Payable to subsidiaries due to taxation on a consolidated basis was 458 million euros and 437 million euros at December 31, 2014 and 2013, 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 97 million euros (104 million euros in 2013), Telefónica Móviles España, S.A.U. for 101 million euros (116 million euros in 2013) and Latin American Cellular Holdings, S.L for 122 million euros (154 million euros in 2013).

Telefónica, S.A. 48

Table of Contents

Financial Statements

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

During 2014, 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, 2014, the total outstanding balance of derivatives transactions was 162,926 million euros (139,000 million euros in 2013), of which 132,950 million euros related to interest rate risk and 29,976 million euros to foreign currency risk. In 2013, 109,389 million euros related to interest rate risk and 29,610 million euros to foreign currency risk.

It should be noted that at December 31, 2014, Telefónica, S.A. had transactions with financial institutions to hedge exchange rate risk for other Telefónica Group companies amounting to 2,420 million euros (1,429 million euros in 2013). At year-end 2014 and 2013, 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.

The breakdown of Telefónica, S.A.'s interest rate and exchange rate derivatives at December 31, 2014, their notional amounts at year end and the expected maturity schedule is as follows:

Telefónica, S.A. 49

Table of Contents

Financial Statements

2014

Millions of euros Type of risk	Value in Euros	Telefonica receives		Telefonica pays	
		Carrying	Currency	Carrying	Currency
Euro interest rate swaps	101,258				
Fixed to fixed	85	85	EUR	85	EUR
Fixed to floating	45,923	45,956	EUR	45,923	EUR
Floating to fixed	55,200	55,200	EUR	55,200	EUR
Floating to floating	50	50	EUR	50	EUR
Foreign currency interest rate swaps	29,456				
Fixed to floating					
CHFCHF	520	625	CHF	625	CHF
CZKCZK	418	11,600	CZK	11,600	CZK
GBPGBP	4,866	3,790	GBP	3,790	GBP
JPYJPY	117	17,000	JPY	17,000	JPY
USDUSD	18,674	22,672	USD	22,672	USD
Floating to fixed					
CZKCZK	45	1,250	CZK	1,250	CZK
GBPGBP	2,359	1,838	GBP	1,838	GBP
USDUSD	2,457	2,984	USD	2,984	USD
Exchange rate swaps	15,191				
Fixed to fixed					
EURBRL	466	524	EUR	1,502	BRL
EURCLP	51	47	EUR	37,800	CLP
EURCZK	352	401	EUR	9,759	CZK
Fixed to floating					
JPYEUR	95	15,000	JPY	95	EUR
Floating to floating					
CHFEUR	515	625	CHF	515	EUR
EURCZK	148	162	EUR	4,114	CZK
EURGBP	519	588	EUR	405	GBP
GBPEUR	829	700	GBP	829	EUR
JPYEUR	167	17,000	JPY	167	EUR
USDEUR	12,049	16,074	USD	12,049	EUR
Forwards	12,435				
BRLEUR	2,755	9,312	BRL	2,755	EUR
CLPEUR	14	10,063	CLP	14	EUR
EURBRL	384	372	EUR	1,238	BRL
EURCZK	24	24	EUR	667	CZK
EURGBP	1,646	1,622	EUR	1,282	GBP
EURMXN	225	216	EUR	4,031	MXN
EURUSD	2,939	2,831	EUR	3,569	USD

Edgar Filing: TELEFONICA S A - Form 6-K

GBPEUR	2,176	1,725	GBP	2,176	EUR
GBPUSD	57	44	GBP	69	USD
USDBRL	21	25	USD	66	BRL
USDCLP	5	6	USD	3,752	CLP
USDCOP	1	1	USD	2,976	COP
USDEUR	1,884	2,357	USD	1,884	EUR
USDGBP	36	44	USD	28	GBP
USDPEN	2	2	USD	5	PEN
CZKEUR	266	7,352	CZK	266	EUR
Subtotal		158,340			

Telefónica, S.A. 50

Table of Contents

Financial Statements

Millions of euros

Notional amounts of structured products with options	Value in euros	Notional	Currency
Interest rate options Caps & Floors	2,236		
Caps&Floors	2,236		
USD	23	28	USD
EUR	1,250	1,250	EUR
GBP	963	750	GBP
Currency options	2,350		
EURUSD	797	797	EUR
USDEUR	1,553	1,885	USD
Subtotal	4,586		
TOTAL	162,926		

The breakdown by average maturity is as follows:

Millions of euros

Hedged underlying item	Notional	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
With underlying instrument					
Promissory notes	260		60		200
Loans	33,111	3,863	6,191	8,597	14,460
in national currency	22,785	2,850	3,500	5,450	10,985
in foreign currencies	10,326	1,013	2,691	3,147	3,475
Debentures and bonds MtM	79,792	8,701	26,511	13,636	30,944
in national currency	34,948	2,750	12,748	8,350	11,100
in foreign currencies	44,844	5,951	13,763	5,286	19,844
Other underlying*	49,763	27,216	11,183	4,370	6,994
CCS	1,201	680	521		
Currency options	3,595	1,323	2,151	121	
Forward	10,556	10,556			
IRS	34,411	14,657	8,511	4,249	6,994
Total	162,926	39,780	43,945	26,603	52,598

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

Table of Contents

Financial Statements

The breakdown of Telefónica, S.A.'s derivatives in 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	Telefonica receives		Telefonica pays	
		Carrying	Currency	Carrying	Currency
Euro interest rate swaps	81,956				
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
Foreign currency interest rate swaps	25,254				
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
Exchange rate swaps	14,941				
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
Forwards	12,319				
ARSUSD					
CLPEUR	54	40,200	CLP	54	EUR
BRLEUR	5	19	BRL	5	EUR

Edgar Filing: TELEFONICA S A - Form 6-K

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

Telefónica, S.A. 52

Table of Contents

Financial Statements

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

Subtotal **134,470**

Millions of euros**Notional amounts of structured products with options** **Value in Euros Notional** **Currency****Interest rate options Caps & Floors****2,180****Caps&Floors****2,180**

USD

30

42

USD

EUR

1,250

1,250

EUR

GBP

900

544

GBP

Currency options**2,350**

GBP/EUR

797

797

EUR

USD/EUR

1,553

3,422

USD

Subtotal**4,530****TOTAL****139,000**

The breakdown by average maturity is as follows:

Millions of euros

Hedged underlying item	Notional	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
With underlying instrument					
Promissory notes	540	281		59	200
Loans	19,935	696	4,983	6,367	7,889
in national currency	10,100		3,200	3,050	3,850
in foreign currencies	9,835	696	1,783	3,317	4,039
Debentures and bonds MtM	78,758	4,058	22,830	17,409	34,461
in national currency	35,629	2,605	6,638	12,139	14,247

Edgar Filing: TELEFONICA S A - Form 6-K

in foreign currencies	43,129	1,453	16,192	5,270	20,214
Without underlying*	39,767	19,555	4,410	8,597	7,205
CCS	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
Total	139,000	24,590	32,223	32,432	49,755

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

Telefónica, S.A. 53

Table of Contents

Financial Statements

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.

The fair value of Telefónica, S.A.'s derivatives portfolio with external counterparties at December 31, 2014 was equivalent to a net liability of 1,999 million euros (net liability of 66 million euros in 2013).

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 and in the United Kingdom), 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.

Telefónica, S.A. 54

Table of Contents

Financial Statements

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. This objective is also reflected on the decrease of the sensitivity to exchange rate variations of the net debt to OIBDA ratio, in order to protect the Group solvency. The degree of exchange rate hedging employed varies depending on the type of investment. For transactions of purchase or sale of business in currencies other than euro, additional hedges can be made on the estimate prices of the transactions or on estimated cash flows and OIBDA.

Telefónica occasionally takes out dollar-denominated debt to hedge the euro-dollar intermediate component in the relation Euro-Latin American currencies, 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, 2014, pound sterling-denominated net debt was approximately 1.82 times the value of our 2014 Operating Income Before Depreciation and Amortization (OIBDA) from the business in the United Kingdom, helping to reduce the sensitivity of the Telefónica Group net debt over OIBDA ratio to changes in the value of the pound sterling against euro. Debt denominated in pound sterling as of December 31, 2014 amounts to 3,043 million euros, lower than 3,342 million as of December 31, 2013.

After the completion of the sale of Telefónica Czech Republic, a.s., the exchange rate risk in Czech Crowns is limited only to deferred price amounts which as of December 31, 2014 are 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 2014 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 76 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 10 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 2014, the rates applied to the largest amount of short-term debt were mainly based on the Euribor, 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, 2014 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 2013 has also been assumed.

Table of Contents

Financial Statements

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, 2014 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.

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

	Impact on Consolidated net income (*)	Impact on P/LTelefónica, S.A. (*)	Impact on Consolidated Equity	Impact on Telefónica, S.A. Equity
+100bp	(111)	(24)	370	318
-100bp	68	13	(113)	(67)

(*) 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 convertible or exchangeable instruments issued by Telefónica Group, from treasury shares and from equity derivatives.

According to the Share-based payments plans (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, 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.

In 2014 a new long-term incentive Plan, called Performance and Investment Plan (PIP), consisting of the delivery of shares of Telefónica, S.A. aimed at members of the Executives of Telefónica Group was launched, furthermore 2014 Ordinary General Shareholders Meeting approved a Global incentive Telefónica, S.A. shares purchase Plan for the Employees of the Telefónica Group.

To reduce the risk associated with variations in share price under these plans, Telefónica could acquire instruments that replicate the risk profile of some of these plans as it was done in previous years.

In addition, the Group may use part of the treasury shares of Telefónica, S.A. held at December 31, 2014 to cover shares deliverable under the PIP or the 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

Telefónica, S.A. 56

Table of Contents

Financial Statements

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.

Country risk

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

1. 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,
2. Repatriating funds generated in Latin America that are not required for the pursuit of new, profitable business development opportunities in the region.

Credit risk

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 or in case of Spanish entities in line with the credit rating of Kingdom of Spain. 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, the CDS (Credit Default Swap) 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, assuming a stable sovereign rating provides a ceiling which 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: the maximum amounts to be invested by counterparty based on its rating (long-term debt rating); and 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 sustainable business and customer base growth targets in a manner that is consistent with Telefónica Corporate Risk Management Policy. This management approach relies on the active monitoring of the risk assumed and the resources necessary to grant the adequate risk-reward balance in the operations and the 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 consolidated 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 product and services available 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.

Table of Contents

Financial Statements

Telefónica, S.A. provides operating guarantees granted by external counterparties, which are offered during its normal commercial activity. At December 31, 2014, these guarantees amounted to approximately 77 million euros.

Capital management

Telefónica's corporate finance department, takes into consideration several factors for the evaluation of the Telefónica's capital structure, with the aim of maintaining the solvency and creating value to the shareholders.

The corporate finance department estimates the cost of capital on a continuous basis through the monitoring of the financial markets and the application of standard industry approaches for calculating weighted average cost of capital, or WACC, so that it can be applied in the valuation of businesses in course and in the evaluation of investment projects. Telefónica also uses as a reference a net financial debt ratio below 2.35x OIBDA in the medium term (excluding items of a non-recurring or exceptional nature), with the objective of protecting the credit rating over the medium term, and making this rating compatible with alternative uses of cash flow that could arise at any time.

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 that are considered when evaluating the financial structure of the Telefónica Group and its different areas.

Derivatives Policy

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.

Table of Contents

Financial Statements

In 2014 the Company recognized a loss of 0.25 million euros for the ineffective part of cash flow hedges (0.15 million euros in 2013).

The breakdown of the Company's derivatives with counterparties not belonging to the Telefónica Group at December 31, 2014 and 2013 by type of hedge, their fair value at year end and the expected maturity schedule is as follows:

Telefónica, S.A. 59

Table of Contents

Financial Statements

2014

Millions of euros	Fair value (**)	Notional amount maturities (*)				
		2015	2016	2017	Subsequent years	Total
Derivatives						
Interest rate hedges	(471)	(1,000)	2,045	210	(2,928)	(1,673)
Cash flow hedges	665	(1,000)	800	460	3,350	3,610
Fair value hedges	(1,136)		1,245	(250)	(6,278)	(5,283)
Exchange rate hedges	(809)	4,718	3,141	913	3,799	12,571
Cash flow hedges	(809)	4,718	3,141	913	3,799	12,571
Interest and exchange rate hedges	(453)	(221)	549	228	2,767	3,323
Cash flow hedges	(453)	(221)	549	228	2,767	3,323
Net investment Hedges	(65)	(726)	(588)			(1,314)
Other derivatives	(201)	7,385	(111)	(1,243)	(1,437)	4,594
Interest rate	34	7,893	452	(325)	(1,557)	6,463
Exchange rate	(192)	(481)	(563)	(168)	120	(1,092)
Other	(43)	(27)		(750)		(777)

(*) 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.

(***) The fair value of Telefónica derivatives amounted to a positive MTM (accounts receivable) of 1,999 million euros

2013

Millions of euros	Fair value (**)	Notional amount maturities (*)				
		2014	2015	2016	Subsequent years	Total
Derivatives						
Interest rate hedges	438	(3,460)	2,155	1,053	(1,590)	(1,842)
Cash flow hedges	752	(3,230)	2,150		8,420	7,340
Fair value hedges	(314)	(230)	5	1,053	(10,010)	(9,182)
Exchange rate hedges	361	70	1,564	3,157	4,726	9,517
Cash flow hedges	361	70	1,564	3,157	4,726	9,517
Interest and exchange rate hedges	(22)	(405)	(221)	549	2,812	2,735
Cash flow hedges	(22)	(405)	(221)	549	2,812	2,735
Net investment Hedges	(111)	(273)		(588)		(861)
Other derivatives	(600)	374	(225)	(1,273)	(1,989)	(3,113)
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.

Telefónica, S.A. 60

Table of Contents

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 2014 comprised 49 companies.

Amendment of the Corporate Income Tax Law in Spain

Spanish Law 27/2014 of 27 November on Corporate Income Tax stipulates a reduction of the current tax rate for financial year ending in 2014 (30%). It has been set at 28% for financial year ending in 2015, and at 25% for financial year ending in 2016 and following years.

In addition, although a limit is established to offset tax losses carryforwards at 60% for 2016 and at 70% for 2017 and subsequent years, the time limit to offset them, which was 18 years, is removed.

This amendment reduces the tax on Spanish companies' profits, but also means less can be claimed back on tax losses carried forward from previous years on the balance sheet.

Based on estimates of the taxable profit and recovery of deferred tax assets and liabilities on the balance sheet, the Company has quantified the impact of this change on the 2014 annual accounts, recording a 457 million euro charge under Corporate income tax and a reduction in equity amounting 32 million euros.

Tax balances are as follows:

Millions of euros	2014	2013
Tax receivables:	4,943	4,985
Deferred tax assets:	4,289	4,325
Deferred income tax (income)	3,096	3,115
Long-term tax loss carryforwards	1,167	1,203
Deductions	26	7
Current tax receivables (Note 10):	654	660
Withholdings	66	21
Corporate income tax payable	574	617
VAT and Canary Islands general indirect tax refundable	14	22
Tax payable:	254	304
Deferred tax liabilities:	179	262
Current payables to public administrations (Note 18):	75	42
Personnel income tax withholdings	1	4
Corporate income tax payable	12	13
Withholding on investment income, VAT and other	61	24
Social security	1	1

The tax group had unused tax loss carryforwards at December 31, 2014 amounting to 9,557 million euros:

2014/12/31	Total	Less than 1 year	More than 1 year
Tax loss carryforwards	9,557		9,557

Total tax credits based on the taxable income recognized in the balance sheet at December 2014 therefore amount to 1,167 million euros (1,203 million euros in 2013).

As of December 2014, non-registered taxable income amounts to 4,889 million euros.

Telefónica, S.A. 61

Table of Contents

Financial Statements

During 2014, Telefónica, S.A., as head of the Telefónica tax group, made payments on account of 2014 income tax amounting to 270 million euros (436 million euros in 2013).

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, 2014 and 2013 are as follows:

2014

Millions of euros	Tax credits	Temporary differences, assets	Deductions	Total deferred tax assets	Deferred tax liabilities
Opening balance	1,203	3,115	7	4,325	262
Arising in the year	34	536		570	
Reversal		(560)	(15)	(575)	(92)
Transfers to the tax group's net position	(70)	5	34	(31)	(6)
Other movements					15
Closing balance	1,167	3,096	26	4,289	179

2013

Millions of euros	Tax credits	Temporary differences, assets	Deductions	Total deferred tax assets	Deferred tax liabilities
Opening balance	1,170	3,634	291	5,095	499
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
Closing balance	1,203	3,115	7	4,325	262

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 (see Note 8).

Table of Contents

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 2014 and 2013 is as follows.

Millions of euros	2014	2013
Accounting profit before tax	1,989	33
Permanent differences	(5,472)	(4,787)
Temporary differences:	1,651	3,243
Arising in the year	1,555	2,690
Arising in prior years	96	553
Tax result	(1,832)	(1,511)
Gross tax payable	(550)	(454)
Tax credits capitalized/disposed of	15	(9)
Corporate income tax refundable	(536)	(462)
Temporary differences for tax valuation	(487)	(973)
Temporary differences derived from the consolidation process	(8)	
Other effects	437	778
Corporate income tax accrued in Spain	(593)	(657)
Foreign taxes	(21)	27
Income tax	(615)	(631)
Current income tax	(561)	(429)
Deferred income tax	(54)	(202)

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 2014, this adjustment came to 25 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 2014, 76 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 effect of the tax rate reduction related to the above mentioned amendment of the Corporate Income Tax Law in Spain.

17.3 Tax inspections and tax-related lawsuits

In December 2012 the National Court of Justice issued a ruling on the tax inspection for the years 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 and rejecting the other allegations. On December 28, 2012 the Company filed an appeal with the Supreme Court.

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

Telefónica, S.A. 63

Table of Contents

Financial Statements

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.

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.

At 2014 year end, it is not expected that the final outcome of the inspections in progress as well as the assessments and lawsuits in progress or pending, will require any additional significant liabilities to be recognized in Telefónica, S.A.'s annual accounts.

Tax deductibility of financial goodwill (Article 12.5)

Spain added a new Article 12.5 to its Corporate Income Tax Law, which came into force on 1 January 2002. The article concerned the deductibility of tax amortization of financial goodwill arising from the acquisition of non-Spanish companies, which could be amortized over 20 years at 5% per annum.

Telefónica, S.A. has been amortizing financial goodwill from its investments in O2, Cesky Telecom and BellSouth (all predating December 21, 2007) with a cumulative positive impact on consolidated income tax expense since 2004 to 2014 of 784 million euros.

On December 20, 2007 the European Commission challenged Spanish law, on the grounds that this tax benefit constituted state aid. On 28 October 2009 the Commission issued a First Decision ruling that Article 12.5 constituted state aid, although it upheld the legitimacy of operations carried out prior to publication of the commencement of the investigation procedure in the EU's Official Journal.

On January 12, 2011 the Commission issued a Second Decision ruling that, in the case of acquisitions in non-European Union countries up to May 21, 2011, the system established in the original version of Article 12.5 could still be applied, provided certain conditions were fulfilled.

After the proceedings initiated on July 17, 2013, on October 15, 2014 the Commission declared that the Binding Consultation in connection with financial goodwill on indirect acquisitions also constituted state aid and cast doubt on the applicability of the principle of legitimate expectations acknowledged in the two previous Decisions, and refused to permit the concept for indirect acquisitions.

On November 7, 2014 the European Union General Court issued two rulings overturning the First and Second European Union Decisions, considering that the system permitting amortization of goodwill in Spain did not constitute state aid because it had not been proven that the action taken by the Spanish authorities was selective. The European Commission submitted an appeal against both rulings to the EU's Court of Justice.

Table of Contents

Financial Statements

Note 18. Trade and other payables

The breakdown of Trade and other payables is as follows:

Millions of euros	2014	2013
Suppliers	140	131
Other payables	121	113
Current income tax liabilities (Note 17)	12	13
Other payables to public administrations (Note 17)	63	29
Total	336	286

Trade payables

In performance of Telefónica's irrevocable undertaking of 2010 to give Fundación Telefónica a total of 280 million euros, in 2014 the Company made cash payments in the amount of 41 million euros (53 million in 2013). After 2014 amounts disbursed the irrevocable undertaking of 2010 has been fully paid.

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 (amended by Law 31/2014) and Royal Decree 4/2013, amending Law 3/2004, establishing measures against late payment in commercial transactions. Engagement conditions with commercial suppliers in both 2014 and 2013 included payment periods of up to 60, 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 tables below.

Payments to Spanish suppliers in 2014 and 2013 surpassing the legal limit were due to circumstances or incidents beyond the payment policies, mainly the delay in the billing process (a legal obligation for the supplier), the closing of agreements with suppliers over the delivery of goods or the rendering of services, or occasional processing issues.

Ejercicio 2014	Ejercicio 2013
-----------------------	-----------------------

Millions of euros	Amount	%	Amount	%
Payments made on time	307	95	298	98
Other	15	5	8	2
Total payments to commercial suppliers	322	100	306	100
Weighted average maturity exceeded (days)	27		17	
Deferrals at year-end that exceed the limit	1		2	

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.

In accordance with the above mentioned criteria, average payment period to suppliers of Telefónica, S.A. in 2014 is 35 days, according to the Company's best estimates.

Telefónica, S.A. 65

Table of Contents

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 2014 and 2013, Rendering of services to Group companies and associates included 553 million euros and 609 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 2014 and 2013 amounted to 29 million euros and 16 million euros, in each case, recognized under Rendering of services to Group companies and associates .

Revenues also include property rental income amounting to 49 and 52 million euros in 2014 and 2013, 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 2014 and 2013 is as follows:

Millions of euros	2014	2013
Telefónica Internacional, S.A.U.	3,238	4,500
Telefónica de España, S.A.U.	1,999	1,600
Telefónica Europe, plc.	1,304	1,309
Telefónica Móviles España, S.A.U.	994	1,081
Telefónica Brasil, S.A.	255	495
Compañía Inversiones y Teleservicios, S.A.U.		440
Sao Paulo Telecomunicações	56	160
Telefónica Czech Republic, a.s.		158
Telefónica Móviles Argentina, S.A. y Telefónica Móviles Argentina Holding, S.A.		89
Telefónica Gestión de Servicios Compartidos España, S.A.U.		55
Other companies	128	191
Total	7,974	10,078

c) Interest income on loans to Group companies and associates

Edgar Filing: TELEFONICA S A - Form 6-K

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	2014	2013
Telefónica Móviles México, S.A. de C.V.	54	100
Telefónica de España, S.A.U.	20	13
Telefónica de Contenidos, S.A.U.		56
Telefónica Móviles Argentina, S.A.	8	
Other companies	25	66
Total	107	235

Telefónica, S.A. 66

Table of Contents

Financial Statements

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	2014	2013
Wages, salaries and other personnel expenses	203	135
Pension plans	8	(1)
Social security costs	22	20
Total	233	154

In 2014, Wages, salaries and other personnel expenses includes 18 million euros of compensation payable during the year (11 million euros in 2013).

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, 2014, 1,896 employees had signed up for the plan (1,833 employees in 2013). 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 2014 (4 million euros in 2013).

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. has recorded costs related to the contributions to this executive plan of 9 million euros in 2014 (8 million euros in 2013).

In 2014, 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 4 million euros (12 million euros in 2013).

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

The share-based payment plans are the following:

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.

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

Table of Contents

Financial Statements

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.

The first phase expired on June 30, 2014. The maximum number of shares assigned to this phase of the plan was 5,545,628 shares assigned on July 1, 2011, with a fair value of 8.28 euros per share. Delivery of shares was not required at the end of the phase according to the general conditions of the plan; therefore, managers did not receive any shares.

For the first phase of the Plan, Telefónica, S.A. acquired a derivative instrument from a financial institution with the same features of the plan and its cost was 37 million euros. At the maturity date of this phase of the plan, the derivative instrument was also cancelled and registered in reserves.

Regarding the second and third allocations of shares under this plan, the maximum number of shares assigned (including the amount of co-investment) and the number of shares outstanding at December 31, 2014 is as follows:

	No. of shares assigned	No. of shares assigned at 12/31/14	Unit fair value	End date
2nd phase July 1, 2012	7,347,282	6,007,909	5.87	June 30, 2015
3rd phase July 1, 2013	7,020,473	6,494,041	6.40	June 30, 2016

From the total number of shares assigned, 2,061,032 and 2,219,790 shares were assigned to employees of Telefónica, S.A. in phases 2 and 3, respectively.

At the General Shareholders Meeting held on May 30, 2014, the second 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 first Performance Investment 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.

On October 1st 2014, the assignment of shares corresponding to the first phase was completed. On October 1st, 2015 and 2016 the assignments for phases second and third will be done.

The maximum number of shares assigned (including the amount of co-investment) and the number of shares outstanding at December 31, 2014 is as follows:

	No. of shares assigned	No. of shares assigned at 12/31/14	Unit fair value	End date
1st phase October 1, 2014	6,927,953	6,918,686	6.82	September 30, 2017

Out of the total figure of shares assigned at 12/31/2014, 2,769,606 shares correspond to employees of Telefónica, S.A.

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

In addition to PIP share plans, during 2012 to 2014 period there has been another incentive plan based on Telefónica, S.A. shares. The plan's share holding period came to an end in December 2014. More than 21,000 employees on the scheme were rewarded with a total of 1,778,099 shares from Telefónica, valued at approximately 20 million euros at the time they were delivered (see Note 11.1).

Telefónica, S.A. 68

Table of Contents

Financial Statements

Likewise, the Telefónica, S.A. Ordinary General Shareholders Meeting on May 30, 2014 approved a new voluntary plan for incentivized purchases of shares for the employees of the Group, which at the date of preparation of these annual accounts is pending to be implemented.

19.4 Average number of employees in 2014 and 2013 and number of employees at year-end:**2014**

Professional category	Employees at 12/31/14			Average no. of employees in 2014		
	Females	Males	Total	Females	Males	Total
General managers and chairmen		1	1		1	1
Directors	57	154	211	57	147	204
Managers	137	144	281	131	140	271
Project Managers	161	113	274	157	107	264
University graduates and experts	93	56	149	90	54	144
Administration, clerks, advisors	106	8	114	120	8	128
Total	554	476	1,030	555	457	1,012

2013

Professional category	Employees at 12/31/13			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
Total	533	421	954	502	400	902

In 2014 continued the concentration in the Headquarters of some activities that had previously been developed in the different regions of the Telefonica Group, a fact that explains the increase in headcount with respect to 2013.

19.5 External services.

The items composing External services are as follows:

Millions of euros	2014	2013
Rent	11	11
Independent professional services	174	169
Marketing and advertising	74	80
Other expenses	43	69
Total	302	329

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.

Telefónica, S.A. 69

Table of Contents

Financial Statements

Future minimum rentals payable under non-cancellable operating leases without penalization at December 31, 2014 and 2013 are as follows:

Millions of euros	Total	From 1 to 3			
		Up to 1 year	years	From 3 to 5 years	Over 5 years
Future minimum rentals 2014	52	5	10	11	26
Future minimum rentals 2013	53	5	10	11	27

19.6 Finance revenue

The items composing Finance revenue are as follows:

Millions of euros	2014	2013
Dividends from other companies	4	7
Other finance revenue	180	172
Total	184	179

The interests rendered in 2014 by the bonds acquired to Telco, S.p.A. (49 million euros) are included within other finance revenue because after the loss of significant influence detailed in Note 9, this financial asset has been reclassified to current credits to third parties.

19.7 Finance costs

The breakdown of Finance costs is as follows:

Millions of euros	2014	2013
Interest on borrowings from Group companies and associates	2,034	1,971
Finance costs payable to third parties and gains (losses) on interest rates of financial hedges	262	741
Total	2,296	2,712

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

Millions of euros	2014	2013
-------------------	------	------

Edgar Filing: TELEFONICA S A - Form 6-K

Telefónica Europe, B.V.	431	238
Telefónica Emisiones, S.A.U.	1,550	1,712
Other companies	53	21
Total	2,034	1,971

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.

Telefónica, S.A. 70

Table of Contents

Estados financieros

19.8 Exchange differences:

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

Millions of euros	2014	2013
On current operations	33	37
On loans and borrowings	66	813
On derivatives	1,062	769
On other items	16	8
Total	1,177	1,627

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

Millions of euros	2014	2013
On current operations	61	22
On loans and borrowings	545	270
On derivatives	656	1,197
On other items	11	56
Total	1,273	1,545

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 strengthened against euro in 2014, reversing 2013 trend: Brazilian real strengthening by 0.2% (weakening by 16.54% in 2013), US dollar strengthening by 13.6% (weakening by 4.33% in 2013) and the pound sterling strengthening by 7.04% (weakening by 2.11% in 2013). The impact of Czech crown exchange-rate in 2014 is not significant (weakening by 8.33% in 2013). These impacts are offset by the hedges contracted to mitigate exchange rate fluctuations.

19.9 Impairment losses on disposal of financial instruments with third parties

The amount included under this caption corresponds to the change in valuation of Telco, S.p.A. investments as described in Note 9.

Telefónica, S.A. 71

Table of Contents

Financial Statements

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

At December 31, 2014, Telefónica, S.A. had provided financial guarantees for its subsidiaries and investees to secure their transactions with third parties amounting to 45,742 million euros (42,535 million euros at December 31, 2013). These guarantees are measured as indicated in Note 4.g).

Millions of euros		
Nominal Amount	2014	2013
Debentures and bonds	41,814	38,780
Loans and other payables	3,432	2,776
Other marketable debt securities	496	979
Total	45,742	42,535

The debentures, bonds and equity instruments in circulation at December 31, 2014 issued by Telefónica Emisiones, S.A.U., Telefonica Europe, B.V., Telefónica Finanzas México, S.A. de C.V. and Telefónica Participaciones, S.A.U., were guaranteed by Telefónica, S.A. The nominal amount guaranteed was equivalent to 41,814 million euros at December 31, 2014 (38,780 million euros at December 31, 2013). During 2014, Telefónica Emisiones, S.A.U. issued debt instruments on capital markets for an equivalent of 2,962 million euros (4,883 million euros in 2013) and 4,055 million euros matured during 2014 (3,354 million euros during 2013); Telefonica Europe, B.V. issued undated subordinated securities by an equivalent to 2,600 million euros and Telefónica Participaciones, S.A.U. issued notes mandatorily convertible into Telefónica, S.A. shares by 1,500 million euros.

The main loans and other debts guaranteed by Telefónica, S.A. at December 31, 2014 are: credit facilities obtained by Telefónica Finanzas, S.A. from the European Investment Bank, whose outstanding principal at December 31, 2014 was equivalent to 665 million euros (707 million euros at December 31, 2013); a financing agreement entered into with China Development Bank (CDB) and Industrial and Commercial Bank of China (IDBC) on August 28, 2012 by Telefónica Europe, B.V., whose outstanding principal at December 31, 2014 was 844 million US dollars (equivalent to 695 million euros); and a financing agreement entered into with China Development Bank on January 5, 2012 by Telefónica Europe, B.V., whose outstanding principal at December 31, 2014 was 375 million US dollars (equivalent to 309 million euros). During 2014, approximately 57 million euros was paid 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 Telefonica Europe, B.V. The outstanding balance of commercial paper in circulation issued through this program at December 31, 2014 was 496 million euros (720 million euros at December 31, 2013). On June 30, 2014 Telefonica Finance USA, LLC, fully redeemed the remaining preferred shares (59 million euros).

Telefónica, S.A. provides operating guarantees granted by external counterparties, which are offered during its normal commercial activity. At December 31, 2014, these guarantees amounted to approximately 77 million euros (114 million euros in 2013).

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. 72

Table of Contents

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.

Among unresolved cases or those underway in 2014 (see Note 17 for details of tax-related cases), the following are of special note:

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

On July 9, 2007, Telefónica, S.A. was notified of the Decision issued by the European Commission (the "EC") imposing on Telefónica, S.A. 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 favor 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, S.A. and Telefónica de España 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, S.A. presented its case. On March 29, 2012, the General Court ruled rejecting the appeal by Telefónica, S.A. 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 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 court of first instance.

On July 10, 2014, the European Union Court of Justice dismissed the appeal, maintaining the fine imposed for abuse of dominant position (margin squeeze) on wholesale prices charged by Telefónica and Telefónica de España, for broadband access in Spain. This ended the appeal process. Telefónica de España, S.A.U. has disbursed the amounts derived from this litigation.

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 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. During 2014 there has not been no significant advances in this lawsuit.

Telefónica, S.A. 73

Table of Contents

Financial Statements

Judicial appeals against the decisions by the Conselho Administrativo de Defesa Econômica (CADE) regarding the acquisition by Telefónica, S.A. of stakes in Portugal Telecom, SGPS S.A. and Telco, S.p.A.

On December 4, 2013, the Brazilian Antitrust Regulator, 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. (Vivo):

The entry of a new shareholder in Vivo, sharing the control of Vivo with Telefónica in conditions identical to those that were applicable to the PT Companies when they had a participation in Brasilcel N.V., or

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, S.p.A. 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.

The fine imposed by CADE on Telefónica, S.A. relates to the agreement reached on September 24, 2013, between 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.) whereby Telefónica 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 non-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 remained unchanged (46.18%), although its interest in the total share capital of Telco stand at 66%.

On July 9, 2014, Telefónica filed a judicial appeal against both decisions, requesting they be overturned citing numerous procedural improprieties (the rulings were issued before Telefónica presented its allegations) and a clear lack of legal grounds. At the same time, it requested the decisions be rendered null as CADE has not provided any proof that Telefónica's actions undermine competition or infringe on applicable legislation. In this respect, the decision regarding the acquisition by Telefónica of PT Companies' indirect stake in Vivo Participações, S.A. was issued three years after the deal was approved by the Brazilian telecommunications regulator (ANATEL). The transaction was completed - prior approval by the CADE was not required at the time - immediately after ANATEL's approval on September 27, 2010.

b) 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.

Telefónica, S.A. 74

Table of Contents

Financial Statements

Share purchase Agreement for the acquisition of Distribuidora de Televisión Digital, S.A. (DTS)

On June 2, 2014, Telefónica de Contenidos, S.A.U. (Telefónica Contenidos) executed a share purchase agreement, jointly and severally guaranteed by Telefónica, S.A., with Promotora de Informaciones, S.A. for the acquisition of a 56% of the share capital of Distribuidora de Televisión Digital, S.A. (DTS) for amount of 750 million euros. The closing of this purchase agreement is subject to obtaining the relevant authorization of the competition authorities.

Moreover, on July 4, 2014, Telefónica de Contenidos acquired 22% of the share capital of DTS owned by Mediaset España Comunicación, S.A. (Mediaset) for an amount of 295 million euros. Furthermore, a payment of an amount of 30 million euros was satisfied as consideration for the waiver of Mediaset s pre-emptive rights relating the stake held by PRISA in DTS referred in the paragraph above.

Pursuant to the agreement, Mediaset will receive an amount of 10 million euros in the event that Telefónica de Contenidos closes the acquisition of the 56% stake of DTS held by PRISA and, in that case, an amount of up to 30 million euros depending on the evolution of the Pay-TV customers in Spain of the Telefónica Group during the 4 years following the closing of such acquisition.

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

On June 16, 2014, the three Italian shareholders of Telco, S.p.A. requested the initiation of the process of demerger (spin off) of the company, as provided in the shareholders agreement. Implementation of the demerger, approved by the General Meeting of Shareholders of Telco, S.p.A. held on July 9, 2014, remains subject to obtaining the required anti-trust and telecommunications approvals (including those from Brazil and Argentina). Once the aforementioned approvals are obtained, this decision will be implemented by transferring all the current stake of Telco, S.p.A. in Telecom Italia, S.p.A. (Telecom Italia) to four newly created companies. The share capital of each of these companies will belong in its entirety to each of the shareholders of Telco, S.p.A. and each of these companies will receive a number of shares of Telecom Italia proportional to the current economic stake in Telco of each respective shareholder.

The application process of the aforementioned anti-trust and telecommunications approvals (including those in Brazil and Argentina), to proceed to the demerger (spin off) of Telco started, once the corresponding corporate documents were entered into in Italy. On December 22, 2014, ANATEL (Brazilian Telecommunications Regulator) approved the demerger (spin off) subject to compliance with certain obligations (see Note 8), although CADE (Brazilian Conselho Administrativo de Defesa Econômica) and CNDC (Comisión Nacional de Defensa de la Competencia of Argentina) have not rendered any decision yet.

Furthermore, on July 24, 2014, Telefónica issued 750 million euros bonds mandatorily exchangeable into ordinary shares of Telecom Italia maturing on July 24, 2017, representing, as of that date, 6.5% of its current voting share capital. The bonds may be exchanged in advance of the transfer of the shares, except under certain circumstances where the Company may opt to redeem the bonds in cash.

It is also significant that, within the framework of the GVT transaction and its holding company GVT Participações, SA, Vivendi, S.A. will acquire 1,110 million ordinary shares owned by Telefónica in Telecom Italia.

Agreement for the Acquisition of Global Village Telecom, S.A. and its holding company GVT Participações, S.A.

On September 19, 2014, Telefónica, S.A. signed an agreement with Vivendi S.A. for the acquisition by Telefónica Brasil, S.A. of Global Village Telecom, S.A. and its holding company GVT Participações, S.A. (jointly "GVT") for a cash consideration of 4,663 million euros, and a payment in shares representing 12.0% of the share capital of Telefónica Brasil, S.A., after its combination with GVT.

As part of the agreement, Vivendi, S.A. will acquire from Telefónica 1,110 million ordinary shares in Telecom Italia currently representing 8.3% of Telecom Italia's voting share capital (equivalent to 5.7% of its total share capital), in exchange for 4.5% of Vivendi, S.A.'s capital in Telefónica Brasil, S.A., after its combination with GVT (which represents all of the voting shares and 0.7% of the preferred shares to be received by Vivendi S.A. under the agreement referred to above).

Telefónica, S.A. 75

Table of Contents

Financial Statements

The cash payment for this transaction is expected to be financed via a capital increase by Telefónica Brasil S.A., which Telefónica S.A. intends to subscribe in proportion to its current stake in Telefónica Brasil, S.A. and intends to fund, in turn, via a capital increase.

The final closing of the operation is subject to obtaining the relevant regulatory authorizations (including telecommunication and anti-trust approval). On December 22, 2014, ANATEL approved the acquisition of GVT subject to compliance with certain obligations, although the resolution about the acquisition by Vivendi, S.A. of the 1,110 million of ordinary shares of Telecom Italia is still pending. Meanwhile, CADE continues to analyze the process.

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 2014 amounted to 3,486,935 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.

The tables below presents the fixed amounts established in 2014 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**Amounts in euros**

Position	Board of Directors	Executive Committee	Advisory or Control Committees (*)
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

Appendix 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 2014.

Table of Contents

Financial Statements

e) 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, 2014 is 6.25% and 5.25%, respectively.

Millions of euros		
2014	BBVA	la Caixa
Financial expenses	8	2
Receipt of services	4	3
Total expenses	12	5
Financial revenues	4	19
Dividends received (1)	14	
Total revenues	18	19
Financing transactions	1,107	1,173
Guarantees granted	68	8
Time deposits	302	21
Dividends distributed (2)	194	98

(1) As of December 31, 2014 Telefónica holds 0.72% investment in BBVA (See Note 9.3.).

(2) Additionally to the amount included in this line, it should be considered the shares received by la Caixa, in relation with the scrip dividend paid on December 2014.

Millions of euros		
2013	BBVA	la Caixa
Financial expenses	2	1
Receipt of services	3	2
Total expenses	5	3
Financial revenues	8	8
Dividends received	14	

Total revenues	22	8
Financing transactions	1,568	1,671
Guarantees granted		
Time deposits	310	214
Dividends distributed	108	89

In addition, the nominal value of derivatives held with BBVA and la Caixa in 2014 amounted to 23,233 and 1,221 million euros, respectively (12,268 million euros held with BBVA and 1,200 million euros held with la Caixa in 2013). As explained in Derivatives policy in Note 16, this figure is inflated by the use in some cases of several levels of derivatives applied to the nominal value of a single underlying.

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, 2014 and 2013 are detailed in the notes to these individual financial statements.

Telefónica, S.A. 77

Table of Contents

Cuentas Anuales 2012

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, are detailed in Note 20.d and Appendix II to these financial statements.

Certain members of Telefónica, S.A.'s Board of Directors are also board members of Abertis Infraestructuras, S.A., parent of Abertis. Telefónica signed agreements with Abertis, through its subsidiary Abertis Tower, S.A.U., by virtue of which Telefónica Spain sold 1,725 and 690 mobile phone towers in 2014 and 2013, respectively, generating a gain of 193 million euros in 2014 and a gain of 70 million euros in 2013.

An agreement has also been signed through which Abertis Tower, S.A.U. leases certain space in the aforesaid infrastructures for Telefónica Móviles España, S.A.U. to install its communications equipment.

f) Auditors' fees

The fees accrued in 2014 and 2013 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 2014 and 2013) belongs, amounted to 3.6 million euros and 3.19 million euros, respectively, broken down as follows.

Millions of euros	2014	2013
Audit services	3.38	2.90
Audit-related services	0.22	0.29
Total	3.60	3.19

EY has not provided the Company with tax advice or other services except as disclosed above.

g) 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.

h) 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. 78

Table of Contents

Financial Statements

Note 21. Cash flow analysis

Cash flows from/(used in) operating activities

The net result before tax in 2014 amounted to 1,989 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 3,679 million euros (impairment in 2013 of 7,998 million euros).

Declared dividends as income in 2014 for 7,974 million euros (10,078 million euros in 2013), interest accrued on loans granted to subsidiaries of 107 million euros (235 million euros in 2013) and a net financial expense of 2,535 million euros (2,491 million euros in 2013), 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 8,222 million euros (6,017 million euros in 2013). The main items included are:

a) Net interest paid:

Payments of net interest and other financial expenses amounted to 1,872 million euros (1,664 million euros in 2013), including:

Net payments external credit entities of 10 million euros (174 million euros in 2013), and

Interest and hedges paid to Group companies of 1,862 million euros (1,838 million euros in 2013). The main payments in 2014 were to Telefónica Emisiones, S.A.U., for 1,682 million euros, and to Telefónica Europe, B.V., for 362 million euros.

b) Dividends received:

The main receipts relate to:

Millions of euros	2014	2013
Telefónica de España, S.A.U.	1,999	1,600
Telefónica Móviles España, S.A.U.	994	1,080
Telefónica Europe, plc.	1,304	1,309
Telefónica Czech Republic, a.s.		147
Telefónica Internacional, S.A.U.	4,500	1,500
Compañía de Inversiones y Teleservicios, S.A.U.	440	
Telefónica Brasil, S.A. (Telesp)	199	398
Sao Paulo Telecomunicações	54	141
Other dividend collections	260	253
Total	9,750	6,428

In addition to the dividends recognized as income in 2014 (see Note 19.1) and collected in the same period, this caption also includes dividends from 2013 collected in 2014.

- 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 270 million euros were made in 2014 (436 million in 2013), as disclosed in Note 17. In this regard, the main amounts passed on to subsidiaries of the tax group were as follows:

Table of Contents

Financial Statements

Telefónica Móviles España, S.A.U.: collection of 156 million euros, corresponding to: 35 million euros for the 2013 income tax settlement, 59 million in payments of account of 2014 income tax and 62 million euros of the third payment of account of 2013 income tax that has been paid in 2014.

In 2013, rebilling amounted to 648 million euros, corresponding mainly to: 311 million euros for the 2012 income tax settlement and 326 million in payments of account of 2013 income tax.

Telefónica de España, S.A.U.: collection of 322 million euros, corresponding to: 66 million euros for the 2013 income tax settlement, 140 million in payments of account of 2014 income tax and 116 million euros of the third payment of account of 2013 income tax that has been paid in 2014.

In 2013, rebilling amounted to 931 million euros, corresponding mainly to: 362 million euros for the 2012 income tax settlement and 531 million in payments of account of 2013 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 5,704 million euros (2,938 million euros in 2013). The main transactions to which these payments refer are as follows:

Capital increases: the main disbursements correspond to Telfin Ireland, Ltd- amounting to 3,700 million euros, Telefónica de Contenidos, S.A.U. amounting to 400 million euros and Telefónica Digital Holding, S.A.U. amounting to 268 million euros. These capital increases, as well as other minor disbursements of this same concept are disclosed fully in Note 8.1.a.

550 million euro loans awarded and paid out in 2014 to Telefónica de España, S.A.U. and 134 million euro loan awarded and paid to Telefónica Whosale Services II, S.A.U.,

All transactions are fully described in Note 8.5.

Proceeds from disposals totaling 2,680 million euros in 2014 (2,791 million euros in 2013) includes:

Proceeds from the sale of Telefónica Czech Republic, a.s. totaling 2,163 million euros.

The proceeds from the maturity of debentures and bonds issued by Telefónica Emisiones, S.A.U. amounting to 211 million euros.

Cash flows from/(used in) financing activities

This caption includes the following items:

- i. Net payments for equity instruments of 21 million euros (244 million euros in 2013), relating to the net amount of treasury shares acquired in 2014 and the proceeds, netted of commissions, from issuance of the bonds exchangeable into treasury shares included as other equity instruments (Note 11 e) with a net amount of 1,182 million euros.

- ii. Proceeds from financial liabilities:

Telefónica, S.A. 80

Table of Contents

Financial Statements

- a) Debt issues: The main collections comprising this heading are as follows:

Millions of euros	2014	2013
Issue exchangeable into ordinary shares of Telecom Italia, S.p.A.	750	
Bilateral credit (Note 14.4)	2,000	
EKN credit facility (Note 14.2)		407
Telefónica Emisiones, S.A.U. (Note 15)	2,918	4,352
Telefónica Europe, B.V. (Note 15)	2,600	3,078
Telfisa Global, B.V. financing (Note 15)	580	1,633
Commercial paper issued by Telefónica Europe, B.V.		153
Vendor Financing	380	
Commercial paper (Note 13)		31
Export Development Canadá Loan	185	
Kutxabank Loan	125	
Other collections	500	473
Total	10,038	10,127

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

Millions of euros	2014	2013
Preferred shares bonds (Note 13)	582	582
8bn syndicated loan (Note 14)	3,672	4,000
Telefónica Europe, B.V. (Note 15)	929	1,500
Telefónica Finanzas, S.A.U.	1,799	2,081
Telefónica Emisiones, S.A.U. (Note 15)	4,059	3,594
Citibank Loan	923	
Commercial paper issued by Telefónica Europe, B.V.	423	
Commercial paper	355	
Banco Sabadell Loan	200	
Export Development Canadá Loan	206	
Other payments	392	274
Total	13,540	12,031

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 2,001 million euros (1,588 million euros in 2013) as described in Note 11.1. d). The difference between the figure of Dividends shown in this Note and in Note 11 is caused by withholding taxes deducted in the payment to certain major shareholders, and despite the reimbursement of the amounts has been requested to Tax Authorities, the cash has not been received until 2015.

Table of Contents

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 9, 2015 Telefónica Europe, B.V. made an early repayment for 844 million US dollars (695 million euros) of its bilateral loan on supplies signed on August 28, 2012 and originally scheduled to mature on October 31, 2023. This loan was guaranteed by Telefónica, S.A.

On January 15, 2015, Telefónica Emisiones, S.A.U. redeemed 1,250 million US dollars (1,068 million euros) of its notes, issued on July 6, 2009. The notes were guaranteed by Telefónica, S.A.

On January 30, 2015, the 375 and 100 million euros loan facilities arranged between Telefónica Finanzas S.A.U. and the European Investment Bank (EIB) matured as scheduled. These loans were guaranteed by Telefónica, S.A.

On February 19, 2015, Telefónica, S.A. signed a 2,500 million euros syndicated credit facility maturing in 2020, with two twelve month extension options requiring mutual agreement of the parties (which could extend the maturity to as late as 2022). This agreement entered into effect on February 26, 2015 and allowed us to cancel in advance the syndicated loan facility of Telefónica Europe, B.V. dated on March 2, 2012 with two tranches of 756 million euros and 1,469 million pounds sterling originally scheduled to mature in 2017. On the same date, Telefónica S.A. signed an amendment to its 3,000 million euros syndicated credit facility arranged on February 18, 2014 maturing in 2019 in which the parties mutually agreed two twelve month extension options (which could extend the maturity to as late as 2021).

Exclusive negotiations with Hutchison Whampoa Group

On January 23, 2015 Telefónica and Hutchison Whampoa Group agreed to enter into exclusive negotiations for the potential acquisition by the latter of Telefónica's subsidiary in the UK (O2 UK) for an indicative price in cash (firm value) of £10.25bn (approximately 13.5bn); composed of (i) an initial amount of £9.25bn (approximately 12.2bn) which would be paid at closing and (ii) an additional deferred payment of £1.0bn (approximately 1.3bn) to be paid once the cumulative cash flow of the combined company in the UK has reached an agreed threshold.

The exclusivity period will last several weeks, allowing Telefónica and Hutchison Whampoa Group to negotiate definitive agreements, while Hutchison Whampoa Group completes its due diligence over Telefónica's subsidiary in the UK (O2 UK).

Table of Contents

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 23, 2015. In the event of a discrepancy, the Spanish-language version prevails.

Telefónica, S.A. 83

Table of Contents

Financial Statements

Appendix I: Details of subsidiaries and associates at December 31, 2014

MILLIONS OF EUROS	% OWNERSHIP		INCOME (LOSS)				Gross carrying amount	
	Direct	Indirect	Capital	Reserves	Dividends	From operations		For the year
Telefónica Europe plc (UNITED KINGDOM) Wireless communications services operator Wellington Street, Slough, SL1 1YP	100.00%		13	14,339	1,304	(6)	1,292	25,458
Telefónica Internacional, S.A.U. (SPAIN) Holding company Gran Vía, 28 - 28013 Madrid	100.00%		2,839	470	3,238	(53)	2,640	8,132
Telefónica Móviles España, S.A.U. (SPAIN) Wireless communications services provider Distrito Telefónica, Ronda de la Comunicación s/n, Madrid 28050	100.00%		423	498	994	1,054	718	5,775
Telfin Ireland Limited (IRELAND) Intragroup financing 28/29 Sir John Rogerson's Quay, Dublin 2	100.00%			8,556			160	8,191
O2 (Europe) Ltd. (UNITED KINGDOM) Holding company Wellington Street, Slough, SL1 1YP	100.00%		1,239	4,776			18	2,764
Telefónica Móviles México, S.A. de C.V. (MEXICO) (1) Holding company Prolongación Paseo de la Reforma 1200 Col. Cruz Manca, México D.F. CP.05349	100.00%		4,369	(2,947)		(24)	(147)	4,117
Telefónica de España, S.A.U. (SPAIN) Telecommunications service provider in Spain Gran Vía, 28 - 28013 Madrid	100.00%		1,024	1,513	1,999	2,419	1,607	2,303
Telefónica de Contenidos, S.A.U. (SPAIN) Organization and operation of multimedia service-related activities and businesses	100.00%		226	441		(11)	9	2,642

Distrito Telefónica, Ronda de la
Comunicación s/n, Madrid 28050

Telefónica Datacorp, S.A.U. (SPAIN)	100.00%	700	84	50	(43)	(23)	1,343
--	---------	-----	----	----	------	------	-------

Holding company

Gran Via, 28 - 28013 Madrid

Telfisa Global, B.V. (NETHERLANDS)	100.00%		727		(4)	11	712
---	---------	--	-----	--	-----	----	-----

Integrated cash management, consulting
and financial support for Group companies
Strawinskyiaan 1259 ; tower D ; 12th floor
1077 XX - Amsterdam

Ecuador Cellular Holdings, B.V. (NETHERLANDS)	100.00%,		595				581
--	----------	--	-----	--	--	--	-----

Holding company

Strawinskyiaan 3105, Atium 7th,
Amsterdam

Telefónica Chile Holdings B.V. (NETHERLANDS)	100.00%		1,464			8	473
---	---------	--	-------	--	--	---	-----

Holding company

Herikerbergwebr 238, 1101CM 23393,
1100DW - Amsterdam Zuidoost
(Netherlands)

Compañía de Inversiones y Teleservicios, S.A. (SPAIN)	100.00%	24	93		(13)	9	256
--	---------	----	----	--	------	---	-----

Holding company

Distrito Telefónica, Ronda de la
Comunicación s/n, Madrid 28050

Panamá Cellular Holdings, B.V. (NETHERLANDS)	100.00%		2			(1)	52
---	---------	--	---	--	--	-----	----

Holding company

Strawinskyiaan 3105, Atium 7th,
Amsterdam

* continue with this information

Telefónica, S.A. 84

Table of Contents

Financial Statements

MILLIONS OF EUROS	% OWNERSHIP		INCOME (LOSS)				Gross From For the carrying operations year amount	
	Direct	Indirect	Capital	Reserve	Dividend	operations		
NAME AND CORPORATE PURPOSE * on the previous page.								
Telefónica de Costa Rica TC, S.A. (COSTA RICA) Holding company Plaza Roble, Edificio Los Balcones 4to. Piso, San José	100.00%		264	(113)		(30)	(30)	264
Telefónica Global Technology, S.A. (SPAIN) Global management and operation of IT systems Gran Vía, 28 - 28013 Madrid	100.00%		16	93		9	2	181
Telefónica Capital, S.A. (SPAIN) Finance company Gran Via, 28 - 28013 Madrid	100.00%		7	131			4	110
Seguros de Vida y Pensiones Antares, S.A. (SPAIN) Life insurance, pensions and health insurance Ronda de la Comunicación, s/n Distrito Telefónica Edificio Oeste 1, planta 9- 28050 Madrid	100.00%		51	62	10	15	13	69
Telefónica Digital Holdings, S.L. (SPAIN) Holding company Ronda de la Comunicación, s/n Distrito Telefónica Edificio Central - 28050 Madrid	100.00%		10	243		(293)	(296)	423
Taetel, S.L. (SPAIN) Acquisition, ownership and disposal of shares and stakes in other companies Gran Via, 28 - 28013 Madrid	100.00%		28	6				28
Telefónica Gestión de Servicios Compartidos España, S.A. (SPAIN) Management and administrative services rendered Gran Via, 28 - 28013 Madrid	100.00%		8	26		(8)	1	24
Lotca Servicios Integrales, S.L. (SPAIN) Holding and operation of aircraft and aircraft leases Gran Via, 28 - 28013 Madrid	100.00%		17	(6)		1	(1)	17
Telefónica Ingeniería de Seguridad, S.A. (SPAIN)	100.00%		12	9		(24)	(24)	38

Security services and systems Ramón Gómez de la Serna, 109-113 posterior - 28035 Madrid							
Compañía Española de Tecnología, S.A. (SPAIN)	100.00%	5	4				14
Promotion of business initiatives and holding of real estate assets Gran Vía, 28 - 28013 Madrid							
Telefónica Finanzas, S.A.U. (TELFISA) (SPAIN)	100.00%	3	69	(2)	15		13
Integrated cash management, consulting and financial support for Group companies Ronda de la Comunicación, s/n 28050 Madrid							
Centro de Investigación y Experimentación de la Realidad Virtual, S.L. (SPAIN)	100.00%						10
Design of communications products Vía de Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta. Pozuelo de Alarcón - 28224 Madrid							
Telefónica International Wholesale Services II, S.L. (SPAIN)	100.00%		(94)	(41)	(36)		25
Telecommunications service provider and operator Ronda de la Comunicación, s/n 28050 Madrid							
Telefónica Investigación y Desarrollo, S.A.U. (TIDSA) (SPAIN)	100.00%	6	20	6	7		6
Telecommunications research activities and projects Telecomunicaciones Ronda de la Comunicación, s/n 28050 Madrid							

*1 continue with this information

Table of Contents

Financial Statements

MILLIONS OF EUROS NAME AND CORPORATE PURPOSE *1 on the previous page.	% OWNERSHIP		INCOME (LOSS)				Gross From For the carrying operations year amount
	Direct	Indirect	Capital Reserve	Dividends			
Telefonica Luxembourg Holding S.à.r.L. (LUXEMBOURG) Holding company 26, rue Louvingny, L-1946- Luxembourg	100.00%		3	76			4
Venturini España, S.A. (SPAIN) Property leasing Avda. de la Industria, 17 Tres Cantos - 28760 Madrid	100.00%		3	2			4
Fisatel Mexico, S.A. de C.V. (MEXICO) Integrated cash management, consulting and financial support for Group companies Boulevard Manuel Avila Camacho, 24 -16 ^a Plta. - Lomas de Chapultepec - 11000 Mexico D.F.	100.00%		195	1	(1)	7	196
Terra Networks Marocs S.A.R.L. Dormant Company 332 Boulevard Brahim Roudani, Casablanca	100.00%						
Telefónica Participaciones, S.A (SPAIN) Integrated cash management, consulting and financial support for Group Companies Gran Via, 28 - 28013 Madrid	100.00%						
Telefónica Emisiones, S.A.. (SPAIN) Integrated cash management, consulting and financial support for Group Companies Gran Via, 28 - 28013 Madrid	100.00%			5	(2)	1	
Telefónica Europe, B.V. (NETHERLANDS) Fund raising in capital markets Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX Amsterdam	100.00%			5	1	(1)	1
Telefónica Internacional USA Inc. (EE.UU.) Financial advisory services 1221 Brickell Avenue suite 600 - 33131 Miami Florida	100.00%			1			
Telefónica Latinoamérica Holding, S.L. (SPAIN)	94.59%	5.41%	198	2,012		21	1,762

Holding company								
Ronda de la Comunicación, s/n Distrito								
Telefónica - 28050 Madrid								
Telefónica International Wholesale Services, S.L. (SPAIN)	92.51%	7.49%	230	85	19	11	2	213
International services provider								
Ronda de la Comunicación, s/n Distrito								
Telefónica - 28050 Madrid								
Corporation Real Time Team, S.L. (SPAIN)	87.96%	12.04%						12
Internet design, advertising and consulting								
Plaza Canalejas, 3 28014 Madrid								
Telefónica Móviles Argentina Holding, S.A. (ARGENTINA)	75.00%	25.00%	298	584		416	227	856
Holding company								
Ing Enrique Butty 240, piso 20-Capital								
Federal-Argentina								

Telefónica, S.A. 86

Table of Contents

Financial Statements

MILLIONS OF EUROS	% OWNERSHIP		INCOME (LOSS)					Gross carrying amount
	Direct	Indirect	Capital	Reserve	Dividend	From operations	For the year	
NAME AND CORPORATE PURPOSE								
Telefónica International Wholesale Services America, S.A. (URUGUAY) (1) Provision of high bandwidth communications services Luis A. de Herrera, 1248 Piso 4 Montevideo	74.36%	25.64%	562	(487)		(23)	(23)	325
Telefonica Centroamérica Inversiones, S.L (SPAIN) Holding company Distrito Telefónica. Avda. Ronda Comunicación, s/n. - 28050 Madrid	60.00%		1	989	19		26	651
Comtel Comunicaciones Telefónicas, S.A. (VENEZUELA) Holding company Torre Edicampo, Avda. Francisco de Miranda, Caracas 1010	65,14%	34,86%		(94)		(41)	(36)	
Telefónica América, S.A (SPAIN). Investment managment and gestion of companies in the telecommunications sector Distrito Telefónica. Avda. Ronda Comunicación, s/n. - 28050 Madrid	50.00%	50.00%						
Aliança Atlântica Holding B.V. (NETHERLANDS) Portfolio company Strawinskylaan 1725 1077 XX Amsterdam	50.00%	43.99%	40	2				22
Sao Paulo Telecomunicacoes Participações, Ltda (BRAZIL) Holding company Rua Martiniano de Carvalho, 851 20º andar, parte, Sao Paolo	44.72%	55.28%	3,889	(185)	56	(14)	306	3,092
Telefónica Brasil, S.A. (BRAZIL) (1)(*) Wireline telephony operator in Sao Paulo Sao Paulo	24.68%	49.28%	15,194	(1,167)	255	1,682	1,634	9,823
Colombia Telecomunicaciones, S.A. ESP (COLOMBIA) (1) Wireless operator Calle 100, N° 7-33, Piso 15, Bogotá, Colombia	18.51%	51.49%	485	(1,309)		203	313	272

Pléyade Peninsular, Correduría de Seguros y Reaseguros del grupo Telefónica, S.A. (SPAIN)	16.67%	83.33%			1	4	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) (2)	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%			5	4	2	
Management and administrative services rendered Av. Ing. Huergo 723 PB - Buenos Aires								
Inversiones Telefónica Móviles Holding, Ltd. (CHILE)	3.11%	96.89%	971	17			138	89
Holding company Miraflores, 130 - 12° - Santiago de Chile								

Telefónica, S.A. 87

Table of Contents

Financial Statements

MILLIONS OF EUROS	% OWNERSHIP		INCOME (LOSS)					
	Direct	Indirect	Capital	Reserve	Dividend	From operations	For the year	Gross carrying amount
Telefónica de Argentina, S.A. (1) (ARGENTINA) Telecommunications service provider Av. Ingeniero Huergo, 723, PB - Buenos Aires	1.80%	98.20%	185	212		68	19	23
Telefónica Venezolana, C.A. (VENEZUELA) (1) Wireless operator Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060	0.09%	99.91%	616	(99)		170	(2)	123
Telefónica Factoring España, S.A. (SPAIN) Factoring Zurbano, 76, 8 Plta. - 28010 Madrid	50.00%		5	2		14	12	3
Telefónica Factoring México, S.A. de C.V. SOFOM ENR (MEXICO) Factoring México D.F.	40.50%	9.50%	2				1	1
Telefónica Factoring Perú, S.A.C. (PERÚ) Factoring Ciudad de Lima	40.50%	9.50%	1	1			2	1
Telefónica Factoring Colombia, S.A. (COLOMBIA) Factoring Bogotá	40.50%	9.50%	1	1		2	1	1
Telefónica Factoring Chile, S.A. (CHILE) Factoring Ciudad y Comuna de Santiago.	40.50%	9.50%				1	1	
Telefónica Factoring Do Brasil, Ltd. (BRASIL) Factoring Avda. Paulista, 1106 Sao Paulo	40.00%	10.00%	1	(2)		(1)	10	1
Jubii Europe N.V. (NETHERLANDS) (*) Internet portal - In liquidation Richard Holkade 36, 2033 PZ Haarlem PAISES BAJOS	32.10%		N/D	N/D		N/D	N/D	13

Torre de Collçerola, S.A. (SPAIN)	30.40%		6				2
Operation of telecommunicatios mast and technical assistance and consulting services.							
Ctra. Vallvidrera-Tibidabo, s/nº - 08017							
Barcelona							
Other investments	N/D	N/D	N/D	N/D	28	N/D	355
Total group companies and associates					7,974		82,005

(1) Consolidated data.

(2) Data included in Telefónica Móviles Argentina Holding as consolidated figures.

(*) Companies listed on international stock exchanges at December 31, 2014.

Table of Contents

Financial Statements

Appendix II: Board of Director s Compensation

TELEFÓNICA, S.A.

(Euros)

Director	Wage / Compensation¹	Fixed payment²	Attendance fees³	Short term variable compensation⁴	Fixed payments Board Committees⁵	Other items⁶	Total
Mr. César Alierta Izuel	2,230,800	240,000		3,050,000	80,000	155,110	5,755,910
Mr. Isidro Fainé Casas		200,000			80,000	8,000	288,000
Mr. José María Abril Pérez		200,000	3,000		91,200		294,200
Mr. Julio Linares López		200,000	16,000		45,733		261,733
Mr. José María Alvarez-Pallete López	1,923,100			2,900,000		128,415	4,951,515
Mr. Fernando de Almansa Moreno-Barreda		120,000	14,000		33,600	8,000	175,600
Ms. Eva Castillo Sanz ⁷	1,264,000			1,463,712		53,554	2,781,266
Mr. Carlos Colomer Casellas		120,000	24,000		147,200	8,000	299,200
Mr. Peter Erskine		120,000	17,000		124,800		261,800
Mr. Santiago Fernández Valbuena							
Mr. Alfonso Ferrari Herrero		120,000	35,000		158,400	8,000	321,400
Mr. Luiz Fernando Furlán		120,000					120,000
Mr. Gonzalo Hinojosa Fernández de Angulo		120,000	30,000		158,400	8,000	316,400
Mr. Pablo Isla Álvarez de Tejera		120,000	6,000		22,400		148,400
Mr. Antonio Massanell Lavilla		120,000	13,000		56,000	8,000	197,000
Mr. Ignacio Moreno Martínez		120,000	15,000		33,600		168,600
Mr. Javier de Paz Mancho		120,000	9,000		113,600		242,600
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.
- 4 Short-term variable compensation (bonus): 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 2013 and paid in 2014. Concerning the bonus referred to 2014, to be paid during 2015, the Executive Directors will perceive the following amounts: Mr. César Alierta Izuel, 4,027,486 euros and Mr. José María Álvarez-Pallete López, 3,471,965 euros. In January 2015, Ms. Eva Castillo received variable remuneration of 1,200,000 euros corresponding to fiscal year 2014.
- 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.
- 7 On February 26, 2014, Ms. Eva Castillo Sanz ceased to hold office as Chair of Telefónica Europe, although she continued to fulfill duties at the Telefónica Group other than those inherent in her capacity as Director through December 31, 2014. The table above setting forth the total remuneration received by the directors during the fiscal year includes the remuneration received by Ms Eva Castillo Sanz through December 31, 2014. After that date, Ms. Eva Castillo Sanz stopped performing any duties other than those inherent in her capacity as Director, and received 2,405,000 euros in January 2015 as compensation for the aforementioned termination, and the sum of 862,475 euros in settlement of her participation in the Performance & Investment Plan (equal to the value of the Telefónica, S.A. shares to which she was entitled for participating in such plan), for the two cycles covering 2012-2015 and 2013-2016.

Table of Contents

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 2014, including both fixed payments and fees for attending meetings:

TELEFÓNICA, S.A. ADVISORY OR CONTROL COMMITTEES

(Euros)

Director	Audit and Control	Nomination, Compensation and Corporate Governance	Service Quality and Customer Service	Innovation Strategy	Institutional Affaires	TOTAL 2014
Mr. César Alierta Izuel						
Mr. Isidro Fainé Casas						
Mr. José María Abril Pérez				14,200		14,200
Mr. Julio Linares López				17,133	16,200	28,400
Mr. José María Álvarez-Pallete López						
Mr. José Fernando de Almansa Moreno-Barreda			15,200		16,200	16,200
Ms. Eva Castillo Sanz						
Mr. Carlos Colomer Casellas	33,400	18,200	12,200	27,400		91,200
Mr. Peter Erskine		19,200		15,200	27,400	61,800
Mr. Santiago Fernández Valbuena						
Mr. Alfonso Ferrari Herrero	21,200	31,400	15,200	12,200	16,200	17,200
Mr. Luiz Fernando Furlán						
Mr. Gonzalo Hinojosa Fernández de Angulo	20,200	19,200	26,400	12,200	15,200	15,200
Mr. Pablo Isla Álvarez de Tejera		17,200	11,200			
Mr. Antonio Massanell Lavilla	21,200		23,400	12,200		12,200
Mr. Ignacio Moreno Martínez	22,200		14,200	12,200		
Mr. Francisco Javier de Paz Mancho			14,200	12,200		16,200
Mr. Chang Xiaobing						

Table of Contents

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)

Director	Wage / Compensation¹	Fixed payment²	Attendance fees³	Short term variable compensation⁴	Fixed payments Board Committees⁵	Other items⁶	Total
Mr. César Alierta Izuel							
Mr. Isidro Fainé Casas							
Mr. José María Abril Pérez							
Mr. Julio Linares López						200,000	200,000
Mr. José María Álvarez-Pallete López							
Mr. José Fernando de Almansa Moreno-Barreda						120,000	282,557
Ms. Eva Castillo Sanz			162,557				3,876
Mr. Carlos Colomer Casellas						10,000	10,000
Mr. Peter Erskine						151,056	151,056
Mr. Santiago Fernández Valbuena (*)	1,177,811			1,318,677		260,799	2,757,287
Mr. Alfonso Ferrari Herrero						120,000	189,628
Mr. Luiz Fernando Furlán						140,000	234,455
Mr. Gonzalo Hinojosa Fernández de Angulo						60,000	81,895
Mr. Pablo Isla Álvarez de Tejera							
Mr. Antonio Massanell Lavilla						10,000	10,000
Mr. Ignacio Moreno Martínez							
Mr. Francisco Javier de Paz Mancho						120,000	248,383
Mr. Chang Xiaobing			128,383				

- 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) for a period equal to or up to a year, corresponding to 2013 and paid in 2014. Concerning the bonus referred to 2014, the amount that will be perceived by the Executive Director Mr. Santiago Fernández Valbuena is 1,417,613 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 from June 2014 is the Advisory Committee of Spain-, Latam and Digital-removed in June 2014) and other in-kind compensation (such as general medical insurance and dental coverage), paid by any Telefónica Group Company.
- (*) It is hereby stated for the record that Executive Director Mr. Santiago Fernández Valbuena collects his remuneration in Brazilian reais, and accordingly, the stated amount of his remuneration may vary, depending on the exchange rate applicable at any particular time.

Table of Contents

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 2014 by the Company to long-term savings schemes (Pension Plans and Pension Plan for Senior Executives):

LONG-TERM SAVINGS SCHEMES

(Euros)

Director	Contributions 2014
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	935,010

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

(Euros)

Director	Contributions to Pension Plans	Contributions to Benefits Plan¹
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	109,167	825,843

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.

It is also stated for the record that in February 2015, the golden parachute provisions included in the four-year contract of the Executive Chairman, Mr. César Alierta Izuel, were replaced by an extraordinary one-time contribution of 35.5 million euros to a benefit plan, as part of the company's policy of reducing indemnity provisions, in line with best corporate governance practices. After this extraordinary contribution, Telefónica, S.A. will not contribute any additional annual amounts to the Benefit Plan for Officers with respect to for Mr. Alierta Izuel. Such contribution would be received by Mr. Alierta Izuel in the same instances established in the benefit plan for officers (plan de previsión social de directivos) (PPSD) applicable to the other officers.

Life insurance premiums paid in 2014 are as follows:

LIFE INSURANCE PREMIUMS

(Euros)

Director	Life insurance premiums
Mr. César Alierta Izuel	73,952
Mr. José María Álvarez-Pallete López	19,935
Ms. Eva Castillo Sanz	9,667
Mr. Santiago Fernández Valbuena	8,050

Telefónica, S.A. 92

Table of Contents

Financial Statements

Regarding share-based payment plans (those exclusively for Executive Directors), there were two long-term variable compensation plans in place in 2014:

The first Plan is the so-called Performance & Investment Plan (PIP), approved at the General Shareholders Meeting of May 18, 2011 whose first phase began in 2011 and ended 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 regarding the first phase of this Plan (2011-2014), the general terms for the delivery of shares were not met. Therefore, no shares were delivered to Executive Directors.

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 PIP- Second phase / 2012-2015

Directors	Theoretical shares assigned	Maximum number of shares*
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
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.

FIRST PIP- Third phase / 2013-2016

Directors	Theoretical shares assigned	Maximum number of shares*
Mr. César Alierta Izuel	324,000	506,250
Mr. José María Álvarez-Pallete López	192,000	300,000
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.

It is further stated for the record that, as of December 31, 2014, a maximum of 149,787 shares and 162,500 shares had been allocated to Ms. Eva Castillo Sanz for her participation in the Performance & Investment Plan, for the two cycles of 2012-2015 and 2013-2016, respectively, and that, as stated above, in January 2015, she received 862,475 euros (equivalent to the value of shares of Telefónica S.A. that corresponded for her participation in this Plan) in settlement of her participation in the aforementioned plan.

The second plan, called as well Performance & Investment Plan (PIP), approved at the General Shareholders Meeting of May 30, 2014 whose first phase began in 2014 and will end in October 2017, second phase will begin in 2015 and will end in October 2018, and third phase will begin 2016 and will end in October 2019.

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 second Plan and the maximum target TSR established for each phase are met, are as follows:

Telefónica, S.A. 93

Table of Contents

Financial Statements

SECOND PIP- First phase / 2014-2017

Directors	Theoretical shares assigned	Maximum number of shares*
Mr. César Alierta Izuel	324,000	506,250
Mr. José María Álvarez-Pallete López	192,000	300,000
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 May 18, 2011, shareholders approved a Telefónica, S.A. share incentive purchase plan (2012-2014), 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.

The Executive Directors that decided to take part in this Plan (2012-2014) contributing the maximum (i.e. 100 euros a month, over 12 months), had acquired a total of 626 shares (including free shares received under the general terms and conditions of the Plan).

It should be noted that the external Directors do not receive and did not receive in 2014 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 (except as indicated for Ms. Castillo and Mr. Linares in the above tables).

In addition, the Company does not grant and did not grant in 2014 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.

Telefónica, S.A. 94

Table of Contents

Financial Statements

Senior executives compensation

Meanwhile, the Executives considered as Senior Executives⁽¹⁾ of the Company in 2014, excluding those that are also members of the Board of Directors, have received a total amount of 10,525,981 euros in 2014.

In addition, the contributions by the Telefónica Group in 2014 with respect to the Benefits Plan for Senior Executives described in Note on Revenue and Expenses for these Executives amounted to 1,240,757 euros. Contribution to the Pension Plan amounted to 163,065 euros and compensation in kind (including life and other insurance premiums such as general medical and dental insurance) to 122,689 euros.

Also, regarding the first Performance and Investment Plan (PIP) composed for three phases (2011-2014; 2012-2015; 2013-2016) approved at the General Shareholders Meeting of May 18, 2011, it is hereby stated that regarding the first phase of the Plan (2011-2014), the general terms for the delivery of shares were not met. Therefore, no shares were delivered to the Executives.

The number of shares assigned at the beginning of the phase to the Executives considered Senior Executives of the Company in the second phase (2012-2015) is 294,136 shares and 322,520 shares in the third phase (2013-2016).

Regarding the second Performance and Investment Plan (PIP) composed for three phases (2014-2017; 2015-2018; 2016-2019) approved at the General Shareholders Meeting of May 30, 2014, the number of shares assigned at the beginning of the phase to the Executives considered Senior Executives of the Company in the first phase (2014-2017) is 356,624 shares.

Finally, regarding 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 677 shares (including free shares received under the general terms and conditions of the Plan).

(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. Additionally, and for the purposes of annual remuneration, the person in charge of the internal audit is included.

It is hereby stated that Mr. Matthew Key ceased to be part of the Senior Executives of the Company on February 26, 2014, having perceived in January 2015 (date of his departure from the Group), in accordance with the conditions laid down, in that day, in his contract, an amount of 15,150,969 euros as a result of the termination in the performance of executive functions in the Telefónica Group.

Telefónica, S.A. 95

Table of Contents

Financial Statements

Management report 2014

This Management Report has been prepared taking into consideration the Guidelines on the preparation of annual corporate governance reports for listed companies , published by CMNV in July 2013.

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.

Telefonica's 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.

On February 26, 2014, the Board of Directors of Telefónica, S.A. approved the implementation of a new organizational structure focused on clients and which incorporates the digital offering as the main focus of commercial policies. The structure gives greater visibility to local operators, bringing them closer to the corporate decision-making center, simplifying the Group's global structure and strengthening cross-cutting areas to improve flexibility and agility in decision making.

From January 1 2014 on, and due to the implementation of this new organizational structure, the new organizational structure is composed of Telefónica Spain, Telefónica Brazil, Telefónica Germany, Telefónica United Kingdom and Telefónica Hispanoamérica (comprised of our consolidated subsidiaries in Argentina, Chile, Peru, Colombia, Mexico, Venezuela & Central America, Ecuador and Uruguay). These segments include all the information related to fixed, mobile, DSL, internet TV, as well as other digital services appropriate to each country. Any services not specifically included in these new segments are part of Other companies and eliminations .

The Telefónica's Group's 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 growth rate 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 segment.

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.

Simplify the operative model.

Reduce legacy cost, especially legacy network costs.

In addition, Telefónica maintains an industrial alliance with China Unicom. Furthermore, in order to potentially 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 Telefónica Partners Program

Table of Contents

Financial Statements

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 (digital services, roaming, services to multinationals, procurement, devices, etc.).

Elsewhere, in 2014 Telefónica's portfolio was restructured through the acquisition of E-Plus by Telefónica Deutschland to form the leading operator in the European. Also we are in process of acquire GVT by Telefónica Brazil, once regulatory approval has been obtained.

Additional information

Telefónica, S.A. have adapted their internal processes and payment schedules to the provisions of Law 15/2010 (amended by the Law 31/2014) and of Royal Decree-Law 4/2013, amending the Law 3/2004, which establishes measures against late payment in commercial transactions. Engagement conditions with commercial suppliers in 2014 included payment periods of up to 60 days, according to the terms agreed between the parties. For efficiency purposes, the Company has defined payment schedules with suppliers, whereby payments are made on set days. Payments to Spanish suppliers in 2014 and 2013 surpassing the established legal limit were the result of circumstances or incidents beyond the payment policies, mainly the delay in the billing process (a legal obligation for the supplier), closing of agreements with suppliers over the delivery of goods or the rendering of services, or occasional processing issues. According to the criteria previously commented, the average payment period to suppliers of the Telefónica, S.A. in Spain at December 31, 2014, according to the best estimations, amounts to 35 days.

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, in the Regulation of the General Shareholders' Meeting, and in the 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 to Telefónica's executive bodies (primarily through the Executive Committee) and management team.

Telefónica, S.A. 97

Table of Contents

Financial Statements

Economic results of Telefónica, S.A.

Telefónica, S.A. obtained net profit of 2,604 million euros in 2014. Highlights of the 2014 income statement include:

Revenue from operations, amounting to 8,727 million euros has decreased year on year, primarily due to the lower dividend distributions from Group companies and associates. The most significant variation comes from Telefónica Internacional, S.A.U. with 3,238 million euros (4,500 million euros in 2013), Compañía de Inversiones y Teleservicios, S.A.U. distributed 440 million euros in 2013 and there has been no distribution in 2014 and Telefónica Czech Republic, a.s. which distributed 158 million euros in 2013 and its sale has been completed in January 2014, therefore no new dividends have been received from this subsidiary in 2014.

The figure of Impairment and gains (losses) on disposal of financial instruments amounting to 3,679 million euros has decreased considerably compared to 2013 due to impairment charges recognized to investments in Telefónica Brasil, S.A. and Sao Paulo Telecomunicações, S.A. totalling 735 million euros (in 2013 the write down was 3,863 million euros).

Net financial expense totaled 2,535 million euros in 2014, compared to 2,491 million euros in 2013. This was mainly due to finance costs with Group companies and associates, of which the largest came from Telefónica Europe, B.V. amounting to 431 million euros (238 million euros in 2013), Telefónica Emisiones, S.A.U. totalling 1,550 million euros (1,712 million euros in 2013) and the impact of the change in the valuation of Telco, S.p.A as available for sale financial asset (270 million euros in 2014 and no impact in the previous year).

Telefónica, S.A. 98

Table of Contents

Financial Statements

Investment activity**2014**

On January 28th, 2014 Telefónica announces that after obtaining the relevant regulatory approval, the sale transaction of the 65.9% of the capital share of Telefónica Czech Republic, a.s. to PPF Group N.V.I. has been completed. This concept was registered in 2013 balance under caption Non-current assets held for sale for an amount of 2,302 million euros.

On June 16, 2014 the three Italian shareholders of Telco, S.p.A. requested the initiation of the process of demerger (spin off) of the Company, as provided in the Shareholders Agreement. Implementation of the demerger, approved by the General Meeting of Shareholders of Telco, S.p.A. held on July 9, 2014, is subject to obtaining any required anti-trust and telecommunications approvals (including Brazil and Argentina). Once the aforementioned approvals are obtained, this decision will be implemented by transferring all the current stake of Telco, S.p.A. in Telecom Italia to four newly created companies. The share capital of each of these companies will belong in its entirety to each of the shareholders of Telco, S.p.A. and each of these companies will receive a number of shares of Telecom Italia S.p.A. proportional to the current economic stake in Telco, S.p.A. of its respective shareholder.

The application process of the aforementioned anti-trust and telecommunications approvals (including Brazil and Argentina) to proceed to the demerger (spin off) of Telco, S.p.A. has already started, once completed in Italy the corresponding corporate documents.

At a meeting on December 22, 2014, the Brazilian telecommunications regulator (ANATEL) approved the demerger on condition of suspension of Telefónica's voting rights in Telecom Italia, S.p.A. and its subsidiaries, among certain other measures. Telefónica has agreed with the aforementioned suspension of voting rights and has offered the presentation of a formal statement to ANATEL in this regard. Therefore, on the same date Telefónica ceased to have significant influence through its indirect holding in Telecom Italia, S.p.A. and reclassified this investment as an available-for-sale financial asset.

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.

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.

Table of Contents

Financial Statements

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 held a stake of 4.9% in Telefónica Czech Republic until the date of the sale.

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, were reclassified to the *Non-current assets held for sale* until the pertinent authorisations were received from the regulators. 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.

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%.

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, 2014.

As a result of these estimations and the effect of the net investment hedge in 2014, an impairment provision of 3,679 million euros was recognized (7,998 million euros in 2013). This amount derives mainly from the following companies:

(a) write down recognized for Telefónica Europe, plc. Amounting to 2,352 million euros in 2014 (2,423 million euros in 2013), increased by 148 million euros for the effect of the net investment hedge (70 million euros in 2013).

Edgar Filing: TELEFONICA S A - Form 6-K

(b) write down of 559 million euros for Telefónica Brasil, S.A. (2,948 million euros in 2013) and 176 million euros for Sao Paulo Telecomunicações, S.A. (915 million euros in 2013).

(c) write down of 92 million euros for Telco, S.p.A. (359 million euros in 2013), the owner of a stake in Telecom Italia.

(d) write down of 126 million euros for Telefónica México, S.A. de C.V. (211 million euros in 2013).

(e) write down of 300 million euros for Telefónica Digital Holding, S.A.U. (166 million euros in 2013).

In 2013, a write down recognised for Telefónica Czech Republic of 643 million euros was also included.

The write down in Telefónica Europe, plc. is mainly due to the impact of the 1,304 million-euro dividend distribution in 2014 and the changes in the present value of the expected turnover of the subsidiary. In this regard, the Operating Income Before Depreciation and Amortization (OIBDA) margin used to calculate long term cash flows is 1.7 p.p. lower compared with the same parameter used in 2013 plan.

Telefónica, S.A. 100

Table of Contents

Financial Statements

The write down of the stake in Telefónica Brasil, S.A. and Sao Paulo Telecomunicações, S.A. in 2014 results from the changes in the macroeconomic scenario. The estimate of GDP growth in the country, prepared by Focus Economics and analysts, was estimated in 2.3% for 2014 and it has finally been 0.2% and it will be no higher than 0.7% in 2015. The change in expectations has been reflected in the decrease of OIBDA used to calculate future cash flows. The OIBDA margin used to calculate long term cash flows, has decreased 2 p.p. compared with those used in 2013.

Telefónica, S.A. 101

Table of Contents

Financial Statements

Share price performance

The main European stock markets made gains in 2014 thanks to the general fall in risk aversion amid a gradual economic recovery in the US and to a lesser extent in Europe, and announcements of stimulus packages by central banks. The Ibex-35 (+3.7%) outperformed its peers (EStoxx-50 +1.2%; DAX +2.7%; CAC-40 -0.5%; FTSEMIB +0.2% and FTSE-100 -2.7%) on the strength of better macroeconomic prospects in Spain and a lower yield on the Spanish 10-year bond, which closed the year at 1.5% (a far cry from the 4.1% observed at year-end 2013), bringing the spread over German bonds to 104.8 basis points (218.3 at the end of 2013).

The European telecommunications sector posted profitability of 7.5%, outstripping the general DJ Stoxx 600 index by 3.1 p.p. (+4.4%), as a result of: i) corporate consolidation transactions in a number of markets, ii) better business fundamentals, driven by macroeconomic improvements and the first positive signals arising from technological transformation; monetization of mobile data and fiber, iii) expectations of a regulatory environment more conducive to investment by the new European Commission, iv) high dividend yields, and v) attractive valuations.

Against this backdrop, Telefónica shares rose by 0.7%, with total shareholder return of 7.0% including dividends distributed in 2014, to close the year at 11.92 euros per share. This was thanks to successful implementation of the strategy to transform Telefónica into a Digital Telco, stronger competitive positioning due to consolidation in major markets, and a gradual improvement in the trend in results, offsetting the negative currency effect observed mostly in Latin America.

By company, the best performances were produced by operators that began the year with valuation levels below the standard for the sector and that were exposed to potential corporate transactions: Orange (+57.2% - expectations of consolidation in its domestic market-) and Telecom Italia (+22.3% - expectations of consolidation in Brazil and Italy). KPN closed the year with up 12.2%, Deutsche Telekom was up +6.6%, BT up +5.8% and Telefónica Deutschland up +0.7%. The negative side of things featured Portugal Telecom (-72.7% - failed investments in Banco Espírito Santo commercial paper and the adjustment to the exchange ratio of its merger with Oi as a result) and Vodafone (-7.6% after returning part of the Verizon Wireless divestment to its shareholders).

At the 2014 year end, Telefónica featured among the world's ten largest telecommunications companies by market cap (55,514 million euros). Daily trading volume in Telefónica shares on Spain's continuous market was 33.6 million shares.

Telefónica, S.A. 102

Table of Contents

Financial Statements

Research, development and innovation

Telefónica remains firmly committed to technological innovation as an essential tool for achieving competitive advantages, trying to anticipate 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. Within this open innovation strategy, the Open Future program was reinforced during 2014. This program is designed to connect entrepreneurs, startups, investors and public and private organizations from all over the world with a view to fostering innovation and developing viable projects.

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 2014, 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 2014, 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 added-value services leveraging on the potential of the new infrastructures. 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.

Telefónica, S.A. 103

Table of Contents

Financial Statements

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.

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

Telefónica I+D works on new networks, primarily in collaboration with Telefónica's Global Resources team. These activities are related to 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 the digital services strategy. 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 aims to look into opportunities relating to new networks and services and solutions to the technological challenges that arise.

In 2014, Telefónica in collaboration with the Chilean government launched a new R&D center in Chile, with focus on Internet of Things and Big Data, in the field of Smart Cities, Smart Industry and Smart Agro.

At December 31, 2014, Telefónica I+D had 652 employees (689 employees in 2013).

Total I+D expense in the Group for 2014 amounted to 1,111 million euros, up 6.2% from the 1,046 million euros incurred in 2013 (1,071 million euros in 2012). This expense represents 2.2%, 1.8% and 1.7% of the Group's consolidated revenue for 2014, 2013 and 2012, respectively. These figures were calculated using guidelines of the Organization for Economic Co-operation and Development (OECD).

During 2014, Telefónica filed 27 new patent applications, all of them registered through the Spanish Patent and Trademark Office (OEPM), of which 25 are European applications (EP) and 2 are International applications (PCT). Additionally 2 utility models were filed, also through OEPM.

Table of Contents

Financial Statements

Environment

Objectives and policies related to environmental management and the control of environmental risks

Telefónica has an Environmental Policy applicable to all its companies, and a Global Environmental Management System that ensures compliance with environmental aspects and extends a culture of environmental responsibility to customers. Currently over 50% of the Group companies, which represent 70% of global billing, have Environmental Management Systems in accordance with ISO 14001, certified by an external entity.

Telefónica's environmental risks are controlled and managed by the Company's global risk management model. Although the environmental aspects of telecommunication operations are low-intensity, the extremely dispersed geography makes environmental management based on processes absolutely essential.

Telefónica has a global team of environmental management experts, who address environmental issues at local level.

Guidelines

Telefónica's activities are regulated, in environmental matters, by local laws, especially in activities related to the network infrastructure. These activities entail obtaining environmental permits for operations, waste management, noise control, and the monitoring of electromagnetic fields, among others.

The Global Environmental Management System guarantees compliance with environmental legislation at local level, and enables checks to be extended to suppliers and contractors.

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, always promoting the sharing of infrastructure with other operators (over 34,000 sites in 2014), and the development of technical adaptations to reduce the visual impact of mobile telephony antennae.

Waste produced by networks and customers, especially waste from electric and electronic equipment, is handled by approved managers in due adherence to environmental legislation and always in the following order: reduce, reuse, recycle. All group companies have waste management schemes and recycling and/or reuse initiatives to manage customer waste.

The Climate Change and Energy Efficiency Office is responsible for rolling out processes to boost energy efficiency and shrink Telefónica's carbon footprint. The company has a structured corporate governance model and an energy manager in each country for proper management of energy and carbon. Telefónica has corporate targets for the reduction of energy and emissions: 30% of electricity consumption in the network by 2015 and 30% of CO2 by 2020; both measured by equivalent customer access. In 2014 a new energy/financial target was introduced to reduce Telefónica's energy bill by 50 million euros by 2017 through energy-efficiency measures. In 2014 Telefónica was recognized by the Carbon Disclosure Project, the largest climate change investment index worldwide, as a sectoral

leader in terms of management of energy and carbon.

These initiatives enabled Telefónica to extend its environmental responsibility to residential customers and companies, and to meet the ongoing demand by investors and shareholders for responsible environmental management.

Telefónica, S.A. 105

Table of Contents

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 72% (76% in 2013).

Employee training

Just like in the rest of Telefonica's business operation units, in Telefónica S.A. employee training is an absolute priority, in these times of deep change and evolution for the company. In 2014 most of the L&D efforts were devoted to transforming the company into a Digital Telco, leveraging on specific training programs by Universitas Telefonica.

Universitas Telefonica operates at two levels: on premises and virtual programs. On premises programs are delivered both at our campus in Barcelona where more than 500 executives from TSA participated in our leadership transformation programs, plus 250 mid managers more, trained in our local offices in Madrid and Brazil. In all cases the programs are focused in Telefonica's transformation and delivered by Universitas Telefonica mostly internal faculty.

On the other hand, Universitas Telefonica operates also virtually through its on-line learning platform. In 2014 all on-line contents related to the digital transformation were promoted, resulting in a 30% increase of the use of our on-line learning services, incorporating new units like TGS and CCDO for a much broader use of the on-line learning platform.

In 2014, over 37,000 training hours were carried out. For the Company, managing knowledge is a priority. In 2014, the cost of training amounted to over 1 million euros.

Equality in Diversity at Telefónica

Diversity is a competitive advantage. Having a team of professionals that accurately reflects the societies in which we operate, allows us to better understand our clients and surprise them with new products that fit their needs. It also makes it possible to offer them high quality services, which subsequently have an impact on our profits.

Our Business Principles include the fundamental right to equality:

We promote equal opportunities and we treat all individuals fairly and impartially, without discriminating on the basis of race, color, nationality, ethnic origin, religion, gender, sexual orientation, marital status, age, disability or family responsibilities.

Telefónica, S.A. 106

Table of Contents

Financial Statements

However the concept of diversity goes much further, it is a fundamental value. The reasons why diversity is a critical management factor for us are many. But from these we can highlight, first, the need to use all of our talent, and second, the importance of other market segments, of other non-traditional groups with a large purchasing capacity, such as women, handicapped individuals, elderly, etc. The intended impact is achieved through proper management of employee diversity; these employees come from over 24 countries (four of which are represented on the Board of Directors) and which belong to more than 100 nationalities.

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.

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.

Talent management

Talent is a global asset, and at Telefónica we boost it through benchmark training programmes, promoting diversity and facilitating ways to achieve a work-life balance. Developing the talent of our employees, giving them opportunities of personal and professional development, and supporting their personal growth constantly are the distinctive purposes at Telefónica.

The evaluation of talent lets us have a map of the management talent of the whole Company, as well as a structured succession plan. This is a fundamental tool of differential management and boosts a meritocratic culture which should facilitate decision-making on aspects such as development, organisation, pay, etc.

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. 107

Table of Contents

Financial Statements

Liquidity and capital resources**Financing**

The main financing transactions carried out in the bond market in 2014 are as follows:

Description	Issue date	Maturity date	Nominal amount (millions)		Currency of issue	Coupon
			Currency	Euros ⁽¹⁾		
Telefónica Emisiones, S.A.U.⁽²⁾						
EMTN bonds	03/26/14	03/26/16	200	200	EUR	Euribor 3M + 0.65%
	04/10/14	04/10/17	200	200	EUR	Euribor 3M + 0.75%
	05/27/14	05/27/22	1,250	1,250	EUR	2.242%
	06/04/14	04/10/17 ⁽³⁾	100	100	EUR	Euribor 3M + 0.75%
	10/17/14	10/17/29	800	800	EUR	2.932%
SHELF bond	06/23/14	06/23/17	500	412	USD	Libor 3M + 0.65%
Telefónica, S.A.						
Bond mandatory exchangeable into Telecom Italia ordinary shares						
	07/24/14	07/24/17	750	750	EUR	6.00%

(1) Exchange rate as at December 31, 2014.

(2) Guaranteed by Telefónica, S.A.

(3) Retap bond of the 200 million euros issuance dated on April 10, 2014.

The main financing transactions carried out in the bank market in 2014 are as follows:

Item	Limit	Currency	Outstanding balance (millions)		Arrangement Date	Maturity date
			of euros)			
Telefónica, S.A.						
Syndicated Tanche B (1)	3,000	EUR			02/18/14	02/18/19
Bilateral loan	2,000	EUR	2,000		06/26/14	06/26/17

(1) On 02/18/14 a syndicated credit revolving facility for 3,000 million euros was signed, entering into effect on 02/25/14, canceling the syndicated credit facility dated on 07/28/10 scheduled to mature originally on 07/28/15.

Available funds

At December 31, 2014, available funds from undrawn lines of credit in different financial institutions totaled 7,445 million euros. Out of this figure, around 6,841 million euros have a maturity longer than 12 months. Additionally, cash and cash equivalents other than Telefónica's share in Telco, S.p.A's bond with a nominal amount of 1,225 million euros, as of December 31, 2014 amount to 4,584 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 the financial statements.

Contractual commitments

Note 19.5 to the financial statements provides information on firm commitments giving rise to future cash outflows and associated with operating leases, primarily.

Telefónica, S.A. 108

Table of Contents

Financial statements

Credit risk management

The credit risk in Telefónica, S.A. mainly refers to the one associated with financial derivative instruments arranged with different entities. The detailed description of how those risks are managed and hedged is included in Note 16.

Credit rating

At December 31, 2014, Telefónica, S.A.'s long-term issuer default rating is BBB+/stable outlook from Fitch, Baa2/negative outlook from Moody's and BBB/stable outlook from Standard & Poor's. The most recent updates on these ratings were issued by Standard and Poor's on May 19, 2014, Fitch on March 21, 2014 and Moody's on July 25, 2013. The only change in the long-term issuer default rating and outlook for Telefónica, S.A. during 2014 was that Standard and Poor's revised the outlook to stable from negative on May 19, 2014.

In 2014, among the measures taken to help to protect the credit rating, it is noteworthy an intensive and prudent financing activity together with a conservative liquidity policy, the implementation of a scrip dividend (instead of cash only dividend) in November 2014, a portfolio rationalization through the total or partial sale of certain assets such as Telefonica Ireland, Telefónica Czech Republic and China Unicom, the issuance of financial instruments with high equity content to finance the E-Plus acquisition (such as bond mandatorily convertible into Telefónica shares) and the issuance of undated deeply subordinated securities as a solvency protection measure to mitigate negative impacts on our consolidated financial statements deriving from unforeseen events such as the devaluation in Venezuela.

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 2014, it was resolved to pay a dividend, via scrip dividend of approximately 0.35 euros per share in November 2014, 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 2015.

In November 2014, 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. 109

Table of Contents

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, 2014 and 2013, Telefónica, S.A. held the following treasury shares:

	Number of shares	Euros per share		Market value (1)	%
		Acquisition price	Trading price		
Treasury shares at 14/12/31	128,227,971	11.68	11.92	1,528	2.75332%

(1) Millions of euros

	Euros per share		
	Trading price	Market value (1)	%

	Number of shares	Acquisition price			
Treasury shares at 13/12/31	29,411,832	11.69	11.84	348	0.64627%

(1) Millions of euros

The movement in treasury shares of Telefónica, S.A. in 2014 and 2013 is as follows:

	Number of shares
Treasury shares at 12/12/31	47,847,809
Acquisitions	113,154,549
Disposals	(131,590,526)
Treasury shares at 13/12/31	29,411,832
Acquisitions	100,723,415
Disposals	(129,177)
GESP share plan delivery	(1,778,099)
Treasury shares at 14/12/31	128,227,971

Telefónica, S.A. 110

Table of Contents

Financial Statements

Acquisitions

The amount paid to acquire treasury shares in 2014 and 2013 was 1,176 million euros and 1,216 million euros, respectively.

Disposals

Treasury shares sold in 2014 and 2013 amounted to 1 million euros and 1,423 million euros, respectively. The main transactions 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. (See Note 8.5 of the financial statements). In addition to these disposals, on November 28, 2014, 1,778,099 shares were delivered to Group employees when the second phase of the Global Employee Share Plan (the GESP) matured.

Options on treasury shares

At December 31, 2014, Telefónica held 76 million call options on treasury shares subject to physical delivery at a fix price (134 million options on treasury shares at December 31, 2013) 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 30 million shares in 2013 to 32 million shares in 2014, and is recognized under Derivatives (financial liabilities, current) both in 2014 and 2013.

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.

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. 111

Table of Contents

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 of operations, must be considered jointly with the information in the financial statements, and are as follows:

Group-related risks**Worsening of the economic and political environment could negatively affect Telefónica's business.**

Telefónica's international presence enables the diversification of its activities across countries and regions, but it is affected by various legislations, as well as the political and economic environments of the countries in which it operates. Any adverse developments or even uncertainties in this regard, including exchange-rate or sovereign-risk fluctuations, may adversely affect the business, financial position, cash flows and/or the performance of some or all of the Group's financial indicators.

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. Factors such as high debt levels, ongoing restructuring of the banking sector, the implementation of pending structural reforms and continued fiscal austerity measures could hinder more dynamic growth in Europe and, in turn, the consumption and volume of demand for the Group's services, which could materially adversely affect the Group's business, financial condition, results of operations and cash flows.

The soft economic recovery in Europe together with low inflation rates, and the risk of deflation, has led and may still lead to monetary and fiscal easing from key players, with a view to creating a relatively benign scenario for Europe. In this region, the Telefónica Group generated 23.9% of its total revenues in Telefónica Spain, 14.0% in the Telefónica United Kingdom and 11.0% in Telefónica Germany in 2014.

In addition, the Group's business may be affected by other possible effects from the economic crisis, including possible insolvency of key customers and suppliers.

In Latin America, the most important challenge is the exchange-rate risk in Venezuela and Argentina, given the negative impact that depreciation in their currencies could have on cash flows from both countries. International financial conditions may be unfavorable and may lead to 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), an (a key region for Latin America) and slow progress with structural reforms projects in the majority of these countries limiting potential for higher growth rates. Among the most significant macroeconomic risk factors in the region are the high inflation rates, negative economic growth and high internal and external funding needs in Venezuela. These funding needs are significant and are affected by the recent fall in oil prices, which is the main and almost sole source of foreign currency in the country. These factors are affecting Venezuela's competitiveness and may result in a currency devaluation. Other risks in the region are

Argentina's high level of inflation coupled with a phase of economic slowdown and weak public finances. Moreover, the recent decline in the prices of oil and other commodities could have a negative impact on the external accounts of countries such as Brazil, Chile, Peru and Colombia.

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". For the year ended December 31, 2014, Telefónica Hispanoamérica and Telefónica Brazil represented 26.1% and 22.3% of the Telefónica Group's revenues, respectively. Moreover, approximately 9.6% of the Group's revenues in the telephony business are generated in countries that do not have investment grade status (in order of importance, Argentina, Venezuela, Ecuador, Nicaragua, Guatemala, El Salvador and Costa Rica), and other countries are only one notch away from losing this threshold. It is also significant that, despite clear improvements in Brazil, the uncertainty surrounding the political situation, fiscal policy stimuli and a relatively high inflation rate could result in a rating downgrade that, depending on the

Table of Contents

Financial Statements

extent of such downgrade, could result in strong exchange-rate volatility due to an outflow of investments, especially in relation to fixed-income.

Country risk factors include the following:

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 business in such countries;

abrupt exchange-rate fluctuations may occur mainly due to high levels of inflation and both fiscal and external deficits with the resulting exchange-rate overvaluation. This movement could lead to strong exchange-rate depreciation in the context of a floating exchange rate regime, a significant devaluation off the back of abandoning fixed exchange rates regimes or the introduction of varying degrees of restrictions on capital movement. For example, in Venezuela, the official U.S. dollar to bolívar 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 the Complementary System for Administration of Foreign Currency (*Sistema Complementario de Administración de Divisas* or SICAD) regular and selective auctions. In February 2015, a new Exchange Rate Agreement was established, including the regulations for the Foreign Exchange Marginal System (SIMADI), and the Central Bank of Venezuela published on February 18, 2015 a weighted average exchange rate equal to 172.1 bolívares to the U.S. dollar for the markets referred to in chapters II and IV of such Exchange Rate Agreement. Additionally, the acquisition or use of foreign currencies by Venezuelan or Argentinean companies (in some cases) to pay foreign debt or dividends is subject to the pre-authorization of the relevant authorities. Also, the Argentinean peso, despite its recent stability, continues to be under the threat of a sustained accelerated depreciation against the U.S. dollar;

governments may expropriate or nationalize assets, 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 limits on profit margins may be imposed in order to limit the prices of goods and services through the analysis of cost structures. For example, in Venezuela, a maximum profit margin has been introduced that will be set annually by the Superintendence for Defense of Socioeconomic Rights.

Any of the foregoing may adversely affect the business, financial position, results of operations and cash flows of the Group.

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, 2014, 70% of the Group's net debt (in nominal terms) was pegged to fixed interest rates for a period greater than one year, while 27% 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, 2014: (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 111 million euros, (ii) whereas a 100 basis points decrease in interest rates in all currencies except the euro, the 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 68 million euros. These calculations were made using the same balance position in each currency and same balance position equivalent at such 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 76 million euros, primarily due to the

Telefónica, S.A. 113

Table of Contents

Financial Statements

weakening of the Venezuelan bolivar and the Argentinean peso. These calculations were made using the same balance position in each currency with an impact on profit or loss at such date, including derivative instruments in place. For the year ended December 31, 2014, 22.8% of the Telefónica Group's operating income before depreciation and amortization (OIBDA) was concentrated in Telefónica Brazil, 26.2% in Telefónica Hispanoamérica and 11.2% in the Telefónica United Kingdom.

The Telefónica Group uses a variety of strategies to manage these risks, mainly through the use of financial derivatives, which themselves also expose us 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, the development and implementation of new technologies or the renewal of licenses as well as expansion of our business in countries where we operate may 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 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 to raise funds from the Group's shareholders, and may negatively affect the Group's liquidity. At December 31, 2014, gross financial debt scheduled to mature in 2015 amounted to 8,491 million euros (which includes the net position of derivative financial instruments and certain current payables), and gross financial debt scheduled to mature in 2016 amounted to 8,407 million euros. Despite having covered gross debt maturities of 2015, 2016 and part of 2017 by available cash and lines of credit at December 31, 2014, possible difficulties in maintaining 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.

In 2013 the Telefónica Group issued bonds mainly (i) in euro totaling 3,250 million euros with an average coupon of 3.690%; (ii) in dollars totaling 2,000 million U.S. dollars with an average coupon of 3.709%; and (iii) in Swiss Francs totaling 225 million Swiss francs with an annual coupon of 2.595%. The Telefónica Group also issued undated deeply subordinated securities in euros totaling 1,750 million euros with an average coupon of 6.902%; and in sterling pounds totaling 600 million sterling pounds with a coupon of 6.750%. In 2014 the Telefónica Group issued bonds mainly in the European market with a maturity of eight years totaling 1,250 million euros with an annual coupon of 2.242%, and bonds with a fifteen-year maturity totaling 800 million euros with an annual coupon of 2.932%. In addition, the Telefónica Group issued undated deeply subordinated securities in 2014 totaling 2,600 million euros with an average coupon of 5.075%.

Despite having its gross debt maturities profile covered for more than two years, 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 the Group's ability to meet its debt maturities.

Moreover, market conditions could make it harder to renew existing undrawn credit lines, 8% of which, at December 31, 2014, were scheduled to mature prior to December 31, 2015.

In addition, the impact of the sovereign debt crisis and the rating downgrades in certain Eurozone countries should be taken into account. Any deterioration in the sovereign debt markets, doubts about developments in European projects (such as implementation of the banking union project, the results of the elections in Europe, including Spain among others, or progress towards fiscal integration), as well as further credit restrictions by the banking sector could have an adverse effect on the Telefónica Group's ability to access funding and/or

Table of Contents

Financial Statements

liquidity, which could have a significant adverse effect on the Group's businesses, financial position, results of operations and cash flows.

Risks Relating 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 the Group provides 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 those related to spectrum regulation and licenses/concessions, rates, universal service regulation, regulated wholesale services over 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, potentially, 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.

In this regard, the Telefónica Group pursues its license renewals 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, service and coverage standards 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 authorities 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 harm to the future growth of certain businesses.

Regulation of spectrum and government concessions

In Europe, the amendments by the EU Parliament to the Commission's proposal on the Digital Single Market (the DSM) package of measures are currently being discussed by the European Council. The DSM measures 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 licenses, etc.

In addition, the main allocation criteria for the 700 MHz band of Digital Dividend II (the second spectrum allocation process from television operators to electronic communications services) will be defined in the coming years. This could require new cash outflows ahead of the Group's previously anticipated schedule (it is expected that the spectrum will be available between 2018 and 2021).

Nevertheless, Germany will be the first country in Europe to award spectrum in the 700 MHz band. On January 29, 2015, the German regulator (BNetzA) published respective final decisions on the spectrum allocation proceedings and on the auction conditions of the 700 MHz and 1500 MHz bands. The auction will also include the spectrum corresponding to GSM licenses the entire 900 MHz band and most of the 1800 MHz band (which will expire at the end of 2016) . Interested bidders may submit applications by March 6, 2015. The auction (Simultaneous Multi-Round Auction) will take place in the second quarter of 2015.

On July 4, 2014, BNetzA adopted a decision concerning the frequency aspects of the Telefónica Deutschland Holding AG merger with E-Plus Mobilfunk GmbH & Co KG (E-Plus). BNetzA has instructed Telefónica Deutschland (the surviving entity after the merger takes place) to anticipate the termination of its rights of use in the 900 / 1800 MHz bands by December 31, 2015, (instead of December 31, 2016), if Telefónica Deutschland (the surviving entity) does not reacquire these frequencies at the above-mentioned auction proceeding. Both Telefónica Deutschland and E-Plus have legally challenged this BNetzA decision on August 4, 2014. The German regulator also announced that, once the auction of spectrum mentioned above mentioned is over, it will

Telefónica, S.A. 115

Table of Contents

Financial Statements

perform a frequency distribution analysis, and determine whether any additional action is needed, particularly in the area of the 2GHz spectrum band granted to Telefonica Deutschland.

In addition, and within the framework of the conditions imposed by the European Commission in connection with the merger, the surviving entity of the merger is obliged to offer up to 2x10 MHz in the 2600 MHz as well as up to 2x10 MHz in the 2100 MHz spectrum band to one potential new mobile network operator. This offer is open to any potential new mobile network operator that had declared a respective interest by December 31, 2014, and to the operator with whom Telefónica Deutschland has signed the network access agreement (Drillisch Group).

On December 26, 2014, the Spanish Government adopted a law in which it delayed, to a maximum period ended on April 1, 2015, the effective delivery of the frequencies in the 800 MHz spectrum which are part of the Digital Dividend (the spectrum allocation process from television operators to electronic communications services), and which were expected to be delivered on January 1, 2015 to the already awarded mobile operators. The license term has been extended accordingly to April 24, 2015.

In the United Kingdom a significant increase in the annual license fees charged for the use of the spectrum in 900 MHz and 1800 MHz bands has been proposed by the regulator (the Office of Communications (Ofcom)). The outcome of it remains uncertain. Separately, the United Kingdom Government announced recently an agreement with the United Kingdom mobile operators, including Telefonica UK, under which the mobile operators would accept a 90% geographic coverage obligation for voice and text services. Given the agreement, Ofcom has agreed to consider the impact of the geographic coverage obligation on its valuation of annual fees for 900 MHz and 1800 MHz spectrum. This is expected to delay Ofcom's decision. In addition, on November 7, 2014, Ofcom released a public consultation on the award of 2.3 GHz and 3.4 GHz bands that is expected to take place in late 2015 or early 2016.

In Latin America, spectrum auctions are expected to take place implying potential cash outflows to obtain additional spectrum or to meet the coverage requirements associated with these licenses. Specifically, the procedures expected to take place in 2015 are:

Peru: The government announced plans to auction the 700 MHz spectrum band in the first half of 2015 (three blocks of 2x15 MHz have been defined).

Costa Rica: Costa Rica's government has communicated its intention to auction spectrum in the 1800 MHz and AWS bands during 2015.

Mexico: The Federal Institute of Telecommunications (Instituto Federal de Telecomunicaciones) (IFT) published its Annual Program for Frequency Use and Development 2015. The program specifies IFT's intention to award Advanced Wireless Services (AWS) concessions during the course of 2015.

Further to the above, certain administrations may not have announced their intention to release new spectrum and may do so during the year. The above does not include processes announced via general statements by administrations,

which involve bands not key to Telefónica's needs. Telefónica may also seek to acquire spectrum on the secondary market should opportunities arise.

In Argentina, on December 1, 2014, the Secretary of Communication through Resolution 85/2014 officially awarded Telefónica Argentina the block 1710-1720/2110-2120 for a period of 15 years and the 700 MHz block (703-713/758-768 MHz) is expected to be officially transferred to Telefónica Argentina during 2015.

In the state of São Paulo, Telefónica Brasil provides local and national long-distance Commuted Fixed Telephony Service (CFTS) under the public regime, through a concession agreement, which will be in force until 2025. In this regard, in June 27, 2014, as established in the concession agreement, the National Telecommunications Agency (Agência Nacional de Telecomunicações) (ANATEL) issued a public consultation for the revision of the concession agreement. Such public consultation revising the concession agreement ended on December 26, 2014 and allowed contributions on certain topics such as service universalization, rates and fees and quality of services, among others. Definitive conditions will be published in 2015.

Telefónica, S.A. 116

Table of Contents

Financial Statements

Additionally, in Colombia the Information and Communication Technologies (ITC) Ministry issued a Resolution on March 27, 2014 to renew 850 MHz/1900 MHz licenses for 10 additional years. The reversion of assets and the liquidation of the concession contract will be discussed until May 2015, taking into consideration the terms of the contract, and the Constitutional Court's review of Law 422 of 1998, which established the reversion of only the radio-electric frequencies.

In Peru, an application for partial renewal of the concessions for the provision of the fixed-line service for another five years has been issued, although assurance has been given by the Ministry of Transport and Communications (Ministerio de Transportes y Comunicaciones) in previous renewals, that the concession will remain in force until November 2027. Also, a new law has been enacted establishing mobile virtual network operator (MVNOs) and Rural Mobile Infrastructure Operators (RMIOs) in the Peruvian market.

In Mexico, in light of the constitutional reform resulting from the Pact for Mexico political initiative, it is expected that a publicly-owned wholesale network, which will offer wholesale services in the 700 MHz band, will be created. As of today, the funding and the marketing model of this project have not yet been determined.

Telefónica Móviles Chile, S.A. was awarded spectrum on the 700 MHz (2x10 MHz) band in March 2014. A third party provider opposed this allocation of spectrum on the basis that it would exceed the limit spectrum of 60 MHz established by a judgment of the Supreme Court of January 27, 2009. This cap was established for the AWS auction held in 2009, but not for subsequent auctions (2600 MHz and 700 MHz). In a judgment on December 31, 2014, the court of appeals rejected the third party claim. Consequently, the regulator is in a position to adopt a Decree awarding the concession to Telefónica.

The consolidated investment in spectrum acquisitions and renewals in 2014 amounted to 1,294.2 million euros.

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 inability to assume the related costs, could have an adverse impact on 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 business, financial condition, results of operations and cash flows.

Regulation of wholesale and retail charges

In terms of roaming, the regulated Eurotariffs were reduced on July 1, 2014 (in the wholesale market, the price of data was reduced by 67%, the price of call by 50%; and in the retail market, the price of data was reduced by 55%, the price of outgoing voice call by 21%, the price of incoming voice call by 28% and the price of outgoing texts by 25%), as per the regulation approved in 2012. The structural roaming solutions which could lead to a price decrease in the intra-European Union roaming services also took effect in July 2014. Furthermore, the package of DSM measures mentioned above, which is under discussion, also includes a proposal to eliminate European Union roaming charges as of a yet to be determined date. However, the European Parliament proposed the end of roaming by December 15, 2015 in a proposal known as Roaming Like at Home .

The decreases in wholesale mobile network termination rates (MTR) in Europe are also noteworthy. In the United Kingdom, wholesale MTRs have been reduced to 0.845 ppm (pence/minute) from April 1, 2014 (representing a 0.3%

reduction compared to the previous rates). In a consultation document published in June 2014, Ofcom has proposed a further reduction to 0.545 ppm, from April 1, 2015.

In Germany, on September 3, 2014, the BNetzA adopted a proposal to reduce MTRs. The new prices will gradually decrease to 0.0172 euro/minute from December 1, 2014, and in a second stage, from 0.0172 euro/minute to 0.0166 euro/minute from December 1, 2015 until the end of November 2016. The European Commission has requested that the German regulator withdraw or amend its latest decision on mobile termination rates, in force as at the date of this Annual Report. There is a risk that the European Commission will initiate infringement proceedings against Germany, and rates may be further reduced.

In Spain, the National Regulatory & Competition Authority (*Comisión Nacional de los Mercados y la Competencia*) has adopted a final decision on the third round analysis of the wholesale market for fixed call

Table of Contents

Financial Statements

termination. From November 1, 2014, a symmetric fixed termination rate (FTR) of 0.0817 euro cents/minute applies, based on pure bottom-up long run incremental costs (BU-LRIC) meaning that billing must be entirely conducted on a per second basis, without a peak/off-peak differentiation. The decision therefore eliminates the asymmetry in FTRs that existed since 2006 when alternative network operators were allowed to charge up to 30% above Telefónica's per minute local FTR. It also brings forth an important reduction in average termination prices for Telefónica (by 80%) in comparison to the former applicable tariffs.

In Latin America, there are also moves to review MTRs leading to these being reduced. Thus, for example, developments in Mexico are among the most relevant, where the IFT has declared the América Móvil Group a preponderant operator in the telecommunications market. As a result, on March 26, 2014, it introduced, among others, special regulations on asymmetric interconnection rates. In that sense, the Federal Telecommunications and Broadcasting law, effective as of August 13, 2014, imposed several obligations on the preponderant operator, which are quite extensive and, in principle, potentially significantly beneficial to Telefónica's competitive position, particularly with regards to the measures imposed on preponderant operators (to the extent they nominally retain such qualification). With regards to MTR, Telefónica México 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 the date of this Annual Report, no ruling has been made on this appeal. Recently, IFT determined the mobile termination rates for 2012, and Telefónica México filed an injunction against this rate. Once these appeals have been concluded, the rates applied may be further reduced retroactively. As of the date of this Annual Report, IFT has not approved the termination rates for 2013, 2014 or 2015 for Telefónica México.

In Brazil, at the end of 2012, ANATEL launched the *Plano Geral de Metas de Competição* (PGMC) regarding fixed-mobile rate adjustment reductions until February 2016 and amending the previous reduction conditions (75% of the 2013 rate in 2014 and 50% of the 2013 rate in 2015). In order to complement reductions and approach the cost of the services according to a financial cost model, on July 7, 2014, ANATEL published reference values for MTR taking effect from 2016 to 2019. Such reductions are approximately 44% per year. Furthermore, there are several legislative initiatives that aim to abolish the basic fee of fixed-telephony service. Price protection practices (reimbursement of differences in prices of a product to customers if this falls within a relative short period of time) may also have a negative impact in Telefónica Brasil, in both economic and image terms.

In Chile, a tariff decree was issued to set fixed-line termination charges for the 2014-2019 periods. The new tariff entered into effect on May 8, 2014 and applies a reduction of 37% in prices against those charged for the period prior to such tariff. A tariff decree has been issued for mobile networks covering the 2014-2019 five-year period. Such tariff decree entered into effect on January 25, 2014 and implies a reduction of 74.7% with respect to the previous rates. After a review by the general comptroller (*Contraloría General*) an additional 1.7% reduction was approved on May 27, 2014.

In Ecuador the rate-related risks relate to 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 control measures. Under this Act, in January 2014, an organic fair price law was issued, which caps

the revenue of related enterprises at 30% of their operating costs. In relation to MTRs with the national operator of reference (Compañía Anónima Nacional Teléfonos de Venezuela) (CANTV), these have been reduced by 6% compared to the previous rates. In November 2014, near the end of the term allowing the enactment of laws autonomously granted to the President of the Republic, new important decree-laws were enacted, in particular, the Reform of the Law on Foreign Investment, in which, among other things, new requirements for the return of foreign investment were established; the Reform of the Antitrust Law, which was predominantly aimed at enhancing monopoly control regulation and increasing penalties for infringement; and the Reform of the Exchange Crimes Law, which increased economic sanctions.

In Colombia, on December 30, 2014, the Colombian regulator (CRC) enacted Resolution 4660 establishing a gradual reduction for MTRs. The glide path initiates in 2015 in 32.88 Colombian pesos per minute representing a decrease of 41.7% and then descends approximately 42.2% in 2016 and 42.2% in 2017 (each

Table of Contents

Financial Statements

such reduction being as compared to the previous year). This regulatory measure also imposes asymmetric MTRs to the dominant provider (the América Móvil Group), imposing the final rate established in the glide path from 2015 to 2017. The CRC also regulated the charges for national roaming and the SMS termination rates, setting a reduction of 41.5% in 2015, 39.6% in 2016 and 43.3% in 2017 (each such reduction being as compared to the previous year).

Regulation of universal services

Further to its formal obligation to review the scope of the Universal Service Directive (the set of basic electronic communication services whose provision is guaranteed to any user requesting it, regardless of its location, with a specified quality at an affordable price), the European Commission is expected to undertake a public consultation in the months following the date of this Annual Report, which may include both the potential inclusion of broadband in its scope and a possible reduction of some of the current universal service obligations. Depending on the terms that will be 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 last *Plano Geral de Metas de Universalização* (PGMU) was published in Brazil on June 30, 2011 and applies to the 2011-2015 period. This sets goals for public phones, low cost fixed-lines and coverage density in rural and poor areas with 2.5GHz/450 MHz. Also according to such PGMU, the assets assigned to the provision of the services described in the public concession agreement are considered reversible assets. In 2014, ANATEL issued a public consultation with its proposals for the 2015-2020 period universalization targets. The agency's proposal focuses on reducing the distance between public telephones and backhaul's expansion.

Regulation of fiber networks

In December 2014, the Spanish National Regulatory & Competition Authority (*Comisión Nacional de los Mercados y la Competencia*) has conducted a public consultation on the regulatory obligations for broadband market regulation in Spain. As a result of this consultation, the new regulation that will apply to NGN (Next Generation Networks) could be approved in the fourth quarter of 2015 and will last for at least three years. This could increase Telefónica's regulatory obligations in Spain and the ability of other operators to compete in such market.

In Colombia, the regulatory authority CRC published a regulatory project for transmission capacity between municipalities through fiber networks or connectivity to impose open network and elements access through a mandatory offer for those enterprises that have overcapacity and have some unused installed network elements. This project will be discussed in the first half of 2015.

Regulations on privacy

In Europe, a new Data Protection Regulation is undergoing the European legislative process which, as the date of this Annual Report, is not expected to end before mid-2015. 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.

In Brazil, triggered by the approval of Civil Rights Framework for Internet Governance, which provides certain generic rules about data protection, the Ministry of Justice could in the near future, adopt the final version of the Draft Personal Data Protection Act. This could lead to a greater number of obligations for operators in relation to the collection of personal data of telecom services users and further restrictions on the treatment of such data.

Regulation of functional separation

The principles established in Europe's common regulatory framework, adopted in 2009 and transposed in the national legislation of each Member State in which Telefónica operates 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

Table of Contents

Financial Statements

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, national regulators are seeking to strengthen their supervision of operators with regard to the blocking of access, discrimination of applications or Internet service quality. The European Parliament and the Council are simultaneously debating the draft of the European DSM Regulation proposed by the European Commission that, among other things, deals with the principle of network neutrality. The regulation of network neutrality could directly affect possible future business models of Telefónica and may affect the network management or differentiation of characteristics and quality of Internet access service.

Telefónica is present in countries where net neutrality has already been ruled, such as Chile, Colombia, Peru and more recently Brazil, but this remains a live issue and with varying degrees of development in other countries where it operates. In Germany, the Economy Minister withdrew a draft law that it published on June 20, 2013, to regulate net neutrality, especially with regard to the blocking and discrimination of content and Internet services. It plans to submit a new draft after the EU has settled on a position on net neutrality within the DSM approach, which might occur in early 2015. In addition, one German region (Bundesland of Thuringia) has passed a new law (which applies only in such region) with the aim that broadcasting and tele-media may not be blocked, limited or treated differently from other data traffic.

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 its business, financial condition, results of operations and cash flows.

The Telefónica Group is exposed to risks in relation to compliance with anti-corruption laws and regulations and economic sanctions programs.

The Telefónica Group is required to comply with the laws and regulations of various jurisdictions where it conducts operations. In particular, the Group's international operations are subject to the U.S. Foreign Corrupt Practices Act of 1977 (FCPA) and the United Kingdom Bribery Act of 2010 (the Bribery Act), and economic sanction programs, including those administered by the United Nations, the European Union and the United States, including the U.S. Treasury Department's Office of Foreign Assets Control (OFAC). The FCPA prohibits providing anything of value to foreign officials for the purposes of obtaining or retaining business or securing any improper business advantage. As part of the Telefónica Group's business, it may deal with entities, the employees of which are considered foreign officials for purposes of the FCPA. In addition, economic sanctions programs restrict the Group's business dealings with certain sanctioned countries, individuals and entities.

Although the Group has internal policies and procedures designed to ensure compliance with applicable anti-corruption laws and sanctions regulations, there can be no assurance that such policies and procedures will be sufficient or that the Group's employees, directors, officers, partners, agents and service providers will not take actions in violation of the Group's policies and procedures (or otherwise in violation of the relevant anti-corruption laws and sanctions regulations) for which the Group or they may be ultimately held responsible. Violations of anti-corruption

laws and sanctions regulations could have a material adverse effect on the Group's business, reputation, results of operations and financial condition.

Customers' perceptions of services offered by the Company may put it at a disadvantage compared to competitors' offerings.

Customers' perceptions of the assistance and services 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 adequately could have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

Company may not be able to adequately foresee and respond to technological changes and sector trends.

Telefónica, S.A. 120

Table of Contents

Financial Statements

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, secure 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 of these characteristics, it is subject to the effects of actions by competitors in these markets and to its ability to anticipate and adapt, in a timely manner, to constant technological changes, changes in customer preferences that are taking place in the industry, as well as economic, political and social circumstances.

Failure to do so adequately could have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

New products and technologies arise constantly, and their 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 1,111 million euros and 1,046 million euros in 2014 and 2013, respectively; representing an increase of 6.2% from 1,046 million euros in 2013. These expenses represented 2.2% and 1.8% of the Group's consolidated revenue, respectively. These figures have been calculated using the guidelines established in the Organization for Economic Cooperation and Development (OECD) manual. 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, such as 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. While an increasing demand for the capabilities offered by these new networks to end users exists, the high level of the investments requires a continuous analysis of the return on investment.

The explosion of the digital market and entry of new players in communications market, such as MVNOs, Internet companies or device manufacturers, may cause the loss of value of certain assets, and affect the Group's ability to generate income. Therefore, it is necessary to update the business model, encouraging the pursuit of incomes and additional efficiencies to those followed traditionally. Failure to do so adequately could have an adverse impact on the Group's business, 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 its 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

Company's operations, and may cause legal contingencies or damages to the Company's image in the event that inappropriate practices are produced by a participant in the supply chain.

As of December 31, 2014, the Telefónica Group depended on six handset suppliers and 11 network infrastructure suppliers, which together accounted for 80% of the awarded contracts for the year then ended. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own stock shortfalls 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 otherwise 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.

Telefónica, S.A. 121

Table of Contents

Financial Statements

Unanticipated network interruptions as a result of system failures, including those due to network, hardware or software, stealing of infrastructure elements 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 these types of incidents, and the claims and loss in revenue caused by service interruptions to date have been covered by these policies, these policies may not be sufficient to cover all possible monetary losses.

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 certain expert groups and public health agencies, including the World Health Organization (WHO), that states that currently there are no established risks associated with exposure to low frequency signals in mobile communications. However, the scientific community is still investigating this issue especially with respect to 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.

Worries about radio frequency 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, how they operate, the use of mobile telephones and 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.

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 of operations and cash flows of the 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 costs. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and to

recognize impairment 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 impairments on certain of its investments, affecting its results of operations in the year in which they were experienced. For example, with respect to the investment in Telco, S.p.A. (Telco), value adjustments were made in fiscal years 2013 and 2014 with a negative impact of 267 million euros and 464 million euros, respectively.

The Telefónica Group's networks carry and store large volumes of confidential, personal and corporate data, and its Internet access and hosting services may lead to claims for illegal or illicit use of the Internet.

The Telefónica Group's networks carry and store large volumes of confidential, personal and business data, through both voice and data traffic. The Telefónica Group stores increasing quantities and types of customer

Table of Contents

Financial Statements

data in both business and consumer segments. Despite its best efforts to prevent it, the Telefónica Group may be found liable for any loss, transfer, or inappropriate modification of the customer data or general public data stored on its servers or transmitted through its networks, any of which could involve many people and have an impact on the Group's reputation, or lead to legal claims and liabilities that are difficult to measure in advance.

In addition, the Telefónica Group's 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 any loss, transfer or inappropriate modification of the customer data stored on its servers or carried by its networks.

In most countries in which the Telefónica Group 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.

Any of the foregoing could have an adverse impact on the business, financial position, results of operations and cash flows of the Group.

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, the Telefónica Group has open judicial procedures in Peru concerning the clearance of previous years income tax, for which a contentious-administrative appeal is currently pending; as well as in Brazil, with CADE's (Conselho Administrativo de Defesa Econômica) resolution with regard to the acquisition of a 50% stake in Vivo and with certain open tax procedures, primarily relating to the CIMS (a Brazilian tax on telecommunication services). Further details on these matters are provided in the Note 17 and 20 of the financial statements.

Telefónica, S.A. 123

Table of Contents

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 its scale.

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. Among other developments, Telefónica may 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 where 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 2014, Telefónica took a further step towards its transformation into a leading digital telecommunications company, in a sector which we believe still offers excellent growth potential. Digital capacities were boosted, new products were developed, and new business models were set up. This was achieved as a result of a transformation drive implemented throughout the Company.

2013 marked a turning point with the launch of a multinational program, *Be More*, focused on transformation and growth and the deleveraging of our business in Ireland, Czech Republic and 40% of Central America. This program aims to take advantage of our customer insight, the capture of future Business to Business (B2B) opportunities, further data monetization of our services and reinforcing our video business. In addition, we will seek to simplify our operating model and increase investments in fiber and LTE, transforming the IT in our operating business. In 2014, we made progress in the transformation process of Telefónica, simplifying the Company and building the bases for a new organization, simplifying operations, making provisions for a leaner staffing at a number of group operators and making key changes to our structure.

We believe that both the completion of the consolidation of our operations in Germany and the acquisition of GVT in Brazil (which is still pending approval by the regulator), which entail structural changes to the Company's positioning in two of its largest markets, points to, and strengthens, our capacity for future growth.

The pace of addition of high-value customers was stepped up in 2014, with more than 21 million new smartphones, 1.5 million new Pay TV accesses and 927 new fiber accesses. We believe these figures indicate a growing generalization of usage-intensive data and content services.

Intense commercial activity in the area of high-value services was attributable mainly to greater investment, which allowed us to double the size of our FTTH network to 14.7 million premises passed, securing LTE coverage of 41% of the outdoor population in the regions where we operate, thereby increasing the number of LTE base stations to more than 20 thousand in 2014 (2.2X compared to 2013).

Telefónica Spain showed a change in trend due to the in-depth transformation process rolled out by the company to steady the pace of the year-on-year fall in revenue, with the assistance of intense commercial activity, especially in terms of fiber and Pay TV. Movistar Fusión continued to grow steadily mainly as a result of the offering of the new bundled portfolio including TV in almost all our portfolio with a competitive price from 60 euros/month, which continued to attract customers to value-added offers.

Table of Contents

Financial Statements

Telefónica United Kingdom continued to work on the deployment of its LTE network, reaching 58% outdoor coverage at year-end, keeping the focus on offering a positive network experience and an exclusive content proposition to 4G customers. The operator is still migrating its high-value customers to LTE, with a view to boosting the network experience and customer satisfaction. Telefónica United Kingdom continues to deliver a good commercial performance with its Refresh offer, helping improve the market distribution dynamics towards more efficient channels.

On August 29, 2014 the Company was given the green light from the European Commission to purchase the E-Plus Group, and the transaction was completed on October 1, 2014. The E-Plus Group has been part of Telefónica Deutschland since that date. The new company is intent on becoming Germany's leading digital telecommunications company, and aims to secure synergies of more than 5 billion euros of present value, mainly produced by the network, customer service, overheads and new opportunities for generating income.

Telefónica Germany continued to perform well in 2014, mainly in the mobile contract segment, thanks to a strategy focusing on data monetization. This performance was achieved against a more competitive backdrop with growing demand for LTE offers and terminals. Year-on-year revenue stabilized, and mobile revenue rose again year-on-year.

As part of the transformation process, embarked by the Group, a significant provision was recorded for E-Plus in connection with the planned downsizing of its staffing, which aims to lay the foundations for future growth.

In Brazil, we consolidated the leadership in the higher-value mobile segments, maintaining our dominance of the market. The Company was awarded one of the three blocks of radioelectric spectrum for LTE auctioned in the 700 MHz band (2x10 MHz) on September 30, 2014, for the minimum reserve price of the block (approximately 619 million euros). This gave Telefónica Brazil the spectrum it needed to expand the 4G services in the medium and long term, and accelerate adoption of data (in 2014, data revenue accounted for 38.6% of the total).

In the fixed business, fiber deployment was key, with 14.7 million premises passed by December 2014, and the number of connected homes gradually rose to 1.8 million.

On September 19, 2014 the Company entered into an agreement with Vivendi to purchase GVT, with a view to creating an integrated operator with national coverage focused on higher-value customers to give a major boost to the Company's market positioning. The purchase is pending approval by the regulator.

Strong commercial activity by Telefónica Hispanoamérica, along with robust investment to improve service quality, continued to drive steady year-on-year growth of revenue and OIBDA, especially in Mexico, Colombia and Peru.

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.

Table of Contents

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 9, 2015 Telefónica Europe, B.V. made an early repayment for 844 million US dollars (695 million euros) of its bilateral loan on supplies signed on August 28, 2012 and originally scheduled to mature on October 31, 2023. This loan was guaranteed by Telefónica, S.A.

On January 15, 2015, Telefónica Emisiones, S.A.U. redeemed 1,250 million US dollars (1,068 million euros) of its notes, issued on July 6, 2009. The notes were guaranteed by Telefónica, S.A.

On January 30, 2015, the 375 and 100 million euros loan facilities arranged between Telefónica Finanzas S.A.U. and the European Investment Bank (EIB) matured as scheduled. These loans were guaranteed by Telefónica, S.A.

On February 19, 2015, Telefónica, S.A. signed a 2,500 million euros syndicated credit facility maturing in 2020, with two twelve month extension options requiring mutual agreement of the parties (which could extend the maturity to as late as 2022). This agreement entered into effect on February 26, 2015 and allowed us to cancel in advance the syndicated loan facility of Telefónica Europe, B.V. dated on March 2, 2012 with two tranches of 756 million euros and 1,469 million pounds sterling originally scheduled to mature in 2017. On the same date, Telefónica S.A. signed an amendment to its 3,000 million euros syndicated credit facility arranged on February 18, 2014 maturing in 2019 in which the parties mutually agreed two twelve month extension options (which could extend the maturity to as late as 2021).

Exclusive negotiations with Hutchison Whampoa Group

Telefónica and Hutchison Whampoa Group agreed to enter into exclusive negotiations for the potential acquisition by the latter of Telefónica's subsidiary in the UK (O2 UK) for an indicative price in cash (firm value) of £10.25bn (approximately 13.5bn); composed of (i) an initial amount of £9.25bn (approximately 12.2bn) which would be paid at closing and (ii) an additional deferred payment of £1.0bn (approximately 1.3bn) to be paid once the cumulative cash flow of the combined company in the UK has reached an agreed threshold.

The exclusivity period will last several weeks, allowing Telefónica and Hutchison Whampoa Group to negotiate definitive agreements, while Hutchison Whampoa Group completes its due diligence over Telefónica's subsidiary in the UK (O2 UK).

Table of Contents

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
2014-12-09	4,657,204,330.00	4,657,204,330	4,657,204,330

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	% of total voting rights
Banco Bilbao Vizcaya Argentaria, S.A.	291,194,876	13,132	6.25%
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	0	244,647,885	5.25%
Blackrock, Inc.	0	177,257,649	3.81%

Through: Name or corporate name

Name or corporate name of indirect holder	Through: Name or corporate name of the direct holder	Number of voting rights
Banco Bilbao Vizcaya Argentaria, S.A.	BBVA Seguros, S.A. de Seguros y Reaseguros	13,132
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Caixabank, S.A.	244,604,533
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Vidacaixa, S.A. Seguros y Reaseguros	43,352
Blackrock, Inc	Blackrock Investment Management (UK)	177,257,649

Indicate the most significant movements in the shareholder structure during the year:

Name or corporate name of shareholder	Date of transaction	Description of transaction
---------------------------------------	---------------------	----------------------------

Telefónica, S.A. 127

Table of Contents

Financial Statements

A.3. Complete the following tables on company directors holding voting rights through company shares:

Name or corporate name director	Number of direct voting rights	Number of indirect voting rights	% of total voting rights
Mr. César Alierta Izuel	4,545,928	0	0.10%
Mr. Isidro Fainé Casas	523,414	0	0.01%
Mr. José María Abril Pérez	97,288	111,481	0.00%
Mr. Julio Linares López	430,923	1,941	0.01%
Mr. José María Álvarez-Pallete López	335,260	0	0.01%
Mr. José Fernando de Almansa Moreno-Barreda	19,562	0	0.00%
Ms. Eva Castillo Sanz	99,863	0	0.00%
Mr. Carlos Colomer Casellas	49,360	63,190	0.00%
Mr. Peter Erskine	73,111	0	0.00%
Mr. Santiago Fernández Valbuena	111,210	0	0.00%
Mr. Alfonso Ferrari Herrero	603,105	20,057	0.01%
Mr. Luiz Fernando Furlán	35,031	0	0.00%
Mr. Gonzalo Hinojosa Fernández de Angulo	47,725	197,474	0.01%
Mr. Pablo Isla Álvarez de Tejera	9,067	0	0.00%
Mr. Antonio Massanell Lavilla	2,413	0	0.00%
Mr. Ignacio Moreno Martínez	13,076	0	0.00%
Mr. Francisco Javier de Paz Mancho	57,024	0	0.00%

Through: Name or company name

Name or company name of indirect shareholder	of direct shareholder	Number of voting rights
Mr. José María Abril Pérez	Other shareholders of the company	111,481
Mr. Julio Linares López	Other shareholders of the company	1,941
Mr. Carlos Colomer Casellas	Other shareholders of the company	63,190
Mr. Alfonso Ferrari Herrero	Other shareholders of the company	20,057
Mr. Gonzalo Hinojosa Fernández de Angulo	Other shareholders of the company	197,474

% of total voting rights held by the Board of Directors

0,16%

Telefónica, S.A. 128

Table of Contents

Financial Statements

Complete the following tables on share options held by directors:

Name or corporate name of director	Number of direct	Number of indirect voting rights	Equivalent	% total
	voting rights		number of shares voting rights	
Mr. César Alierta Izuel	972,417	0	1,519,401	0.02%
Mr. Julio Linares López	13,878	0	21,686	0.00%
Mr. José María Álvarez-Pallete López	572,131	0	893,955	0.01%
Mr. Santiago Fernández Valbuena	1,311,223	0	1,486,287	0.03%

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. (TFP), 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.
Fundación Bancaria Caixa de 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.

Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa

Corporate Joint shareholding of Finconsum, Establecimiento Financiero de Crédito, S.A.U. (subsidiary of CaixaBank, S.A.) with Telefónica, S.A., in Telefónica Consumer Finance, Establecimiento Financiero de Crédito, S.A.

Telefónica, S.A. 129

Table of Contents

Financial Statements

Fundación Bancaria Caixa d Estalvis i Pensions 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 Yaap Digital Services,
S.L.

Telefónica, S.A. 130

Table of Contents

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

Telefónica, S.A.

China Unicom (Hong Kong) Limited

% of share capital affected

1.38%

Brief description of the agreement:

See Section H - Other Information of Interest, Note 3 to Section A.6.

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

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

Telefónica, S.A. 131

Table of Contents

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
128,227,971	0	2.75%

(*) 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
2014/01/29	47,122,215	0	1.04%
2014/07/01	46,011,480	0	1.01%

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 May 30, 2014, the shareholders resolved to renew the authorization granted at the General Shareholders Meeting of June 2, 2010, for the derivative acquisition of treasury stock, either directly or through Group companies, in the terms literally transcribed below:

A) To authorize, pursuant to the provisions of Section 144 et seq., of the Spanish Companies Act (Ley de Sociedades de Capital), the derivative acquisition by Telefónica, S.A. -either directly or through any of the subsidiaries- at any time and as many times as it deems appropriate, of its own fully-paid in shares through purchase and sale, exchange or any other legal transaction.

The minimum price or minimum value consideration shall be equal to the par value of the shares of its own stock acquired, and the maximum acquisition price or maximum value consideration 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 directly or indirectly pursuant to this authorization added to those already held by Telefónica, S.A. and any of its 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 market 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 their option rights, all within the framework of duly approved compensation systems referencing the listing price of the Company's shares.

Telefónica, S.A. 132

Table of Contents

Financial Statements

B) 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.

C) To deprive of effect, to the extent of the unused amount, the authorization granted under Item III on the Agenda by the shareholders at the Ordinary General Shareholders Meeting of the Company on June 2, 2010 .

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

See Section H Other Information of Interest , Note 4 to Section A.10

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 shares have the same characteristics, rights and obligations.

Edgar Filing: TELEFONICA S A - Form 6-K

On the stock markets of New York and Lima, Telefónica, S.A. s shares are traded via American Depositary Shares (ADSs), representing each ADS one share in the Company.

Telefónica, S.A. 133

Table of Contents

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.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 to 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 Corporate 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, if 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, shall be necessary, at the first call, 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 twenty five 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 Corporate 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 Corporate 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.

Article 291 of the Corporate 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.

Telefónica, S.A. 134

Table of Contents

Financial Statements

The voting procedure on proposals is governed by article 197 bis of the Corporate Enterprises Act and by Telefónica's internal regulations (in particular, article 23 of the Rules of Procedure of the General Assembly). These states, i.a., that in case of amending the Articles of Association, 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	
2013/05/31	6.53%	47.35%	0.01%	0.59%	54.48%
2014/05/30	5.66%	48.65%	0.01%	0.48%	54.80%

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

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)** in the section **Shareholders and Investors** (<http://www.telefonica.com/en/shareholders-investors/jsp/home/home.jsp>), 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.

Telefónica, S.A. 135

Table of Contents

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:

Maximum number of directors	20
Minimum number of directors	5

C.1.2. Complete the following table with board members details:

Name or corporate name of director	Position on the representative board	Date of first appointment	Date of last appointment	Election procedure
Mr. César Alierta Izuel	Chairman	1997/01/29	2012/05/14	Resolution approved at General Shareholders Meeting
Mr. Julio Linares López	Vice Chairman	2005/12/21	2011/05/18	Resolution approved at General Shareholders Meeting
Mr. José María Abril Pérez	Vice Chairman	2007/07/25	2013/05/31	Resolution approved at General Shareholders Meeting
Mr. Isidro Fainé Casas	Vice Chairman	1994/01/26	2011/05/18	Resolution approved at General Shareholders Meeting
Mr. José María Álvarez-Pallete López	Chief Operating Officer	2006/07/26	2012/05/14	Resolution approved at General Shareholders Meeting
Mr. Peter Erskine	Director	2006/01/25	2011/05/18	Resolution approved at General Shareholders Meeting
Ms. Eva Castillo Sanz	Director	2008/01/23	2013/05/31	Resolution approved at General Shareholders Meeting
Mr. Luiz Fernando Furlán	Director	2008/01/23	2013/05/31	Resolution approved at General Shareholders Meeting

Mr. Chang Xiaobing	Director	2011/05/18	2011/05/18	Resolution approved at General Shareholders Meeting
Mr. José Fernando de Almansa Moreno-Barreda	Director	2003/02/26	2013/05/31	Resolution approved at General Shareholders Meeting
Mr. Gonzalo Hinojosa Fernández de Angulo	Director	2002/04/12	2012/05/14	Resolution approved at General Shareholders Meeting
Mr. Carlos Colomer Casellas	Director	2001/03/28	2011/05/18	Resolution approved at General Shareholders Meeting
Mr. Antonio Massanell Lavilla	Director	1995/04/21	2011/05/18	Resolution approved at General Shareholders Meeting
Mr. Pablo Isla Álvarez de Tejera	Director	2002/04/12	2012/05/14	Resolution approved at General Shareholders Meeting
Mr. Ignacio Moreno Martínez	Director	2011/12/14	2012/05/14	Resolution approved at General Shareholders Meeting
Mr. Santiago Fernández Valbuena	Director	2012/09/17	2013/05/31	Resolution approved at General Shareholders Meeting
Mr. Alfonso Ferrari Herrero	Director	2001/03/28	2011/05/18	Resolution approved at General Shareholders Meeting

* continue with this information

Table of Contents

Financial Statements

* on the previous page.

Mr. Francisco Javier de Paz Mancho	Director	2007/12/19	2013/05/31	Resolution approved at General Shareholders Meeting
------------------------------------	----------	------------	------------	---

Total number of directors

18

Indicate any board members who left during this period:

C.1.3. Complete the following tables on board members and their respective categories:**EXECUTIVE DIRECTORS**

Name or corporate name of director	Committee proposing appointment	Post held in the company
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 (C.O.O.)
Mr. Santiago Fernández Valbuena	Nominating, Compensation and Corporate Governance Committee	Chief Strategy Officer
Total number of executive directors		3
% of the board		16.67%

EXTERNAL PROPRIETARY DIRECTORS

Name or Corporate Name Director	Committee proposing appointment	Name or corporate name of significant shareholder represented or proposing appointment
Mr. José María Abril Pérez	Nominating, Compensation and Corporate Governance Committee	Banco Bilbao Vizcaya Argentaria, S.A.
Mr. Ignacio Moreno Martínez	Nominating, Compensation and Corporate Governance Committee	Banco Bilbao Vizcaya Argentaria, S.A.
Mr. Isidro Fainé Casas		Fundación Bancaria Caixa d Estalvis i Pensions de

Edgar Filing: TELEFONICA S A - Form 6-K

	Nominating, Compensation and Corporate Governance Committee	Barcelona, la Caixa
Mr. Antonio Massanell Lavilla	Nominating, Compensation and Corporate Governance Committee	Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa
Mr. Chang Xiaobing	Nominating, Compensation and Corporate Governance Committee	China Unicom (Hong Kong) Limited
Total number of proprietary directors		5
% of the board		27.78%

Telefónica, S.A. 137

Table of Contents

Financial Statements

INDEPENDENT EXTERNAL DIRECTORS

Name or Corporate name of Director	Profile
Mr. Alfonso Ferrari Herrero	Industrial Engineer. He was formerly Executive Chairman of Beta Capital, S.A. and senior manager at Banco Urquijo.
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. 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 Juan Carlos I.
Mr. Gonzalo Hinojosa Fernández de Angulo	Industrial Engineer. He was formerly Chairman and CEO of Cortefiel Group
Mr. Carlos Colomer Casellas	Graduate in Economics. He was Chairman of the Colomer Group until 2013
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. He was General manager of Telefónica Europe until 2007. Currently Chairman of Ladbrokes, Plc.
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.

Total number of independent directors	8
--	----------

% of the board	44.44%
-----------------------	---------------

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.

Yes

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 Director	Description relationship	Reasons
Mr. Carlos Colomer Casellas	<p>Mr. Carlos Colomer Casellas is an independent Director of Abertis Infraestructuras, S.A., parent company of Abertis Group, which has made certain transactions with Telefónica Group (transmission and leasing of mobile phone towers). Described in detail in section H Other Information of Interest (Note 16 paragraph D.5)</p>	<p>According to the assessment made attending the nature ,the transactions are not liable , by its object and specialty, to generate any ability to influence by one party over the other; attending to the amount, from the point of view of Telefónica and Abertis immaterial;- and attending to the fact that Mr. Colomer Casellas is an Independent Director in Abertis Infraestructuras, S.A., the Board of Directors of Telefónica, S.A. considers that those transactions constitute a not suitable transaction in order to condition in any way the independence of Mr. Colomer Casellas.</p>

Table of Contents

Financial Statements

Other External Directors

Name or corporate name of director	Committee notifying or proposing appointment
Mr. Julio Linares López	Nominating, Compensation and Corporate Governance Committee
Ms. Eva Castillo Sanz	Nominating, Compensation and Corporate Governance Committee
Total number of Other External Directors	2
% of the board	11.11%

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 Director**Reasons**

Mr. Julio Linares López

On September 17, 2012, Mr. Julio Linares López resigned from his post as Chief Operating Officer (C.O.O.) 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.

Ms. Eva Castillo Sanz

On February 26, 2014, Ms. Eva Castillo Sanz resigned from her executive position as Chairwoman of Telefónica Europe, to being classified in the Other External Directors category.

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
Ms. Eva Castillo Sanz	2014/02/26	Executive Director	Other External Directors

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
-----------------------------------	--

Edgar Filing: TELEFONICA S A - Form 6-K

	Year 2014	Year 2013	Year 2012	Year 2011	Year 2014	Year 2013	Year 2012	Year 2011
Executive	0	1	1	0	0.00%	25.00%	25.00%	0.00%
Proprietary	0	0	0	0	0.00%	0.00%	0.00%	0.00%
Independent	0	0	0	1	0.00%	0.00%	0.00%	12.50%
Other External	1	0	0	0	50.00%	0.00%	0.00%	0.00%
Total:	1	1	1	1	5.56%	5.56%	5.56%	5.56%

Telefónica, S.A. 139

Table of Contents

Financial Statements

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 Director of Telefónica. This appointment was ratified by the Ordinary General Shareholders Meeting of Telefónica held on April 22, 2008, and having been re-elected for that position by the Ordinary General Shareholders Meeting held on May 31, 2013.

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 Vice General Counsel 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.

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.

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 by 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. Nevertheless, in the year 2014, there has been no circumstance to alter the current composition of the Board.

C.1.7. Explain how shareholders with significant holdings are represented on the board.

Telefónica, S.A. 140

Table of Contents

Financial Statements

As stated in Section C.1.3 of this Annual Corporate Governance Report, at December 31, 2014, the group of External Directors of Telefónica, S.A. was composed of 15 members (of a total of 18 Board members), of whom 5 are Proprietary Directors, 8 are Independent Directors and 2 falls under the Other External Directors category.

Of the five Proprietary Directors, two act in representation of Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona la Caixa, which holds 5.25% of the capital of Telefónica, S.A., two act in representation of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), which holds 6.25% of the capital, and one acts in representation of China Unicom (Hong Kong) Limited (China Unicom) which holds a 1.38% stake.

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 H Other Information of Interest, Note 3 to 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. 141

Table of Contents

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 (C.O.O) 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. 142

Table of Contents

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:

Name or corporate name of Director	Corporate name of the group company	Post
Mr. Alfonso Ferrari Herrero	Telefónica del Perú, S.A.A.	Director
	Telefónica Chile, S.A.	Acting Director
Mr. Francisco Javier de Paz Mancho	Telefónica de Argentina, S.A.	Director
	Telefónica Brasil, S.A.	Director
	Telefónica Gestión de Servicios Compartidos, S.A.	Chairman
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 Deutschland Holding, A.G.	Chairwoman of the Supervisory Board
D. Santiago Fernández Valbuena	Colombia Telecomunicaciones, S.A. E.S.P.	Director
	Telefónica América, S.A.	Chairman
	Telefónica Brasil, S.A.	Vice Chariman
	Telefónica Capital, S.A.	Sole Director
	Telefónica Chile, S.A.	Acting Director
	Telefónica Internacional, S.A.U.	Chairman
	Telefónica Móviles México, S.A. de C.V.	Vice Chairman
	Fonditel Pensiones, Entidad Gestora de Fondos de Pensiones, S.A. (E. G. F. P.)	Chairman

Telefónica, S.A. 143

Table of Contents

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.

Name or corporate name Director	Name of listed company	Post
Mr. César Alierta Izuel	China Unicom (Hong Kong) Limited	Director
	International Consolidated Airlines Group, S.A. (IAG)	Director
Mr. Isidro Fainé Casas	Banco Portugués de Investimento, S.A. (BPI)	Director
	The Bank of East Asia	Director
	Abertis Infraestructuras, S.A.	First Vice Chairman
	Repsol, S.A.	First Vice Chairman
	Caixabank, S.A.	Chairman
	Suez Environnement Company	Director
Mr. Carlos Colomer Casellas	Abertis Infraestructuras, S.A.	Director
	Inversiones Mobiliarias Urquiola, S.A. SICAV	Chairman
	Ahorro Bursatil, S.A. SICAV	Chairman
Ms. Eva Castillo Sanz	Bankia, S.A.	Director
D. Pablo Isla Alvarez de Tejera	Inditex, S.A.	Chairman-CEO
D. Luiz Fernando Furlán	Brasil Foods, S.A. (BRF)	Director
	AGCO Corporation	Director
D. Ignacio Moreno Martínez	Secuoya, Grupo de Comunicación, S.A.	Director
D. Santiago Fernández Valbuena	Ferrovial, S.A.	Director
D. Peter Erskine	Ladbrokes, Plc	Chairman
D. Antonio Massanell Lavilla	Boursorama, S.A.	Director
	Caixabank, S.A.	Vice Chairman
	Banco Portugués de Investimento, S.A. (BPI)	Director
D. Chang Xiaobing	China United Network Communications Limited	Chairman
	China Unicom (Hong Kong) Limited	Chairman-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:No

Table of Contents

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:

Investment and financing policy	Yes
Design of the structure of the corporate group	Yes
Corporate governance policy	Yes
Corporate social responsibility policy	Yes
Strategic or business plans, management targets and annual budgets	Yes
Remuneration and evaluation of senior officers	Yes
Risk control and management, and the periodic monitoring of internal information and control systems	Yes
Dividend policy, as well as the policies and limits applying to treasury stock	Yes

C.1.15. List the total remuneration paid to the Board of Directors in the year:

Board remuneration (thousands of euros)	25,528
Amount of total remuneration corresponding to accumulated pension rights (thousands of euros)	1,375
Total board remuneration (thousands of euros)	26,903

C.1.16. List any members of senior management who are not executive directors and indicate total remuneration paid to them during the year:

Name or corporate name	Position(s)
Mr. Ignacio Cuesta Martín-Gil	Director Internal Audit
Mr. Ramiro Sánchez de Lerín García-Ovies	General Counsel and Secretary of the Board of Directors
Mr. Ángel Vilá Boix	General Manager of Finance and Corporate Development
Mr. Guillermo Ansaldo Lutz	General manager of Global Resources
Mr. Eduardo Navarro de Carvalho	Chief Commercial Digital Officer (CCDO)
	26,766

Total remuneration received by senior management (in thousands of euros)

Telefónica, S.A. 145

Table of Contents

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:

Name or corporate name of Director	Name or corporate name of significant shareholder	Post
Mr. Isidro Fainé Casas	Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Chairman Criteria Caixaholding, S.A. Chairman Fundació Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa Chairman Caixabank, S.A. Director Boursorama, S.A. Vice Chairman Caixabank, S.A.
Mr. Antonio Massanell Lavilla	Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Non Executive Chairman Cecabank, S.A. Director Banco Portugués de Investimento, S.A. (BPI) Director Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria (SAREB) Chairman Barcelona Digital Centre Tecnològic Director Mediterranea Beach & Golf Community, S.A.
Mr. José Fernando de Almansa Moreno-Barreda	Banco Bilbao Vizcaya Argentaria, S.A.	Acting Director Grupo Financiero BBVA Bancomer, S.A. de C.V. Acting Director 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:

Name or company name of director with relationship	Name or company name of significant shareholder with relationship	Description of relationship
Mr. Cesar Alierta Izuel	Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Trustee of Fundació Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa
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.

Table of Contents

Financial Statements

C.1.18. Indicate whether any changes have been made to the board regulations during the year:

No

Description of amendments

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.

In this regard, on certain occasions that it is essential due to vacancies after the Annual General Meeting, is appropriate in accordance with the provisions of the Corporate Enterprises Act, to the appointment by cooptation; submitting to ratification such appointment at the next General Meeting of Shareholders held.

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

Table of Contents

Financial Statements

The Directors may be re-elected for one or more subsequent similar initial 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

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

Table of Contents

Financial Statements

In a meeting on February 26, 2014 the Nominating, Compensation and Corporate Governance Committee revised and analyzed the results of Telefónica, S.A.'s evaluation of the performance in 2013 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:

- i) 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, whenever possible
- ii) Oversee all necessary measures in order to ensure the General Shareholders' Meetings of the Company are conducted normally.
- iii) Conduct a detailed review of the 2014 Action Plans review of each Board Committees, to avoid duplication in the subjects treated by them.

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

Telefónica, S.A. 149

Table of Contents

Financial Statements

under Good Governance practices.

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, without prejudice to the powers of the General Meeting of Shareholders under the law, Bylaws and Regulations of the General Meeting.

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.

Table of Contents

Financial Statements

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

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

Table of Contents

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

C.1.26. Indicate whether the bylaws or the regulations of the Board of Directors set any age limit for directors:

No

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

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.

Moreover, the Article 529 quater of the Corporate Enterprises Act states that the Non-Executive Directors may only delegate their representation to another Non-Executive Director.

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.

Number of board meetings	14
Number of Board meetings held without the Chairman's attendance	0

Indicate the number of meetings of the various board committees held during the year:

Telefónica, S.A. 152

Table of Contents

Financial Statements

Number of meetings of the Executive or Delegated Committee	18
Number of meetings of the Audit and Compliance Committee	11
Number of meetings of the Nominating, Compensation and Corporate Governance Committee	11
Number of meetings of the Regulation Committee	5
Number of meetings of the Service Quality and Customer Service Committee	2
Number of meetings of the Institutional Affairs Committee	6
Number of meetings of the Strategy Committee	5
Number of meetings of the Innovation Committee	5

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:

Directors attendance	11
% of attendances of the total votes cast during the year	98.81%

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.
- 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.

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

Table of Contents

Financial Statements

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.

4) 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.

5) 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 eleven (11) meetings in 2014.

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

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.

Telefónica, S.A. 154

Table of Contents

Financial Statements

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

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

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

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

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:

Company	Group
---------	-------

Number of consecutive years	10	10
	Company	Group
Number of years audited by current audit firm/Number of years the company's financial statements have been audited (%)	31.30%	41.70%

C.1.40. Indicate and give details of any procedures through which directors may receive external advice:
Yes

Telefónica, S.A. 156

Table of Contents

Financial Statements

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

Details of rules

Telefónica, S.A. 157

Table of Contents

Financial Statements

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

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 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).

2.- On February 18, 2014, Telefónica, SA, as borrower, and a group of credit institutions as lenders, with The Royal Bank of Scotland PLC as bank agent, signed a syndicated loan agreement in an aggregate amount up to three thousand (3,000) million euros (the Facility Agreement).

As provided in the Facility Agreement, in the event of a change of control in Telefónica, S.A., the lenders entities may, under certain circumstances, require the early cancellation of the Facility Agreement.

To determine whether there has been a change of control for these purposes, the Facility Agreement serves the usual criteria of such agreements, such as obtaining control of the majority of the voting rights, on the

Telefónica, S.A. 158

Table of Contents

Financial Statements

appointment of the majority of the members of the board, or on the financial and operating policies of the company.

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	48
--------------------------------	----

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.

Therefore, the contracts executed since 2006 have followed the criteria stated above regarding the 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.

Requiring the Executive Chairman, as of the date of issuance of this Report, the Chairman has no golden parachute provision.

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.

Table of Contents

Financial Statements

Indicate whether these agreements must be reported to and/or authorized by the governing bodies of the company or its group:

	Board of Directors	General Shareholders Meeting
Body authorizing clauses	Yes	No
Is the General Shareholders Meeting informed of such clauses?		Yes

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 COMMISSION**

Name	Post	Type
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

% of executive directors	22.00%
% of proprietary directors	22.00%
% of independent directors	56.00%
% of Other External Directors	0.00%

AUDIT AND CONTROL COMMITTEE

Name	Post	Type
Mr. Carlos Colomer Casellas	Chairman	Independent

Edgar Filing: TELEFONICA S A - Form 6-K

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

% of executive directors	0.00%
% of proprietary directors	40.00%
% of independent directors	60.00%
% of Other External Directors	0.00%

Telefónica, S.A. 160

Table of Contents

Financial Statements

NOMINATING, COMPENSATION AND CORPORATE GOVERNANCE COMMITTEE

Name	Position	Type
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

% of executive directors	0.00%
% of proprietary directors	0.00%
% of independent directors	100.00%
% of Other External Directors	0.00%

REGULATION COMMITTEE

Name	Position	Type
Mr. Gonzalo Hinojosa Fernández de Angulo	Chairman	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	Other External
Mr. Ignacio Moreno Martínez	Member	Proprietary

% of executive directors	0.00%
% of proprietary directors	17.00%
% of independent directors	67.00%
% of Other External Directors	17.00%

SERVICE QUALITY AND CUSTOMER SERVICE COMMITTEE

Name	Position	Type
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	Other External

Edgar Filing: TELEFONICA S A - Form 6-K

Mr. Ignacio Moreno Martínez	Member	Proprietary
Mr. Francisco Javier de Paz Mancho	Member	Independent

% of executive directors	0.00%
% of proprietary directors	29.00%
% of independent directors	57.00%
% of Other External Directors	14.00%

Telefónica, S.A. 161

Table of Contents

Financial Statements

INSTITUTIONAL AFFAIRS COMMITTEE

Name	Post	Type
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

% of executive directors	0.00%
% of proprietary directors	17.00%
% of independent directors	67.00%
% of Other External Directors	17.00%

STRATEGY COMMITTEE

Name	Position	Type
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	Other External
Mr. Julio Linares López	Member	Other External

% executive directors	0.00%
% proprietary directors	0.00%
% independent directors	67.00%
% of Other External Directors	33.00%

INNOVATION COMMITTEE

Name	Position	Type
Mr. Carlos Colomer Casellas	Chairman	Independent
Mr. Antonio Massanell Lavilla	Member	Proprietary
Mr. José María Abril Pérez	Member	Proprietary
Mr. Peter Erskine	Member	Independent

Table of Contents

Financial Statements

	Number of female directors							
	Year 2014		Year 2013		Year 2012		Year 2011	
	Number	%	Number	%	Number	%	Number	%
Executive Committee	0		0		0		0	
Audit and Control Committee	0		0		0		0	
Nomination, Compensation and Corporate Governance Committee	0		0		0		0	
Regulation Committee	1	(16.67%)	1	(14.29%)	1	(20.00%)	1	(16.67%)
Service Quality and Customer Service Committee	1	(14.29%)	1	(14.29%)	1	(16.67%)	1	(16.67%)
Institutional Affairs Committee	0		0		0		0	
Strategy Committee	1	(16.67%)	1	(16.67%)	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:

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	Yes
To regularly review internal control and risk management systems, so main risks are correctly identified, managed and notified	Yes
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	Yes
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	Yes
To submit to the board proposals for the selection, appointment, reappointment and removal of the External Auditor, and the engagement conditions	Yes
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	Yes
To ensure the independence of the External Auditor	Yes

C.2.4. Describe the organizational and operational rules and the responsibilities attributed to each of the board committees.

See Section H Other Information of Interest, Note 14 to Section C.2.4.

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.

The organization and operation of the Board of Directors Committees are governed by the Regulations of the Board of Directors. Also, and particularly, the Executive Commission is regulated in Article 38 of the Corporate By-laws, the Audit and Control Committee in Article 39 of the Corporate By-laws, and the Nominating, Compensation and Corporate Governance Committee in the Article 40 of the Corporate By-laws These documents are available for consultation on the Company s website.

As mentioned in Note 14 to Section C.2.4 of Section H Other Information of Interest , the Board Committees draw up an internal Activities Report summarizing the main activities and actions taken during

Telefónica, S.A. 163

Table of Contents

Financial Statements

the year detailing the issues discussed at their meetings and highlighting certain aspects regarding their powers and duties, composition and operation.

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. 164

Table of Contents

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. 165

Table of Contents

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:

Name or corporate name of significant shareholder	Name or corporate name of the company or its group company	Nature of the relationship	Type of transaction	Amount (Thousands of euros)
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Interest paid	7,944
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Receipt of services	4,136
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Interest paid	4,105
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance Arrangements: other	1,106,941
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance Arrangements: loans	302,921
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Guarantees	67,951
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Dividends and other distributed earning	193,840
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Others	23,247.109
Banco Bilbao Vizcaya Argentaria, S.A.	Rest Telefonica Group	Contractual	Interest paid	18,553
Banco Bilbao Vizcaya Argentaria, S.A.	Rest Telefonica Group	Contractual	Operating lease contracts	325
Banco Bilbao Vizcaya Argentaria, S.A.	Rest Telefonica Group	Contractual	Receipt of services	3,956
Banco Bilbao Vizcaya Argentaria, S.A.	Rest Telefonica Group	Contractual	Interest Charged	9,663
Banco Bilbao Vizcaya Argentaria, S.A.	Rest Telefonica Group	Contractual	Services Delivery	61,176
Banco Bilbao Vizcaya Argentaria, S.A.	Rest Telefonica Group	Contractual	Sale of goods	5,471
Banco Bilbao Vizcaya Argentaria, S.A.	Rest Telefonica Group	Contractual	Finance Arrangements: other	339
Banco Bilbao Vizcaya Argentaria, S.A.	Rest Telefonica Group	Contractual	Finance Arrangements: loans	113,639
Banco Bilbao Vizcaya Argentaria, S.A.	Rest Telefonica Group	Contractual	Financial Lease Arrangement	159
Banco Bilbao Vizcaya Argentaria, S.A.	Rest Telefonica Group	Contractual	Guarantees	461,054
Banco Bilbao Vizcaya Argentaria, S.A.	Rest Telefonica Group	Contractual	Stock options purchase agreements	31,545
Banco Bilbao Vizcaya Argentaria, S.A.	Rest Telefonica Group	Contractual	Other	1,150,169
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Telefónica, S.A.	Contractual	Interest paid	1,860
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Telefónica, S.A.	Contractual	Receipt of services	2,939
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Telefónica, S.A.	Contractual	Interest Charged	19,032
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Telefónica, S.A.	Contractual	Finance Arrangements: other	1,173,075

Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Telefónica, S.A.	Contractual	Finance Arrangements: loans	21,071
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Telefónica, S.A.	Contractual	Guarantees	8,271
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Telefónica, S.A.	Contractual	Dividends and other distributed earning	98,271
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Telefónica, S.A.	Contractual	Others	1,220,965
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Rest Telefonica Group	Contractual	Finance costs	353
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Rest Telefonica Group	Contractual	Operating Lease Arrangements	306
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Rest Telefonica Group	Contractual	Receipt of services	56,430
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Rest Telefonica Group	Contractual	Interest Charged	24

Telefónica, S.A. 166

Table of Contents

Financial Statements

Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Rest Telefonica Group	Contractual	Receipt of services	95,042
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Rest Telefonica Group	Contractual	Sale of goods (finished or unfinished)	1,608
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Rest Telefonica Group	Contractual	Finance Arrangements: loans	10,000
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Rest Telefonica Group	Contractual	Guarantees	66,600
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Rest Telefonica Group	Contractual	Stock options purchase agreements.	67,348
Fundación Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa	Rest Telefonica Group	Contractual	Other	53

Telefónica, S.A. 167

Table of Contents

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:

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:

D.5. Indicate the amount from related-party transactions.
193,615 (thousands 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.

In accordance with the provisions of the Company in its corporate governance rules, the principles governing possible conflicts of interest that may affect Directors, senior executives or significant shareholders are:

With respect to Directors, Article 31 of the Regulations of the Board of Directors expressly 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).

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

Telefónica, S.A. 168

Table of Contents

Financial Statements

indirectly, with Directors, with significant shareholders or shareholders represented on the Board, or with persons related thereto.

The performance of such operations or 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 paragraph 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. 169

Table of Contents

Financial Statements

D.7. Is more than one Group Company listed in Spain?

No

Identify the listed subsidiaries in Spain:

Listed Subsidiaries

[REDACTED]

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

[REDACTED]

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. 170

Table of Contents

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 in a transversal way 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. The responsibilities of the Audit and Control Committee also includes the monitoring risk management.

As per the Group's Risk Management Policy, various local and corporate units are involved in managing risks.

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 regarding this point is contained in Annex to this Report.

E.4. Identify if the company has a risk tolerance level.

Telefónica, S.A. 171

Table of Contents

Financial Statements

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.

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 negatively 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, regarding the investment in Telco, S.p.A. (Telco) has been made correction to the value in the 2013 and 2014 financials years, with a negative impact of 267 and 464 millions euros respectively.

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, 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.

Table of Contents

Financial Statements

F. SYSTEMS OF INTERNAL RISK MANAGEMENT AND INTERNAL CONTROL OVER FINANCIAL REPORTING (ICFR)

Describe the mechanisms which comprise the internal control over financial reporting (ICFR) risk control and management system at the company.

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 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 services 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 any additional time 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.

Telefónica, S.A. 173

Table of Contents

Financial Statements

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.

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.

Reporting and Audit instructions for the third quarter and 2014 year-end closings, published annually and quarterly 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 at the beginning of each period the monthly accounting-financial reporting dates.

These documents also define and delimit responsibilities at each level of the organization regarding the reliability of the information published.

Code of conduct, approving body, dissemination and instruction degree, principles and values included (stating whether there are specific reference to operation recording and the preparation of financial information), body in charge of analyzing non-compliance and of suggesting corrective actions and

sanctions.

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 conduct, named "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 specific principles aimed at ensuring the trust of the customers, professionals, shareholders, suppliers and society in general.

Telefónica, S.A. 174

Table of Contents

Financial Statements

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 senior representatives of the General Secretary's Office, Human Resources, Internal Audit and Public Affairs and Regulations.

The following the responsibilities of this office stand out:

- 1.- Guaranteeing that Telefónica conducts business in an ethical and responsible manner, and that the Company's reputation is not tarnished.
- 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 strengthen the knowledge of Business Principles.

- 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.

Whistle-blowing channel, which enables communication to the Audit Committee about irregularities of a financial and accounting nature, and also about possible cases of non-compliance with the code of conduct as well as about irregular activities in the organization, informing, where applicable, if non-compliance is of a confidential nature.

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.

This channel is accessible from 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.

Telefónica, S.A. 175

Table of Contents

Financial Statements

Business Principles Whistle-blowing Channel: In addition to the Business Principles ethical code, the Board of Directors approved a whistle-blowing channel for employees 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.

This channel follows the principle of not encouraging anonymous communication. Confidentiality of the identity of the whistle-blower is guaranteed at every moment.

The channel is accessible through the Business Principles webpage on Telefónica's intranet. Telefónica S.A.'s

Office of Business Principles is responsible for the Business Principles Whistle-blowing Channel.

Periodic training and refresher programs for staff involved in the preparation and review of financial information, as well as in ICFR assessment, which cover, at least, accounting, auditing, internal control and risk management standards.

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.

Likewise, Telefónica S.A.'s Finance Department offers specific 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, from an accounting and financial point of view, are relevant in order to prepare consolidated financial information.

Updated Information Newsletters on NIIF (International Financial Reporting Standards) are also issued, these newsletters provide a summary of the main novelties in the accounting field, as well as clarifying on the various aspects which may rise with regard to this issue.

Finance personnel also attend technical sessions run by external consultancy firms related to main accounting changes. 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.

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 in the processes affecting financial reporting are analyzed.

Telefónica, S.A. 176

Table of Contents

Financial Statements

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. 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.

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. In the process of identifying the Corporate perimeter, the Finance Department periodically monitors the changes in the Corporate Group s perimeter. On a periodic basis, an updating of the consolidation perimeter is made, checking additions and deletions in companies with legal and financial departments in the various companies which are part of the Group.

The process addresses other types of risk (operational, technological, financial, legal, reputational, environmental, etc.) insofar as they may affect the financial statements. Telefónica, besides what has been explained in the previous items, has a Risk Management Model covering four key areas of risk:

Business risks

Operational risks

Global risks

Financial risks

Financial risks include risks associated with the accuracy, completeness and publication of reporting information.

Finally, which of the company s governing bodies is responsible for overseeing the process. The Board of Directors, through the Audit and Control Committee, is the body in the entity which oversees the process, as defined in art. 22 of the Regulations of the Board of Directors of Telefonica.

F.3. Control activities

Indicate the existence of at least the following components, specifying 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 . This regulation establishes 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 Telefónica s 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.

Telefónica, S.A. 177

Table of Contents

Financial Statements

Likewise, the Telefónica Group has documented accounting-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.

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 Finance 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.

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.

Finally, Internal audit, within its annual audit plan establishes, annually work plans to assess the Internal Control Model over financial reporting.

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 defining the strategy and technology planning, ensuring the conditions of quality of service, cost and safety required by the Group.

Within its different functions is in charge of the development and the implementation of systems that improve the efficiency, effectiveness and profitability of the group processes, 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.

The Corporate Policy on Information Security defines as strategic assets the information and the systems that treat it and establishes both the safety requirements which Group companies must have and the action lines to be followed compulsorily by implementing appropriate controls according to the following domains:

Organization and functions

Obligations relating to staff

Classification and information processing

Identification and authentication

Access control

Audit Logs and monitoring

Telefónica, S.A. 178

Table of Contents

Financial Statements

Networking and Communications

Software Control

Development and maintenance of systems

Incident management

Management and distribution of supports

Backup & Recovery copies

Business Continuity

Physical and environmental security

Compliance with currently legislation

Finally, Internal Audit in its annual audit plan establishes work plans to verify the effectiveness and efficiency of IT governance model, the adequacy of controls, and the completeness of information.

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 and conclusions may materially impact 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 jointly with the procurement department. The finance department has control activities in place to guarantee the validity of the data, the methods used and the reasonability of the assumptions used by the third party by making a recurrent follow-up of KPIs specific to each function which enable to ensure compliance with the outsourced process in accordance with policies and guidelines provided by the Group.

Likewise, there is an internal procedure for engaging independent experts which requires specific levels of approval.

F.4. Information and communication

Report, specifying, at least, the main characteristics the existence of at least:

- F.4.1. A specific function in charge of defining and maintaining update accounting policies (accounting policies area or department) and settling doubts or disputes over their interpretation, which is in regular

Table of Contents

Financial Statements

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 Group Finance Department is in charge of 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 consolidated financial statements.

This documentation is sent periodically via electronic mail and is available for the whole Group at the eAccounting portal in the Intranet of Telefónica.

Likewise, the accounting policies department has a fluent communication with the people responsible for accounting in the main companies of the Group, both proactively and reactively. This communication is useful to solve doubts or conflicts and it is also useful to guarantee homogeneity in accounting criteria in the Group and it also enables to share best practices among the operators.

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** which 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. Likewise 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

Telefónica, S.A. 180

Table of Contents

Financial Statements

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 function is developed according to 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 as a company listed on the New York Stock Exchange 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 issue 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 on three levels the Internal Audit function is responsible for evaluating its performance annually.

Self-assessment Questionnaires

All the Group's subsidiaries complete Self-assessment 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.

Review of processes and specific controls

As well as the requirement to complete the Self-assessment 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, for this purpose, the Scope Definition Model is used, which enables to identify critical accounts in each Telefónica Group

company employing previously-established assumptions.

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.

General controls review

Group general controls are assessed at least annually, considering aspects mainly related to rules and guidelines in force across the entire Group.

Telefónica, S.A. 181

Table of Contents

Financial Statements

Supervision of general controls over information systems has as objective reviewing the management of changes in programs, access to data and systems and the management of changes in infrastructures, back up, programmed tasks and incidents.

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 results of the final appraisal for 2014 were presented at the February 2015 meeting of the Audit and Control Committee. No material weaknesses or significant shortcomings in the ICFR structure and procedures were identified.

The results of the assessment for the year 2014 have been presented in the Audit and Control in February 2015, informing that this evaluation have not revealed material weaknesses or significant deficiencies in the structure and procedures of internal control over financial reporting (ICFR).

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 material weaknesses or significant deficiencies for 2014.

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

Not Applicable

F.7. External auditor report

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.

Edgar Filing: TELEFONICA S A - Form 6-K

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. 182

Table of Contents

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 that this measure does not constitute a blocking mechanism of takeover bids but rather a guarantee that the acquisition of control required in the interests 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.

Table of Contents

Financial Statements

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.

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 section: 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.

Telefónica, S.A. 184

Table of Contents

Financial Statements

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

- 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:**

- i. The strategic or business plan, management targets and annual budgets;**
- ii. Investment and financing policy;**
- iii. Design of the structure of the corporate group;**
- iv. Corporate governance policy;**
- v. Corporate social responsibility policy;**
- vi. Remuneration and evaluation of senior officers;**
- vii. Risk control and management, and the periodic monitoring of internal information and control systems.**
- viii. Dividend policy, as well as the policies and limits applying to treasury stock.**

See sections: C.1.14, C.1.16 and E.2

Table of Contents

Financial Statements

b) The following decisions:

- i. On the proposal of the company's chief executive, the appointment and removal of senior officers, and their compensation clauses.**
- ii. Directors' remuneration, and, in the case of executive directors, the additional consideration for their management duties and other contract conditions.**
- iii. The financial information that all listed companies must periodically disclose.**
- iv. Investments or operations considered strategic by virtue of their amount or special characteristics, unless their approval corresponds to the General Shareholders' Meeting;**
- v. 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

Telefónica, S.A. 186

Table of Contents

Financial Statements

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 and C.1.3

Complies

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 and 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 2014, the group of External Directors of Telefónica, S.A. was composed of 15 members (of a total of 18 Members), of whom 5 are Proprietary Directors, 8 are Independent Directors and 2 falls under the "Other External Directors" category.

Of the five Proprietary Directors, two act in representation of Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa", which holds 5.25% of the capital of Telefónica, S.A., two act in representation of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), which holds 6.25% of the capital, and one acts in representation of China Unicom (Hong Kong) Limited (China Unicom) which holds a 1.38% 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

Telefónica, S.A. 187

Table of Contents

Financial Statements

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 55,514 million euros at December 31, 2014, 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 3,470 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

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 and 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 and C.2.4

Explain

Telefónica, S.A. 188

Table of Contents

Financial Statements

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, having been re-elected for that position by the General Shareholders Meeting that was held on May 31, 2013. 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 Vice General Counsel 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 and C.1.41

Complies

- 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.**

Telefónica, S.A. 189

Table of Contents

Financial Statements

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

19 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 and C.1.30

Complies

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 and C.1.20

Complies

Telefónica, S.A. 190

Table of Contents

Financial Statements

- 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

- 24 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

Partially Complies

Telefónica, SA has not established quantitative rules about the number of Boards that its Directors may sit. Nevertheless, the Regulations of the Board of Directors includes among the obligations of Directors (Article 28.2 of the Board Regulations) that Directors must devote the time and effort required to perform its functions and, to this end, shall inform to the Nominating, Compensation and Corporate Governance Committee about any other professional obligations that might interfere with the performance of their duties as Directors.

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

Telefónica, S.A. 191

Table of Contents

Financial Statements

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

- 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

Telefónica, S.A. 192

Table of Contents

Financial Statements

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

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

Telefónica, S.A. 193

Table of Contents

Financial Statements

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.**

Telefónica, S.A. 194

Table of Contents

Financial Statements

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

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

Table of Contents

Financial Statements

Complies

45 The Audit Committee's role should be:

1st. 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.

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.

2nd. 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.

Telefónica, S.A. 196

Table of Contents

Financial Statements

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

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 section: 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.

Table of Contents

Financial Statements

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

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

Table of Contents

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, 2014, 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

At the General Shareholders Meeting on May 18, 2011, shareholders approved the introduction of a long-term incentive plan for managers 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 remuneration. This 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.

Moreover, at the General Shareholders Meeting on May 30, 2014, shareholders approved the introduction of a new long-term incentive plan for managers of the Group (including Executive Directors), also known as the Performance & Investment Plan (PIP). Under this plan, participants who met the qualifying requirements were also awarded a certain number of Telefónica, S.A. shares as a form of variable remuneration. This 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.

Telefónica, S.A. 199

Table of Contents

Financial Statements

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, 972,417-1,519,401; Mr. Julio Linares López, 13,878-21,686; Mr. José María Álvarez-Pallete López, 572,131-893,955; and Mr. Santiago Fernández Valbuena, 1,311,223-1,486,287) relate to the theoretical number of shares assigned and the maximum possible number of shares to be received in the second and third phase of the Plan approved by the General Shareholders Meeting of May 18, 2011, and to the first phase of the Plan approved by the General Shareholders Meeting of May 30, 2014, if the co-investment requirement established in these Plans and the maximum target TSR established for each phase are met.

In the case of Mr. Julio Linares López, the number of shares quoted exclusively matches the theoretical number of shares assigned, and the maximum possible number of shares to be received, in the second and third phase of the Plan approved by the General Shareholders Meeting of May 18, 2011.

In the case of Mr. Santiago Fernández Valbuena, this figure includes 500,000 call options granting the right to purchase 500,000 Telefónica, S.A. shares at the maturity date (September 11, 2015) at an exercise price of 12.55 euros, and a further 500,000 call options granting the right to purchase 500,000 Telefónica, S.A. shares at the maturity date (January 29, 2016) at an exercise price of 13.37 euros.

It is further stated for the record that, as of December 31, 2014, a maximum of 149,787 shares and 162,500 shares (in total 312,287) had been allocated to Ms. Eva Castillo Sanz, for her participation in the Performance & Investment Plan, for the two cycles of 2012-2015 and 2013-2016, respectively, and that in January 2015, she received 862,475 euros in settlement of her participation in the aforementioned plan.

- Note 3 to Section A.6.]

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 July 2), on October 22, 2009, the Company notified the Spanish Securities Market Commission (Comisión Nacional del Mercado de Valores, CNMV) 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 518 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 undertook 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. Through its subsidiary Telefónica Internacional, S.A.U., Telefónica acquired a number of China Unicom shares amounting to 500 million US dollars from third parties, within nine months of signature of this agreement. In recognition of China Unicom's stake in Telefónica, the latter committed to proposing the appointment of a board member nominated by China Unicom at 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.

Telefónica, S.A. 200

Table of Contents

Financial Statements

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 capital.

After securing the requisite regulatory authorizations, the sales transaction was completed on July 30, 2012.

Subsequent to the transaction, Telefónica and China Unicom remained 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.

On November 10, 2014 Telefónica sold 597,844,100 shares in China Unicom, representing 2.5% of the capital of the latter, in a block trade process, at a price of HK \$ 11.14 per share, in a total amount of HK \$ 6,660 million, approximately 687 million euros at current exchange rates.

Telefónica undertook not to sell any shares held directly or indirectly in China Unicom on the market for a period of 12 months from the selling date.

Telefónica maintains its commitment to the Strategic Partnership with China Unicom.

Note 4 to Section A.10.]

In accordance with Article 26 of the Corporate By-laws, no shareholder may cast a number of votes in excess of 10% 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% voting ceiling.

The 10% 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% 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.

Note 5 to Section B.6.]

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:

Telefónica, S.A. 201

Table of Contents

Financial Statements

The transformation of the Company into a holding company through subsidiarization or by entrusting subsidiaries with the conduct of core activities previously 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.

- Note 6 to Section C.1.12.]

Mr. Ignacio Moreno Martínez of Secuoya, Grupo de Comunicación, S.A., is the individual representing the Board member Cardomana Servicios y Gestiones, S.L.

Mr. Antonio Massanell Lavilla, in the company Boursorama, S.A. is the individual representing the Board member Fundació Bancaria Caixa d Estalvis i Pensions de Barcelona, La Caixa .

The appointment of Mr. Antonio Massanell Lavilla as Director of Banco Portugués de Investimento, S.A. (BPI) is pending of registration in the Public Register of Directors.

- Note 7 to Section C.1.13.]

Telefónica, S.A. has not established quantitative rules about the number of Boards that its Directors may sit. Nevertheless, the Regulations of the Board of Directors includes among the obligations of the Directors (Article 28.2 of the Board Regulations) that Directors must devote the time and effort required to perform its functions and, to this end, shall inform the Nominating, Compensation and Corporate Governance Committee about any other professional obligations that might interfere with the performance of their duties as Directors.

- 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 competence of the Board of Directors of the Company.

- Note 9 to Section C.1.16.]

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. Additionally, and for the purposes of annual remuneration, the person in charge of the internal audit is included.

It is hereby stated that Mr. Matthew Key ceased to be part of the Company's Senior Management on February 26, 2014, having perceived in January 2015 (date of his departure from the company) under the conditions established in its day, on his contract, an amount of 15,150,969 euros as result of the termination of his executive functions in the

Telefónica Group. The amount of 15,150,969 euros is included in the amount of 26,766 thousand euros, consigned as Total remuneration received by senior management in the section of this report C.1.16 of this report.

Note 10 to Section C.1.17.]

Mr. Antonio Massanell Lavilla is Non Executive Chairman of Cecabank, S.A.

Mr. Jose Fernando de Almansa Moreno-Barreda is Acting Director of Grupo Financiero BBVA Bancomer, S.A. de C.V. and of BBVA Bancomer, S.A.

- Note 11 to Section C.1.31.]

Table of Contents

Financial Statements

In accordance with U.S. securities market regulations, the information contained in the Annual Report in 20-F format (which includes the consolidated financial statements 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 12 to Section C.1.39.]

Financial year 1983 was the first audited by an External Auditor. Previously the financial statement were revised by chartered accountants (known at the time as *censores de cuentas*). Therefore, 1983 is the base year taken for calculating the percentage in the case of audits of the Individual Financial Statements of Telefónica, S.A., while 1991 is the date taken for the calculation of the percentage in the case of the Consolidated Financial Statements, as 1991 was the first year in which the Telefónica Group prepared Consolidated Financial Statements.

- Note 13 to Section C.1.45]

It is also stated for the record that in February 2015, the golden parachute provisions included in the four-year contract of the Executive Chairman, Mr. César Alierta Izuel, were replaced by an extraordinary one-time contribution of 35.5 million euro to a benefit plan, as part of the company's policy of reducing indemnity provisions, in line with best corporate governance practices. After this extraordinary contribution, Telefónica, S.A. will not contribute any additional annual amounts to the Benefit Plan for Officers with respect to for Mr. Alierta Izuel. Such contribution would be received by Mr. Alierta Izuel in the same instances established in the benefit plan for officers (*plan de previsión social de directivos*) (PPSD) applicable to the other officers.

- Note 14 to Section C.2.4.]**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 one year from the date when he ceased to hold office.

b) Duties.

Edgar Filing: TELEFONICA S A - Form 6-K

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.

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

Telefónica, S.A. 203

Table of Contents

Financial Statements

well as, where appropriate, terms for the hiring thereof, the scope of its professional engagement and the revocation or renewal of its appointment.

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 the internal audit.
- c) To propose the budget for this service.
- d) To review the annual internal audit work plan and the annual activities report.
- e) To receive periodic information on its activities.
- f) To verify that senior executives take account of the conclusions and recommendations of the reports.

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.

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) establishment of the level of risk that the Company deems acceptable; the measures to mitigate the impact of the identified risks, should they materialize.

- c) the control and information systems to be used to control and manage these risks.

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.

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.

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.

- c) Operation.

The Audit and Control Committee shall meet at least once every quarter and as often as appropriate, when called by its Chairman.

Table of Contents

Financial Statements

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.

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:

To periodically examine, review and monitor the quality indices of the principal services provided by the companies of the Telefónica Group.

To evaluate levels of customer service provided by the companies of the Group to their customers.

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 analyzing and monitoring the Telefónica Group's global strategy policy.

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.

Telefónica, S.A. 205

Table of Contents

Financial Statements

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) Competences.

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.
- 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 at any given 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

Table of Contents

Financial Statements

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.

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.

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.

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.

Telefónica, S.A. 207

Table of Contents

Financial Statements

b) Duties.

The Board of Directors, always subject to the legal provisions in force, delegates 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.

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.

c) Relations 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).

Action Plan and Report

As for the Board itself, at the beginning of each year and in accordance with Article 20 b) 3. of the Regulations of the Board of Directors, all Committees shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

All Committees shall also draw up an internal Activities Report summarizing the main activities and actions taken during the previous 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 addressed by the Committees.

- Note 15 to Section D.2.]

The following is hereby placed on record:

The operations included in this section under the heading Other , to the value of 23,247,109 with Banco Bilbao Vizcaya Argentaria, S.A. correspond to Dividends received (13,847) and Derivatives (23,233,262).

The operations included in this section under the heading Other , to the value of 1,150,169 with Banco Bilbao Vizcaya Argentaria, S.A. correspond to Other costs (3,280), Profits from retirement or disposal of assets (6), Other income (2,504), Other operations (111,562), and Derivatives (1,032,817).

The operations included in this section under the heading Other , to the value of 1,220,965 with Fundació Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa , correspond to Derivatives.

The operations included in this section under the heading Other , to the value of 53 with Fundació Bancaria Caixa d Estalvis i Pensions de Barcelona, la Caixa , correspond to Other costs.

Telefónica, S.A. 208

Table of Contents

Financial Statements

- Note 16 to Section D.5.]

Certain members of the Board of Directors of Telefónica, SA are themselves members of the Board of Directors of Abertis Infraestructuras, S.A., parent company of the Group Abertis. In 2014 and 2013, Telefónica has reached agreements with Abertis, through its company Abertis Tower, S.A., under which Telefónica Móviles Spain, S.A.U. transferred mobile telephone towers to Abertis, earning capital gains of 193 and 70 million euros, respectively. An agreement was also drawn up whereby Abertis Tower, S.A.U. leased space in this infrastructure for Telefónica Móviles España, S.A.U. to install its communications equipment.

Finally, it should be said that as of the year 2010, Telefónica, S.A. adheres to the Code of Good Fiscal Practices, as approved by the Large Companies Forum a body in which major Spanish companies and the Spanish tax authorities participate, and complies with the content of the same.

Similarly, Telefónica Group is committed to the application of the Universal Declaration of Human Rights, the United Nations Global Compact, and other conventions and treaties agreed by international bodies such as the Organization for Economic Cooperation and Development and the International Labor Organization.

This annual corporate governance report was adopted by the Company's Board of Directors at its meeting held on February 23, 2015.

State whether any directors voted against approval of this Report, or abstained from voting.

No

Name or corporate name of director	Reasons (voted against, abstention, non-attendance)	Explain the reasons

Telefónica, S.A. 209

Table of Contents

Financial Statements

ANNEX TO THE ANNUAL CORPORATE GOVERNANCE REPORT

E.3 Indicate the main risks that may affect the achievement of business objectives.

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 of operations, must be considered jointly with the information in the financial statements, and are as follows:

Group-related risks**Worsening of the economic and political environment could negatively affect Telefónica's business.**

Telefónica's international presence enables the diversification of its activities across countries and regions, but it is affected by various legislations, as well as the political and economic environments of the countries in which it operates. Any adverse developments or even uncertainties in this regard, including exchange-rate or sovereign-risk fluctuations, may adversely affect the business, financial position, cash flows and/or the performance of some or all of the Group's financial indicators.

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. Factors such as high debt levels, ongoing restructuring of the banking sector, the implementation of pending structural reforms and continued fiscal austerity measures could hinder more dynamic growth in Europe and, in turn, the consumption and volume of demand for the Group's services, which could materially adversely affect the Group's business, financial condition, results of operations and cash flows.

The soft economic recovery in Europe together with low inflation rates, and the risk of deflation, has led and may still lead to monetary and fiscal easing from key players, with a view to creating a relatively benign scenario for Europe. In this region, the Telefónica Group generated 23.9% of its total revenues in Telefónica Spain, 14.0% in the Telefónica United Kingdom and 11.0% in Telefónica Germany in 2014.

In addition, the Group's business may be affected by other possible effects from the economic crisis, including possible insolvency of key customers and suppliers.

In Latin America, the most important challenge is the exchange-rate risk in Venezuela and Argentina, given the negative impact that a depreciation in their currencies could have on cash flows from both countries. International financial conditions may be unfavorable and may lead to 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) an economic slowdown in Asia (a key region for Latin America) and slow progress with structural reforms projects in the majority of these countries limiting potential for

higher growth rates. Among the most significant macroeconomic risk factors in the region are the high inflation rates, negative economic growth and high internal and external funding needs in Venezuela. These funding needs are significant and are affected by the recent fall in oil prices, which is the main and almost sole source of foreign currency in the country. These factors are affecting Venezuela's competitiveness and may result in a currency devaluation. Other risks in the region are Argentina's high level of inflation coupled with a phase of economic slowdown and weak public finances. Moreover, the recent decline in the prices of oil and other commodities could have a negative impact on the external accounts of countries such as Brazil, Chile, Peru and Colombia.

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". For the year ended December 31, 2014, Telefónica Hispanoamérica and Telefónica Brazil represented 26.1% and 22.3% of the Telefónica Group's revenues, respectively. Moreover, approximately 9.6% of the Group's revenues in the telephony business are generated in countries that do not

Telefónica, S.A. 210

Table of Contents

Financial Statements

have investment grade status (in order of importance, Argentina, Venezuela, Ecuador, Nicaragua, Guatemala, El Salvador and Costa Rica), and other countries are only one notch away from losing this threshold. It is also significant that, despite clear improvements in Brazil, the uncertainty surrounding the political situation, fiscal policy stimuli and a relatively high inflation rate could result in a rating downgrade that, depending on the extent of such downgrade, could result in strong exchange-rate volatility due to an outflow of investments, especially in relation to fixed-income.

Country risk factors include the following:

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 business in such countries;

abrupt exchange-rate fluctuations may occur mainly due to high levels of inflation and both fiscal and external deficits with the resulting exchange-rate overvaluation. This movement could lead to strong exchange-rate depreciation in the context of a floating exchange rate regime, a significant devaluation off the back of abandoning fixed exchange rates regimes or the introduction of varying degrees of restrictions on capital movement. For example, in Venezuela, the official U.S. dollar to bolívar 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 the Complementary System for Administration of Foreign Currency (*Sistema Complementario de Administración de Divisas* or SICAD) regular and selective auctions. In February 2015, a new Exchange Rate Agreement was established, including the regulations for the Foreign Exchange Marginal System (SIMADI), and the Central Bank of Venezuela published on February 18, 2015 a weighted average exchange rate equal to 172.1 bolívares to the U.S. dollar for the markets referred to in chapters II and IV of such Exchange Rate Agreement. Additionally, the acquisition or use of foreign currencies by Venezuelan or Argentinean companies (in some cases) to pay foreign debt or dividends is subject to the pre-authorization of the relevant authorities. Also, the Argentinean peso, despite its recent stability, continues to be under the threat of a sustained accelerated depreciation against the U.S. dollar;

governments may expropriate or nationalize assets, 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 limits on profit margins may be imposed in order to limit the prices of goods and services through the analysis of cost structures. For example, in Venezuela, a maximum profit margin has been introduced that will be set annually by the Superintendence for Defense of Socioeconomic Rights.

Any of the foregoing may adversely affect the business, financial position, results of operations and cash flows of the Group.

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, 2014, 70% of the Group's net debt (in nominal terms) was pegged to fixed interest rates for a period greater than one year, while 27% 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, 2014: (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 111 million euros, (ii) whereas a 100 basis points decrease in interest rates in all currencies except the euro, the 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 68 million euros. These calculations were made using the same balance position in each currency and same balance position equivalent at such date and bearing in mind the derivative financial instruments arranged.

Telefónica, S.A. 211

Table of Contents

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 76 million euros, primarily due to the weakening of the Venezuelan bolivar and the Argentinean peso. These calculations were made using the same balance position in each currency with an impact on profit or loss at such date, including derivative instruments in place. For the year ended December 31, 2014, 22.8% of the Telefónica Group's operating income before depreciation and amortization (OIBDA) was concentrated in Telefónica Brazil, 26.2% in Telefónica Hispanoamérica and 11.2% in the Telefónica United Kingdom.

The Telefónica Group uses a variety of strategies to manage these risks, mainly through the use of financial derivatives, which themselves also expose us 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, the development and implementation of new technologies or the renewal of licenses as well as expansion of our business in countries where we operate may 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 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 to raise funds from the Group's shareholders, and may negatively affect the Group's liquidity. At December 31, 2014, gross financial debt scheduled to mature in 2015 amounted to 8,491 million euros (which includes the net position of derivative financial instruments and certain current payables), and gross financial debt scheduled to mature in 2016 amounted to 8,407 million euros. Despite having covered gross debt maturities of 2015, 2016 and part of 2017 by available cash and lines of credit at December 31, 2014, possible difficulties in maintaining 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.

In 2013 the Telefónica Group issued bonds mainly (i) in euro totaling 3,250 million euros with an average coupon of 3.690%; (ii) in dollars totaling 2,000 million U.S. dollars with an average coupon of 3.709%; and (iii) in Swiss Francs totaling 225 million Swiss francs with an annual coupon of 2.595%. The Telefónica Group also issued undated deeply subordinated securities in euros totaling 1,750 million euros with an average coupon of 6.902%; and in sterling pounds totaling 600 million sterling pounds with a coupon of 6.750%. In 2014 the Telefónica Group issued bonds mainly in the European market with a maturity of eight years totaling 1,250 million euros with an annual coupon of 2.242%, and bonds with a fifteen-year maturity totaling 800 million euros with an annual coupon of 2.932%. In

addition, the Telefónica Group issued undated deeply subordinated securities in 2014 totaling 2,600 million euros with an average coupon of 5.075%.

Despite having its gross debt maturities profile covered for more than two years, 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 the Group's ability to meet its debt maturities.

Moreover, market conditions could make it harder to renew existing undrawn credit lines, 8% of which, at December 31, 2014, were scheduled to mature prior to December 31, 2015.

In addition, the impact of the sovereign debt crisis and the rating downgrades in certain Eurozone countries should be taken into account. Any deterioration in the sovereign debt markets, doubts about developments in

Telefónica, S.A. 212

Table of Contents

Financial Statements

European projects (such as implementation of the banking union project, the results of the elections in Europe, including Spain among others, or progress towards fiscal integration), as well as further credit restrictions by the banking sector could have an adverse effect on the Telefónica Group'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.

Risks Relating 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 the Group provides 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 those related to spectrum regulation and licenses/concessions, rates, universal service regulation, regulated wholesale services over 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, potentially, 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.

In this regard, the Telefónica Group pursues its license renewals 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, service and coverage standards 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 authorities 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 harm to the future growth of certain businesses.

Regulation of spectrum and government concessions

In Europe, the amendments by the EU Parliament to the Commission's proposal on the Digital Single Market (the DSM) package of measures are currently being discussed by the European Council. The DSM measures 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 licenses, etc.

In addition, the main allocation criteria for the 700 MHz band of Digital Dividend II (the second spectrum allocation process from television operators to electronic communications services) will be defined in the coming years. This

could require new cash outflows ahead of the Group's previously anticipated schedule (it is expected that the spectrum will be available between 2018 and 2021).

Nevertheless, Germany will be the first country in Europe to award spectrum in the 700 MHz band. On January 29, 2015, the German regulator (BNetzA) published respective final decisions on the spectrum allocation proceedings and on the auction conditions of the 700 MHz and 1500 MHz bands. The auction will also include the spectrum corresponding to GSM licenses – the entire 900 MHz band and most of the 1800 MHz band (which will expire at the end of 2016) . Interested bidders may submit applications by March 6, 2015. The auction (Simultaneous Multi-Round Auction) will take place in the second quarter of 2015.

On July 4, 2014, BNetzA adopted a decision concerning the frequency aspects of the Telefónica Deutschland Holding AG merger with E-Plus Mobilfunk GmbH & Co KG (E-Plus). BNetzA has instructed Telefónica Deutschland (the surviving entity) to anticipate the termination of its rights of use in the 900 / 1800 MHz bands by December 31, 2015, (instead of December 31, 2016), if Telefónica Deutschland (the surviving entity) does not reacquire these frequencies at the above-mentioned auction proceeding. Both Telefónica

Telefónica, S.A. 213

Table of Contents

Financial Statements

Deutschland and E-Plus have legally challenged this BNetzA decision on August 4, 2014. The German regulator also announced that, once the auction of spectrum mentioned above mentioned is over, it will perform a frequency distribution analysis, and determine whether any additional action is needed, particularly in the area of the 2GHz spectrum band granted to Telefonica Deutschland (surviving entity).

In addition, and within the framework of the conditions imposed by the European Commission in connection with the merger, the surviving entity of the merger is obliged to offer up to 2x10 MHz in the 2600 MHz as well as up to 2x10 MHz in the 2100 MHz spectrum band to one potential new mobile network operator. This offer is open to any potential new mobile network operator that had declared a respective interest by December 31, 2014, and to the operator with whom Telefónica Deutschland has signed the network access agreement (Drillisch Group).

On December 26, 2014, the Spanish Government adopted a law in which it delayed, to a maximum period ended on April 1, 2015, the effective delivery of the frequencies in the 800 MHz spectrum which are part of the Digital Dividend (the spectrum allocation process from television operators to electronic communications services), and which were expected to be delivered on January 1, 2015 to the already awarded mobile operators. The license term has been extended accordingly to April 24, 2031.

In the United Kingdom a significant increase in the annual license fees charged for the use of the spectrum in 900 MHz and 1800 MHz bands has been proposed by the regulator (the Office of Communications (Ofcom)). The outcome of it remains uncertain. Separately, the United Kingdom Government announced recently an agreement with the United Kingdom mobile operators, including Telefonica UK, under which the mobile operators would accept a 90% geographic coverage obligation for voice and text services. Given the agreement, Ofcom has agreed to consider the impact of the geographic coverage obligation on its valuation of annual fees for 900 MHz and 1800 MHz spectrum. This is expected to delay Ofcom's decision. In addition, on November 7, 2014, Ofcom released a public consultation on the award of 2.3 GHz and 3.4 GHz bands that is expected to take place in late 2015 or early 2016.

In Latin America, spectrum auctions are expected to take place implying potential cash outflows to obtain additional spectrum or to meet the coverage requirements associated with these licenses. Specifically, the procedures expected to take place in 2015 are:

Peru: The government announced plans to auction the 700 MHz spectrum band in the first half of 2015 (three blocks of 2x15 MHz have been defined).

Costa Rica: Costa Rica's government has communicated its intention to auction spectrum in the 1800 MHz and AWS bands during 2015.

Mexico: The Federal Institute of Telecommunications (Instituto Federal de Telecomunicaciones) (IFT) published its Annual Program for Frequency Use and Development 2015. The program specifies IFT's intention to award Advanced Wireless Services (AWS) concessions during the course of 2015.

Edgar Filing: TELEFONICA S A - Form 6-K

Further to the above, certain administrations may not have announced their intention to release new spectrum and may do so during the year. The above does not include processes announced via general statements by administrations, which involve bands not key to Telefónica's needs. Telefónica may also seek to acquire spectrum on the secondary market should opportunities arise.

In Argentina, on December 1, 2014, the Secretary of Communication through Resolution 85/2014 officially awarded Telefónica Argentina the block 1710-1720/2110-2120 for a period of 15 years and the 700 MHz block (703-713/758-768 MHz) is expected to be officially transferred to Telefónica Argentina during 2015.

In the state of São Paulo, Telefónica Brasil provides local and national long-distance Commuted Fixed Telephony Service (CFTS) under the public regime, through a concession agreement, which will be in force until 2025. In this regard, in June 27, 2014, as established in the concession agreement, the National Telecommunications Agency (Agência Nacional de Telecomunicações) (ANATEL) issued a public consultation for the revision of the concession agreement. Such public consultation revising the concession agreement ended on December 26, 2014 and allowed contributions on certain topics such as service

Telefónica, S.A. 214

Table of Contents

Financial Statements

universalization, rates and fees and quality of services, among others. Definitive conditions will be published in 2015.

Additionally, in Colombia the Information and Communication Technologies (ITC) Ministry issued a Resolution on March 27, 2014 to renew 850 MHz/1900 MHz licenses for 10 additional years. The reversion of assets and the liquidation of the concession contract will be discussed until May 2015, taking into consideration the terms of the contract, and the Constitutional Court's review of Law 422 of 1998, which established the reversion of only the radio-electric frequencies.

In Peru, an application for partial renewal of the concessions for the provision of the fixed-line service for another five years has been issued, although assurance has been given by the Ministry of Transport and Communications (Ministerio de Transportes y Comunicaciones) in previous renewals, that the concession will remain in force until November 2027. Also, a new law has been enacted establishing mobile virtual network operator (MVNOs) and Rural Mobile Infrastructure Operators (RMIOs) in the Peruvian market.

In Mexico, in light of the constitutional reform resulting from the Pact for Mexico political initiative, it is expected that a publicly-owned wholesale network, which will offer wholesale services in the 700 MHz band, will be created. As of today, the funding and the marketing model of this project have not yet been determined.

Telefónica Móviles Chile, S.A. was awarded spectrum on the 700 MHz (2x10 MHz) band in March 2014. A third party provider opposed this allocation of spectrum on the basis that it would exceed the limit spectrum of 60 MHz established by a judgment of the Supreme Court of January 27, 2009. This cap was established for the AWS auction held in 2009, but not for subsequent auctions (2600 MHz and 700 MHz). In a judgment on December 31, 2014, the court of appeals rejected the third party claim. Consequently, the regulator is in a position to adopt a Decree awarding the concession to Telefónica.

The consolidated investment in spectrum acquisitions and renewals in 2014 amounted to 1,294.2 million euros.

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 inability to assume the related costs, could have an adverse impact on 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 business, financial condition, results of operations and cash flows.

Regulation of wholesale and retail charges

In terms of roaming, the regulated Eurotariffs were reduced on July 1, 2014 (in the wholesale market, the price of data was reduced by 67%, the price of call by 50%; and in the retail market, the price of data was reduced by 55%, the price of outgoing voice call by 21%, the price of incoming voice call by 28% and the price of outgoing texts by 25%), as per the regulation approved in 2012. The structural roaming solutions which could lead to a price decrease in the intra-European Union roaming services also took effect in July 2014. Furthermore, the package of DSM measures mentioned above, which is under discussion, also includes a proposal to eliminate European Union roaming charges as of a yet to be determined date. However, the European Parliament proposed the end of roaming by December 15, 2015 in a proposal known as Roaming Like at Home .

The decreases in wholesale mobile network termination rates (MTR) in Europe are also noteworthy. In the United Kingdom, wholesale MTRs have been reduced to 0.845 ppm (pence/minute) from April 1, 2014 (representing a 0.3% reduction compared to the previous rates). In a consultation document published in June 2014, Ofcom has proposed a further reduction to 0.545 ppm, from April 1, 2015.

In Germany, on September 3, 2014, the BNetzA adopted a proposal to reduce MTRs. The new prices will gradually decrease to 0.0172 euro/minute from December 1, 2014, and in a second stage, from 0.0172 euro/minute to 0.0166 euro/minute from December 1, 2015 until the end of November 2016. The European Commission has requested that the German regulator withdraw or amend its latest decision on mobile termination rates, in force as at the date of this Annual Report. There is a risk that the European Commission will initiate infringement proceedings against Germany, and rates may be further reduced.

Table of Contents

Financial Statements

In Spain, the National Regulatory & Competition Authority (*Comisión Nacional de los Mercados y la Competencia*) has adopted a final decision on the third round analysis of the wholesale market for fixed call termination. From November 1, 2014, a symmetric fixed termination rate (FTR) of 0.0817 euro cents/minute applies, based on pure bottom-up long run incremental costs (BU-LRIC) meaning that billing must be entirely conducted on a per second basis, without a peak/off-peak differentiation. The decision therefore eliminates the asymmetry in FTRs that existed since 2006 when alternative network operators were allowed to charge up to 30% above Telefónica's per minute local FTR. It also brings forth an important reduction in average termination prices for Telefónica (by 80%) in comparison to the former applicable tariffs.

In Latin America, there are also moves to review MTRs leading to these being reduced. Thus, for example, developments in Mexico are among the most relevant, where the IFT has declared the América Móvil Group a preponderant operator in the telecommunications market. As a result, on March 26, 2014, it introduced, among others, special regulations on asymmetric interconnection rates. In that sense, the Federal Telecommunications and Broadcasting law, effective as of August 13, 2014, imposed several obligations on the preponderant operator, which are quite extensive and, in principle, potentially significantly beneficial to Telefónica's competitive position, particularly with regards to the measures imposed on preponderant operators (to the extent they nominally retain such qualification). With regards to MTR, Telefónica México 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 the date of this Annual Report, no ruling has been made on this appeal. Recently, IFT determined the mobile termination rates for 2012, and Telefónica México filed an injunction against this rate. Once these appeals have been concluded, the rates applied may be further reduced retroactively. As of the date of this Annual Report, IFT has not approved the termination rates for 2013, 2014 or 2015 for Telefónica México.

In Brazil, at the end of 2012, ANATEL launched the *Plano Geral de Metas de Competição* (PGMC) regarding fixed-mobile rate adjustment reductions until February 2016 and amending the previous reduction conditions (75% of the 2013 rate in 2014 and 50% of the 2013 rate in 2015). In order to complement reductions and approach the cost of the services according to a financial cost model, on July 7, 2014, ANATEL published reference values for MTR taking effect from 2016 to 2019. Such reductions are approximately 44% per year. Furthermore, there are several legislative initiatives that aim to abolish the basic fee of fixed-telephony service. Price protection practices (reimbursement of differences in prices of a product to customers if this falls within a relative short period of time) may also have a negative impact in Telefónica Brasil, in both economic and image terms.

In Chile, a tariff decree was issued to set fixed-line termination charges for the 2014-2019 periods. The new tariff entered into effect on May 8, 2014 and applies a reduction of 37% in prices against those charged for the period prior to such tariff. A tariff decree has been issued for mobile networks covering the 2014-2019 five-year period. Such tariff decree entered into effect on January 25, 2014 and implies a reduction of 74.7% with respect to the previous rates. After a review by the general comptroller (*Contraloría General*) an additional 1.7% reduction was approved on May 27, 2014.

In Ecuador the rate-related risks relate to 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 control measures. Under this Act, in January 2014, an organic fair price law was issued, which caps the revenue of related enterprises at 30% of their operating costs. In relation to MTRs with the national operator of reference (Compañía Anónima Nacional Teléfonos de Venezuela) (CANTV), these have been reduced by 6% compared to the previous rates. In November 2014, near the end of the term allowing the enactment of laws autonomously granted to the President of the Republic, new important decree-laws were enacted, in particular, the Reform of the Law on Foreign Investment, in which, among other things, new requirements for the return of foreign investment were established; the Reform of the Antitrust Law, which was predominantly aimed at enhancing monopoly control regulation and increasing penalties for infringement; and the Reform of the Exchange Crimes Law, which increased economic sanctions.

Table of Contents

Financial Statements

In Colombia, on December 30, 2014, the Colombian regulator (CRC) enacted Resolution 4660 establishing a gradual reduction for MTRs. The glide path initiates in 2015 in 32.88 Colombian pesos per minute representing a decrease of 41.7% and then descends approximately 42.2% in 2016 and 42.2% in 2017 (each such reduction being as compared to the previous year). This regulatory measure also imposes asymmetric MTRs to the dominant provider (the América Móvil Group), imposing the final rate established in the glide path from 2015 to 2017. The CRC also regulated the charges for national roaming and the SMS termination rates, setting a reduction of 41.5% in 2015, 39.6% in 2016 and 43.3% in 2017 (each such reduction being as compared to the previous year).

Regulation of universal services

Further to its formal obligation to review the scope of the Universal Service Directive (the set of basic electronic communication services whose provision is guaranteed to any user requesting it, regardless of its location, with a specified quality at an affordable price), the European Commission is expected to undertake a public consultation in the months following the date of this Annual Report, which may include both the potential inclusion of broadband in its scope and a possible reduction of some of the current universal service obligations. Depending on the terms that will be 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 last *Plano Geral de Metas de Universalização* (PGMU) was published in Brazil on June 30, 2011 and applies to the 2011-2015 period. This sets goals for public phones, low cost fixed-lines and coverage density in rural and poor areas with 2.5GHz/450 MHz. Also according to such PGMU, the assets assigned to the provision of the services described in the public concession agreement are considered reversible assets. In 2014, ANATEL issued a public consultation with its proposals for the 2015-2020 period universalization targets. The agency's proposal focuses on reducing the distance between public telephones and backhaul's expansion.

Regulation of fiber networks

In December 2014, the Spanish National Regulatory & Competition Authority (*Comisión Nacional de los Mercados y la Competencia*) has conducted a public consultation on the regulatory obligations for broadband market regulation in Spain. As a result of this consultation, the new regulation that will apply to NGN (Next Generation Networks) could be approved in the fourth quarter of 2015 and will last for at least three years. This could increase Telefónica's regulatory obligations in Spain and the ability of other operators to compete in such market.

In Colombia, the regulatory authority CRC published a regulatory project for transmission capacity between municipalities through fiber networks or connectivity to impose open network and elements access through a mandatory offer for those enterprises that have overcapacity and have some unused installed network elements. This project will be discussed in the first half of 2015.

Regulations on privacy

In Europe, a new Data Protection Regulation is undergoing the European legislative process which, as the date of this Annual Report, is not expected to end before mid-2015. 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.

In Brazil, triggered by the approval of Civil Rights Framework for Internet Governance, which provides certain generic rules about data protection, the Ministry of Justice could in the near future, adopt the final version of the Draft Personal Data Protection Act. This could lead to a greater number of obligations for operators in relation to the collection of personal data of telecom services users and further restrictions on the treatment of such data.

Telefónica, S.A. 217

Table of Contents

Financial Statements

Regulation of functional separation

The principles established in Europe's common regulatory framework, adopted in 2009 and transposed in the national legislation of each Member State in which Telefónica operates 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, national regulators are seeking to strengthen their supervision of operators with regard to the blocking of access, discrimination of applications or Internet service quality. The European Parliament and the Council are simultaneously debating the draft of the European DSM Regulation proposed by the European Commission that, among other things, deals with the principle of network neutrality. The regulation of network neutrality could directly affect possible future business models of Telefónica and may affect the network management or differentiation of characteristics and quality of Internet access service.

Telefónica is present in countries where net neutrality has already been ruled, such as Chile, Colombia, Peru and more recently Brazil, but this remains a live issue and with varying degrees of development in other countries where it operates. In Germany, the Economy Minister withdrew a draft law that it published on June 20, 2013, to regulate net neutrality, especially with regard to the blocking and discrimination of content and Internet services. It plans to submit a new draft after the EU has settled on a position on net neutrality within the DSM approach, which might occur in early 2015. In addition, one German region (Bundesland of Thuringia) has passed a new law (which applies only in such region) with the aim that broadcasting and tele-media may not be blocked, limited or treated differently from other data traffic.

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 its business, financial condition, results of operations and cash flows.

The Telefónica Group is exposed to risks in relation to compliance with anti-corruption laws and regulations and economic sanctions programs.

The Telefónica Group is required to comply with the laws and regulations of various jurisdictions where it conducts operations. In particular, the Group's international operations are subject to the U.S. Foreign Corrupt Practices Act of 1977 (FCPA) and the United Kingdom Bribery Act of 2010 (the Bribery Act), and economic sanction programs, including those administered by the United Nations, the European Union and the United States, including the U.S. Treasury Department's Office of Foreign Assets Control (OFAC). The FCPA prohibits providing anything of value to foreign officials for the purposes of obtaining or retaining business or securing any improper business advantage. As part of the Telefónica Group's business, it may deal with entities, the employees of which are considered foreign officials for purposes of the FCPA. In addition, economic sanctions programs restrict the Group's business dealings with certain sanctioned countries, individuals and entities.

Although the Group has internal policies and procedures designed to ensure compliance with applicable anti-corruption laws and sanctions regulations, there can be no assurance that such policies and procedures will be sufficient or that the Group's employees, directors, officers, partners, agents and service providers will not take actions in violation of the Group's policies and procedures (or otherwise in violation of the relevant anti-corruption laws and sanctions regulations) for which the Group or they may be ultimately held responsible. Violations of anti-corruption laws and sanctions regulations could have a material adverse effect on the Group's business, reputation, results of operations and financial condition.

Customers' perceptions of services offered by the Company may put it at a disadvantage compared to competitors' offerings.

Customers' perceptions of the assistance and services 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

Telefónica, S.A. 218

Table of Contents

Financial Statements

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 adequately could have an adverse impact on the Group's business, 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, secure 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 of these characteristics, it is subject to the effects of actions by competitors in these markets and to its ability to anticipate and adapt, in a timely manner, to constant technological changes, changes in customer preferences that are taking place in the industry, as well as economic, political and social circumstances.

Failure to do so adequately could have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

New products and technologies arise constantly, and their 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 1,111 million euros and 1,046 million euros in 2014 and 2013, respectively; representing an increase of 6.2% from 1,046 million euros in 2013. These expenses represented 2.2% and 1.8% of the Group's consolidated revenue, respectively. These figures have been calculated using the guidelines established in the Organization for Economic Cooperation and Development (OECD) manual. 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, such as 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. While an increasing demand for the capabilities offered by these new networks to end users exists, the high level of the investments requires a continuous analysis of the return on investment.

The explosion of the digital market and entry of new players in communications market, such as MVNOs, Internet companies or device manufacturers, may cause the loss of value of certain assets, and affect the Group's ability to generate income. Therefore, it is necessary to update the business model, encouraging the pursuit of incomes and additional efficiencies to those followed traditionally. Failure to do so adequately could have an adverse impact on the Group's business, 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 its 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 Company's operations, and may cause legal contingencies or damages to the Company's image in the event that inappropriate practices are produced by a participant in the supply chain.

As of December 31, 2014, the Telefónica Group depended on six handset suppliers and 11 network infrastructure suppliers, which together accounted for 80% of the awarded contracts for the year then ended. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own stock shortfalls and business requirements.

Telefónica, S.A. 219

Table of Contents

Financial Statements

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 otherwise 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, stealing of infrastructure elements 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 these types of incidents, and the claims and loss in revenue caused by service interruptions to date have been covered by these policies, these policies may not be sufficient to cover all possible monetary losses.

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 certain expert groups and public health agencies, including the World Health Organization (WHO), that states that currently there are no established risks associated with exposure to low frequency signals in mobile communications. However, the scientific community is still investigating this issue especially with respect to 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.

Worries about radio frequency 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, how they operate, the use of mobile telephones and 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.

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 of operations and cash flows of the 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 costs. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and to recognize impairment 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 impairments on certain of its investments, affecting its results of operations in the year in which they were experienced. For example, with respect to the investment in Telco, S.p.A. (Telco), value adjustments were made in fiscal years 2013 and 2014 with a negative impact of 267 million euros and 464 million euros, respectively.

Telefónica, S.A. 220

Table of Contents

Financial Statements

The Telefónica Group's networks carry and store large volumes of confidential, personal and corporate data, and its Internet access and hosting services may lead to claims for illegal or illicit use of the Internet.

The Telefónica Group's networks carry and store large volumes of confidential, personal and business data, through both voice and data traffic. The Telefónica Group stores increasing quantities and types of customer data in both business and consumer segments. Despite its best efforts to prevent it, the Telefónica Group may be found liable for any loss, transfer, or inappropriate modification of the customer data or general public data stored on its servers or transmitted through its networks, any of which could involve many people and have an impact on the Group's reputation, or lead to legal claims and liabilities that are difficult to measure in advance.

In addition, the Telefónica Group's 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 any loss, transfer or inappropriate modification of the customer data stored on its servers or carried by its networks.

In most countries in which the Telefónica Group 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.

Any of the foregoing could have an adverse impact on the business, financial position, results of operations and cash flows of the Group.

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, the Telefónica Group has open judicial procedures in Peru concerning the clearance of previous years income tax, for which a contentious-administrative appeal is currently pending; as well as in Brazil, with CADE's (Conselho Administrativo de Defesa Econômica) resolution with regard to the acquisition of a 50% stake in Vivo and with certain open tax procedures, primarily relating to the CIMS (a Brazilian tax on telecommunication services). Further details on these matters are provided in the Note 17 and 20 of the financial statements.

Telefónica, S.A. 221

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, 2014. 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, 2014, 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 in Spain. 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* (2013).

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

Edgar Filing: TELEFONICA S A - Form 6-K

a material effect on the financial statements.

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

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, 2014, 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* (2013). We also have checked that the disclosures included in the accompanying description of the internal control over financial reporting at December 31, 2014 comply, in all material respects, with the requirements of article 540 of the Spanish Companies Law, approved by Royal Legislative Decree 1/2010 of July 2, 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, 2014, 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 in Spain, and our report dated February 27, 2015 expressed an unqualified opinion on the aforementioned consolidated financial statements.

ERNST & YOUNG, S.L.

/s/ Ignacio Viota del Corte
Ignacio Viota del Corte

February 27, 2015

Table of Contents

**AUDIT REPORT, CONSOLIDATED ANNUAL FINANCIAL
STATEMENTS, AND CONSOLIDATED MANAGEMENT REPORT ALL
FOR THE YEAR ENDED DECEMBER 31, 2014**

Table of Contents

Independent Audit Report

TELEFÓNICA, S.A. AND SUBSIDIARIES

Consolidated Financial Statements and

Consolidated Management Report

for the year ended

December 31, 2014

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)

INDEPENDENT AUDIT REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

To the Shareholders of

Telefónica, S.A.

Report on the consolidated financial statements

We have audited the accompanying 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, 2014, and 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.

Directors' responsibility for the consolidated financial statements

The Directors of the Parent Company are responsible for the preparation of the accompanying consolidated financial statements so that they give a true and fair view of the consolidated equity and consolidated financial position and the consolidated results of Telefónica, S.A. and subsidiaries, in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union, and other provisions in the regulatory framework applicable to the Group in Spain, and for such internal control as they determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on the accompanying consolidated financial statements based on our audit. We conducted our audit in accordance with prevailing audit regulations in Spain. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation of consolidated financial statements by the Directors of the Parent Company in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the accompanying 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, 2014, and its consolidated results and consolidated cash flows for the year then ended, in accordance with IFRS, as adopted by the European Union, and other provisions in the regulatory framework for financial information applicable in Spain.

Report on other legal and regulatory requirements

The accompanying 2014 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 2014 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

February 27, 2015

Table of Contents

2014

Consolidated financial statements (Consolidated annual accounts) and Consolidated management report for 2014

Telefónica, S.A. and subsidiaries composing the Telefónica Group

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>	28
<u>Note 6. Intangible assets</u>	31
<u>Note 7. Goodwill</u>	33
<u>Note 8. Property, plant and equipment</u>	37
<u>Note 9. Associates and joint ventures</u>	39
<u>Note 10. Related parties</u>	42
<u>Note 11. Trade and other receivables</u>	44
<u>Note 12. Equity</u>	45
<u>Note 13. Financial assets and liabilities</u>	53
<u>Note 14. Trade and other payables</u>	61
<u>Note 15. Provisions</u>	63
<u>Note 16. Derivative financial instruments and risk management policies</u>	69
<u>Note 17. Income tax matters</u>	80
<u>Note 18. Revenue and expenses</u>	86
<u>Note 19. Share-based payment plans</u>	90
<u>Note 20. Cash flow analysis</u>	92
<u>Note 21. Other information</u>	96
<u>Note 22. Finance leases</u>	104
<u>Note 23. Events after the reporting period</u>	104
<u>Note 24. Additional note for English translation</u>	105

Table of Contents

<u>Appendix I: Changes in the consolidation scope</u>	106
<u>Appendix II: Board of Director s Compensation</u>	109
<u>Appendix III: Debentures and bonds</u>	116
<u>Appendix IV: Financial instruments</u>	120
<u>Appendix V: Interest-bearing debt</u>	130
<u>Appendix VI: Main companies comprising the Telefónica Group</u>	131
<u>Appendix VII: Key regulatory issues and concessions and licenses held by the Telefónica Group</u>	138
<u>2014 Consolidated Management Report</u>	168
<u>Business model</u>	168
<u>Financial Results</u>	170
<u>2014 Consolidated results</u>	174
<u>Segments Discussion</u>	185
<u>Definitions</u>	205
<u>Services and products</u>	208
<u>Share price performance</u>	210
<u>Research, Development and Innovation</u>	211
<u>Human Resources</u>	213
<u>Environment</u>	215
<u>Liquidity and Capital Resources</u>	216
<u>Treasury shares</u>	219
<u>Risks and uncertainties facing the company</u>	223
<u>Trend evolution</u>	236
<u>Events after the reporting period</u>	237
<u>Annual Corporate Governance Report for Listed Companies</u>	238

Table of Contents

2014 Consolidated Financial Statements

Telefónica Group

Consolidated statements of financial position at December 31

Millions of euros	NOTES	2014	2013
ASSETS			
A) NON-CURRENT ASSETS		99,435	89,597
Intangible assets	(Note 6)	22,353	18,548
Goodwill	(Note 7)	25,111	23,434
Property, plant and equipment	(Note 8)	33,343	31,040
Investments accounted for by the equity method	(Note 9)	788	2,424
Non-current financial assets	(Note 13)	10,973	7,775
Deferred tax assets	(Note 17)	6,867	6,376
B) CURRENT ASSETS		22,864	29,265
Inventories		934	985
Trade and other receivables	(Note 11)	10,606	9,640
Tax receivables	(Note 17)	1,749	1,664
Current financial assets	(Note 13)	2,932	2,117
Cash and cash equivalents	(Note 13)	6,529	9,977
Non-current assets held for sale	(Note 2)	114	4,882
TOTAL ASSETS (A+B)		122,299	118,862
	NOTE	2014	2013
EQUITY AND LIABILITIES			
A) EQUITY		30,289	27,482
Equity attributable to equity holders of the parent and other holders of equity instruments	(Note 12)	21,115	21,185
Equity attributable to non-controlling interests	(Note 12)	9,174	6,297
B) NON-CURRENT LIABILITIES		62,311	62,236
Non-current interest-bearing debt	(Note 13)	50,688	51,172
Non-current trade and other payables	(Note 14)	2,377	1,701
Deferred tax liabilities	(Note 17)	2,566	3,063
Non-current provisions	(Note 15)	6,680	6,300
C) CURRENT LIABILITIES		29,699	29,144
Current interest-bearing debt	(Note 13)	9,094	9,527
Current trade and other payables	(Note 14)	16,943	15,221
Current tax payables	(Note 17)	2,026	2,203
Current provisions	(Note 15)	1,595	1,271

Liabilities associated with non-current assets held for sale	(Note 2)	41	922
TOTAL EQUITY AND LIABILITIES (A+B+C)		122,299	118,862

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

2014 Consolidated Financial Statements

Telefónica Group

Consolidated income statements for the years ended December 31

Millions of euros	NOTES	2014	2013	2012
INCOME STATEMENTS				
Revenues	(Note 18)	50,377	57,061	62,356
Other income	(Note 18)	1,707	1,693	2,323
Supplies		(15,182)	(17,041)	(18,074)
Personnel expenses		(7,098)	(7,208)	(8,569)
Other expenses	(Note 18)	(14,289)	(15,428)	(16,805)
OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION (OIBDA)		15,515	19,077	21,231
Depreciation and amortization	(Note 18)	(8,548)	(9,627)	(10,433)
OPERATING INCOME		6,967	9,450	10,798
Share of loss of investments accounted for by the equity method	(Note 9)	(510)	(304)	(1,275)
Finance income		992	933	963
Exchange gains		4,110	3,323	2,382
Finance costs		(3,511)	(3,629)	(4,025)
Exchange losses		(4,413)	(3,493)	(2,979)
Net financial expense	(Note 16)	(2,822)	(2,866)	(3,659)
PROFIT BEFORE TAX		3,635	6,280	5,864
Corporate income tax	(Note 17)	(383)	(1,311)	(1,461)
PROFIT FOR THE YEAR		3,252	4,969	4,403
Non-controlling interests	(Note 12)	(251)	(376)	(475)
PROFIT FOR THE YEAR ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT		3,001	4,593	3,928
Basic and diluted earnings per share attributable to equity holders of the parent (euros)	(Note 18)	0.61	0.99	0.85

The accompanying Notes 1 to 24 and Appendices I to VII are an integral part of these consolidated income statements.

Telefónica, S.A. 5

Table of Contents

2014 Consolidated Financial Statements

Telefónica Group

Consolidated statements of comprehensive income for the years ended December 31

Millions of euros	2014	2013	2012
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME			
Profit for the year	3,252	4,969	4,403
Other comprehensive income (loss)			
(Losses) gains on measurement of available-for-sale investments	(45)	32	(49)
Income tax impact	7	(10)	4
Reclassification of losses included in the income statement		51	46
Income tax impact		(15)	(3)
	(38)	58	(2)
(Losses) gains on hedges	(507)	831	(1,414)
Income tax impact	127	(247)	376
Reclassification of losses included in the income statement (Note 16)	163	121	173
Income tax impact	(49)	(36)	(5)
	(266)	669	(870)
Share of losses recognized directly in equity of associates and others	(27)	(29)	(27)
Income tax impact	3	4	9
Reclassification of losses included in the income statement	103	1	4
Income tax impact	(24)		
	55	(24)	(14)
Translation differences	(2,810)	(6,454)	(1,862)
Total other comprehensive loss recognized in the period (Items that may be reclassified subsequently to profit or loss)	(3,059)	(5,751)	(2,748)
Actuarial losses and impact of limit on assets for defined benefit pension plans	(173)	(49)	(154)
Income tax impact	38	1	39
	(135)	(48)	(115)
Total other comprehensive loss recognized in the period (Items that will not be reclassified subsequently to profit or loss)	(135)	(48)	(115)
Total comprehensive income (loss) recognized in the year	58	(830)	1,540

Attributable to:

Equity holders of the parent and other holders of equity instruments	(258)	(434)	1,652
Non-controlling interests	316	(396)	(112)
	58	(830)	1,540

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

2014 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 others	Translation differences	(Note 12)		
Financial position at December 31, 2013	4,551	460	(544)	2,466	984	22,517	94	(37)	(31)	(9,275)	21,185	6,297	27,482
Profit for the year						3,001					3,001	251	3,252
Other comprehensive loss						(121)	(39)	(297)	55	(2,857)	(3,259)	65	(3,194)
Total comprehensive income						2,880	(39)	(297)	55	(2,857)	(258)	316	58
Dividends distribution (Note 12)	106					(2,138)					(2,032)	(406)	(2,438)
Net movement in treasury shares			(1,042)			(113)					(1,155)		(1,155)
Acquisitions and disposals of non-controlling interests and business combinations (Note 5)						(307)					(307)	2,965	2,658
Undated Deeply Subordinated Securities and				3,885		(129)					3,756		3,756

notes mandatorily convertible (Note 12)													
Other movements						(74)				(74)	2	(72)	
Financial position at December 31, 2014	4,657	460	(1,586)	6,351	984	22,636	55	(334)	24	(12,132)	21,115	9,174	30,289
Financial position at December 31, 2012	4,551	460	(788)		984	19,569	36	(715)	(7)	(3,629)	20,461	7,200	27,661
Profit for the year						4,593					4,593	376	4,969
Other comprehensive loss						(48)	58	678	(24)	(5,691)	(5,027)	(772)	(5,799)
Total comprehensive loss						4,545	58	678	(24)	(5,691)	(434)	(396)	(830)
Dividends distributions (Note 12)						(1,588)				(1,588)	(739)	(2,327)	
Net movement in treasury shares			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
Financial position at December 31, 2013	4,551	460	(544)	2,466	984	22,517	94	(37)	(31)	(9,275)	21,185	6,297	27,482
Financial position at December 31,	4,564	460	(1,782)		984	19,374	38	154	7	(2,163)	21,636	5,747	27,383

2011													
Profit for the year						3,928					3,928	475	4,403
Other comprehensive loss						(112)	(2)	(870)	(14)	(1,278)	(2,276)	(587)	(2,863)
Total comprehensive income						3,816	(2)	(870)	(14)	(1,278)	1,652	(112)	1,540
Dividends distributions (Note 12)	71					(2,907)					(2,836)	(442)	(3,278)
Net movement in treasury shares			(327)			(299)					(626)		(626)
Acquisitions and disposals of non-controlling interests and business combinations (Note 5)						1,170		1		(188)	983	1,800	2,783
Capital reduction	(84)		1,321			(1,237)							
Other movements						(348)					(348)	207	(141)
Financial position at December 31, 2012	4,551	460	(788)	984	19,569	36	(715)	(7)	(3,629)	20,461	7,200	27,661	

The accompanying Notes 1 to 24 and Appendices I to VII are an integral part of these consolidated statements of changes in equity.

Table of Contents

2014 Consolidated Financial Statements

Telefónica Group

Consolidated statements of cash flows for the years ended December 31

Millions of euros	NOTES	2014	2013	2012
Cash flows from operating activities				
Cash received from customers		61,522	69,149	75,962
Cash paid to suppliers and employees		(45,612)	(50,584)	(55,858)
Dividends received		48	49	85
Net interest and other financial expenses paid		(2,578)	(2,464)	(2,952)
Taxes paid		(1,187)	(1,806)	(2,024)
Net cash from operating activities	(Note 20)	12,193	14,344	15,213
Cash flows from investing activities				
Proceeds on disposals of property, plant and equipment and intangible assets		340	561	939
Payments on investments in property, plant and equipment and intangible assets		(9,205)	(9,674)	(9,481)
Proceeds on disposals of companies, net of cash and cash equivalents disposed		3,615	260	1,823
Payments on investments in companies, net of cash and cash equivalents acquired		(5,020)	(398)	(37)
Proceeds on financial investments not included under cash equivalents		302	50	30
Payments on financial investments not included under cash equivalents		(247)	(386)	(834)
Proceeds (payments) on placements of cash surpluses not included under cash equivalents		217	(314)	(318)
Government grants received		30	1	1
Net cash used in investing activities	(Note 20)	(9,968)	(9,900)	(7,877)
Cash flows from financing activities				
Dividends paid	(Note 12)	(2,328)	(2,182)	(3,273)
Transactions with equity holders		(427)	65	656
Operations with other equity holders	(Note 12)	3,713	2,466	
Proceeds on issue of debentures and bonds, and other debts	(Note 13)	4,453	5,634	8,090
Proceeds on loans, borrowings and promissory notes		4,290	3,231	6,002
Cancellation of debentures and bonds, and other debts	(Note 13)	(5,116)	(5,667)	(4,317)
Repayments of loans, borrowings and promissory notes		(8,604)	(6,232)	(8,401)
Payments on financed spectrum licenses		(22)		
Net cash used in financing activities	(Note 20)	(4,041)	(2,685)	(1,243)
Effect of changes in exchange rates		(1,616)	(1,468)	(382)
Effect of changes in consolidation methods		(16)	(161)	1

Net increase (decrease) in cash and cash equivalents during the year		(3,448)	130	5,712
CASH AND CASH EQUIVALENTS AT JANUARY 1		9,977	9,847	4,135
CASH AND CASH EQUIVALENTS AT DECEMBER 31	(Note 13)	6,529	9,977	9,847

RECONCILIATION OF CASH AND CASH EQUIVALENTS WITH THE STATEMENT OF FINANCIAL POSITION

BALANCE AT JANUARY 1		9,977	9,847	4,135
Cash on hand and at banks		7,834	7,973	3,411
Other cash equivalents		2,143	1,874	724
BALANCE AT DECEMBER 31	(Note 13)	6,529	9,977	9,847
Cash on hand and at banks		4,912	7,834	7,973
Other cash equivalents		1,617	2,143	1,874

The accompanying Notes 1 to 24 and Appendices I to VII are an integral part of these consolidated statements of cash flows.

Telefónica, S.A. 8

Table of Contents

2014 Consolidated Financial Statements

Telefónica, S.A. and subsidiaries composing the Telefónica Group

Notes to the consolidated financial statements (consolidated annual accounts) for the year ended December 31, 2014

Note 1. Background and general information

Telefónica, S.A. and its subsidiaries and investees (Telefónica , the Company , the Telefónica Group or the Group) make up an integrated and diversified telecommunications group operating mainly in Europe and Latin America. The Group s activity is centered around services of wireline and wireless telephony, broadband, internet, data traffic, Pay TV and other digital services.

The parent company of the Group is Telefónica, S.A., a public limited company incorporated on April 19, 1924 for an indefinite period. Its registered office is at calle Gran Vía 28, Madrid (Spain).

Appendix VI lists the main companies composing the Telefónica Group, their corporate purpose, country, functional currency, share capital, the Group s effective shareholding and their method of consolidation.

The website www.telefonica.com provides more information about the organizational structure of the Group, the sectors in which it operates and the products it offers.

As a multinational telecommunications company which operates in regulated markets, the Group is subject to different laws and regulations in each of the jurisdictions in which it operates, pursuant to which permits, concessions or licenses must be obtained in certain circumstances to provide the various services.

In addition, certain wireline and wireless telephony services are provided under regulated rate and price systems.

Telefónica, S.A. 9

Table of Contents

2014 Consolidated Financial Statements

Note 2. Basis of presentation of the consolidated financial statements

The accompanying consolidated financial statements were prepared from the accounting records of Telefónica, S.A. and of each of the companies comprising the Telefónica Group, whose separate financial statements were prepared in accordance with the generally accepted accounting principles prevailing in the various countries in which they are located, and for purposes of these consolidated financial statements are presented in accordance with the International Financial Reporting Standards (IFRS) adopted by the European Union, which for the purposes of the Telefónica Group are not different from those issued by the International Accounting Standards Board (IASB), to give a true and fair view of the consolidated equity and financial position at December 31, 2014, and of the consolidated results of operations, changes in consolidated equity and the consolidated cash flows obtained and used in the year then ended. The figures in these consolidated financial statements are expressed in millions of euros, unless otherwise indicated, and therefore may be rounded. The euro is the Group's reporting currency.

The accompanying consolidated financial statements for the year ended December 31, 2014 were approved by the Company's Board of Directors at its meeting on February 23, 2015 for submission for approval at the General Shareholders' Meeting, which is expected to occur without modification.

Note 3 contains a detailed description of the most significant accounting policies used to prepare these consolidated financial statements.

Materiality criteria

These consolidated 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 IFRS conceptual framework, insofar as the Telefónica Group consolidated financial statements, taken as a whole, are concerned.

Comparative information and main changes in the consolidation scope

For comparative purposes, the accompanying consolidated financial statements for 2014 include the figures for 2013, and in the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows, and the notes thereto for the year then ended, on a voluntary basis, those of 2012.

Telefónica, S.A. 10

Table of Contents

2014 Consolidated Financial Statements

The main events and changes in the consolidation scope affecting comparability of the consolidated information for 2014 and 2013 (see Appendix I for a more detailed explanation of the changes in consolidation scope) are as follows:

a) Exchange rate regime in Venezuela

On February 8, 2013, the Venezuelan bolivar was devalued from 4.3 bolivars per U.S. dollar to 6.3 bolivars per U.S. dollar.

The exchange rate of 6.3 bolivars per U.S. dollar was used in the translation of the financial information of Venezuelan subsidiaries for the whole year 2013.

During 2014, by virtue of certain Exchange Agreements the allocations conducted through the Complementary System for Administration of Foreign Currency (SICAD I), to which Telefónica Venezuela had access for imports, were expanded and, in addition, a new exchange mechanism with a more widespread use was put in place, called SICAD II.

The exchange rates resulting in the last allocations of SICAD I and SICAD II before December 31, 2014 were 12 and 49.988 bolívares per U.S. dollar, respectively.

In the absence of SICAD I auctions since mid-October 2014, and the lack of expectations of new auctions close to 2014 year-end, in a macroeconomic context aggravated by the fall of the oil price, the Company has decided to take as a reference the rate resulting in the allocations conducted through SICAD II for translating the financial statements of the Venezuelan subsidiaries. The Company has considered that it is the most representative among the available official exchange rates at 2014 year-end for the monetary translation of the accounting figures of transactions, cash flows and balances.

The main impacts of using this new exchange rate in the Telefónica Group's consolidated financial statements as of December 31, 2014 were as follows:

A decrease in Equity, within the caption Translation differences, of approximately 2,950 million euros (see Note 12.f) as a combined result of the translation to euros at the new exchange rate partially offset by the impact in equity of the inflation adjustment for the period.

As part of the decrease mentioned in the preceding paragraph, the value in euros of the net financial assets denominated in bolivars decreased by approximately 2,700 million euros, as per the balance as of December 31, 2014.

The results from the Telefónica's subsidiaries in Venezuela have been translated at the new exchange rate. This implies a reduction in Operating income before depreciation and amortization (OIBDA) and profit for

the year of, approximately, 1,730 and 660 million euros, respectively.

b) Acquisition of E-Plus

Telefónica finalized the E-Plus Mobilfunk GmbH & Co KG (E-Plus) purchase on October 1, 2014, once the approval of the European Commission was obtained and the share capital increase by Telefónica Deutschland Holding, A.G. to finance the operation was completed.

Following the acquisition of E-Plus, the Telefónica Group's stake in Telefónica Deutschland Holding, A.G. decreased from 76.83% to 62.1%. The Group consolidates E-Plus from October 1, 2014 using the full consolidation method.

The purchase consideration amounts to 7,463 million euros. The fair value of the assets acquired and the liabilities assumed was 7,460 and 1,683 million euros, respectively. The goodwill generated on the transaction amounts to 1,686 million euros (see Note 5).

c) Recording of the investment in Telecom Italia, S.p.A.

Telefónica, S.A.'s shareholding in Telco, S.p.A., (holding company of our investment in Telecom Italia, S.p.A.), previously accounted for using the equity method (see Note 9), was classified as an available-for-sale

Telefónica, S.A. 11

Table of Contents

2014 Consolidated Financial Statements

financial asset under Non-current financial assets (see Note 13), as of December 31, 2014, as it was considered that Telefónica ceased to have significant influence in its indirect stake in Telecom Italia, S.p.A.

The impact of this reclassification, together with the contribution of Telco, S.p.A. to results for the year, led to a negative impact of 464 million euros in 2014 under the heading Share of loss of investments accounted for by the equity method .

In 2013, the negative impact of Telco, S.p.A. on Share of loss of investments accounted for by the equity method was 267 million euros.

d) Sale of ownership interest in Telefónica Czech Republic, a.s.

On November 5, 2013 Telefónica reached an agreement to sell 65.9% of Telefónica Czech Republic, a.s. to PPF Group N.V.I. for an equivalent of approximately 2,467 million euros in cash at the date of the agreement.

As a result of the transaction, a loss was recognized for the 176 million-euro adjustment to the value of the assets assigned to Telefónica Czech Republic, under Other expenses in the consolidated income statement for 2013 (see Note 18).

Consolidated assets and liabilities subject to this transaction were classified under Non-current assets held for sale and Liabilities associated with non-current assets held for sale , respectively, in the consolidated statement of financial position at December 31, 2013. Their composition is as follows:

Millions of euros	12/31/2013
Non-current assets	3,436
Current assets	412
Non-current liabilities	280
Current liabilities	436

The transaction was completed in January 2014, once the pertinent regulatory authorization was obtained, and the entity was removed from the consolidation scope as of January 1, 2014. The impact to Equity attributable to non-controlling interests is a 666 million euros decrease (see Note 12.h).

Subsequent to this transaction, Telefónica held a 4.9% stake in the company, which in turn was sold in October 2014 for 160 million euros.

e) Sale of ownership interest in Telefónica Ireland, Ltd.

In June 2013 Telefónica reached an agreement with Hutchison Whampoa Group for the sale of Telefónica s 100% participation in Telefónica Ireland, Ltd. for 850 million euros, including an initial cash consideration of 780 million euros to be paid at the closing of the transaction, and an additional deferred payment of 70 million euros to be settled based on the completion of agreed financial objectives.

Edgar Filing: TELEFONICA S A - Form 6-K

Consolidated assets and liabilities subject to this transaction have been classified under Non-current assets held for sale and Liabilities associated with non-current assets held for sale, respectively, in the consolidated statement of financial position at December 31, 2013. Their composition is as follows:

Telefónica, S.A. 12

Table of Contents

2014 Consolidated Financial Statements

Millions of euros	12/31/2013
Non-current assets	836
Current assets	191
Non-current liabilities	35
Current liabilities	171

The sale was concluded on July 15, 2014, once the pertinent regulatory authorizations were obtained.

Key performance indicators

The Group uses a series of indicators in its decision-making which it considers provide a better indication of its performance. These indicators, different from accounting measures, are as follows:

Operating income before depreciation and amortization (OIBDA)

Operating income before depreciation and amortization (OIBDA) is calculated by excluding depreciation and amortization from operating income. OIBDA is considered to be more important for investors as it provides a gauge of segment operating performance and profitability using the same measures utilized by management. This metric also allows for comparisons with other companies in the telecommunications sector without consideration of their asset structure.

OIBDA is used to track the performance of the business and to establish operating and strategic targets. OIBDA is a commonly reported measure and is widely used among analysts, investors and other interested parties in the telecommunications industry, although not a measure explicitly defined in IFRS, and therefore, may not be comparable to similar indicators used by other companies. OIBDA should not be considered as an alternative to operating income as a measurement of operating results or as an alternative to cash flows from operating activities as a measurement of liquidity.

The following table presents the reconciliation of OIBDA to operating income for the Telefónica Group for the years ended December 31, 2014, 2013 and 2012:

Millions of euros	2014	2013	2012
OIBDA	15,515	19,077	21,231
Depreciation and amortization	(8,548)	(9,627)	(10,433)
Operating income	6,967	9,450	10,798

Telefónica, S.A. 13

Table of Contents

2014 Consolidated Financial Statements

The following table presents the reconciliation of OIBDA to operating income for each business segment for the years ended December 31, 2014, 2013 and 2012:

2014

Millions of euros	Telefónica						Total Group
	Spain	United Kingdom	Germany	Brazil	Hispano-américa	Other and eliminations	
OIBDA	5,671	1,744	733	3,543	4,068	(244)	15,515
Depreciation and amortization	(1,805)	(1,121)	(1,426)	(1,762)	(2,034)	(400)	(8,548)
Operating income	3,866	623	(693)	1,781	2,034	(644)	6,967

2013

Millions of euros	Telefónica						Total Group
	Spain	United Kingdom	Germany	Brazil	Hispano-américa	Other and eliminations	
OIBDA	6,340	1,637	1,308	3,940	5,531	321	19,077
Depreciation and amortization	(1,903)	(1,016)	(1,231)	(2,109)	(2,524)	(844)	(9,627)
Operating income	4,437	621	77	1,831	3,007	(523)	9,450

2012

Millions of euros	Telefónica						Total Group
	Spain	United Kingdom	Germany	Brazil	Hispano-américa	Other and eliminations	
OIBDA	6,815	1,602	1,351	5,161	5,983	319	21,231
Depreciation and amortization	(2,063)	(995)	(1,233)	(2,318)	(2,762)	(1,062)	(10,433)
Operating income	4,752	607	118	2,843	3,221	(743)	10,798

Table of Contents

2014 Consolidated Financial Statements

Debt indicators

The following table presents the reconciliation between the Telefónica Group's gross financial debt, net financial debt and net debt at December 31, 2014, 2013 and 2012:

Millions of euros	12/31/2014	12/31/2013	12/31/2012
Non-current interest-bearing debt	50,688	51,172	56,608
Current interest-bearing debt	9,094	9,527	10,245
Gross financial debt	59,782	60,699	66,853
Non-current trade and other payables	1,276	1,145	1,639
Current trade and other payables	210	99	145
Non-current financial assets	(6,267)	(4,468)	(5,605)
Trade and other receivables	(453)		
Current financial assets	(2,932)	(2,117)	(1,926)
Cash and cash equivalents	(6,529)	(9,977)	(9,847)
Net financial debt	45,087	45,381	51,259
Net commitments related to employee benefits	1,976	2,270	2,036
Net debt	47,063	47,651	53,295

Net financial debt is calculated from gross financial debt by including certain amounts of the current and non-current line items Trade and other payables for 1,486 million euros, and subtracting 6,529 million euros of Cash and cash equivalents, 2,932 million euros of Current financial assets, 453 million euros of Trade and other receivables with a maturity of less than one year and 6,267 million euros of certain investments in financial assets with a maturity of over one year, included in the consolidated statement of financial position under Non-current financial assets. Net financial debt does not include non-current financial assets that cover net commitments related to employee benefits, even though they are included in the net commitments related to employee benefits (see Note 13.a). After adjustment for these items, net financial debt at December 31, 2014 amounted to 45,087 million euros, a decrease of 0.6% from 2013 (45,381 million euros at December 31, 2013).

Telefónica, S.A. 15

Table of Contents

2014 Consolidated Financial Statements

Note 3. Accounting policies

As stated in Note 2, the Group's consolidated financial statements have been prepared in accordance with IFRSs and interpretations issued by the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (IFRIC) as endorsed by the European Commission for use in the European Union (IFRSs – EU).

Accordingly, only the most significant accounting policies used in preparing the accompanying consolidated financial statements, in light of the nature of the Group's activities, are set out below, as well as the accounting policies applied where IFRSs permit a policy choice, and those that are specific to the sector in which the Group operates.

a) Hyperinflationary economies

Venezuela is considered as a hyperinflationary economy since 2011. The inflation rates used to prepare the restated financial information are those published by the Central Bank of Venezuela, or the best estimate in case the definitive index is not available. On an annual basis, these rates are 64.1% and 56.2% for 2014 and 2013, respectively.

b) Translation methodology

The income statements and statements of cash flows of the Group's foreign subsidiaries (except Venezuela) were translated into euros at the average exchange rates for the year.

c) Goodwill

After initial recognition, goodwill is carried at cost, less any accumulated impairment losses. Goodwill is recognized as an asset denominated in the currency of the company acquired and is tested for impairment annually or more frequently, if there are certain events or changes indicating the possibility that the carrying amount may not be fully recoverable. The potential impairment loss is determined by assessing the recoverable amount of the cash generating unit (or group of cash generating units) to which the goodwill is allocated from the acquisition date.

d) Intangible assets

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

Intangible assets are amortized on a straight-line basis according to the following:

Expenditures incurred in developing new products to be available for sale or use within the Group's own network, and whose future economic viability is reasonably certain (Development costs), are amortized on a straight-line basis over the period during which the related development project is expected to generate economic benefits, upon its completion.

Licenses granted to the Telefónica Group by various public authorities to provide telecommunications services and the value allocated to licenses held by certain companies at the time they were included in the Telefónica Group (Service concession arrangements and licenses) are amortized on a straight-line basis over the duration of related licenses from the moment commercial operation begins.

The allocation of acquisition costs attributable to customers acquired in business combinations, as well as the acquisition value of this type of assets in a third-party transaction for consideration (Customer base) are amortized on a straight-line basis over the estimated period of the customer relationship.

Software is amortized on a straight-line basis over its useful life, generally estimated to be between two and five years.

Table of Contents

2014 Consolidated Financial Statements

e) Property, plant and equipment

Property, plant and equipment is carried at cost less any accumulated depreciation and any accumulated impairment in value.

Cost includes, among others, direct labor used in installation and the allocable portion of the indirect costs required for the related asset. The latter two items are recorded as revenue under the concept "Own work capitalized" of the line item "Other income".

Interest and other financial expenses incurred and directly attributable to the acquisition or construction of qualifying assets are capitalized. Qualifying assets for the Telefónica Group are those assets that require a period of at least 18 months to bring the assets to the condition necessary for their intended use or sale.

The Group's subsidiaries depreciate their property, plant and equipment, from the time they can be placed in service, amortizing the cost of the assets, net of their residual values on a straight-line basis over the assets' estimated useful lives, which are calculated in accordance with technical studies that are revised periodically in light of technological advances and the rate of dismantling, as follows:

	Years of estimated useful life
Buildings	25 - 40
Plant and machinery	10 - 15
Telephone installations, networks and subscriber equipment	5 - 20
Furniture, tools and other items	2 - 10

f) Impairment of non-current assets

Non-current assets, including goodwill and intangible assets are assessed at each reporting date for indicators of impairment. Wherever such indicators exist, or in the case of assets which are subject to an annual impairment test, recoverable amount is estimated. An asset's recoverable amount is the higher of fair value less costs to sell and 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 using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

The Group bases the calculation of impairment on the business plans of the various cash generating units 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.

g) Lease agreements

The determination of whether an arrangement is, or contains a lease is based on the substance of the agreement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset and the agreement conveys a right to the use of the asset.

Leases where the lessor does not transfer substantially all the risks and benefits of ownership of the asset are classified as operating leases.

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards incidental to ownership of the leased item to the Group.

h) Investment in associates and joint arrangements

The Group assesses whether it has significant influence not only on the basis of its ownership percentage but also on the existence of qualitative factors such representation on the board of directors of the investee, its participation in decision-making processes, interchange of managerial personnel and access to technical information.

Table of Contents

2014 Consolidated Financial Statements

The Group assesses rights and obligations agreed to by the parties to a joint arrangement and, when relevant, other facts and circumstances in order to determine whether the joint arrangement in which it is involved is a joint venture or a joint operation.

i) Financial assets and liabilities***Financial investments***

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

Financial assets which the Group intends to hold for an indefinite period of time and could be sold at any time in response to needs for liquidity requirements or in response to changes in market conditions are classified as available-for-sale. These investments are presented as non-current assets, unless it is probable and feasible that they will be sold within 12 months.

Derivative financial instruments and hedge accounting

When the Group chooses not to apply hedge accounting criteria, gains or losses resulting from changes in the fair value of derivatives are taken directly to the income statement. In this respect, transactions used to reduce the exchange rate risk of income contributed by foreign subsidiaries are not treated as hedging transactions.

j) Inventories

Materials stored for use in investment projects and inventories for consumption and replacement are valued at the lower of weighted average cost and net realizable value.

k) Pensions and other employee obligations

Provisions required to cover the accrued liability for defined-benefit pension plans are determined using the projected unit credit actuarial valuation method. The calculation is based on demographic and financial assumptions determined at a country level, and in consideration of the macroeconomic environment. The discount rates are determined based on high quality market yield curves. Plan assets are measured at fair value.

Provisions for post-employment benefits (e.g. early retirement or other) are calculated individually based on the terms agreed with the employees. In some cases, these may require actuarial valuations based on both demographic and financial assumptions.

l) Revenue and expenses

The Telefónica Group revenues are derived principally from providing the following telecommunications services: traffic, connection fees, regular (normally monthly) network usage fees, interconnection, network and equipment leasing, handset sales and other digital services such as Pay TV and value-added services (text or data messages,

among others) or maintenance. Products and services may be sold separately or bundled in promotional packages.

Revenues from calls carried on Telefónica's networks (traffic) entail an initial call establishment fee plus a variable call rate, based on call length, distance and type of service. Both wireline and wireless traffic is recognized as revenue as service is provided. For prepaid calls, the amount of unused traffic generates a deferred revenue presented in Trade and other payables on the statement of financial position. Prepaid cards generally expire within 12 months and any deferred revenue from prepaid traffic is recognized directly in the income statement when the card expires as the Group has no obligation to provide service after expiry date.

Revenues from traffic sales and services at a fixed rate over a specified period of time (flat rate) are recognized on a straight-line basis over the term covered by the rate paid by the customer.

Connection fees arising when customers connect to the Group's network are deferred and recognized in the income statement throughout the average estimated customer relationship period, which varies by type of service. All related costs, except those related to network expansion, as well as administrative expenses and overhead, are recognized in the income statement as incurred.

Table of Contents

2014 Consolidated Financial Statements

Installation fees are taken to the income statement on a straight-line basis over the related period. Equipment leases and other services are taken to profit or loss as they are consumed.

Interconnection revenues from wireline-wireless and wireless-wireline calls and other customer services are recognized in the period in which the calls are made.

Revenues from handset and equipment sales are recognized once the sale is considered complete, i.e., generally when delivered to the end customer.

For bundled packages that include multiple elements sold in the wireline, wireless, internet and television businesses it is determined whether it is necessary to separate the separately identifiable elements and apply the corresponding revenue recognition policy to each element. Total package revenue is allocated among the identified elements based on their respective fair values (i.e. the fair value of each element relative to the total fair value of the package).

As connection or initial activation fees, or upfront non-refundable fees, are not separately identifiable elements in these types of packages, any revenues received from the customer for these items are allocated to the remaining elements. Additionally, when allocating the package revenue to the elements, amounts contingent upon delivery of undelivered elements are not allocated to delivered elements.

All expenses related to bundled promotional packages are recognized in the income statement as incurred.

m) Use of estimates

The key assumptions concerning the future and other relevant sources of uncertainty in estimates at the reporting date that could have a significant impact on the consolidated financial statements within the next financial year are discussed below.

A significant change in the facts and circumstances on which these estimates and related judgments are based could have a material impact on the Group's results and financial position. Accordingly, sensitivity analyses are disclosed for the most relevant situations (see notes 7 and 15).

Property, plant and equipment, intangible assets and goodwill

The accounting treatment of investments in property, plant and equipment and intangible assets entails the use of estimates to determine the useful life for depreciation and amortization purposes and to assess fair value at their acquisition dates for assets acquired in business combinations.

Determining useful life requires making estimates in connection with future technological developments and alternative uses for assets. There is a significant element of judgment involved in making technological development assumptions, since the timing and scope of future technological advances are difficult to predict.

The decision to recognize an impairment loss involves developing estimates that include, among others, an analysis of the causes of the potential impairment, as well as its timing and expected amount. Furthermore, additional factors,

such as technological obsolescence, the suspension of certain services and other circumstantial changes, which highlight the need to evaluate a possible impairment, are taken into account.

The Telefónica Group evaluates its cash-generating units' performance regularly to identify potential goodwill impairments. Determining the recoverable amount of the cash-generating units to which goodwill is allocated also entails the use of assumptions and estimates and requires a significant element of judgment.

Deferred income taxes

The Group assesses the recoverability of deferred tax assets based on estimates of future earnings. Such recoverability ultimately depends on the Group'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 that are continuously updated to reflect the latest trends.

The recognition 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 Group company income

Table of Contents

2014 Consolidated Financial Statements

tax receipts and payments could differ from the estimates made by the Group as a result of changes in tax legislation or unforeseen transactions that could affect tax balances.

Provisions

The amount of the provision is determined based on the best estimate of the outflow of resources required to settle the obligation, bearing in mind all available information at the statement of financial position date, including the opinions of independent experts such as legal or financial counsel.

Given the uncertainties inherent in the estimates used to determine the amount of provisions, actual outflows of resources may differ from the amounts recognized originally on the basis of the estimates.

Revenue recognition

Connection fees

Connection fees generated when customers connect to the Group's network are deferred and recognized as revenue over the average estimated customer relationship period.

The estimate of the average customer relationship period is based on the recent history of customer churn. Potential changes in estimates could lead to changes in both the amount and timing of the future recognition of revenues.

Bundled offers

Bundled offers that combine different elements are assessed to determine whether it is necessary to separate the different identifiable components and apply the corresponding revenue recognition policy to each element. Total package revenue is allocated among the identified elements based on their respective fair values.

Determining fair values for each identified element requires estimates that are complex due to the nature of the business.

A change in estimates of fair values could affect the apportionment of revenue among the elements and, as a result, the date of recognition of revenues.

Exchange rate used to translate the financial statements of our Venezuelan subsidiaries

As of December 31, 2014, there are multiple exchange mechanisms and published exchange rates potentially available for translation of the financial statements of the Group's Venezuelan subsidiaries.

We review, on a regular basis, the economic conditions in Venezuela and the specific circumstances of our Venezuelan operations. Assessment of the exchange rate that best reflects the economics of Telefónica's business activities in Venezuela relies on several factors and is performed considering all the information available at the closing date, and entails the use of assumptions and estimates and significant management judgment.

Due to inherent uncertainties in the estimates required to determine the appropriate exchange rate for the conversion of BsF-denominated financial statements, actual cash flows denominated in such currency may differ from the amounts currently recognized on the basis of our estimates, as a result of changes in currency laws or changes in exchange mechanisms or published exchange rates that may have a material impact on the conversion rate used for our Venezuelan subsidiaries' financial statements, affecting the net monetary position of assets (liabilities) denominated in BsF.

n) New IFRS and interpretations of the IFRS Interpretations Committee (IFRIC)

The accounting policies applied in the preparation of the consolidated financial statements for the year ended December 31, 2014 are consistent with those used in the preparation of the Group's consolidated financial statements for the year ended December 31, 2013, except for the application of new standards, amendments to standards and interpretations published by the IASB and the IFRIC, and adopted by the European Union, effective as of January 1, 2014, noted below:

Telefónica, S.A. 20

Table of Contents

2014 Consolidated Financial Statements

IAS 32 Offsetting Financial Assets and Financial Liabilities – Amendments to IAS 32

These amendments clarify the meaning of “currently has a legally enforceable right to set-off” and the criteria for non-simultaneous settlement mechanisms of clearing houses to qualify for offsetting. The application of these amendments has had no impact in the Group’s consolidated financial position or results.

IFRIC Interpretation 21 Levies (IFRIC 21)

IFRIC 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached. The adoption of IFRIC 21 did not have a material financial impact in the Group’s consolidated financial position or results.

IAS 39 Novation of Derivatives and Continuation of Hedge Accounting – Amendments to IAS 39

These amendments provide relief from discontinuing hedge accounting when novation (that was not contemplated on the original hedging documentation) of a derivative designated as a hedging instrument meets certain criteria: the novation is made pursuant to laws or regulations, a clearing counterparty becomes the new counterparty to each of the original parties and changes to the terms of the derivative are limited to those necessary to change the counterparty. The application of these amendments has had no impact on the Group’s consolidated financial position or results.

Recoverable Amount Disclosures for Non-Financial Assets – Amendments to IAS 36 Impairment of Assets

These amendments remove the unintended consequences of IFRS 13 Fair Value Measurement on the disclosures required under IAS 36. Under the amendments, recoverable amount is required to be disclosed only when an impairment loss has been recognized or reversed during the period. Accordingly, these amendments have been considered while making disclosures for impairment of non-financial assets in these consolidated financial statements.

Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)

These amendments provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10. The exception to consolidation requires investment entities to account for subsidiaries – as well as investments in associates and joint ventures – at fair value through profit or loss. This amendment is not relevant to the Group, since none of the entities in the Group qualifies to be an investment entity under IFRS 10.

New standards and IFRIC interpretations issued but not effective as of December 31, 2014

At the date of authorization for issue of the accompanying consolidated financial statements, the following IFRS, amendments and IFRIC interpretations had been issued by the IASB, but their application was not mandatory:

Standards and amendments		Mandatory application: annual periods beginning on or after
Amendments to IAS 19	<i>Defined Benefit Plans: Employee Contributions</i>	July 1, 2014
Improvements to IFRS 2010-2012		July 1, 2014
Improvements to IFRS 2011-2013		July 1, 2014
Improvements to IFRS 2012-2014		January 1, 2016
IFRS 14	<i>Regulatory Deferral Accounts</i>	January 1, 2016
Amendments to IFRS 11	<i>Accounting for Acquisitions of Interests in Joint Operations</i>	January 1, 2016

Telefónica, S.A. 21

Table of Contents

2014 Consolidated Financial Statements

Standards and amendments		Mandatory application: annual periods beginning on or after
Amendments to IAS 16 and IAS 38	<i>Clarification of Acceptable Methods of Depreciation and Amortization</i>	January 1, 2016
Amendments to IAS 16 and IAS 41	<i>Agriculture: Bearer Plants</i>	January 1, 2016
Amendments to IFRS 10 and IAS 28	<i>Sale or Contribution of Assets between an Investor and its Associate or Joint Venture</i>	January 1, 2016
Amendments to IAS 1	<i>Disclosure Initiative</i>	January 1, 2016
Amendments to IFRS 10, IFRS 12 and IAS 28	<i>Investment Entities: Applying the Consolidation Exception</i>	January 1, 2016
IFRS 15	<i>Revenues from Contracts with Customers</i>	January 1, 2017
IFRS 9	<i>Financial instruments</i>	January 1, 2018
Amendments to IFRS 7	<i>Disclosures - Transition to IFRS 9</i>	January 1, 2018

Based on the analyses made to date, the Group estimates that the adoption of most of these standards, amendments and improvements will not have a significant impact on the consolidated financial statements in the initial period of application. However, IFRS 15 is likely to have an impact in the timing and amount of revenue recognition in connection with certain bundled revenue transactions, The Group is currently assessing the impact of the application of this standard. Also, the changes introduced by IFRS 9 will affect financial instruments and transactions with financial instruments carried out on or after January 1, 2018.

Telefónica, S.A. 22

Table of Contents

2014 Consolidated Financial Statements

Note 4. Segment information

On February 26, 2014, the Board of Directors of Telefónica, S.A. approved the implementation of a new organizational structure completely focused on clients and which incorporates the digital offering as the main focus for commercial policies. The structure gives greater visibility to local operators, bringing them closer to the corporate decision-making center, simplifying the Group's global structure and strengthening the transverse areas to improve flexibility and agility in decision making.

As a result of this organization, the new structure is made up of the following segments: Telefónica Spain, Telefónica Brazil, Telefónica Germany, Telefónica UK and Telefónica Hispanoamérica (formed by the Group's operators in Argentina, Chile, Peru, Colombia, Mexico, Venezuela and Central America, Ecuador and Uruguay). These segments include all information relating to wireline, wireless, cable, internet, television businesses and other digital services in accordance with each location. Other companies and eliminations includes the companies belonging to the transverse areas as well as other Group companies and eliminations in the consolidation process.

The Group's segment information of years before 2014 were revised in the accompanying consolidated financial statements to reflect this new organization.

Segment reporting takes into account the impact of the purchase price allocation to assets acquired and the liabilities assumed from the companies included in each segment. The assets and liabilities presented in each segment are those managed by the heads of each segment, irrespective of their legal structure.

The Group manages borrowing activities and taxes centrally. Therefore, it does not disclose the related assets, liabilities, revenue and expenses by reportable segments. In addition, revenue and expenses arising from intra-group invoicing for the use of the trademark and management services have been eliminated from the operating results of each Group segment. These adjustments have no impact on the Group's consolidated results.

Inter-segment transactions are carried out at market prices.

Telefónica, S.A. 23

Table of Contents

2014 Consolidated Financial Statements

Key segment information is as follows:

2014

Millions of euros	Telefónica Spain	Telefónica UK	Telefónica Germany	Telefónica Brazil	Telefónica Hispanoamérica	Other and eliminations	Total Group
Revenues	12,023	7,062	5,522	11,231	13,155	1,384	50,377
External revenues	11,832	7,021	5,500	11,200	13,013	1,811	50,377
Inter-segment revenues	191	41	22	31	142	(427)	
Other operating income and expenses	(6,352)	(5,318)	(4,789)	(7,688)	(9,087)	(1,628)	(34,862)
OIBDA	5,671	1,744	733	3,543	4,068	(244)	15,515
Depreciation and amortization	(1,805)	(1,121)	(1,426)	(1,762)	(2,034)	(400)	(8,548)
Operating income	3,866	623	(693)	1,781	2,034	(644)	6,967
Capital expenditures	1,732	755	849	2,933	2,842	337	9,448
Investments accounted for by the equity method	2	2		3	2	779	788
Fixed assets	14,057	11,173	16,703	21,795	14,922	2,157	80,807
Total allocated assets	18,520	14,105	21,186	28,570	21,800	18,118	122,299
Total allocated liabilities	9,599	4,740	6,645	8,898	14,480	47,648	92,010

Telefónica, S.A. 24

Table of Contents

2014 Consolidated Financial Statements

2013 (*)

Millions of euros	Telefónica Spain	Telefónica UK	Telefónica Germany	Telefónica Brazil	Telefónica Hispanoamérica	Other and eliminations	Total Group
Revenues	12,959	6,692	4,914	12,217	16,855	3,424	57,061
External revenues	12,734	6,652	4,876	12,186	16,736	3,877	57,061
Inter-segment revenues	225	40	38	31	119	(453)	
Other operating income and expenses	(6,619)	(5,055)	(3,606)	(8,277)	(11,324)	(3,103)	(37,984)
OIBDA	6,340	1,637	1,308	3,940	5,531	321	19,077
Depreciation and amortization	(1,903)	(1,016)	(1,231)	(2,109)	(2,524)	(844)	(9,627)
Operating income	4,437	621	77	1,831	3,007	(523)	9,450
Capital expenditures	1,529	1,385	666	2,127	3,118	570	9,395
Investments accounted for by the equity method	6	11		2	1	2,404	2,424
Fixed assets	14,191	10,781	9,143	20,648	16,071	2,188	73,022
Total allocated assets	18,895	13,144	11,682	27,324	24,432	23,385	118,862
Total allocated liabilities	9,258	4,051	3,213	8,294	16,177	50,387	91,380

(*) Revised

Telefónica, S.A. 25

Table of Contents

2014 Consolidated Financial Statements

2012 (*)

Millions of euros	Telefónica Spain	Telefónica UK	Telefónica Germany	Telefónica Brazil	Telefónica Hispanoamérica	Other and eliminations	Total Group
Revenues	14,996	7,042	5,213	13,618	16,741	4,746	62,356
External revenues	14,725	6,922	5,186	13,585	16,638	5,300	62,356
Inter-segment revenues	271	120	27	33	103	(554)	
Other operating income and expenses	(8,181)	(5,440)	(3,862)	(8,457)	(10,758)	(4,427)	(41,125)
OIBDA	6,815	1,602	1,351	5,161	5,983	319	21,231
Depreciation and amortization	(2,063)	(995)	(1,233)	(2,318)	(2,762)	(1,062)	(10,433)
Operating income	4,752	607	118	2,843	3,221	(743)	10,798
Capital expenditures	1,692	748	609	2,444	2,988	977	9,458
Investments accounted for by the equity method	4			1	2	2,461	2,468
Fixed assets	14,618	10,636	9,713	24,743	17,327	8,025	85,062
Total allocated assets	19,848	13,451	11,701	33,926	26,793	24,054	129,773
Total allocated liabilities	10,623	3,161	2,718	10,212	17,811	57,587	102,112

(*) Revised

Telefónica, S.A. 26

Table of Contents

2014 Consolidated Financial Statements

The composition of segment revenues, detailed by the main countries in which the Group operates, is as follows:

Country	2014				2013				2012			
	Fixed	Mobile	Other and elims.	Total	Fixed	Mobile	Other and elims.	Total	Fixed	Mobile	Other and elims.	Total
Spain	8,543	4,556	(1,076)	12,023	8,861	5,121	(1,023)	12,959	9,541	6,464	(1,009)	14,996
UK		7,062		7,062		6,692		6,692	242	6,800		7,042
Germany	1,138	4,375	9	5,522	1,235	3,673	6	4,914	1,363	3,845	5	5,213
Brazil	3,613	7,618		11,231	4,125	8,092		12,217	5,045	8,573		13,618
Hispanoamérica	3,604	9,578	(27)	13,155	4,272	13,020	(437)	16,855	4,424	12,724	(407)	16,741
Argentina	1,055	2,008		3,063	1,247	2,434		3,681	1,274	2,423		3,697
Chile	842	1,247		2,089	988	1,495		2,483	1,045	1,524		2,569
Peru	1,077	1,427		2,504	1,121	1,333		2,454	1,135	1,265		2,400
Colombia	629	1,090		1,719	652	1,053		1,705	695	1,070		1,765
Mexico		1,649		1,649		1,580		1,580		1,596		1,596
Venezuela and Central America		1,420		1,420		4,228		4,228		4,009		4,009
Remaining operators and segment eliminations	1	737	(27)	711	264	897	(437)	724	275	837	(407)	705
Other and inter-segment eliminations ⁽¹⁾				1,384				3,424				4,746
Total Group				50,377				57,061				62,356

Note: In some operating business of Telefónica Hispanoamérica segment, the breakdown of revenues presented allocating intercompany eliminations to fixed and mobile businesses. Therefore, the comparative information for the years 2013 and 2012 has been revised.

- (1) Other and inter-segment eliminations included in 2013 revenue in Czech Republic amounted to 1,818 million euros (2,010 million euros in 2012) and revenues in Ireland amounted to 556 million euros (629 million euros in 2012).

Table of Contents

2014 Consolidated Financial Statements

Note 5. Business combinations and acquisitions of non-controlling interests**Business combinations****Acquisition of E-Plus**

On July 23, 2013 Telefónica, S.A. and its listed German subsidiary Telefónica Deutschland Holding, A.G. (Telefónica Deutschland) signed a contract (subsequently amended until a final version was produced on September 30, 2014) with Koninklijke KPN, N.V. (hereinafter, KPN), whereby Telefónica Deutschland undertook to buy up 100% of the shares of the German subsidiary of KPN, E-Plus Mobilfunk GmbH & Co. KG (E-Plus). In return KPN received a 24.9% holding in Telefónica Deutschland and a cash amount, which was established as 3,636 million euros.

In addition, in the context of this transaction, Telefónica, S.A. entered into an agreement with KPN to buy a 4.4% stake of Telefonica Deutschland for 1,300 million euros, and a call option agreement that will entitle Telefónica, S.A. to acquire an additional stake of up to 2.9% in this company, such right being exercisable on the first anniversary of the closing date at a strike price of up to 510 million Euros.

E-Plus dates back to 1993. It provides customers in Germany mainly with multi-brand mobile telecommunications services. The integration with Telefonica Deutschland notably reinforces the competitive position of Telefonica in the largest market in Europe, with around 47 million accesses, and implies significant value creation on synergies generation, particularly with respect to network, distribution and customer service, selling, general and administration as well as CapEx.

On July 2, 2014 the European Commission issued conditional authorization for Telefónica Deutschland to purchase E-Plus. Final authorization by the European Commission for the purchase of E-Plus was obtained on August 29, 2014.

On October 1, 2014, following the share capital increase by Telefónica Deutschland to finance the purchase of E-Plus, the latter was finally acquired by Telefónica Deutschland. Telefónica then purchased a 4.4% stake in Telefónica Deutschland from KPN, thereby reducing KPN's stake in Telefónica Deutschland to 20.5%. The Telefónica Group considers these two transactions together, as a single acquisition.

Following the acquisition of E-Plus, the Telefónica Group's stake in Telefónica Deutschland fell from 76.83% to 62.1% (increased to 62.37% at December 31, 2014). The share capital increase at Telefónica Deutschland and this dilution of the Group's percentage stake affected the Equity attributable to non-controlling interests in the amount of 3,615 million euros (see Note 12.h).

The fair value of the ordinary shares of Telefonica Deutschland delivered to KPN as part of payment was calculated on the basis of their opening price at the date of closing of the operation (October 1, 2014). As a result of the difference between the fair value and the carrying amount of Telefónica Deutschland's net assets, the dilution of the Group's percentage stake had an adverse effect on Equity attributable to the parent company in the amount of 307 million euros, under Retained earnings.

The following table sets out the consideration paid, the fair values of the assets and liabilities identified at the time of purchase, and the goodwill generated. At the time these consolidated financial statements were drawn up, the purchase price allocation process had not been completed, and thus changes may be made to the fair values of the assets and liabilities, particularly the licenses for the use of spectrum, for which there are certain pending regulatory analyses (see Appendix VII). In addition, the final adjustment to the cash consideration, based on the determination of working capital and net debt as established in the aforementioned share purchase agreement, has not yet been completed.

Table of Contents

2014 Consolidated Financial Statements

Million euros	
Cash payment	4,936
Fair value of the T. Deutschland shares purchased by KPN	2,527
Consideration paid	7,463
Intangible assets	4,328
Customer relationships	2,718
Frequency usage rights	1,342
Other intangible assets	268
Property, plant and equipment	1,931
Inventories	21
Trade and other receivables	677
Other financial assets	19
Other non-financial assets	93
Cash and cash equivalents	396
Deferred revenue	(220)
Provisions	(254)
Interest-bearing debt	(505)
Current trade and other payables	(709)
Fair value of net assets	5,777
Goodwill (Note 7)	1,686

Frequency usage rights were valued using the Greenfield method, which consists of the valuation of a hypothetical newly created company that starts its business with no assets except the asset being measured. The cash flows attributable to the build-up and operation of the company are determined and discounted to the present value.

Customer relationships were valued using the MEEM (Multiple Excess Earnings Method), which is based on calculating the discounted cash flows reflecting the economic benefits attributable to the customer base after consideration of all value contributions of other assets.

The detail of the fair value of trade and other receivables is as follows:

Millions of euros	Gross amount	Impairment	Preliminary fair value
Trade receivables	797	(164)	633
Other receivables	44		44
Total trade and other receivables	841	(164)	677

The Group consolidates E-Plus as of October 1, 2014 using the full consolidation method. Had the acquisition occurred on January 1, 2014, the Telefónica Group's revenues and profit for the year would have reached approximately 52,640 and 2,798 million euros, respectively.

At the date of the operation, tax-deductible goodwill in Germany amounted to 1,252 million euros. Differences between applicable IFRS and tax rules create a difference between the accounting goodwill and the tax deductible goodwill, and consist consists mainly of the different dates used to consider the acquisition of the company, the determination of the purchase price and the allocation of the purchase price.

Transactions with non-controlling interests

2014

No material transactions with non-controlling interests were carried out that were significant for the Group in 2014, except for those detailed above regarding the E-Plus acquisition.

Table of Contents

2014 Consolidated Financial Statements

2013*Sale of 40% of the stake in Telefónica's subsidiaries in Guatemala, El Salvador, Nicaragua and Panama*

In April 2013 Telefónica reached an agreement with Corporación Multi Inversiones to sell 40% of Telefónica's stake in its subsidiaries in Guatemala, El Salvador, Nicaragua and Panama, through Telefónica Centroamérica Inversiones, S.L.

The closing of the transaction was on August 2, 2013, upon the fulfillment of the sale conditions. The value of the sale amounted to 500 million U.S. dollars (equivalent to 377 million euros on the date of closing of the sale), plus payment of an additional variable amount of up to 72 million U.S. dollars, depending to the evolution and operational performance of the transferred assets.

The Telefónica Group maintains control of these companies, and therefore the transaction had no impact on the consolidated income statement at its completion, as it is a transaction with non-controlling interests. The impact of this transaction on the consolidated equity was a 111 million euros increase in Equity attributable to equity holders of the parent and other holders of equity instruments, and a 283 million euros increase in Equity attributable to non-controlling interests.

2012*Restructuring of the wireline and wireless businesses in Colombia*

In 2012, Telefónica Móviles Colombia, S.A. (a wholly-owned subsidiary of the Telefónica Group), the Colombian National Government and Colombia Telecomunicaciones, S.A. ESP (a company 52% owned by the Telefónica Group and 48% by the Colombian government) signed an agreement to restructure their wireline and wireless businesses in Colombia, which culminated in the merger of the two companies. Telefónica obtained 70% shareholding in the resulting company and the Colombian government obtained the remaining 30% shareholding.

Public offering of shares in Telefónica Deutschland Holding, A.G.

On October 29, 2012, the public offering of shares of the subsidiary Telefónica Deutschland Holding, A.G. was finalized, corresponding to 23.17% of the capital of that company.

Telefónica, S.A. 30

Table of Contents

2014 Consolidated Financial Statements

Note 6. Intangible assets

The composition of and movements in net intangible assets in 2014 and 2013 are as follows:

Millions of euros	Balance at 12/31/2013	Additions	Amortization	Disposals	Translation differences and Transfer hyperinflation inclusion and other adjustments companies			Balance at 12/31/2014
					and other	inclusion	companies	
Service concession arrangements and licenses	12,034	1,294	(1,154)		31	58	1,342	13,605
Software	3,044	665	(1,432)	(5)	632	(143)	144	2,905
Customer base	1,022		(349)		(47)	22	2,718	3,366
Other intangible assets	1,487	40	(256)	(4)	12	30	121	1,430
Intangible assets in process	961	389			(314)	8	3	1,047
Total intangible assets	18,548	2,388	(3,191)	(9)	314	(25)	4,328	22,353

Millions of euros	Balance at 12/31/2012	Additions	Amortization	Disposals	Translation differences and Transfer hyperinflation inclusion and other adjustments companies			Balance at 12/31/2013
					and other	inclusion	companies	
Service concession arrangements and licenses	13,545	1,223	(1,116)		(406)	(1,212)		12,034
Software	3,529	717	(1,701)	(8)	709	(202)		3,044
Customer base	1,932	1	(415)		(360)	(136)		1,022
Other intangible assets	1,839	66	(216)	(8)	(86)	(108)		1,487
Intangible assets in process	1,233	302		(2)	(561)	(11)		961
Total intangible assets	22,078	2,309	(3,448)	(18)	(704)	(1,669)		18,548

Telefónica, S.A. 31

Table of Contents

2014 Consolidated Financial Statements

The gross cost, accumulated amortization and impairment losses of intangible assets at December 31, 2014 and 2013 are as follows:

Balance at 12/31/2014

Millions of euros	Gross cost	Accumulated amortization	Impairment losses	Intangible assets
Service concession arrangements and licenses	22,297	(8,692)		13,605
Software	14,168	(11,260)	(3)	2,905
Customer base	5,974	(2,606)	(2)	3,366
Other intangible assets	3,647	(2,212)	(5)	1,430
Intangible assets in process	1,046		1	1,047
Intangible assets	47,132	(24,770)	(9)	22,353

Balance at 12/31/2013

Millions of euros	Gross cost	Accumulated amortization	Impairment losses	Intangible assets
Service concession arrangements and licenses	19,763	(7,729)		12,034
Software	14,320	(11,259)	(17)	3,044
Customer base	4,257	(3,235)		1,022
Other intangible assets	3,433	(1,938)	(8)	1,487
Intangible assets in process	962		(1)	961
Intangible assets	42,735	(24,161)	(26)	18,548

Inclusion of companies in 2014 corresponds to the acquisition of E-Plus (see Note 5).

Outstanding among Additions in 2014 is the acquisition by Telefónica Brasil of a LTE block in the 700 MHz band, for 889 million euros. Additions in 2014 include also LTE licenses acquired by the Telefonica operating companies in Argentina, Colombia, Panama, Venezuela and Nicaragua, for 405 million euros.

Additions in 2013 include Telefónica UK Ltd.'s acquisition of two 10 MHz blocks in the 800 MHz spectrum band for 719 million euros.

The spectrum licenses in the 800 MHz and 900 MHz acquired by Telefónica Móviles España in 2011 for 793 million euros are recognized under Intangible assets in process as their availability will begin in 2015.

The net balance of Transfers and others for 2013 primarily includes the reclassification to Non-current assets held for sale of the intangible assets of Telefónica Ireland and Telefónica Czech Republic (see Note 2).

Details of the principal concessions and licenses with which the Group operates are provided in Appendix VII.

Other intangible assets includes the amounts allocated to trademarks acquired in business combinations, of 2,119 million euros and 1,951 million euros at December 31, 2014 and 2013, respectively (1,133 million euros and 1,071 million euros, respectively, net of the related accumulated amortization).

The impact of the monetary adjustments due to hyperinflation in Venezuela is included under Translation differences and hyperinflation adjustments .

Telefónica, S.A. 32

Table of Contents

2014 Consolidated Financial Statements

Note 7. Goodwill

The movement in this heading assigned to each Group segment was the following:

2014

Millions of euros	Balance at 12/31/13	Acquisitions	Transfers	Translation differences and hyperinflation adjustments	Balance at 12/31/14
Telefónica Spain	3,332				3,332
Telefónica Brazil	8,392			15	8,407
Telefónica Germany	2,779	1,686	(4)		4,461
Telefónica United Kingdom	4,948			348	5,296
Telefonica Hispanoamérica	3,748			(383)	3,365
Others	235	1		14	250
Total	23,434	1,687	(4)	(6)	25,111

2013

Millions of euros	Balance at 12/31/12	Acquisitions	Transfers	Translation differences and hyperinflation adjustments	Balance at 12/31/13
Telefónica Spain	3,332				3,332
Telefónica Brazil	10,056			(1,664)	8,392
Telefónica Germany	2,779				2,779
Telefónica United Kingdom	5,055			(107)	4,948
Telefónica Hispanoamérica	4,210			(462)	3,748
Others	2,531	2	(2,089)	(209)	235
Total	27,963	2	(2,089)	(2,442)	23,434

The amount in Acquisitions of the Telefónica Germany segment for 2014 corresponds to the acquisition of E-Plus (see Note 5).

The column Transfers in 2013 mainly includes the reclassification to Non-current assets held for sale of the goodwill allocated to Telefónica Ireland and Telefónica Czech Republic (see Note 2).

In order to test for impairment, goodwill has been allocated to the different cash-generating units (CGUs), which are grouped into the following reportable operating segments:

Table of Contents

2014 Consolidated Financial Statements

	12/31/2014	12/31/2013
Telefónica Spain	3,332	3,332
Telefónica Brazil	8,407	8,392
Telefónica Germany	4,461	2,779
Telefónica United Kingdom	5,296	4,948
Telefónica Hispanoamérica	3,365	3,748
Chile	978	996
Peru	788	738
Mexico	558	554
Argentina	349	403
Others Telefónica Hispanoamérica	692	1,057
Others	250	235
TOTAL	25,111	23,434

The strategic plans of the various cash-generating units (CGU) to which goodwill is allocated are used to perform the impairment test at year-end. The process of preparing the CGUs' strategic plans takes into consideration the current condition of each CGU's market, analyzing the macroeconomic, competitive, regulatory and technological climate together with each CGU's position in this context and the growth opportunities given the market projections and their competitive positioning. A growth target is then defined for each CGU in terms of market share, which is a critical factor when forecasting future revenues. The operating resources and fixed asset investments that need to be assigned in order to reach the growth target are estimated following a basic premise of boosting operating efficiency, with a view to increase operating cash flow over the life of the plan. In this process, the Group has also assessed the level of fulfillment of the strategic plans in the past.

Main assumptions used in calculating value in use

Value in use is calculated for the various CGUs based on the approved business plans and taking into account certain variables such as the OIBDA margin and the CAPEX ratio for non-current assets, expressed as a percentage of revenue, and discount and perpetuity growth rates. Following is a description of the principal variables considered for each CGU with significant goodwill (Brazil, Spain, Germany and United Kingdom).

OIBDA margin and long-term Capital Expenditure (CapEx)

The values obtained as described in the preceding paragraphs are compared with available data of our competitors in the geographical markets in which the Group operates. This analysis has identified that the OIBDA margin determined for the operations in Spain, Germany and United Kingdom is in line with the average for European peers, which stands at approximately 33%. With respect to the ratio of CapEx over revenues, over the term of the strategic plan, the Group's European operators invest at a percentage of revenue that lies at the bottom end of the range for peers in the region. The OIBDA margin for Brazil is in line with the average for peers in emerging markets of approximately 36%. Over the term of the strategic plan, the Group's operator in Brazil invests a percentage located in the lower range estimated as the average for its peers.

Discount rate

The discount rate, applied to measure free cash flow, is the weighted average cost of capital (WACC), determined by the weighted average cost of equity and debt according the finance structure established for each CGU.

This rate is calculated using the capital asset pricing model (CAPM), which takes into account the asset's systemic risk, and the impact of risks on cash flows not generated internally, such as country risk, business-specific credit risk, currency risk and price risk specific to the financial asset. The data used in these calculations are obtained from independent and renowned external information sources.

Telefónica, S.A. 34

Table of Contents

2014 Consolidated Financial Statements

The discount rates applied to the cash flow projections in 2014 and 2013 are as follows:

Discount rate in local currency	2014	2013
Spain	6.1%	6.3%
Brazil	10.9%	11.6%
United Kingdom	6.2%	6.1%
Germany	5.5%	5.3%

The main variation relates to Brazil, where a combination of a reduction in the systemic risk and an improvement in the terms of financing in U.S. dollars has contributed to the decrease in the discount rate.

Perpetuity growth rate

In all cases, impairment tests are performed using the projected cash flows estimated according to the strategic plans over a five-year period. Cash flow projections as from the sixth year are calculated using an expected constant growth rate, taking as the perpetuity growth rate consensus estimates among analysts for each business and country, based on the maturity of the industry depending on technology and the degree of development of each country. Each indicator is compared to the forecasted long-term GDP growth of each country and growth data from external sources, adjusted for any specific characteristics of the business.

The perpetuity growth rates applied to the cash flow projections in 2014 and 2013 are as follows:

Perpetuity growth rate in local currency	2014	2013
Spain	0.8%	0.8%
Brazil	4.8%	5.0%
United Kingdom	1.0%	1.0%
Germany	1.2%	1.1%

In the case of Brazil, although the perpetuity growth rate in nominal terms is above 3%, it is in line with the Brazilian Central Bank's medium-term inflation target (4.5%, within a range of ± 2 p.p.) and is below the analyst consensus forecasted near-term inflation rates of the Strategic Plan (approximately 5%-6%). Stripping out the difference in inflation between Brazil and the Eurozone, the equivalent rate in euros would be below 3% in both years.

Sensitivity to changes in assumptions

The Group carries out a sensitivity analysis of the impairment test by considering reasonable changes in the main assumptions used in such test. For each CGU with significant goodwill (Brazil, Spain, Germany and United Kingdom) the following maximum increases or decreases, expressed in percentage points (p.p.) were assumed:

Table of Contents

2014 Consolidated Financial Statements

Changes in key assumptions, In percentage points (p.p.)	Germany	
	Spain	
	United Kingdom	Brazil
Financial variables		
Discount rate	+/- 0.5	+/- 1
Perpetuity growth rates	+/- 0.25	+/- 0.5
Operating variables		
OIBDA Margin	+/- 2	+/- 2
Ratio of CAPEX/Revenues	+/- 1	+/- 1

The sensitivity analysis performed at year-end 2014 indicates that there are no significant risks arising from reasonably possible changes in the financial and operating variables, considered individually. In other words, the Company considers that within the above ranges, reasonably wide, no impairment losses would be recognized over the carrying amounts of the CGUs with significant goodwill identified.

Telefónica, S.A. 36

Table of Contents

2014 Consolidated Financial Statements

Note 8. Property, plant and equipment

The composition of and movement in the items comprising net Property, plant and equipment in 2014 and 2013 were the following:

Millions of euros	Balance at 12/31/13	Additions	Depreciation	Disposals	Translation differences and Transfers, hyperinflation, inclusion of companies and other adjustments			Balance at 12/31/14
Land and buildings	5,234	70	(468)	(43)	360	(131)	43	5,065
Plant and machinery	21,246	1,290	(4,349)	(22)	4,756	(814)	1,712	23,819
Furniture, tools and other items	1,328	178	(540)	(25)	382	(20)	8	1,311
PP&E in progress	3,232	5,522		(9)	(5,616)	(149)	168	3,148
Total PP&E	31,040	7,060	(5,357)	(99)	(118)	(1,114)	1,931	33,343

Millions of euros	Balance at 12/31/12	Additions	Depreciation	Disposals	Translation differences and Transfers, hyperinflation, inclusion of companies and other adjustments			Balance at 12/31/13
Land and buildings	6,049	51	(598)	(50)	119	(337)		5,234
Plant and machinery	23,213	1,565	(4,860)	(67)	3,059	(1,663)	(1)	21,246
Furniture, tools and other items	2,007	174	(721)	(27)	13	(114)	(4)	1,328
PP&E in progress	3,752	5,296		(8)	(5,426)	(382)		3,232
Total PP&E	35,021	7,086	(6,179)	(152)	(2,235)	(2,496)	(5)	31,040

The gross cost, accumulated depreciation and impairment losses of property, plant and equipment at December 31, 2014 and 2013 are as follows:

Balance at December 31, 2014

Millions of euros	Gross cost	Accumulated depreciation	Impairment losses	PP&E
Land and buildings	11,493	(6,427)	(1)	5,065
Plant and machinery	92,061	(68,183)	(59)	23,819
Furniture, tools and other items	6,487	(5,165)	(11)	1,311

PP&E in progress	3,160		(12)	3,148
Total PP&E	113,201	(79,775)	(83)	33,343

Balance at December 31, 2013

Millions of euros	Gross cost	Accumulated depreciation	Impairment losses	PP&E
Land and buildings	11,633	(6,398)	(1)	5,234
Plant and machinery	90,723	(69,420)	(57)	21,246
Furniture, tools and other items	6,487	(5,148)	(11)	1,328
PP&E in progress	3,255		(23)	3,232
Total PP&E	112,098	(80,966)	(92)	31,040

Inclusion of companies in 2014 corresponds to the acquisition of E-Plus (see Note 5).

Investment by Telefónica Spain in property, plant and equipment in 2014 and 2013 amounted to 1,500 and 1,182 million euros, respectively. Fiber optic was rolled out rapidly, and by year-end 2014 Telefónica Spain reached more than 10 million premises passed in Spain, and had invested more in LTE networks.

Table of Contents

2014 Consolidated Financial Statements

Investment by Telefónica UK in 2014 and 2013 amounted to 617 and 593 million euros, respectively. The increased investment in the UK was due to greater LTE coverage, which outdoor extends to the areas where 58% of the population is concentrated, and a network capacity ramped up to cope with denser 3G and 4G traffic.

Investment by Telefónica Germany in 2014 and 2013 amounted to 656 and 524 million euros, respectively. The operator continues to focus on its LTE roll-out strategy, securing 61% coverage in 2014 Telefónica Germany consolidated E-Plus as of October 1, 2014 (see Note 5).

Investment by Telefónica Brazil in 2014 and 2013 amounted to 1,798 and 1,674 million euros, respectively. The mobile segment featured a continuation of LTE roll-outs in 2014, improving network capacity, systems and applications. Investment in the fixed line network was used to expand roll-out of fiber optic, larger volumes of IPTV customers and corporate projects.

Investment by Telefónica Hispanoamérica in 2014 and 2013 amounted to 2,282 and 2,742 million euros, respectively. Higher levels of investment mainly focused on LTE roll-outs in practically all operations in the region. Investment was also allocated to the densification of the 3G network, optimization of fixed-mobile convergence systems, the continuation of ultra broad band (UBB) roll-out for fixed broadband by speed upgrades and network digitalization, television and digital initiatives.

Disposals mainly include the impact of the disposal by the Group of non-strategic assets (see Note 18).

The column Transfers and others in 2013 mainly includes the reclassification to Non-current assets held for sale of the property, plant and equipment of Telefónica Ireland and Telefónica Czech Republic (see Note 2).

The impact of the monetary adjustments due to hyperinflation in Venezuela is included under Translation differences and hyperinflation adjustments .

Telefónica Group companies have purchased insurance policies to reasonably cover the possible risks to which their property, plant and equipment used in operations are subject, with suitable limits and coverage. In addition, as part of its commercial activities and network roll-out, the Group maintains several property acquisition commitments. The timing of scheduled payments in this regard is disclosed in Note 18.

Property, plant and equipment deriving from finance leases amounted to 419 million euros at December 31, 2014 (463 million euros at December 31, 2013). The most significant finance leases are disclosed in Note 22.

Table of Contents

2014 Consolidated Financial Statements

Note 9. Associates and joint ventures

The breakdown of amounts related to associates and joint ventures recognized in the consolidated statements of financial position and income statements is as follows:

Millions of euros	12/31/14	12/31/13
Investments accounted for by the equity method	788	2,424
Loans to associates and joint ventures	16	1,281
Receivables from associates and joint ventures for current operations (Note 11)	43	85
Financial debt, associates and joint ventures	21	20
Payables to associates and joint ventures (Note 14)	724	578

Millions of euros	2014	2013	2012
Share of (loss) of investments accounted for by the equity method	(510)	(304)	(1,275)
Revenue from operations with associates and joint ventures	472	524	535
Expenses from operations with associates and joint ventures	503	552	634
Financial income with associates and joint ventures	49	38	32
Financial expenses with associates and joint ventures	16	10	4

The Group has entered into factoring agreements in 2014 through the associate Telefónica Factoring España, S.A. amounting to 176 million euros (386 million euros in 2013).

The detail of the movement in investments in associates in 2014 and 2013 was the following:

Investments accounted for by the equity method	Millions of euros
Balance at 12/31/12	2,468
Additions	363
Disposals	(2)
Translation differences and other comprehensive income	(121)
Income (loss)	(304)
Dividends	(28)
Transfers and other	48
Balance at 12/31/13	2,424
Additions	382
Disposals	(697)
Translation differences and other comprehensive income	(20)

Income (loss)	(510)
Dividends	(34)
Transfers and other	(757)
Balance at 12/31/14	788

In November 2014 Telefónica, through its subsidiary Telefónica Internacional, S.A.U., sold shares representing 2.5% of the share capital of China Unicom (Hong Kong) Limited for 687 million euros at the exchange rate of the date of the transaction. Following this transaction, the remainder of Telefónica s China

Table of Contents

2014 Consolidated Financial Statements

Unicom investment (equivalent to 2.51% of its share capital) was reclassified as an available-for-sale financial asset (see Note 13); nevertheless, a representative from Telefónica remains on China Unicom's board of directors, and vice versa.

In July 2014 Telefónica officially purchased a further 22% of the share capital of Distribuidora de Televisión Digital, S.A. for 295 million euros. A payment of 30 million euros was also agreed in return for a waiver by Mediaset of preferential purchase rights to the stake held by Promotora de Informaciones, S.A. in this company (see Note 21).

On June 16, 2014 the three Italian shareholders who, together with Telefónica, S.A., form the shareholder structure of Telco, S.p.A., requested that a demerger process be initiated for this company in accordance with that established in the Shareholders' Agreement. The implementation of this demerger process, approved at the Telco, S.p.A. General Shareholders' Meeting on July 9, 2014, is subject to prior approval by the competition and telecommunication authorities where necessary, including those in Brazil and Argentina (see Note 21).

At a meeting on December 22, 2014, the Brazilian telecommunications regulator (ANATEL) approved the demerger on condition of suspension of Telefónica's voting rights in Telecom Italia, S.p.A. and its subsidiaries, among certain other measures. Telefónica has agreed with the aforementioned suspension of voting rights and has offered the presentation of a formal statement to ANATEL in this regard. Therefore, on the same date Telefónica ceased to have significant influence through its indirect holding in Telecom Italia, S.p.A. and reclassified this investment as an available-for-sale financial asset (see Note 13). The quoted price of Telecom Italia, S.p.A. shares at the reference date was 0.89 euros per share. The impact of the value adjustment of the stake in Telco, S.p.A., together with its contribution to results for the year, led to a negative impact of 464 million euros in 2014. Share of loss of investments accounted for by the equity method (see Note 2).

As a result of the classification of the investment in Telco, S.p.A. as an available-for-sale financial asset, the bond of this company subscribed by Telefónica, S.A. (see Note 13), which amounted to 1,307 million euros at December 31, 2014, including principal and interest (1,258 million euros at December 31, 2013), was excluded from the breakdown of amounts related to associates and joint ventures at 2014 year end in the table above.

In 2013 Telefónica and the other Telco, S.p.A. shareholders established an agreement whereby Telefónica increased its ownership interest in Telco, S.p.A. through a cash contribution of 324 million euros. Likewise, in 2013 a valuation adjustment was recognized in respect of the stake held by Telco, S.p.A. in Telecom Italia, S.p.A. which, together with the contribution to results for the year, led to a negative impact of 267 million euros in 2013 under the heading Share of loss of investments accounted for by the equity method (see Note 2).

Table of Contents

2014 Consolidated Financial Statements

The breakdown of the main investments accounted for by the equity method and key financial highlights for the last 12-month period available at the time of preparation of the consolidated financial statements for 2014 and 2013 are as follows:

December 31, 2014

Millions of euros

COMPANY	% holding	Total assets	Total liabilities	Operating revenue	Profit (loss) for the year	Carrying amount
DTS Distribuidora de Televisión Digital, S.A. (Spain)	44%	1,265	622	1,168	(210)	703
Other						85
TOTAL						788

December 31, 2013

Millions of euros

COMPANY	% holding	Total assets	Total liabilities	Operating revenue	Profit (loss) for the year	Carrying amount
Telco, S.p.A. (Italy) (Note 21.b)	66%	3,001	2,416		(474)	390
DTS Distribuidora de Televisión Digital, S.A. (Spain)	22%	1,381	528	1,166	(74)	434
China Unicom (Hong Kong) Limited	5.01%	61,320	35,389	34,775	1,227	1,539
Other						61
TOTAL						2,424

Telefónica, S.A. 41

Table of Contents

2014 Consolidated Financial Statements

Note 10. Related parties**Significant shareholders**

A summary of significant transactions between the Telefónica Group and the companies of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) and those of Caja de Ahorros y Pensiones de Barcelona (la Caixa), significant shareholders of the Company with stakes in Telefónica, S.A. of 6.25% and 5.25%, respectively, at December 31, 2014, is as follows:

All of these transactions were carried out at market prices.

Millions of euros		
2014	BBVA	La Caixa
Finance costs	26	2
Receipt of services	8	59
Other expenses	3	
Total costs	37	61
Finance income	14	19
Dividends received ⁽¹⁾	14	N/A
Services rendered	61	95
Sale of goods	5	2
Other income	3	
Total revenue	97	116
Finance arrangements: loans and capital contributions (borrower)	417	31
Guarantees	529	75
Commitments	32	67
Finance arrangements: loans and capital contributions (lender)	1,107	1,173
Dividends ⁽²⁾	194	98
Other operations (factoring operations)	112	

(1) At December 31, 2014, Telefónica holds a 0.72% stake in the share capital of Banco Bilbao Vizcaya Argentaria, S.A. (see Note 13.a).

(2) The shares received by la Caixa for the scrip dividend paid on December 2014 should be considered in addition to the amount included in this file.

Table of Contents

2014 Consolidated Financial Statements

Millions of euros		
2013	BBVA	La Caixa
Finance costs	45	2
Receipt of services	19	57
Other expenses	1	
Total costs	65	59
Finance income	35	8
Dividends received	14	N/A
Services rendered	68	78
Sale of goods	5	3
Other income	2	
Total revenue	124	89
Finance arrangements: loans and capital contributions (borrower)	399	214
Guarantees	452	134
Commitments	32	69
Commitments/guarantees canceled	69	
Finance arrangements: loans and capital contributions (lender)	1,626	1,671
Financial lease contracts (lessee)	5	
Amortization or cancellation of credits and lease contracts (lessee)	13	
Dividends	108	89
Other operations (factoring operations)	210	

In addition, the nominal value of derivatives held with BBVA and la Caixa in 2014 amounted to 24,266 and 1,221 million euros, respectively (13,352 million euros held with BBVA and 1,200 million euros held with la Caixa in 2013). As explained in Derivatives policy in Note 16, this figure is inflated by the use in some cases of several levels of derivatives applied to the nominal value of a single underlying.

Other related parties

The most significant balances and transactions with associates and joint ventures are detailed in Note 9.

During the financial year to which these accompanying consolidated financial statements refer, the Directors and senior executives did not perform any transactions with Telefónica, S.A. 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 are detailed in Note 21.f and Appendix II of these consolidated financial statements.

Certain members of Telefónica, S.A.'s Board of Directors are also board members of Abertis Infraestructuras, S.A., parent of Abertis. Telefónica has signed agreements with Abertis, through its subsidiary Abertis Tower, S.A.U., by virtue of which Telefónica Spain has sold 1,725 and 690 mobile phone towers in 2014 and 2013, respectively, generating a gain of 193 million euros in 2014 and a gain of 70 million euros in 2013.

An agreement has also been signed through which Abertis Tower, S.A.U. leases certain space in the aforesaid infrastructures for Telefónica Móviles España, S.A.U. to install its communications equipment.

Telefónica, S.A. 43

Table of Contents

2014 Consolidated Financial Statements

Note 11. Trade and other receivables

The breakdown of this consolidated statement of financial position heading at December 31, 2014 and 2013 is as follows:

Millions of euros	Balance at 12/31/2014	Balance at 12/31/2013
Trade receivables billed	9,172	8,184
Trade receivables unbilled	2,529	2,258
Impairment of trade receivables	(2,757)	(2,598)
Receivables from associates and joint ventures (Note 9)	43	85
Other receivables	540	571
Short-term prepayments	1,079	1,140
Total	10,606	9,640

Public-sector net trade receivables at December 31, 2014 and 2013 amounted to 437 million euros and 577 million euros, respectively.

The movement in impairment of trade receivables in 2014 and 2013 is as follows:

	Millions of euros
Impairment provision at December 31, 2012	3,196
Allowances	674
Amounts applied	(809)
Translation differences and other	(463)
Impairment provision at December 31, 2013	2,598
Allowances	808
Amounts applied	(801)
Inclusion of companies	152
Translation differences and other	
Impairment provision at December 31, 2014	2,757

The balance of trade receivables billed net of impairment losses at December 31, 2014 amounted to 6,415 million euros (5,586 million euros at December 31, 2013), of which 4,162 million euros were not yet due (3,056 million euros at December 31, 2013).

Net balance of trade receivables billed of 207 million euros and 354 million euros are over 360 days due at December 31, 2014 and 2013, respectively. They are mainly with the public sector.

Table of Contents

2014 Consolidated Financial Statements

Note 12. Equity**a) Share capital and share premium**

At December 31, 2014, Telefónica, S.A.'s share capital amounted to 4,657,204,330 euros and consisted of 4,657,204,330 fully paid ordinary shares of a single series, par 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 London and Buenos Aires Stock Exchanges, and on the New York and Lima Stock Exchanges, through American Depositary Shares (ADSs).

On December 9, 2014, the deed of a share capital increase of 106,179,744 euros was executed, during which 106,179,744 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 4,657,204,330 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, once 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, 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.

Furthermore, 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 30, 2014 Shareholders Meeting, authorization was given for the Board of Directors to issue debentures, bonds, notes and other fixed-income securities and hybrid instruments, including 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, or debt instruments of similar category or hybrid instruments whatever may be the forms admitted in law, plain or, in the case of debentures, bonds and hybrid instruments convertible into shares of the Company and/or exchangeable for shares of any of the Group companies, or any other company. This delegation also includes warrants or other similar securities that might give the right to directly or indirectly subscribe or acquire shares of the Company, whether newly issued or outstanding, and which may be paid for by physical delivery or by offset. The aggregated amount of the issuance(s) of securities approved under this delegation of powers may not exceed, at any given time, the sum of 25,000 million 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. Also for purposes of the foregoing limit, in

the case of warrants, the sum of the premiums and exercise prices of the warrants for each issuance that is approved under this delegation shall be taken into account.

Telefónica, S.A. 45

Table of Contents

2014 Consolidated Financial Statements

Proposed distribution of profit attributable to equity holders of the parent

Telefónica, S.A. generated 2,604 million euros of profit in 2014.

The Company's Board of Directors will submit the following proposed distribution of 2014 profit for approval at the Shareholders Meeting:

	Millions of euros
Goodwill reserve	2
Voluntary reserves	812
Interim dividend	1,790
Total	2,604

b) Dividends**Dividends distribution in 2014 and capital increase**

Approval was given at the Board of Directors Meeting of April 25, 2014 to pay a gross 0.40 euros dividend per outstanding share against 2014 profit. This dividend was paid on May 7, 2014 for a gross amount of 1,790 million euros.

In accordance with Article 277 of the Corporate Enterprises Act, the following table presents the mandatory statement of accounts prepared to confirm the existence of sufficient liquidity to pay the dividend at the date of its approval.

Liquidity statement	Millions of euros
Income from January 1 through March 31, 2014	3,177
Mandatory appropriation to reserves	
Distributable income	3,177
Proposed interim dividend (maximum amount)	1,820
Cash position	
Funds available for distribution:	
Cash and cash equivalents	4,135
Unused credit facilities	4,397
Proposed interim dividend (maximum amount)	1,820
Difference	6,712

The Telefónica Group manages its liquidity risks (see Note 16) in order to have cash available for 2015.

At its meeting held on November 14, 2014, the Executive Commission of Telefonica, S.A.'s Board of Directors agreed to carry out the execution of the increase in paid-up capital, related to the shareholders compensation by means of a scrip dividend, approved by the Annual General Shareholder's Meeting held on May 30, 2014.

Thus, each shareholder received one free allotment right for each Telefónica share held. Such free allotment rights were traded on the Continuous Market in Spain during a period of fifteen calendar days. Once this trading period ended, the shareholders of 15.8% of the free-of-charge allotment rights accepted the irrevocable purchase commitment assumed by Telefónica, S.A. Cash payment to these shareholders was made on December 8, 2014, representing an impact in equity of 242 million euros.

The shareholders of 84.2% of the free-of-charge allotment rights were entitled, therefore, to receive new shares of Telefónica, S.A. Nevertheless, Telefónica, S.A. has waived the subscription of new shares corresponding to its treasury shares, so the final number of shares issued in the capital increase was 106,179,744 shares with a nominal value of 1 euro each.

Dividends distribution in 2013

Table of Contents

2014 Consolidated Financial Statements

At its meeting of May 31, 2013, Telefónica, S.A.'s Board of Directors resolved to pay a dividend with a charge to unrestricted reserves of a fixed gross 0.35 euros per outstanding share carrying dividend rights. This dividend was paid in full on November 6, 2013, and the total amount paid was 1,588 million euros.

Dividends distribution in 2012 and capital increase

Approval was given at the General Shareholders Meeting of May 14, 2012 to pay a gross 0.53 euros 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 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.

Therefore, holders of 62.32% of free subscription rights were entitled to receive new Telefónica shares. However, Telefónica, S.A. waived the subscription of new shares corresponding to treasury shares, so the final number of shares issued in the bonus issue was 71,237,464 shares with a nominal value of 1 euro each.

c) Other equity instruments**Undated deeply subordinated securities****Issued in 2014**

On March 25, 2014, Telefónica Europe, B.V. issued undated deeply subordinated reset rate guaranteed securities in an aggregate principal amount of 1,750 million euros. This issue entails two tranches: one of them subject to a call option exercisable by Telefónica Europe, B.V. starting on the sixth anniversary of the issuance date in an aggregate principal amount of 750 million euros (the Sixth-Year Non-Call Securities), and the other subject to a call option exercisable by Telefónica Europe, B.V. starting on the tenth anniversary of the issuance date in an aggregate principal amount of 1,000 million euros (the Tenth-Year Non-Call Securities). In both tranches there is an early redemption option for the issuer.

The Sixth-Year Non-Call Securities will accrue a fixed coupon at a rate of 5% annually as from the issuance date up to March 31, 2020 (not inclusive). From March 31, 2020 (inclusive) onwards, the Sixth-Year Non-Call Securities will accrue a fixed coupon equal to the applicable 6 year euro swap rate plus a margin of: (i) 3.804% per year as from March 31, 2020 up to March 31, 2024 (not inclusive); (ii) 4.054% per year as from March 31, 2024 up to March 31, 2040 (not inclusive); and (iii) 4.804% per year as from March 31, 2040.

Edgar Filing: TELEFONICA S A - Form 6-K

The Tenth-Year Non-Call Securities will accrue a fixed coupon at a rate of 5.875% annually as from the issuance date up to March 31, 2024 (not inclusive). From March 31, 2024 (inclusive) onwards, the Tenth-Year Non-Call Securities will accrue a fixed coupon equal to the applicable 10 year euro swap rate plus a margin of: (i) 4.301% per year as from March 31, 2024 up to March 31, 2044 (not inclusive); (ii) 5.051% per year as from March 31, 2044.

On December 4, 2014, Telefónica Europe, B.V. issued undated deeply subordinated reset rate guaranteed securities in an aggregate principal amount of 850 million euros and subject to a call option exercisable by Telefónica Europe, B.V. starting on the fifth anniversary of the issuance date. The Securities will accrue a fixed coupon at a rate of 4.20% annually as from the issuance date up to December 4, 2019 (not inclusive). From December 4, 2019 (inclusive) onwards, the Securities will accrue a fixed coupon equal to the applicable 5 year swap rate plus a margin of: (i) 3.806% per year as from December 4, 2019 up to December 4, 2024 (not inclusive); (ii) 4.056% per year as from December 4, 2024 up to December 4, 2039 (not inclusive); and (iii) 4.806% per year as from December 4, 2039.

Telefónica, S.A. 47

Table of Contents

2014 Consolidated Financial Statements

Issued in 2013

On September 18, 2013, Telefónica Europe, B.V. issued undated deeply subordinated reset rate guaranteed securities in an aggregate principal amount of 1,750 million euros. This issue entails two tranches: one of them subject to a call option exercisable by Telefónica Europe, B.V. starting on the fifth anniversary of the issuance date in an aggregate principal amount of 1,125 million euros (the Five-Year Non-Call Securities), and the other subject to a call option exercisable by Telefónica Europe, B.V. starting on the eighth anniversary of the issuance date in an aggregate principal amount of 625 million euros (the Eight-Year Non-Call Securities). In both tranches there is an early redemption option for the issuer.

The Five-Year Non-Call Securities will accrue a fixed coupon at a rate of 6.5% annually as from the issuance date (inclusive) up to September 18, 2018. From September 18, 2018 (inclusive) onwards, the Five-Year Non-Call Securities will accrue a fixed coupon equal to the applicable 5 year swap rate plus a margin of: (i) 5.038% per year as from September 18, 2018 up to September 18, 2023 (not inclusive); (ii) 5.288% per year as from September 18, 2023 up to September 18, 2038 (not inclusive); and (iii) 6.038% per year as from September 18, 2038 (inclusive).

The Eight-Year Non-Call Securities will accrue a fixed coupon at a rate of 7.625% annually as from the issuance date (inclusive) up to September 18, 2021. From September 18, 2021 (inclusive) onwards, the Eight-Year Non-Call Securities will accrue a fixed coupon equal to the applicable 8 year swap rate plus a margin of: (i) 5.586% per year as from September 18, 2021 up to September 18, 2023 (not inclusive); (ii) 5.836% per year as from September 18, 2023 up to September 18, 2041 (not inclusive); and (iii) 6.586% per year as from September 18, 2041 (inclusive).

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 principal amount of 600 million pounds sterling (equivalent to 716 million euros at the closing date) and subject to a call option exercisable by Telefónica Europe, B.V. starting on the seventh anniversary of the issuance date. The securities will accrue a coupon at a rate of 6.75% annually as from the issuance date (inclusive) up to November 26, 2020. From November 26, 2020 (inclusive), the securities will accrue a fixed coupon equal to the applicable five years swap rate resettable every five years plus a margin of: (i) 4.458% per year as from November 26, 2020 up to November 26, 2025 (not inclusive); (ii) 4.708% per year as from November 26, 2025 up to November 26, 2040 (not inclusive); and (iii) 5.458% per year as from November 26, 2040 (inclusive).

In all issuances of subordinated perpetual instruments in 2014 and 2013, the issuer has an option to defer the payment of coupons; holders of these securities cannot call for payment.

As the repayment of principal and the payment of coupons depend solely on Telefónica's decision, these subordinated perpetual instruments are equity instruments and are presented under Other equity instruments in the accompanying consolidated statement of changes in equity.

The payment of the coupons related to the undated deeply subordinated securities issued in 2013 in an aggregate amount, net of tax effects, of 129 million euros, with negative impact on Retain earnings in the consolidated statements of changes in equity, was recorded in September 2014.

Notes mandatorily convertible into shares of Telefonica, S.A.

On September 24, 2014, Telefónica Participaciones, S.A.U., issued 1,500 million euros of notes mandatorily convertible into new and/or existing shares of Telefónica, S.A. at a nominal fixed interest rate of 4.9%, due on September 25, 2017, guaranteed by Telefónica, S.A. The notes could be converted at the option of the noteholders or the issuer at any time from the 41st day after the issue date up to the 25th trading day prior to the maturity date. The minimum conversion price of the notes will be equal to 11.9 euros per share and the maximum conversion price will be equal to 14.5775 euros per share, resulting in a premium equal to 22.5% over the minimum conversion price.

These notes mandatorily convertible are compound instruments that have been split into its two components: a debt component amounting 215 million euros, corresponding to the present value of the coupons; and an

Telefónica, S.A. 48

Table of Contents

2014 Consolidated Financial Statements

equity component, for the remaining amount, due to the issuer option to convert the treasury shares to a fix ratio, included in the heading other equity instruments .

d) Legal reserve

According to the consolidated 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, 2014, the Company had duly set aside this reserve, amounting to 984 million euros.

e) Retained earnings

These reserves include undistributed profits of companies comprising the consolidated Group less interim dividends paid against profit for the year, actuarial gains and losses, the impact of the asset ceiling on defined-benefit plans and the payment of coupons related to subordinated securities, if applicable.

In addition, these reserves include revaluation reserves and reserve for cancelled share capital. These reserves are regulated by some restrictions for their distribution.

Revaluation reserves

The balance of Revaluation reserves arose as a result of the revaluation made pursuant to Royal Decree-Law 7/1996 dated June 7 and may be used, free of tax, to offset any losses incurred in the future and to increase capital. Also 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, an amount of 8 million euros was reclassified to Retained earnings in 2014 (7 million euros in 2013 and 10 million euros in 2012), corresponding to revaluation reserves subsequently considered unrestricted. At December, 31 2014 this reserve amounts to 101 million euros.

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. No additional amounts have been added to this reserve in 2014 and 2013, and the cumulative amount of the reserve for cancelled share capital at December 31, 2014 and 2013 was 582 million euros.

f) Translation differences

The breakdown of the accumulated contribution of translation differences at December 31 is as follows:

Millions of euros	2014	2013	2012
Brazilian real	(5,552)	(5,556)	(2,395)
Venezuelan bolivar	(2,923)	27	645
Pound sterling	(1,901)	(2,455)	(2,251)
Other currencies	(1,756)	(1,291)	372
Total Group	(12,132)	(9,275)	(3,629)

The translation differences movement in 2014 is mainly due to the impact of translating the financial statements of the Group's subsidiaries in Venezuela to SICAD II (see Note 2).

Table of Contents

2014 Consolidated Financial Statements

g) Treasury share instruments

At December 31, 2014, 2013 and 2012, Telefónica Group companies held the following shares in the Telefónica, S.A. parent company:

	Number of shares	Euros per share			
		Acquisition price	Trading price	Market value*	%
Treasury shares at 12/31/14	128,227,971	11.68	11.92	1,528	2.75332%
Treasury shares at 12/31/13	29,411,832	11.69	11.84	348	0.64627%
Treasury shares at 12/31/12	47,847,810	10.57	10.19	488	1.05136%

(*) Millions of euros

Telefónica, S.A. directly owns all treasury shares in the Group at December 31, 2014.

In 2014, 2013 and 2012 the following transactions involving treasury shares were carried out:

	Number of shares
Treasury shares at 12/31/11	84,209,364
Acquisitions	126,489,372
Disposals	(76,569,957)
Employee share option plan	(2,071,606)
Capital reduction	(84,209,363)
Treasury shares at 12/31/12	47,847,810
Acquisitions	113,154,549
Disposals	(131,590,527)
Treasury shares at 12/31/13	29,411,832
Acquisitions	100,723,415
Disposals	(129,177)
Employee share option plan	(1,778,099)
Treasury shares at 12/31/14	128,227,971

Treasury shares purchases in 2014 amounted to 1,176 million euros (1,216 million euros and 1,346 million euros in 2013 and 2012, respectively).

Treasury shares disposed of in 2014, 2013 and 2012 amounted to 1 million euros, 1,423 million euros and 801 million euros, respectively.

Edgar Filing: TELEFONICA S A - Form 6-K

The main disposal of treasury shares in 2014 are mainly due to the shares delivered to Group employees when the second phase of the Global Employee Share Plan (the GESP) matured (see Note 19).

The main sales of treasury shares in 2013 are as follows:

An agreement was reached with qualified and professional investors on March 26, 2013 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 from the remaining shareholders of Telco, S.p.A. 23.8% of the non-convertible bonds issued by Telco, S.p.A. (Note 13.a). The payment of this transaction consisted of the transmission of 39,021,411 treasury shares of the Company (see Note 13.a).

At December 31, 2014, Telefónica held 76 million call options on treasury shares subject to physical delivery at a fixed price (134 and 178 million options on treasury shares at December 31, 2013 and 2012, respectively), which are presented as a reduction in equity under the caption Treasury shares . They are valued at the amount of premium paid, and upon maturity if the call options are exercised the premium is

Telefónica, S.A. 50

Table of Contents

2014 Consolidated Financial Statements

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 financial instrument subject to net settlement on a notional equivalent to 32 million Telefónica shares, recognized under Current interest-bearing debt in the accompanying consolidated statement of financial position (derivative over 30 million shares in 2013 recognized under Current interest-bearing debt and derivative over 28 million shares in 2012 recognized under Current financial assets).

h) Equity attributable to non-controlling interests

Equity attributable to non-controlling interests represents the share of non-controlling interests in the equity and income or loss for the year of fully consolidated Group companies. The movements in this heading of the 2014, 2013 and 2012 consolidated statement of financial position are as follows:

Millions of euros	Balance at 12/31/13	Acquisitions of Sales of non-controlling controlling interests interests and and inclusion exclusion		Dividends distributions	Profit/(loss) the year	Change in translation differences	Other movements	Balance at 12/31/14
		of companies	of companies					
Telefónica Czech Republic, a.s.	666		(666)					
Telefónica Brasil, S.A.	3,491			(269)	423	(5)	16	3,656
Telefónica Deutschland Holding, A.G.	1,962	3,615		(122)	(277)		(12)	5,166
Colombia Telecomunicaciones, S.A., ESP	(165)				91	7	17	(50)
Telefónica Centroamericana Inversiones, S.L.	283	6		(14)	9	41	1	326
Other	60	10		(1)	5	4	(2)	76
Total	6,297	3,631	(666)	(406)	251	47	20	9,174

Telefónica, S.A. 51

Table of Contents

2014 Consolidated Financial Statements

Millions of euros	Acquisitions of Sales of non -controlling controlling interests interests and and inclusion exclusion		Dividends distributions	Change Profit/(loss) for in the translation Other		Balance at 12/31/13		
	Balance at 12/31/12	of companies		of companies	the year		movements	
Telefónica Czech Republic, a.s.	813		(46)	(100)	63	(64)		666
Telefónica Brasil, S.A.	4,373			(522)	335	(694)	(1)	3,491
Telefónica Deutschland Holding, A.G.	2,084			(117)	(1)	(1)	(3)	1,962
Colombia Telecomunicaciones, S.A., ESP	(139)				(37)	21	(10)	(165)
Telefónica Centroamericana Inversiones, S.L.		283			11	(12)	1	283
Other	69	1			5	(13)	(2)	60
Total	7,200	284	(46)	(739)	376	(763)	(15)	6,297

Millions of euros	Acquisitions of Sales of non -controlling controlling interests interests and and inclusion exclusion		Dividends distributions	Change Profit/(loss) for in the translation Other		Balance at 12/31/12		
	Balance at 12/31/11	of companies		of companies	the year		movements	
Telefónica Czech Republic, a.s.	940		(113)	(107)	66	27		813
Telefónica Brasil, S.A.	4,745		(12)	(331)	454	(478)	(5)	4,373
Telefónica Deutschland Holding, A.G.		2,043			41			2,084
Colombia Telecomunicaciones, S.A., ESP			(116)		(93)	(138)	208	(139)
Other	62		(2)	(4)	7	5	1	69
Total	5,747	2,043	(243)	(442)	475	(584)	204	7,200

Revenues, OIBDA, capital expenditure and the main items of the statement of financial position for the main companies of the Telefónica Group with non-controlling interests, Telefónica Brazil and Telefónica Germany, are included in the Note 4.

2014

In 2014, Sales of non-controlling interests and inclusion of companies reflects the effect of the capital increase in Telefónica Deutschland Holding, A.G. for the acquisition of E-Plus, and the changes in the investment percentages related to the same operation, amounting to 3,615 million euros (see Notes 2 and 5). The removal of Telefónica Czech Republic, a.s. from the scope of consolidation is also significant (see Note 2).

2013

In 2013, Sales of non-controlling interests and inclusion of companies reflects the effect of the sale of 40% of the investment through Telefónica Centroamérica Inversiones, S.L. in Guatemala, El Salvador, Nicaragua and Panama, with an impact of 283 million euros (see Note 5).

2012

In 2012, Sales of non-controlling interests and inclusion of companies reflects the effect of the public offering of shares in Telefónica Deutschland Holding, A.G. This share offering, which totaled 23.17% of capital, entailed non-controlling interests of 2,043 million euros. The heading also includes the impact of the corporate reorganization agreement in the fixed and mobile businesses in Colombia, with an impact of 116 million euros (see Note 5).

Table of Contents

2014 Consolidated Financial Statements

Note 13. Financial assets and liabilities**1.- Financial assets**

The breakdown of financial assets of the Telefónica Group at December 31, 2014 and 2013 is as follows:

December 31, 2014

Millions of euros	Fair value through profit or loss			Measurement hierarchy						Total carrying amount	Total fair value
	Held for trading	Fair value option	Available-for-sale	Level 1 (Quoted prices)	Level 2 (Observable inputs)	Level 2 (Unobservable inputs)	Level 3 (Unobservable inputs)	Level 4 (Unobservable inputs)	Level 5 (Unobservable inputs)		
Non-current financial assets	2,453	245	1,875	3,046	1,492	6,114	13	137	3,217	10,973	10,981
Investments			1,278		1,170	108				1,278	1,278
Long-term credits		245	597		84	745	13	47	2,248	3,137	2,643
Deposits and guarantees								90	1,471	1,561	1,561
Derivative instruments	2,453			3,046	238	5,261				5,499	5,499
Impairment losses									(502)	(502)	
Current financial assets	500	97	63	571	423	808		9	8,221	9,461	9,454
Financial investments	500	97	63	571	423	808		9	1,692	2,932	2,925
Cash and cash equivalents									6,529	6,529	6,529
Total financial assets	2,953	342	1,938	3,617	1,915	6,922	13	146	11,438	20,434	20,435

Telefónica, S.A. 53

Table of Contents

2014 Consolidated Financial Statements

December 31, 2013

Millions of euros	Fair value through profit or loss		Measurement hierarchy					Cost of financial assets		Total carrying amount	Total fair value
	Held for trading	Fair value option	Available-for-sale	Level 1 (Quoted market prices)	Level 2 (Observable market inputs)	Level 3 (Unobservable inputs)	At maturity	At amortized cost			
Non-current financial assets	1,462	356	1,101	1,205	746	3,378	36	3,615	7,775	7,775	
Investments			550		433	117			550	550	
Long-term credits		356	551		171	736		7	2,562	3,476	3,127
Deposits and guarantees								29	1,403	1,432	1,431
Derivative instruments	1,462			1,205	142	2,525				2,667	2,667
Impairment losses								(350)	(350)		
Current financial assets	548	146	54	125	327	546	727	10,494	12,094	12,094	
Financial investments	548	146	54	125	327	546	727	517	2,117	2,117	
Cash and cash equivalents								9,977	9,977	9,977	
Total financial assets	2,010	502	1,155	1,330	1,073	3,924	763	14,109	19,869	19,869	

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

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.

Table of Contents

2014 Consolidated Financial Statements

a) Non-current financial assets

The movement in items composing Non-current financial assets in 2014 and 2013 is as follows:

Millions of euros	Long-term Deposits and Derivative Impairment					Total
	Investments	credits	guarantees	financial assets	provision	
Balance at 12/31/12	586	2,940	1,986	4,213	(386)	9,339
Acquisitions	10	1,269	158	188	(4)	1,621
Disposals	(106)	(462)	(61)		1	(628)
Translation differences	(12)	(111)	(285)	73	29	(306)
Fair value adjustments	80	(85)	38	(1,459)		(1,426)
Transfers	(8)	(75)	(404)	(348)	10	(825)
Balance at 12/31/13	550	3,476	1,432	2,667	(350)	7,775
Acquisitions	58	916	161	423	(5)	1,553
Disposals	(21)	(451)	(148)	(16)	6	(630)
Translation differences	(5)	18	(25)	124	5	117
Fair value adjustments	(113)	35	103	2,538		2,563
Transfers and others	809	(857)	38	(237)	(158)	(405)
Balance at 12/31/14	1,278	3,137	1,561	5,499	(502)	10,973

Investments

Investments includes the fair value of investments in companies where Telefónica does not exercise significant control and for which there is no specific disposal plan for the short term (see Note 3.i).

In Transfers in 2014 there is mainly the reclassification as non-current financial assets available-for-sale of our investment in China Unicom (Hong Kong) Limited and Telco, S.p.A. (see Note 9), consolidated until that moment by the equity method.

At December 31, 2014 the Telefónica Group's shareholding in China (Hong Kong) Limited is 2.51%, valued at 662 million euros. At the same date, the stake in Telco, S.p.A. is 66% (see Note 21.b) amounting to a book value of 73 million euros.

Additionally, the Group's shareholding in Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) amounts to 347 million euros (383 million euros at December 31, 2013), representing 0.72% of its share capital at December 31, 2014.

Disposals in 2013 mainly include the full divestment of the stake in Portugal Telecom.

At year-end the Group assessed the securities in its portfolio of listed available-for-sale assets individually for impairment. The analysis did not uncover the need to recognize any significant impairment losses.

Long-term credits and impairment provision

Millions of Euros	12/31/2014	12/31/2013
Long-term loans to associates		1,225
Long-term trade receivables	825	444
Long-term prepayments	338	154
Long-term receivables for indirect taxes	112	121
Other long-term credits	1,862	1,532
Total	3,137	3,476

Other long-term credits includes long-term financial assets of the subsidiary Seguros de Vida y Pensiones Antares, S.A., fundamentally fixed-income securities, amounting to 816 million euros and 795 million euros at December 31, 2014 and 2013, respectively. These assets are mainly intended to cover the obligations from

Table of Contents

2014 Consolidated Financial Statements

the defined benefit plans of Telefónica de España (ITP and Survival), though they do not qualify as plan assets under IAS 19 (see Note 15).

Other long-term credits in 2014 includes the deferred account receivable generated from the sale of Telefónica Czech Republic, a.s. (see Note 2), in the amount of 217 million euros. This same item amounts to 86 million euros on a current basis. The sale agreement contemplates a payment schedule that extends to January 2018.

In 2013, Telefónica acquired 23.8% of the non-convertible bonds of Telco, S.p.A. from this company's other shareholders, through the transfer of 39,021,411 treasury shares (see Note 12.g). This transaction is recognized under Long-term credits for 417 million euros. At December 31, 2013, Telefónica, S.A. had subscribed Telco, S.p.A. bonds totaling 1,225 million euros, transferred to short term in 2014 (see Note 9).

Additionally, Acquisitions in 2013 included the purchase of exchangeable bond into Telecom Italia, S.p.A. shares for a nominal amount of 103 million euros, which was cancelled in 2014.

Impairment provision for long-term credits amounted to 502 and 350 million euros at December 31, 2014 and December 31, 2013, respectively.

b) Current financial assets

This heading includes the following items:

Short-term credits amounting to 1,527 million euros, mainly including Telco, S.p.A.'s bond totaling 1,307 million euros at December 31, 2014 (principal plus interests).

On July 9, 2014, each of the Telco shareholders, among which Telefónica is one of them, executed with Telco a shareholders loan agreement with a maturity date no later than April 30, 2015. The aggregate amount of shareholders loans made available pursuant to such loans is up to 2,550 million Euros (1,683 million euros corresponding to Telefónica, S.A. according to its stake in Telco), which will enable Telco to repay in full all amounts due by Telco under its banking debt and the subordinated bond. As of December 31, 2014 there was no outstanding amount under these loans.

Short-term investments in financial instruments recognized at fair value to cover commitments undertaken by the Group's insurance companies, amounting to 377 million euros at December 31, 2014 (430 million euros at December 31, 2013).

Derivative financial assets with a short-term maturity or not used to hedge non-current items in the consolidated statement of financial position, in the amount of 813 million euros (412 million euros in 2013).

Short-term deposits and guarantees amounting to 179 million euros at December 31, 2014 (175 million euros at December 31, 2013).

Current investments of cash surpluses which, given their characteristics, have not been classified as Cash and cash equivalents.

Current financial assets that are highly liquid and have maturity periods of three months or less from the date contracted, and present an insignificant risk of value changes, are recorded under Cash and cash equivalents on the accompanying consolidated statement of financial position.

Table of Contents

2014 Consolidated Financial Statements

2.- Financial liabilities

The breakdown of financial liabilities at December 31, 2014 and the corresponding maturities schedule is as follows:

Millions of euros

Maturity	Current		Non-current			Subsequent	Non-current	Total
	2015	2016	2017	2018	2019	years	total	
Debentures and bonds	4,601	6,722	6,392	4,834	3,465	18,214	39,627	44,228
Promissory notes & commercial paper	502							502
Other marketable debt securities								
Total Issues	5,103	6,722	6,392	4,834	3,465	18,214	39,627	44,730
Loans and other payables	3,590	1,533	3,205	761	849	1,482	7,830	11,420
Other financial liabilities (Note 16)	401	152	347	477	357	1,898	3,231	3,632
TOTAL	9,094	8,407	9,944	6,072	4,671	21,594	50,688	59,782

The estimate of future payments for interest on these financial liabilities at December 31, 2014 is as follows: 2,215 million euros in 2015, 1,960 million euros in 2016, 1,671 million euros in 2017, 1,279 million euros in 2018, 1,077 million euros in 2019 and 6,586 million euros in years after 2019. For floating rate financing, the Group mainly estimates future interest using the forward curve of the various currencies at December 31, 2014.

The amounts shown in this table take into account the fair value of derivatives classified as financial liabilities (i.e., those with a negative mark-to-market) and exclude the fair value of derivatives classified as current financial assets, for 813 million euros, and those classified as non-current, for 5,499 million euros (i.e., those with a positive mark-to-market).

The composition of these financial liabilities, by category, at December 31, 2014 and 2013 is as follows:

December 31, 2014

Millions of euros	Fair value through profit or loss	Hedges	Measurement hierarchy
-------------------	-----------------------------------	--------	-----------------------

	Held for trading	Fair value option	Level 1 (Quoted prices)	Level 2 (Other observable inputs)	Level 3 (Unobservable inputs)	Liabilities at amortized cost	Total carrying amount	Total fair value
Issues						44,730	44,730	49,434
Loans, other payables and other financial liabilities	2,562	1,070	105	3,527		11,420	15,052	15,212
Total financial liabilities	2,562	1,070	105	3,527		56,150	59,782	64,646

Table of Contents

2014 Consolidated Financial Statements

December 31, 2013

Millions of euros	Fair value through profit or loss		Measurement hierarchy				Total carrying amount	Total fair value
	Held for trading	Fair value option Hedges	Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)	Liabilities at amortized cost		
Issues							43,418	46,120
Loans, other payables and other financial liabilities	1,315	1,631	111	2,835			14,335	17,401
Total financial liabilities	1,315	1,631	111	2,835			57,753	63,521

The calculation of the fair values of the Telefónica Group's debt instruments required an estimate, for each currency and subsidiary, of the credit spread curve using the prices of the Group's bonds and credit derivatives.

At December 31, 2014, some of the financing arranged by Telefónica Group companies in Latin America (Brazil, Colombia, Chile and Panama), which amount to approximately 5% of the Telefónica Group's gross debt was subject to compliance with certain financial covenants. To date, these covenants are being met. Due to the absence of cross-defaults, breach of the covenants would not affect the debt at a Telefónica, S.A. level.

Part of the amount owed by the Telefónica Group includes restatements to amortized cost at December 31, 2014 and 2013 as a result of fair value interest rate and exchange rate hedges.

a) Issues

The movement in issues of debentures, bonds and other marketable debt securities in 2014 and 2013 is as follows:

Millions of euros	Debt and Short-term promissory		Other non-Current	Total
	bond issues	notes and commercial paper	Marketable debt securities	
Balance at 12/31/12	44,142	1,128	59	45,329
New issues	5,634	195		5,829
Redemptions, conversions and exchanges	(5,667)	(45)		(5,712)

Revaluation and other movements	(2,029)	1		(2,028)
Balance at 12/31/13	42,080	1,279	59	43,418
New issues	4,453	27		4,480
Redemptions, conversions and exchanges	(5,057)	(805)	(59)	(5,921)
Revaluation and other movements	2,751	2		2,753
Balance at 12/31/14	44,228	502		44,730

Debentures and bonds

At December 31, 2014, the nominal amount of outstanding debentures and bonds issues was 42,083 million euros (41,036 million euros at December, 31, 2013). Appendix III presents the characteristics of all outstanding debentures and bond issues at year-end 2014, as well as the significant issues made in the year.

Telefónica, S.A. has a full and unconditional guarantee on issues made by Telefónica Emisiones, S.A.U., Telefónica Finanzas México, S.A. de C.V., Telefónica Europe, B.V. and Telefónica Participaciones, S.A.U., all of which are, directly or indirectly, wholly-owned subsidiaries of Telefónica, S.A.

Table of Contents

2014 Consolidated Financial Statements

Short-term promissory notes and commercial paper

The main programs for issuance of promissory notes and commercial paper are the following:

At December 31, 2014, Telefónica Europe, B.V., had a program for issuance of commercial paper, guaranteed by Telefónica, S.A., for up to 3,000 million euros. The outstanding balance of commercial paper issued under this program at December 31, 2014 was 496 million euros, issued at an average interest rate of 0.36% for 2014 (920 million euros issued in 2013 at an average rate of 0.42%).

At December 31, 2014, Telefónica, S.A. had a corporate promissory note program for 500 million euros, which can be increased to 2,000 million euros, with an outstanding balance at that date of 6 million euros (359 million euros in 2013).

Other long-term marketable debt securities

On October 31, 2012, an offer to purchase the preferred securities of Telefónica Finance USA, LLC. was launched. Holders accepting such offer would receive, concurrently and in connection with, Telefónica's ordinary shares and they would subscribe new debt securities of Telefónica. As a result of this offer, on November 29, 2012, the Group purchased 1,941,235 preferred securities (representing 97.06% of total). On June 30, 2014, the remaining 58,765 preferred securities were fully redeemed at face value of 1,000 euros. There were no outstanding preferred securities after this redemption.

b) Interest-bearing debt

The average interest rate on outstanding loans and other payables at December 31, 2014 was 2.88% (3.43% in 2013). This percentage does not include the impact of hedges arranged by the Group.

The main financing transactions included under Interest-bearing debt outstanding at December 31, 2014 and 2013 and their nominal amounts are provided in Appendix V.

Interest-bearing debt arranged or repaid in 2014 mainly includes the following:

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 and originally scheduled to mature 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 and originally scheduled to mature on December 14, 2015. This financing was guaranteed by Telefónica, S.A.

On February 18, 2014, Telefónica, S.A. signed a 3,000 million euros syndicated revolving credit facility maturing on February 18, 2019. This agreement entered into effect on February 25, 2014 cancelling the 3,000 million euros syndicated credit facility (Tranche B) signed on July 28, 2010 (originally scheduled to mature in 2015). At December 31, 2014 there was no outstanding amount under this facility.

On June 26, 2014, Telefónica, S.A. signed a 2,000 million euros bilateral loan maturing on June 26, 2017. At the same date it was fully disbursed.

On August 28, 2014, Telefónica Europe, B.V. cancelled 356 million US dollars (293 million euros) of the limit of its bilateral loan on supplies of 1,200 million US dollars (988 million euros) with an outstanding balance at December 31, 2014 that amounted to 844 million US dollars (695 million euros).

During 2014, Telefónica, S.A., made an early repayment for 1,672 million euros of its syndicated loan, Tranche A3, dated July 28, 2010 and originally scheduled to mature on July 28, 2016. As of December 31, 2014 the outstanding balance of this financing was 328 million euros (2,000 million euros in 2013).

Telefónica, S.A. 59

Table of Contents

2014 Consolidated Financial Statements

During 2014, Telefónica, S.A. repaid in full its syndicated loan (Tranche A2) of 2,000 million euros dated July 28, 2010 and originally scheduled to mature on July 28, 2014. At the same time, its *forward start facilities* (Tranche A2A and A2B) dated February 22, 2013 and available as of July 28, 2014 were fully canceled.

During 2014, Telefónica, S.A. drew down an aggregate principal amount of 310 million US dollars (255 million euros) of its bilateral loan on supplies of 1,001 million US dollars (825 million euros); the outstanding balance at December 31, 2014 amounted to 694 million US dollars (571 million euros). At December 31, 2014, the Telefónica Group presented availabilities of financing from different sources amounting to 11,545 million euros (13,197 million euros at December 31, 2013).

Loans by currency

The breakdown of Loans and other payables by currency at December 31, 2014 and 2013, along with the equivalent value of foreign-currency loans in euros, is as follows:

Currency	Outstanding balance (in millions)			
	Currency		Euros	
	12/31/14	12/31/13	12/31/14	12/31/13
Euro	5,077	7,918	5,077	7,918
US dollar	3,683	3,622	3,033	2,626
Brazilian Real	3,010	3,667	933	1,135
Colombian Peso	5,592,388	5,377,545	1,925	2,024
Pounds Sterling	140	189	180	227
Other currencies			272	405
Total Group			11,420	14,335

Telefónica, S.A. 60

Table of Contents

2014 Consolidated Financial Statements

Note 14. Trade and other payables

The composition of Trade and other payables is as follows:

Millions of euros	12/31/2014		12/31/2013	
	Non-current	Current	Non-current	Current
Trade payables		8,770		8,144
Other payables	1,500	6,008	1,324	5,146
Deferred revenue	877	1,441	377	1,353
Payable to associates and joint ventures (Note 9)		724		578
Total	2,377	16,943	1,701	15,221

Deferred revenue principally includes the amount of deferred revenue from sales of prepaid cards, from handsets transferred to the distributor, rights of use on the cable network, activation fees not yet recognized in the income statement and loyalty campaigns.

At December 31, 2014, non-current Other payables comprise the deferred portion of the payment for acquiring the spectrum use license in Mexico in 2010, for an equivalent of 849 million euros (856 million euros at December 31, 2013), and the deferred portion of the payment for the refarming of the radioelectric spectrum acquired in 2014 by Telefónica Brasil, amounting to 237 million euros (see Appendix VII).

The detail of current Other payables at December 31, 2014 and 2013 is as follows:

Millions of euros	Balance at 12/31/2014	Balance at 12/31/2013
Dividends pending payment to non-controlling interests	231	228
Payables to suppliers of property, plant and equipment	3,890	3,248
Short term debt for spectrum acquisition	272	211
Accrued employee benefits	821	745
Advances received on orders	216	126
Other non-financial non-trade payables	578	588
Total	6,008	5,146

Information on average payment period to suppliers of Spanish companies

The Telefónica Group's Spanish companies have adapted their internal processes and payment schedules to the provisions of Law 15/2010 (amended by Law 31/2014) and Royal Decree-Law 4/2013, amending Law 3/2004, which

establishes measures against late payment in commercial transactions. Engagement conditions with commercial suppliers in 2014 included payment periods of up to 60 days, according to the terms agreed between the parties.

For efficiency purposes and in line with general business practice, the Telefónica Group's companies in Spain have agreed payment schedules with suppliers, whereby most of the payments are made on set days of each month. Invoices falling due between two payment days are settled on the following payment date in the schedule.

Payments to Spanish suppliers in 2014 and 2013 surpassing the established legal limit were the result of circumstances or incidents beyond the payment policies, mainly the delay in issuing invoices (legal obligation of the supplier), the closing of agreements with suppliers over the delivery of goods or the rendering of services, or occasional processing issues.

Table of Contents

2014 Consolidated Financial Statements

Information of payments to commercial suppliers that exceed the maximum period established in the Spanish Law is as follows:

Millions of euros	2014		2013	
	Amount	%	Amount	%
Payments within allowable period	5,408	95.0	5,897	94.0
Other	277	5.0	375	6.0
Total payments to commercial suppliers	5,685	100.0	6,272	100.0
Weighted average days past due	28		35	
Deferrals at year-end that exceed the limit (*)	11		17	

(*) At the date of authorization for issue of these consolidated financial statements, the Group had made the outstanding payments, except in exceptional cases where an agreement with suppliers was being negotiated. According to such criteria, the average payment period to suppliers of the Telefónica Group's companies in Spain in 2014, according to our best estimates, amounted to 51 days.

Telefónica, S.A. 62

Table of Contents

2014 Consolidated Financial Statements

Note 15. Provisions

The amounts of provisions in 2014 and 2013 are as follows:

Millions of euros	12/31/2014			12/31/2013		
	Current	Non-current	Total	Current	Non-current	Total
Employee benefits	1,021	3,426	4,447	763	3,722	4,485
Termination plans	956	2,430	3,386	703	2,762	3,465
Post-employment defined benefit plans		872	872		799	799
Other benefits	65	124	189	60	161	221
Other provisions	574	3,254	3,826	508	2,578	3,086
Total	1,595	6,680	8,275	1,271	6,300	7,571

The Group made a provision in 2014 amounting to 652 million euros for employee restructuring costs and other non recurring costs, with the aim of enhancing the company's future efficiency (adjusting the structure to reduce complexity and gain agility in execution).

Termination plans

The movement in provisions for post-employment plans in 2014 and 2013 is as follows:

Millions of euros	Total
Provisions for post-employment plans at 12/31/12	4,151
Additions	68
Retirements/amount applied	(688)
Transfers	(4)
Translation differences and accretion	(62)
Provisions for post-employment plans at 12/31/13	3,465
Additions	525
Retirements/amount applied	(733)
Transfers	(14)
Inclusion of companies	12
Translation differences and accretion	131
Provisions for post-employment plans at 12/31/14	3,386

Telefónica Germany

Within the context of transformation of Telefónica Deutschland following the purchase of E-Plus (see Note 5) in a bid to increase profitability by securing operational synergies, an employee restructuring plan is being carried out in

respect of which a provision of 321 million euros was recorded in 2014. The plan is expected to reduce 1,600 of the approximately 9,100 current full-time positions of Telefonica Deutschland in the period from 2015-2018.

Telefónica Spain

In the last few years, the Telefónica Group carried out early retirement plans in order to adapt its cost structure to the prevailing environment in the markets where it operates, making certain strategic decisions relating to its size and organization.

Concerning the 2003-2007 labor force reduction plan in Telefónica de España, concluded with 13,870 employees taking part, provisions recorded at December 31, 2014 and 2013 amounted to 454 and 701 million euros, respectively.

Table of Contents

2014 Consolidated Financial Statements

Concerning the 2011-2013 labor force reduction plan in Telefónica de España, concluded with 6,830 employees taking part, provisions recorded at December 31, 2014 and 2013 amounted to 2,097 and 2,366 million euros, respectively.

The companies bound by these commitments calculated provisions required at 2014 and 2013 year-end using actuarial assumptions pursuant to current legislation, including the PERM/F- 2000 C mortality tables and high quality credit market based interest rate.

The discount rate used for these provisions at December 31, 2014, was 0.97%, with an average length of the plans of 3.9 years.

Post-employment defined benefit plans

The Group has a number of defined-benefit plans in the countries where it operates. The following tables present the main data of these plans:

12/31/2014

Millions of euros	United			Hispano			Total
	Spain	Kingdom	Germany	Brazil	américa	Others	
Obligation	593	1,529	201	239	37	11	2,610
Assets		(1,567)	(112)	(145)		(11)	(1,835)
Net provision before asset ceiling	593	(38)	89	94	37		775
Asset ceiling				42		3	45
Net provision	593	9	89	141	37	3	872
Net assets		47		5			52

12/31/2013

Millions of euros	United			Hispano			Total
	Spain	Kingdom	Germany	Brazil	américa	Others	
Obligation	567	1,251	93	211	93	9	2,224
Assets		(1,236)	(91)	(146)		(6)	(1,479)
Net provision before asset ceiling	567	15	2	65	93	3	745
Asset ceiling			3	45			48
Net provision	567	15	5	116	93	3	799
Net assets				6			6

Table of Contents

2014 Consolidated Financial Statements

The movement in the present value of obligations in 2014 and 2013 is as follows:

Millions of euros	United			Hispano			Total
	Spain	Kingdom	Germany	Brazil	américa	Other	
Present value of obligation at 12/31/12	654	1,139	81	298	76	9	2,257
Translation differences		(21)		(43)	(39)		(103)
Current service cost	2	4	3	3	44		56
Past service cost		(4)					(4)
Interest cost	12	49	3	24	6		94
Actuarial losses and gains	(49)	106	7	(58)	22		28
Benefits paid	(52)	(22)	(1)	(13)	(16)		(104)
Present value of obligation at 12/31/13	567	1,251	93	211	93	9	2,224
Translation differences		95		(1)	(68)	1	27
Current service cost	3		4	1	11		19
Interest cost	15	58	4	23	2		102
Actuarial losses and gains	59	147	47	19	4	1	277
Benefits paid	(51)	(22)	(2)	(14)	(5)		(94)
Inclusion of companies			55				55
Present value of obligation at 12/31/14	593	1,529	201	239	37	11	2,610

Movements in the fair value of plan assets in 2014 and 2013 are as follows:

Millions of euros	United				Total
	Kingdom	Germany	Brazil	Other	
Fair value of plan assets at 12/31/12	1,191	76	225	6	1,498
Translation differences		(27)		(32)	(59)
Expected return on plan assets	54	2	18		74
Actuarial losses and gains	(19)		(57)		(76)
Company contributions	59	14	3		76
Benefits paid	(22)	(1)	(11)		(34)
Fair value of plan assets at 12/31/13	1,236	91	146	6	1,479
Translation differences		95		2	97
Expected return on plan assets	59	4	17	1	81
Actuarial losses and gains	118	(1)	(6)	1	112
Company contributions	81	9		1	91
Benefits paid	(22)	(2)	(12)		(36)
Inclusion of companies			11		11
Fair value of plan assets at 12/31/14	1,567	112	145	11	1,835

The amount in Inclusion of companies corresponds to the post-employment defined benefit plan of E-Plus employees (see Note 5).

Table of Contents

2014 Consolidated Financial Statements

The Group's principal defined-benefit plans are:

a) ITP (Spain)

Telefónica Spain reached an agreement with its employees whereby it recognized supplementary pension payments for employees who had retired as of June 30, 1992, equal to the difference between the pension payable by the social security system and that which would be paid to them by ITP (Institución Telefónica de Previsión). Once the aforementioned supplementary pension payments had been quantified, they became fixed, lifelong and non-updateable and 60% of the payments are transferable to the surviving spouse, recognized as such as of June 30, 1992, and to underage children.

The amount for this provision totaled 326 million euros at December 31, 2014 (334 million euros at December 31, 2013).

b) Survival (Spain)

Serving employees who did not join the defined pension plan are still entitled to receive survivorship benefits at the age of 65.

The amount for this provision totaled 267 million euros at December 31, 2014 (233 million euros at December 31, 2013).

As detailed in Note 13, the Group has long term financial assets to cover the obligations of these two defined benefit plans.

The discount rate used for these provisions at December 31, 2014, was 1.49%, with an average length of the plans of 10 years.

The main actuarial assumptions used in valuing these plans are as follows:

	Survival		ITP	
	12/31/2014	12/31/2013	12/31/2014	12/31/2013
Discount rate	0.494%-2.011%	0.683%-3.286%	0.494%-2.011%	0.683%-3.286%
Expected rate of salary increase	0%-0.5%	0.00%		
Mortality tables	PERM/F-2000C - OM77	PERM/F-2000C - OM77	90% PERM 2000C/98% PERF 2000 C	90% PERM 2000C/98% PERF 2000 C

The table below shows the sensitivity of the value of termination and post-employment obligations of Telefónica Group companies in Spain to changes in the discount rate:

-100 b.p.		+100 b.p.	
Impact on value	Impact on income statement	Impact on value	Impact on income statement
-146	-94	134	89

Variations of less than -100bp are considered for terms of less than five years to prevent negative rates.

A 100 b.p. increase in the discount rate would reduce the value of the liabilities by 134 million euros and have a positive impact on income statement of 89 million euros before tax. However, a 100 b.p. decrease in the discount rate would increase the value of the liabilities by 146 million euros and have a negative impact on income statement of 94 million euros before tax.

The Telefónica Group actively manages this position and has arranged a derivatives portfolio to minimize the impact of changes in the discount rate (see Note 16).

Telefónica UK Pension Plan

The Telefónica UK Pension Plan provides pension benefits to the various companies of the Telefónica Group in UK coming from the O2 Group. The Plan is comprised of defined contribution and defined benefit

Table of Contents

2014 Consolidated Financial Statements

sections. The defined benefit sections were closed to future accrual with effect from February 28, 2013. The companies continued to provide retirement benefits through the defined contribution sections of the Plan.

The number of beneficiaries of these plans at December 31, 2014 and 2013 are 4,563 and 4,572 respectively. At December 31, 2014, the weighted average duration of the Plan was 23 years.

The main actuarial assumptions used in valuing the Plan are as follows:

	12/31/2014	12/31/2013
Nominal rate of pension payment increase	3.05%	3.25%
Discount rate	3.70%	4.50%
Expected inflation	3.20%	3.40%
Mortality tables	95% S2NA, CMI 2014 1%	S1NA_L, CMI 2013 1%

Fair value of Plan assets is as follows:

Millions of euros	12/31/2014	12/31/2013
Shares	328	259
Bonds	1,205	977
Cash equivalents	34	
Total	1,567	1,236

At December 31, 2014, reasonably possible changes to one of the following actuarial assumptions, holding other assumptions constant, would have affected the defined benefit obligation by the amounts shown below:

Millions of euros	Increase in defined benefit obligation
Discount rate (0.25% decrease)	90
Expected inflation (0.25% increase)	78
Life expectancy (1 year longer)	36

Telefónica Brazil pension plans

Telefónica Brazil and its subsidiaries had various pension plan, medical insurance and life insurance obligations with employees.

The main actuarial assumptions used in valuing these plans are as follows:

	12/31/2014	12/31/2013
Discount rate	11.17% - 11.31%	10.77%
Nominal rate of salary increase	6.69%	6.18%
Expected inflation	5.00%	4.50%
Cost of health insurance	8.15%	7.64%
Mortality tables	AT 2000 M/F	AT 2000 M/F

In addition, Telefónica Brazil, along with other companies resulting from the privatization of Telebrás (Telecomunicações Brasileiras, S.A.) in 1998, adhered to PBS-A, a non-contribution defined benefit plan managed by Fundação Sistel de Seguridade Social, whose beneficiaries are employees that retired prior to January 31, 2000. At December 31, 2014 net plan assets amounted to 999 million Brazilian reais (918 million Brazilian reais at December 31, 2013), equivalent to 310 million euros (284 million euros at December 31, 2013). This plan does not have an impact on the consolidated statement of financial position, given that recovery of the assets is not foreseeable.

Telefónica, S.A. 67

Table of Contents

2014 Consolidated Financial Statements

The valuations used to determine the value of obligations and plan assets, where appropriate, were performed as of December 31, 2014 by external and internal actuaries. The projected unit credit method was used in all cases.

Other provisions

The movement in Other provisions in 2014 and 2013 is as follows:

	Millions of euros
Other provisions at December 31, 2012	3,392
Additions and accretion	968
Retirements/amount applied	(735)
Translation differences and other	(539)
Other provisions at December 31, 2013	3,086
Additions and accretion	1,149
Retirements/amount applied	(853)
Inclusion of companies	197
Translation differences and other	249
Other provisions at December 31, 2014	3,828

With respect to the European Commission Decision of July 4, 2007 concerning Telefónica Spain's broadband pricing policy, on July 10, 2014 the European Union Court of Justice dismissed the appeal submitted by Telefónica, S.A. and Telefónica de España, maintained the fine and terminated the appeal (see Note 21). Consequently the Group paid a fine of 152 million euros and 58 million euros of interest. Provision for this item totaled 205 million euros at December 31, 2013.

In addition to the employee restructuring plan in Telefonica Deutschland described above, this company made a provision of 87 million euros in 2014, primarily to cover the costs linked to the cancellation of certain contracts as a result of the integration with E-Plus (see Note 5).

Other provisions include the provisions for dismantling of assets recognized by Group companies in the amount of 883 million euros (483 million euros at the 2013 year end), of which 501 million euros correspond to Telefonica Germany (79 million euros at the 2013 year end).

At December 31, 2014, Telefónica Brazil has the following provisions for an amount of 1,501 million euros equivalent to cover the risks to which it is exposed:

Provisions for disputes regarding federal, state and municipal taxes totaling approximately 813 million euros (735 million euros at December 31, 2013).

Provisions for labor-related contingencies of approximately 315 million euros (307 million euros at December 31, 2013), which basically relate to claims filed by former and outsourced employees.

Civil claims by private consumers and consumer associations regarding services rendered, and other legal proceedings related with normal operations. Certain administrative proceedings are also in progress concerning disputes about obligations established in sector regulations. The amount accrued for these matters totals approximately 373 million euros (303 million euros at December 31, 2013).

Given the nature of the risks covered by these provisions, it is not possible to determine a reliable schedule of potential payments, if any.

Table of Contents

2014 Consolidated Financial Statements

Note 16. Derivative financial instruments and risk management policies

The Telefónica Group 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 Group companies are as follows:

Exchange rate risk

Exchange rate risk arises primarily from: (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 (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 long-term 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

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

Finally, the Telefónica Group 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 the Telefónica Group operates, especially in Latin America.

Risk management

The Telefónica Group 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, it attempts to protect the Telefónica Group's solvency, facilitate financial planning and take advantage of investment opportunities.

The Telefónica Group manages its exchange rate risk and interest rate risk in terms of net debt and net financial debt as calculated by them. The Telefónica Group 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 the Telefónica Group should be considered an alternative to gross financial debt (the sum of current and non-current interest-bearing debt) as a measure of liquidity.

For a more detailed description on reconciliation of net debt and net financial debt to gross financial debt, see Note 2.

Table of Contents

2014 Consolidated Financial Statements

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. This objective is also reflected on the decrease of the sensitivity to exchange rate variations of the net debt to OIBDA ratio, in order to protect the Group solvency. The degree of exchange rate hedging employed varies depending on the type of investment. For transactions of purchase or sale of business in currencies other than euro, additional hedges can be made on the estimate prices of the transactions or on estimated cash flows and OIBDA.

At December 31, 2014, net debt in Latin American currencies was equivalent to approximately 8,379 million euros. However, the Latin American currencies in which this debt is denominated is not distributed in proportion to the cash flows generated in each currency. The future effectiveness of the strategy described above as a hedge of exchange rate risks therefore depends on which currencies depreciate relative to the euro.

Telefónica occasionally takes out dollar-denominated debt to hedge the euro-dollar intermediate component in the relation Euro-Latin American currencies, 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, 2014, the Telefónica Group's net debt denominated in dollars was equivalent to 1,254 million euros.

At December 31, 2014, pound sterling-denominated net debt was approximately 1.82 times the value of the 2014 operating income before depreciation and amortization (OIBDA) from the business in the United Kingdom, helping to reduce the sensitivity of the Telefónica Group net debt over OIBDA ratio to changes in the value of the pound sterling against euro. Pound sterling-denominated net debt at December 31, 2014, was equivalent to 3,043 million euros, lower than the 3,342 million euros at December 31, 2013.

After the completion of the sale of Telefónica Czech Republic a.s, the exchange rate risk in Czech crowns is limited only to deferred price amounts which as of December 31, 2014 are totally hedged.

The Telefónica Group also manages exchange rate risk 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.

Exchange rate management in 2014 produced a negative impact in the amount of 293 million euros (disregarding the effect of monetary correction), mainly due to the fluctuation in the exchange rate of the Venezuelan bolivar from 6.30 to 49.988 bolivars per dollar and, to a lesser extent, the difficulty in covering commercial positions in US dollars in Argentina, compared to the negative impact of 111 million euros recognized in 2013.

The following table illustrates the sensitivity of foreign currency gains and losses and of equity to changes in exchange rates, where: a) in calculating the impact on the income statement, the exchange rate position affecting the income statement at the end of 2014 was considered constant during 2015; b) in calculating the impact on equity, only monetary items have been considered, namely debt and derivatives such as hedges of net investment and loans to subsidiaries related to the investment, whose breakdown is considered constant in 2015 and identical to that existing at the end of 2014. In both cases, Latin American currencies are assumed to depreciate against the dollar and the rest of the currencies against the euro by 10%.

Telefónica, S.A. 70

Table of Contents

2014 Consolidated Financial Statements

Millions of euros

Currency	Change	Impact on the consolidated income statement	Impact on consolidated equity
All currencies vs EUR	10%	76	(284)
USD vs EUR	10%	2	(107)
European currencies vs EUR	10%	1	(230)
Latin American currencies vs USD	10%	73	53
All currencies vs EUR	(10)%	(76)	284
USD vs EUR	(10)%	(2)	107
European currencies vs EUR	(10)%	(1)	230
Latin American currencies vs USD	(10)%	(73)	(53)

The exchange position of the Venezuelan bolivar affects the estimates made by the Group of the net asset value of the foreign currency position related to investments in Venezuela, the negative impact of which on the 2014 financial statements amounted to 271 million euros.

The Group's monetary position in Venezuela at December 31, 2014 is a net creditor position of 12,404 million Venezuelan bolivars (equivalent to approximately 204 million euros). It had a debtor position until July; nevertheless the average exposure in 2014 has been a creditor position, which led to a higher financial expense in the amount of 11 million euros due to the effect of the monetary correction for inflation during the year.

Interest rate risk

The Telefónica Group's financial expenses are exposed to changes in interest rates. In 2014, the rates applied to the largest amount of short-term debt were mainly based on the Euribor, the Brazilian SELIC, the US dollar and pound sterling Libor, the Mexican UDI and the Colombian UVR. In nominal terms, at December 31, 2014, 70% of Telefónica's net debt (or 70% of long-term net debt) was pegged to fixed interest rates for a period greater than one year, compared to 71% of net debt (74% of long-term net debt) in 2013. Of the remaining 30% (net debt at floating rates or at fixed rates maturing in under one year), 10 percentage points had interest rates collared in a period over one year (or 3% of long-term debt), while at December 31, 2013 this was the case for 11 percentage points of net debt at floating rates or with fixed rates maturing within one year (3% of long-term net debt).

In addition, early retirement liabilities were discounted to present value over the year, based on the curve for instruments with very high credit quality. The decrease in interest rates has increased the market value of these liabilities. However, this increase was nearly completely offset by the increase in the value of the hedges on these positions.

Net financial expense amounted to 2,822 million euros in 2014 (-1.6% year-on-year), and includes 293 million euros due to net negative foreign exchange differences primarily as a result of the Company's decision to adopt the SICAD II exchange rate of the Venezuelan bolivar. Excluding this effect, net financial expenses fell 8.2% year-on-year, mainly

due to a 9.1% reduction in the average debt, placing the effective cost of debt over the last twelve months at 5.40%, 6 basis points higher than in December 2013. The greater weight of debt in Latin America currencies and repayment and maturity of cheap debt in euros increases the average cost in 47 basis points, while the lowest rates in Latin America and Europe reduce it in 41 basis points.

To illustrate the sensitivity of financial expenses to variability in short-term interest rates, a 100 basis points increase in interest rates in all currencies in which Telefónica has financial positions at December 31, 2014 has been assumed, and a 100 basis points decrease in interest rates in all currencies except those currencies with low interest rates, in order to avoid negative rates (euro, pound sterling and the US dollar) and a constant position equivalent to that prevailing at the end of 2014.

To illustrate the sensitivity of equity to variability in interest rates, a 100 basis point increase in interest rates in all currencies and terms of the curve, in which Telefónica holds financial positions at December 31, 2014 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 fundamentally the only positions where changes in market value due to interest-rate fluctuations are recognized in equity.

Table of Contents

2014 Consolidated Financial Statements

Millions of euros

Change in basis points (bp)	Impact on consolidated income statement	Impact on consolidated equity
+100bp	(111)	370
-100bp	68	(113)

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 convertible or exchangeable instruments issued by Telefónica Group, from treasury shares and from equity derivatives.

According to the Share-based payments plans (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, 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.

In 2014 a new long-term incentive Plan consisting of the delivery of shares of Telefónica, S.A. aimed at members of the Executives of Telefónica Group was launched denominated Performance Share Plan (PIP). Furthermore 2014 Ordinary General Shareholders Meeting approved a Global incentive Telefónica, S.A. shares purchase Plan for the Employees of the Telefónica Group.

To reduce the risk associated with variations in share price under these plans, Telefónica could acquire instruments that replicate the risk profile of some of these plans as it was done in previous years.

In addition, the Group may use part of the treasury shares of Telefónica, S.A. held at December 31, 2014 to cover shares deliverable under the PIP or the 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.

At December 31, 2014, the average maturity of net financial debt (45,087 million euros) was 6.2 years.

At December 31, 2014, gross financial debt scheduled to mature in 2015 amounted to approximately 8,491 million euros (which includes the net position of derivative financial instruments and certain current

Telefónica, S.A. 72

Table of Contents

2014 Consolidated Financial Statements

payables). These maturities are lower than the amount of funds available, calculated as the sum of a) cash and cash equivalents and current financial assets other than those in Venezuela (367 million euros) and Telefónica participation in Telco's bond (principal amount of 1,225 million euros) totalling 7,869 million euros; b) annual cash generation projected for 2015, and c) undrawn credit facilities arranged with banks whose original maturity is over one year (an aggregate of more than 10,618 million euros at December 31, 2014), providing flexibility for the Telefónica Group with regard to accessing capital or credit markets in the next 12 months. For a further description of Telefónica Group's liquidity and capital resources in 2014, see note 13.2 Financial Liabilities and Appendix V.

Country risk

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

1. 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
2. Repatriating funds generated in Latin America that are not required for the pursuit of new, profitable business development opportunities in the region.

Regarding the first point, at December 31, 2014, the Telefónica Group's Latin American companies had net debt not guaranteed by the parent company of 5,049 million euros, which represents 10.7% of net debt. Nevertheless, in certain countries, such as Venezuela, there is a net cash balance (instead of a net liability balance).

Regarding the repatriation of funds to Spain, 1,118 million euros from Latin America companies have been received in 2014, of which 961 million euros were from dividends and 157 million euros were for other items.

In this regard, it is worth noting that since February 2003, Venezuela has had an exchange control mechanism in place, managed by the Centro Nacional de Comercio Exterior (CENCOEX). The body has issued a number of regulations (*providencias*) governing the modalities of currency sales in Venezuela at official exchange rates. Foreign companies which are duly registered as foreign investors are entitled to request approval to acquire currencies at the official exchange rate by the CENCOEX, in line with regulation number 056, article 2, section c) Remittance of profits, income, interest and dividends from international investment Telefónica Venezolana, C.A. (formerly Telcel, C.A.), a Telefónica Group subsidiary in Venezuela, obtained the aforementioned requested approval on 295 million Venezuelan bolivars in 2006, 473 million Venezuelan bolivars in 2007 and 785 million Venezuelan Bolivars in 2008. At December 31, 2014, payment of two dividends agreed by the company in the amount of 5,882 million Venezuelan bolivars is pending approval by the CENCOEX.

Credit risk

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 or in case of Spanish entities in line with the credit rating of Kingdom of Spain. 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, the CDS (Credit Default Swap) 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, assuming a stable sovereign rating provides a ceiling which 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

Table of Contents

2014 Consolidated Financial Statements

framework sets: the maximum amounts to be invested by counterparty based on its rating (long-term debt rating); and 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 sustainable business and customer base growth targets in a manner that is consistent with Telefónica Corporate Risk Management Policy. This management approach relies on the active monitoring of the risk assumed and the resources necessary to grant the adequate risk-reward balance in the operations and the 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 consolidated 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 product and services available for the different customer profiles.

The Telefónica Group's maximum exposure to credit risk is initially represented by the carrying amounts of the financial assets (Notes 11 and 13) and the guarantees given by the Telefónica Group.

Several Telefónica Group companies provide operating guarantees granted by external counterparties, which are offered during their normal commercial activity, in bids for licenses, permits and concessions, and spectrum acquisitions. At December 31, 2014, these guarantees amounted to approximately 4,401 million euros.

Capital management

Telefónica's corporate finance department takes into consideration several factors for the evaluation of the Telefónica's capital structure, with the aim of maintaining the solvency and creating value to the shareholders.

The Corporate finance department estimates the cost of capital on a continuous basis through the monitoring of the financial markets and the applications of standard industry approaches for calculating weighted average cost of capital, or WACC, so that it can be applied in the valuation of businesses in course and in the evaluation of the investment projects. Telefónica also uses as reference a net financial debt ratio below 2.35x OIBDA in the medium term (excluding items of a non-recurring or exceptional nature), with the objective of protecting the credit rating over the medium term, and making this rating compatible with alternative uses of cash flow that could arise at any time.

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, that are considered when evaluating the financial structure of the Telefónica Group and its different areas.

Derivatives policy

At December 31, 2014, the nominal value of outstanding derivatives with external counterparties amounted to 193,152 million equivalent, a 17% increase from December 31, 2013 (164,487 million euros equivalent). This figure is inflated by the use in some cases of several levels of derivatives applied to the nominal value of a single underlying liability. For example, a foreign currency loan can be hedged into floating rate, and then each interest rate period can be fixed using a fixed rate hedge, or FRA (forward rate agreement). Even using such techniques to reduce the position, it is still necessary to take extreme care in the use of derivatives to avoid potential problems arising through error or a failure to understand the real position and its associated risks.

1) Derivatives based on a clearly identified underlying.

Telefónica's derivatives policy emphasizes the following points:

Acceptable underlyings include assets and liabilities, profits, revenues and cash flows in either a company's functional currency or another currency. These flows can be contractual (debt and interest payments,

Table of Contents

2014 Consolidated Financial Statements

settlement of foreign currency payables, etc.), reasonably certain or foreseeable (PP&E purchases, future debt issues, commercial paper programs, etc.). The acceptability of an underlying asset in the above cases does not depend on whether it complies with accounting rules requirements for hedge accounting, as is required in the case of certain intragroup transactions, for instance. Parent company investments in subsidiaries with functional currencies other than the euro also qualify as acceptable underlying assets.

Economic hedges, which are hedges with a designated underlying asset and which in certain circumstances offset fluctuations in the underlying asset value, do not always meet the requirements and effectiveness tests laid down by accounting standards for treatment as hedges. The decision to maintain positions that cease to qualify as effective or fail to meet other requirements will depend on the marginal impact on the income statement and how far this might compromise the goal of a stable income statement. In any event, the variations are recognized in the income statement.

2) Matching of the underlying to one side of the derivative.

This matching basically applies to foreign currency debt and derivatives hedging foreign currency payments by Telefónica Group subsidiaries. The aim is to eliminate the risk arising from changes in foreign currency interest rates. Nonetheless, even when the aim is to achieve perfect hedging for all cash flows, the lack of liquidity in certain markets, especially in Latin American currencies, has meant that historically there have been mismatches between the terms of the hedges and those of the debts they are meant to hedge. The Telefónica Group intends to reduce these mismatches, provided that doing so does not involve disproportionate costs. In this regard, if adjustment does prove too costly, the financial timing of the underlying asset in foreign currency will be modified in order to minimize interest rate risk in foreign currency.

In certain cases, the timing of the underlying as defined for derivative purposes may not be exactly the same as the timing of the contractual underlying.

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

Generally, the aim is to ensure that the hedging derivative and the hedged asset or liability belong to the same company. Sometimes, however, the holding companies (Telefónica, S.A. and Telefónica Internacional, S.A.) have arranged hedges on behalf of a subsidiary that owns the underlying asset. The main reasons for separating the hedge and the underlying asset were possible differences in the legal validity of local and international hedges (as a result of unforeseen legal changes) and the different credit ratings of the counterparties (of the Telefónica Group companies as well as those of the banks).

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

The Telefónica Group uses a number of tools to measure and manage risks in derivatives and debt. The main ones are Kondor+, licensed by Reuters, which is widely used by financial institutions, and MBRM specialist financial calculator libraries.

5) Sale of options only when there is an underlying exposure.

Telefónica considers the sale of options when: i) there is an underlying exposure (on the consolidated statement of financial position or associated with a highly probable cash outflow) that would offset the potential loss for the year if the counterparty exercised the option, or ii) the option is part of a structure in which another derivative offsets any loss. The sale of options is also permitted in option structures where, at the moment they are taken out, the net premium is either positive or zero.

For instance, it would be possible to sell short-term options on interest rate swaps that entitle the counterparty to receive a certain fixed interest rate, below the level prevailing at the time the option was sold. This would mean that if rates fell and the counterparty exercised its option, the Group would swap part of its debt from floating rate to a lower fixed rate, having received a premium.

6) Hedge accounting.

The main risks that may qualify for hedge accounting are as follows:

Table of Contents

2014 Consolidated Financial Statements

Variations in market interest rates (either money-market rates, credit spreads or both) that affect the value of the underlying asset or the measurement of the cash flows.

Variations in exchange rates that change the value of the underlying asset in the company's functional currency and affect the measurement of the cash flow in the functional currency.

Variations in the volatility of any financial variable, asset or liability that affect either the valuation or the measurement of cash flows on debt or investments with embedded options, whether or not these options are separable.

Variations in the valuation of any financial asset, particularly shares of companies included in the portfolio of Available-for-sale financial assets .

Regarding the underlying:

Hedges can cover all or part of the value of the underlying.

The risk to be hedged can be for the whole period of the transaction or for only part of the period.

The underlying may be a highly probable future transaction, or a contractual underlying (loan, foreign currency payment, investment, financial asset, etc.) or a combination of both that defines an underlying with a longer term.

This may on occasion mean that the hedging instruments have longer terms than the related contractual underlying. This happens when the Group enters into long-term swaps, caps or collars to protect ourselves against interest rate rises that may raise the financial expense of its promissory notes, commercial paper and some floating rate loans which mature earlier than their hedges. These floating rate financing programs are highly likely to be renewed and Telefónica commits to this by defining the underlying asset in a more general way as a floating rate financing program whose term coincides with the maturity of the hedge.

Hedges can be of three types:

Fair value hedges.

Cash flow hedges. Such hedges can be set at any value of the risk to be hedged (interest rates, exchange rates, etc.) or for a defined range (interest rates between 2% and 4%, above 4%, etc.). In this last case, the hedging instrument used is options and only the intrinsic value of the option is recognized as an effective hedge.

Hedges of net investment in consolidated foreign subsidiaries. Generally such hedges are arranged by the parent company and the other Telefónica holding companies. Wherever possible, these hedges are implemented through real debt in foreign currency. Often, however, this is not always possible as many Latin American currencies are non-convertible, making it impossible for non-resident companies to issue local currency debt. It may also be that the debt market in the currency concerned is too thin to accommodate the required hedge (for example, pounds sterling), or that an acquisition is made in cash with no need for market financing. In these circumstances derivatives, either forwards or cross-currency swaps are used to hedge the net investment.

Hedges can comprise a combination of different derivatives.

Management of accounting hedges is not static, and the hedging relationship may change before maturity. Hedging relationships may change to allow appropriate management that serves the Group's stated principles of stabilizing cash flows, stabilizing net financial income/expense and protecting 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, the Group analyzes 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 both prospectively and retrospectively.

Table of Contents

2014 Consolidated Financial Statements

The main guiding principles for risk management are laid down by Telefónica's Finance Department and implemented by company financial officers (who are responsible for balancing the interests of each company and those of the Telefónica Group). The Corporate Finance 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. New companies joining the Telefónica Group as a result of mergers or acquisitions may also need time to adapt.

The breakdown of the financial results recognized in 2014, 2013 and 2012 is as follows:

Millions of euros	2014	2013	2012
Interest income	553	613	557
Dividends received	5	11	28
Other financial income	228	203	276
Subtotal	786	827	861
Changes in fair value of financial assets at fair value through profit or loss	1,004	(427)	648
Changes in fair value of financial liabilities at fair value through profit or loss	(1,059)	388	(550)
Transfer from equity to profit and loss from cash flow hedges	(163)	(121)	(173)
Transfer from equity to profit and loss from available-for-sale assets and others		(52)	(50)
Gain/(loss) on fair value hedges	865	(935)	198
(Loss)/gain on adjustment to items hedged by fair value hedges	(796)	961	(145)
Subtotal	(149)	(186)	(72)
Interest expenses	(2,556)	(2,898)	(3,094)
Ineffective portion of cash flow hedges			1
Accretion of provisions and other liabilities	(400)	(201)	(469)
Other financial expenses	(200)	(238)	(289)
Subtotal	(3,156)	(3,337)	(3,851)
Net finance costs excluding foreign exchange differences and hyperinflationary adjustments	(2,519)	(2,696)	(3,062)

Table of Contents

2014 Consolidated Financial Statements

The breakdown of Telefónica's derivatives at December 31, 2014, their fair value at year-end and the expected maturity schedule is as set forth in the table below:

2014

Millions of euros	Fair value (**)	Notional amount Maturities (*)				
		2015	2016	2017	Subsequent years	Total
Derivatives						
Interest rate hedges	(482)	(1,384)	1,877	292	(3,502)	(2,717)
Cash flow hedges	648	(1,050)	706	460	3,265	3,381
Fair value hedges	(1,130)	(334)	1,171	(168)	(6,767)	(6,098)
Exchange rate hedges	(966)	7,784	3,141	913	3,799	15,637
Cash flow hedges	(964)	7,992	3,141	913	3,799	15,845
Fair value hedges	(2)	(208)				(208)
Interest and exchange rate hedges	(890)	(538)	422	64	1,495	1,443
Cash flow hedges	(592)	(373)	465	167	2,675	2,934
Fair value hedges	(298)	(165)	(43)	(103)	(1,180)	(1,491)
Net investment hedges	(121)	(1,436)	(750)	(60)		(2,246)
Other derivatives	(221)	7,957	51	(1,183)	(1,437)	5,388
Interest rate	34	7,893	452	(325)	(1,557)	6,463
Exchange rate	(145)	91	(401)	(108)	120	(298)
Others	(110)	(27)		(750)		