RAND CAPITAL CORP
Form DEF 14A
March 18, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

SCHEDULE 14A

(RULE 14a-101)

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities

Exchange Act of 1934 (Amendment No.)

Filed by the Registrant x

Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

x Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to §240.14a-12

Rand Capital Corporation

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

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(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

Rand Capital Corporation

2200 Rand Building

Buffalo, New York 14203

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

TO OUR SHAREHOLDERS

The 2014 Annual Meeting of Shareholders of Rand Capital Corporation will be held on Thursday, April 24 at 10:30 a.m. in Room 410, Rand Building, 14 Lafayette Square, Buffalo, New York, for the following purposes:

1. To elect six Directors to hold office until the next annual meeting of shareholders and until their successors have been elected and qualified.

2. To approve, by advisory vote, executive compensation.

3. To ratify the selection of Freed Maxick CPAs, P.C. as our independent registered public accounting firm for the year ending December 31, 2014.

4. To consider and act upon such other business as may properly come before the meeting.

Shareholders of record at the close of business on March 10, 2014 are entitled to notice of, and to vote at the meeting, and any adjournment thereof.

March 21, 2014
Buffalo, New York

By order of the Board of Directors,
Reginald B. Newman II
Chairman

IMPORTANT NOTICE REGARDING

INTERNET AVAILABILITY OF PROXY MATERIALS

FOR THE SHAREHOLDER MEETING TO BE HELD ON

APRIL 24, 2014

THE PROXY STATEMENT AND ANNUAL REPORT

TO SHAREHOLDERS IS AVAILABLE AT HTTP://MATERIALS.PROXYVOTE.COM/752185

Proxy 1

Rand Capital Corporation

2200 Rand Building

Buffalo, New York 14203

Proxy Statement

GENERAL INFORMATION

We are furnishing this Proxy Statement in connection with the solicitation of proxies by the Board of Directors of Rand Capital Corporation (Rand or the Corporation) for the Annual Meeting of Shareholders to be held on April 24, 2014. Only shareholders of record at the close of business on March 10, 2014 (Record Date) are entitled to notice of and to vote at the meeting, and at any adjournment thereof. On the Record Date, Rand had outstanding 6,411,918 Common Shares, par value $.10 per share (shares).

Each share entitles the holder to one vote. Shares cannot be voted at the meeting unless the shareholder is present or represented by proxy. If the enclosed form of proxy is returned properly executed, the shares represented thereby will be voted at the meeting in accordance with the instructions contained in the proxy, unless the proxy is revoked prior to its exercise. Any shareholder may revoke a proxy by executing a subsequently dated proxy or a notice of revocation, provided that the subsequent proxy or notice is delivered to us prior to the taking of a vote, or by voting in person at the meeting.

Under the New York Business Corporation Law (the BCL) and our by-laws, the presence, in person or by proxy, of the holders of a majority of the outstanding shares is necessary to constitute a quorum of the shareholders to take action at the Annual Meeting. The shares that are present at the meeting or represented by a proxy will be counted for quorum purposes. Proxies submitted with abstentions and broker non-votes will be counted in determining whether or not a quorum is present. Under the BCL and our by-laws, once a quorum is established, Directors standing for election may be elected by a plurality of the votes cast, and other matters expected to be brought before the meeting may be approved by a majority of votes cast. Votes withheld, broker non-votes, and abstentions will not be counted as votes cast on any matter and will have no effect on the results of the vote. A broker non-vote occurs when a broker holding shares for a beneficial owner does not vote on a particular proposal because the broker does not have discretionary voting power for that particular item and has not received instructions from the beneficial owner.

This Proxy Statement and accompanying form of proxy are being mailed to shareholders on or about March 21, 2014. A copy of Rand s 2013 Annual Report, which contains financial statements, accompanies this Proxy Statement.

We will bear the cost of soliciting proxies in the accompanying form. We do not expect to pay any compensation for the solicitation of proxies, but may pay brokers, nominees, fiduciaries and other custodians their reasonable fees and expenses for sending proxy materials to beneficial owners and obtaining their instructions. In addition to solicitation by mail, our Directors, officers and employees may solicit proxies in person or by telephone, and they will receive no additional compensation therefor.

Our office is located at 2200 Rand Building, Buffalo, New York 14203 and our telephone number is 716-853-0802.

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BENEFICIAL OWNERSHIP OF SHARES

Unless otherwise indicated, the following table sets forth beneficial ownership of our common shares on March 10, 2014, by (a) persons known by us to be beneficial owners of more than 5% of the outstanding shares, (b) the Directors, nominees for Director, and the executive officers of Rand, and (c) all Directors and executive officers as a group. Unless otherwise stated, each person named in the table has sole voting and investment power with respect to the shares indicated as beneficially owned by that person.

Beneficial Owner	Amount and Nature of Beneficial Ownership (1)	Percent of Class (4)
(a) More than 5% Owners:		
NSB Advisors LLC (NSB) 200 Westage Center Drive, Suite 228 Fishkill, NY	924,168(2)	14.4%
Colmac Holdings, Ltd. 8 King Street East, Suite 1901 Toronto, ON Canada	810,000	12.6%
Utility Service Holding Co. P.O. Box 120 Warthen, GA	742,977	11.6%
Lynn E. Gorguze 1200 Prospect Street, Suite 325 LaJolla, CA	465,657	7.3%
(b) Directors, nominees for Director and executive officers:		
Allen F. Grum	101,142	1.6%
Erland E. Kailbourne	20,000	0.3%
Ross B. Kenzie	100,000	1.6%
Reginald B. Newman II	189,538	3.0%
Jayne K. Rand	115,433	1.8%
Robert M. Zak	40,000	0.6%
Daniel P. Penberthy	67,800	1.1%
(c) All Directors and executive officers as a group (seven persons)	633,913(3)	9.9%

(1) The beneficial ownership information presented is based upon information furnished by each person or contained in filings made with the Securities and Exchange Commission (SEC).
(2) Shares are owned by clients of NSB Advisors LLC, an SEC-registered investment adviser. NSB has shared investment power but no voting power with respect to the shares. Shares were reported on a Form 13F filed with the SEC by NSB Advisors LLC on February 14, 2014.
(3) Members of the group have sole voting and investment power over these shares.
(4) Percent of Class calculated based on 6,411,918 common shares outstanding at Record Date.

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PROPOSAL 1. ELECTION OF DIRECTORS

Six Directors are to be elected at the Annual Meeting of Shareholders. The six nominees were elected at the last Annual Meeting of Shareholders.

Each of the nominees was elected to the Board of Directors at Rand s last Annual Meeting of Shareholders and was recommended for re-election by the Governance and Nominating Committee, which is comprised of non-employee, independent Directors. Each of the nominees has consented to serve as a Director if elected. If at the time of the meeting any nominee should be unable to serve, it is the intention of the persons designated as proxies to vote, in their discretion, for such other person as may be designated as a nominee by the Board of Directors.

Director Independence

The Board of Directors affirmatively determined that the five non-employee Directors, Erland E. Kailbourne, Ross B. Kenzie, Reginald B. Newman II, Jayne K. Rand and Robert M. Zak are Independent Directors under the rules of the SEC and under the rules and guidelines of the NASDAQ Stock Market including without limitation Rule 5605(a)(2) and, therefore, that a majority of a corporation s six-person Board of Directors is currently independent as so defined. The Board of Directors has determined that there are no relationships between Rand and the Directors classified as independent other than service on its Board of Directors and compensation paid to Directors.

The nominees for the 2014 Election of Directors have been selected by Rand s independent Board of Directors upon the recommendation of Rand s Governance and Nominating Committee comprised solely of independent Directors in compliance with NASDAQ Rule 5605(e)(1).

One of the Directors, Allen F. Grum, is not an independent Director. Mr. Grum is deemed to be an Interested Person under Section 2(a)(19) of the Investment Company Act of 1940, as amended (the Investment Company Act), with respect to Rand because he is an executive officer of Rand. Persons who are Interested Persons are not independent Directors under the rules and guidelines of the NASDAQ Stock Market.

The independence determination of the Board of Directors under the SEC rules and under the NASDAQ Stock Market rules and guidelines also included conclusions that:

- each of the members of the Audit Committee, the Governance and Nominating Committee, and the Compensation Committee are independent under the standards described above for purposes of membership on each of those committees;

- the 2013 compensation of the executive officers was determined by a majority of the independent Directors of the Board; and

- each of the members of the Audit Committee also meets the additional independence requirements under SEC Rule 10A-3(b) and NASDAQ Rule 5605(a)(2).

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each of the members of the Compensation Committee also meet the independence requirements under the rules and guidelines of the NASDAQ Stock Market, including without limitation, NASDAQ Rule 5605(d) and 5605(a)(2).

Rand s Chairman, Mr. Newman, serves as chair of meetings of the Independent Directors. It is currently contemplated that executive sessions of the Independent Directors will occur at least twice during the fiscal year ending December 31, 2014, in addition to separate meetings of standing committees of the Board of Directors.

Board Leadership Structure

Reginald B. Newman II has served as Chairman of the Board of the Corporation since 1996 and is not an Interested Person under Section 2(a)(19) of the Investment Company Act with respect to Rand. His long standing business experience is invaluable to the Corporation s Board discussions. Allen F. Grum has served as President since 1996 and is an Interested Person under Section 2(a)(19) of the Investment Act with respect to Rand. The Corporation believes that separating the Chairman and President (CEO) roles provides independent oversight of the Corporation, enhanced leadership to the independent Directors, and a check on management, and results in high corporate governance standards.

The Board s Role in Risk Oversight

The Board s role in the Corporation s risk oversight process consists of receiving regular reports from Rand s senior management on areas of material risk to the Corporation, including operational, financial, legal and regulatory, and strategic and reputational risks. The full Board (or the appropriate Committee in the case of risks that are under the purview of a particular Committee) reviews these reports from the Corporation to understand and provide input into management of these risks.

Shareholder Communications

Communications to an individual Director, to non-management Directors as a group, or to the entire Board, should be addressed as follows: Reginald B. Newman, II, Security Holder Board Communications, 2200 Rand Building, Buffalo, New York, 14203, with an indication of the individual or subgroup (if any) to whose attention the communication is directed. All security holder communications addressed in that manner will be delivered directly to Mr. Newman, who will receive communications for the Board and non-management Directors, and who will deliver the communication unopened to any individual indicated Director.

Meeting Attendance

All nominated Directors attended last year s Annual Meeting of Shareholders, and the current nominees are expected to do so this year. Directors are expected to attend the annual meeting of shareholders, but such attendance is not required.

Information Regarding Directors, Nominees for Director, and Officers

The following table provides information concerning all persons who are Directors, nominees for Director, or officers of Rand. Rand is not part of a fund complex.

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Name, Age and Address	**Position(s) held with Fund**	**Length of Time Served (1)**	**Business Experience and Occupations During Last Five Years**	**Other Director-ships (2)**
Directors who are Interested Persons (3)				
Allen F. Grum (56) c/o 2200 Rand Building Buffalo NY 14203	President of Rand and a Director	1996	President and Chief Executive Officer since 1996. Prior thereto, Mr. Grum served as Senior Vice President of Rand Capital Corporation commencing in June 1995. From 1994 to 1995, Mr. Grum was Executive Vice President of Hamilton Financial Corporation and from 1991-1994 he served as Senior Vice President of Marine Midland Mortgage Corporation. Mr. Grum serves on a number of Boards of Directors of companies in which Rand Capital Corporation has an investment. His in-depth knowledge of Rand Capital Corporation s operations, and the industries in which the Company operates makes Mr. Grum highly qualified to serve as a Director.	None
Directors who are not Interested Persons				
Erland E. Kailbourne (72) c/o 2200 Rand Building	Director	1999	Chairman of Albany International, Inc. since May 2009. Prior thereto, from January 2006 until May 2010,	Chairman of Albany International, Inc., Director of Financial Institutions, Inc. and its subsidiary Five Star

Buffalo, NY 14203	Mr. Kailbourne was Chairman of Financial Institutions, Inc. and its subsidiary Five Star Bank. He retired as Chairman and Chief Executive Officer (New York Region) of Fleet National Bank, a banking subsidiary of Fleet Financial Group, Inc., in 1998. From 1995 2000, he was Vice Chairman State University of New York (SUNY). He was Chairman and Chief Executive Officer of Fleet Bank, also a subsidiary of Fleet Financial Group, Inc., from 1993 until its merger into Fleet National Bank in 1997. He is a Director of the New York ISO, Financial Institutions, Inc. and Five Star Bank, Albany International Corporation, Allegany Co-op Insurance Company, Conemaugh Valley Insurance Company, and The Thomas and Laura Moogan Foundation. Mr. Kailbourne s extensive banking and financial experience provide necessary attributes as a Director of Rand.	Bank

Ross B. Kenzie (82) 1961 Wehrle Drive Suite 5 Buffalo, NY 14221	Director	1996	Mr. Kenzie has been retired since 1989. Prior thereto, he was the Chairman of the Board and Chief Executive Officer of Goldome Bank, Buffalo, NY, a savings bank, from 1980. Prior thereto, Mr. Kenzie was Executive Vice President and Director of Merrill Lynch Pierce Fenner & Smith as well as Merrill Lynch & Co. Mr. Kenzie is a former Director of Biophan Technologies, Inc. and Natural Nano, Inc., development companies specializing in highly marketable business devices and naturally occurring nanotube technologies; and a former Director of Merchants Mutual Insurance Company. Mr. Kenzie s banking and financial experience in addition to his involvement with emerging companies, provide invaluable expertise as a Director of Rand.	None
Reginald B. Newman II (76) 50 North Airport Drive Buffalo, NY 14225	Director and Chairman of Board	1987	Mr. Newman has been Chairman of the Board since 1996. Mr. Newman is the Chairman of Prior Aviation Service, Inc., the Fixed Base Operator (FBO) at Buffalo Niagara International Airport, Buffalo, NY. He is a Director of Dunn Tire LLC and Taylor Devices, Inc. and former Director of M&T Bank Corporation. Mr. Newman s involvement with small businesses provides necessary skills as a Director of Rand.	Director of Taylor Devices, Inc.

Jayne K. Rand (53) c/o 2200 Rand Building Buffalo, NY 14203	Director	1989	Since 1993, Miss Rand has been a Vice President of M&T Bank. Miss Rand s banking experience and credit underwriting abilities provide necessary expertise as a Director of Rand.	None
Robert M. Zak (56) 250 Main Street Buffalo, NY 14202	Director	2005	Since 1995, Mr. Zak has been President and Chief Executive Officer of Merchants Mutual Insurance Company, which operates under the trade name Merchants Insurance Group. Mr. Zak joined Merchants in 1985. Prior to that, his career was in public accounting. Mr. Zak s executive leadership and public accounting experience provide desirable attributes as a Director of Rand.	Director of Manning & Napier, Inc.
<u>Non-Director Officers</u>				
Daniel P. Penberthy (51) c/o 2200 Rand Building Buffalo, NY 14203	Executive Vice President and Treasurer of Rand	N/A	Mr. Penberthy has served as Treasurer of Rand since August 1997. Since January 2002, Mr. Penberthy has served as Executive Vice President, and he has continued to serve as the Chief Financial Officer since 1997. From 1993 to 1997, Mr. Penberthy served as Chief Financial Officer for both the Greater Buffalo Partnership (formerly the Chamber of Commerce) and the Greater Buffalo Convention and Visitors Bureau. Prior thereto, from 1990 to 1993, Mr. Penberthy was employed by Greater Buffalo Development Foundation and KPMG.	None

(1) Indicates initial year in which person became Director. All Directors terms of office will be through the next annual meeting of shareholders and until their successors have been elected and qualified.
(2) Indicates directorships of companies with a class of equity securities registered under Section 12 of the Securities Exchange Act, subject to the requirements of Section 15(d) of the Securities Exchange Act, or registered as an investment company under the Investment Company Act.
(3) Allen F. Grum is an officer of Rand, and is deemed to be an Interested Person under Section 2(a)(19) of the Investment Company Act.

The Board of Directors of the Company unanimously recommends a vote FOR the election of the nominees named in this Proxy Statement.

Approximate Value of Investments in Rand

The following table indicates the range of value as of March 10, 2014 of the common shares of Rand (the Fund) beneficially owned by each Director and nominee for Director of Rand. Rand is not part of a family of investment companies.

Name of Director or Nominee	Dollar Range of Equity Securities in the Fund
(a) Directors who are not Interested Persons:	
Erland E. Kailbourne	$50,000 - $100,000
Robert M. Zak	Over $100,000
Ross B. Kenzie	Over $100,000
Reginald B. Newman, II	Over $100,000
Jayne K. Rand	Over $100,000
(b) Directors who are Interested Persons:	
Allen F. Grum	Over $100,000

COMMITTEES AND MEETING DATA

The Committees of the Board of Directors have the following members:

Compensation Committee	Governance and Nominating Committee	Audit Committee
Robert M. Zak (Chair)	Erland E. Kailbourne (Chair)	Ross B. Kenzie (Chair)
Erland E. Kailbourne	Ross B. Kenzie	Erland E. Kailbourne
Jayne K. Rand	Jayne K. Rand	Robert M. Zak

In 2013, the full Board met on four occasions, the Audit Committee met five times, the Governance and Nominating Committee met twice and the Compensation Committee met once. All Directors attended 100% of the total number of meetings of the Board of Directors and the total number of meetings of Committees of the Board that the respective Director was eligible to attend during 2013.

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Compensation Committee

The Compensation Committee is comprised of independent Board members, each of whom meet the independence requirements of the NASDAQ Stock Market and applicable law, and advises the independent members of the Board of Directors with respect to the compensation of the executive officers and reviews the criteria that form the basis for management compensation. None of the persons on the Compensation Committee are Interested Persons as defined in Section 2(a)(19) of the Investment Company Act.

The compensation levels of Rand s President/CEO and Executive Vice President were recommended by Rand s Compensation Committee and approved by the independent members of the Board of Directors, representing a majority of its membership.

The Compensation Committee s Charter may be accessed at Rand s website, www.randcapital.com.

Governance and Nominating Committee

The primary purposes of the Governance and Nominating Committee include:

- developing, recommending to the Board and assessing corporate governance policies for Rand;
- overseeing the evaluation of the Board and its Committees;
- recommending to the Board of Directors the individuals qualified to serve on Rand s Board of Directors for election by shareholders at each annual meeting of shareholders, and recommending to the Board of Directors candidates to fill vacancies on the Board of Directors.

The Governance and Nominating Committee s Charter may be accessed at Rand s website, www.randcapital.com. None of the persons on the Governance and Nominating Committee are Interested Persons as defined in Section 2(a)(19) of the Investment Company Act. The Committee is comprised of members each of whom meet the independence requirements of the NASDAQ Stock Market.

Nomination of Directors

The Governance and Nominating Committee, as part of the responsibilities under its Charter, oversees the identification of qualified individuals to serve on the Board.

We seek Directors who have the required and appropriate skills and characteristics, including business experience and personal skills in finance, marketing, business and other areas that are expected to contribute to an effective board and who meet the criteria set forth in Rand s Corporate Governance Guidelines. We identify new Director candidates from prominent business persons and professionals in the communities Rand serves. We consider nominees of shareholders in the same manner as other nominees.

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If a Board vacancy occurs, the Governance and Nominating Committee may recommend a replacement candidate to the Board. The Board may appoint the new Director to fill the unexpired term of the seat. Annually, the Governance and Nominating Committee will recommend a slate of new and/or continuing candidates for the Board of Directors. The Board will select a slate of nominees for Director from recommendations of the Governance and Nominating Committee, and submit the slate of nominees to be voted on by shareholders at Rand s next Annual Meeting.

Rand s by-laws provide that an Annual Meeting of Shareholders shall be held on the fourth Tuesday in April, or such other time within 30 days before or after such date as the Chairman or Board of Directors shall determine. The number of Directors is determined by the Board of Directors, but in no event may it be less than three.

Criteria and Diversity

In considering whether to recommend any candidate for inclusion in the Board s slate of recommended director nominees, including candidates recommended by shareholders, the Nominating and Corporate Governance Committee will apply the criteria set forth in Rand s Corporate Governance Guidelines. These criteria include the candidate s experience, business skill set and the ability to act in the interests of all shareholders. Our Corporate Governance Guidelines specify that the value of diversity on the Board should be considered by the Nominating and Corporate Governance Committee in the director identification and nomination process. The Committee seeks nominees with a broad diversity of experience, professions, skills, and backgrounds. The Committee does not assign specific weights to particular criteria and no particular criterion is necessarily applicable to all prospective nominees. Rand believes that the backgrounds and qualifications of the directors, considered as a group, should provide a significant composite mix of experience, knowledge and abilities that will allow the Board to fulfill its responsibilities. Nominees are not discriminated against on the basis of race, religion, national origin, sexual orientation, disability or any other basis proscribed by law.

Procedure for Shareholders to Nominate Directors

Any shareholder who intends to present a Director nomination proposal for consideration at the 2015 Annual Meeting and intends to have that proposal included in the proxy statement and related materials for the 2015 Annual Meeting must deliver a written copy of the proposal to Rand no later than the deadline, and in accordance with the procedures specified under Shareholder Proposals in this proxy statement, and in accordance with the requirements of SEC Rule 14a-8.

If a shareholder does not comply with the foregoing procedures, the shareholder may use the procedures set forth in Rand s by-laws, although Rand would not in the latter case be required to include the nomination as a proposal in its proxy statement and proxy card mailed to shareholders in connection with the next annual meeting.

The shareholder nomination proposal referred to above must set forth (1) the name and address of the shareholder who intends to make the nomination and of the person or persons to be nominated; (2) a representation that the shareholder is a shareholder of record of Rand common shares entitled to vote at the meeting and intends to appear in person or by proxy at the meeting to nominate the person or persons specified in the proposal; (3) a description of the arrangements or understandings between the shareholder and each nominee or any other person or persons (naming such person or persons) pursuant to which the nomination or nominations are being made by the shareholder; (4) such other information regarding each nominee proposed by the shareholder as would have been required to be included in a proxy statement filed under the proxy rules of the SEC had each nominee been nominated or intended to be nominated by the Board of Directors; and (5) the consent of each nominee to serve as a Director of the Corporation if elected. The Governance and Nominating Committee may refuse to acknowledge a proposal for the nomination of any person not made in accordance with the foregoing procedure. Recommendations for nominees should be sent to: Rand Capital Corporation, Attention: Board Nominations, 2200 Rand Building, Buffalo, New York 14203.

Rand did not receive any nominations from shareholders for the 2014 Board of Directors election.

Code of Ethics

Rand has adopted a Code of Ethics which applies to Rand s chief executive officer, chief financial officer, and vice president of finance, and a Business Ethics Policy applicable to Rand s Directors, officers and employees. The Code of Ethics and the Business Ethics Policy are available in the Governance section of Rand s website at www.randcapital.com. They are also available in print to any shareholder who requests it. Rand will disclose any substantive amendments to, or waiver from provisions of, the Code of Ethics made with respect to the chief executive officer, chief financial officer or vice president of finance via its website.

Audit Committee

The Board of Directors has determined that none of the members of the Audit Committee are Interested Persons as defined in Section 2(a)(19) of the Investment Company Act. The Audit Committee is comprised of independent members, all of whom meet the independence requirements of the NASDAQ Stock Market. The Board of Directors has determined that Ross B. Kenzie is an Audit Committee financial expert (as defined by SEC regulations) (see Mr. Kenzie s relevant work experience in the Table under Information Regarding Directors, Nominees for Directors and Officers). Mr. Kenzie is an independent member of Rand s Board of Directors (as defined by SEC and NASDAQ Stock Market regulations).

The Audit Committee s charter may be accessed at Rand s website, www.randcapital.com. The Audit Committee reviews the scope and results of the annual audit, receives reports from Rand s independent public accountants, and reports the Audit Committee s findings and recommendations to the Board of Directors.

The Audit Committee has adopted necessary reporting procedures for the confidential submission, receipt, retention and treatment of accounting and auditing complaints.

Independent Registered Public Accountant (Independent Accountant) Fees

The aggregate fees for each of the last two fiscal years for services rendered by our auditing firm, Freed Maxick CPAs, P.C. (Freed) are as follows:

Audit Fees

This category consists of fees for the audit of annual consolidated financial statements, review of consolidated financial statements included in quarterly reports on Form 10-Q and services that are normally provided by the independent accountant in connection with statutory and regulatory filings or audit engagements for those fiscal years.

Audit fees for professional services provided by Freed for the fiscal years ended December 31, 2013 and 2012 were $71,675 and $69,575, respectively.

Audit Related Fees

This category consists of assurance and related services by the independent accountant that are reasonably related to the performance of the audit and review of financial statements and are not reported under audit fees.

During the fiscal years ended December 31, 2013 and 2012, there were no audit related fees for assurance and related services.

Tax Fees

This category consists of professional services rendered by the independent accountant for tax compliance and tax planning. The services for the fees disclosed under this category include tax return preparation and technical advice provided by Freed.

During the fiscal years ended December 31, 2013 and 2012, tax fees were $20,000 and $26,900, respectively.

All Other Fees

This category consists of fees not covered by Audit Fees, Audit Related Fees and Tax Fees.

For the fiscal years ended December 31, 2013 and 2012, Rand did not receive or pay for any products or services in this category from Freed.

For fiscal years 2013 and 2012, all of the services of Freed described in the above categories were pre-approved by the Audit Committee.

Estimates of annual audit, quarterly review and tax fees to be paid during the year are submitted annually to the Audit Committee for its review and pre-approval and then budgeted for by Rand. All other non-audit services must be pre-approved by the Audit Committee prior to engagement, as required by the Committee s Charter.

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Audit Committee Report

The Audit Committee has reviewed and discussed Rand s audited consolidated financial statements with management. In addition, the Audit Committee has discussed with Rand s independent accountants, Freed Maxick CPAs, P.C., the matters required to be discussed by Auditing Standards No. 16, as amended (AICPA, *Professional Standards*, Vol. 1 AU section 380), as adopted by the Public Company Accounting Oversight Board in Rule 3200T.

The Audit Committee has received the written disclosures and the letter from the independent accountants required by the Public Company Accounting Oversight Board regarding the independent accountants communications with the Audit Committee concerning independence, and has discussed the independent accountants independence with the independent accountants.

Based on the Audit Committee s review and discussions referred to above, the Audit Committee recommended to the Board of Directors that the audited consolidated financial statements be included in Rand Capital Corporation s Annual Report on Form 10-K for the year ended December 31, 2013 for filing with the Securities and Exchange Commission.

This report is respectfully submitted by the Audit Committee of the Board of Directors.

Ross B. Kenzie, Chair

Erland E. Kailbourne

Robert M. Zak

The information provided in the preceding Audit Committee Report will not be deemed to be soliciting material or filed with the Securities and Exchange Commission or subject to Regulation 14A or 14C, or to the liabilities of section 18 of the Securities Exchange Act, unless in the future the Corporation specifically requests that the information be treated as soliciting material or specifically incorporates it by reference into any filing under the Securities Act or the Securities Exchange Act.

COMPENSATION DISCUSSION AND ANALYSIS

Rand s President, Executive Vice President, Vice President of Finance and Office Manager are employees of Rand for whom Rand pays salaries and other employee benefits. The President and Executive Vice President serve as the Management and Investment Committee of Rand s wholly owned subsidiary, Rand Capital SBIC, Inc. (Rand SBIC), and are parties to a Profit Sharing Plan (the Plan) of Rand SBIC that was adopted by Rand as a requirement for the licensing of Rand SBIC as a Small Business Investment Company by the U.S. Small Business Administration (SBA).

Rand s principal executive officer is its President, Allen F. Grum, and Rand s principal financial officer is its Executive Vice President/Chief Financial Officer, Daniel P. Penberthy. They are Rand s Named Executive Officers (NEOs).

The Compensation Committee, all of the members of which are independent members of the Board, makes determinations and recommendations to the Board of Directors with respect to the compensation of the NEOs. Each of the members (i) satisfies all of the independence requirements under the current NASDAQ Listing Standards as discussed under the Director Independence section of the Proxy Statement; (ii) are outside Directors (as defined in Regulations pursuant to Section 162(m) of the Code and (iii) are non-employee Directors (as defined in Rule 166-3 of the Securities Exchange Act of 1934). The Compensation Committee s responsibilities and authority are set forth in the Compensation Committee Charter which is disclosed on the Rand Capital website. The Compensation Committee recommendations are then reviewed by the independent members of the Board, who are responsible for establishing such compensation. Rand s President is responsible for the compensation of Rand s staff other than the NEOs.

Introduction

This Compensation Discussion and Analysis is designed to provide shareholders with an understanding of our compensation philosophy and objectives as well as the analysis that we performed in setting executive compensation. It discusses the Compensation Committee s determination of how and why, in addition to what, compensation actions were taken for the NEOs.

Objectives of Rand s Compensation Programs and What they are Designed to Reward

Rand depends on the management and analytical abilities of its NEOs for its long-term success and the enhancement of long-term shareholder value. The objectives of Rand s compensation programs are to provide appropriate levels of compensation, reward above average corporate performance, recognize individual initiative and achievement, attract and retain qualified individuals to contribute to Rand s success, and motivate management to enhance shareholder value.

Key Elements of Rand s Compensation Plans and Why they are Paid:

Base Salary Base salaries should meet the objectives of attracting and retaining the management talent needed to operate the business successfully. Individual salary amounts are not determined by formulas, but instead reflect the Compensation Committee s judgment with respect to each NEO s responsibility, performance,

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experience and past compensation, internal equity considerations and other factors, including retention. Annually, the Board, on recommendation of the Compensation Committee, sets base salaries for the NEOs that it believes are appropriate given the scope of their duties and responsibilities.

Bonus Rand provides the opportunity to earn bonuses to its NEOs and staff based on the Compensation Committee s and Board s evaluation of performance and results, as well as to motivate them to achieve results that exceed the annual budget or provide value to the Corporation. The bonus is based on a qualitative consideration of individual and company performance. The Compensation Committee considers, and may make appropriate adjustments for, unusual items that are deemed to be outside the control of the executives.

Profit Sharing Plan Rand provides long-term incentives to its NEOs through the Plan, which allows them to participate in the growth of its portfolio and aligns their long-term interests with those of Rand s shareholders. The terms of Rand s license to operate Rand SBIC require that it maintain a profit sharing plan, which provides for payment by Rand of designated percentages of net realized capital gains (net of all realized capital losses and unrealized depreciation) of Rand SBIC. Amounts paid or accrued pursuant to the Plan cannot exceed 20% of Rand s net income. The Compensation Committee does not have discretion to change the amounts due under the Plan. For 2013, a total of $887,244 was earned by the NEOs pursuant to the Plan. No other bonus payments were awarded to the NEOs for 2013. This amount was accrued in 2013 and expected to be substantially paid in 2014 following the receipt of proceeds from realized gains and related escrows.

Equity Although we believe that equity ownership by management incentivizes management to increase shareholder value, restrictions imposed by the Investment Company Act preclude Rand from offering stock options or other equity incentives to its NEOs at any time when they participate in a profit sharing plan. Rand has a stock option plan that was adopted in 2001 (see Option Plan, below), but no options have been or will be granted under it while the Plan is in effect.

Standard Employee Benefits Rand provides employee benefits that are considered competitive and necessary to attract and retain talented personnel. Rand maintains a 401(k) plan for its employees under which participants may elect to contribute up to 20% of their compensation on a pretax basis, to a maximum of $17,500 ($23,000 if age 50 or over) for 2013. Rand makes a contribution of 1% of compensation for each participant and matches participant contributions up to 5% of compensation. Rand may also elect to contribute discretionary amounts under the 401(k) plan as determined by the Board. No discretionary amounts have been contributed since the 401(k) plan s inception. Rand also provides life insurance and automobile reimbursement benefits to its NEOs.

Consideration of Prior Shareholder Advisory Vote on Executive Compensation

At our 2013 Annual Meeting of shareholders, we provided our shareholders the opportunity to vote to approve, on an advisory basis, the compensation of our NEOs. At the 2013 Annual Meeting, our shareholders cast 2,291,643 votes, or 98%, in favor of approving the compensation, and 42,976 votes, or 2% against. Our Compensation Committee and Board value the opinions

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expressed by our shareholders, including the non-binding advisory vote on executive compensation. We are mindful of the strong support our shareholders expressed for our philosophy of linking compensation to our operating objectives and the enhancement of shareholder value. As a result, our Compensation Committee took the results of the vote into account when determining that our 2013, and anticipated 2014, executive compensation policies should largely remain consistent with our policies in prior years and should continue to emphasize the performance, alignment, and retention objectives described above.

How the Amounts of Each Element of the Compensation are Determined and How They Fit Into Rand s Overall Compensation Objectives

Salary, Bonus and Profit Sharing

The Compensation Committee determined that the salary paid to NEO s for the 2013 fiscal year was in the best interests of shareholders. No discretionary bonus payments were paid for 2013. However, the NEOs were eligible for a profit sharing payment. In making its determination, the Compensation Committee considered whether the salaries and bonuses and profit sharing amounts due to its NEOs were consistent with the compensation philosophy described above.

The Analysis Used in Setting Compensation Levels

When making individual compensation decisions for NEOs, the Compensation Committee takes many factors into account, including the individual s role and responsibilities, performance, and experience; the overall performance of Rand; the recommendations of Board Committee Chairs; the individual s past compensation; and comparison to other NEOs of Rand. The Compensation Committee retained a compensation consultant to provide insight into setting compensation levels for 2013.

Specifically, the Committee has considered factors such as:

- total compensation in relation to Rand s size, and the composition and performance of its investments and total investment capital available;
- Rand s success in identifying appropriate investment opportunities and returns on its investments;
- the value of Rand s assets in accordance with Accounting Standards Codification 820 fair value measurement ,
- the responsibilities and duties of the NEOs,
- whether there has been any adjustment or potential recovery of prior payments resulting from the restatement of prior performance measures upon which bonus or profit sharing awards were based. No such adjustments

or recovery occurred during 2012 or 2013; and

realized income from investment exits in the consolidated Rand and Rand SBIC portfolios.

Evaluating Performance

The Compensation Committee evaluates the performance of the NEOs annually, and consults with the other Directors and Committee Chairs regarding that performance. The Compensation Committee also seeks the advice of the President in connection with the performance evaluation for the other NEO; however, the President is not present when the Compensation Committee meets to evaluate his performance and recommend compensation for the NEOs.

Individual Performance

The Compensation Committee uses discretion in a qualitative evaluation of individual performance and considers the following factors, among others, in recommending to the Board any annual bonus awards to the NEOs: the input of other Board Committee Chairs, and each NEO s contribution to Rand s leadership, management, strategic planning, business development, and investment returns.

Change of Control and Termination Benefits

Rand does not provide any employment contracts, or change of control or termination benefits to its employees.

Accounting and Tax Treatments of Compensation

The Compensation Committee s policy is to structure compensation in a way that allows it to be fully deductible, where doing so will further the purposes of the executive compensation programs. The Committee also considers it important to retain flexibility to design compensation programs that recognize a full range of criteria important to Rand s success, even where compensation payable under the programs may not be fully deductible.

Compensation Consultant

During 2012, the Compensation Committee engaged, at Rand s expense, The Burke Group to serve as compensation consultant to the Compensation Committee. The Committee assessed the independence of The Burke Group (and any individuals working on the Corporation s account on The Burke Group s behalf) in accordance with NASDAQ Listing Rules and determined that its work on behalf of the Compensation Committee raised no conflict of interest. Following such determination, The Burke Group was engaged as an independent advisor to provide the following services:

- To review NEO compensation levels;

- To review compensation levels in an appropriate peer group of Rand;

- To review compensation levels as reported in survey data for the Financial Industry; and

- To review Rand s overall compensation strategy, including base salary, bonus, profit sharing plan and equity, identifying industry best practices, trends, and areas for improvement.

The Burke Group delivered its report to the Compensation Committee in 2013, noting that the unique nature of Rand s corporate structure, market capitalization, asset base, and regulatory requirements creates challenges in both establishing and implementing the Corporation s overall compensation strategy. Other than changes to the NEOs base salary, the Compensation Committee did not make changes to the key elements of Rand s compensation programs as a result of the report. The Compensation Committee remains focused on the best means to align management s and Rand s interests to enhance shareholder value.

Profit Sharing Plan

We believe Rand s salaries, bonuses and the Plan create an appropriate focus on long-term objectives and promote NEO retention. The terms of the SBA s license for Rand s SBIC subsidiary require it to maintain a profit sharing plan that provides for payment of the designated percentages of the net realized capital gains (net of all unrealized capital losses and unrealized depreciation) of the SBIC that are provided for in the Plan to our NEOs. The Compensation Committee does not have discretion to change the amounts due under the Plan.

Under the Plan, Rand pays its NEOs cumulative profit sharing payments equal to 12% of realized capital gains of Rand SBIC, net of realized capital losses and unrealized depreciation of Rand SBIC, for each fiscal year of Rand SBIC, computed in accordance with the Plan and Rand s interpretation of the Plan.

The profit sharing payments are shared equally between Rand s two NEOs, who are fully vested in the Plan. Under the Investment Advisers Act of 1940 (Section 205 (b)(3)) requirements, the aggregate amount which may be paid or accrued under the Plan and any other incentive based plan maintained by Rand during any fiscal year, may not exceed 20% of Rand s net income afterTD> Telefónica Móviles Chile
S.A. 3,603,432 4,633,690 - - 96,672,160-k Telefónica Móviles Chile Larga Distancia
S.A. 3,437,405 - - - 59,083,900-0 Telefónica Ingeniería de Seguridad S.A. 530,089 - - - Foreign Telefónica Gestión de Servicios Compartidos España S.A. 8,598 - - - Foreign Telefónica
Argentina 114,155 - - - Foreign Telefónica España 1,809 - - - Foreign Telefónica
Perú 16,088 54,602 - - Foreign Telefónica Guatemala 15,330 76,585 - - Foreign Telefónica Móvil El Salvador S.A. de C.V. 21,258 54,957 - - Foreign Telefónica Whole Sale International
Services 180,185 613,109 - - Foreign Telefónica Puerto Rico 7,962 7,459 - - Foreign Telefónica Investigación y Desarrollo - 976,394 - - Foreign Telecomunicaciones de Sao Paulo S.A. 63,839 3,496 - - Foreign Terra Networks Inc 2,141,915 - - -

Total

31,191,834 31,018,895 - -

As per Article No. 89 of the Corporations Law, all these transactions are carried out under normal market conditions.

6. Balances and Transactions with Related Companies, continued:

c) Transactions:

Company	Tax No.	Nature of Relationship	Description of transaction	2005 ThCh$		2004 ThCh$	
Telefónica España	Foreign	Related to parent company	Sales	477,153	477,153	739,961	739,961
			Purchases	(214,023)	(214,023)	(173,175)	(173,175)
			Other non-perating income	3,515	3,515	-	-
			Other non-operating expenses	(3,755)	(3,755)	-	-
Telefonica Data Usa Inc.	Foreign	Related to parent company	Sales	8,080	8,080	4,434	4,434
			Financial income	-	-	1,117,155	1,117,155
Telefónica Internacional Chile S.A.	96,527,390-5	Parent company	Purchases	(435,852)	(435,852)	(435,558)	(435,558)
Terra Networks Chile S.A.	96,834,230-4	Related company	Sales	5,486,411	5,486,411	4,032,743	4,032,743
			Purchases	(477,268)	(477,268)	(714,971)	(714,971)
Atento Chile S.A.	96,895,220-k	Related company	Sales	952,877	952,877	1,422,003	1,422,003
			Purchases	(11,597,690)	(11,597,690)	(12,593,445)	(12,593,445)
Telefónica Argentina	Foreign	Related to parent company	Sales	1,333,432	1,333,432	794,019	794,019
			Purchases	(816,119)	(816,119)	(637,335)	(637,335)
Telecomunicaciones de Sao Paulo	Foreign	Related to parent company	Sales	100,943	100,943	121,155	121,155
			Purchases	(97,231)	(97,231)	(145,072)	(145,072)
Telefónica Guatemala	Foreign	Related to parent company	Sales	6,795	6,795	-	-
			Purchases	(33,287)	(33,287)	-	-
Telefónica del Perú	Foreign	Related to parent company	Sales	657,967	657,967	370,720	370,720
			Purchases	(477,501)	(477,501)	(421,403)	(421,403)
Telefónica LD Puerto Rico	Foreign	Related to parent company	Sales	7,367	7,367	8,571	8,571
			Purchases	(12,710)	(12,710)	(12,061)	(12,061)

Telefónica El Salvador	Foreign	Related to parent company	Sales Purchases	3,809 (22,767)	3,809 (22,767)	3,694 (20,687)	3,694 (20,687)
Telefónica Móvil de Chile S.A.	96,786,140-5	Related to parent company	Sales Purchases Other non-operating income	9,971,028 (28,743,074) 3,770	9,971,028 (28,743,074) 3,770	10,046,525 (35,693,164) -	10,046,525 (35,693,164) -
Telefónica Moviles Chile Larga Distancia S.A.	96,672,160-k	Related to parent company	Sales Purchases	246,145 (4,581,798)	246,145 (4,581,798)	1,214,264 (9,647,093)	1,214,264 (9,647,093)
Telefónica WholeSale International Services España	Foreign	Related to parent company	Sales Purchases	- -	- -	221,185 (1,896,172)	221,185 (1,896,172)
Telefónica Móviles Chile Inversiones S.A.	96,672,150-2	Related to parent company	Sales Purchases	6,016 -	6,016 -	498,551 (29,029)	498,551 (29,029)
Atento Guatemala	Foreign	Related to parent company	Sales Purchases	- -	- -	6,396 (24,199)	6,396 (24,199)
Telefónica Wholesale Internacional Services Uruguay	Foreign	Related to parent company	Purchases	(840,805)	(840,805)	(838,260)	(838,260)
Telefónica Gestión de Serv.Compartidos España S.A.	Foreign	Related to parent company	Purchases Other non-operating income	(8,624) 137	(8,624) 137	- -	- -
Telefónica Ingeniería de Seguridad S.A.	59,083,900-0	Related to parent company	Sales Purchases	104,671 (28,188)	104,671 (28,188)	7,758 -	7,758 -
Telefónica Mobile Solutions Chile S.A.	96,942,730-3	Related to parent company	Sales	-	-	60,915	60,915
Telefónica Moviles Soluciones y Aplicaciones	96,990,810-7	Related to parent company	Sales	65,369	65,369	-	-

S.A.							
Terra Networks Inc.	Foreign	Related to parent company	Sales	83	83	-	-
Telefónica Internacional Wholesale Services Chile S.A.	96,910,730-9	Related to parent company	Sales Purchases Expenses	1,364,458 (350,411) (2,592,581)	1,364,458 (350,411) (2,592,581)	775,394 - -	775,394 - -

The conditions of the agreement related to intercompany transactions between the Company and its equity-method investees and its mercantile current account are both short and long-term, denominated in US dollars and accrue interest at a variable rate adjusted to market rates (US$ + Market Spread).

In the case of Sales and Services Rendered, these mature in the short-term (less than a year) and the maturity terms for each case varies based on the related transaction.

7. Current and Deferred Income Taxes:

a) General information:

As of September 30, 2006 and 2005, the Parent Company has established a first category income tax provision, as it has taxable net income of ThCh$111,327,512 and ThCh$82,549,712, respectively.

In addition, as of September 30, 2006 and 2005, a provision for first category income tax in subsidiaries was recorded for ThCh$33,487,044 and ThCh$26,791,812, respectively.

As of September 30, 2006 and 2005, accumulated tax losses of subsidiaries amount to ThCh$6,651,982 and ThCh$8,200,912 respectively.

The companies in the group with positive retained taxable earnings and their associated credits are as follows:

Subsidiaries	**Retained Taxable Earnings w/15% credit ThCh$**	**Retained Taxable Earnings w/16% credit ThCh$**	**Retained Taxable Earnings w/16.5% credit ThCh$**	**Retained Taxable Earnings w/17% credit ThCh$**	**Retained Taxable Earnings w/o credit ThCh$**	**Amount of credit ThCh$**
Telefónica Larga Distancia S.A.	2,183,566	827,286	4,968,536	52,908,844	3,687,262	12,361,453
Telefónica Empresas CTC Chile S.A.	103	-	1,727,946	34,232,282	2,061,037	7,352,889
Telefónica Chile S.A.	-	-	-	72,653,563	18,474,574	14,880,830
Telefónica Internet Empresas S.A.	-	-	-	1,760,566	-	360,597
Total	**2,183,669**	**827,286**	**6,696,482**	**161,555,255**	**24,222,873**	**34,955,769**

7. Current and Deferred Income Taxes, continued:

b) Deferred taxes:

As of September 30, 2006 and 2005 the accumulated balances of temporary differences that originated net deferred tax liabilities in the amount of ThCh$(41,402,486) and ThCh$(47,255,696), are as follows:

	2006				**2005**			
Description	**Deferred tax assets**		**Deferred tax liabilities**		**Deferred tax assets**		**Deferred tax liabilities**	
	Short-term ThCh$	**Long-term ThCh$**	**Short-term ThCh$**	**Long-term ThCh$**	**Short-term ThCh$**	**Long-term ThCh$**	**Short-term ThCh$**	**Long-term ThCh$**
Allowance for doubtful accounts	11,077,725	-	-	-	9,715,397	-		
Vacation provision	720,252	-	-	-	2,132,938	-	-	
Tax benefits for tax losses	-	1,130,837	-	-	24,340	1,369,815	-	
Staff severance indemnities	828	4,897	-	4,879,963	-	-	-	6,328,21
Leased assets and liabilities	-	20,653	-	202,649	-	62,429	-	125,53
Property, plant and equipment	-	679,594	-	150,980,679	9,145	4,145,101	-	171,579,73
Provision for staff severance indemnities	-	-	-	-	-	-	-	
Difference in amount of capitalized staff severance	-	506,812	355	-	-	593,855	-	
Software	-	-	-	-	-	-	-	2,855,22
Deferred charge on sale of assets	-	-	-	347,961	-	-	-	1,328,62
Development software	-	-	-	2,215,699	-	-	-	
Collective negotiation bonus	-	-	-	82,888	-	-	-	43,00
Other	985,869	231,696	58,691	4,105,412	1,100,338	294,280	10,281	4,435,14
Sub-Total	**12,784,674**	**2,574,489**	**59,046**	**162,815,251**	**12,982,158**	**6,465,480**	**10,281**	**186,695,48**

Complementary accounts net of accumulated amortization	-	(854,751)	-	(106,967,399)	**-**	(3,841,509)	**-**	(123,843,94
Sub-Total	**12,784,674**	**1,719,738**	**59,046**	**55,847,852**	**12,982,158**	**2,623,971**	**10,281**	**62,851,54**
Tax reclassification	(59,046)	(1,719,738)	(59,046)	(1,719,738)	(10,281)	(2,623,971)	(10,281)	(2,623,97
Total	**12,725,628**	-	-	**54,128,114**	**12,971,877**	**-**	**-**	**60,227,57**

7. Current and Deferred Income Taxes, continued:

c) Income tax detail:

The Company s income tax expense for the period is based on the entries in the table below:

Description	2006 ThCh$	2005 ThCh$
Common tax expense before tax credit (income tax 17%)	24,618,475	18,588,059
Current tax expense (article 21 single tax at 35%)	27,878	45,133
Common tax expense (first category (corporate) single income tax)	-	347,708
Tax expense adjustment (previous period)	(337,697)	90,181
Income tax subtotal	**24,308,656**	**19,071,081**
- Current period deferred taxes	(12,813,591)	(3,459,081)
- Tax benefits from tax loss carry forwards	-	(448,437)
- Effect of amortization of complementary accounts for deferred assets and liabilities	10,402,263	10,462,574
Deferred tax subtotal	**(2,411,328)**	**6,555,056**
Total expense tax	**21,897,328**	**25,626,137**

8. Other Current Assets:

The detail of other current assets is as follows:

Description	2006 ThCh$	2005 ThCh$
Fixed income securities purchased with resale agreement (note 9)	3,700,686	14,003,284
Deferred union contract bonus (1)	827,211	1,845,152
Deferred exchange insurance premiums	-	202,788
Telephone directories for connection program	3,262,574	4,239,097
Deferred higher bond discount rate (note 25)	232,295	56,694
Deferred disbursements for placement of bonds (note 25)	129,687	419,905
Commercial paper issuance costs (note 25)	17,155	225,895
Deferred disbursements for foreign financing proceeds (2)	468,575	619,048
Exchange difference insurance receivable	802,550	4,520,561
Deferred staff severance indemnities charges (3)	1,210,332	1,056,509
Dispensable property	121,420	-
Other	1,009,281	871,100
Total	**11,781,766**	**28,060,033**

(1) Between May and September 2006, the Company negotiated a collective agreement for 38 and 48 months with part of its employees, granting them, among other benefits, a negotiation bonus. This bonus was paid in July, August and September 2006. The total benefit amounted to ThCh $ 2,756,430 (historical), and is deferred using the straight-line method during the term of the collective agreement. The long-term portion is presented under Others (in Other Assets) (Note 14).

(2) This amount corresponds to the cost (net of amortization) ofthe mandatory reserve paid to the Central Bank of Chile and disbursements incurred for foreign loans obtained by the Company to finance its investment plan. The long-term portion is presented under Others (in Other Assets) (Note 14).

(3) Corresponds to the short-term portion to be amortized due to changes in the actuarial hypotheses and for the concept of loans to employees. The long-term portion is presented under Other (in Other Assets) (Note 14).

9.- Information Regarding Sales Commitment Transactions (Agreements):

Code	Dates		Counterparty	Original	Subscription	Rate	Final Value	Instrument	Book Value
	Inception	End		currency	value ThCh$		ThCh$	Identification	ThCh$
CRV	September 28, 2006	October 04, 2006	BANCO DE CREDITO E INVERSIONES	USD	1,200,000	0.43%	1,201,032	BCP0800407	1,200,344
CRV	September 29, 2006	October 12, 2006	BANCO DEL ESTADO DE CHILE	USD	1,077,390	0.43%	1,079,398	BCD0500907	1,077,545
CRV	September 29, 2006	October 12, 2006	BANCO DEL ESTADO DE CHILE	USD	422,610	0.43%	423,397	CERO010310	422,670
CRV	September 29, 2006	October 11, 2006	BANCO SANTANDER SANTIAGO	USD	1,000,000	0.38%	1,001,520	BCD0500108	1,000,127
			Total		**3,700,000**		**3,705,347**		**3,700,686**

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10. Property, Plant and Equipment:

The detail of property, plant and equipment is as follows:

	2006		2005	
Description	**Accumulated depreciation ThCh$**	**Gross prop., plant and equipment ThCh$**	**Accumulated depreciation ThCh$**	**Gross prop., plant and equipment ThCh$**
Land	**-**	**27,915,058**	**-**	**27,971,738**
Building and improvements	**354,612,472**	**796,478,290**	**259,734,545**	**794,598,779**
Machinery and equipment	**2,110,067,519**	**2,758,723,152**	**2,032,642,948**	**2,725,755,433**
Central office telephone equipment	1,291,505,642	1,558,258,972	1,212,483,233	1,552,890,561
External plant	609,853,040	928,600,040	639,264,454	931,366,172
Subscribers equipment	172,381,849	234,791,173	143,901,888	203,288,446
General equipment	36,326,988	37,072,967	36,993,373	38,210,254
Other Property, Plant and Equipment	**170,923,236**	**298,904,660**	**156,828,109**	**256,790,812**
Office furniture and equipment	91,899,192	112,422,738	82,050,035	110,446,867
Projects, work in progress and materials (2)	-	93,951,341	-	48,659,591
Leased assets (1)	62,897	504,997	59,692	488,345
Property, plant and equipment temporarily out of service	7,031,951	7,031,951	10,770,745	12,098,082
Software	70,959,489	83,817,719	63,031,366	83,933,147
Other	969,707	1,175,914	916,271	1,164,780
Technical revaluation Circular 550	**10,883,087**	**9,500,729**	**11,231,675**	**9,994,097**
Total	**2,646,486,314**	**3,891,521,889**	**2,460,437,277**	**3,815,110,859**

(1) Leased assets have a gross value of ThCh$504,997 and ThCh$488,345 for the concept of buildings for 2006 and 2005, respectively, with accumulated depreciation of ThCh$62,897 and ThCh$59,692 for 2006 and 2005, respectively.

(2) Until December 31, 2002, works in progress included capitalization of the related borrowing costs, as per Technical Bulletin No. 31 of the Chilean Association of Accountants, and therefore, the gross property, plant and equipment balance includes interest of ThCh$198,250,122. Accumulated depreciation for this interest amounts to ThCh$136,400,074 and ThCh$124,111,139 for 2006 and 2005, respectively.

A depreciation charge for the period amounting to ThCh$148,020,564 and ThCh$145,920,331 for 2006 and 2005, respectively, was recorded as an operating cost, and a depreciation charge of ThCh$8,942,671 for 2006 and ThCh$5,286,815 for 2005 as an administrative and selling cost. Depreciation of property, plant and equipment that is temporarily out of service is made up mainly of telephone equipment under repair and incurred depreciation amounting to ThCh$879,772 and ThCh$2,211,169 in 2006 and 2005, which is classified under Other Non-operating Expenses (note 22b).

The detail by item of the technical revaluation is as follows:

Description	Net Balance ThCh$	Accumulated Depreciation ThCh$	Gross property, plant and equipment 2006 ThCh$	Gross property, plant and equipment 2005 ThCh$
Land	(519,218)	-	(519,218)	(519,216)
Building and improvements	(827,840)	(4,154,739)	(4,982,579)	(4,982,320)
Machinery and equipment	(35,300)	15,037,826	15,002,526	15,495,633
Total	**(1,382,358)**	**10,883,087**	**9,500,729**	**9,994,097**

Depreciation of the technical reappraisal surplus for the period of ThCh$(49,784) and ThCh$(16,440) for 2006 and 2005, respectively.

Gross property, plant and equipment includes assets that have been totally depreciated in the amount of ThCh$1,298,796,680 in 2006 and ThCh$1,076,978,124 in 2005, which include ThCh$12,923,489 and ThCh$12,541,805, respectively, from the reappraisals mentioned in Circular No. 550.

11. Investments in Related Companies:

The detail of investments in related companies is as follows:

Taxp. No.	Company	Country of origin	Currency controlling the investment	Number of shares	Percentage participation 2006 %	Percentage participation 2005 %	Equity of the companies 2006 ThCh$	Equity of the companies 2005 ThCh$
Foreign	TBS Celular Participación S.A. (1)	Brazil	Dollar	48,950,000	2.61	2.61	152.596.730	154.299.653
96,895,220-K	Atento Chile S.A. (3)	Chile	Pesos	3,049,998	28.84	28.84	16.281.879	15.232.075
96,922,950-1	Empresa de Tarjetas Inteligentes S.A. (2)	Chile	Pesos	-	-	20.00	-	12.539

Taxp. No.	Company	Net income (loss) of the companies 2006 ThCh$	Net income (loss) of the companies 2005 ThCh$	Equity in income (loss) of the investment 2006 ThCh$	Equity in income (loss) of the investment 2005 ThCh$	Investment value 2006 ThCh$	Investment value 2005 ThCh$	Investment book value 2006 ThCh$	Investment book value 2005 ThCh$
Foreign	TBS Celular Participación S.A. (1)	(1,235,113)	2,497,305	(32,236)	65,179	3,982,775	4,027,220	3,982,775	4,027,220
96,895,220-K	Atento Chile S.A. (3)	4,791,856	3,906,050	1,381,971	1,126,506	4,695,694	4,392,934	4,695,694	4,392,934
96,922,950-1	Empresa de Tarjetas Inteligentes S.A. (2)	-	(168,566)	-	(33,713)	-	-	-	-
	Total					**8,678,469**	**8,420,154**	**8,678,469**	**8,820,154**

(1) The Company records its investment in TBS Celular using the equity method since it exercises significant influence through the business group to which it belongs, as established in paragraph N° 4 of Circular N° 1,179 issued

by the Superintendency of Securities and Insurance and ratified in Title II of Circular N° 1,697. Although Telefónica Chile only has a 2.61% direct participation in TBS Celular, its parent company, Telefónica España, has direct and indirect participation exceeding 20% ownership of the capital stock of that company.

(2) The Extraordinary Shareholders Meeting agreed to the dissolution of Empresa de Tarjetas Inteligentes S.A. During September 2005, the Chilean Internal Revenue Service authorized the closing of this company.

(3) The equity value as of September 30, 2006 and 2005 was recognized on the basis of the interim financial statements which did not undergo a limited review.

As of the date of these financial statements, there are no liabilities for hedge instruments assigned to foreign investments. The Company intends to reinvest net income from foreign investments on a permanent basis; therefore, there is no potentially remittable net income.

12. Goodwill:

The detail of goodwill is as follows:

Taxpayer No.	Company	Year	2006 Amount amortized in the period ThCh$	2006 Balance of Goodwill ThCh$	2005 Amount amortized in the period ThCh$	2005 Balance of Goodwill ThCh$
Foreign	TBS Celular Participación S.A.	2001	142,991	2,405,191	142,991	2,596,370
96,551,670-0	Telefónica Larga Distancia S.A.	1998	882,201	14,219,867	882,201	15,399,366
78,703,410-1	Telefónica Multimedia Chile S.A. (1)	1998	761,341	-	116,736	819,713
96,834,320-3	Telefónica Internet Empresas S.A.(2)	1999	72,100	409,887	72,100	506,285
	Total		**1,858,633**	**17,034,945**	**1,214,028**	**19,321,734**

(1) As indicated in Note 2d) No. 1 as a product of the sale made on January 26, 2006, the Board of Directors of Telefónica Internet Empresas S.A. agreed to sell the shares of Telefónica Multimedia Chile S.A. to Telefónica Chile S.A. This sale was made at book value, not considering goodwill in the price, which required the extraordinary recognition of the total balance of goodwill as of that date.

(2) On January 27, 2006 Telefónica Empresas CTC Chile sold its entire ownership interest of 215,099 shares to Telefónica Chile S.A. for ThCh$1,468,683.

On January 26, CTC Equipos y Servicios de Telecomunicaciones sold its entire ownership interest of 16 shares to Telefónica Chile S.A. for ThCh$132.

Goodwill amortization periods have been determined taking into account aspects such as the nature and characteristics of the business and estimated period of return of investment.

13. Intangibles:

The detail of intangibles is as follows:

Description	2006 ThCh$	2005 ThCh$
Underwater cable rights (gross)	37,965,919	36,890,870
Accumulated amortization, previous period	(7,552,764)	(5,273,768)
Amortization for the period	(1,336,856)	(1,331,637)
Licenses (Software) (gross)	14,430,479	11,794,970
Accumulated amortization, previous periods	(5,162,855)	(1,975,621)
Amortization for the period	(2,513,678)	(1,868,366)
Total Net Intangibles	**35,830,245**	**38,236,448**

14. Other Non-current Assets:

The detail of other non-current assets is as follows:

Description	2006 ThCh$	2005 ThCh$
Deferred disbursement for obtaining external financing (see note 8(2)) (1)	806,320	1,132,793
Deferred union contract bonus (see note 8(1))	1,656,577	90,183
Bond issue expenses (see note 25)	723,039	28,947
Bond discount (see note 25)	1,181,554	193,067
Securities deposits	118,973	141,098
Deferred charge due to change in actuarial estimations (see note 8(3)) (2)	8,223,494	7,696,031
Deferred staff severance indemnities (3)	4,305,721	4,955,140
Other	185,029	34,924
Total	**17,200,707**	**14,272,183**

(1) This amount corresponds to the cost (net of amortizations) of the mandatory reserve paid to the Chilean Central Bank and disbursements incurred for foreign loans obtained by the Company to finance its investment plan. The short-term portion is presented under Other Current Assets (Note 8).

(2) In light of the new contractual conditions derived from the organizational changes experienced by the Company, a series of studies has allowed for, beginning in 2004, modification of the variable for future years of service of employees within the basis for calculating staff severance indemnities. After concluding these studies, in 2005 other estimations were incorporated such as mortality of employees and future salary increases and includes the rate change mentioned in Note 3 b i) for 2006, all determined on the basis of actuarial calculations, as established in Technical Bulletin No. 8 of the Chilean Association of Accountants. The short-term portion is presented under Other Current Assets (Note 8)

The difference at the beginning of the year as a result of changes in the actuarial estimates constitutes actuarial gains or losses, which are deferred and amortized during the average remaining future years of service for the employees that will receive the benefit (see Note 2s).

(3) In conformity with the union agreements between the Company and its employees, loans were granted to employees, the amounts and conditions of which were based, among other aspects, on the accrued balances of staff severance indemnities when they were granted. The short-term portion is presented under Other Current Assets (Note 8)

The staff severance indemnities provision has been recorded in part at its current value, deferring and amortizing this effect over the years of average remaining service life of employees eligible for the benefit. The loan is presented under Other Long-Term Receivables.

15. Short-Term Obligations with Banks and Financial Institutions:

The detail of short-term obligations with banks and financial institutions is as follows:

Taxp.No.	Bank or financial institution	US$		U.F.		TOTAL	
		2006	2005	2006	2005	2006	2005
	Current maturities of long-term debt	**ThCh$**	**ThCh$**	**ThCh$**	**ThCh$**	**ThCh$**	**ThCh$**
97,015,000-5	BANCO SANTANDER SANTIAGO (4)	-	-	970,411	597,924	970,411	597,924
Foreign	CALYON NEW YORK BRANCH AND OTHERS	155,722	105,367	-	-	155,722	105,367
97,008,000-7	CITIBANK (2)	671,377	487,505	-	-	671,377	487,505
Foreign	BBVA BANCOMER AND OTHERS (3)	800,982	-	-	-	800,982	-
Foreign	ABN AMRO BANK	-	17,331,796	-	-	-	17,331,796
	Total	**1,628,081**	**17,924,668**	**970,411**	**597,924**	**2,598,492**	**18,522,592**
	Outstanding principal	-	**16,463,598**	-	-	-	**16,463,598**
	Average annual interest rate	5.76%	4.67%	3.16%	1.95%	5.25%	4.58%

Percentage of obligations in foreign currency : 62.65 % for 2006 and 96.77 % for 2005
Percentage of obligations in local currency : 37.35 % for 2006 and 3.23 % for 2005

16. Long-Term Obligations with Banks and Financial Institutions

Long-term obligations with banks and financial institutions:

Taxp.No.	Bank or financial institution	Currency or Indexation Index	Years to maturity for long-term portion 1 to 2	2 to 3	3 to 5	Long-term portion as of June 30,2006	Average annual interest rate %	Lo p 30
			ThCh$	**ThCh$**	**ThCh$**	**ThCh$**	**ThCh$**	**T**
	LOANS IN DOLLARS							
Foreign	CALYON NEW YORK BRANCH AND OTHERS (1)	US$	-	107,406,000	-	107,406,000	Libor + 0.35%	109
Foreign	BBVA BANCOMER AND OTHERS (3)	US$	-	-	80,554,500	80,554,500	Libor + 0.334%	
97,008,000-7	BANCO CITIBANK (2)	US$	80,554,500	-	-	80,554,500	Libor + 0.31%	82
Foreign	ABN AMRO BANK	US$	-	-	-	-	-	65
	SUBTOTAL		**80,554,500**	**107,406,000**	**80,554,500**	**268,515,000**	**5.76%**	**257**
	LOANS IN UNIDADES DE FOMENTO							
97,015,000-5	BANCO SANTANDER SANTIAGO (4)	UF	-	-	65,416,088	65,416,088	Tab 360+0.45%	65
	SUBTOTAL				**65,416,088**	**65,416,088**	**3.16%**	**65**
	TOTAL		**80,554,500**	**107,406,000**	**145,970,588**	**333,931,088**	**5.25%**	**323**

Percentage of obligations in foreign currency	:	80.41 % for 2006	and	79.79 % for 2005
Percentage of obligations in local currency	:	19.59 % for 2006	and	20.21 % for 2005

(1) In December 2004, the Company renegotiated this loan, extending its due date from February and August 2005 to December 2009, in addition to changing the agent bank, which was the Bilbao Viscaya Argentaria Bank.
(2) In May 2005, the Company renegotiated this loan, extending its due date from April 2006 and April 2007 to December 2008, in addition to changing the agent bank, which was the ABN Amro Bank.
(3) In November 2005, the Company renegotiated this loan, extending its due date from April 2006, April 2007 and April 2008 to June 20011, in addition to changing the agent bank, which was the ABN Amro Bank.
(4) In April, the Company renegotiated this loan, extending its maturity due from April 2010 and reducing the interest rate to TAB 360 + 0.45% .

17. Obligations with the Public:

a) Commercial paper:

On January 27, 2003 and May 12, 2004, Telefónica Chile registered two commercial paper lines in the securities registry, the inspection numbers of which are 005 and 015, respectively. The maximum amount of each line is ThCh$35,000,000, and placements charged to the line may not exceed that amount. The term of each line will be 10 years from the date of registration with the Superintendency of Securities and Insurance. The interest rate will be defined upon each issuance of these commercial papers.

On January 18, 2005, a Series E placement of the same type of instrument was made for ThCh$12,000,000. The placement agent was Scotiabank Sudamericano Corredores de Bolsa.

On April 27, 2005, a Series F placement of the same type of instrument was made for ThCh$23,000,000. The placement agent was Scotiabank Sudamericano Corredores de Bolsa.

On March 21, 2006, a Series I placement of the same type of instrument was made for ThCh$12,000,000. The placement agent was Inversiones Boston Corredores de Bolsa.

On July 11, 2006, the Company placed a fourth issuance of its line of Commercial Paper with a charge to line No. 015. This issuance was performed in three series (J1 - J2 - J3) for a total of ThCh$7,000,000, maturing as of September 27, 2006. The placement rate for all the series was 0.44% monthly. On this occasion, the placing agent was Inversiones Boston.

The details of these transactions are described below:

Registration or identification number of the instrument	Series	Current nominal amount placed ThCh$	Bond readjustment unit ThCh$	Interest rate %	Final Maturity	Book value		Placement in Chile or abroad
						2006 ThCh$	2005 ThCh$	
Short-term commercial paper								
005	E	12,000,000	Ch$ non-adjustable	0.3100	Oct 13, 2005	-	12,427,874	Chile
005	F	23,000,000	Ch$ non-adjustable	0.4100	Oct 13, 2005	-	23,295,064	Chile
015	I	12,000,000	Ch$ non-adjustable	0.4800	Dec 06, 2006	11,876,498	-	Chile
				Total		**11,876,498**	**35,722,938**	

17. <u>Obligations with the Public,</u> continued:

b) Bonds

The detail of obligations with the public for bond issues, classified as short and long-term, is as follows:

Registration number or identification of the instrument	Series	Nominal Amount of issue	Readjustment unit for bond	Nominal annual interest rate	Final maturity	Frequency		Par value	
						Interest payment	Amortizations	2006 ThCh$	20 Th
				%					
Short-term portion of long-term bonds									
143,27,06,91	**F**	71,429	U.F.	6.000	Apr, 2016	Semi-annual	Semi-annual	1,676,676	1,7
281,20,12,01	**L (1)**	-	U.F.	3.750	Oct, 2012	Semi-annual	Maturity	900,166	
Issued in New York	**Yankee Bonds**	-	US$	7.625	Jul, 2006	Semi-annual	Maturity	-	27,6
Issued in New York	**Yankee Bonds**	-	US$	8.375	Jan, 2006	Semi-annual	Maturity	-	87,6
							Total	**2.576.842**	**117,0**
Long-term bonds									
143,27,06,91	**F**	642,857	U.F.	6.000	Apr, 2016	Semi-annual	Semi-annual	11,829,319	13,1
281,20,12,01	**L (1)**	3,000,000	U.F.	3.750	Oct, 2012	Semi-annual	Maturity	55,203,450	
							Total	**67,032,769**	**13,1**

(1) On March 29, 2006, the Company placed bonds in the local market for a nominal amount of UF3,000,000 (equivalent to US$102.1 million) of a series denominated L, which is composed of 6,000 bonds with a value of UF 500 each. These bonds mature in one installment on October 25, 2012 at an annual interest rate of UF + 3.75% . Interest is paid biannually. There is a redemption option as of October 25, 2007.

18. <u>Provisions and Write-offs</u>:

The detail of provisions and write-offs shown in liabilities is as follows:

Short-term	2006 ThCh$	2005 ThCh$
Staff severance indemnities	431,550	381,067
Provision for employee vacations	4,305,778	4,010,454
Goal achievement incentive	4,584,149	4,979,090
Other employee benefits (1)	1,985,708	2,667,622
Employee benefit advances	(2,044,982)	(2,804,472)
Sub-Total	**9,262,203**	**9,233,761**
Long-term	**2006 ThCh$**	**2005 ThCh$**
Staff severance indemnities	35,286,751	36,110,711
Total	**44,584,954**	**45,344,472**

(1) Includes provisions for the Independence Day bonus, Christmas bonus, bonus guaranteed under the current union contract, and miscellaneous.

During the periods ended September 30, 2006 and 2005, there were bad debt write-offs of ThCh$4,012,339 and ThCh$33,478,235, respectively, which were charged against the related allowance for doubtful accounts.

19. <u>Staff Severance Indemnities</u>:

The detail of the charge to income for staff severance indemnities is as follows:

	2006 ThCh$	2005 ThCh$
Operating costs and administrative and selling expenses	3,086,450	3,487,910
Other non-operating expenses	9,249,217	-
Total	**12,335,667**	**3,487,910**
Payments and other changes in the period (1)	(3,091,601)	2,285,204

20. <u>Minority Interest:</u>

Minority interest recognizes the portion of equity and revenues of subsidiaries owned by third parties. The detail for 2006 and 2005 is as follows:

Subsidiaries	**Percentage Minority Interest**		**Participation in equity**		**Participation in net income (loss)**	
	2006 %	**2005 %**	**2006 ThCh$**	**2005 ThCh$**	**2006 ThCh$**	**2005 ThCh$**
Administradora de Sistemas de Telepeajes de Chile S.A.	20.00	20.00	6,835	239,301	(42,715)	(20,190)
Telefónica Larga Distancia S.A.	0.82	0.84	1,231,521	1,140,206	98,469	1,548
Fundación Telefónica	50.00	50.00	(35,079)	196,581	(311,748)	(51,124)
Telefónica Gestión Servicios Compartidos de Chile S.A.	0.001	-	16	-	2	-
CTC Equipos y Servicios de Telecomunicaciones S.A.	-	0.0001	-	38	-	4
		Total	**1,203,293**	**1,576,126**	**(255,992)**	**(69,762)**

21. <u>Shareholders Equity</u>

During the periods 2006 and 2005, changes in shareholders equity accounts are as follows:

	Paid-in capital	Price-level restatement of paid-in capital	Other reserves	Retained earnings	Net income	Interim dividend	Total Shareholders equit
2006	ThCh$	ThCh$	ThCh$	ThCh$	ThCh$	ThCh$	ThCh$
Balances as of December 31, 2005	912,692,729	-	(1,751,241)	-	25,183,320	(10,549,786)	925,575,0
Transfer of 2005 net income to retained earnings	-	-	-	25,183,320	(25,183,320)	-	
Capital decrease	(40,200,514)	-	-	-		-	(40,200,5
Absorption of interim dividend	-	-	-	(10,528,728)		10,528,728	
Final dividend 2005	-	-	-	(14,654,592)		-	(14,654,5
Cumulative translation adjustment	-	-	134,548	-	-	-	134,5
Price-level restatement, net	-	21,892,706	(43,781)	-	-	21,058	21,869,9
Other reserves	-	-	(679,178)	-	-	-	(679,1
Net income	-	-	-	-	19,748,132	-	19,748,1
Balances as of September 30, 2006	**872,492,215**	**21,892,706**	**(2,339,652)**	**-**	**19,748,132**	**-**	**911,793,4**
2005							
	880,977,537	-	(1,237,651)	48,806,351	311,628,674	(255,303,899)	984,871,0

Balances as of December 31, 2004							
Transfer of 2004 income to retained earnings	-	-	-	311,628,674	(311,628,674)	-	
Absorption of interim dividend	-	-	-	(255,303,899)	-	255,303,899	
Final dividend 2004	-	-	-	(56,324,775)	-	-	(56,324,7
Interim dividend	-	-	-	(48,806,351)	-	-	(48,806,3
Cumulative translation adjustment	-	-	(300,175)	-	-	-	(300,1
Price-level restatement, net	-	21,143,461	(29,704)	-	-	-	21,113,7
Net income	-	-	-	-	21,727,781	-	21,727,7
Balances as of September 30, 2005	**880,977,537**	**21,143,461**	**(1,567,530)**	**-**	**21,727,781**	**-**	**922,281,2**
Restated balances as of September 30, 2006	**913,584,031**	**21,926,017**	**(1,625,547)**	**-**	**22,531,964**	**-**	**956,416,4**

21. Shareholders Equity, continued:

(a) Paid-in capital:

As of September 30, 2006 the Company s paid-in capital is as follows:

Number of shares:

Series	No. of subscribed shares	No. of paid shares	No. of shares with voting rights
A	873,995,447	873,995,447	873,995,447
B	83,161,638	83,161,638	83,161,638

Paid-in capital:

Series	Subscribed Capital ThCh$	Paid-in Capital ThCh$
A	796,686,600	796,686,600
B	75,805,615	75,805,615

(b) Shareholder distribution:

As indicated in SVS Circular No.792, the distribution of shareholders by their ownership percentage in the Company as of September 30, 2006 is as follows:

Type of shareholder	Percentage of Total holdings %	Number of shareholders
10% holding or more	55.35	2
Less than 10% holding:	43.89	1,606
Investment equal to or exceeding UF 200		
Investment under UF 200	0.76	11,112
Total	**100.00**	**12,720**
Company controller	44.90	1

21. Shareholders Equity, continued:

(c) Dividends:

i) Dividend policy:

In accordance with Law No.18,046, unless otherwise decided at the Shareholders Meeting by unanimous vote, when there is net income at least 30% must be distributed in dividends.

Considering the cash situation, levels of projected investment and the solid financial indicators for 2005 and future years, on April 14, 2005, the Ordinary Shareholders Meeting modified the dividend distribution policy reported at the Ordinary Shareholders Meeting of April 2004, and agreed to distribute 100% of net income generated during the respective year, by means of an interim dividend in November of each year and a final dividend in May of the following year.

ii) Dividend distributed in the period:

On April 14, 2005, the Extraordinary Shareholders Meeting approved the payment of a final dividend (No. 168) of Ch$ 58.84591 per share with a charge to net income for 2004 of ThCh$56,324,775. Likewise, it approved payment of a provisional dividend (No.169) of Ch$ 50.99095 per share, with a charge to retained earnings as of December 2004 of ThCh$48,806,351. Both dividends were paid on May 30, 2005.

On October 27, 2005, the Board approved payment of an interim dividend (No. 170) of Ch$11.00 per share, with a charge to 2005 net income equivalent to ThCh$ 10,528,728.

On April 20, 2006, the Extraordinary Shareholders Meeting approved the payment of a final dividend (No. 171) of Ch$15.31 per share with a charge to net income for 2005 of ThCh$14,654,592. The dividend was paid on June 22, 2006.

In addition, the shareholders approved the modification of the Company s bylaws to decrease capital by ThCh$40,200,514, in order to distribute additional cash to the shareholders in 2006. Capital distribution No. 1 was equivalent to Ch$42 per share and Ch$168 per ADR.

(d) Other reserves:

Other Reserves include the participation of the reserve established by Telefónica Larga Distancia S.A. for the acquisition of the shares of dissident minority shareholders and the net effect of the foreign currency translation adjustment, as established in Technical Bulletin No. 64 of the Chilean Association of Accountants, the detail of which is as follows:

		Amount			
	Company	December 31, 2005 ThCh$	Price-level restatement ThCh$	Net Movement ThCh$	Balance as of September 30, 2006 ThCh$
96,551,670-0	Telefónica Larga	-	-	(679,178)	(679,178)

Foreign	Distancia S.A. TBS Celular Participación S.A.	(1,751,241)	(43,781)	134,548	(1,660,474)
	Total	**(1,751,241)**	**(43,781)**	**(544,630)**	**(2,339,652)**

22. Other Non-Operating Income and Expenses:

(a) Other non-operating income:

The detail of other non-operating income is as follows:

Other Income	2006 ThCh$	2005 ThCh$
Administrative services	172,495	-
Fines levied on suppliers and indemnities	125,860	24,448
Proceeds from sale of used equipment	544,567	1,022,359
Real estate rental	340,222	263,183
Net income on the sale of Intelsat shares	-	648,979
Other	103,382	320,862
Total	**1,286,526**	**2,279,831**

(b) Other non-operating expenses:

The detail of other non-operating expenses is as follows:

Other Expenses	2006 ThCh$	2005 ThCh$
Lawsuit and other provisions	1,125,332	1,090,022
Depreciation and retirement of out-of-service property, plant and equipment (1)	879,772	2,211,169
Retirement of property, plant and equipment that is out of service	666,989	1,105,937
Non-recovered VAT credit	-	1,007,411
Lower market value provision	26,213	90,954
Restructuring costs (2)	9,334,410	-
Other	149,528	733,072
Total	**12,182,244**	**6,238,565**

(1) As of June 2006, this item is composed mainly of depreciation of telephone equipment maintained in stock for replacements.
(2) Corresponds mainly to payments made to employees on the basis of the Early Retirement Plan.

23. Price-Level Restatement:

The detail of price-level restatement is as follows:

Assets (Charges)/ Credits	Indexation	2006 ThCh$	2005 ThCh$
Inventory	C.P.I.	25,622	64,712
Prepaid expenses	C.P.I.	(1,255)	4,757
Prepaid expenses	U.F.	26,843	(9,824)
Other current assets	C.P.I.	151,404	(28,528)
Other current assets	U.F.	88,942	(147,872)
Short- and long-term deferred taxes	C.P.I.	2,862,075	3,057,773
Property, plant and equipment	C.P.I.	33,525,277	34,536,852
Investments in related companies	C.P.I.	177,873	181,800
Goodwill	C.P.I.	442,344	481,307
Long-term receivables	U.F.	(308,854)	(1,960,187)
Long-term receivables	C.P.I.	180,767	203,352
Other long-term assets	C.P.I.	669,052	1,036,030
Other long-term assets	U.F.	(99,973)	7,585
Expense accounts	C.P.I.	6,194,293	6,459,618
Total Credits		**43,934,410**	**43,887,375**

Liabilities Shareholders Equity (Charges)/ Credits	Indexation	2006 ThCh$	2005 ThCh$
Short-term obligations	U.F.	(167,619)	(7,370,796)
Long-term obligations	C.P.I.	(28,507)	(12,674)
Long-term obligations	U.F.	(9,525,766)	(5,038,566)
Shareholders equity	C.P.I.	(21,869,983)	(21,895,213)
Revenue accounts	C.P.I.	(9,513,020)	(10,553,433)
Total Charges		**(41,104,895)**	**(44,870,682)**
Price-level restatement, net		**2,829,515**	**(983,307)**

24. Foreign Currency Translation:

The detail of the gain on foreign currency translation is as follows:

Assets (Charges)/ Credits	Currency	2006 ThCh$	2005 ThCh$
Inventory	US$	-	(530,625)
Other current assets	US$	3,995,160	6,104,610
Other current assets	EURO	1,571	(8,035)
Other current assets	BRAZILIAN REAL	138,666	(26,960)
Long-term receivables	US$	1,411,885	6,102,192
Other long-term assets	US$	(851)	6,490
Total Credits		**5,546,431**	**11,647,672**

Liabilities (Charges)/ Credits	Currency	2006 ThCh$	2005 ThCh$
Short-term obligations	US$	(2,251,670)	(995,674)
Short-term obligations	EURO	947	230
Short-term obligations	BRAZILIAN REAL	82,030	17,817
Long-term obligations	US$	(3,059,391)	(9,240,660)
Total Charges		**(5,228,084)**	**(10,218,287)**

Foreign currency translation, net		**318,347**	**1,429,385**

25. Share and Debt Title Issuance and Placement Expense:

The detail of this item is as follows:

	Short-term		Long-term	
	2006 ThCh$	**2005 ThCh$**	**2006 ThCh$**	**2005 ThCh$**
Bond issuance expenses	129,687	419,905	723,039	28,947
Discount on debt	232,295	56,694	1,181,554	193,067
Commercial paper issuance expense	17,155	225,895	-	-
Total	**379,137**	**702,494**	**1,904,593**	**222,014**

These items are classified under Other Current Assets and Other Long-term Assets, as applicable, and are amortized over the term of the respective obligations.

26. Cash Flows:

Financing and investing activities that do not generate cash flows during the period, but which commit future cash flows are as follows:

a) Financing activities: Financing activities that commit future cash flows are as follows:

Obligations with banks and financial institutions	- see Notes 15 and 16
Obligations with the public	- see Note 17

b) Investing activities: Investing activities that commit future cash flows are as follows:

	Maturity	ThCh$
BCD	2007	14,251,499
BCU	2009	1,939,814

c) Cash and cash equivalents:

	2006 ThCh$	2005 ThCh$
Cash	10,260,452	8,984,683
Time deposits	9,339,772	3,209,393
Marketable securities (less than 90 days)	-	562,449
Other current assets	3,700,686	14,003,286
Total	**23,300,910**	**26,759,811**

27. <u>Derivative Contracts:</u>

The detail of derivate contracts is as follows:

		Description of Contract								
Type of Derivate	Type of Contract	Contract Value	Maturity or Expir.	Specific Item	Purchase Sale Position	Hedged Item or Transaction		Value of Hedged Item ThCh$	Asset/Lia	
						Name	Amount		Name	A T
FR	CCPE	150,000,000	III Quarter 2008	Cross Currency Swap	C	Oblig.in US$	150,000,000	80,554,500	asset liability	8 (89
FR	CCPE	200,000,000	II Quarter 2009	Cross Currency Swap	C	Oblig.in US$	200,000,000	107,406,000	asset liability	10 (119
FR	CCPE	150,000,000	II Quarter 2011	Cross Currency Swap	C	Oblig.in US$	150,000,000	80,554,500	asset liability	8 (83
FR	CI	26,400,000	III Quarter 2006	Exchange rate	V	Oblig.in US$	18,000,000	14,280,680	asset liability	14 (14
FR	CCPE	10,198,454	IV Quarter 2006	Exchange rate	C	Oblig.in US$	10,198,454	5,476,876	asset liability	(5
FR	CCPE	2,599,039	I Quarter 2007	Exchange rate	C	Oblig.in US$	2,599,039	1,395,762	asset liability	(1
FR	CI	2,522,787	IV Quarter 2006	Exchange rate	C	Oblig.in US$	2,522,787	624,491	asset liability	
FR	CI	391,416	I Quarter 2007	Exchange rate	C	Oblig.in US$	391,416	96,981	asset liability	
Deferred income for exchange forward contracts									liabilities	
Deferred costs for exchange insurance									asset	
Exchange forward contracts expensed during the year (net)										
				TOTAL						

Type of derivates :	FR: Forwad S : Swap	**Type of Contract**:	CCPE: Hedge contract for existing transactions CI: Investment hedge contract CCTE: Hedge contract for anticipated transactions

28. <u>Contingencies and Restrictions</u>:

a) Lawsuits:

(i) Claims presented by VTR Telefónica S.A.:

On September 30, 2000, VTR Telefónica S.A. filed an ordinary suit for the collection of access charges in the amount of ThCh$2,500,000, based on the differences that would arise from the lowering of access charge rates, due to Tariff Decree No. 187 of Telefónica Chile. The initial sentence accepted VTR s claim and the compensation disputed by Telefónica Chile. The Company filed a motion to vacate and appeal, which is currently underway.

(ii) Labor lawsuits:

In the course of normal operations, labor lawsuits have been filed against the Company.

To date, among others, there are labor proceedings involving former employees, who claim wrongful dismissal. These employees did not sign termination releases or receive staff severance indemnities. On various occasions, the Supreme Court has reviewed the sentences handed down on the matter, accepting the argument of the Company and ratifying the validity of the terminations.

There are, in addition, other lawsuits involving former employees in some proceedings, whose staff severance indemnities have been paid and their termination releases signed, who in spite of having chosen voluntary retirement plans or having been terminated due to company needs, intend to have the terminations voided. Of these lawsuits, to date, two have received a sentence favorable to the Company, rejecting the annulments.

Certain unions have filed complaints before the Santiago Labor Courts, requesting damage payments for various concepts.

In the opinion of Management and internal legal counsel, the risk that the Company will be required to pay indemnities in the amount claimed in the previously mentioned lawsuits, in addition to other civil and labor suits in which the Company is the defendant, is remote. Management considers it unlikely that the Company s income and equity will be significantly affected by these loss contingencies. Consequently, no provisions have been established in relation to the severance indemnities claimed.

(iii) Lawsuits against the Government:

On October 31, 2001,Telefónica Chile filed an administrative motion before the Ministry of Transport and Telecommunications and the Ministry of Economy,requesting correction of the errors and illegalities in Tariff Decree No. 187 of 1999. On January 29, 2002, the Ministries issued a joint response rejecting the administrative recourse, after having carefully evaluated, only the viability and timeliness of the petition made, considering the set of circumstances that concur in the problem stated and the prudence that must orient public actions , adding that such rejection has had no other motivation than to protect the general interest and progress of the telecommunications services .

Upon extinguishing the administrative instances to correct the errors and illegalities involved in the tariff setting process of 1999, in March 2002, Telefónica Chile filed a lawsuit for damages against the State of Chile for the sum of Ch$ 181,038,411,056, plus readjustments and interest, which covers past and future damages until May 2004. Currently a decision is pending in this case.

28. Contingencies and Restrictions, continued:

(iii) Lawsuits against the Government, continued**:**

Telefónica Chile and Telefónica Larga Distancia filed a plenary damage indemnity lawsuit against the Government of Chile, claiming damages due to modification of telecommunications networks related to work performed by highway concessionaries from 1996 to 2000.

The Government forced both companies to pay to transfer their communications networks due to the construction of public works on concession under the Concessions Law, and the related damages amount to:

a.- Compañía de Telecomunicaciones de Chile S.A.: Ch$1,929,207,445
b.- Telefónica Larga Distancia S.A.: Ch$ 2,865,208,840

The process is currently at the final sentencing stage.

(iv) Manquehue Net:

On June 24, 2003, Telefónica Chile filed a forced compliance of contracts complaint with damage indemnity before the mixed arbitration court of Mr. Victor Vial del Río against Manquehue Net, in the amount of Ch$ 3,647,689,175, in addition to costs incurred during the proceeding. Likewise, and on the same date, Manquehue Net filed a compliance with discounts complaint (in the amount of UF 107,000), in addition to an obligation to perform complaint (signing of a 700 services contract). After completion of the evidence period, on June 5, 2004, the arbiter called the parties together to pronounce a sentence.

On April 11, 2005, the Court notified the first instance sentence accepting the claim made by Telefónica Chile and ordering Manquehue Net to pay approximately Ch$ 452 million, and at the same time accepted Manquehue Net s claim and ordered Telefónica Chile to pay 47,600 UF.

Telefónica Chile filed an appeal for dismissal on the grounds of errors in the form in both cases; which are currently pending before the Court of Appeals of Santiago.

(v) Chilectra and CGE:

In June 2006, Telefónica Chile filed complaints against Chilectra S.A. and Río Maipo (currently CGE Distribución), in which it requests a readjusted refund of the Reimbursable Financial Contributions (AFR) (Aportes Financieros Reembolsables) made by the Company between 1992 and 1998, in relation to the Electrical Law. The restitution amounts claimed are ThCh$899,658 and ThCh$117,350, respectively. The lawsuits have recently been notified.

28. Contingencies and Restrictions, continued:

(vi) Protection Motion:

On June 28, 2006, TV channels UCTV and TVN filed a protection motion against Telefónica Chile requesting suspension of the inclusion of such signals in the Digital Television plans. On June 30, the First Court of Appeals declared the motion inadmissible, which was confirmed on July 4, when the appeals motion was rejected by the appellate court.

The complaint filed before the Supreme Court by the channels against the ministers integrating the Courtroom was declared inadmissible on July 13, 2006.

b) Other contingencies:

(i) Financial restrictions:

In order to carry out its investment plans, the Company obtained financing in the local and foreign market (notes 15, 16 and 17), which established, among others restrictions, the maximum debt that the Company may have.

The maximum debt ratio for these contracts is 1.60

Non-compliance with these clauses implies that all the obligations included in these financing contracts will be considered as due.

As of September 30, 2006, the Company is in compliance with all the financial restrictions.

29. Third party guarantees:

The Company has not received any guarantees from third parties.

30. Local and Foreign Currency:

A summary of the assets in local and foreign currency is as follows:

Description	Currency	2006 ThCh$	2005 ThCh$
Total current assets:		**287,683,551**	**305,945,323**
Cash	Non-indexed Ch$	5,920,363	5,555,720
	Dollars	4,292,718	3,379,141
	Euros	47,371	49,822
Time deposits	Indexed Ch$	302,776	295,307
	Non-indexed Ch$	4,811,035	2,914,086
	Dollars	4,225,961	-
Marketable securities	Indexed Ch$	1,939,814	-
	Dollars	14,251,499	42,891,665
Notes and accounts receivable (1)	Indexed Ch$	16,093	-
	Non-indexed Ch$	189,804,994	174,647,090
	Dollars	6,671,708	6,914,176
	Euros	20,428	-
Accounts receivable from related companies	Non-indexed Ch$	12,869,822	12,548,236
	Dollars	4,192,783	2,439,058
Other current assets (2)	Indexed Ch$	12,584,224	17,972,435
	Non-indexed Ch$	25,606,251	33,367,505
	Dollars	52,710	2,925,683
	Brazilian Real	73,001	45,399
Total property, plant and equipment :		**1,245,035,575**	**1,354,673,582**
Property, plant and equipment and accumulated depreciation	Indexed Ch$	1,245,035,575	1,354,673,582
Total other long-term assets		**90,643,081**	**95,428,628**
Investment in related companies	Indexed Ch$	8,678,469	8,420,154
Investment in other companies	Indexed Ch$	4,195	4,195
Goodwill	Indexed Ch$	17,034,945	19,321,734
Other long-term assets (3)	Indexed Ch$	43,893,930	64,712,035
	Non-indexed Ch$	20,976,760	2,970,510
	Dollars	54,782	-
Total assets		**1,623,362,207**	**1,756,047,533**
Subtotal by currency	**Indexed Ch$**	**1,329,490,021**	**1,465,399,442**
		259,989,225	**232,003,147**

Non-indexed Ch$		
Dollars	**33,742,161**	**58,549,723**
Euros	**67,799**	**49,822**
Brazilian Real	**73,001**	**45,399**

(1) Includes the following balance sheet accounts: Trade Accounts Receivable, Notes Receivable and Miscellaneous Accounts Receivable.
(2) Includes the following balance sheet accounts: Inventories, Recoverable Taxes, Prepaid Expenses, Deferred Taxes and Other Current Assets.
(3) Includes the following balance sheet accounts: Long-term Receivables, Intangibles, Accumulated Amortization and Other.

30. Local and Foreign Currency (continued):

A summary of the current liabilities in local and foreign currency is as follows:

Description	Currency	Up to 90 days				90 days up to 1 year			
		2006		2005		2006		2005	
		Amount ThCh$	Average annual interest %	Amount ThCh$	Average annual interest %	Amount ThCh$	Average annual interest %	Amount ThCh$	Averag annua interes %
Short-term portion of obligations with banks and financial institutions	Indexed Ch$	970,411	3.16	597,924	1.95	-	-	-	
	Dollars	1,628,081	5.76	1,461,070	4.46	-	-	16,463,598	4.6
Obligations with the public (Commercial paper)	Non-indexed Ch$	11,876,498	5.76	12,427,874	3.72	-	-	23,295,064	4.9
Obligations with the public (Bonds payable)	Indexed Ch$	2,576,842	4.15	1,710,317	6.00	-	-	-	
	Dollars	-	-	-	-		-	115,355,095	8.2
Long-term obligations maturing within a year	Indexed Ch$	3,736	8.10	5,562	9.06	11,205	8.10	16,687	9.0
Accounts payable to related parties	Indexed Ch$	-	-	-	-	-	-	143,311	
	Non-indexed Ch$	28,800,876	-	30,109,393	-	-	-	-	
	Dollars	2,390,958	-	766,199	-	-	-	-	
Other current liabilities	Indexed Ch$	234,130	-	-	-	-	-	163,600	
	Non-indexed Ch$	126,114,845	-	130,390,838	-	3,344,382	-	5,573,921	
	Dollars	13,615,092	-	3,682,306	-	9,250	-	-	

	Euros	154,180	-	-	-	-	-	-
	Brazilian Real	6,805	-	-	-	-	-	-
TOTAL CURRENT LIABILITIES		**188,372,454**		**181,151,475**		**3,364,837**		**160,991,276**
Subtotal by currency	**Indexed Ch$**	**3,785,119**		**2,313,803**		**11,205**		**323,598**
	Non-indexed Ch$	**166,792,219**		**172,928,105**		**3,344,382**		**28,868,985**
	Dollars	**17,634,131**		**5,909,567**		**9,250**		**131,798,693**
	Euros	**154,180**		**-**		**-**		**-**
	Brazilian Real	**6,805**		**-**		**-**		**-**

(4) Includes the following balance sheet accounts: Dividends payable, Trade accounts payable, Notes payable, Miscellaneous accounts payable, Accruals, Withholdings, Income taxes, Unearned Income and Other current liabilities.

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30. Local and Foreign Currency (continued):

A summary of the long-term liabilities in local and foreign currency for 2006 is as follows:

		1 to 3 years 2006		3 to 5 years 2006		5 to 10 years 2006		over 10 years	
Description	**Currency**	**Amount**	**Average annual interest rate**	**Amount**	**Average annual interest rate**	**Amount**	**Average annual interest rate**	**Amount**	**Average annual interest rate**
		ThCh$	**%**	**ThCh$**	**%**	**ThCh$**	**%**	**ThCh$**	**%**
LONG-TERM LIABILITIES									
Obligation with banks and financial institutions	Indexed Ch$	-	-	65,416,088	3.16	-	-	-	-
	Dollars	187,960,500	5.74	80,554,500	5.80	-	-	-	-
Bonds payable	Indexed Ch$	2,490,383	6.00	2,490,383	6.00	62,052,003	4.15	-	-
Other long-term liabilities (5)	Indexed Ch$	39,957,008	-	14,105,646	-	22,701,482	-	31,505,479	-
	Non-indexed Ch$	1,029,283	-	382,163	-	955,407	-	7,027,897	-
TOTAL LONG-TERM LIABILITIES		**231,437,174**		**162,948,780**		**85,708,892**		**38,533,376**	
Subtotal by currency	**Indexed Ch$**	**42,447,391**		**82,012,117**		**84,753,485**		**31,505,479**	
	Non-indexed Ch$	**1,029,283**		**382,163**		**955,407**		**7,027,897**	
	Dollars	**187,960,500**		**80,554,500**		**-**		**-**	

A summary of the long-term liabilities in local and foreign currency for 2005 is as follows :

Description	**Currency**	**1 to 3 years 2005**	**3 to 5 year 2005**	**5 to 10 years 2005**	**over 10 years**
		Amount	**Amount**	**Amount**	**Amount**

			Average annual interest rate		Average annual interest rate		Average annual interest rate		Average annual interest rate
		ThCh$	**%**	**ThCh$**	**%**	**ThCh$**	**%**	**ThCh$**	**%**
LONG-TERM LIABILITIES									
Obligation with banks and financial institutions	Indexed Ch$	-	-	65,317,143	1.95	-	-	-	-
	Dollars	65,854,392	4.69	192,075,312	4.22	-	-	-	-
Bonds payable	Indexed Ch$	2,624,759	6.00	2,624,760	6.00	7,874,287	6.00	-	-
	Dollars	-	-	-	-	-	-	-	-
Other long-term liabilities (5)	Indexed Ch$	12,647,538	-	8,142,796	-	20,365,784	-	19,983,712	-
	Non-indexed Ch$	10,175,903	-	495,508	-	9,619,440	-	38,110,857	-
TOTAL LONG-TERM LIABILITIES		**91,302,592**		**268,655,519**		**37,859,511**		**58,094,569**	
Subtotal by currency	**Indexed Ch$**	**15,272,297**		**76,084,699**		**28,240,071**		**19,983,712**	
	Non-indexed Ch$	**10,175,903**		**495,508**		**9,619,440**		**38,110,857**	
	Dollars	**65,854,392**		**192,075,312**		**-**		**-**	

(5) Includes the following balance sheet accounts: Accounts payable to related companies, Miscellaneous accounts payable, Accruals, Deferred long-term taxes, Other long-term liabilities.

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31. Sanctions:

Neither the Company nor its Directors and Managers have been sanctioned by the Superintendency of Securities and Insurance or any other administrative authority during 2006 and 2005.

32. Subsequent Events:

On October 18, 2006, the Company informed the SVS of the acquisition of 44,173 shares of its subsidiary Telefónica Larga Distancia S.A., increasing its ownership interest to 99.25% .

On October 26, 2006, the Board of Directors of Telefónica Chile agreed to distribute an interim dividend, with a charge to net income obtained by the Company as of September 30, 2006, for a total of Ch$10,528,727,935, equivalent to Ch$11 per share. This dividend will be paid as of November 23, 2006.

Management is unaware of any other significant subsequent events that have occurred between October 1 and 26, 2006, and that may affect the Company s financial position or the interpretation of these interim consolidated financial statements.

33. Environment:

In the opinion of Management and the Company s in-house legal counsel, and because the nature of the Company s operations does not directly or indirectly affect the environment, as of the closing date of these interim consolidated financial statements, no resources have been set aside nor have any payments been made for non-compliance with municipal ordinances or to other supervising organizations.

34. Time deposits:

The detail of time deposits is as follows:

Placement	Institution	Currency	Principal ThCh$	Rate %	Maturity	Principal ThCh$	Accrued interest	2006 ThCh$
Aug 03, 2006	BCO. CREDITO E INVERSIONES	USD	139,431	5.18	02-Oct-06	74,878	302	75,180
Aug 03, 2006	BCO. CREDITO E INVERSIONES	USD	148,522	5.18	02-Oct-06	79,761	333	80,094
Sep 05, 2006	BCO. CREDITO E INVERSIONES	UF	16,440	4.80	05-Dic-06	302,518	258	302,776
Sep 11, 2006	BCO. SANTANDER SANTIAGO	$	1,000,000	5.76	12-Mar-07	1,000,000	3,040	1,003,040
Sep 13, 2006	BCO. SANTANDER SANTIAGO	$	1,800,000	5.82	12-Mar-07	1,800,000	4,947	1,804,947
Sep 26, 2006	BCO. SANTANDER SANTIAGO	$	1,000,000	5.76	12-Mar-07	1,000,000	640	1,000,640
Sep 27, 2006	BCO. SANTANDER SANTIAGO	$	1,000,000	5.76	12-Mar-07	1,000,000	480	1,000,480
Sep 29, 2006	ABN AMRO BANK	USD	7,580	5.30	02-Oct-06	4,070,687	-	4,070,687
		$	1,928	-	31-Oct-06	1,928	-	1,928

Sep 29, 2006	BCO. SANTANDER SANTIAGO			
	Total	**9,329,772**	**10,000**	**9,339,772**

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35. Accounts Payable:

The detail of the accounts payable balance is as follows:

Description		2006 ThCh$	2005 ThCh$
Suppliers			
Chilean		73,145,935	56,244,667
Foreign		4,036,718	4,983,110
Provision for work in progress		9,197,098	5,535,976
	Total	**86,379,751**	**66,763,753**

36. Other Accounts Payable:

The detail of other accounts payable is as follows:

Description		2006 ThCh$	2005 ThCh$
Exchange insurance contract payables		31,623	26,288,816
Billing on behalf of third parties		7,082,557	6,144,374
Accrued supports		2,548,917	1,265,787
Carrier service		10,564,331	6,694,956
Other		40,022	1,490,591
	Total	**20,267,450**	**41,884,524**

Antonio José Coronet
General Accountant

José Molés Valenzuela
General Manager

MANAGEMENT S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2006 and 2005

Management s Discussion and Analysis of the Consolidated Financial Statements

COMPAÑÍA DE TELECOMUNICACIONES DE CHILE S.A. AND SUBSIDIARIES

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Management's Discussion and Analysis of the Consolidated Financial Statements

1. HIGHLIGHTS

Collective Bargaining Processes

During the third quarter of 2006, the Company successfully completed the collective bargaining processes with seven existing union organizations, which altogether comprise 2,141 employees, representing 94% of union employees. The main issues incorporated in the collective agreements were related to remuneration variability, in accordance with the structure of compensation levels and as a function of the Company s income, and annual readjustments of labor benefits and conditions. The average duration of these agreements is 48 months.

Decrease in Financial Debt

Telefónica Chile has continued to improve its level of indebtedness and financial ratios through a decrease in the debt level in 2006. As of September 30, 2006, the financial debt reached Ch$414,152 million, reflecting a 17.7% decrease with respect to the financial debt of Ch$502,943 million recorded as of September 30, 2005. The decrease in the indebtedness levels, together with the improved financing conditions and the drop in the value of the dollar, translated into a decrease of 34.4% in financial expenses as of September 30, 2006.

Dividends Policy

Telefónica Chile
On September 21, 2004, after taking into consideration the cash situation, levels of projected investment and solid financial indicators, the Company s Board of Directors modified the dividend distribution policy, from 30% to 100% of net income generated during the respective year. These dividends will be paid through an interim dividend in November of each year and a final dividend in May of the following year. The dividend policy for 2006 was informed at the Shareholders Meeting of April 20, 2006.

Telefónica Larga Distancia
On September 23, 2006, the Board of Directors of Telefónica de Larga Distancia agreed to modify the dividend policy and established its intention to distribute 30% of net income generated during the respective year, through a final dividend in May of each year, which will be proposed at the Ordinary Shareholders Meeting.

Capital Decrease

On May 25, 2006, the Board of Directors of Telefónica Chile agreed to pay to the shareholders the capital decrease of Ch$40,200,513,570 (historical) (Ch$42.00 per share) beginning on June 15, 2006, as approved at the extraordinary shareholders meeting held on April 20, 2006

Permit for Limited Satellite and Cable Television Service

Through Exempt Resolution No. 1605 of December 23, 2005, the Undersecretary of Telecommunications (Subtel) granted Telefónica Multimedia Chile S.A. (formerly Tecnonáutica S.A.) a limited satellite television service permit to operate throughout the national territory for a renewable 10-year term. In addition, Telefónica Multimedia has a limited cable television service permit to provide services through the broadband network of Telefónica Chile.

Telefónica Multimedia began commercialization of the satellite television service. In turn, Telefónica Chile began commercializing a bundled service which includes voice, pay television and broadband.

Modifications of the Regulatory Framework: Extension of the Length of Public Telephone Services Subscriber Number

By means of Resolution No. 1120 of September 28, 2005, published in the Official Gazette on October 4, 2005, Subtel set a period of 10 months to extend the local telephone numbers in the Primary Zones of Valparaiso and Concepción by one digit. Furthermore, by means of Decree No. 400, of October 4, 2005, issued by the Ministry of Transport and Telecommunications, the Fundamental Telephone Numbering Technical Plan was modified in order to define the virtual mobile network area code with the number 09, and by means of Exempt Resolution No. 27 of 2006, August 19, 2006 was established as the date on which the new virtual mobile area code will begin operating.

Telefónica Chile is performing the network and systems modifications needed to enable the new regulatory requirements related to telephone numbers, which are operating normally.

Setting Post Support Tariffs

Telefónica Chile, together with other telecommunications companies, expressed dissent before the Panel of Experts of the Electric Law, regarding service tariffs corresponding to post supports, and proposed an annual tariff for each post support of approximately 0.02 UF. Likewise, the distribution companies also expressed their dissent before the Panel of Experts with respect to the post support tariffs, and proposed an annual tariff of between 0.4 UF and 0.5 UF per support.

2. VOLUME STATISTICS, STATEMENTS OF INCOME AND RESULTS BY BUSINESS AREA

TABLE No. 1
VOLUME STATISTICS

DESCRIPTION	SEPTEMBER 2005	SEPTEMBER 2006	VARIATION Q	%
Lines in Service (end of period)	2,475,007	2,235,686	-239,321	-9.7%
Normal	1,510,732	969,425	-541,307	-35.8%
Plans	416,616	901,579	484,963	116.4%
Prepaid	547,659	364,682	-182,977	-33.4%
Broadband	268,344	464,764	196,420	73.2%
DLD Traffic (thousands) Total minutes (188+120)	457,967	411,437	-46,530	-10.2%
ILD Traffic (thousands) Outgoing minutes (188+120)	49,284	50,393	1,109	2.3%
IP Dedicated	10,591	11,786	1,195	11.3%
Digital Television	n.d.	52,380	n.d.	n.d.

TABLE No. 2
CONSOLIDATED STATEMENTS OF INCOME FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30,2006 AND 2005
(Figures in millions of pesos as of 09.30.06)

DESCRIPTION	JAN SEP 2005	JAN DEC 2005	JAN-SEP 2006	VARIATION (2006/2005) ThCh$	%
OPERATING REVENUES					
FIXED TELECOMUNICATIONS	**341,658**	**452,513**	**333,090**	**(8,568)**	**-2.5%**
Basic Telephony	**230,236**	**301,641**	**202,896**	**(27,340)**	**-11.9%**
Fixed Charge	99,330	126,627	65,561	(33,769)	-34.0%
Variable Charge	76,862	99,331	55,377	(21,485)	-28.0%
Connections and Other Installations	2,398	3,362	1,092	(1,306)	-54.5%
Flexible Plans (Minutes)	31,688	46,870	63,818	32,130	101.4%
Value Added Services	15,471	19,962	11,944	(3,527)	-22.8%
Other Basic Telephony Services	4,487	5,489	5,104	617	13.8%
Broadband and Broadband Plus Voice	**31,292**	**43,974**	**45,154**	**13,862**	**44.3%**
Access Charges and Interconnections (1)	**33,110**	**45,104**	**38,761**	**5,651**	**17.1%**
Domestic Long Distance (DLD)	8,204	10,603	6,487	(1,717)	-20.9%
International Long Distance (ILD)	2,000	2,430	1,237	(763)	-38.2%
Other Interconnection Services	22,906	32,071	31,037	8,131	35.5%
Other Fixed Telephony Services	**47,020**	**61,794**	**46,279**	**(741)**	**-1.6%**
Advertising in Telephone Directories	4,501	5,503	3,760	(741)	-16.5%
ISP (Switchboard and Dedicated)	2,001	2,594	1,679	(322)	-16.1%
Telemergencia (Security Services)	6,067	8,283	6,691	624	10.3%
Public Phones	7,845	10,064	7,697	(148)	-1.9%
Interior Installation and Equipment Rental	23,544	31,454	23,396	(148)	-0.6%
Equipment Commercialization	3,062	3,896	2,235	(827)	-27.0%
Other	-	-	821	821	n.a.
LONG DISTANCE	**45,113**	**59,422**	**44,070**	**(1,043)**	-2.3%
Long Distance	18,401	23,850	16,620	(1,781)	-9.7%
International Service	15,086	19,951	16,793	1,707	11.3%
Network Capacity and Circuit Rentals	11,626	15,621	10,657	(969)	-8.3%
CORPORATE COMMUNICATIONS	**58,189**	**80,169**	**56,378**	**(1,811)**	-3.1%
Terminal Equipment	9,799	13,712	8,487	(1,312)	-13.4%
Complementary Services	11,214	15,033	10,412	(802)	-7.2%
Data Services	21,939	28,822	19,794	(2,145)	-9.8%
Dedicated Links and Others	15,237	22,602	17,685	2,448	16.1%
OTHER BUSINESSES (2)	**2,212**	**3,124**	**2,048**	**(164)**	**-7.4%**
TOTAL OPERATING REVENUES	**447,172**	**595,228**	**435,586**	**(11,586)**	**-2.6%**
Salaries	(61,270)	(81,055)	(51,991)	9,279	-15.1%
Depreciation	(151,207)	(201,571)	(156,963)	(5,756)	3.8%

Other Operating Costs	(166,102)	(223,328)	(165,109)	993	-0.6%
TOTAL OPERATING COSTS	**(378,579)**	**(505,954)**	**(374,063)**	**4,516**	**-1.2%**
OPERATING INCOME	**68,593**	**89,274**	**61,523**	**(7,070)**	**-10.3%**
Interest Income	6,457	8,184	3,474	(2,983)	-46.2%
Other Non-operating Income	2,280	3,183	1,287	(993)	-43.6%
Income from Investment in Related Companies (3)	1,158	1,722	1,350	192	16.6%
Interest Expenses	(23,393)	(30,239)	(15,352)	8,041	-34.4%
Amortization of Goodwill	(1,214)	(1,623)	(1,859)	(645)	53.1%
Other Non-operating Expenses	(6,239)	(13,404)	(12,182)	(5,943)	95.3%
Price-level restatement	447	2974	3,148	2,701	n.a.
NON-OPERATING INCOME	**(50,204)**	**(29,203)**	**(20,134)**	**370**	**-1.8%**
INCOME BEFORE INCOME TAX	**48,089**	**60,071**	**41,389**	**(6,700)**	**-13.9%**
Income taxes	(25,626)	(34,227)	(21,897)	3,729	-14.6%
Minority Interest	69	(31)	256	187	n.a.
NET INCOME (4)	**22,532**	**25,813**	**19,748**	**(2,784)**	**-12.4%**

(1) Due to accounting consolidation does not include access charges of Telefónica Larga Distancia.
(2) Includes revenues from T-gestiona, Telepeajes and Fundación.
(3) For the purposes of a comparative analysis, participation in income from investments in related companies is shown net (net income/losses).
(4) For comparison purposes, certain reclassifications have been made to the 2005 statements of income.

3. ANALYSIS OF INCOME FOR THE PERIOD

3.1 OPERATING INCOME

As of September 30, 2006, operating income amounted to Ch$ 61,523 million, which represents a 10.3% decrease with respect to the previous year.

Operating Income

Operating income for the period amounted to Ch$435,586 million, or a decrease of 2.6% in relation to operating income for the same period in 2005 of Ch$447,172 million. This variation was mainly the result of the decrease in revenues from basic and long distance telephone service due to less traffic recorded in the period.

Fixed Telephony Revenues: Fixed telephony revenues decreased 2.5% with respect to the previous period, mainly due to a drop of 11.9% in basic telephony revenues, which resulted from a 28.0% decrease in variable charge revenues. This decrease shows the effect of lower revenues derived from the downturn in traffic per line and migration of customers to flexible plans. Similarly, fixed charge revenues from the fixed monthly network connection charge dropped 34.0% . This change is mainly explained by the incorporation of customers to flexible plans, which grew by 101.4% with respect to the previous year. Consequently, the incorporation of customers to flexible plans contributed positively to income, growing Ch$ 32,130 million with respect to the previous year. Revenues from connections and other installations are 54.5% below the previous year s level, whereas value-added service revenues decreased by 22.8%, mainly due to the drop in average lines in use. Other basic telephony revenues increased 13.8% .

Revenues from broadband services have shown sustained growth, reaching Ch$ 45,154 million, or 44.3% growth, in 2006, as compared to reached Ch$ 31,292 million in 2005.

Access charges and interconnections increased by 17.1%, mainly due to the 35.5% increase in ***other interconnection services,*** where there were particularly noteworthy increases in media rental services, carrier information and connection services, and unbundling services. On the other hand, there was a 38.2% drop in revenues from **international long distance** access charges and a 20.9% drop in **domestic long distance**.

Revenues from **other fixed telephony businesses** decreased 3.1%, equivalent to Ch$ 741 million. This change is primarily explained by the decreases in revenues of Ch$827 million from commercialization of equipment; Ch$ 480 million from public telephones; Ch$ 741 million from telephone book advertising; and Ch$322 million from switchboard and dedicated ISP. The drop was offset by an increase of Ch$ 624 million in Telemergencia s revenues, with respect to 2005. In addition, others includes income obtained from commercialization of DTH television service in the amount of Ch$ 821 million.

Long Distance: Revenues from long distance services decreased by 2.3% in comparison to 2005, due to a decrease of 9.7% in DLD and a decrease of 8.3% in Network Capacity and Circuit Rentals. However, the decline was offset by an 11.3% increase in ILD income from international services income, due to correspondent charges recorded during the third quarter of 2005.

Corporate Communications**:** Revenue from corporate communications decreased 3.1% with respect to the previous year, due to decreases in all lines of business: 9.8% in data services, 13.4% in sales of terminal equipment, and 7.2% in complementary services. This was partly offset by a 16.1% increase in revenues from circuits and others.

Other Businesses: Revenue from other businesses decreased 4%, mainly because of lower revenues from the subsidiary Telepeajes (automatic toll services).

Operating Costs

Operating costs for the period amounted to Ch$ 374,063 million, decreasing by 1.2% in relation to 2005, when they amounted to Ch$ 378,579 million. This change is mainly explained by a Ch$9,297 million decrease in remunerations as a product of the restructuring performed at the beginning of 2006. Furthermore, there was a 0.5% drop in other operating costs, which was offset by an increase in depreciation costs.

3.2 NON-OPERATING INCOME

Non-operating income obtained in the period ended on September 30, 2006 shows a deficit of Ch$ 20,134 million, whereas in the previous period it was Ch$ 20,504 million, which implied a 1.8% drop in the deficit. Where:

Financial income decreased 46.2%, mainly because in 2005 the greater volume of funds in the 2005 period was temporarily allocated to financial investments.

Other non-operating income amounted to Ch$1,287 million, which is lower than the Ch$2,280 million in 2005. This difference is mainly because of lower income obtained on the sale of recovered material, as well as the effect of the sale of Intelsat shares on 2005 net income.

Financial expenses decreased by 34.4% in 2006, as a product of lower interest-bearing debt.

Amortization of goodwill increased Ch$645 million in relation to 2005, mainly because of the full amortization of the goodwill of Tecnonaútica, due to the restructuring of the Telefonica Chile group.

Other non-operating expenses amounted to Ch$12,182 million, a Ch$6,239 million increase with respect to 2005. This increase is explained by the costs incurred in the personnel restructuring that took place at the beginning of 2006.

The Company recorded positive net ***price-level restatement*** in 2006 in the amount of Ch$3,148 million, mainly due to the variations in the CPI, UF and exchange rate. It should be noted that the Company s hedging activities covered 100% of exchange rate fluctuations and 84% of interest rate fluctuations. As a result of the Chilean peso-U.S. dollar exchange rate hedges, the effect of exchange rate variation in 2005 and 2006 was neutral.

3.3 NET INCOME FOR THE PERIOD

The Company recorded net income of Ch$19,748 million for the 2006 period, compared to Ch$22,532 million in 2005. The lower income obtained in 2006 is explained by a 10.3% decrease in operating income, which was partially offset by a 1.8% decrease in the non-operating deficit, and by the drop in income taxes.

No . TABLE 3
REVENUES AND COSTS BY BUSINESS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2006
(Figures in millions of pesos as of 09.30.06)

	Fixed Telecommunications			**Corporate Communications**			**Long Distance**			**Other**	
	Jan-Sep 2005	**Jan-Dec 2005**	**Jan-Sep 2006**	**Jan-Sep 2005**	**Jan-Dec 2005**	**Jan-Sep 2006**	**Jan-Sep 2005**	**Jan-Dec 2005**	**Jan-Sep 2006**	**Jan-Sep 2005**	**Jan-Dec 2005**
Operating Revenues	**376,365**	**513,727**	**368,407**	**66,184**	**90,181**	**64,951**	**61,267**	**81,067**	**63,105**	**13,277**	**18,226**
Revenues	341,658	452,513	333,090	58,199	80,169	56,378	45,113	59,421	44,070	2,212	3,125
Intercompany Transfers	34,707	61,214	35,317	7,995	10,012	8,573	16,154	21,646	19,035	11,065	15,101
Operating Expenses	**(326,125)**	**(449,994)**	**(335,584)**	**(55,572)**	**(75,313)**	**(51,869)**	**(56,798)**	**(74,990)**	**(48,433)**	**(12,650)**	**(17,393)**
Payroll	(46,405)	(61,170)	(39,609)	(8,113)	(10,839)	(7,807)	(1,984)	(2,686)	(1,383)	(4,768)	(6,360)
Depreciation	(135,008)	(180,571)	(139,983)	(7,533)	(9,934)	(8,784)	(8,529)	(10,890)	(8,191)	(137)	(176)
Goods and Services	(110,916)	(148,018)	(120,641)	(13,608)	(20,063)	(12,075)	(34,863)	(45,876)	(26,657)	(6,715)	(9,371)
Intercom pany Transfers	(33,796)	(60,235)	(35,351)	(26,318)	(34,477)	(23,203)	(11,422)	(15,538)	(12,202)	(1,030)	(1,486)
Operating Income	**50,240**	**63,733**	**32,823**	**10,612**	**14,868**	**13,082**	**4,469**	**6,077**	**14,672**	**627**	**833**
Non-operating Income and Expenses											
Financial Expenses	(23,337)	(30,221)	(15,288)	2	(7)	(27)	(4)	(4)	(38)	(6)	(6)
Other Income and Expenses	4,793	4,228	5,404	(1,045)	(1,261)	(484)	(826)	(1,784)	67	(81)	(147)
Restructuring Cost	0	0	(8,115)	0	0	(393)	0	0	(489)	0	0
Intercompany Transfers	1,745	1,644	(191)	558	875	621	270	1,143	817	72	101
Non-operating Income	**(16,799)**	**(24,349)**	**(18,190)**	**(485)**	**(393)**	**(283)**	**(560)**	**(645)**	**357**	**(15)**	**(52)**
EBITDA (*) and extraordinary items	**191,786**	**250,176**	**178,019**	**17,658**	**24,416**	**22,003**	**12,442**	**16,326**	**23,747**	**755**	**963**

Taxes and Others	(19,966)	(27,117)	(15,618)	(2,445)	(3,428)	(2,886)	(3,202)	(3,781)	(3,091)	56	68
Income After Taxes	**13,475**	**12,267**	**(985)**	**7,682**	**11,047**	**9,913**	**707**	**1,651**	**11,938**	**668**	**849**

(*) EBITDA: Earnings before interest, taxes, depreciation and amortization.
(**)This due to lower operating income, generated by a decrease in operating income and an increase in operating costs. Addec is the greater non-operating deficit, mainly due to recording the cost of the restructuring performed in the first quarter of 2006.

3.4 RESULTS BY BUSINESS AREA

1. Fixed Telecommunications Business: For the fixed telecommunications business, the Company recorded a net loss of Ch$985 million for the nine-months ended September 30, 2006, which is comparatively lower than the net income of Ch$ 13,475 million recorded for the same period in 2005. The difference is explained in part by lower operating income, which results from lower operating revenues and higher operating costs, and in part by higher non-operating losses, mainly due to the restructuring cost incurred during the first quarter of 2006.

2. Corporate Communications Business: The corporate communications business contributed net income of Ch$9,913 million, a 29.0% increase in relation to 2005, when net income was Ch$7,682 million. The increase is mainly explained by higher operating income, due to the decrease in payroll costs, as well as smaller non-operating losses.

3. Long Distance Business: The Company recorded net income of Ch$11,939 million for the long distance business for the nine months ended September 30, 2006. This figure exceeds 2005 net income of Ch$707 million, as a result of improvements in both operating income and non-operating income, owing to the changes in international businesses, which required the recognition of extraordinary charges during the third quarter of 2005.

4. Other Businesses Other businesses mainly include the services of Telefónica Multimedia, Telepeajes, T-gestiona, Fundación and Tecnonautica (corresponding to 2005). These businesses altogether generated a net loss of Ch$1,119 million in 2006, whereas during the same period the previous year they generated net income of Ch$668 million. The difference is primarily the result of lower income obtained by Fundación and Telepeajes

4. STATEMENT OF CASH FLOWS

TABLE No. 4
CONSOLIDATED CASH FLOWS
(Figures in millions of pesos as of September 30, 2006)

DESCRIPTION	JAN-SEP 2005	JAN-SEP 2006	VARIATION ThCh$	VARIATION %
Cash and cash equivalents at beginning of period	**166,869**	**97,643**	**-69,226**	**-41.5%**
Net cash from operating activities	161,236	145,799	-15,437	-9.6%
Net cash from financing activities	(221,343)	(158,353)	62,990	-28.5%
Net cash from investing activities	(78,728)	(60,763)	17,965	-22.8%
Effect of inflation on cash and cash equivalents	(1,274)	(1,025)	249	-19.5%
Cash and cash equivalents at end of period	**26,760**	**23,301**	**-3,459**	**-12.9%**
Net change in cash and cash equivalents for the year	**(140,109)**	**(74,342)**	**65,767**	**-46.9%**

The net negative variation in cash and cash equivalents of Ch$74,324 million in cash flows for the 2006 period, compared to the negative variation of Ch$140,109 million in 2005, is because of a decrease in cash flows from financing activities in 2006. The decrease is mainly caused by a lower distribution of dividends. In addition, lower cash flows were allocated to investing activities, as there was less investment in short-term instruments. These effects were offset by the decrease in cash flows provided by operating activities.

5. FINANCIAL INDICATORS

TABLE No. 5
CONSOLIDATED FINANCIAL INDICATORS

DESCRIPTION	JAN-SEP 2005	JAN-DEC 2005	JAN-SEP 2006
LIQUIDITY RATIOS			
Current Ratio (Current Assets / Current Liabilities)	0.89	0.97	1.50
Acid Ratio (Most liquid assets / Current Liabilities)	0.16	0.33	0.19
DEBT RATIOS			
Leverage Ratio (Total Liabilities / Shareholders Equity)	0.83	0.84	0.78
Long-term Debt Ratio (Long-term Liabilities / Total Liabilities)	0.57	0.58	0.73
Financial Expenses Coverage (Income Before Taxes and Interest / Interest Expenses)	2.78	2.72	3.47
RETURN AND EARNINGS PER SHARE RATIOS			
Operating Margin (Operating Income / Operating Revenues)	15.30%	15.0%	14.12%
Return on Fixed Assets (Operating Income / Net Property, Plant and Equipment (1))	4.70%	6.2%	4.62%
Earnings per Share (Net Income / Average number of paid shares each year)	Ch$22.70	Ch$26.31	Ch$20.69
Return on Equity (Income / Average shareholders equity)	2.25%	2.60%	2.13%
Profitability of Assets (Income/Average assets)	1.20%	1.38%	1.17%
Operating Assets (Net income / Average operating assets (2))	1.60%	1.85%	4.77%

Return on Dividends (Paid dividends / Market Price per Share)		7.1%		10.8%		2.8%
ACTIVITY INDICATORS						
Total Assets	MCh$	1,756,048	MCh$	1,751,520	MCh$	1,623,207
Sale of Assets	MCh$	813	MCh$	1,351	MCh$	823
Investments in other companies and property, plant and equipment	MCh$	48,432	MCh$	78,312	MCh$	73,224
Inventory Turnover (Cost of Sales / Average Inventory)		2.38		2.78		2.54
Days in Inventory (Average Inventory / Cost of sales times 360 days)		151.2		129.6		141.54

(1) Figures at the beginning of the year, restated.
(2) Property, plant and equipment are considered operating assets

The key points from the table above are the following:

The current ratio increase is the result of a 6.0% drop in current assets and a 44.0% drop in current liabilities. The change in current liabilities is explained by a decrease in financial debt in comparison to September of the previous year.

The decrease in the leverage ratio is explained by a 11.0% drop in total liabilities as well as a 4.6% decrease in shareholders equity, which was the result of both the distribution of retained earnings through the payment of dividends and the capital decrease.

6. EXPLANATION OF THE MAIN DIFFERENCES BETWEEN MARKET OR ECONOMIC VALUE AND THE BOOK VALUE OF THE COMPANY S ASSETS

Due to market imperfections regarding the capital assets of the sector, there is no economic or market value that can be compared to their accounting values. However, there are certain buildings with a book value equal or close to zero. These buildings have a market value, but it is not significant with respect to the Company s assets in the aggregate.

For other assets with a referential market value, such as marketable securities (shares and promissory notes), provisions have been established when the market value is less than the book value.

7. ANALYSIS OF MARKETS, COMPETITION AND RELATIVE MARKET SHARE

Relevant Industry Information

During the first nine months of 2006, the sector has begun to develop the concept of convergence of services and hybrid wireless solutions.

The most relevant event is the launching of Telefónica Chile s Satellite Digital TV during the second quarter of 2006. The launch of this new product was followed by rapid growth in bundled offers of voice, broadband and pay TV services. Other fixed telephony operators have replicated this offer through alliances with satellite operators.

Wireless technology continues its development through deployment of Telefónica Chile s WiFi solutions, the launching of Telsur s PHS (Personal Handy System), and the recent entrance of Transam to local telephony through the GSM standard. In turn, Entel announced the completion of the upgrade of its WLL network to Wimax.

The mobile sector continues to be highly dynamic. This year has been marked by the massive migration of Telefónica Móviles and América Móviles to the GSM standard. América Móviles changed its local brand from Smartcom to Claro toward the end of July 2006. At the same time there is great interest, mainly from retail chains, in entering the sector as virtual mobile operators (VMO).

Market Evolution

Estimates indicate that as of September 2006 the fixed-line market had approximately 3.3 million lines, a drop of 3.9% with respect to September 2005. Within fixed voice consumption, there were decreases of 4.3% in local consumption, 12.9% in DLD and 13.5% in ILD with respect to the same period the previous year.

According to estimates, as of September 2006 the mobile telephone market had a total of 12.4 million subscribers, which represents growth of 14% in comparison to September 2005.

The Internet market continues with the migration from switchboard access to broadband, resulting in a 52% decrease in switchboard market access, with an estimated total of 2.18 billion annual minutes, and a 51% increase in the Broadband market, with 975,000 accesses, 58% of which use ADSL technology.

Relative Market Share

The following table shows the relative market share of Telefónica Chile in the markets where it participates:

Business	Market Share	Market Penetration	Telefónica Chile s Position in the Market
Fixed Telephony	68%	20.0 lines / 100 inhabitants	1
Domestic Long Distance	47%	74 minutes / inhabitant per year	1
International Long Distance	38%	11 minutes / inhabitant per year	2
Corporate Communications	43%	n.d.	1
Broadband	48%	903,540 Connections	1
Security Services	28%	197,551 Connections	2
Pay TV	5%	953,500 Customers	-

8. ANALYSIS OF MARKET RISK

Financial Risk Coverage

Due to the attractive foreign interest rates in certain periods, the Company has obtained financing abroad, denominated mainly in dollars and in certain cases at a floating interest rate. Consequently, the Company faces two types of financial risks: the risk of exchange rate fluctuations and the risk of interest rate fluctuations.

Financial risk due to foreign currency fluctuations

The Company has exchange rate hedging instruments. The purpose of these instruments is to reduce the negative impact of fluctuations of the dollar on Company results. The percentage of interest-bearing debt exposure is defined and continuously reviewed, basically considering the volatility of the exchange rate, its trend, and the cost and availability of hedging instruments for different terms.

The main hedging instruments used are Cross Currency Swaps and dollar/UF and dollar/peso exchange insurance.

As of September 30, 2006, the interest-bearing debt in original currency expressed in dollars was US$ 774 million, including US$ 500 million in financial liabilities in dollars, US$ 251 million of debt expressed in UF and US$ 22 million of debt in Chilean pesos. In this manner Ch$ 268,515 million corresponds to debt directly exposed to the variations of the dollar.

During the period, the Company had Cross Currency Swaps, dollar/peso exchange insurance and assets in dollars that resulted, as of the end of the third quarter 2006, in close to 0% exposure to foreign exchange fluctuations.

Financial risk due to floating interest rate fluctuations

The policy for hedging interest rates seeks to reduce the negative impact on financial expenses due to interest rate increases.

As of September 30, 2006, the Company had debt at the variable interest rates Libor and TAB, mainly for bank loans.

To protect the Company from increases in the floating interest rates, derivative financial instruments have been used, particularly Cross Currency Swaps (which cover the Libor rate), to limit the future fluctuation of interest rates. As of September 30, 2006, the use of these swaps has allowed the Company to limit its exposure to 16% of the total interest-bearing debt in Chilean pesos.

Industry Risks

Voissnet Makes an Accusation Before the National Economic Attorney General s Office (Fiscalía Nacional Económica) and Files Suit Before the Antitrust Commission, both against Telefónica Chile

On January 20, 2005, Telefónica Chile responded to the accusation made by Voissnet filed before the National Economic Attorney General s Office for alleged events which in Voissnet s opinion attempted to violate free competition and to impede the development and growth of Internet technology, and in particular broadband telephony and access to broadband, since they prohibit carrying voice using the Internet broadband access provided by Telefónica Chile. Voissnet s intention is for the TDLC to force Telefónica Chile to allow third parties to provide IP Telephony through the Internet using the ADSL owned by Telefónica Chile.

Telefónica Chile rejected each and every part of the accusations made by Voissnet, providing market, legal and regulatory information regarding the development of the broadband market in Chile. Subtel submitted the report requested by the TDLC in relation to the complaint presented by Voissnet, without making reference to the countersuit presented by Telefónica Chile, questioning the contractual restrictions imposed by Telefónica Chile.

In June 2006, the evidentiary hearings concluded. The Antitrust Commission set the date to hear the allegations of the parties. On August 9, 2006, the allegations of the parties were heard.

On October 26, 2006, the Company was notified of the sentence dictated by the Antitrust Commission, which partially accepted the complaint filed by Voissnet S.A. and the requirement of the National Economic Attorney General s Office and fined Telefónica Chile 1,500 UTA (Annual Tax Units).

The Company is analyzing both the verdict and the actions to be followed in this respect, and it faces a deadline of ten business days to file a complaint before the Supreme Court.

Public Tender to Grant Wireless Local Public Telephone Concessions on the 3,400 3,600 MHz Frequency Band

On September 15, 2005, the companies participating in the public tender called by Subtel to grant wireless local public telephone concessions on the 3,400 3,600 MHz band delivered their proposals.

The companies participating in the tender were Telefónica Chile, Telmex Servicios Empresariales, MIC Chile S.A. (owned by Telmex Chile) and VTR.

On December 13, 2005, Subtel informed that VTR and Telmex were awarded the concessions to offer wireless local telephone throughout the country, through the preferential rights of both companies.

Telefónica Chile appealed the awarding of the concessions in conformity with the procedure established in the General Telecommunications Law. Additionally on December 27, 2005 Telefónica Chile filed a public law motion to vacate before the 2nd Civil Court of Santiago against the Ministry of Transportation and Telecommunications and Subtel, requesting that the recognition of the preferential right of Telmex Servicios Empresariales S.A. be declared null. The Court accepted the mentioned complaint for processing. On February 1, 2006, Telefónica Chile presented a complaint before the General Controllership of the Republic, claiming that the provisions for the Bases of the Public Tender to grant concessions are illegal.

Regarding the projects corresponding to Regions XI and XII, the Ministry of Transportation and Telecommunications communicated that by means of Resolutions No. 64 and No. 65, both of January 20, 2006, it assigned the regional concessions to provide wireless local telephone services in Regions XI and XII to Telefónica Chile, since it was the only bidder.

Implementation of SAP System

As part of its ongoing efforts to improve customer service, Telefónica Chile has decided to implement a world class ERP application. Implementation of this system, which will contribute to better performance and generate operating cost efficiencies, was completed in August 2006.

This implementation includes the financial-economic and logistical processes of companies that form part of the Telefónica Chile Group. The SAP system is currently in its stabilization phase.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 30, 2006

COMPAÑÍA DE TELECOMUNICACIONES DE CHILE S.A.

By: /s/ **Julio Covarrubias F.**

Name: Julio Covarrubias F.
Title: Chief Financial Officer