TELEFONICA S A
Form 6-K
March 30, 2012

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 6-K

**Report of Foreign Private Issuer**

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

**of the Securities Exchange Act of 1934**

**For the month of March, 2012**

**Commission File Number: 001-09531**

# Telefónica, S.A.

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

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

**28050 Madrid, Spain**

**3491-482 85 48**

**(Address of principal executive offices)**

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

Form 20-F x Form 40-F ¨

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

Yes ¨ No x

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

Yes ¨ No x

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

Yes ¨ No x

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

**Telefónica, S.A.**

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| | Account Auditor s Report, Annual Accounts and Management Report of the Consolidated Group of Companies, all for the Fiscal Year 2011. | |

Telefónica, S.A. hereby submits the Individual Annual Accounts of Telefónica, S.A. and the Consolidated Annual Accounts of Telefónica S.A. and its Group of Subsidiaries for 2011 financial year, that have been filed with the Spanish National Securities Market Commission (Comisión Nacional del Mercado de Valores CNMV).

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

Madrid, March $30^{th}$, 2012

AUDIT REPORT, ANNUAL FINANCIAL STATEMENTS, AND

MANAGEMENT REPORT OF TELEFÓNICA, S.A., ALL FOR THE

YEAR ENDED DECEMBER 31, 2011

Audit Report

TELEFÓNICA, S.A.

Financial Statements and Management Report

for the year ended

December 31, 2011

*Translation of a report and financial statements originally issued in Spanish. In the event of*

*discrepancy, the Spanish-language version prevails (See Note 23)*

AUDIT REPORT ON THE FINANCIAL STATEMENTS

To the Shareholders of

Telefónica, S.A.

We have audited the financial statements of Telefónica, S.A., which comprise the balance sheet at December 31, 2011, the income statement, the statement of changes in equity, the cash flow statement, and the notes thereto for the year then ended. The Company s Directors are responsible for the preparation of the financial statements in accordance with the regulatory framework for financial information applicable to the entity in Spain (identified in Note 2.a to the accompanying financial statements), and specifically in accordance with the accounting principles and criteria contained therein. Our responsibility is to express an opinion on the aforementioned financial statements taken as a whole, based upon work performed in accordance with prevailing audit regulation in Spain, which require the examination, through the performance of selective tests, of the evidence supporting the financial statements and the evaluation of whether their presentation, the accounting principles and criteria applied and the estimates made are in agreement with the applicable regulatory framework for financial information.

In our opinion, the accompanying 2011 financial statements give a true and fair view, in all material respects, of the equity and financial position of Telefónica, S.A. at December 31, 2011, and of the results of its operations and its cash flow for the year then ended, in conformity with the applicable regulatory framework for financial information in Spain, and specifically the accounting principles and criteria contained therein.

The accompanying 2011 management report contains such explanations as the Directors consider appropriate concerning the situation of the Company, the evolution of its business and other matters; however, it is not an integral part of the financial statements. We have checked that the accounting information included in the aforementioned management report agrees with the 2011 financial statements. Our work as auditors is limited to verifying the management report in accordance with the scope mentioned in this paragraph, and does not include the review of information other than that obtained from the Company s accounting records.

ERNST & YOUNG, S.L.

Ignacio Viota del Corte

March 28, 2012

Domicilio Social: Pl. Pablo Ruiz Picasso, 1. 28020 Madrid

Inscrita en el Reqistro Mercantil de Madrid al

Tomo 12749, Libro 0, Folio 215, Sección 8ª,

Hoja M-23123, Inscripción 116. C.l.F. B-78970506

# TELEFÓNICA, S.A.

## ANNUAL FINANCIAL STATEMENTS AND MANAGEMENT

## REPORT

## FOR THE YEAR ENDED DECEMBER 31, 2011

**TELEFÓNICA, S.A.**

**BALANCE SHEET AT DECEMBER 31**

*(Millions of euros)*

| ASSETS | Notes | 2011 | 2010 |
|---|---|---|---|
| **NON-CURRENT ASSETS** | | **87,198** | **87,748** |
| **Intangible assets** | **5** | **68** | **71** |
| Patents, licenses, trademarks, and others | | 9 | 4 |
| Software | | 11 | 14 |
| Other intangible assets | | 48 | 53 |
| **Property, plant and equipment** | **6** | **338** | **381** |
| Land and buildings | | 154 | 150 |
| Plant and other PP&E items | | 141 | 157 |
| Property, plant and equipment under construction and prepayments | | 43 | 74 |
| **Investment property** | **7** | **423** | **345** |
| Land | | 65 | 65 |
| Buildings | | 358 | 280 |
| **Non-current investments in Group companies and associates** | **8** | **79,036** | **81,726** |
| Equity instruments | | 77,396 | 78,870 |
| Loans to Group companies and associates | | 1,618 | 2,832 |
| Other financial assets | | 22 | 24 |
| **Financial investments** | **9** | **4,728** | **3,008** |
| Equity instruments | | 556 | 473 |
| Loans to third parties | | 37 | 36 |
| Derivatives | 16 | 4,118 | 2,486 |
| Other financial assets | | 17 | 13 |
| **Deferred tax assets** | **17** | **2,605** | **2,217** |
| **CURRENT ASSETS** | | **5,339** | **5,369** |
| **Non-current assets held for sale** | **8** | | **624** |
| **Trade and other receivables** | **10** | **698** | **574** |
| **Current investments in Group companies and associates** | **8** | **3,478** | **3,335** |
| Loans to Group companies and associates | | 3,390 | 3,295 |
| Derivatives | 16 | 57 | 12 |
| Other financial assets | | 31 | 28 |
| **Investments** | **9** | **394** | **414** |
| Loans to companies | | 46 | 29 |
| Derivatives | 16 | 348 | 360 |
| Other financial assets | | | **25** |
| **Accruals** | | **4** | **6** |
| **Cash and cash equivalents** | | **765** | **416** |
| Cash | | 765 | 416 |
| **TOTAL ASSETS** | | **92,537** | **93,117** |

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

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**TELEFÓNICA, S.A.**

**BALANCE SHEET AT DECEMBER 31**

*(Millions of euros)*

| EQUITY AND LIABILITIES | Notes | 2011 | 2010 |
|---|---|---|---|
| **EQUITY** | | **26.597** | **29.400** |
| **CAPITAL AND RESERVES** | | **27,212** | **29,550** |
| **Share capital** | **11** | **4,564** | **4,564** |
| **Share premium** | **11** | **460** | **460** |
| **Reserves** | **11** | **22,454** | **24,710** |
| Legal | | 984 | 984 |
| Other reserves | | 21,470 | 23,726 |
| **Treasury shares and own equity instruments** | **11** | **(1,782)** | **(1,376)** |
| **Profit for the year** | **3** | **4,910** | **4,130** |
| **Interim dividend** | **3** | **(3,394)** | **(2,938)** |
| **UNREALIZED GAINS (LOSSES) RESERVE** | **11** | **(615)** | **(150)** |
| **Available-for-sale financial assets** | | **(40)** | **(5)** |
| **Hedging instruments** | | **(575)** | **(145)** |
| **NON-CURRENT LIABILITIES** | | **47,236** | **43,693** |
| **Non-current provisions** | | **42** | **42** |
| Other provisions | | 42 | 42 |
| **Non-current borrowings** | **12** | **11,339** | **8,009** |
| Bonds and other marketable debt securities | 13 | 170 | 148 |
| Bank borrowings | 14 | 9,046 | 6,822 |
| Derivatives | 16 | 2,033 | 1,031 |
| Finance leases | | 86 | |
| Other debts | | 4 | 8 |
| **Non-current borrowings from Group companies and associates** | **15** | **35,381** | **34,864** |
| **Deferred tax liabilities** | **17** | **474** | **778** |
| **CURRENT LIABILITIES** | | **18,704** | **20,024** |
| **Current provisions** | | **65** | **4** |
| **Current borrowings** | **12** | **1,033** | **1,455** |
| Bonds and other marketable debt securities | 13 | 87 | 104 |
| Bank borrowings | 14 | 742 | 1,176 |
| Derivatives | 16 | 204 | 175 |
| **Current borrowings from Group companies and associates** | **15** | **17,140** | **16,009** |
| **Trade and other payables** | **18** | **440** | **2,522** |
| **Accruals** | | **26** | **34** |
| **TOTAL EQUITY AND LIABILITIES** | | **92,537** | **93,117** |

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

**TELEFÓNICA, S.A.**

**INCOME STATEMENTS FOR THE YEARS ENDED DECEMBER 31**

| (Millions of euros) | Notes | 2011 | 2010 |
|---|---|---|---|
| **Revenue** | **19** | **7,952** | **7,439** |
| Rendering of services to Group companies and associates | | 707 | 583 |
| Rendering of services to non-group companies | | 3 | 4 |
| **Dividends from Group companies and associates** | | **6,967** | **6,474** |
| **Interest income on loans to Group companies and associates** | | **275** | **378** |
| **Impairment and gains (losses) on disposal of financial instruments** | **19** | **(1,082)** | **(1,985)** |
| Impairment losses and other losses | 8 | (1,606) | (1,985) |
| Gains (losses) on disposal and other gains and losses | | 524 | |
| **Other operating income** | **19** | **157** | **103** |
| Non-core and other current operating revenues Group companies and associates | | 140 | 91 |
| Non-core and other current operating revenue non-group companies | | 17 | 12 |
| **Employee benefits expense** | **19** | **(244)** | **(193)** |
| Wages, salaries and others | | (213) | (165) |
| Social security costs | | (31) | (28) |
| **Other operating expenses** | | **(399)** | **(687)** |
| External services Group companies and associates | 19 | (94) | (85) |
| External services non-group companies | 19 | (296) | (592) |
| Taxes other than income tax | | (9) | (10) |
| **Depreciation and amortization** | **5, 6 and 7** | **(72)** | **(70)** |
| **Gains (losses) on disposal of fixed assets** | | **1** | **(11)** |
| **OPERATING PROFIT** | | **6,313** | **4,596** |
| **Finance revenue** | **19** | **139** | **224** |
| From equity investments of third parties | | 38 | 37 |
| From marketable securities and other financial instruments | | 101 | 187 |
| **Finance costs** | **19** | **(2,119)** | **(1,812)** |
| Borrowings from Group companies and associates | | (1,872) | (1,791) |
| Third-party borrowings | | (247) | (21) |
| **Change in fair value of financial instruments** | | **(91)** | **(245)** |
| Trading portfolio and other securities | | (11) | (2) |
| Gain (loss) on available-for-sale financial assets recognized in the period | 9 | (80) | (243) |
| **Exchange losses** | **19** | **(138)** | **122** |
| **Impairment and gains (losses) on disposal of financial instruments with third parties** | **19** | **(105)** | |
| **NET FINANCIAL EXPENSE** | | **(2,314)** | **(1,711)** |
| **PROFIT BEFORE TAX** | **21** | **3,999** | **2,885** |
| **Income tax** | **17** | **911** | **1,245** |
| **PROFIT FOR THE YEAR** | | **4,910** | **4,130** |

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

**TELEFÓNICA, S.A.**

**STATEMENTS OF CHANGES IN EQUITY FOR THE YEARS ENDED DECEMBER 31**

**A) STATEMENT OF RECOGNIZED INCOME AND EXPENSE**

| *(Millions of euros)* | **Notes** | **2011** | **2010** |
|---|---|---|---|
| **Profit for the period** | | **4,910** | **4,130** |
| **Total income and expense recognized directly in equity** | **11** | **(612)** | **(44)** |
| From measurement of available-for-sale financial assets | | (50) | (120) |
| From cash flow hedges | | (824) | 57 |
| Income tax impact | | 262 | 19 |
| **Total amounts transferred to income statement** | **11** | **147** | **221** |
| From measurement of available-for-sale financial assets | | | 243 |
| From cash flow hedges | | 210 | 73 |
| Income tax impact | | (63) | (95) |
| **TOTAL RECOGNIZED INCOME AND EXPENSE** | | **4,445** | **4,307** |

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

**TELEFÓNICA, S.A.**

**B) STATEMENTS OF TOTAL CHANGES IN EQUITY FOR THE YEARS ENDED DECEMBER 31**

| *(Millions of euros)* | Share capital | Share premium | Reserves | Treasury shares and own equity investments | Profit for the year | Interim dividend | Net unrealized gains (losses) reserve | TOTAL |
|---|---|---|---|---|---|---|---|---|
| **Balance at December 31, 2009** | **4,564** | **460** | **20,145** | **(527)** | **6,252** | **(2,277)** | **(327)** | **28,290** |
| Total recognized income and expense | | | | | 4,130 | | 177 | **4,307** |
| Transactions with shareholders and owners | | | (2,959) | (849) | | (2,938) | | **(6,746)** |
| Capital decreases | | | | | | | | |
| Dividends paid | | | (2,934) | | | (2,938) | | **(5,872)** |
| Transactions with treasury shares or own equity instruments (net) | | | (25) | (849) | | | | **(874)** |
| Other movements | | | 3,549 | | | | | **3,549** |
| Appropriation of prior year profit (loss) | | | 3,975 | | (6,252) | 2,277 | | |
| **Balance at December 31, 2010** | **4,564** | **460** | **24,710** | **(1,376)** | **4,130** | **(2,938)** | **(150)** | **29,400** |
| Total recognized income and expense | | | | | 4,910 | | (465) | **4,445** |
| Transactions with shareholders and owners | | | (3,455) | (777) | | (3,394) | | **(7,626)** |
| Capital decreases | | | | | | | | |
| Dividends paid | | | (3,458) | | | (3,394) | | **(6,852)** |
| Transactions with treasury shares or own equity instruments (net) | | | 3 | (777) | | | | **(774)** |
| Other movements | | | 7 | 371 | | | | **378** |
| Appropriation of prior year profit (loss) | | | 1,192 | | (4,130) | 2,938 | | |
| **Balance at December 31, 2011** | **4,564** | **460** | **22,454** | **(1,782)** | **4,910** | **(3,394)** | **(615)** | **26,597** |

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

**TELEFÓNICA, S.A.**

**CASH FLOW STATEMENTS FOR THE YEARS ENDED DECEMBER 31**

| *(Millions of euros)* | **Notes** | **2011** | **2010** |
|---|---|---|---|
| **A) CASH FLOWS FROM OPERATING ACTIVITIES** | | **6,423** | **6,833** |
| Profit before tax | | 3,999 | 2,885 |
| Adjustments to profit: | | (3,773) | (3,115) |
| Depreciation and amortization | 5, 6 and 7 | 72 | 70 |
| Impairment of investments in Group companies and associates | 8 | 1,606 | 1,985 |
| Impairment of investments in non-group companies | | | |
| Change in trade provisions | | | (40) |
| Gains on the sale of financial assets | | (524) | |
| Losses on disposal of property, plant and equipment | | 1 | 11 |
| Dividends from Group companies and associates | 19 | (6,967) | (6,474) |
| Interest income on loans to Group companies and associates | 19 | (275) | (378) |
| Net financial expense | 19 | 2,314 | 1,711 |
| Change in working capital | | (108) | 310 |
| Trade and other receivables | | (51) | 53 |
| Other current assets | | (16) | (64) |
| Trade and other payables | | (106) | 392 |
| Other current liabilities | | 65 | (50) |
| Other non-current assets and liabilities | | | (21) |
| Other cash flows from operating activities | 21 | 6,305 | 6,753 |
| Net interest paid | | (1,405) | (1,061) |
| Dividends received | | 7,073 | 6,621 |
| Income tax receipts | | 637 | 1,193 |
| **B) CASH FLOWS (USED IN)/FROM INVESTING ACTIVITIES** | | **(1,235)** | **(8,429)** |
| Payments on investments | 21 | (3,554) | (10,521) |
| Proceeds from disposals | 21 | 2,319 | 2,092 |
| **C) CASH FLOWS USED IN FINANCING ACTIVITIES** | | **(4,817)** | **(2,992)** |
| Payments on equity instruments | 11 | (377) | (883) |
| Proceeds from financial liabilities | 21 | 2,412 | 3,763 |
| Debt issues | | 7,533 | 14,848 |
| Repayment and redemption of debt | | (5,121) | (11,085) |
| Dividends paid | 11 | (6,852) | (5,872) |
| **D) NET FOREIGN EXCHANGE DIFFERENCE** | | **(22)** | **33** |
| **E) NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS** | | **349** | **(4,555)** |
| Cash and cash equivalents at January 1 | | 416 | 4,971 |
| Cash and cash equivalents at December 31 | | 765 | 416 |

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

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**TELEFÓNICA, S.A.**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED**

**DECEMBER 31, 2011**

## (1) INTRODUCTION AND GENERAL INFORMATION

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

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

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

In keeping with the above, Telefónica is currently the parent company of a group that operates mainly in the telecommunications, media and entertainment industries, providing a wide range of services on the international stage.

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

## (2) BASIS OF PRESENTATION

**a) True and fair view**

These financial statements have been prepared from Telefónica, S.A. s accounting records by the Company s Directors in accordance with the accounting principles and standards contained in the Code of Commerce, developed in the Spanish GAAP in force (2007 Spanish GAAP) and other prevailing legislation at the date of these financial statements, to give a true and fair view of the Company s equity, financial position, results of operations and of the cash flows obtained and applied in 2011.

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

**b) Comparison of information**

***Acquisition of Brasilcel, N.V. and subsequent merger with Telefónica, S.A.***

On July 28, 2010 Telefónica, S.A. and Portugal Telecom, SGPS, S.A. reached an agreement for the acquisition by Telefónica, S.A. of 50% of the capital stock of Brasilcel, N.V. (a company in which Portugal Telecom and Telefónica had equal joint interests until that date, and which held approximately 60% of the capital stock of the Brazilian company Vivo Participações, S.A.). The acquisition price for the aforementioned capital stock of Brasilcel, N.V. was 7,500 million euros, of which 2,000 million euros was paid on October 31, 2011 (see Note 18.b). At the time of the acquisition the company announced that it would merge Brasilcel, N.V. into the company as part of the same transaction. This agreement also established inter alia that Portugal Telecom waived the declared dividend payable by Brasilcel, N.V., amounting to 49 million euros and still outstanding, which was recognized as a reduction in the cost of this acquisition. Taking into account the conditions established, the discounted price at which this acquisition was recognized was 7,419 million euros (see Note 8.1).

Subsequently, on September 28, 2010 the two boards of directors approved the merger of Telefónica and Brasilcel, N.V., which was recognized on that date. This merger was entered in the Mercantile Registry on December 21, 2010 and gave rise to a reserve of 3,602 million euros, reduced by 49 million euros corresponding to the aforementioned dividends. The net amount by which Telefónica, S.A. s equity was affected by this transaction was therefore 3,553 million euros (see Note 11).

In 2011, Telefónica restructured Group entities in Brazil. These transactions are disclosed fully in Note 8.

**c) Use of estimates**

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

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

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

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

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

Recoverable amount of investments in group companies, joint ventures and associates is measured as described in Note 4.e.

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

***Deferred taxes***

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

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

**(3) PROPOSED APPROPRIATION OF PROFIT**

Telefónica, S.A. obtained 4,910 million euros of profit in 2011.

Accordingly, the Company s Board of Directors will submit the following proposed appropriation of 2011 profit for approval at the Shareholders Meeting:

| | *Millions of euros* |
|---|---|
| **Proposed appropriation:** | |
| Profit for the year | 4,910 |
| **Distribution to:** | |
| Interim dividend (paid in May 2011) | 3,394 |
| Goodwill reserve (Note 11.c) | 2 |
| Voluntary reserves | 1,514 |

At its meeting of April 12, 2011, the Company s Board of Directors resolved to pay an interim dividend against 2011 profit of a fixed gross 0.75 euros for each of the outstanding shares carrying dividend rights. This dividend was paid in full on May 6, 2011. The total amount paid was 3,394 million euros (see Note 11.1.d).

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

| | *Millions of euros* |
|---|---|
| **Liquidity statement at April 12, 2011** | |
| Income from January 1 through March 31, 2011 | 5,961 |
| Mandatory appropriation to reserves | |
| Distributable income | 5,961 |
| | |
| **Proposed interim dividend (maximum amount)** | **3,423** |
| | |
| **Cash position at April 12, 2011** | |
| Funds available for distribution | |
| Cash and cash equivalents | 1,670 |
| Unused credit facilities | 6,593 |
| Proposed interim dividend (maximum amount) | (3,423) |
| Difference | 4,840 |

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

**(4) RECOGNITION AND MEASUREMENT ACCOUNTING POLICIES**

The main recognition and measurement accounting policies applied in the preparation of the 2011 annual financial statements are the following:

**a) Intangible assets**

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

The useful lives of intangible assets are assessed individually to be either finite or indefinite. Intangible assets with finite lives are amortized systematically over the useful economic life and assessed for impairment whenever events or changes indicate that their carrying amount may not be recoverable.

Amortization methods and schedules are revised annually at year end and, where appropriate, adjusted prospectively.

Intangible assets include mainly the following:

1. Computer software licenses, which are recorded at cost and amortized on a straight-line basis over their useful lives, generally estimated at three years.

2. Intellectual property, which is recorded at the amounts paid to acquire ownership of or rights to use patents and trademarks and amortized on a straight-line basis over the useful life of the patent or trademark for a period of 3 to 10 years.

3. The goodwill arising from the merger of Telefónica, S.A. and Terra Networks, S.A. carried out in 2005. This is included under Other intangible assets at the carrying amount at January 1, 2008 of 33 million euros, calculated in accordance with the former accounting principles, less any accumulated impairment losses. Goodwill is not amortized, but is tested for impairment annually or more frequently if there are certain events or changes indicating the possibility that the carrying amount may not be fully recoverable (see Note 4.c).

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

Property, plant and equipment is stated at cost, net of accumulated depreciation and any accumulated impairment in value. Land is not depreciated.

Cost includes external costs plus any internal costs comprising warehouse materials used, direct labor costs incurred in installation work and the allocable portion of the indirect costs required for the related investment. Cost includes, where appropriate, the initial estimate of decommissioning, retirement and site reconditioning costs when the Company is under obligation to incur such costs due to the use of the asset.

Costs incurred for expansion, remodeling or improvements which increase the productivity, capacity, or prolong the useful life of the asset are capitalized when the capitalization requirements are met.

Interest and other borrowing costs incurred and directly attributable to the acquisition or construction of assets that require preparation of more than one year for their intended use or sale are capitalized.

Upkeep and maintenance expenses are expensed as incurred.

The Company assesses the need to write down, if appropriate, the carrying amount of each item of property, plant and equipment to its recoverable amount whenever there are indications that the assets carrying amount exceeds the higher of its fair value less costs to sell or its value in use. The impairment provision is not maintained if the factors giving rise to the impairment disappear (see Note 4.c).

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

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

Assets estimated residual values and methods and depreciation periods are reviewed, and adjusted if appropriate, prospectively at each financial year end.

Investment property is measured using the same criteria described for land and buildings for own use. Buildings included in investment property are depreciated on a straight-line basis over a period of up to 40 years.

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

Non-current assets are assessed at each reporting date for indications of impairment losses. Where such indications exist, or in the case of assets which are subject to an annual impairment test, the Company estimates the asset s recoverable amount as the higher of its fair value less costs to sell and its value in use. In assessing value in use, the estimated future cash flows deriving from the use of the asset or its cash generating unit, as applicable, are discounted to their present value in the currency in which they will be generated, using a pre-tax discount rate appropriate to that currency and reflecting current market assessments of the time value of money and the risks specific to the asset. The Company translates that present value into its accounting currency at the exchange rate prevailing at the close of the day of calculation of value in use. When the carrying amount of an asset exceeds its recoverable amount, the asset is considered to be impaired. In this case, the carrying amount is written down to recoverable amount and the resulting loss is taken to the income statement. Future depreciation or amortization charges are adjusted for the asset s new carrying amount over its remaining useful life. The Company assesses each asset individually for impairment, unless the asset does not generate cash inflows that are largely independent of those from other assets (or cash-generating units).

The Company bases the calculation of impairment on the business plans of the various cash-generating units to which the assets are allocated. These business plans generally cover a period of three to five years. For periods beyond the strategic plan, an expected constant or decreasing growth rate is applied to the projections based on these plans from the fifth year.

When there are new events or changes in circumstances that indicate that a previously recognized impairment loss no longer exists or has been decreased, a new estimate of the asset s recoverable amount is made. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset s recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. The reversal is limited to the net carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the income statement and the depreciation charge is adjusted in future periods to the asset s revised carrying amount.

**d) Leases**

The determination of whether an arrangement is, or contains, a lease is based on the substance of the agreement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset and the agreement conveys a right to the Company to use the asset.

Leases where the lessor does not transfer substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in the income statement on a straight-line basis over the lease term.

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards incidental to ownership of the leased item to the Company. These are classified at the inception of the lease, in accordance with its nature and the associated liability, at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance costs and reduction of the principal of lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance costs are taken to the income statement over the lease term.

**e) Financial assets and liabilities**

***Financial investments***

All regular way purchases and sales of financial assets are recognized on the trade date, i.e. the date that the Company commits to purchase or sell the asset. The Company classifies its financial assets into the following categories for initial recognition purposes: financial assets held for trading, other financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, investments in Group companies, joint ventures and associates, and available-for-sale financial assets. When appropriate, the Company re-evaluates the designation at each financial year end.

Financial assets held for trading, i.e., investments made with the aim of realizing short-term profits as a result of price changes, are included in *Financial assets held for trading* and presented under current or non-current assets depending on their maturity. Derivatives are classified as held for trading unless they are designated as effective hedging instruments.

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

Financial investments which the Company intends to hold for an unspecified period of time and could be sold at any time to meet specific liquidity requirements or in response to interest-rate movements and which have not been included in the preceding categories are classified as *available-for-sale*. These investments are recorded under Non-current assets, unless it is probable and feasible that they will be sold within 12 months. Financial assets in this category are measured at fair value. Gains or losses arising from changes in fair value are recognized in equity until the asset is derecognized or impaired, at which time the cumulative gain or loss previously reported in equity is taken to the income statement. Dividends from available-for-sale equity investments are recognized in the income statement once the Company has the right to receive the dividend. Fair value is determined in accordance with the following criteria:

1. <u>Listed securities on active markets</u>: Fair value is considered to be the quoted market price at the closing date.

2. <u>Unlisted securities</u>: Fair value is determined using valuation techniques such as discounted cash flow analysis, option valuation models, or by reference to arm s length market transactions. When fair value cannot be reliably determined, these investments are carried at cost.

*Loans and receivables* includes trade or non-trade financial assets, that are neither derivatives nor equity instruments, with fixed or determinable payments and that are not quoted in an active market and not included in any of the preceding classifications. Upon initial recognition, these assets are recognized at fair value which, unless there is evidence to the contrary, is the transaction price, which is equivalent to the fair value of the consideration paid plus directly attributable transaction costs. Following initial recognition, these financial assets are measured at amortized cost using the effective interest rate method. Gains and losses are recognized in the income statement when the loans and receivables are settled or impaired, as well as through the amortization process. Trade receivables are recognized at the original invoice amount. A provision is recorded when there is objective evidence of customer collection risk. The amount of the impairment is calculated as the difference between the carrying amount of the doubtful trade receivables and their recoverable amount. As a general rule, current trade receivables are not discounted, unless the effect of such discount is material.

The Group assesses at each reporting date whether a financial asset is impaired. If there is objective evidence that an impairment loss has been incurred on a financial asset carried at amortized cost, the amount of the loss is measured as the difference between the asset s carrying amount and its recoverable value, calculated as the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset s original effective interest rate. If in a subsequent period the impairment loss decreases as a result of a subsequent event, the loss is reversed, with the asset s amortized cost had no impairment loss been recognized as the upper limit. Such a reversal is recognized in the income statement of that year.

For equity instruments recognized as available-for-sale financial assets, the Company assesses individually for each security whether there is any objective evidence that an asset is impaired as a result of one or more events indicating that the carrying amount of the security will not be recovered. If there is objective evidence that an available-for-sale financial instrument is impaired, the cumulative loss recognized in equity measured as the difference between the acquisition cost (net of any principal payments and amortization made) and the current fair value, less any impairment loss on that investment previously recognized in the income statement, is removed from equity and recognized in the income statement. If in a subsequent period the fair value of the financial asset increases because of a subsequent event, the impairment loss is reversed through the income statement if the asset is a debt instrument. For equity instruments, the loss is not reversed in the income statement for the period, but rather in equity, as the instrument is measured at its new fair value, with any changes taken to equity.

Recoverable amount for estimating impairment of investments in group companies, joint ventures and associates is the higher of the investment s fair value less costs to sell and the present value of the future cash flows derived from the investment. These cash flows can be calculated by estimating the cash flows to be received from dividends or from the disposal or derecognition of the investment, or the Company s share of the cash flows expected to be generated by the investment (from operations, or the investment s disposal or derecognition).

Financial assets are only fully or partially derecognized when:

1. The rights to receive cash flows from the asset have expired.

2. The Company has transferred its rights to receive cash flows from the asset to a third party and transferred substantially all the risks and rewards of the asset.

***Cash and cash equivalents***

Cash and cash equivalents included on the balance sheet include cash on hand and at banks, demand deposits and other highly liquid investments with an original maturity of three months or less. These items are stated at historical cost, which does not differ significantly from realizable value.

For the purpose of the cash flow statement, cash and cash equivalents are shown net of any outstanding bank overdrafts.

***Issues and interest-bearing debt***

These debts are recognized initially at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, these financial liabilities are measured at amortized cost using the effective interest rate method. Any difference between the cash received (net of transaction costs) and the repayment value is recognized in the income statement over the life of the debt. Interest-bearing debt is considered non-current when its maturity is over 12 months or the Company has full discretion to defer settlement for at least another 12 months from the reporting date.

Financial liabilities are derecognized when the obligation under the liability is discharged, cancelled or expires. When an existing financial liability is replaced with another on substantially different terms, such an exchange is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in their respective carrying amounts is taken to the income statement.

***Derivative financial instruments and hedge accounting***

Derivative financial instruments are initially recognized at fair value, normally equivalent to cost. Their carrying amounts are subsequently remeasured at fair value. Derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative. They are classified as current or non-current depending on whether they fall due within less than or after one year, respectively. Derivatives that meet all the criteria for consideration as long-term hedging instruments are recorded as non-current assets when fair value is positive and non-current liabilities when fair value is negative.

The accounting treatment of any gain or loss resulting from changes in the fair value of a derivative depends on whether the derivative in question meets all the criteria for hedge accounting and, if appropriate, on the nature of the hedge.

The Company designates certain derivatives as:

1. Fair value hedges, when hedging the exposure to changes in the fair value of a recognized asset or liability or a firm transaction;

2. Cash flow hedges, when hedging exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction; or

3. Hedges of a net investment in a foreign operation.

A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value or a cash flow hedge.

Changes in fair value of derivatives that qualify as fair value hedges are recognized in the income statement, together with changes in the fair value of the hedged item attributable to the risk hedged.

Changes in the fair value of derivatives that qualify and have been assigned to hedge cash flows, which are highly effective, are recognized in equity. The portion considered ineffective is taken directly to the income statement. Fair value changes from hedges that relate to firm commitments or forecast transactions that result in the recognition of non-financial assets or liabilities are included in the initial measurement of those assets or liabilities. Otherwise, changes in fair value previously recognized in equity are recognized in the income statement in the period in which the hedged transaction affects profit or loss.

An instrument designed to hedge foreign currency exposure on a net investment in a foreign operation is accounted for in a way similar to foreign currency fair value hedges. For these purposes, the net investment in the foreign operation comprises not only the share in the equity of the foreign investment, but also the monetary item receivable or payable, the settlement of which is not expected or likely to take place in the foreseeable future, excluding trade items.

The application of the Company s corporate risk-management policies could result in financial risk-hedging transactions that make economic sense, yet do not comply with the criteria and effectiveness tests required by accounting policies to be treated as hedges. Alternatively, the Company may opt not to apply hedge accounting criteria in certain instances. In these cases, gains or losses resulting from changes in the fair value of derivatives are taken directly to the income statement.

From inception, the Company formally documents the hedge relationship between the derivative and the hedged item, as well as the associated risk management objectives and strategies. The documentation includes identification of the hedge instrument, the hedged item or transaction and the nature of the risk being hedged. In addition, it states how it will assess the hedging instrument s effectiveness in offsetting the exposure to changes in the hedged item s fair value or cash flows attributable to the hedged risk. Hedge effectiveness is assessed, prospectively and retrospectively, both at the inception of the hedge relationship and on a systematic basis throughout the life of the hedge.

Hedge accounting is discontinued whenever the hedging instrument expires or is sold, terminated or settled, the hedge no longer meets the criteria for hedge accounting or the Company revokes the designation. In these instances, gains or losses accumulated in equity are not taken to the income statement until the forecast transaction or commitment affects profit or loss. However, if the hedged transaction is no longer expected to occur, the cumulative gains or losses recognized directly in equity are taken immediately to the income statement.

The fair value of the derivative portfolio includes estimates based on calculations using observable market data, as well as specific pricing and risk-management tools commonly used by financial entities.

**f) Treasury shares**

Treasury shares are stated at cost and deducted from equity. Any gain or loss obtained on the purchase, sale, issue or cancellation of treasury shares is recognized directly in equity.

Call options on treasury shares to be settled through the physical delivery of a fixed number of shares at a fixed price are considered treasury share instruments. They are stated at the premium paid as a reduction in equity. If the call options are exercised upon maturity, the amount previously recognized is reclassified to treasury shares along with the consideration paid. If the call options are not exercised, their value is recognized directly in equity.

**g) Foreign currency transactions**

Monetary items denominated in foreign currencies are translated to euros at the exchange rates prevailing on the related transaction date, and are retranslated at the year end to the exchange rates then prevailing.

All realized or unrealized exchange gains or losses are taken to the income statement for the year, with the exception of non-monetary items measured at fair value, provided that they are recognized directly in equity (such as investments in equity instruments classified as available-for-sale financial assets). In these cases, any exchange differences included in gains or losses recognized in equity derived from changes in the value of the non-monetary items measured at fair value are also recognized directly in equity.

**h) Provisions**

***Pensions and other employee obligations***

The Company has a defined-contribution pension plan for employees. The obligations are limited to the regular payment of the contributions, which are taken to the income statement as incurred.

***Other provisions***

Provisions are recognized when the Company has a present obligation (legal or constructive), as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset, but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement. If the effect of the time value of money is material, provisions are discounted, and the corresponding increase in the provision due to the passage of time is recognized as a finance cost.

**i) Share-based payments**

For equity-settled share option plans, fair value at the grant date is measured by applying statistical techniques or using benchmark securities. The cost is recognized, together with a corresponding increase in equity, over the vesting period. At each subsequent reporting date, the Company reviews its estimate of the number of options it expects to vest, with a corresponding adjustment to equity.

**j) Income tax**

The income tax expense of each year includes both current and deferred taxes, where applicable.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

Deferred income tax is provided using the balance sheet liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts.

The main temporary differences arise due to discrepancies between the tax bases and accounting amounts of investments in Group companies and associates.

Furthermore, deferred taxes arise from unused tax credits and tax loss carryforwards.

The Company determines deferred tax assets and liabilities by applying the tax rates that will be effective when the corresponding asset is received or the liability settled, based on tax rates and tax laws that are enacted (or substantively enacted) at the reporting date.

Deferred income tax assets and liabilities are not discounted to present value and are classified as non-current, irrespective of the date of their reversal.

The carrying amount of deferred income tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized.

Unrecognized deferred income tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred income tax relating to items directly recognized in equity is recognized in equity.

**k) Revenue and expenses**

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

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

**l) Related party transactions**

Related party transactions are accounted for in accordance with the criteria described above.

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

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

The effective date of mergers and spin-offs for accounting purposes is taken as the first day of the year in which the merger or spin-off was approved, to the extent that it falls after the companies were incorporated into the group. If one of the companies joins the group in the year of the merger or spin-off, the acquisition date is used for accounting purposes.

**m) Financial guarantees**

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

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

i) the amount in accordance with rules for measuring provisions and contingencies; and

ii) the amount initially recognized less, when applicable, any amounts take to the income statement corresponding to accrued income.

**n) Non-current assets held for sale**

Non-current assets (and certain groups of assets and liabilities defined as disposal groups) are classified as *held for sale* when their carrying amounts will be recovered primarily through their sale, which is considered to be highly probable. Non-current assets (and disposal groups) held for sale are accounted for at the lower of their carrying amount and fair value less cost to sell, and are recognized on a separate line of the balance sheet.

**o) Consolidated data**

As required under prevailing legislation, the Company has prepared separate consolidated annual financial statements, drawn up in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The balances of the main headings of the Telefónica Group s consolidated financial statements for 2011 and 2010 are as follows:

| **Item** ***(millions of euros)*** | ***2011*** | ***2010*** |
|---|---|---|
| Total assets | 129,623 | 129,775 |
| Equity: | | |
| Attributable to equity holders of the parent | 21,636 | 24,452 |
| Attributable to minority interests | 5,747 | 7,232 |
| Revenue from operations | 62,837 | 60,737 |
| Profit for the year: | | |
| Attributable to equity holders of the parent | 5,403 | 10,167 |
| Attributable to minority interests | 784 | (95) |

**(5) INTANGIBLE ASSETS**

The movements in the items composing intangible assets and the related accumulated amortization in 2011 and 2010 are as follows:

***(Millions of euros)***

| ***2011*** | **Opening balance** | **Additions and allowances** | **Disposals** | **Transfers** | **Closing balance** |
|---|---|---|---|---|---|
| **INTANGIBLE ASSETS, GROSS** | **311** | **5** | **(11)** | **15** | **320** |
| Patents, licenses, trademarks, and others | 22 | 2 | | 5 | 29 |
| Software | 176 | 3 | (11) | 5 | 173 |
| Other intangible assets | 113 | | | 5 | 118 |
| **ACCUMULATED AMORTIZATION** | **(240)** | **(22)** | **10** | | **(252)** |
| Patents, licenses, trademarks, and others | (18) | (2) | | | (20) |
| Software | (162) | (10) | 10 | | (162) |

| | | | | | |
|---|---|---|---|---|---|
| Other intangible assets | (60) | (10) | | | (70) |
| **Net carrying amount** | **71** | **(17)** | **(1)** | **15** | **68** |

| *(Millions of euros)* 2010 | Opening balance | Additions and allowances | Disposals | Transfers | Closing balance |
|---|---|---|---|---|---|
| **INTANGIBLE ASSETS, GROSS** | **346** | **6** | **(42)** | **1** | **311** |
| Patents, licenses, trademarks, and others | 62 | 2 | (42) | | 22 |
| Software | 171 | 4 | | 1 | 176 |
| Other intangible assets | 113 | | | | 113 |
| **ACCUMULATED AMORTIZATION** | **(217)** | **(25)** | **2** | | **(240)** |
| Patents, licenses, trademarks, and others | (17) | (3) | 2 | | (18) |
| Software | (152) | (10) | | | (162) |
| Other intangible assets | (48) | (12) | | | (60) |
| **Net carrying amount** | **129** | **(19)** | **(40)** | **1** | **71** |

Disposals in 2011 relate to sales of software, at carrying amount, to other Telefónica Group companies.

In 2010 the rights to operate and commercialize the Altamira Platform were sold to a company outside the Telefónica Group. The carrying amount of this asset was 40 million euros on the sale date.

At December 31, 2011 commitments exist to acquire intangible assets amounting to 1.1 million euros (0.3 million euros at December 31, 2010). Future finance lease commitments are also disclosed in Note 19.5.

At December 31, 2011 and 2010, the Company had 190 million euros and 167 million euros, respectively, of fully amortized intangible assets.

## (6) PROPERTY, PLANT AND EQUIPMENT

The movements in the items composing property, plant and equipment and the related accumulated depreciation in 2011 and 2010 are as follows:

| *(Millions of euros)* 2011 | Opening balance | Additions and allowances | Disposals | Transfers | Closing balance |
|---|---|---|---|---|---|
| **PROPERTY, PLANT AND EQUIPMENT, GROSS** | **598** | **12** | **(1)** | **(15)** | **594** |
| Land and buildings | 219 | 1 | | 8 | 228 |
| Plant and other PP&E items | 305 | 9 | (1) | 10 | 323 |
| Property, plant and equipment under construction and prepayments | 74 | 2 | | (33) | 43 |
| **ACCUMULATED DEPRECIATION** | **(217)** | **(40)** | **1** | | **(256)** |
| Buildings | (69) | (5) | | | (74) |
| Plant and other PP&E items | (148) | (35) | 1 | | (182) |
| **Net carrying amount** | **381** | **(28)** | | **(15)** | **338** |

| *(Millions of euros)* | Disposals | Transfers |
|---|---|---|

| **2010** | **Opening balance** | **Additions and allowances** | | **Closing balance** |
|---|---|---|---|---|
| **PROPERTY, PLANT AND EQUIPMENT, GROSS** | **591** | **33** | **(26)** | **598** |
| Land and buildings | 243 | | (24) | 219 |
| Plant and other PP&E items | 294 | 2 | 9 | 305 |
| Property, plant and equipment under construction and prepayments | 54 | 31 | (11) | 74 |
| **ACCUMULATED DEPRECIATION** | **(180)** | **(37)** | | **(217)** |
| Buildings | (65) | (4) | | (69) |
| Plant and other PP&E items | (115) | (33) | | (148) |
| **Net carrying amount** | **411** | **(4)** | **(26)** | **381** |

Firm commitments to acquire property, plant and equipment at December 31, 2011 and 2010 amounted to 0.4 million euros and 0.3 million euros, respectively.

In 2011 and 2010, no interest or other borrowing costs incurred in the construction of property, plant and equipment were capitalized.

At December 31, 2011 and 2010, the Company had 36 million euros and 21 million euros, respectively, of fully depreciated items of property, plant and equipment.

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

Property, plant and equipment includes the net carrying amount of the land and buildings occupied by Telefónica, S.A. at its Distrito Telefónica headquarters, amounting to 73 million euros and 95 million euros at the 2011 and 2010 year-ends, respectively. Also included is the net carrying amount of the remaining assets (mainly plant and property) related to the operational headquarters built in the Las Tablas district, called Distrito Telefónica, of 114 million euros at December 31, 2011 and 134 million euros at December 31, 2010.

**(7) INVESTMENT PROPERTIES**

The movements in the items composing investment properties in 2011 and 2010 and the related accumulated depreciation are as follows:

| ***(Millions of euros)***<br>***2011*** | **Opening balance** | **Additions and allowances** | **Disposals** | **Transfers** | **Closing balance** |
|---|---|---|---|---|---|
| **INVESTMENT PROPERTIES, GROSS** | **386** | **88** | | | **474** |
| Land | 65 | | | | 65 |
| Buildings | 321 | 88 | | | 409 |
| **ACCUMULATED DEPRECIATION** | **(41)** | **(10)** | | | **(51)** |
| Buildings | (41) | (10) | | | (51) |
| **Net carrying amount** | **345** | **78** | | | **423** |

| ***(Millions of euros)***<br>**2010** | **Opening balance** | **Additions and allowances** | **Disposals** | **Transfers** | **Closing balance** |
|---|---|---|---|---|---|
| **INVESTMENT PROPERTIES, GROSS** | **361** | | | **25** | **386** |
| Land | 65 | | | | 65 |
| Buildings | 296 | | | 25 | 321 |
| **ACCUMULATED DEPRECIATION** | **(33)** | **(8)** | | | **(41)** |
| Buildings | (33) | (8) | | | (41) |
| **Net carrying amount** | **328** | **(8)** | | **25** | **345** |

In January 2011, the Telefónica Group moved its offices to the recently completed Diagonal 00 building, its new corporate headquarters in Barcelona. In the view of the terms of the contract, the Company has determined that the building satisfies the requirements for recognition as an asset acquired under a finance lease; it is accordingly shown under Additions in the above table at the present value of the rental payments, 88 million euros. 100% of this space is rented to Telefónica Group companies under 15-year non-cancellable lease contracts that can be renewed for up to 50 years at the discretion of Telefónica.

Investment properties mainly includes the value of land and buildings leased by Telefónica, S.A. to other Group companies at the Distrito Telefónica head offices in Madrid and Telefónica s new headquarters in Barcelona, Diagonal 00.

The Company has buildings with a total area of 367,167 square meters leased to several Telefónica Group and other companies, equivalent to an occupancy rate of 93.3% of the buildings it has earmarked for lease. In 2010, it had a total of 361,475 square meters leased, equivalent to an occupancy rate of 92.97% of the buildings earmarked for lease.

Total income from leased buildings in 2011 (see Note 19.1) amounted to 52 million euros (43 million euros in 2010). Future minimum rentals receivable under non-cancellable leases are as follows:

| | **2011** | | **2010** | |
|---|---|---|---|---|
| *(Millions of euros)* | **Future minimum recoveries** | **Present value** | **Future minimum recoveries** | **Present value** |
| Up to one year | 51 | | 50 | |
| Between one and five years | 121 | | | |
| Over 5 years | 5 | | | |
| **Total** | **177** | **151** | **50** | **48** |

All lease contracts held with subsidiaries occupying Distrito Telefónica premises expired in 2010. These contracts were renewed in 2011, for a non-cancellable period of three years. The figures for 2011 also reflect non-cancellable lease revenue from Diagonal 00, the contracts for which expire in 2016.

The main contracts in which Telefónica, S.A. acts as lessee are described in Note 19.5.

## (8) INVESTMENTS IN GROUP COMPANIES AND ASSOCIATES

8.1 The movements in the items composing investments in Group companies, joint ventures and associates in 2011 and 2010 are as follows:

*(Millions of euros)*

| 2011 | Opening balance | Additions | Disposals | Transfers | Exchange losses | Dividends | Hedges of a net investment | Closing balance | Fair value |
|---|---|---|---|---|---|---|---|---|---|
| Non-current: | | | | | | | | | |
| -Equity instruments | 78,870 | (1,148) | (404) | 123 | | (113) | 68 | 77,396 | 139,678 |
| (Net) (1): | | | | | | | | | |
| Equity instruments | | | | | | | | | |
| (Cost) | 86,824 | 458 | (404) | 123 | | (113) | 68 | 86,956 | |
| Impairment losses | (7,954) | (1,606) | | | | | | (9,560) | |
| -Loans to Group companies and associates | 2,832 | 149 | (31) | (1,322) | (10) | | | 1,618 | 1,681 |
| -Other financial assets | 24 | 25 | | (27) | | | | 22 | 22 |
| **Total non-current investment in Group companies and associates** | **81,726** | **(974)** | **(435)** | **(1,226)** | **(10)** | **(113)** | **68** | **79,036** | **141,381** |
| Current: | | | | | | | | | |
| -Loans to Group companies and associates | 3,295 | 750 | (1,856) | 1,322 | (121) | | | 3,390 | 3,467 |
| -Derivatives | 12 | 57 | (12) | | | | | 57 | 57 |
| -Other financial assets | 28 | 9 | (33) | 27 | | | | 31 | 31 |
| **Total current investments in Group companies and associates** | **3,335** | **816** | **(1,901)** | **1,349** | **(121)** | | | **3,478** | **3,555** |

*(Millions of euros)*

| 2010 | Opening balance | Additions | Disposals | Business combinations | Transfers | Exchange losses | Dividends | Hedges of a net investment | Closing balance | Fair value |
|---|---|---|---|---|---|---|---|---|---|---|
| Non-current: | | | | | | | | | | |
| -Equity instruments | | | | | | | | | | |
| (Net) (1): | 66,542 | 9,219 | | 3,505 | (610) | | (21) | 235 | 78,870 | 146,118 |
| Equity instruments | | | | | | | | | | |
| (Cost) | 72,535 | 11,204 | (5) | 3,505 | (629) | | (21) | 235 | 86,824 | |
| Impairment losses | (5,993) | (1,985) | 5 | | 19 | | | | (7,954) | |
| -Loans to Group companies and associates | 4,000 | 769 | (30) | | (2,116) | 209 | | | 2,832 | 2,832 |
| -Other financial assets | 23 | 24 | | | (23) | | | | 24 | 24 |
| **Total non-current investment in Group companies and associates** | **70,565** | **10,012** | **(30)** | **3,505** | **(2,749)** | **209** | **(21)** | **235** | **81,726** | **148,974** |
| Current: | | | | | | | | | | |
| -Loans to Group companies and associates | 3,141 | 1,115 | (3,095) | | 2,116 | 18 | | | 3,295 | 3,295 |
| -Derivatives | 29 | 12 | (29) | | | | | | 12 | 12 |
| -Other financial assets | 29 | 23 | (47) | | 23 | | | | 28 | 28 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Total current investments in Group companies and associates** | **3,199** | **1,150** | **(3,171)** | | **2,139** | **18** | | | **3,335** | **3,335** |

(1) Fair value at December 31, 2011 and 2010 of Group companies and associates quoted in an active market (Telefónica de Perú, S.A.A. and Telefónica Czech Republic, a.s. in 2010, and, additionally in 2011, Telefónica Brasil, S.A.) was calculated taking the listing of the investments on the last day of the year; the rest of the shareholdings are stated at the value of discounted cash flows based on those entities business plans.

On March 25, 2011 the Boards of Directors of each of the subsidiaries controlled by Telefónica, Vivo Participações and Telesp, approved the terms and conditions of a restructuring process whereby all shares of Vivo Participações that were not owned by Telesp were exchanged for Telesp shares, at a rate of 1.55 new Telesp shares for each Vivo Participações share. These shares then became the property of Telesp, whereby Vivo Participações then became a wholly owned subsidiary of Telesp. The restructuring process was approved by the shareholders of Vivo Participações at the Extraordinary General Shareholders Meeting held on April 27, 2011 and by the shareholders of Telesp at the Extraordinary General Shareholders Meeting held on the same date following authorization by the Brazilian telecommunications regulator, Anatel.

At that date, Telefónica, S.A. held a direct stake of approximately 60% in Vivo Participaçoes, Ltda., valued at 13,021 million euros (see Note 8.c), subsequent to the liquidation by absorption of Portelcom Participaçoes, S.A., PTelecom Brasil, S.A. and Telefónica Brasil Sul Celular Participaçoes, Ltda.

The restructuring process was approved by the shareholders of Vivo Participações at the Extraordinary General Shareholders Meeting held on April 27, 2011 and by the shareholders of Telesp at the Extraordinary General Shareholders Meeting held on the same date.

Following the share exchange, a partial contribution was made to Sao Paulo Telecommunicaçoes (SPT), leaving the direct stake in Telesp at 24.68%. As all the aforementioned transactions were performed at the carrying amounts, they are not reflected in the table of movements for 2011.

On June 14, 2011, the Boards of Directors of Vivo Participações and Telesp approved a restructuring plan whose objective was to simplify the corporate structure of both companies and foster their integration, eliminating Vivo Participações from the corporate chain through the incorporation of its total equity into Telesp, and concentrating all mobile telephony activities in Vivo, S.A. (now a direct subsidiary of Telesp).

This deal was submitted for consideration by the Brazilian telecommunications regulator and finally approved at the General Shareholders Meetings of both companies on October 3, 2011. The company arising from the merger changed its name to Telefónica Brasil, S.A.

In 2011, *Transfers* primarily reflected capitalization on June 15, 2011 and September 12, 2011 of accrued interest receivable on loans granted to Telefónica Móviles México, S.A. de C.V., amounting to 32 million euros (541 million Mexican pesos) and 30 million euros (524 million Mexican pesos), respectively.

In January and October 2011, invoices issued in 2010 and 2011 to Telcel, C.A. were contributed to Latin American Cellular Holding, S.A., so that the latter could offset these collection rights against the loan it had received from the former. These invoices amounted to 61 million euros, as reflected under Transfers.

In both 2011 and 2010, movement in *Transfers* under Loans to Group companies and associates primarily relates to the reclassification from long-term to short-term, in accordance with the loan maturity schedule.

The column headed *Dividends* sets out the amounts of dividends paid out by Group companies and associates in respect of earnings generated prior to the effective date of the corresponding shareholding. In 2011, these figures relate chiefly to SPT (107 million euros).

On June 23, 2010 Telefónica S.A. reduced its ownership interest in Portugal Telecom by 6.49%, resulting in cash inflow of 512 million euros from the sale of these shares. In addition, Telefónica entered into three equity swap contracts for Portugal Telecom shares with a number of financial institutions, subject to net settlement, which grant Telefónica the equivalent total return of the investment. At that time, this investment, previously recognized under Investments in associates, was reclassified to Non-current assets held for sale . At December 31, 2010 Telefónica, S.A. held a 2.02% interest in Portugal Telecom, which was also reclassified to this heading. Both movements were included under Transfers in the table of movements for 2010.

In 2011, equity swap contracts were partially cancelled through the sale of 33 million shares in Portugal Telecom, generating gains of 13 million euros. These gains were recognized under the income statement caption Gains (losses) on disposal and other gains and losses . Given that the listed price of these shares dropped considerably in the second half of the year, the Company made a financial provision amounting to 135 million euros, recognized under the income statement caption Impairment and gains (losses) on disposal of financial instruments (see Note 19.10). In October 2011, in view of the adverse outlook published for this stock by financial analysts, the Company decided to extend the equity swap contracts and reclassified the net carrying amount of the direct stake in Portugal Telecom (which continued to be 2.02%) and the shares allocated to the equity swap contracts, a total amount for direct and indirect stake of 235 million euros to Available-for-sale assets within the caption Non-current financial investments, until it could design an appropriate divestment policy in view of market value trends for this investee (see Note 9).

The impact in 2011 of hedges of net investments in foreign operations amounted to a gain of 68 million euros (235 million euros in 2010).

In 2011 and 2010, Telefónica, S.A. bought and sold the following shareholdings:

a) Acquisitions of investments and capital increases:

| | *Millions of euros* | |
|---|---|---|
| **Companies** | ***2011*** | ***2010*** |
| **Subsidiaries:** | | |
| Casiopea Re, S.A. | 80 | |
| Telefónica Global Technology, S.A.U. | 38 | |
| Telefónica Móviles México, S.A. de C.V. | 176 | |
| Telefónica de Costa Rica, S.A. | 127 | |
| Brasilcel, N.V. | | 7,419 |
| Telfin Ireland, Ltd. | | 3,410 |
| Telefónica Europe, Ltd. | | 35 |
| Others | 37 | 340 |
| **Total subsidiaries** | **458** | **11,204** |

*2011*

On June 27, 2011, Telefónica, S.A. performed a capital increase of 1,285 million Mexican pesos (76 million euros) at its subsidiary Telefónica Móviles México, S.A. de C.V. In October 2011, several more capital increases were carried out, totaling 1,832 million Mexican pesos (100 million euros).

In late 2010, the Telefónica Group was awarded a mobile telephone license in Costa Rica. Until that date, the Group had no operations in that country. To operate under this license, on February 14, 2011 Telefónica, S.A. incorporated the company Azules y Platas, S.A., with 2 million US dollars. The Company made an additional contribution to equity of 6 million euros on February 15, 2011, as well as a capital increase of 170 million US dollars on June 26, 2011. The euros value of the three aforementioned capital increases is 127 million euros. On September 22, 2011 the change of name of this company, to Telefónica de Costa Rica, S.A., was formally entered in the pertinent mercantile registry.

On September 26, 2011, Telefónica, S.A. injected a further 80 million euros of equity into Casiopea Re, S.A.

On October 31, 2011, Telefónica, S.A. injected a further 38 million euros of equity in its subsidiary Telefónica Global Technology, S.A.U.

*2010*

On February 10, 2010 Irish company Telfin Ireland Limited was incorporated by means of a 919 million euro contribution by Telefonica, S.A. (its sole shareholder). On April 28, 2010, Telefónica, S.A. injected a further 243 million euros of equity into this company. Then on May 21, 2010, Telefónica, S.A. injected a further 1,379 million euros and on June 24, 2010 another 869 million euros. These funds were used by Telfin Ireland, Ltd. to finance other Group companies in transactions performed during 2010.

On July 28, 2010, Telefónica and Portugal Telecom signed an agreement for the acquisition by Telefónica of 50% of the capital stock of Brasilcel (company then jointly owned in equal shares by Telefónica and Portugal Telecom; the joint venture in its turn owned shares representing, approximately, 60% of the capital stock of Brazilian company Vivo Participações, S.A.). The acquisition price for the aforementioned capital stock of Brasilcel was 7,500 million euros, of which 4,500 million euros was paid at the closing of the transaction on September 27, 2010, 1,000 million euros on December 30, 2010, and the remaining 2,000 million euros on October 31, 2011.

b) Disposals of investments and capital decreases:

| | ***Millions of euros*** | |
|---|---|---|
| **Companies** | ***2011*** | ***2010*** |
| **Subsidiaries:** | | |
| Telefónica Móviles Argentina Holding, S.A. | 285 | |
| Atento Inversiones y Teleservicios, S.A. | 116 | |
| Others | 3 | 5 |
| **Total subsidiaries** | **404** | **5** |

*2011*

In January 2011, Telefónica, S.A. sold a 25% stake in Telefónica Móviles Argentina Holding, S.A. to Telefónica Internacional, S.A.U., at market value as determined in an independent expert report. This sale generated gains of 511 million euros, recognized under Gains (losses) on disposal and other gains and losses in the accompanying income statement (see Note 19.9).

On March 31, 2011, Atento Inversiones y Teleservicios, S.A. resolved to pay out 150 million euros to its sole shareholder, Telefónica, S.A. 116 million euros of that amount related to a reduction in the share premium, recognized as a return of contributions and thus stated as a disposal in the table of movements for the year. The remainder, 34 million euros, was recognized in the income statement as income from dividends.

*2010*

In January 2010, Mobipay Internacional was liquidated. Full provision had been made for the investment in this company of 5 million euros.

c) Business combinations

*2011*

No business combinations were carried out in 2011.

*2010*

On September 27, 2010 the corresponding boards of directors agreed to start the take-over of Brasilcel, N.V. by Telefónica, which was completed on December 21, 2010 after being entered in the Madrid Mercantile Registry.

Brasilcel, N.V. had the following merger balance sheet:

| ***(Millions of euros)*** | |
|---|---|
| Investments in Group companies | 4,574 |
| Other assets | 103 |
| **Total assets** | **4,677** |
| **Liabilities and equity** | **4,677** |

As a result of this transaction, Telefónica, S.A. acquired direct investments in Vivo Participaçoes, S.A. (35.89%), Portelcom Participaçoes, S.A. (84.78%), PTelecom Brasil, S.A. (100%), and increased its stake in Telefónica Brasil Sul Celular Participaçoes, Ltda. to 74.39%. The total direct and indirect stake in Vivo Participaçoes held by Telefónica, S.A. at December 31, 2010 amounted to approximately 60%. The gross value of these stakes amounts to 13,021 million euros which, less the acquisition cost of Brasilcel, N.V., amounts to 3,505 million euros, as shown in the Business combinations column of the table showing investments in Group companies and associates in 2010.

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

At each year end, the Company re-estimates the future cash flows derived from its investments in Group companies and associates. The estimate is made based on the discounted cash flows to be received from each subsidiary in its functional currency, net of the liabilities associated with each investment (mainly net borrowings and provisions) and translated to euros at the official closing rate of each currency at December 31, 2011 and 2010.

As a result of these re-estimations and the effect of the net investment hedge in 2011, an impairment provision of 1,606 million euros was recognized. This amount reflects the net effect of the following: (a) the reversal of the impairment loss recorded for Telefónica Europe, plc. (1,279 million euros), less 120 million euros for the effect of the net investment hedge; (b) the write-down of 2,085 million euros in Telefónica Móviles México, S.A. de C.V.; (c) the write-down of 629 million euros made in Telco, S.p.A. to reflect the decrease in value of the stake in Telecom Italia, along with the effect of recovering part of the operational synergies during the year.

In 2010, the Company recognized write-downs of its shareholding in Telefónica Europe, plc. amounting to 1,985 million euros, of which 124 million euros related to the effect of net investment hedges.

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

8.4 Transactions protected for tax purposes

Transactions carried out in 2011 that are considered protected for tax purposes, as defined in Articles 83 or 94, as applicable, of Chapter VII of Title VII of Legislative Royal Decree 4/2004 of March 5 approving the Revised Spanish Corporate Income Tax Law, are detailed in the following paragraphs. Transactions protected for tax purposes carried out in prior years are disclosed in the annual financial statements for those years.

The main operation of this type which took place in 2011 between subsidiaries belonging to the tax Group headed by Telefónica, S.A. is the following:

On September 26, 2011 the Luxembourg-based company Casiopea Re, S.A., a wholly-owned subsidiary of Telefónica S.A., signed a public deed whereby its entire shareholding in the Spanish company Pléyade Peninsular Correduría de Seguros y Reaseguros (an 83.33% stake) was spun off to Telefónica Finanzas S.A.U., a Spanish company fully owned by Telefónica S.A. The spin-off was completed with the corresponding share capital increase in Telefónica Finanzas S.A.U., fully subscribed by Telefónica, S.A.

8.5 The breakdown and maturity of loans to Group companies and associates in 2011 and 2010 are follows:

**2011**

| **Company (*millions of euros*)** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017 and subsequent years** | **Final balance, current and non-current** |
|---|---|---|---|---|---|---|---|
| Telefónica de España, S.A.U. | 1,036 | | | | | | 1,036 |
| Telefónica Móviles México, S.A. de C.V. | 1,298 | | | | | | 1,298 |
| Telefónica de Contenidos, S.A.U. | 2 | 1,142 | | 79 | | | 1,223 |
| Telefónica Móviles Argentina, S.A. | 8 | 5 | | | | | 13 |
| Telefónica Global Technology, S.A.U. | 5 | 5 | 5 | 1 | 13 | 75 | 104 |
| Telco, S.p.A. | 614 | | | | | | 614 |
| Telefónica Emisiones, S.A.U. | 4 | 117 | 42 | | | | 163 |
| Others | 423 | 26 | 22 | 27 | 7 | 52 | 557 |
| **Total** | **3,390** | **1,295** | **69** | **107** | **20** | **127** | **5,008** |

**2010**

| **Company (*millions of euros*)** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016 and subsequent years** | **Final balance, current and non-current** |
|---|---|---|---|---|---|---|---|
| Telefónica de España, S.A.U. | 1,079 | 698 | | | | | 1,777 |
| Telefónica Móviles España, S.A.U. | 236 | | | | | | 236 |
| Telefónica Móviles México, S.A. de C.V. | 1,697 | | | | | | 1,697 |
| Telefónica de Contenidos, S.A.U. | 28 | | 1,142 | | 79 | | 1,249 |
| Telefónica Móviles Argentina, S.A. | 8 | 8 | 5 | | | | 21 |
| Inversiones Telefónica Móviles Holding, Ltd. | 50 | | | | | | 50 |
| Telefónica Global Technology, S.A.U. | 4 | 5 | 5 | 5 | 2 | 66 | 87 |
| Telco, S.p.A. | 14 | 600 | | | | | 614 |
| Telefónica Internacional, S.A.U. | 56 | | | | | | 56 |
| Others | 123 | 24 | 86 | 14 | 16 | 77 | 340 |
| **Total** | **3,295** | **1,335** | **1,238** | **19** | **97** | **143** | **6,127** |

The main loans granted to Group companies are described below:

Financing granted to Telefónica de España, S.A.U. consists mainly of a loan dated January 4, 1999 resulting from the company s spin-off from Telefónica, that bears interest at 6.80% and had an outstanding short-term balance of 698 million euros at December 31, 2011. The short-term amount includes accrued interest receivable of 6 million euros (11 million euros in 2010).

On December 29, 2011 Telefónica, S.A. acquired two buildings from Telefónica de España, S.A.U., the market value of which amounted to 51 million euros (see Note 18.a, Donation to the Telefónica Foundation). The balance payable on this acquisition was recorded as a decrease in the aforementioned financing and will be allocated in three equal installments upon the next loan maturities. The first installment was reduced through a payment at December 31, 2011, resulting in an outstanding balance payable of 34 million. This amount has been applied as a reduction in the balance payable in 2012, shown in the above table.

The Company also has tax receivables from this subsidiary amounting to 366 million euros, in connection with the consolidated tax group.

At December 31, 2009, the total drawn amount on the credit facilities extended to Telefónica Móviles México, S.A. de C.V. (the principal of the loans) came to 27,912 million Mexican pesos, or 1,494 million euros. One of the lines of credit of 4,519 million Mexican pesos (279 million euros) matured in 2010 and was offset by a payable Telefónica had with Telfisa Global, B.V. for the same amount in euros. No cash flow therefore occurred in relation to this repayment. The movement was recognized as a disposal in the 2010 table of movements.

On September 23, 2010, an additional loan of 269 million euros was extended to Telefónica Móviles México, S.A. de C.V., maturing in March 2011, to cover the financing requirements of the subsidiary during the second half of 2010. On March 23, 2011, this loan was repaid, decreasing the balance Telefónica, S.A. had payable to Telfisa Global, B.V. for the same amount in euros.

In 2011 the Company capitalized accrued interest receivable amounting to 1,065 million Mexican pesos, equivalent to 62 million euros.

At December 31, 2011 and 2010 the balance of the two outstanding loans amounted to 23,393 million Mexican pesos, equivalent to 1,298 million euros in 2011 (1,418 million euros in 2010).

At December 31, 2011 there was no accrued interest receivable on the aforementioned loans extended to Telefónica Móviles México, S.A. de C.V. Accrued interest receivable on these loans at December 31, 2010 amounted to 11 million euros.

Financing granted to Telefónica de Contenidos, S.A.U. comprises a 1,142 million euro participating loan, extended in 2003 and fully drawn down at December 31, 2011 and 2010, which bears interest based on Telefónica de Contenidos, S.A.U. s business performance. In addition, in 2005 Telefónica, S.A. granted a new participating loan of 79 million euros maturing in 2015. This second loan was also fully drawn down at December 31, 2011 and 2010. The current portion of this loan in 2010 included accrued interest receivable of 11 million euros. No interest receivable is outstanding in respect of 2011.

The Company also has tax receivables from this subsidiary amounting to 2 million euros, in connection with the consolidated tax group.

On January 11, 2010, Telco, S.p.A. ( Telco ) arranged a 1,300 million euro loan with Intesa Sanpaolo, S.p.A., Mediobanca, S.p.A., Société Générale, S.p.A. and Unicredito, S.p.A. maturing on May 31, 2012, part of which is secured with Telecom Italia, S.p.A. shares. The lending banks granted Telco shareholders a call option on the Telecom Italia, S.p.A. shares that they may be entitled to receive as a result of the potential execution of the pledge.

In line with the commitments assumed by Telco shareholders, on December 22, 2009, the rest of Telco s financing needs with respect to debt maturities were met with a bridge loan granted by shareholders Telefónica, Intesa Sanpaolo, S.p.A. and Mediobanca, S.p.A., for approximately 902 million euros, and a bank bridge loan granted by Intesa Sanpaolo, S.p.A. and Mediobanca, S.p.A., for the remaining 398 million euros.

The financing from the bridge loans was substituted with a bond subscribed by Telco s shareholder groups, on a pro-rate basis in accordance with their interests in the company, on February 19, 2010 (maturing on June 8, 2012) for 1,300 million euros, of which 600 million euros corresponded to Telefónica, accruing interest at a fixed rate of 4%. At the 2011 year end, this bond had generated accrued interest receivable of 14 million euros (14 million euros at December 31, 2010).

A floating-rate loan linked to three-month Euribor was granted to Telefónica Internacional, S.A.U. on April 15, 2008 for 1,000 million euros, maturing in April 2011. At that time, the loan was raised to 1,300 million euros, maturing on April 14, 2012. No amounts were drawn as at December 31, 2011 or 2010, although 700 million euros were drawn down in the course of 2011 and repaid prior to the year-end (see Note 21).

In January 2010, a 19 million euro loan was extended to Telefónica Global Technology, S.A. (hereinafter TGT), which matures in 2015 and accrues interest at a variable rate linked to the six-month Euribor. At December 31, 2011 a total of 15 million euros had been drawn down on this loan (18 million euros at December 31, 2010).

On September 10, 2010, Telefónica, S.A. extended a 111 million euro participating floating-rate Euribor-linked loan to TGT, maturing in 2020. This loan accrues interest based on the performance of the company. At December 31, 2011 and 2010, 68 million euros was drawn down on this loan.

In October 2011, Telefónica, S.A. extended another Euribor-linked variable-interest participating loan, for 59 million euros, maturing in 2019. This loan accrues interest based on the performance of the company. At December 31, 2011, 21 million euros was drawn down on this loan.

At December 31, 2011 and 2010, financing granted to Telefónica Móviles Argentina, S.A. comprised a 47 million US dollar loan granted in July 2006, on which 15 million US dollars (13 million euros) were drawn down at the 2011 year end.

Financing granted to Inversiones Telefónica Móviles Holding, Ltd. was arranged on November 4, 2008 as a result of the loan assigned by Telefónica Internacional Chile, S.A. to Telefónica, S.A. for 284 million euros. Upon maturity of this loan in 2010, it was extended to July 26, 2011. The balance was therefore recognized as a current loan in the 2010 table, for the amount drawn down (50 million euros). This amount was repaid on maturity.

In the second half of 2010, Telefónica, S.A. acquired bonds issued by Telefónica Emisiones, S.A.U. amounting to 56 million euros. The bond acquisition policy for this subsidiary was carried on in 2011, reaching a total of 159 million euros.

Other accrued interest payable amounts to 4 million euros.

Disposals of current credit facilities to group companies and associates includes the cancellation of balances receivable from subsidiaries on account of their membership of Telefónica, S.A. s tax group against debts held by these same subsidiaries totalling 703 million euros (2010: 1,166 million euros).

Additions also include 665 million euros (703 million euros in 2010) for credits arising in connection with the taxation of Telefónica, S.A. as the head of the tax group pursuant to the consolidated tax regime applicable to corporate groups (see Note 17), mainly 264 million euros to Telefónica Móviles España, S.A.U. (236 million euros in 2010) and 366 million euros to Telefónica de España, S.A.U. (371 million euros in 2010). There is no balance receivable from Telefónica Internacional, S.A.U. in 2011 (56 million euros in 2010). All these amounts mature in the short term.

Loans to Group companies and associates includes accrued interest receivable at December 31, 2011 amounting to 27 million euros (51 million euros in 2010).

### 8.6 Other financial assets with Group companies and associates

This includes rights to collect amounts from other Group companies related to share-based payment plans involving Telefónica, S.A. shares offered by subsidiaries to their employees maturing in 2012, 2013 and 2014 (see Note 19.3).

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## (9) FINANCIAL INVESTMENTS

9.1. The breakdown of Financial investments at December 31, 2011 and 2010 is as follows:

| ***2011*** (Millions of euros) | ASSETS AT FAIR VALUE: Available-for-sale financial assets | Financial assets held for trading | Hedges | Subtotal assets at fair value | Measurement hierarchy: Level 1: quoted prices | Level 2: Estimates based on other directly observable market inputs | Level 3: Estimates not based on observable market data | ASSETS AT AMORTIZED COST: Loans and receivables | Other financial assets | Subtotal assets at amortized cost | Subtotal liabilities at fair value | TOTAL CARRYING AMOUNT | TOTAL FAIR VALUE |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Non-current financial investments** | **556** | **1,574** | **2,544** | **4,674** | **556** | **4,118** | | **37** | **17** | **54** | **54** | **4,728** | **4,728** |
| Equity instruments | 556 | | | 556 | 556 | | | | | | | 556 | 556 |
| Derivatives (Note 16) | | 1,574 | 2,544 | 4,118 | | 4,118 | | | | | | 4,118 | 4,118 |
| Loans to third parties and other financial assets | | | | | | | | 37 | 17 | 54 | 54 | 54 | 54 |
| **Current financial investments** | | **159** | **189** | **348** | | **348** | | **46** | | **46** | **46** | **394** | **394** |
| Loans to third parties | | | | | | | | 46 | | 46 | 46 | 46 | 46 |
| Derivatives (Note 16) | | 159 | 189 | 348 | | 348 | | | | | | 348 | 348 |
| **Total financial investments** | **556** | **1,733** | **2,733** | **5,022** | **556** | **4,466** | | **83** | **17** | **100** | **100** | **5,122** | **5,122** |

| ***2010*** *(Millions of euros)* | ASSETS AT FAIR VALUE: Available-for-sale financial assets | Financial assets held for trading | Hedges | Subtotal assets at fair value | Measurement hierarchy: Level 1: quoted prices | Level 2: Estimates based on other directly observable market inputs | Level 3: Estimates not based on observable market data | ASSETS AT AMORTIZED COST: Loans and receivables | Other financial assets | Subtotal assets at amortized cost | Subtotal liabilities at fair value | TOTAL CARRYING AMOUNT | TOTAL FAIR VALUE |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Non-current financial investments** | **473** | **936** | **1,550** | **2,959** | **473** | **2,486** | | **36** | **13** | **49** | **49** | **3,008** | **3,008** |
| Equity instruments | 473 | | | 473 | 473 | | | | | | | 473 | 473 |
| Derivatives (Note 16) | | 936 | 1,550 | 2,486 | | 2,486 | | | | | | 2,486 | 2,486 |
| Loans to third parties and other financial assets | | | | | | | | 36 | 13 | 49 | 49 | 49 | 49 |
| **Current financial investments** | | **170** | **190** | **360** | | **360** | | **29** | **25** | **54** | **54** | **414** | **414** |

| | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Loans to third parties | | | | | | | | 29 | 25 | 54 | 54 | 54 | 54 |
| Derivatives (Note 16) | | 170 | 190 | 360 | | 360 | | | | | | 360 | 360 |
| **Total financial investments** | **473** | **1,106** | **1,740** | **3,319** | **473** | **2,846** | | **65** | **38** | **103** | **103** | **3,422** | **3,422** |

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

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

9.2 Held-for-trading financial assets and hedges.
These two categories include the fair value of outstanding derivate financial instruments at December 31, 2011 and 2010 (see Note 16).

9.3 Available-for-sale financial assets.
This category mainly includes the fair value of investments in listed companies (equity instruments). The movement of items composing this category at December 31, 2011 and 2010 are as follows:

| | December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| ***(Millions of euros)*** | **Opening balance** | **Additions** | **Disposals** | **Other movements** | **Fair value adjustments** | **Closing balance** |
| Banco Bilbao Vizcaya Argentaria, S.A. | 418 | | | (11) | (80) | 327 |
| Portugal Telecom, S.G.P.S., S.A. | | | (10) | 235 | (32) | 193 |
| Other companies | 55 | | (1) | | (18) | 36 |
| **Total** | **473** | | **(11)** | **224** | **(130)** | **556** |

| | December 31, 2010 | | | |
|---|---|---|---|---|
| ***(Millions of euros)*** | **Opening balance** | **Additions** | **Fair value adjustments** | **Closing balance** |
| Banco Bilbao Vizcaya Argentaria, S.A. | 468 | 49 | (99) | 418 |
| Amper, S.A. | 11 | | (6) | 5 |
| Zon Multimedia Serviços de Telecomunicaçoes e Multimedia, SGPS, S.A. | 65 | | (15) | 50 |
| **Total** | **544** | **49** | **(120)** | **473** |

In view of the ongoing drop in the price of Portugal Telecom, SGPS, S.A. shares, in October 2011 the Company reclassified the carrying amount of its stake in that investee from Non-current assets held for sale to Available-for-sale financial assets (see Note 8). Consequently, since that month, changes in the market value of these shares have been reflected under equity (32 million euros, net of the tax effect). In December 2011, the Company sold 1.9 million shares, reflected under Disposals in the table of movements.

In 2011, Telefónica, S.A. adjusted the cost of its investment in Banco Bilbao Vizcaya Argentaria, S.A. by 80 million euros, in order to bring the cost per share in line with the fair value. This adjustment was taken directly to the income statement, under Gain (loss) on available-for-sale financial assets recognized in the period , with no impact on the statement of recognized income and expenses.

The amount shown under Additions in 2010 reflected the capital increase performed on November 30, 2010, in which Telefónica, S.A. acquired 7,359,889 new shares in the investee.

In 2010, Telefónica, S.A. transferred the stake in Banco Bilbao Vizcaya Argentaria, S.A. of 191 million euros and in Zon Multimedia Serviços de Telecomunicaçoes e Multimedia, S.G.P.S., S.A. of 52 million euros from equity to net financial expense. These transfers were recognized in Gain (loss) on available-for-sale financial assets recognized in the period .

At December 31, 2011 Telefónica, S.A. s investment in Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), held since 2000, represents 0.90% of that company s share capital.

9.4 Other financial assets and loans to third parties

The breakdown of investments included in this category at December 31, 2011 and 2010 is as follows:

| ***(Millions of euros)*** | **2011** | **2010** |
|---|---|---|
| Other non-current financial assets | | |
| Loans to third parties | 37 | 36 |
| Prepayments | 2 | 1 |
| Guarantees given | 15 | 12 |
| Other current financial assets: | | |
| Loans to third parties | 46 | 29 |
| Guarantees given | | 25 |
| **Total** | **100** | **103** |

9.4.1 Loans to third parties

Non-current loans to third parties includes the cost of the financial instrument arranged in 2011 to partially cover share-based payment schemes involving Telefónica, S.A. shares (Manager and Senior Executive Options Remuneration Plan Performance & Investment Plan (PIP)) for 37 million euros (see Note 19.3).

The value of the financial instrument arranged in 2010 partly to cover the fourth phase of share-based payment schemes involving Telefónica, S.A. shares, which in 2010 was recorded as non-current, was reclassified to current at December 31, 2011 owing to its falling due in June 2012 (36 million euros).

9.4.2 Guarantees given

Non-current loans to third parties primarily includes guarantees received from tenants of buildings owned by Telefónica, S.A., to be returned in a period of over 12 months.

In 2010 non-current loans to third parties included the remaining guarantee deposit provided to Ipse 2000 S.p.A., for 25 million euros. This amount was released and collected by the Company in 2011 (see Note 20.c).

**(10) TRADE AND OTHER RECEIVABLES**

The breakdown of Trade and other receivables at December 31, 2011 and 2010 is as follows:

| *(Millions of euros)* | **2011** | **2010** |
|---|---|---|
| Trade receivables | 24 | 39 |
| Trade receivables from Group companies and associates | 453 | 388 |
| Other receivables | 21 | 20 |
| Employee benefits payable | 2 | 2 |
| Tax receivables (Note 17) | 198 | 125 |
| **Total** | **698** | **574** |

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

Trade receivables and Trade receivables from Group companies and associates include balances in foreign currency equivalent to 134 million euros (91 million euros at year end 2010). In December 2011, there were receivables in US dollars equivalent to 104 million euros and Czech crowns equivalent to 30 million euros. In December 2011, there were receivables in US dollars equivalent to 57 million euros and Czech crowns equivalent to 34 million euros.

These balances gave rise to exchange losses in the income statement of approximately 8 million euros in 2011 (9 million euros of exchange gains in 2010).

**(11) EQUITY**

11.1 Capital and reserves

a) Share capital

At December 31, 2011, Telefónica, S.A. s share capital amounted to 4,563,996,485 euros and consisted of 4,563,996,485 fully paid ordinary shares of a single series, per value of 1 euro, all recorded by the book-entry system and traded on the Spanish electronic trading system ( Continuous Market ), where they form part of the Ibex 35 Index, on the four Spanish Stock Exchanges (Madrid, Barcelona, Valencia and Bilbao) and listed on the New York, London, Buenos Aires and Lima Stock Exchanges.

With respect to authorizations given regarding share capital, on May 18, 2011, authorization was given at the Annual Shareholders Meeting of Telefónica, S.A. for the Board of Directors, at its discretion and in accordance with the Company s needs, to increase the Company s capital, at one or several times, within a maximum period of five years from that date, under the terms of Article 297.1.b) of the Spanish Enterprise Law up to a maximum increase of 2,281,998,242.50 euros, equivalent to half of Telefónica, S.A. s share capital at that date, by issuing and placing new shares, be they ordinary, preference, redeemable, non-voting or of any other type permitted by the Law, with a fixed or variable premium, and, in all cases, in exchange for cash, and expressly considering the possibility that the new shares may not be fully subscribed. The Board of Directors was also empowered to exclude, partially or fully, pre-emptive subscription rights under the terms of Article 506 of the Spanish Enterprises Act.

In addition, at the June 2, 2010 Shareholders Meeting, authorization was given for the Board of Directors to issue fixed-income securities and preferred shares at one or several times within a maximum period of five years from that date. These securities may be in the form of debentures, bonds, promissory notes or any other kind of fixed-income security, plain or, in the case of debentures and bonds, convertible into shares of the Company and/or exchangeable for shares of any of the Group companies. They may also be preferred shares. The total maximum amount of the securities issued agreed under this authorization is 25,000 million euros or the equivalent in another currency. For promissory notes, the outstanding balance of promissory notes issued under this authorization will be calculated for purposes of the aforementioned limit. As at December 31, 2011, the Board of Directors had exercised these powers, approving two programs for the issuance of corporate promissory notes in 2011 and 2012.

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

At December 31, 2011 and 2010, Telefónica, S.A. held the following treasury shares:

| | | Euros per share | | | |
|---|---|---|---|---|---|
| | Number of shares | Acquisition price | Trading price | Market value (1) | % |
| ***Treasury shares at 12/31/11*** | 84,209,363 | 15.68 | 13.39 | 1,127 | 1.84508% |

*(1) Millions of euros*

| | | Euros per share | | | |
|---|---|---|---|---|---|
| | Number of shares | Acquisition price | Trading price | Market value (1) | % |
| ***Treasury shares at 12/31/10*** | 55,188,046 | 17.01 | 16.97 | 937 | 1.20920% |

*(1) Millions of euros*

The movement in treasury shares of Telefónica, S.A. in 2010 and 2011 is as follows:

| | Number of shares |
|---|---|
| **Treasury shares at 12/31/09** | **6,329,530** |
| Acquisitions | 52,650,000 |
| Disposals | (827,047) |
| Delivery PSP Phase II (Note 19.3) | (2,964,437) |
| **Treasury shares at 12/31/10** | **55,188,046** |
| Acquisitions | 55,979,952 |
| Disposals | (24,058,446) |
| Delivery PSP Phase III (Note 19.3) | (2,900,189) |
| **Treasury shares at 12/31/11** | **84,209,363** |

Furthermore, at December 31, 2011, one Telefónica, S.A. share is held by Telefónica Móviles Argentina, S.A. (16,896 treasury shares held by Telefónica Móviles Argentina, S.A. at December 31, 2010).

The amount paid to acquire treasury shares in 2011 and 2010 was 822 million euros and 897 million euros, respectively.

On June 30, 2011 and July 4, 2011, following the end of the third phase of the Performance Share Plan (PSP) (see Note 19.3), a total of 2,446,104 treasury shares were added, corresponding to two financial instruments arranged by the Company to meet its obligations to deliver treasury shares to managers and executives. The gross number of shares linked to the Plan amounted to 4,166,304 shares, with a net 2,900,189 shares finally delivered (32.6 million euros).

On June 30, 2010, subsequent to the maturing of the second phase of the Performance Share Plan (PSP) (see Note 19.3) a total of 2,964,437 treasury shares were delivered at a price of 16.93 euros per share (50.1 million euros).

Expanding on the existing strategic alliance, on January 23, 2011, Telefónica, S.A. and China Unicom (Hong Kong) Limited ( China Unicom ) signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. In 2011, Telefónica acquired through its subsidiary Telefónica Internacional, S.A.U. 2011 282,063,000 shares of China Unicom amounted to 358 millons euros. In recognition of China Unicom s stake in Telefónica, approval was given at Telefónica s General Shareholders Meeting held on May 18, 2011 for the appointment of a board member named by China Unicom.

Treasury shares sold in 2011 and 2010 amounted to 445 million euros and 14 million euros, respectively. The sales for 2011 included 371 million euros in respect of the Strategic Partnership Agreement with China Unicom, referred to above.

At the date of authorization for issue of these financial statements, Telefónica held 234 million call options on treasury shares subject to physical settlement (190 million and 160 million options on treasury shares at December 31, 2011 and 2010, respectively).

The Company also holds a derivative on approximately 26 million Telefónica shares, subject to net settlement, recognized under Derivative financial liabilities (current) on the balance sheet.

b) Legal reserve

According to the text of the Spanish Enterprise Law, companies must transfer 10% of profit for the year to a legal reserve until this reserve reaches at least 20% of share capital. The legal reserve can be used to increase capital by the amount exceeding 10% of the increased share capital amount. Except for this purpose, until the legal reserve exceeds the limit of 20% of share capital, it can only be used to offset losses, if there are no other reserves available. At December 31, 2011, the Company had duly set aside this reserve.

c) Other reserves

Other reserves includes:

The Revaluation reserve which arose as a result of the revaluation made pursuant to Royal Decree-Law 7/1996 dated June 7. The revaluation reserve may be used, free of tax, to offset any losses incurred in the future and to increase capital. From January 1, 2007, it may be allocated to unrestricted reserves, provided that the capital gain has been realized. The capital gain will be deemed to have been realized in respect of the portion on which the depreciation has been recorded for accounting purposes or when the revalued assets have been transferred or derecognized. In this respect, at the end of 2011, an amount of 15 million euros corresponding to revaluations reserves subsequently considered unrestricted has been reclassified to Other reserves. In 2010, an amount of 16 million euros was reclassified in this connection. The balance of this reserve at December 31, 2011 and 2010 was 126 million and 141 million euros, respectively.

Reserve for cancelled share capital:
In accordance with Article 335.c) of the Spanish Enterprise Law and to render null and void the right of opposition provided for in Article 334 of the same Law, whenever the Company decreases capital it records a reserve for cancelled share capital for an amount equal to the par value of the cancelled shares, which can only be used if the same requirements as those applicable to the reduction of share capital are met. The cumulative amount of the reserve for cancelled share capital at December 31, 2011 and 2010 was 498 million euros.

Pursuant to the provisions of Royal Decree 1514/2007, since 2008, after the distribution of profits for each year, the Company sets aside a non-distributable reserve of 1.7 million euros for goodwill amortization. The balance of this reserve at December 31, 2011 was 5 million euros. The proposed appropriation of 2011 profit (see Note 3) includes an allocation of 1.7 million euros to this restricted reserve.

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

On September 27, 2010, subsequent to the merger approved by the competent company organs, the merger between Telefónica, S.A. and Brasilcel, N.V. was recognized, and inscribed thereafter on December 21, 2010 in the Madrid Mercantile Registry. This merger generated a distributable reserve of 3,602 million euros, reduced by 49 million euros corresponding to the dividends of Brasilcel, N.V. (see Note 2.b).

d) Dividends

*Dividends paid in 2011*

At its meeting of April 12, 2011, Telefónica, S.A. s Board of Directors resolved to pay an interim dividend against 2010 profit of a fixed gross 0.75 euros per outstanding share carrying dividend rights. This dividend was paid in full on May 6, 2011. The total amount paid was 3,394 million euros.

In addition, approval was given at the General Shareholders Meeting on May 18, 2011 to pay a gross 0.77 dividend per share outstanding carrying dividend rights with a charge to unrestricted reserves. This dividend was paid in full on November 7, 2011, and the total amount paid was 3,458 million euros.

*Dividends paid in 2010*

At its meeting of April 28, 2010, Telefónica, S.A. s Board of Directors resolved to pay an interim dividend against 2010 profit of a fixed gross 0.65 euros per outstanding share carrying dividend rights. This dividend was paid in full on May 11, 2010, and the total amount paid was 2,938 million euros.

In addition, approval was given at the General Shareholders Meeting on June 2nd, 2010 to pay a gross 0.65 dividend per share outstanding carrying dividend rights with a charge to unrestricted reserves. This dividend was paid in full on November 8, 2010, and the total amount paid was 2,934 million euros.

11.2 Unrealized gains (losses) reserve

The movements in the items composing Unrealized gains (losses) reserve in 2011 and 2010 are as follows:

| ***(Millions of euros)*** ***2011*** | **Opening balance** | **Valuation at market value** | **Tax effect of additions** | **Amounts transferred to income statement** | **Tax effect of transfers** | **Closing balance** |
|---|---|---|---|---|---|---|
| Available-for-sale financial assets (Note 9.3) | (5) | (50) | 15 | | | (40) |
| Cash flow hedges (Note 16) | (145) | (824) | 247 | 210 | (63) | (575) |
| **Total** | **(150)** | **(874)** | **262** | **210** | **(63)** | **(615)** |

| ***(Millions of euros)*** ***2010*** | **Opening balance** | **Valuation at market value** | **Tax effect of additions** | **Amounts transferred to income statement** | **Tax effect of transfers** | **Closing balance** |
|---|---|---|---|---|---|---|
| Available-for-sale financial assets (Note 9.3) | (91) | (120) | 36 | 243 | (73) | (5) |
| Cash flow hedges (Note 16) | (236) | 57 | (17) | 73 | (22) | (145) |
| **Total** | **(327)** | **(63)** | **19** | **316** | **(95)** | **(150)** |

## (12) FINANCIAL LIABILITIES

The breakdown of Financial liabilities at December 31, 2011 and 2010 is as follows:

| *2011* | LIABILITIES AT FAIR VALUE | | | Measurement hierarchy | | | LIABILITIES AT AMORTIZED COST | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| *(Millions of euros)* | Financial liabilities held for trading | Hedges | Subtotal financial liabilities at fair value | Level 1: quoted prices | Level 2: Estimates based on other directly observable market inputs | Level 3: Estimates not based on other directly observable market data | Trade and other payables | Subtotal liabilities at fair value | TOTAL CARRYING AMOUNT | TOTAL FAIR VALUE |
| **Non-current financial liabilities** | **1,123** | **910** | **2,033** | | **2,033** | | **44,687** | **41,038** | **46,720** | **43,071** |
| Payable to Group companies and associates | | | | | | | 35,381 | 33,465 | 35,381 | 33,465 |
| Bank borrowings | | | | | | | 9,046 | 7,374 | 9,046 | 7,374 |
| Bonds and other marketable debt securities | | | | | | | 170 | 109 | 170 | 109 |
| Derivatives (Note 16) | 1,123 | 910 | 2,033 | | 2,033 | | | | 2,033 | 2,033 |
| Other financial liabilities | | | | | | | 90 | 90 | 90 | 90 |
| **Current financial liabilities** | **183** | **21** | **204** | | **204** | | **17,969** | **17,078** | **18,173** | **17,282** |
| Payable to Group companies and associates | | | | | | | 17,140 | 16,270 | 17,140 | 16,270 |
| Bank borrowings | | | | | | | 742 | 721 | 742 | 721 |
| Bonds and other marketable debt securities | | | | | | | 87 | 87 | 87 | 87 |
| Derivatives (Note 16) | 183 | 21 | 204 | | 204 | | | | 204 | 204 |
| Other financial liabilities | | | | | | | | | | |
| **Total financial liabilities** | **1,306** | **931** | **2,237** | | **2,237** | | **62,656** | **58,116** | **64,893** | **60,353** |

| *2010* | LIABILITIES AT FAIR VALUE | | | Measurement hierarchy | | | LIABILITIES AT AMORTIZED COST | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| *(Millions of euros)* | Financial liabilities held for trading | Hedges | Subtotal financial liabilities at fair value | Level 1: quoted prices | Level 2: Estimates based on other directly observable market inputs | Level 3: Estimates not based on other directly observable market data | Trade and other payables | Subtotal liabilities at fair value | TOTAL CARRYING AMOUNT | TOTAL FAIR VALUE |
| **Non-current financial liabilities** | 630 | 401 | 1,031 | | 1,031 | | 41,842 | 41,539 | 42,873 | 42,570 |
| Payable to Group companies and associates | | | | | | | 34,864 | 34,969 | 34,864 | 34,969 |
| Bank borrowings | | | | | | | 6,822 | 6,446 | 6,822 | 6,446 |
| Bonds and other marketable debt securities | | | | | | | 148 | 116 | 148 | 116 |
| Derivatives (Note 16) | 630 | 401 | 1,031 | | 1,031 | | | | 1,031 | 1,031 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Other financial liabilities | | | | | 8 | 8 | 8 | 8 |
| **Current financial liabilities** | **109** | **66** | **175** | **175** | **17,289** | **18,128** | **17,464** | **18,303** |
| Payable to Group companies and associates | | | | | 16,009 | 16,866 | 16,009 | 16,866 |
| Bank borrowings | | | | | 1,176 | 1,157 | 1,176 | 1,157 |
| Bonds and other marketable debt securities | | | | | 104 | 105 | 104 | 105 |
| Derivatives (Note 16) | 109 | 66 | 175 | 175 | | | 175 | 175 |
| Other financial liabilities | | | | | | | | |
| **Total financial liabilities** | **739** | **467** | **1,206** | **1,206** | **59,131** | **59,667** | **60,337** | **60,873** |

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

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

## (13) BONDS AND OTHER MARKETABLE DEBT SECURITIES

13.1 The balances and movements in issues of debentures, bonds and commercial paper at December 31, 2011 and 2010 are as follows:

| *(Millions of euros)* *2011* | Non-convertible debentures and bonds | Other marketable debt securities | Total |
|---|---|---|---|
| **Opening balance** | **148** | **104** | **252** |
| Additions | | 44 | 44 |
| Depreciation and amortization | | (62) | (62) |
| Revaluation and other movements | 22 | 1 | 23 |
| **Closing balance** | **170** | **87** | **257** |
| Details of maturities: | | | |
| Non-current | 170 | | 170 |
| Current | | 87 | 87 |

| *(Millions of euros)* *2010* | Non-convertible debentures and bonds | Other marketable debt securities | Total |
|---|---|---|---|
| **Opening balance** | **159** | **368** | **527** |
| Depreciation and amortization | (19) | (272) | (291) |
| Revaluation and other movements | 8 | 8 | 16 |
| **Closing balance** | **148** | **104** | **252** |
| Details of maturities: | | | |
| Non-current | 148 | | 148 |
| Current | | 104 | 104 |

Maturities of the nominal amounts of debenture and bond issues at December 31, 2011 and 2010 are as follows:

| **2011** | | | **Maturity** | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Name** | **Interest rate** | **% interest rate** | **2012** | **2013** | **2014** | **2015** | **2016** | **Subsequent years** | **TOTAL** |
| **DEBENTURES AND BONDS:** | | | | | | | | | |
| JULY 99 | ZERO COUPON (**) | 6.39% | | | | | | 64 | 64 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| MARCH 00 | FLOATING | 3.831%(*) | | | | 50 | | | 50 |
| **Total issues** | | | | | | **50** | | **64** | **114** |

| **2010** | | | | | | **Maturity** | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Name** | **Interest rate** | **% interest rate** | **2011** | **2012** | **2013** | **2014** | **2015** | **Subsequent years** | **TOTAL** |
| **DEBENTURES AND BONDS:** | | | | | | | | | |
| JULY 99 | ZERO COUPON (**) | 6.39% | | | | | | 61 | 61 |
| MARCH 00 | FLOATING | 3.994%(*) | | | | | 50 | | 50 |
| **Total issues** | | | | | | | **50** | **61** | **111** |

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

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

13.2 The detail of the maturities and redemption values of zero-coupon debentures and bonds at December 31, 2011 and 2010 is as follows:

| Issue | Redemption date | Redemption rate | Redemption value |
|---|---|---|---|
| **DEBENTURES AND BONDS:** | | | |
| JULY 99 | 07/21/2029 | 637.639% | 191 |
| **Total** | | | **191** |

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

13.3 At December 31, 2011, Telefónica, S.A. had a corporate promissory note program registered with the CNMV, with the following features:

| Amount (millions of euros) | Placement system | Nominal amount of the Promissory notes | Terms of the Promissory notes | Placement |
|---|---|---|---|---|
| 500 million; can be increased to 2,000 million | Auctions | 1,000 euros | 1, 2, 3, 6, 12, 18 and 25 months | Competitive auctions at least once a month |
| | Tailored | 100,000 euros | Between 7 and 750 days | Specific transactions |

At December 31, 2011 the outstanding balance on this promissory note program was 87 million euros (42 million euros in 2010).

13.4 The average interest rate during 2011 on debentures and bonds outstanding during the year was 4.74% (5.68% in 2010) and the average interest rate on corporate promissory notes was 1.88% (0.685% in 2010).

## (14) INTEREST-BEARING DEBT AND DERIVATIVES

14.1 The balances at December 31, 2011 and 2010 are as follows:

| Item *(millions of euros)* | December 31, 2011 Current | Non-current | Total |
|---|---|---|---|
| Loans with financial entities | 742 | 9,046 | 9,788 |
| Derivative financial liabilities (Note 16) | 204 | 2,033 | 2,237 |
| **Total** | **946** | **11,079** | **12,025** |

| Item *(millions of euros)* | December 31, 2010 Current | Non-current | Total |
|---|---|---|---|
| Loans with financial entities | 1,176 | 6,822 | 7,998 |
| Derivative financial liabilities (Note 16) | 175 | 1,031 | 1,206 |
| **Total** | **1,351** | **7,853** | **9,204** |

14.2 The nominal values of the main interest-bearing debts at December 31, 2011 and 2010 are as follows:

| | | | December 31, 2011 | | | |
|---|---|---|---|---|---|---|
| Description | Value date | Maturity date | Currency | Limit at 12/31/11 | Balance (million currency) | Balance (million euros) |
| 8bn syndicated loan | 07/28/10 | 07/28/16 | EUR | 8,000 | 8,000 | 8,000 |
| Syndicated loan savings banks | 04/21/06 | 04/21/17 | EUR | 700 | 700 | 700 |
| ECAS/EKN loan | 02/12/10 | 11/30/19 | USD | 472 | 335 | 259 |

| | | | December 31, 2010 | | | |
|---|---|---|---|---|---|---|
| Description | Value date | Maturity date | Currency | Limit at 12/31/10 | Balance (million currency) | Balance (million euros) |
| 8bn syndicated loan | 07/28/10 | 07/28/15 | EUR | 8,000 | 6,000 | 6,000 |
| Syndicated loan savings banks | 04/21/06 | 04/21/17 | EUR | 700 | 700 | 700 |
| 6bn syndicated loan | 06/28/05 | 06/28/11 | EUR | 650 | 300 | 300 |

14.3 Maturities of balances at December 31, 2011 and 2010 are as follows:

| | | | December 31, 2011 Maturity | | | | |
|---|---|---|---|---|---|---|---|
| **Item *(millions of euros)*** | **2012** | **2013** | **2014** | **2015** | **2016** | **Subsequent years** | **Closing balance** |
| Loans with financial entities | 742 | 930 | 1,836 | 2,989 | 2,245 | 1,046 | 9,788 |
| Derivative financial liabilities (Note 16) | 204 | 61 | 106 | 287 | 192 | 1,387 | 2,237 |
| **Total** | **946** | **991** | **1,942** | **3,276** | **2,437** | **2,433** | **12,025** |

| | | | December 31, 2010 Maturity | | | | |
|---|---|---|---|---|---|---|---|
| **Item *(millions of euros)*** | **2011** | **2012** | **2013** | **2014** | **2015** | **Subsequent years** | **Closing balance** |
| Loans with financial entities | 1,176 | 35 | 2,967 | 5 | 2,979 | 836 | 7,998 |
| Derivative financial liabilities (Note 16) | 175 | 103 | 69 | 95 | 214 | 550 | 1,206 |
| **Total** | **1,351** | **138** | **3,036** | **100** | **3,193** | **1,386** | **9,204** |

14.4 On June 28, 2010, Telefónica, S.A. obtained a syndicated line of credit with a group of national and international banks for up to a maximum of 8,000 million euros. The line of credit has two tranches: the first for up to 5,000 million euros and a term of three years, and the second for up to 3,000 million euros, structured as a revolving credit facility with a five-year term. On May 12, 2011 Telefónica, S.A. signed an amendment whereby it was agreed that of the 5,000 million euros that would initially mature in July 2013, 2,000 million euros would be extended for another year, i.e. until July 2014, and another 2,000 million for a further three years, i.e. until July 2016. At December 31, 2011 the outstanding balance drawn down on this line of credit amounted to 8,000 million euros (6,000 million euros at December 31, 2010).

On May 3, 2011, Telefónica, S.A. entered into a long-term line of credit facility for an aggregate amount of 376 million US dollars at a fixed rate with the guarantee of the Finnish Export Credits Guarantee Board (Finnvera). This line of credit is structured into four tranches: a tranche of 94 US dollars maturing on January 30, 2020, another of 90 million US dollars maturing on July 30, 2020, a third of 94 million US dollars maturing on January 30, 2021, and a fourth of 98 million US dollars maturing on July 30, 2021. No amounts had been drawn down on this credit facility at December 31, 2011.

On February 12, 2010, Telefónica, S.A. signed a long-term line of credit of 472 million US dollars at a fixed rate and guaranteed by the Swedish Export Credits Guarantee Board (EKN). This credit facility is divided into three tranches: a tranche of 232 US dollars maturing on November 30, 2018, another of 164 million US dollars maturing on April 30, 2019, and a third of 76 million US dollars maturing on November 30, 2019. During the year, it repaid 218 million US dollars of the first tranche and 154 million US dollars of the second, although since this facility has a repayment schedule at December 31, 2011, the outstanding balance amounted to 335 million US dollars (equivalent to 259 million euros).

On April 21, 2006, Telefónica S.A. arranged a 700 million euro syndicated loan, denominated in euros and bearing interest linked to Euribor. In 2011 and 2010, there were no movements in this loan, which will be repaid in two equal installments, in April 2015 and 2017, respectively.

On June 28, 2011, the syndicated loan facility arranged by Telefónica, S.A. on June 28, 2005 for 6,000 million euros matured as scheduled. The outstanding balance prior to maturity was 300 million euros.

In addition, Telefónica signed three equity swap contracts with different financial entities in June 2010. These swaps are based on the share price of Portugal Telecom and are settled net, thereby obtaining the same economic returns. The amount received from these contracts is 541 million euros, recognized as current interest-bearing debts. These contracts were partially cancelled in 2011 through the sale of 33 million shares. The remaining outstanding balance stands at 155 million euros.

14.5 Average interest on loans and borrowings

The average interest rate in 2011 on loans and borrowings denominated in euros was 2.376% and on foreign-currency loans and receivables it was 3.354%.

The average interest rate in 2010 on loans and borrowings denominated in euros was 1.17% and on foreign-currency loans and receivables it was 3.86%.

14.6 Unused credit facilities

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

At 31 December 2011 and 2010, Telefónica had undrawn credit facilities amounting to 6,764 million and 8,670 million euros, respectively.

Financing arranged by Telefónica, S.A. at December 31, 2011 and 2010 is not subject to compliance with any financial covenants.

**(15) PAYABLE TO GROUP COMPANIES AND ASSOCIATES**

15.1 The breakdown at December 31, 2011 and 2010 is as follows:

| | **December 31, 2011** | | |
|---|---|---|---|
| ***(Millions of euros)*** | **Non-current** | **Current** | **Total** |
| Loans | 34,855 | 16,993 | 51,848 |
| Trade payables to Group companies and associates | | 129 | 129 |
| Derivatives (Note 16) | | 14 | 14 |
| Payable to subsidiaries due to taxation on a consolidated basis | 526 | 4 | 530 |
| **Total** | **35,381** | **17,140** | **52,521** |

| | **December 31, 2010** | | |
|---|---|---|---|
| ***(Millions of euros)*** | **Non-current** | **Current** | **Total** |
| Loans | 34,520 | 15,800 | 50,320 |
| Trade payables to Group companies and associates | | 132 | 132 |
| Derivatives (Note 16) | 6 | 20 | 26 |

| | | | |
|---|---|---|---|
| Payable to subsidiaries due to taxation on a consolidated basis | 338 | 57 | 395 |
| **Total** | **34,864** | **16,009** | **50,873** |

The maturity of these loans at the 2011 and 2010 year ends is as follows:

December 31, 2011

| Company *(millions of euros)* | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 and subsequent years | Final balance, current and non-current |
|---|---|---|---|---|---|---|---|
| Telefónica Emisiones, S.A.U. | 1,343 | 3,445 | 4,370 | 3,504 | 6,315 | 13,101 | 32,078 |
| Telefónica Europe, B.V. | 6,478 | 1,957 | 14 | | | 1,599 | 10,048 |
| Telfisa Global, B.V. | 2,332 | | | | | | 2,332 |
| Telefónica Finanzas, S.A.U. | 6,830 | | | 476 | 74 | | 7,380 |
| Others | 10 | | | | | | 10 |
| **Total** | **16,993** | **5,402** | **4,384** | **3,980** | **6,389** | **14,700** | **51,848** |

December 31, 2010

| Company *(millions of euros)* | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 and subsequent years | Final balance, current and non-current |
|---|---|---|---|---|---|---|---|
| Telefónica Emisiones, S.A.U. | 3,713 | 634 | 3,452 | 4,395 | 3,428 | 13,802 | 29,424 |
| Telefónica Europe, B.V. | 1,804 | 4,708 | 1,996 | | | 1,555 | 10,063 |
| Telfisa Global, B.V. | 1,812 | | | | | | 1,812 |
| Telefónica Finanzas, S.A.U. | 8,461 | | | | 475 | 75 | 9,011 |
| Others | 10 | | | | | | 10 |
| **Total** | **15,800** | **5,342** | **5,448** | **4,395** | **3,903** | **15,432** | **50,320** |

The carrying amount of financing raised by Telefónica, S.A. through its subsidiary Telefónica Europe, B.V. at December 31, 2011 was 10,048 million euros (10,063 million euros at the 2010 year end). This financing entails a number of loans paying market rates of interest calculated on a Euribor plus spread basis. The average interest rate in 2011 was 3.52% ( 3.94% in 2010).

This financing mainly derives from the syndicated multicurrency loan arranged between Telefónica Europe, B.V. and a group of financial institutions for an amount of up to 18,500 million pounds sterling on October 31, 2005 to fund the acquisition of O2, Plc., which at December 14, 2006 was reduced to 7,000 million pounds sterling, while the maturity was extended from 2008 to 2013. At December 31, 2011, the balance outstanding on this loan was 2,965 million euros (2,945 million euros at 2010 year end).

The carrying amount of financing raised by Telefónica, S.A. through Telefónica Emisiones, S.A.U. at December 31, 2011 was 32,078 million euros (29,424 million euros in 2010). This financing is arranged as loans from these companies on the same terms as those of the issuance programs. The average interest rate in 2011 was 5.06% (5.06% in 2010). The financing arranged includes, as a related cost, the fees or premiums taken to the income statement for the period corresponding to the financing based on the corresponding effective interest rates. Telefónica Emisiones, S.A.U. raised financing in 2011 mainly by tapping the European and US capital markets, issuing the following bonds totaling 4,495 million euros (5,484 million euros in 2010):

| Description | Issue date | Maturity date | Amount (nominal) | Currency of issue | Coupon |
|---|---|---|---|---|---|
| ***EMTN bonds*** | 02-07-2011 | 02-07-2017 | 1,200,000,000 | EUR | 4.750% |
| | 03-21-2011 | 02-07-2017 | 100,000,000 | EUR | 4.750% |
| | 11-03-2011 | 02-03-2016 | 1,000,000,000 | EUR | 4.967% |
| | 11-04-2011 | 11-04-2016 | 7,000,000,000 | JPY | 2.8247% |

| | | | | | |
|---|---|---|---|---|---|
| ***SHELF bond*** | 02-16-2011 | 02-16-2016 | 1,250,000,000 | USD | 3.992% |
| | 02-16-2011 | 02-16-2021 | 1,500,000,000 | USD | 5.462% |

Part of the amount owed by Telefónica, S.A. to Telefónica Emisiones, S.A.U. and to Telefónica Europe, B.V. includes restatements to amortized cost at December 31, 2011 and 2010 as a result of fair value interest rate and exchange rate hedges.

Meanwhile, at December 31, 2011, Telefónica, S.A. had raised financing from Telefónica Finanzas, S.A.U., in charge of the integrated cash management of the companies comprising the Telefónica Group in Spain, amounting to 7,380 million euros (9,011 million euros at December 31, 2010) in a series of loans bearing interest at market rates.

Telfisa Global, B.V. centralizes and handles cash management and flows for the Telefónica Group in Latin America, the United States and Europe. The balance payable to this subsidiary is formalized through several Deposit Agreements accruing interest at market rates and amounting to 2,332 million euros in 2011 and 1,812 million euros in 2010.

Loans to Group companies under current assets includes accrued interest receivable at December 31, 2011 amounting to 829 million euros (776 million euros in 2010).

15.2 The balance of Payable to subsidiaries due to taxation on a consolidated basis was 530 million euros and 395 million euros at December 31, 2011 and 2010, respectively. This basically includes payables to Group companies for their contribution of taxable income (tax losses) to the tax group headed by Telefónica, S.A. (see Note 17). The current- or non-current classification is based on the Company s projection of maturities.

The main amounts are those relating to Telefónica Internacional, S.A.U. for 283 million euros (147 million euros in 2010), Telefónica Móviles España, S.A.U. for 130 million euros (128 million euros in 2010) and Telefónica de España, S.A.U. for 32 million euros (20 million euros in 2010).

**(16) DERIVATIVE FINANCIAL INSTRUMENTS AND RISK MANAGEMENT POLICIES**

a) Derivative financial instruments

During 2011, the Group continued to use derivatives to limit interest and exchange rate risk on otherwise unhedged positions, and to adapt its debt structure to market conditions.

At December 31, 2011, the total outstanding balance of derivatives transactions was 141,155 million euros (102,008 million euros at December 31, 2010), of which 119,772 million euros related to interest rate risk and 21,383 to foreign currency risk. In 2010 81,470 million euros related to interest rate risk and 20,538 million euros to foreign currency risk.

It should be noted that at December 31, 2011, Telefónica, S.A.was not a party to any transaction with financial institutions to hedge interest-rate risk for other Telefónica Group companies; however, it was a party to transactions worth 696 million euros to hedge exchange rate risk in behalf of other Group companies. In 2010, trades of this nature amounted to 38 million euros for interest rate risk and 987 million euros for exchange rate risk. These external trades are matched by intra-group hedges with identical terms and maturities between Telefónica, S.A. and Group companies, and therefore involve no risk for the Company. External derivatives not backed by identical intragroup transactions consist of hedges on net investment and future acquisitions that, by their nature, cannot be transferred to Group companies and/or transactions to hedge financing raised by Telefónica, S.A. as parent company of the Telefónica Group, which are transferred to Group subsidiaries in the form of financing rather than via derivative transactions.

The breakdown of Telefónica, S.A. s interest-rate and exchange-rate derivatives at December 31, 2011, their notional amounts at year end and the expected maturity schedule is as follows:

| 2011 | | | | | |
|---|---|---|---|---|---|
| **Type of risk** | **Value in** | **Telefónica receives** | | **Telefónica pays** | |
| *Millions of euros* | **Euros** | **Carrying** | **Currency** | **Carrying** | **Currency** |
| **Euro interest rate swaps** | **92,082** | | | | |
| *Fixed to fixed* | 2,078 | 2,078 | EUR | 2,078 | EUR |
| *Fixed to floating* | 21,812 | 21,812 | EUR | 21,812 | EUR |
| *Floating to fixed* | 63,977 | 63,977 | EUR | 63,977 | EUR |
| *Floating to floating* | 4,215 | 4,215 | EUR | 4,215 | EUR |
| **Foreign currency interest rate swaps** | **19,971** | | | | |
| *Fixed to floating* | | | | | |
| GBP/GBP | 2,412 | 2,015 | GBP | 2,015 | GBP |
| JPY/JPY | 220 | 22,000 | JPY | 22,000 | JPY |
| USD/USD | 14,385 | 18,612 | USD | 18,612 | USD |
| *Floating to fixed* | | | | | |
| GBP/GBP | 909 | 760 | GBP | 760 | GBP |
| USD/USD | 2,045 | 2,446 | USD | 2,446 | USD |
| **Exchange rate swaps** | **12,422** | | | | |
| *Fixed to fixed* | | | | | |
| EUR/BRL | 331 | 318 | EUR | 804 | BRL |
| EUR/CLP | 131 | 112 | EUR | 87,800 | CLP |
| EUR/CZK | 606 | 631 | EUR | 15,641 | CZK |
| *Fixed to floating* | | | | | |
| MAD/EUR | 88 | 1,000 | MAD | 88 | EUR |
| JPY/EUR | 95 | 15,000 | JPY | 95 | EUR |
| *Floating to fixed* | | | | | |
| EUR/MAD | 90 | 90 | EUR | 1,000 | MAD |
| *Floating to floating* | | | | | |
| EUR/CZK | *319* | 322 | EUR | 8,228 | CZK |
| EUR/GBP | 484 | 588 | EUR | 405 | GBP |
| JPY/EUR | 244 | 37,000 | JPY | 244 | EUR |
| USD/EUR | 10,034 | 13,482 | USD | 10,034 | EUR |
| **Forwards** | **6,820** | | | | |
| ARS/USD | | 2 | ARS | 1 | USD |
| CLP/EUR | 147 | 101,490 | CLP | 147 | EUR |
| CZK/EUR | 5 | 125 | CZK | 5 | EUR |
| EUR/BRL | 18 | 17 | EUR | 44 | BRL |
| EUR/CZK | 556 | 567 | EUR | 14,335 | CZK |
| EUR/GBP | 941 | 933 | EUR | 786 | GBP |
| EUR/MXN | 2 | 2 | EUR | 35 | MXN |
| EUR/USD | 1,690 | 1,625 | EUR | 2,186 | USD |
| GBP/EUR | 2,447 | 2,094 | GBP | 2,447 | EUR |
| GBP/USD | 17 | 14 | GBP | 22 | USD |
| USD/ARS | 1 | 1 | USD | 6 | ARS |

| | | | | | |
|---|---|---|---|---|---|
| USD/BRL | 168 | 224 | USD | 408 | BRL |
| USD/CLP | 11 | 14 | USD | 7,183 | CLP |
| USD/COP | 1 | 1 | USD | 2,756 | COP |
| USD/EUR | 763 | 1,014 | USD | 763 | EUR |
| USD/GBP | 53 | 69 | USD | 44 | GBP |
| USD/PEN | | | USD | 1 | PEN |
| **Spot** | **1** | | | | |
| MXN/EUR | 1 | 17 | MXN | 1 | EUR |
| USD/EUR | | | USD | | EUR |
| **Subtotal** | **131,296** | | | | |

| *(Millions of euros)* Notional amounts of structured products with options | Value in euros | Notional | Currency |
|---|---|---|---|
| ***Interest rate options*** | ***7,719*** | | |
| **Swaptions** | **850** | **850** | **EUR** |
| **Caps & Floors** | **6,869** | **6,869** | **EUR** |
| USD | 54 | 69 | USD |
| EUR | 4,900 | 4,900 | EUR |
| GBP | 1,915 | 2,293 | GBP |
| ***Currency options*** | ***2,140*** | | |
| USD/EUR | 2,140 | 2,769 | USD |
| **Subtotal** | **9,859** | | |
| **TOTAL** | **141,155** | | |

The breakdown by average maturity is as follows:

| *(Millions of euros)* Hedged underlying item | Notional | Up to 1 year | From 1 to 3 years | From 3 to 5 years | Over 5 years |
|---|---|---|---|---|---|
| **With underlying instrument** | | | | | |
| **Promissory notes** | **536** | **56** | **280** | | **200** |
| **Loans** | **37,993** | **22,567** | **1,794** | **3,430** | **10,202** |
| In national currency | 33,911 | 21,447 | 1,400 | 2,950 | 8,114 |
| In foreign currencies | 4,082 | 1,120 | 394 | 480 | 2,088 |
| **Debentures and bonds** | **80,299** | **16,439** | **13,181** | **23,220** | **27,459** |
| In national currency | 34,446 | 7,014 | 7,951 | 9,145 | 10,336 |
| In foreign currencies | 45,853 | 9,425 | 5,230 | 14,075 | 17,123 |
| **Otros subyacentes*** | **22,327** | **8,979** | **5,343** | **2,499** | **5,506** |
| Swaps | 10,767 | 1,045 | 4,871 | 1,999 | 2,852 |
| Swaptions | 850 | 850 | | | |
| Currency options | 2,140 | 283 | 138 | 160 | 1,559 |
| Forwards | 6,820 | 6,801 | 19 | | |
| **IRS** | **1,750** | | **315** | **340** | **1,095** |
| **Total** | **141,155** | **48,041** | **20,598** | **29,149** | **43,367** |

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

The breakdown of Telefónica, S.A. s derivatives in 2010, their fair value at year end and the expected maturity schedule is as follows:

| 2010 | | | | | |
|---|---|---|---|---|---|
| **Type of risk** | **Value in** | **Telefónica receives** | | **Telefónica pays** | |
| *Millions of euros* | **Euros** | **Carrying** | **Currency** | **Carrying** | **Currency** |
| **Euro interest rate swaps** | **56,424** | | | | |
| *Fixed to fixed* | 55 | 55 | EUR | 55 | EUR |
| *Fixed to floating* | 18,290 | 18,290 | EUR | 18,290 | EUR |
| *Floating to fixed* | 37,987 | 37,984 | EUR | 37,984 | EUR |
| *Floating to floating* | 92 | 92 | EUR | 92 | EUR |
| **Foreign currency interest rate swaps** | **17,325** | | | | |
| *Fixed to floating* | *14,261* | | | | |
| GBP/GBP | 1,801 | 1,550 | GBP | 1,550 | GBP |
| JPY/JPY | 138 | 15,000 | JPY | 15,000 | JPY |
| USD/USD | 12,322 | 16,465 | USD | 16,465 | USD |
| *Floating to fixed* | *3,064* | | | | |
| GBP/GBP | 1,098 | 945 | GBP | 945 | GBP |
| USD/USD | 1,966 | 2,628 | USD | 2,628 | USD |
| **Exchange rate swaps** | **11,122** | | | | |
| *Fixed to fixed* | *621* | | | | |
| EUR/BRL | 129 | 107 | EUR | 288 | BRL |
| EUR/CLP | 140 | 112 | EUR | 87,800 | CLP |
| EUR/CZK | 352 | 352 | EUR | 8,818 | CZK |
| *Fixed to floating* | *183* | | | | |
| JPY/EUR | 95 | 15,000 | JPY | 95 | EUR |
| MAD/EUR | 88 | 1,000 | MAD | 88 | EUR |
| *Floating to fixed* | *143* | | | | |
| EUR/MAD | 89 | 90 | EUR | 1,000 | MAD |
| USD/ARS | 54 | 90 | USD | 285 | ARS |
| *Floating to floating* | *10,175* | | | | |
| EUR/CZK | 328 | 322 | EUR | 8,228 | CZK |
| EUR/GBP | 1,098 | 1,373 | EUR | 945 | GBP |
| JPY/EUR | 178 | 30,000 | JPY | 178 | EUR |
| USD/EUR | 8,571 | 11,395 | USD | 8,570 | EUR |
| **Forwards** | **7,375** | | | | |
| EUR/BRL | 12 | 11 | EUR | 27 | BRL |
| EUR/CZK | 697 | 705 | EUR | 17,457 | CZK |
| EUR/GBP | 961 | 984 | EUR | 828 | GBP |
| EUR/MXN | 2 | 2 | EUR | 36 | MXN |
| EUR/USD | 1,576 | 1,571 | EUR | 2,106 | USD |
| GBP/EUR | 2,247 | 1,927 | GBP | 2,246 | EUR |
| GBP/USD | 26 | 23 | GBP | 35 | USD |
| USD/BRL | 144 | 185 | USD | 320 | BRL |
| USD/CLP | | 1 | USD | 274 | CLP |
| USD/COP | | | USD | 246 | COP |
| USD/EUR | 818 | 1,094 | USD | 818 | EUR |

| | | | | | |
|---|---|---|---|---|---|
| USD/GBP | 70 | 94 | USD | 60 | GBP |
| USD/MXN | 548 | 727 | USD | 9,039 | MXN |
| MXN/USD | 274 | 4,519 | MXN | 366 | USD |
| **Spot** | **1** | | | | |
| MXN/EUR | 1 | 23 | MXN | 1 | EUR |
| **Subtotal** | **92,247** | | | | |

***(Millions of euros)***

| **Notional amounts of structured products with options** | **Value in euros** | **Notional** | **Currency** |
|---|---|---|---|
| **Interest rate options Caps & Floors** | **7,721** | | |
| USD | 62 | 83 | USD |
| EUR | 5,800 | 5,800 | EUR |
| GBP | 1,859 | 1,600 | GBP |
| **Currency options** | **2,040** | | |
| USD/EUR | 2,040 | 2,725 | USD |
| **Subtotal** | **9,761** | | |
| **TOTAL** | **102,008** | | |

The breakdown by average maturity is as follows:

*(Millions of euros)*

| Hedged underlying item | Notional | Up to 1 year | From 1 to 3 years | From 3 to 5 years | Over 5 years |
|---|---|---|---|---|---|
| **With underlying instrument** | | | | | |
| **Promissory notes** | **587** | **51** | **56** | **280** | **200** |
| **Loans** | **26,170** | **11,469** | **6,350** | **2,586** | **5,765** |
| In national currency | 23,485 | 11,394 | 5,177 | 2,400 | 4,514 |
| In foreign currencies | 2,685 | 75 | 1,173 | 186 | 1,251 |
| **Debentures and bonds MtM** | **55,231** | **10,662** | **5,423** | **11,195** | **27,951** |
| In national currency | 22,080 | 4,666 | 2,092 | 6,791 | 8,531 |
| In foreign currencies | 33,151 | 5,996 | 3,331 | 4,404 | 19,420 |
| **Without underlying*** | **20,020** | **8,795** | **3,212** | **3,685** | **4,328** |
| Swaps | 10,615 | 1,297 | 3,024 | 3,524 | 2,770 |
| Spots | 1 | 1 | | | |
| Currency options | 2,040 | 183 | 138 | 161 | 1,558 |
| Forwards | 7,364 | 7,314 | 50 | | |
| **Total** | **102,008** | **30,977** | **15,041** | **17,746** | **38,244** |

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

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

The fair value of Telefónica, S.A. s derivatives portfolio with external counterparties at December 31, 2011 was equivalent to a net asset of 2,229 million euros (net asset of 1,626 million euros in 2010).

b) Risk management policy

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

The main market risks affecting Telefónica are as follows:

1. Exchange rate risk

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

2. Interest rate risk

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

3. Share price risk

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

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

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

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

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

***Exchange rate risk***

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

At December 31, 2011, net debt in Latin American currencies was equivalent to approximately 7,953 million euros. However, the Latin American currencies in which this debt is denominated is not distributed in proportion to the cash flows generated in each currency. The future effectiveness of the strategy described above as a hedge of exchange rate risks therefore depends on which currencies depreciate relative to euro.

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

Telefónica s target is to preserve the same ratio of sterling-denominated net debt to OIBDA as the ratio of net debt to OIBDA for Telefónica as a whole so as to limit sensitivity to the sterling to euro and sterling to Czech crown exchange rates. This objective is similar to that described for the investment in the UK: the amount of Czech crown-denominated debt is proportional to the OIBDA of the Telefónica Europa business unit in the Czech Republic. Czech crown-denominated net debt at December 31, 2011 was 1.7 times OIBDA in Czech crown (1.6 times in 2010) on a consolidated basis and 2.55 times (2.3 times in 2010) on a proportional basis. Both were below the Telefónica Group s net debt to OIBDA ratio in 2011.

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

As Telefónica s direct exposure is counterbalanced by the positions held in subsidiaries, the Company analyses its foreign currency risk exposure at the Group level. To illustrate the sensitivity of exchange gains or losses to variability in exchange rates, assuming the exchange rate position affecting the income statement at the end of 2011 were constant during 2012 and Latin American currencies depreciated against the dollar and the rest of the currencies against the euro by 10%, Telefónica estimates that consolidated exchange losses recorded for 2012 would be 111 million euros. For Telefónica, S.A., assuming only financing arranged with external counterparties, the same change would lead to a decrease in finance costs of 89 million euros. Nonetheless, Telefónica manages its exposure on a dynamic basis to mitigate their impact.

***Interest rate risk***

The Telefónica Group s financial expenses are exposed to changes in interest rates. In 2011, the rates applied to the largest amount of short-term debt were mainly based on the Euribor, the Czech crown Pribor, the Brazilian SELIC, the dollar Libor and the Colombian UVR. Telefónica manages its interest rate risk by entering into derivative financial instruments, primarily swaps and interest-rate options.

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

To calculate the sensitivity of the income statement, a 100 basis point rise in interest rates in all currencies in which there are financial positions at December 31, 2011 has been assumed, as well as a 100 basis point decrease in all currencies except the US dollar and pound sterling, in order to avoid negative rates. The constant position equivalent to that prevailing at the end of 2011 has also been assumed.

To calculate the sensitivity of equity to variability in interest rates, a 100 basis point increase in interest rates in all currencies and terms in which there are financial positions at December 31, 2011 was assumed, as well as a 100 basis point decrease in all currencies and terms. Cash flow hedge positions were also considered as they are, in the main, the only positions where changes in market value due to interest-rate fluctuations are recognized in equity.

| | Impact on consolidated result (*) | Impact on Telefónica SA individual income statement (*) | Impact on consolidated equity | Impact on Telefónica SA individual equity |
|---|---|---|---|---|
| +100bp | (141) | (32) | 779 | 779 |
| -100bp | 147 | 39 | (849) | (849) |

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

***Share price risk***

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

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

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

During 2010, an incentive plan for Group employees to purchase Telefónica shares, approved at the Ordinary General Shareholders Meeting of 2009, was initiated. The cost of this plan will not exceed 50 million euros, as agreed in the aforementioned Ordinary General Shareholders Meeting (see Note 19 for further details).

In addition, the Group may use part of the treasury shares of Telefónica, S.A. held at December 31, 2011 to cover shares deliverable under the PSP or the PIP. The net asset value of the treasury shares could increase or decrease depending on variations in Telefónica, S.A. s share price.

***Liquidity risk***

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

1. The Telefónica Group s average maturity of net financial debt is intended to stay above 6 years, or be restored above that threshold in a reasonable period of time if it eventually falls below it. This principle is considered as a guideline when managing debt and access to credit markets, but not a rigid requirement. When calculating the average maturity for the net financial debt and part of the undrawn credit lines can be considered as offsetting the shorter debt maturities, and extension options on some financing facilities may be considered as exercised, for calculation purposes.

2. The Telefónica Group must be able to pay all commitments over the next 12 months without accessing new borrowing or tapping the capital markets (although drawing upon firm credit lines arranged with banks), assuming budget projections are met.

***Country risk***

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

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

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

***Credit risk***

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

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

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

The Telefónica Group considers managing commercial credit risk as crucial to meeting its sustainable business and customer base growth targets in a manner that is consistent with its risk-management policy.

This is based on continuous monitoring of the risk assumed and the resources necessary to optimize the risk-reward ratio in its operations. Particular attention is given to those clients that could cause a material impact on the Group s consolidated financial statements for which, depending on the segment and type of relation, hedging instruments or collateral may be required to mitigate exposure to credit risk.

All Group companies adopt policies, procedures, authorization guidelines, and homogeneous management practices, in consideration of the particularities of each market and best international practices, and incorporating this commercial credit risk management model into the Group s decision making processes, both from a strategic and day to day operating perspective, which risk assessment guides the commercial offering available for the various credit profiles.

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

Telefónica, S.A. provides operating guarantees granted by external counterparties, which are offered during its normal commercial activity. At December 31, 2011, these guarantees amounted to approximately 239 million euros.

***Capital management***

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

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

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

***Derivatives policy***

Telefónica s derivatives policy emphasizes the following points:

Derivatives based on a clearly identified underlying.

Matching of the underlying to one side of the derivative.

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

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

Sale of options only when there is an underlying exposure.

Hedge accounting

Hedges can be of three types:

Fair value hedges

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

Hedges of net investment in a foreign operation.

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

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

In 2011, the Company recognized a loss of 0.3 million euros for the ineffective part of cash flow hedges (3.8 million euros in 2010).

The breakdown of the Company s derivatives with counterparties not belonging to the Telefónica Group at December 31, 2011 and December 31, 2010 by type of hedge, their fair value at year end and the expected maturity schedule is as follows:

| | | *(Millions of euros)* | | | | |
|---|---|---|---|---|---|---|
| | | **Notional amount MATURITIES (*)** | | | | |
| **2011** | **Fair value** | | | | | |
| **Derivatives** | **(**)** | **2012** | **2013** | **2014** | **Subsequent years** | **Total** |
| **Interest rate hedges** | **(58)** | **(1,536)** | **793** | **(824)** | **8,232** | **6,665** |
| Cash flow hedges | 880 | (1,040) | 1,189 | (350) | 10,992 | **10,791** |
| Fair value hedges | (938) | (496) | (396) | (474) | (2,760) | **(4,126)** |
| **Exchange rate hedges** | **(947)** | **194** | **239** | | **6,482** | **6,915** |
| Cash flow hedges | (947) | 194 | 239 | | 6,482 | **6,915** |
| Fair value hedges | | | | | | |
| **Interest and exchange rate hedges** | **(656)** | **(44)** | **1,154** | **72** | **2,099** | **3,281** |
| Cash flow hedges | (656) | (44) | 1,154 | 72 | 2,099 | **3,281** |
| Fair value hedges | | | | | | |
| **Hedge of net investment** | **(141)** | **(546)** | **(160)** | **(230)** | **(1,152)** | **(2,088)** |
| **Derivatives not designated as hedges** | **(427)** | **8,209** | **(441)** | **(194)** | **(1,576)** | **5,998** |
| Interest rate | (234) | 7,855 | (579) | (144) | (2,404) | **4,728** |
| Exchange rate | (208) | 445 | 138 | (50) | 828 | **1,361** |
| Interest and exchange rate | 15 | (91) | | | | **(91)** |

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

(**) Positive amounts indicate payables.

| **2010** | | | | | | |
|---|---|---|---|---|---|---|
| | | ***(Millions of euros)*** **Notional amount MATURITIES (*)** | | | | |
| **Derivatives** | **Fair value (**)** | **2011** | **2012** | **2013** | **Subsequent years** | **Total** |
| **Interest rate hedges** | **(353)** | **(5,998)** | **60** | **(2,084)** | **7,170** | **(852)** |
| Cash flow hedges | 267 | (3,652) | 556 | (438) | 8,487 | **4,953** |
| Fair value hedges | (620) | (2,346) | (496) | (1,646) | (1,317) | **(5,805)** |
| **Exchange rate hedges** | **(409)** | **854** | **112** | **577** | **4,323** | **5,866** |
| Cash flow hedges | (409) | 854 | 112 | 577 | 4,323 | **5,866** |
| Fair value hedges | | | | | | |
| **Interest and exchange rate hedges** | **(223)** | **27** | **130** | **926** | **2,004** | **3,087** |
| Cash flow hedges | (223) | 27 | 130 | 926 | 2,004 | **3,087** |
| Fair value hedges | | | | | | |
| **Hedge of net investment** | **(288)** | **(1,770)** | | **(160)** | **(980)** | **(2,910)** |
| **Derivatives not designated as hedges** | **(367)** | **4,453** | **316** | **(289)** | **(478)** | **4,002** |
| Interest rate | (238) | 4,415 | 426 | (427) | (1,316) | **3,098** |
| Exchange rate | (115) | 106 | (109) | 138 | 838 | **973** |
| Interest and exchange rate | (14) | (68) | (1) | | | **(69)** |

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

(**) Positive amounts indicate payables.

**(17) INCOME TAX**

Pursuant to a Ministerial Order dated December 27, 1989, since 1990 Telefónica, S.A. has filed consolidated tax returns with certain Group companies. The consolidated tax group in 2011 comprised 48 companies. Included during the year were Wayra Investigación y Desarrollo, S.L.U., Movistar Loyalty, S.L., and Telefónica Digital Holding, S.L. All three companies were incorporated in 2011. Venturini, S.A. ceased forming part of the consolidated tax group in 2011, having been sold during the year.

Tax balances are as follows:

| *(Millions of euros)* | **2011** | **2010** |
|---|---|---|
| **Tax receivables:** | **2,803** | **2,342** |
| ***Deferred tax assets:*** | ***2,605*** | ***2,217*** |
| Impuestos diferidos deducibles frente Hacienda Pública | 124 | 140 |
| Other temporary differences, assets | 1,641 | 1,569 |
| Long-term tax loss carryforwards | 723 | 443 |
| Deductions | 117 | 65 |
| ***Current tax receivables (Note 10):*** | ***198*** | ***125*** |
| Withholdings | 52 | 42 |
| Corporate income tax payable | 120 | 66 |
| VAT and Canary Islands general indirect tax refundable | 26 | 17 |
| **Tax payable:** | **521** | ***824*** |
| ***Deferred tax liabilities:*** | ***474*** | **778** |
| Deferred income tax (expense) | 164 | 10 |
| Other temporary differences, liabilities | 310 | 768 |
| ***Current payables to public administrations (Note 18):*** | ***47*** | ***46*** |
| Personal income tax withholdings | 4 | 5 |
| Corporate income tax payable | 14 | 18 |
| Withholding on investment income, VAT and other | 28 | 10 |
| Social security | 1 | 13 |

The tax group had unused tax loss carryforwards at December 31, 2011 amounting to 4,575 million euros. These losses must be applied within 18 years.

Of this amount, 2,410 million euros gave rise to a tax credit recognized on the balance sheet in the amount of 723 million euros (443 million euros in 2010), of which 982 million euros (226 million euros in 2010) were generated by Telefónica, S.A. itself, net of the rest of the amount, which corresponded to other companies in the tax group.

Unused tax loss carryforwards relate mainly to a negative adjustment made to the taxable base for corporate income tax at Telefónica Móviles, S.A. (now Telefónica, S.A.) in 2002, amounting to 2,137 million euros and resulting from the transfer of certain holdings acquired in previous years where the market value differed from the book value at which they were recognized.

The challenging of this adjustment, which was related to the tax inspection of financial years 2001 to 2004, completed in 2008, has not had an impact on the Company s financial statements. However, the use by the Group of the tax loss carryforward is subject to a successful appeal before the Courts against the assessments arising from this inspection.

As head of the Telefónica Tax Group, in 2011 Telefónica, S.A. made no payments on account of 2011 income tax. In 2010, payments on account of the year totalled 729 million euros.

17.1 Movement in deferred tax assets and liabilities

The balances and movements in Deferred tax assets and Deferred tax liabilities for Telefónica, S.A. at December 31, 2011 and 2010 are as follows:

| ***2011*** <br> ***(Millions of euros)*** | **Tax credits** | **Temporary differences, assets** | **Deductions** | **Total deferred tax assets** | **Deferred tax liabilities** |
|---|---|---|---|---|---|
| **Opening balance** | **443** | **1,709** | **65** | **2,217** | **778** |
| Arising in the year | 756 | 446 | 11 | 1,213 | 280 |
| Reversal | | (358) | | (358) | (604) |
| Transfers to the tax group s net position | (476) | (32) | 41 | (467) | 5 |
| Other movements | | | | | 15 |
| **Closing balance** | **723** | **1,765** | **117** | **2,605** | **474** |

| ***2010*** <br> ***(Millions of euros)*** | **Tax credits** | **Temporary differences, assets** | **Deductions** | **Total deferred tax assets** | **Deferred tax liabilities** |
|---|---|---|---|---|---|
| **Opening balance** | **443** | **454** | **200** | **1,097** | **37** |
| Arising in the year | | 728 | 40 | 768 | 19 |
| Reversal | | (80) | | (80) | (15) |
| Transfers to the tax group s net position | | | (258) | (258) | |
| Other movements | | 607 | 83 | 690 | 737 |
| **Closing balance** | **443** | **1,709** | **65** | **2,217** | **778** |

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

Deferred tax liabilities include 17 million euros corresponding to the tax amortization of goodwill generated on acquiring stakes in the Brazilian subsidiaries of Brasilcel, N.V. (see Note 8.1 c). No impact has been recognized in profit and loss, pending the final decisions on the court and administrative proceedings relating to this matter, which at year-end remained open.

In accordance with article 12.3 of the revised Spanish Income Tax Law ( TRLIS ), as well as with transitional provision 29 of that law, a positive adjustment of 248 million euros was provisionally included in the Company s taxable income declared at 2010 year end, in connection with the decline in value of investees. Finally, using the subsidiaries definitive accounting records, 309 million euros was included in the income tax return. At December 31, 2011 2,489 million euros is pending inclusion for reversal of the adjustment in future periods. In 2010, the variation in equity of investees for which a provision was made amounts to 2,589 million euros.

In addition, at the 2011 year end, a decrease of 551 million euros was provisionally incorporated in the Company s taxable income in connection with impairment of investees for tax purposes.

At December 31, 2011 3,040 million euros is pending inclusion for reversal of the adjustment in future periods.

In 2011, the variation in equity of investees for which a provision was made amounts to 13,771 million euros, primarily in respect of Brazilian companies.

17.2 Reconciliation of accounting profit to taxable income and income tax expense to income tax payable.
The calculation of the income tax expense and income tax payable for 2011 and 2010 is as follows.

| *(Millions of euros)* | **2011** | **2010** |
|---|---|---|
| Accounting profit before tax | **3,999** | **2,885** |
| Permanent differences | (7,177) | (6,598) |
| Permanent differences arising from the first-time application of PGC 2007 | | 210 |
| Temporary differences: | **658** | **2,060** |
| Arising in the year | 1,846 | 2,008 |
| Arising in prior years | (1,188) | 52 |
| **Tax result** | **(2,520)** | **(1,443)** |
| Gross tax payable | (756) | (433) |
| Tax credits capitalized | (11) | (40) |
| **Corporate income tax refundable** | **(767)** | **(473)** |
| Temporary differences for tax valuation | (351) | (618) |
| Tax effect of first-time application of PGC 2007 | | (63) |
| Diferencias temporarias derivadas del proceso de consolidación fiscal | 153 | |
| Other effects | 16 | (100) |
| Corporate income tax accrued in Spain | (949) | (1,254) |
| Foreign taxes | 38 | 9 |
| **Income tax** | **(911)** | **(1,245)** |
| Current income tax | **(718)** | **(487)** |
| Deferred income tax | **(193)** | **(758)** |

The permanent differences relate mainly to changes in investment write-down provisions recorded by the Tax Group companies included in the consolidated corporate income tax return, and to dividends received from Tax Group companies or foreign companies that meet certain requirements.

In addition, they include as a permanent difference the decrease in income tax expense derived from the tax amortization of financial goodwill for foreign shareholding acquisitions made before December 21, 2007. In 2011 and 2010, this income item came to 28 million euros and 139 million euros, respectively. This impact has been lessened as a result of the entry into force of Law 9/2011, which reduced the deductible portion of goodwill amortization under article 12.5 LIS (Corporate Income Tax Act) from 5% to 1% for 2011, 2012 and 2013. The effect is temporary: the 4% not amortized over those three years (12% in total) will be recovered by extending the deduction period from the original 20 years to 22.5 years.

Temporary differences mainly comprise adjustments on eliminating the tax base of impairment provisions and reversals of investment write-downs that are not tax deductible under article 12.3 of the Income Tax Law (LIS).

In 2011 and 2010, the Company capitalized 11 million euros and 40 million euros, respectively, of tax credits. The cumulative amount at year end principally reflects tax deductions for export activities and donations to non-profit organizations (approximately 117 million euros). Given that the tax balance was a negative balance in 2011, no deductions were offset during the year.

17.3 Tax inspections and tax-related lawsuits

On September 25, 2002, tax inspections commenced at several companies included in tax group 24/90, of which Telefónica is the parent company for the years from 1998 to 2000.

The tax assessments related to this review, which included settlement agreements and imposed fines on Telefónica, were signed by the company in disagreement in October 2004 and July 2005. The total amount of these assessments was 140 million euros, corresponding to subsidiaries of the Fiscal Group.

In April 2007, Telefónica filed an administrative appeal before the National Court of Justice requesting not only the avoid of the liquidation but also the consideration of another favourable aspects that were not observed by the inspection. Throughout the process, the Company requested that the execution of the settlements and penalties appealed be suspended by providing the appropriate guarantees. On February 22, 2010, Telefónica received the notification of the ruling by the National Court of Justice dated February 4, 2010, in which it partially accepted the Company s allegations, and cancelled the imposition of penalties. On May 18, 2010, Telefónica, S.A. filed an appeal and the National Court of Justice gave Telefónica, S.A. leave to proceed with its appeal and ruled on April 5, 2010 to refer the case to the Supreme Court. In addition, on June 4, 2010, the Tax Authorities filed an appeal before the Supreme Court against one of the rulings of the National Court of Justice partially accepting Telefónica s allegations. In January 2011, Telefónica submitted a brief of opposition against that appeal.

In addition, a new tax inspection for the period 2001 to 2004 commenced in June 2006 and concluded in July 2008. The Tax Group s income tax and in addition to the above, the inspection has not accepted additional adjustments to the tax amounts considered by Telefónica which amounts to 2,137 million euros (note that consolidated financial statements are not affected by this challenging). Approximately 346 million of additional deductions related to its exporting activity were not accepted y the Tax Authorities either.

In keeping with the above, the Tax Authorities solved the contentious by commencing a new tax liquidation. Telefónica, filed an administrative appeal before the Central Administrative Economic Court, which on September 10, 2009 ruled against the interests of the Company. Telefónica filed an administrative appeal before the National Court of Justice. On April, 2010 the Company filed the claim and on April, 2010, Telefónica presented in writing its conclusions.

Additionally, in June 2010, new inspections of various companies in the 24/90 Tax Group, of which Telefónica, S.A. is the parent, were initiated. The taxes subject to review were corporate income tax for the years 2005 to 2007, VAT, tax withholdings and payments on account in respect of personal income tax, tax on investment income, property tax and non-resident income tax for the years 2006 to 2007.

Therefore, including the years under inspection, Telefónica, S.A. has all taxes since 2005 open to inspection.

In relation to the sale by Terra Networks, S.A. (now Telefónica, S.A.) of it stake in Lycos, Inc. in 2004, the Company began the necessary procedures to enable it to recognize a higher tax loss of up to 7,418 million euros as a conseuqence of measuring the market value of Lycos, Inc. shares received at acquisition value for tax purposes, rather than the book value at which they were recorded, in conformity with Article 159 of the Spanish Corporation Law. However, no accounting adjustments have been recorded until the Company receives a definitive ruling on this procedure.

At 2011 year end, it is not expected that the final outcome of these assessments, lawsuits, and inspections in progress or pending for years open to inspection will require any additional significant liabilities to be recognized in Telefónica, S.A. s financial statements.

## (18) TRADE AND OTHER PAYABLES

The breakdown of Trade and other payables is as follows:

| *(Millions of euros)* | **2011** | **2010** |
|---|---|---|
| Suppliers | 322 | 411 |
| Other payables | 71 | 2,065 |
| Current income tax liabilities (Note 17) | 14 | 18 |
| Other payables to public administrations (Note 17) | 33 | 28 |
| **Total** | **440** | **2,522** |

*a) Trade payables*

In performance of Telefónica s irrevocable undertaking of 2010 to give Fundación Telefónica a total of 280 million euros, in 2011 the Company made cash payments in the amount of 60 million euros and, in addition, contributed real estate previously purchased from Telefónica de España, S.A.U. (see Note 8) at its arm s length value of 51 million euros.

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

Telefónica, S.A. has adapted its internal processes and payment schedules to the provisions of Law 15/2010, establishing measures against late payment in commercial transactions. Engagement conditions with commercial suppliers in 2011 included payment periods of up to 85 days, as laid down in said law.

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

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

Payments to Spanish suppliers in 2011 surpassing the legal limit were due to circumstances or incidents beyond the payment policies, mainly the closing of agreements with suppliers over the delivery of goods or the rendering of services, or occasional processing issues.

| | $00.00 | $00.00 |
|---|---|---|
| | 2011 | |
| **Millions of euros** | **Amount** | **%** |
| Payments made on time | 254 | 93 |
| Other | 19 | 7 |
| **Total payments to commercial suppliers** | **273** | **100** |
| Weighted average maturity exceeded (days) | 52 | |
| Deferrals at year-end that exceed the limit | 2 | |

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

*b) Sundry creditors*

In 2010 this line included 1,977 million euros corresponding to the value of the final payable to Portugal Telecom (2,000 million euros) for the acquisition of 50% of Brasilcel, N.V. (see Note 8.1). This debt was repaid upon maturity.

## (19) REVENUE AND EXPENSES

19.1 Revenue

***a) Rendering of services***

In 2008, Telefónica, S.A. arranged contracts for the right to use the Telefónica brand with Group companies which use the license. The amount each subsidiary must recognize as a cost for use of the license is stipulated in the contract as a percentage of income obtained by the licensor. In 2011 and 2010, Rendering of services to Group companies included 618 million euros and 518 million euros, respectively, for this item.

Telefónica, S.A. has signed contracts to provide management support services to Telefónica de España, S.A.U, Telefónica Móviles España, S.A.U., Telefónica O2 Holding, Ltd. and Telefónica Internacional, S.A.U. Revenue received for this concept in 2011 and 2010 amounted to 25 million euros and 13 million euros, in each case, recognized under Services rendered to Group companies and associates.

Operating revenues also include property rental income amounting to 52 million euros in 2011 and 43 million euros in 2010, mainly from the lease of office space in Distrito Telefónica to several Telefónica Group companies (see Note 7).

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

The detail of the main amounts recognized in 2011 and 2010 is as follows:

| ***(Millions of euros)*** | **2011** | **2010** |
|---|---|---|
| Telefónica Móviles España, S.A.U. | 1,980 | 2,190 |
| Telefónica de España, S.A.U. | 2,430 | 2,827 |
| Telefónica Europe, plc. | 715 | 708 |
| Vivo Participaçoes, Ltda. and subsidiaries | 553 | 47 |
| Telefónica Czech Republic, a.s. | 365 | 331 |
| Latin American Cellular Holding, B.V. | 218 | 65 |
| Brasilcel, N.V. | | 82 |
| Portugal Telecom | | 44 |
| Telecommunicaçoes de Sao Paulo | 235 | |
| Sao Paulo Telecommunicaçoes | 91 | |
| Telefónica Móviles Argentina, S.A. y Telefónica Móviles Argentina Holding, S.A. | 179 | 39 |
| Other companies | 201 | 141 |
| **Total** | **6,967** | **6,474** |

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

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

| ***(Millions of euros)*** | **2011** | **2010** |
|---|---|---|
| Telefónica Móviles México, S.A. de C.V. | 145 | 188 |
| Telefónica de España, S.A.U. | 83 | 130 |
| Other companies | 47 | 60 |

| | | |
|---|---|---|
| **Total** | **275** | **378** |

19.2 Non-core and other current operating revenues Group companies relates to revenues on centralized services that Telefónica, S.A., as head of the Group, provides to its subsidiaries. Telefónica, S.A. bears the full cost of these services and then charges each individual subsidiary for the applicable portion. The amount includes billings to Telefónica Móviles España, S.A.U., which amounted to 26 million euros and 30 million euros in 2011 and 2010, respectively, and to Telefónica de España, S.A.U., for 48 million euros in 2011 and 28 million euros in 2010.

19.3 Personnel expenses and employee benefits

The breakdown of Personnel expenses is as follows:

| ***(Millions of euros)*** | **2011** | **2010** |
|---|---|---|
| Wages, salaries and other personnel expenses | 213 | 165 |
| Pension plans (Note 4.h) | 12 | 10 |
| Social security costs | 19 | 18 |
| **Total** | **244** | **193** |

In 2011 Wages, salaries and other personnel expenses includes 61 million euros for estimated obligations arising from the collective labor force reduction program approved in Telefónica de España, S.A.U. and expected to be passed on to Telefónica, S.A., and for the estimated cost of certain voluntary redundancies approved in 2011 and carried out in early 2012. A balancing entry for this expense was made under Current provisions . In addition to these pending costs, the Company has recognized 10 million euros in connection with severance payments for terminations in 2011.

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

Defined contribution of 4.51% of the participating employees base salary. The defined contributions of employees transferred to Telefónica from other Group companies with different defined contributions (e.g. 6.87% in the case of Telefónica de España, S.A.U.) will be maintained.

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

Individual and financial capitalization systems.

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

At December 31, 2011, 1,717 employees had signed up for the plan (1,536 employees in 2010). This figure includes both employees contributing and those who have ceased to contribute to the plan, as provided for in Royal Decree 304/2004 approving the regulations for Pension Plans and Funds. The cost for the Company amounted to 4 million euros in each of 2011 and 2010.

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

Telefónica, S.A. has recorded costs related to the contributions to this executive plan of 8.2 million euros in 2011 (6.2 million euros in 2010).

In 2010, some executives left this Plan, leading to the recovery of part of the initial extraordinary contributions amounting to 2 million euros.

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

The share-based payment plans are the following:

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

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

The Plan was initially intended to last seven years. It is divided into five phases, each three years long, beginning on July 1 (the Start Date ) and ending on June 30 three years later (the End Date ). At the start of each phase the number of shares to be awarded to Plan beneficiaries is determined based on their success in meeting targets set. The shares are delivered, assuming targets are met, at the End Date of each phase. Each phase is independent from the others. The first started on July 1, 2006 (with shares to be delivered in July 2009) and the fifth phase began on July 1, 2010 (with any shares earned being delivered from July 1, 2013).

Award of the shares is subject to a number of conditions:

- The beneficiary must continue to work for the company throughout the three-year duration of each phase, subject to certain special conditions related to departures.

- The actual number of shares awarded at the end of each phase will depend on success in meeting targets and the maximum number of shares assigned to each executive. Success is measured by comparing the total shareholder return (TSR), which includes both share price and dividends offered by Telefónica shares, with the TSRs offered by a basket of listed telecoms companies that comprise the comparison group. Each employee who is a member of the plan is assigned at the start of each phase a maximum number of shares. The actual number of shares awarded at the end of the phase is calculated by multiplying this maximum number by a percentage reflecting their success at the date in question. This will be 100% if the TSR of Telefónica is equal to or better than that of the third quartile of the Comparison Group and 30% if Telefónica s TSR is in line with the average. The percentage rises linearly for all points between these two benchmarks. If the TSR is below average no shares are awarded.

June 30, 2010 marked the end of the second phase of this plan, which entailed the following maximum number of shares allocated:

| | Number of shares | Unit fair value | End date |
|---|---|---|---|
| 2nd phase July 1, 2007 | 5,556,234 | 7.70 | June 30, 2010 |

Of this amount, the maximum number of shares corresponding to Telefónica, S.A. managers and executives is as follows:

| | Number of shares | Unit fair value | End date |
|---|---|---|---|
| 2nd phase July 1, 2007 | 1,102,711 | 7.70 | June 30, 2010 |

With the maturity of the second phase of the plan on June 30, 2010 a total of 2,964,437 shares (corresponding to a total of 4,091,071 gross shares less a withholding of 1,132,804 shares at the choice of employees) were delivered to Telefónica Group directors included in the second phase. The shares delivered were deducted from the Company s treasury shares in 2010 (see Note 11.1.a). The total net shares delivered to Telefónica, S.A. managers and executives were 816,893.

The cost of the gross amount of shares delivered to the directors of each subsidiary was subsequently billed by Telefónica, S.A., as previously established, with a unit value of 7.7 euros per share. The tax obligations of the directors in each of their countries related to the increase in their personal income from the receipt of the incentive were met by each subsidiary and subsequently charged to Telefónica, S.A., which recognized the cost under Reserves for an amount of 15 million euros in 2010.

June 30, 2011 marked the end of the third phase of this plan, which entailed the following maximum number of shares allocated

| | Number of shares | Unit fair value | End date |
|---|---|---|---|
| 3rd phase July 1, 2008 | 5,286,980 | 8.39 | June 30, 2011 |

Of this amount, the maximum number of shares corresponding to Telefónica, S.A. managers and executives is as follows:

| | Number of shares | Unit fair value | End date |
|---|---|---|---|
| 3rd phase July 1, 2008 | 1,248,067 | 8.39 | June 30, 2011 |

With the maturity of the third phase of the plan on June 30, 2011 a total of 2,900,189 shares (corresponding to a total of 4,166,304 gross shares less a withholding of 1,266,115 shares at the choice of employees) were delivered to Telefónica Group Directors. The shares delivered were deducted from the Company s treasury shares in 2011 (see Note 11.1.a). The total net shares delivered to Telefónica, S.A. managers and executives were 922,266.

The third phase of the Plan was partially covered through two financial instruments relating to 2,446,104 shares at a cost of 10.18 euros per share. The cost of the gross amount of shares delivered to the directors of each subsidiary was subsequently billed by Telefónica, S.A., as previously established, with a unit value of 8.39 euros per share. The tax obligations of the directors in each of their countries related to the increase in their personal income from the receipt of the incentive were met by each subsidiary and subsequently charged to Telefónica, S.A., which recognized the cost under Reserves for an amount of 19 million euros in 2011.

The maximum numbers of shares allotted at the beginning of each phase, and during each of the two phases that were outstanding at December 31, 2011, for the Telefónica Group as a whole, were as follows:

| | No. of shares assigned | No. of shares outstanding at Dec 31, 2011 | Unit fair value | End date |
|---|---|---|---|---|
| 4th phase July 1, 2009 | 6,356,597 | 5,407,401 | 8.41 | June 30, 2012 |
| 5th phase July 1, 2010 | 5,025,657 | 4,684,289 | 9.08 | June 30, 2013 |

Of the total number of shares allotted and outstanding at year-end, those corresponding to Telefónica, S.A. employees, by phase, are as follows:

| | No. of shares assigned | No. of shares outstanding at Dec 31, 2011 | Unit fair value | End date |
|---|---|---|---|---|
| 4th phase July 1, 2009 | 1,555,382 | 1,528,883 | 8.41 | June 30, 2012 |
| 5th phase July 1, 2010 | 1,249,407 | 1,296,953 | 9.08 | June 30, 2013 |

This plan is equity-settled via the delivery of shares to the executives, with a balancing entry for the 15 million euros of employee benefits expense recorded in 2011 (11 million euros in 2010) in equity, net of the related tax effect.

The cost of the shares granted to employees of Group subsidiaries is recognized under Reserves and amounted to 53 million euros in 2011 (52 million euros in 2010). As Telefónica, S.A. will reinvoice these amounts to its subsidiaries at the maturity of the phases, the related receivable is recognized under Other non-current financial assets (phase V) and Other current financial assets (phase IV) (see Note 8.6).

For the fourth phase of the Plan, Telefónica, S.A. acquired an instrument from a financial institution with the same features of the plan, whereby at the end of the phase, Telefónica will obtain part of the shares necessary to settle the phase (4 million shares). The cost of the financial instrument was 36 million euros, equivalent to 8.41 euros per option (see Note 9.4.1).

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

At the June 23, 2009 General Shareholders Meeting of Telefónica, S.A. , the shareholders approved the introduction of a Telefónica, S.A. share incentive plan for all employees of the Telefónica Group worldwide, with certain exceptions. Under this plan, participants who met the qualifying requirements are offered the possibility of acquiring Telefónica, S.A. shares, with this company assuming the obligation of giving participants a certain number of Telefónica, S.A. shares free of charge.

The initial duration of the plan is intended to be two years. Employees subscribed to the plan can acquire Telefónica, S.A. shares through monthly installments of up to 100 euros (or the local currency equivalent), up to a maximum of 1,200 euros over a twelve-month period of (acquisition period). The delivery of shares will occur, where applicable, when the plan is consolidated, as of September 1, 2012, subject to a number of conditions:

- The beneficiary must continue to work for the company throughout the two-year duration of the plan (consolidation period), subject to certain special conditions related to departures.

- The actual number of shares to be delivered at the end of the consolidation period will depend on the number of shares acquired and retained by each employee. Each employee who is a member of the plan, has remained a Group employee, and has retained the shares acquired for an additional twelve-month period after the acquisition date, will be entitled to receive one free share per share acquired and retained at the end of the consolidation period.

The acquisition period started in August 2010, and at December 31, 2011, 37,230 Telefónica Group employees were members of this plan (41,152 in 2010). This plan will be equity-settled via the delivery of shares to the employees. Accordingly, a balancing entry for the employee benefits expenses was made in equity. In 2011, Telefónica, S.A. recognized an expense of 316 thousand euros for this item in its income statement (158 thousand euros in 2010).

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

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

Under this Plan, a certain number of shares of Telefónica, S.A. will be delivered to plan participants selected by the Company who decide to participate on compliance with stated requirements and conditions.

The Plan lasts five years and is divided into three independent three-year phases (i.e. delivery of the shares for each three-year phase three years after the start date). The first phase began on July 1, 2011 (with the delivery of the related shares from July 1, 2014). The second phase will begin on July 1, 2012 (with delivery of the related shares from July 1, 2015). The third phase will begin on July 1, 2013 (with delivery of the related shares from July 1, 2016).

The specific number of Telefónica, S.A. shares deliverable within the maximum amount established to each member at the end of each phase will be contingent and based on the Total Shareholder Return ( TSR ) of Telefónica, S.A. shares (from the reference value) throughout the duration of each phase compared to the TSRs of the companies included in the Dow Jones Global Sector Titans Telecommunications Index. For the purposes of this Plan, these companies make up the comparison group ( Comparison Group ).

The TSR is the indicator used to determine the Telefónica Group s medium- and long-term value generation, measuring the return on investment for each shareholder. For the purposes of this Plan, the return on investment of each phase is defined as the sum of the increase or decrease in the Telefónica, S.A. share price and dividends or other similar items received by the shareholder during the phase in question.

At the beginning of each phase, each Participant is allocated a notional number of shares. The number of shares to be delivered under the Plan is expected to range from:

30% of the number of notional shares if Telefónica, S.A. s TSR is at least equal to the Comparison Group s median, and

100% if Telefónica, S.A. s TSR is within the third quartile or higher than the Comparison Group s. The percentage is calculated using linear interpolation when it falls between the median and third quartile.

No shares will be delivered if Telefónica, S.A. s TSR is below the Comparison Group s median.

The Plan includes an additional condition regarding compliance by all or part of the Participants with a target investment and holding period of Telefónica, S.A. shares through each phase ( Co-Investment ), to be determined for each participant, as appropriate, by the Board of Directors based on a report by the Nominating, Compensation and Corporate Governance Committee. Participants meeting the co-investment requirement will receive an additional number of shares, provided the rest of the requirements established in the Plan are met.

In addition, and independently of any other conditions or requirements that may be established, each in order to be entitled to receive the corresponding shares, each Participant must be a Telefónica Group employee at the delivery date for each phase, except in special cases as deemed appropriate. Shares will be delivered at the end of each phase (i.e., in 2014, 2015, and 2016, respectively). The specific delivery date will be determined by the Board of Directors or the committee or individual entrusted by the Board to do so.

The shares to be delivered to Participants, subject to compliance with the pertinent legal requirements in this connection, may be either (a) treasury shares in Telefónica, S.A. acquired by Telefónica, S.A. itself or by any of the Telefónica Group companies; or (b) newly-issued shares.

The first allocation of shares under this plan was made on July 1, 2011. The maximum number of shares assigned (including the amount of co-investment) under the Plan at December 31, 2011 is as follows:

| | No. of shares assigned | Unit fair value | End date |
|---|---|---|---|
| 1st phase July 1, 2011 | 5,545,628 | 8.28 | June 30, 2014 |

In connection with the PIP Plan, Telefónica, S.A. acquired an instrument from a financial institution with the same features of the plan, whereby at the end of the phase, Telefónica will obtain part of the shares necessary to settle the phase (4 million shares). The cost of the financial instrument was 37 million euros, equivalent to 9.22 euros per option (see Note 9.4.1).

**Restricted Share Plan (RSP)**

At Telefónica, S.A. s General Shareholders Meeting held on May 18, 2011, the Company approved the roll-out of the Restricted Share Plan (RSP), a long-term share-based incentive plan with two primary aims: (a) to retain and motivate certain high-potential employees, and (b) to retain key personnel upon new acquisitions, providing them with an ownership interest in the Company through rights convertible to shares.

The RSP is established for a five-year period, with independent deliveries permitted at any time between 2011 and 2015. At each delivery date the Company extends certain Restricted Share Units (RSUs) carrying the right to automatically receive the same number of Telefónica, S.A. shares at the end of the vesting period, subject to compliance with certain length-of-service requirements.

Delivery of shares is conditional on compliance with certain service-related conditions, namely:

1. Final delivery: participants must have been employed by the Company continuously from the grant date to the conversion date
2. Final delivery: participants must have worked for a minimum period of 12 months within the vesting period

3. The specific duration of the vesting period will be set on a case-by-case basis.

At December 31, 2011 Telefónica, S.A. had carried out only one RSU delivery. Consequently, the cost of this plan is not significant in the income statement.

19.4 Average number of employees in 2011 and 2010 and number of employees at year-end:

| **2011** | **Employees at 12/31/11** | | | **Average no. of employees in 2011** | | |
|---|---|---|---|---|---|---|
| **Professional category** | **Females** | **Males** | **Total** | **Females** | **Males** | **Total** |
| General managers and chairmen | | 4 | 4 | | 4 | 4 |
| Directors | 41 | 147 | 188 | 40 | 138 | 178 |
| Managers | 95 | 131 | 226 | 91 | 112 | 203 |
| Project Managers | 97 | 153 | 250 | 89 | 125 | 214 |
| University graduates and experts | 93 | 54 | 147 | 89 | 50 | 139 |
| Administration, clerks, advisors | 158 | 20 | 178 | 160 | 20 | 180 |
| **Total** | **484** | **509** | **993** | **469** | **449** | **918** |

| 2010<br>Professional category | Employees at 12/31/10<br>Females | <br>Males | <br>Total | Average no. of employees in 2010<br>Females | <br>Males | <br>Total |
|---|---|---|---|---|---|---|
| General managers and chairmen | | 5 | 5 | | 5 | 5 |
| Directors | 38 | 127 | 165 | 40 | 134 | 174 |
| Managers | 82 | 87 | 169 | 81 | 94 | 175 |
| Project Managers | 92 | 80 | 172 | 91 | 77 | 168 |
| University graduates and experts | 81 | 38 | 119 | 80 | 37 | 117 |
| Administration, clerks, advisors | 138 | 21 | 159 | 137 | 20 | 157 |
| **Total** | **431** | **358** | **789** | **429** | **367** | **796** |

19.5 External services

The items composing Finance revenue are as follows:

| *(Millions of euros)* | 2011 | 2010 |
|---|---|---|
| Rent | 11 | 15 |
| Repairs and maintenance | 4 | 5 |
| Independent professional services | 155 | 140 |
| Bank charges | 34 | 44 |
| Donations (Note 18) | 4 | 333 |
| Marketing and advertising | 86 | 77 |
| Utilities | 12 | 12 |
| Other expenses | 84 | 51 |
| **Total** | **390** | **677** |

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

Future minimum rentals payable under non-cancellable leases without penalization at December 31, 2011 and 2010 are as follows:

| *(Millions of euros)* | 2011<br>Future minimum payments | <br>Present value | 2010<br>Future minimum payments | <br>Present value |
|---|---|---|---|---|
| Up to one year | 5 | | 6 | |
| Between one and five years | 19 | | 19 | |
| More than five years | 32 | | 37 | |
| **Total** | **56** | **40** | **62** | **46** |

19.6 Finance revenue

The items composing Finance revenue are as follows:

| *(Millions of euros)* | **2011** | **2010** |
|---|---|---|
| Dividends from other companies | 38 | 37 |
| Other finance revenue | 101 | 187 |
| **Total** | **139** | **224** |

Other finance revenue includes the 48 million euros in gains accrued from the equity swap contracts on the share price of Portugal Telecom (57 million euros in 2010).

19.7 Finance costs

The breakdown of Finance costs is as follows:

| *(Millions of euros)* | **2011** | **2010** |
|---|---|---|
| Interest on borrowings from Group companies and associates | 1,872 | 1,791 |
| Finance costs payable to third parties and gains (losses) on interest rates of financial hedges | 247 | 21 |
| **Total** | **2,119** | **1,812** |

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

| *(Millions of euros)* | **2011** | **2010** |
|---|---|---|
| Telefónica Europe, B,V, | 373 | 454 |
| Telefónica Emisiones, S,A,U, | 1,395 | 1,286 |
| Other companies | 104 | 51 |
| **Total** | **1,872** | **1,791** |

Other companies includes financial costs with Telefónica Finanzas, S.A.U. related to current payables for specific cash needs. In 2011, more withdrawals of funds were made in this way and therefore the attendant financial charge increased.

19.8 Exchange differences:

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

| *(Millions of euros)* | **2011** | **2010** |
|---|---|---|
| On current operations | 26 | |
| On loans and borrowings | 982 | 1,161 |
| On hedging derivatives | 927 | 1,019 |

| | | |
|---|---|---|
| On other items | 40 | 24 |
| **Total** | **1,975** | **2,204** |

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

| *(Millions of euros)* | **2011** | **2010** |
|---|---|---|
| On current operations | 3 | 20 |
| On loans and borrowings | 251 | 408 |
| On hedging derivatives | 1,567 | 1,834 |
| On other items | 16 | 64 |
| **Total** | **1,837** | **2,326** |

The change in exchange gains and losses in 2011 was due mainly to fluctuations in the dollar/euro exchange rate with the dollar losing 3.27% (the dollar rose 7.2% in 2010) and in the pound sterling/euro exchange with the pound sterling falling by 3.05% (the pound gained 3.18% in 2010), which was offset by the effect of hedges arranged for this purpose.

19.9 Impairment and gains (losses) on disposal of financial instruments

At year end, the values of the investments in Group companies and associates were reviewed based on the calculations of their future discounted cash flows. These reviews lead to the recognition of an impairment provision amounting to 1,606 million euros (in 2010, a charge of 1,985 million euros was recognized). The amount of the charge was mainly due to (a) reversal of the impairment provision in respect of Telefónica Europe, plc. For 1,159 million euros, (b) recognition of an impairment of the interest in Telefónica Móviles México, S.A. de C.V., for 2,085 million euros, and (c) recognition of an impairment of the interest in Telco, S.p.A., for 629 million euros (see Note 8.2).

Revenue shown under Gains (losses) on disposal reflects the gains on the sale of a 25% stake in Telefónica Móviles Argentina Holding, S.A. for 511 million euros and on the partial cancellation of Portugal Telecom equity swaps, for 13 million euros. Both transactions are described in Note 8.

19.10. Impairment and gains (losses) on disposal of financial instruments with third parties

This caption reflects the 135 million euro valuation adjustment made to Telefónica, S.A. s stake in Portugal Telecom (both the direct interest and the indirect stake held through the equity swap contracts) in view of the drop in the share price from January to October 2011 (see Note 8).

Revenue recognized under this caption relates to recovery of part of a financial provision made in 2009 upon the collapse of Lehman Brothers. The total amount recovered was 30 million euros.

## (20) OTHER INFORMATION

a) Financial guarantees

At December 31, 2011, Telefónica, S.A. had provided financial guarantees for its subsidiaries and investees to secure their transactions with third parties amounting to 41,513 million euros (39,973 million euros at year-end 2010). These guarantees are measured in the Company s financial statements as indicated in Note 4.m).

***(Millions of euros)***

| ***Nominal amounts*** | **2011** | **2010** |
|---|---|---|
| Debentures and bonds | 33,819 | 31,946 |
| Promissory notes & commercial paper | 1,596 | 1,613 |
| Loans and other payables | 4,098 | 4,414 |
| Other marketable debt securities | 2,000 | 2,000 |
| **Total** | **41,513** | **39,973** |

The debentures and bonds in circulation at December 31, 2011 issued by Telefónica Emisiones, S.A.U., Telefónica Europe, B.V. and Telefónica Finanzas México, S.A. de C.V. were guaranteed by Telefónica, S.A. The nominal amount guaranteed was equivalent to 33,819 million euros at December 31, 2011 (31,946 million euros at December 31, 2010). During 2011, Telefónica Emisiones, S.A.U. and Telefonica Europe, B.V. issued debt instruments on capital markets for a nominal amount of 4,495 million euros (5,484 million euros in 2010).

The commercial paper program of Telefónica Europe, B.V. is also guaranteed by Telefónica, S.A. At December 31, 2011 the outstanding balance of commercial `paper in circulation issued through this program is 1,596 million euros (1,613 million euros at December 31, 2010).

The main loans and other debts guaranteed by Telefónica, S.A. are: a syndicated loan granted to Telefónica Europe, B.V. by various institutions for the acquisition of shares in O2, Plc. in 2006, the principal of which at December 31, 2011 was equivalent to 2,965 million euros (2,945 million euros at December 31, 2010); and credit facilities obtained by Telefónica Finanzas, S.A.U. from the European Investment Bank, the outstanding principal of which at December 31, 2011 was equivalent to 824 million euros (1,171 million euros at December 31, 2010). The nominal amount of maturities in 2011 was 300 million euros.

Other marketable debt securities include the guarantee for preferred shares issued by Telefonica Finance USA, LLC, the redemption value of which amounts to 2,000 million euros guaranteed by Telefónica, S.A.

Telefónica, S.A. provides operating guarantees granted by external counterparties, which are offered during its normal commercial activity. At December 31, 2011, these guarantees amounted to approximately 239 million euros.

b) Litigation

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

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

Among unresolved cases or those underway in 2011 (see Note 17.3 for details of tax-related cases), the following are of special note:

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

On September 26, 2006, Telefónica was notified of the claim filed by former shareholders of Terra Networks, S.A. (Campoaguas, S.L., Panabeni, S.L. and others) alleging breach of contract in respect of the terms and conditions set forth in the Prospectus of the Initial Public Offering of shares of Terra Networks, S.A. dated October 29, 1999. This claim was rejected via a ruling issued on September 21, 2009, and the appellants were charged for the court costs. This ruling was appealed on December 4, 2009. On June 16, 2010, Telefónica was notified of the written appeal filed by the appellants. Telefónica opposed this appeal in January 2011.

**2. Appeal against the European Commission ruling of July 4, 2007 against Telefónica de España s broadband pricing policy**

On July 9, 2007, Telefónica was notified of the decision issued by the European Commission ( EC ) imposing a fine of approximately 152 million euros for breach of the former article 82 of EC Treaty rules by charging unfair prices between whole and retail broadband access services. The ruling charged Telefónica with applying a margin squeeze between the prices it charged competitors to provide regional and national wholesale broadband services and its retail broadband prices using ADSL technology between September 2001 and December 2006.

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

A hearing was held on May 23, 2011, at which Telefónica presented its case. A ruling has yet to be issued as of December 31, 2011.

**3. Case before the European Commission, CE COMP 39.839 Telefónica/Portugal Telecom**

On January 5, 2011, the European Commission sent a request to Telefónica, S.A. for information on the agreements entered into with Portugal Telecom SGPS (Portugal Telecom) for the purchase of its ownership interest in Brasilcel, N.V., a joint venture in which both are venturers and which is the owner of Brazilian company Vivo Participaçoes. On January 24, 2011, the European Commission initiated formal proceedings to investigate whether Telefónica and Portugal Telecom had infringed European Union competition law with respect to a clause contained in these agreements. After responding to a number of requests for information from the European Commission, on September 24, 2011, Telefónica received a list of charges from the European Commission. On January 13, 2012, it presented its response to the charges.

*c)* Commitments

***Guarantee provided for Ipse 2000 S.p.A.***

The Telefónica Group had provided guarantees for the Italian company Ipse 2000 S.p.A. (holder of a UMTS license in Italy and in which the Company has a stake through Solivella B.V.) to ensure the amounts payable to the Italian government in connection with the grant of the license.

In November 2010, the last of the 10 annual payments scheduled was paid. Therefore, the guarantee expired on that day, pending the release letter from the Italian government, which weas issued in 2011. The guarantee has now been entirely extinguished.

d) Directors and senior executives compensation and other benefits

The compensation of Telefónica, S.A. s Directors is governed by Article 28 of the Bylaws, which states that the compensation amount that the Company may pay to all of its Directors as remuneration and attendance fees shall be fixed by the shareholders at the General Shareholders Meeting, which amount shall remain unchanged until and unless the shareholders decide to modify it. The Board of Directors shall determine the exact amount to be paid within such limit and the distribution thereof among the Directors. This compensation, as laid down in said article of the Bylaws, is compatible with other professional or employment compensation accruing to the Directors by reason of any executive or advisory duties that they perform for the Company, other than the supervision and collective decision-making duties inherent in their capacity as Directors.

Accordingly, on April 11, 2003, shareholders set the maximum gross annual amount to be paid to the Board of Directors at 6 million euros. This includes a fixed payment and fees for attending meetings of the Board of Director s advisory or control Committees. Total compensation paid to Telefónica s Directors for discharging their duties in 2011 amounted to 4,549,501 euros in fixed compensation and in fees for attending the Board s advisory or control committees meetings.

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

The following table presents the fixed amounts established for membership to the Telefónica Board of Directors, Executive Commission and the advisory or control Committees:

(Amounts in euro)

| Position | Board of Directors | Executive Commission | Advisory or Control Committees |
|---|---|---|---|
| Chairman | 300,000 | 100,000 | 28,000 |
| Vice Chairman | 250,000 | 100,000 | |
| Board member: | | | |
| Executive | | | |
| Proprietary | 150,000 | 100,000 | 14,000 |
| Independent | 150,000 | 100,000 | 14,000 |
| Other external | 150,00 | 100,000 | 14,000 |

In addition, the amounts paid for attendance at each of the Advisory or Control Committee s meetings is 1,250 euros.

The following table presents the breakdown by ítem of the compensation and benefits paid by Telefónica to its directors in 2011:

*(Euros)*

| Director | Wage/ Compensation[1] | Fixed Payment Board Committees[2] | Attendance fees[3] | Short-term Variable Compensation[4] | Other items[5] | TOTAL |
|---|---|---|---|---|---|---|
| **Executive** | | | | | | |
| Mr. César Alierta Izuel | 2,530,800 | 100,000 | | 4,015,440 | 265,300 | 6,911,540 |
| Mr. Julio Linares López | 1,973,100 | | | 3,011,580 | 126,084 | 5,110,764 |
| Mr. José María Álvarez-Pallete López | 316,000 | | | | 21,570 | 337,570 |
| **Proprietary** | | | | | | |
| Mr. Isidro Fainé Casas | 250,000 | 100,000 | | | 10,000 | 360,000 |
| Mr. Vitalino Nafría Aznar | 250,000 | 56,000 | 26,250 | | | 332,250 |
| Mr. José María Abril Pérez | 150,000 | 122,167 | 13,750 | | | 285,917 |
| Mr. Antonio Massanell Lavilla | 150,000 | 70,000 | 32,500 | | 10,000 | 262,500 |
| Mr. Chang Xiaobing | 87,500 | | | | | 87,500 |
| **Independent** | | | | | | |
| Mr. David Arculus | 150,000 | 28,000 | 11,250 | | | 189,250 |
| Ms. Eva Castillo Sanz | 150,000 | 42,000 | 25,000 | | | 217,000 |
| Mr. Carlos Colomer Casellas | 150,000 | 156,000 | 21,250 | | 130,000 | 457,250 |
| Mr. Alfonso Ferrari Herrero | 150,000 | 212,000 | 58,750 | | 132,500 | 553,250 |
| Mr. Luiz Fernando Furlán | 150,000 | 14,000 | 5,000 | | | 169,000 |
| Mr. Gonzalo Hinojosa Fernández de Angulo | 150,000 | 198,000 | 48,750 | | 133,750 | 530,500 |
| Mr. Pablo Isla Álvarez de Tejera | 150,000 | 75,833 | 13,750 | | | 239,583 |
| Mr. Javier de Paz Mancho | 150,000 | 156,000 | 11,250 | | 120,000 | 437,250 |
| **Other external** | | | | | | |
| Fernando de Almansa Moreno-Barreda | 150,000 | 56,000 | 25,000 | | 10,000 | 241,000 |
| Mr. Peter Erskine | 150,000 | 156,000 | 27,500 | | 3,750 | 337,250 |

1 **Wage/Compensation:** Cash compensation on an established schedule, whether or not consolidable over time, and payable in consideration of the mere fact of employment, regardless of the director s actual attendance at meetings of the Board of Telefónica, S.A. Also includes fixed components of pay earned by the director for performing executive duties, as the case may be.

2 **Fixed Payment Board Committees**: Amount of items other than attendance to meetings payable to Directors for membership to the Executive Committee or advisory or control Committees of Telefónica, S.A., irrespective of effective attendance to meetings of said Committees.

3 **Attendance fees:** Amounts payable for attendance to meetings of the advisory or control Committees of Telefónica, S.A.

4 **Short-term variable compensation:** Variable amount linked to the performance or achievement of individual or group objectives (quantitative or qualitative) and commensurate with other compensation or any other reference in euros for a period of up to a year.

5 **Other items:** Includes, *inter alia*, amounts paid for membership to the various regional advisory committees in Spain, and the Telefónica Corporate University Advisory Council.

It is duly noted that Mr. Vitalino Nafría Aznar tendered his resignation as Director on December 14, 2011. Appointed to replace him by the method of co-option was Mr. Ignacio Moreno Martínez, which did not receive any compensation in this respect in 2011.

The following table presents the specific compensation paid to Directors of Telefónica for membership of the various advisory or control Committees in 2011:

| **Board Members** | Audit and Control | Nomination, Compensation and Corporate Governance | Human Resources and Corporate Reputation and Responsibility | Regulation | Service Quality and Customer Service | International Affairs | Innovation | Strategy | **TOTAL** |
|---|---|---|---|---|---|---|---|---|---|
| Mr. César Alierta Izuel | | | | | | | | | |
| Mr. Isidro Fainé Casas | | | | | | | | | |
| Mr. Vitalino Manuel Nafría Aznar | 26,500 | | 16,500 | 21,500 | | 17,750 | | | 82,250 |
| Mr. Julio Linares López | | | | | | | | | |
| Mr. José María Abril Pérez | | | | | | 20,250 | 15,667 | | 35,917 |
| Mr. José Fernando de Almansa Moreno-Barreda | | | | 21,500 | | 34,250 | | 25,250 | 81,000 |
| Mr. José María Álvarez-Pallete López | | | | | | | | | |
| Mr. David Arculus | | | | 20,250 | | 19,000 | | | 39,250 |
| Ms. Eva Castillo Sanz | | | | 21,500 | 20,250 | | | 25,250 | 67,000 |
| Mr. Carlos Colomer Casellas | | 17,750 | | | 17,750 | | 41,750 | | 77,250 |
| Mr. Peter Erskine | | 20,250 | | | | | 24,000 | 39,250 | 83,500 |
| Mr. Alfonso Ferrari Herrero | 27,750 | 38,000 | 17,750 | 21,500 | 20,250 | 20,250 | | 25,250 | 170,750 |
| Mr. Luiz Fernando Furlán | | | | | | 19,000 | | | 19,000 |
| Mr. Gonzalo Hinojosa Fernández de Angulo | 40,500 | 22,750 | 19,000 | | 20,250 | 20,250 | | 24,000 | 146,750 |
| Mr. Pablo Isla Álvarez de Tejera | | 20,250 | 14,000 | 35,500 | 14,000 | | 5,833 | | 89,583 |
| Mr. Antonio Massanell Lavilla | 25,250 | | 16,500 | | 34,250 | | 26,500 | | 102,500 |
| Mr. Francisco Javier de Paz Mancho | | | 33,000 | 16,500 | | 17,750 | | | 67,250 |
| Mr. Chang Xiaobing | | | | | | | | | |
| **TOTAL** | 120,000 | 119,000 | 116,750 | 158,250 | 126,750 | 168,500 | 113,750 | 139,000 | 1,062,000 |

The following presents a breakdown of the amounts received from other Telefónica Group companies by Directors for discharging executive duties or for membership of the companies governing bodies:

(Amounts in euros)

| Director | Wage/ Compensation[1] | Attendance fees[2] | Short-term variable compensation[3] | Other items[4] | TOTAL |
|---|---|---|---|---|---|
| **Executive** | | | | | |
| Mr. José María Álvarez-Pallete López | 961,709 | | 1,140,138 | 57,553 | 2,159,400 |
| **Proprietary** | | | | | |
| Mr. Vitalino Nafría Aznar | 16,737 | | | | 16,737 |
| **Independent** | | | | | |
| Mr. David Arculus | 86,456 | | | | 86,456 |
| Ms. Eva Castillo Sanz | 240,847 | | | | 240,847 |
| Mr. Alfonso Ferrari Herrero | 297,275 | | | | 297,275 |
| Mr. Luiz Fernando Furlán | 299,406 | | | | 299,406 |
| Mr. Javier de Paz Mancho | 840,667 | | | | 840,667 |
| **Other external** | | | | | |
| Mr. Fernando de Almansa Moreno-Barreda | 436,214 | | | | 436,214 |
| Mr. Peter Erskine | 86,456 | | | | 86,456 |

1 **Wage/Compensation:** Cash compensation on an established schedule, whether or not consolidable over time, and payable in consideration of the mere fact of employment, regardless of the director s actual attendance at meetings of the board or analogous organ of the Telefónica Group entity in question. Also includes fixed components of pay earned by the director for performing executive duties, as the case may be.

2 **Attendance fees:** Amounts payable for attendance to meetings of the Board of Directors or similar bodies of any Telefónica Group company.

3 **Short-term variable compensation**: Variable amount linked to the performance or achievement of individual or group objectives (quantitative or qualitative) and commensurate with other compensation or any other reference in euros for a period of up to a year.

4. **Other items:** Other amounts related to pension schemes**.**

With respect to employee benefits, the following table presents a breakdown of internal or external contributions made in 2011 to both long-term savings schemes (including retirement and any other survival benefit) financed fully or partially by the Company for Directors, along with any other compensation in kind received by the Director during the year:

| Board Members (Executive) | Contributions to pension plans | Contribution to the Pension Plan for Senior Executives[1] | Compensation in kind[2] |
|---|---|---|---|
| Mr. César Alierta Izuel | 8,402 | 1,014,791 | 57,955 |
| Mr. Julio Linares López | 9,468 | 555,033 | 83,923 |
| Mr. José María Álvarez-Pallete López | 7,574 | 355,563 | 17,346 |

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

2 **Compensation in kind** includes life and other insurance premiums (e.g. general medical and dental insurance).

Share-based payment plans information is as follows:

(i) The Performance Share Plan ( PSP ) approved at the General Shareholders Meeting of June 21, 2006, whose fifth and final phase began in 2010. Under this plan, shares corresponding to the third phase were delivered in July 2011. In accordance with the general terms and conditions, a rate of 97.8% was applied to the notional number of shares assigned to each participant to determine the number of shares to deliver. Accordingly, the shares delivered in the third phase of the PSP to the three Executive Directors were as follows: 145,544 shares to Mr. César Alierta Izuel, 99,233 shares to Mr. Julio Linares López, and 66,155 shares to Mr. José María Álvarez-Pallete López. Meanwhile, it is laid down that the maximum number of shares for the fourth and the fifth phase of this Plan to be delivered (from July 1, 2012 and July 1, 2013), to each Executive Director of the Company, in case the covenants are met, are as follows: Mr César Alierta Izuel (173,716 shares for the fourth phase, and 170,897 shares for the fifth phase), Mr Julio Linares López (130,287 shares for the fourth phase, y 128,173 shares for the fifth phase), Mr José María Álvarez-Pallete López (78,962 shares for the fourth phase, y 77,680 shares for the fifth phase); and

(ii) The Performance & Investment Plan ( PIP ) approved at the General Shareholders Meeting of May 18, 2011. Under this plan, participants who meet qualifying requirements receive a number of Telefónica shares as variable remuneration. The first phase of this plan began in 2011, once the PSP had finished. The theoretical number of shares assigned and the maximum possible number of shares to be received by the Executive Directors in the first phase of the PIP if the co-investment requirement established in the Plan and the maximum target TSR established for each phase are met are as follows: (i) to Mr. César Alierta Izuel: 249,917 theoretical shares and a maximum of 390,496 shares; to Mr. Julio Linares López: 149,950 theoretical shares and a maximum of 234,298; and Mr. José María Álvarez-Pallete López: 79,519 theoretical shares and a maximum of 124,249 shares.

Furthermore, at the General Shareholders Meeting of Telefónica, S.A. on June 23, 2009, its shareholders approved the introduction of a Telefónica, S.A. share incentive plan for all employees, including executives and board members, of the Telefónica Group worldwide. Under this plan, employees that meet the qualifying requirements are offered the possibility of acquiring Telefónica, S.A. shares, with this company assuming the obligation of giving participants a certain number of shares free of charge. The maximum sum each employee can assign to this plan is 1,200 euros, while the minimum is 300 euros.

The three board members decided to participate in this plan, contributing the maximum, i.e. 100 euros a month, over 12 months. Therefore, at the date of preparing these financial statements, the three executive Directors had acquired a total of 212 shares through this plan, whereby they are entitled to receive, free of charge, an equivalent number of shares providing that, among other conditions, they retain the acquired shares during the consolidation period (12 months from the end of the acquisition period).

It should be noted that the external Directors do not receive and did not receive in 2011 any compensation in the form of pensions or life insurance, nor do they participate in the share-based payment plans linked to Telefónica s share price.

In addition, the Company does not grant and did not grant in 2011 any advances, loans or credits to the Directors, or to its top executives, thus complying with the requirements of the U.S.A. Sarbanes-Oxley Act, which is applicable to Telefónica, S.A. as a listed company in that market.

(iii) Senior executives compensation

Meanwhile, the seven senior executives[1] of the Company (considering the period since the are senior executives), excluding those that are also members of the Board of Directors, received a total for all items in 2011 of 12,122,954 euros. In addition, the contributions by the Telefónica Group in 2011 with respect to the Pension Plan described in Note 20 for these Directors amounted to 2,709,866 euros. Contribution to the pension plan amounted to 50,208 euros and compensation in kind including life and other insurance premiums (e.g. general medical and dental insurance) to 154,955 euros.

Meanwhile, a total of 299,377 shares corresponding to the third phase of the PSP were delivered to senior executives of the Company. In relation to the fourth and the fifth phase of the forementioned Plan, assigned to senior executives of the Company amounts to 394,779, chares for the fourth phase and 350,485 for the fifth one.

Regarding the PIP approved at the General Shareholders Meeting of May 18, 2011, a total of 457,949 shares were assigned to all executive directors of the Company.

1 In this context, senior executive are taken as being those individuals who, in fact or in law, perform senior management duties, reporting directly to their board of directors or executive committees or the CEOs thereof, including in all cases the Director of Internal Audit.

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

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

| **Name** | **Activity performed** | **Company** | **Position or functions** | **Stake %(*)** |
|---|---|---|---|---|
| Mr. Isidro Fainé | Telecommunications | Abertis Infraestructuras, S.A. | Vice Chairman | < 0.01% |
| Mr. David Arculus | Telecommunications | British Sky Broadcasting Group, Plc. | | < 0.01% |
| | Telecommunications | BT Group, Plc. | | < 0.01% |
| Mr. Ignacio Moreno Martínez | Telecommunications | Conitas Comunicaciones, S.A. | Director | 4.89% |

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

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

in accordance with Article 26 bis of the Company s Bylaws, whereby (...) the following shall not be deemed to be in a situation of effective competition with the Company, even if they have the same or a similar or complementary corporate purpose: (...) companies with which Telefónica, S.A. maintains a strategic alliance , Mr. Xiaobing s interests are not in conflict with those of Telefónica, S.A.

Mr. Xiaobing holds no stakes in the capital of the companies in which he is a Board member (Article 229 of the Spanish Enterprise Law).

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

| Name | Company | Position or functions |
|---|---|---|
| Mr. César Alierta Izuel | Telecom Italia, S.p.A. | Director |
| | China Unicom (Hong Kong) Limited | Director |
| Mr. Julio Linares López | Telecom Italia, S.p.A. | Director |
| Mr. Alfonso Ferrari Herrero | Telefónica Chile, S.A. | Acting Director |
| | Telefónica del Perú, S.A.A. | Director |

| | | |
|---|---|---|
| Mr. Francisco Javier de Paz Mancho | Atento Inversiones y Teleservicios, S.A.U. | Non-executive Chairman |
| | Telefónica Brasil, S.A. | Director |
| | Telefónica de Argentina, S.A. | Director |
| Mr. José Fernando de Almansa Moreno-Barreda | Telefónica Brasil, S.A. | Director |
| | Telefónica de Argentina, S.A. | Director |
| | Telefónica del Perú, S.A.A. | Director |
| | Telefónica Móviles México, S.A. de C.V. | Director |
| Mr. José María Álvarez-Pallete López | Telefónica Europe, Plc. | Chairman of the Board of Directors |
| | Telefónica Czech Republic, a.s. | Chairman of Supervisory Board |
| | Telefónica de Argentina, S.A. | Acting Director |
| | Telefónica del Perú, S.A.A. | Director |
| | Telefónica Datacorp, S.A.U. (*) | Director |
| | Telefónica Móviles Colombia, S.A. | Acting Director |
| Mr. Luiz Fernando Furlán | Telefónica Brasil, S.A. | Director |
| Ms. María Eva Castillo Sanz | Telefónica Czech Republic, a.s. | First Vice Chairman of Supervisory Board |
| Mr. Chang Xiaobing | China United Network Communications Group Company Limited | Chairman |
| | China United Network Communications Corporation Limited | Chairman |
| | China Unicom (Hong Kong) Limited | Executive Chairman |
| | China United Network Communication Limited | Chairman |

**(*)** On February 3, 2012, Mr. José María Álvarez-Pallete López tendered his resignation as Director of Telefónica DataCorp, S.A.U.

f) Related-party transactions

***Significant shareholders***

The main transactions between Telefónica, S.A. and its significant shareholders always concluded at arm s length are as follows:

Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) and subsidiaries comprising the consolidated group:

Financing transactions, with approximately 232 million euros drawn down at December 31, 2011 (323 million euros in 2010).

Derivative transactions, for a total nominal amount of approximately 23,275 million euros at December 31, 2011 (11,062 million euros in 2010).

Time deposits for a total nominal amount of approximately 277 million euros at December 31, 2011 (227 million euros in 2010).

Guarantees granted by BBVA for approximately 0.6 million euros at December 31, 2011 (420 million euros in 2010).

Dividends and other earnings distributed to BBVA in 2011 for 514 million euros (439 million euros in 2010) as a result of the 0.9% shareholding disclosed in Note 9.

Caja de Ahorros y Pensiones de Barcelona ( la Caixa ), and subsidiaries comprising the consolidated group:

Financing transactions, with approximately 355 million euros drawn down at December 31, 2011 (291 million euros in 2010).

Derivative transactions, for a total nominal amount of approximately 800 million euros at December 31, 2011 (800 million euros in 2010).

Time deposits for a total nominal amount of approximately 298 million euros at December 31, 2011 (118 million euros in 2010).

Dividends and other benefits paid to La Caixa in 2011 for 366 million euros (298 million euros in 2010).

***Group companies***

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

The balances and transactions between the Company and these subsidiaries at December 31, 2011 and 2010 are detailed in the notes to these individual financial statements.

***Directors and senior executives***

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

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

g) Auditors fees

The fees paid in 2011 and 2010 to the various member firms of the Ernst & Young international organization, to which Ernst & Young, S.L. (the auditors of Telefónica, S.A. in 2011 and 2010) belongs, amounted to 4.34 million and 3.71 million euros, respectively, broken down as follows.

| *(Millions of euros)* | **2011** | **2010** |
|---|---|---|
| Audit services | 4.03 | 3.29 |
| Audit-related services | 0.31 | 0.42 |
| **TOTAL** | **4.34** | **3.71** |

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

h) Environmental matters

As head of the Telefónica Group, Telefónica, S.A.engages in environmental management activities and projects in line with its environmental strategy. In 2011 and 2010, expenditure and investment for non-material amounts were recognized in the income statement and balance sheet, respectively.

The Group has launched various projects aimed at improving current systems to reduce the environmental impact of its existing installations, with project costs being added to the cost of the installation to which the project relates.

In addition, in line with its commitment to the environment, the Group announced the creation of a Climate Change Office to provide a framework for strategic and RD&I projects in the quest for energy efficient solutions. This initiative entails the launch and implementation of solutions in each area that contribute to optimizing the Company s processes (operations, suppliers, employees, customers and society).

In the area of operations, the main objective is to develop and implement projects that will allow for more efficient networks and systems by reducing and optimizing energy consumption.

In the area of suppliers, active efforts are underway to include energy efficiency criteria in the purchasing process for all product lines in the Telefónica value chain.

In the area of employees, the aim is to foster among the Company s employees a culture of respect and awareness regarding the environment and energy saving.

In the area of customers, work is being carried out to better leverage ICTs (information and communication technologies) and increase energy efficiency with the objective of reducing carbon emissions.

And finally, in the area of society, the objective is to promote change in citizens behavior through Telefónica s actions.

The Group has also rolled out internal control mechanisms sufficient to pre-empt any environmental liabilities that may arise in future, which are assessed at regular intervals either by Telefónica staff or renowned third-party institutions. No significant risks have been identified in these assessments.

i) Trade and other guarantees

The Company is required to issue trade guarantees and deposits for concession and spectrum tender bids and in the ordinary course of its business. No significant additional liabilities in the accompanying financial statements are expected to arise from guarantees and deposits issued (see Note 16.b).

j) Contribution of business unit to Telefónica Digital España, S.L. (formerly Terra Networks Asociadas, S.L.)

On December 14, 2011, the Board of Directors of Telefónica, S.A. authorized the contribution of the digital business unit to Telefónica Digital España, S.L., including assets, accounts receivable and accounts payable, and staff dedicated to that business. The contribution will be finally completed on April 1, 2012.

**(21) CASH FLOW ANALYSIS**

Profit before tax in 2011 amounted to 3,999 million euros (see the income statement), adjusted by items recognized in the income statement that did not require an inflow or outflow of cash in the year.

These adjustments mainly relate to:

Impairments to investments in Group companies, associates and other investments of 1,606 million euros (impairment in 2010 of 1,985 million euros),

Declared dividends as income in 2011 for 6,967 million euros (6,474 million euros in 2010), interest accrued on loans granted to subsidiaries of 275 million euros (378 million euros in 2010) and a net financial loss of 2,314 million euros (1,711 million euros in 2010), adjusted initially to include only movements related to cash inflows or outlooks during the year under Other cash flows from operating activities.

Other cash flows from operating activities amounted to 6,305 million euros (6,753 million euros in 2010). The main items included are:

a) Net interest paid: Payments of net interest and other financial expenses amounted to 1,405 million euros (1,061 million euros in 2010), including:

net interest received from external credit entities of 130 million euros (net payments of 609 million euros in 2010), and

interest and hedges paid to Group companies of 1,535 million euros (452 million euros in 2010). The main interest payments in 2011 were to Telefónica Emisiones, S.A.U., for 1,365 million euros, and to Telefónica Europe, B.V., for 352 million euros, although these amounts are reduced by hedges contracted.

b) Dividends received:

The main receipts relate to:

| *(Millions of euros)* | **2011** | **2010** |
|---|---|---|
| Telefónica de España, S.A.U. | 2,430 | 2,827 |
| Telefónica Móviles España, S.A.U. | 1,980 | 2,190 |
| Telefónica Europe, plc. | 715 | 708 |
| Telefónica Czech Republic, a.s. | 360 | 365 |
| Vivo Participaçoes | 517 | |
| Telefónica Brasil, S.A. (Telesp) | 151 | |
| Telefónica Móviles Argentina Group | 179 | 42 |
| Sao Paulo Telecommunicaçoes | 170 | |
| Other dividends received | 571 | 489 |
| **Total** | **7,073** | **6,621** |

The figures disclosed are dividends recognized as revenue in 2011 (see Note 19.1) and collected in the same year.

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c) Income tax collected: Telefónica, S.A. is the parent of its consolidated Tax Group (see Note 17) and therefore it is liable for filing income tax with the Spanish Treasury. It subsequently informs companies included in the Tax Group of the amounts payable by them. As indicated in Note 17, no payments were made on account of income tax in 2011. In any event, taxes passed on to companies within the tax group are as follows:

Telefónica Móviles España, S.A.U.: 235 million euros, comprising income tax for 2010. In 2010, a payment of 625 million euros was recognized, 309 million euros for 2009 corporate income tax and 316 million euros for payments on account of corporate income tax in 2010.

Telefónica de España, S.A.U.: 369 million euros, comprising income tax for 2010. In 2010, a payment of 874 million euros was recognized, 314 million euros for 2009 corporate income tax and 560 million euros for corporate income tax in 2010.

Payments on investments under Cash flows used in investing activities included a total payment of 3,554 million euros (10,521 million euros in 2010). The main transactions to which these payments refer are as follows:

Acquisition of 50% of Brasilcel, N.V. In October 2011 the last deferred payment for this transaction was made (see Note 18.b).

Several capital increases for a total amount of 458 million euros, primarily in Telefónica Móviles Costa Rica for 127 million euros and in Telefónica Móviles México for 176 million euros, among others. These cash flows are disclosed fully in Note 8.1.a.

Acquisition of bonds issued by Telefónica Emisiones, S.A.U. for 103 million euros (see Note 8.5).

This caption also includes payments in respect of share options.

In addition, Proceeds from disposals includes the repayment of loans granted by Telefónica, S.A. to subsidiaries, the most significant amounts of which, in 2011, were received from Telefónica de España, S.A.U. (681 million euros), Telefónica Internacional, S.A.U. (700 million euros), and Inversiones Telefónica Móviles Holding, Ltd (50 million euros). In addition, 786 million euros was received from Telefónica Internacional, S.A.U. for the sale of 25% of Telefónica Móviles Argentina Holding, S.A. (see Note 8.1.b).

In 2010 the main proceeds recognized under this heading came from Telefónica de España, S.A.U. (698 million euros), Telefónica Internacional, S.A.U. (795 million euros), Telefónica Móviles Argentina, S.A. (118 million euros), and Telefónica Móviles España, S.A.U. (352 million euros).

Cash flows from financing activities includes the following:

i. Payments for equity instruments of 377 million euros (883 million in 2010), relating to the net amount of treasury shares acquired in 2011 (Note 11).

ii. Payments of financial liabilities

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

| *(Millions of euros)* | **2011** | **2010** |
|---|---|---|
| 8bn syndicated loan (Note 14.2) | 2,000 | 6,000 |
| EKN credit facility (Note 14.2) | 267 | |
| Telefónica Emisiones, S.A.U. (Note 15) | 4,387 | 5,484 |
| Telefónica Europe, B.V. commercial paper (Note 20.a) | | 1,062 |
| Telfisa Global, B.V. financing (Note 15) | 742 | 1,630 |
| Equity swaps by Portugal Telecom (Note 14.4) | | 541 |
| Other collections | 137 | 131 |
| **Total** | **7,533** | **14,848** |

b) **Amortización y cancelación de deuda: The main payments comprising this heading are as follows:**

| *(Millions of euros)* | **2011** | **2010** |
|---|---|---|
| Cesky syndicate loan (Note 14.2) | 300 | 5,700 |
| Telefónica Europe, B.V. | 15 | 2,779 |
| Telefónica Finanzas, S.A.U. | 1,262 | |
| Telefónica Emisiones, S.A.U. (Note 15) | 2,954 | 1,348 |
| Cancellation of debentures and bonds (Note 13) | | 19 |
| Promissory note program (Note 13) | 255 | 217 |
| Telefónica Móviles España, S.A.U. (Note 15) | | 300 |
| Other payments | 335 | 722 |
| **Total** | **5,121** | **11,085** |

The 8 billion euro increase in the amount of the syndicated loan reflects a drawdown of 2,000 million in 2011, for the purpose of honoring the final payment obligation in respect of the acquisition of Brasilcel, N.V. (see Note 18.b).

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

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

In 2010, the cancellation of Telefónica Europe, B.V. debt mainly comprises the repayment of a loan and hedges contracted to cover this debt.

iii. Payments of dividends for 6,852 million euros (5,872 million euros in 2010) (see movements in Note 11.1.d)

**(22) EVENTS AFTER THE REPORTING PERIOD**

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

On January 5, 2012, Telefónica Europe, B.V. arranged financing guaranteed by Telefónica, S.A. with China Development Bank (CDB) for an aggregate amount of 375 million US dollars (equivalent to approximately 290 million euros) at a floating rate and maturing in 2022. This financing was paid on February 15, 2012.

On February 7, 2012, Telefónica Emisiones, S.A.U., as part of the European Medium Term Note ( EMTN ) registered with the Financial Services Authority (FSA) in London and updated on June 20, 2011, extended the issue of bonds made on February 7, 2011 for an initial aggregate amount of 1,200 million euros maturing on February 7, 2017, by 120 million euros. These bonds are guaranteed by Telefónica, S.A.

On February 21, 2012, Telefónica Emisiones, S.A.U., as part of the European Medium Term Note ( EMTN ) registered with the Financial Services Authority (FSA) in London and updated on June 20, 2011, issue bonds for an aggregate amount of 1,500 million euros maturing on February 21, 2018. These bonds are guaranteed by Telefónica, S.A.

**(23) ADDITIONAL NOTE FOR ENGLISH TRANSLATION**

These annual financial statements were originally prepared in Spanish and were authorized for issue by the Company s Directors in the meeting held on February 22, 2012. In the event of a discrepancy, the Spanish-language version prevails.

# APPENDIX I

## Details of subsidiaries and

## associates at December 31, 2011

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**DETAILS OF SUBSIDIARIES AND ASSOCIATES AT DECEMBER 31, 2011 (millions of euros)**

| | % Ownership | | | | | Income (loss) | | Gross |
|---|---|---|---|---|---|---|---|---|
| **Name and corporate purpose** | **Direct** | **Indirect** | **Share capital** | **Reserves** | **Dividends received** | **From operations** | **For the year** | **carrying amount** |
| Telefónica Europe plc (UNITED KINGDOM)<br>*Wireless communications services operator*<br>*Wellington Street, Slough, SL1 1YP* | 100.00% | | 13 | 7,656 | 715 | (33) | 8,215 | 25,300 |
| Telefónica Internacional, S.A. (SPAIN)<br>*Investment in the telecommunications industry abroad*<br>*Gran Vía, 28 28013 Madrid* | 100.00% | | 2,839 | 7,925 | | (299) | 937 | 8,132 |
| Telefónica Móviles España, S.A.U. (SPAIN)<br>*Wireless communications services provider*<br>*Plaza de la Independencia, 6 Pta. 5 28001 Madrid* | 100.00% | | 423 | 498 | 1,980 | 1,996 | 1,435 | 5,775 |
| Telfin Ireland Limited (IRELAND)<br>*Intragroup financing*<br>*28/29 Sir John Rogerson s Quay, Dublin 2* | 100.00% | | | 3,410 | 58 | (1) | 105 | 3,410 |
| Telefónica de España, S.A.U. (SPAIN)<br>*Telecommunications service provider in Spain*<br>*Gran Vía, 28 28013 Madrid* | 100.00% | | 1,024 | 1,923 | 2,430 | 597 | 298 | 3,034 |
| Telefónica Móviles México, S.A. de C.V. (MEXICO) (1)<br>*Holding company*<br>*Prolongación Paseo de la Reforma 1200 Col. Cruz Manca, Mexico D.F. CP.05349* | 100.00% | | 3,047 | (2,436) | | 210 | (66) | 2,795 |
| Telefónica de Contenidos, S.A.U. (SPAIN)<br>*Organization and operation of multimedia service-related activities and businesses*<br>*Don Ramón de la Cruz, 84 4ª Pta.- 28006 Madrid* | 100.00% | | 1,865 | (1,675) | | (7) | 22 | 2,242 |
| Latin American Cellular Holdings, B.V. (NETHERLANDS)<br>*Holding company*<br>*Strawinskylaan 3105, Atium 7th, Amsterdam* | 100.00% | | 281 | 2,708 | 218 | | 586 | 1,747 |

| Name and corporate purpose | % Ownership Direct | Indirect | Share capital | Reserves | Dividends received | Income (loss) From operations | For the year | Gross carrying amount |
|---|---|---|---|---|---|---|---|---|
| Telefónica Datacorp, S.A.U. (SPAIN)<br>*Telecommunications service provider and operator*<br>*Gran Via, 28 28013 Madrid* | 100.00% | | 700 | 70 | | 55 | 44 | 1,343 |
| Telefónica Móviles Argentina Holding, S.A. (ARGENTINA)<br>*Holding company*<br>*Ing Enrique Butty 240, piso 20-Capital Federal-Argentina* | 75% | 25% | 306 | 674 | 143 | 536 | 318 | 856 |
| Inversiones Telefónica Móviles Holding, Ltd. (CHILE)<br>*Holding company*<br>*Miraflores, 130 12º Santiago de Chile* | 100.00% | | 752 | (152) | | | 249 | 741 |
| Ecuador Cellular Holdings, B.V. (NETHERLANDS)<br>*Holding company*<br>*Strawinskylaan 3105, Atium 7th, Amsterdam* | 100.00% | | 46 | (59) | 58 | | 31 | 581 |
| Atento Inversiones y Teleservicios, S.A. (SPAIN)<br>*Telecommunications service provider*<br>*C/ Santiago de Compostela, 94 28035 Madrid* | 100.00% | | 24 | 20 | 34 | (30) | 24 | 256 |
| O2 (Europe) Ltd. (UK)<br>*Wireless communications services operator*<br>*Wellington Street, Slough, SL1 1YP* | 100.00% | | 1,239 | 6,453 | | | (97) | 8,779 |
| Telefónica Centroamérica de Guatemala Holdings, S.A. (GUATEMALA) (1)<br>*Holding company*<br>*Bulevar Los Próceres 5-56 Zona 10, Unicentro nivel 10 Guatemala City* | 100.00% | | 280 | (109) | 24 | 36 | 26 | 238 |
| Panamá Cellular Holdings, B.V. (NETHERLANDS)<br>*Holding company*<br>*Strawinskylaan 3105, Atium 7th, Amsterdam* | 100% | | 40 | 44 | 2 | | 21 | 238 |

| Name and corporate purpose | % Ownership Direct | Indirect | Share capital | Reserves | Dividends received | Income (loss) From operations | For the year | Gross carrying amount |
|---|---|---|---|---|---|---|---|---|
| Telefónica El Salvador Holding, S.A. de C.V. (EL SALVADOR) (1)<br>*Holding company*<br>*Alameda Roosvelt y Avenida Sur. Torre Telefónica nivel 10 San Salvador* | 100.00% | | 149 | (66) | | | (1) | 161 |
| Telefónica Móviles Puerto Rico, Inc. (PUERTO RICO)<br>*Ownership of shareholdings in cellular operators in Puerto Rico*<br>*Metro Office Park Calle Edificio #17, Suite 600 00968 Guaynabo* | 100.00% | | 107 | (107) | | | | 110 |
| Telefónica Global Technology, S.A. (formerly Ateseco Comunicación, S.A.) (SPAIN)<br>*Gloabl management and operation of IT systems*<br>*Gran Vía, 28 28013 Madrid* | 100.00% | | 10 | 53 | | (4) | (5) | 121 |
| Telefónica Digital España, S.L. (formerly Terra Networks Asociadas, S.L.) (SPAIN)<br>*Holding company*<br>*Gran Via, 28 28013 Madrid* | 100.00% | | 7 | (20) | | (2) | 2 | 65 |
| Guatemala Cellular Holdings, B.V. (NETHERLANDS)<br>*Holding company*<br>*Strawinskylaan 3105, Atium 7th, Amsterdam* | 100.00% | | 17 | 4 | 3 | | 5 | 30 |
| Taetel, S.L. (SPAIN)<br>*Acquisition, ownership and disposal of shares and stakes in other companies*<br>*Gran Via, 28 28013 Madrid* | 100.00% | | 28 | 6 | 1 | | 1 | 28 |
| Telefónica Gestión de Servicios Compartidos España, S.A. (SPAIN)<br>*Management and administrative services rendered*<br>*Gran Via, 28 28013 Madrid* | 100.00% | | 8 | 39 | | 8 | 6 | 24 |
| Telefónica Capital, S.A. (SPAIN)<br>*Finance company*<br>*Gran Via, 28 28013 Madrid* | 100% | | 7 | 94 | | (1) | | 34 |

| Name and corporate purpose | % Ownership Direct | Indirect | Share capital | Reserves | Dividends received | Income (loss) From operations | For the year | Gross carrying amount |
|---|---|---|---|---|---|---|---|---|
| Lotca Servicios Integrales, S.L. (SPAIN)<br>*Holding and operation of aircraft and aircraft leases.*<br>*Gran Via, 28 28013 Madrid* | 100.00% | | 17 | (5) | | 2 | | 17 |
| Comet, Compañía Española de Tecnología, S.A. (SPAIN)<br>*Promotion of business initiatives and holding of real estate assets*<br>*Villanueva, 2 duplicado planta 1ª Oficina 23 28001 Madrid* | 100.00% | | 5 | 4 | | | | 14 |
| Telefónica Finanzas, S.A.U. (TELFISA) (SPAIN)<br>*Integrated cash management, consulting and financial support for Group companies*<br>*Gran Vía, 30 4ª Plta. 28013 Madrid* | 100.00% | | 3 | 47 | | (1) | 3 | 13 |
| Telefónica Móviles Soluciones y Aplicaciones, S.A. (CHILE)<br>*IT and communications services provider*<br>*Avenida del Cóndor Nº 720, piso 4, comuna de Huechuraba, Santiago de Chile* | 100.00% | | 10 | (3) | | | 1 | 11 |
| Centro de Investigación y Experimentación de la Realidad Virtual, S.L. (SPAIN)<br>*Design of communications products*<br>*Vía de Dos Castillas, 33 Comp. Ática Ed. 1, 1ª Plta. Pozuelo de Alarcón 28224 Madrid* | 100.00% | | | N/A | | N/A | N/A | 10 |
| Telefónica Ingeniería de Seguridad, S.A. (SPAIN)<br>*Security services and systems*<br>*Condesa de Venadito, 1 28027 Madrid* | 100.00% | | 7 | 1 | | | | 15 |
| Telefónica Investigación y Desarrollo, S.A.U. (TIDSA) (SPAIN)<br>*Telecommunications research activities and projects*<br>*Ronda de la Comunicación, s/n 28050 Madrid* | 100.00% | | 6 | 54 | | (7) | (5) | 6 |
| Venturini España, S.A. (SPAIN)<br>*Property leasing* | 100.00% | | 3 | 1 | | | | 4 |

*Avda. de la Industria, 17 Tres Cantos 28760*
*Madrid*

| Name and corporate purpose | % Ownership Direct | Indirect | Share capital | Reserves | Dividends received | Income (loss) From operations | For the year | Gross carrying amount |
|---|---|---|---|---|---|---|---|---|
| Telfisa Global, B.V. (NETHERLANDS)<br>*Integrated cash management, consulting and financial support for Group companies*<br>*Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX Amsterdam* | 100.00% | | | 2 | 2 | (1) | 3 | 2 |
| Telefónica de Centroamérica, S.L. (SPAIN)<br>*Dormant company*<br>*Gran Via, nº 28, 28013 Madrid* | 100.00% | | | | | | | 1 |
| Fisatel Mexico, S.A. de C.V. (MEXICO)<br>*Integrated cash management, consulting and financial support for Group companies*<br>*Boulevard Manuel Avila Camacho, 24 16ª Plta. Lomas de Chapultepec 11000 Mexico D.F.* | 100.00% | | | 2 | | | | |
| Telefónica Emisiones, S.A.U. (SPAIN)<br>*Issuance of preferred securities and/or other financial debt instruments*<br>*Gran Via, 28 28013 Madrid* | 100.00% | | | 2 | | (2) | 1 | |
| Telefónica Europe, B.V. (NETHERLANDS)<br>*Fund raising in capital markets*<br>*Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX Amsterdam* | 100.00% | | | 4 | 2 | (1) | 2 | |
| Telefónica Internacional USA Inc. (US)<br>*Financial advisory services*<br>*1221 Brickell Avenue suite 600 33131 Miami Florida* | 100.00% | | | 1 | | | | |
| Telefónica International Wholesale Services II, S.L. (SPAIN)<br>*Telecommunications service provider and operator*<br>*Ronda de la Comunicación, s/n 28050 Madrid* | 100.00% | | | (11) | | (17) | (15) | 12 |
| Telefonica Luxemburgo Holding S.à.r.L. (LUXEMBOURG)<br>*Holding company*<br>*26, rue Louvingny, L-1946- Luxembourg* | 100.00% | | 8 | 323 | | 7 | 6 | 84 |

| Name and corporate purpose | % Ownership Direct | Indirect | Share capital | Reserves | Dividends received | Income (loss) From operations | For the year | Gross carrying amount |
|---|---|---|---|---|---|---|---|---|
| Telefónica International Wholesale Services, S.L. (SPAIN)<br>*International services provider*<br>*Gran Via, 28 28013 Madrid* | 92.51% | 7.49% | 230 | 23 | | 17 | 9 | 213 |
| Telefónica de Costa Rica TC, S.A.<br>*Wireless telephony operator*<br>*Plaza Roble, Edificio Los Balcones 4to. Piso, San José, Costa* | 100.00% | | 127 | 7 | | (24) | (24) | 127 |
| Seguros de Vida y Pensiones Antares, S.A. (SPAIN)<br>*Life insurance, pensions and health insurance*<br>*Ronda de la Comunicación, s/n Distito C Edificio Oeste 1, planta 9- 28050 Madrid* | 89.99% | 10.01% | 51 | 60 | | 2 | 2 | 59 |
| Corporation Real Time Team, S.L. (SPAIN)<br>*Internet design, advertising and consulting*<br>*Claudio Coello, 32, 1º ext. Madrid* | 87.96% | 12.04% | | N/A | | N/A | N/A | 12 |
| Telefónica International Wholesale Services America, S.A. (URUGUAY) (1)<br>*Provision of high bandwidth communications services Luis A. de Herrera, 1248 Piso 4 Montevideo* | 74.36% | 25.64% | 562 | (181) | | (42) | (43) | 325 |
| Telefónica Czech Republic, a.s. (CZECH REPUBLIC) (*)<br>*Telecommunications service provider*<br>*Za Brumlovkou 266/2,140 22 Praga 4-Michle Czech Republic* | 69.41% | | 833 | 1,285 | 365 | 424 | 332 | 3,468 |
| Telefónica Móviles Panamá, S.A. (PANAMA)<br>*Wireless telephony services*<br>*Edificio Magna Corp. Calle 51 Este y Avda Manuel María Icaza, Ciudad de Panamá* | 56.31% | 43.69% | 20 | 121 | | 22 | 15 | 301 |
| Aliança Atlântica Holding B.V. (NETHERLANDS)<br>*Holding company*<br>*Strawinskylaan 1725 1077 XX Amsterdan* | 50.00% | 43.99% | 40 | 11 | 6 | | 3 | 22 |
| Telefónica Móviles Colombia, S.A. (COLOMBIA) (1)<br>*Wireless operator* | 49.4% | 50.6% | | 538 | | 97 | 5 | 271 |

*Calle 100, Nº 7-33, Piso 15, Bogotá,Colombia*

| Name and corporate purpose | % Ownership Direct | Indirect | Share capital | Reserves | Dividends received | Income (loss) From operations | For the year | Gross carrying amount |
|---|---|---|---|---|---|---|---|---|
| Sao Paulo Telecomunicaciones Participaçoes, Ltda<br><br>*Holding company*<br><br>*Rua Martiniano de Caravalho, 851 20º andar, parte, Sao Paolo* | 44.72% | 55.27% | 3,813 | 411 | 91 | (1) | 190 | 3,092 |
| Telefónica Brasil, S.A. (formerly Telecomunicaçoes de Sao Pualo, S.A.) (1)(*)<br><br>*Wireline telephony operator in Sao Paulo*<br><br>*Sao Paulo* | 24.68% | 49.21% | 15,124 | 873 | 235 | 818 | 784 | 9,820 |
| Telefónica Móviles del Uruguay, S.A. (URUGUAY)<br><br>*Wireless communications and services operator Constituyente 1467 Piso 23, Montevideo 11200* | 32.00% | 68.00% | 7 | 182 | | 80 | 83 | 13 |
| Pléyade Peninsular, Correduría de Seguros y Reaseguros del Grupo Telefónica, S.A. (SPAIN)<br><br>*Distribution, promotion or preparation of insurance contracts, operating as a broker*<br><br>*Avda. General Perón, 38 Master II 17ª P. 28020 Madrid* | 16.67% | 83.33% | | | 1 | 3 | 4 | |
| Telefónica Móviles Argentina, S.A. (ARGENTINA)<br><br>*Wireless communications and services operator*<br><br>*Ing Enrique Butty 240, piso 20-Capital Federal-Argentina* | 15.40% | 84.60% | N/A | N/A | 35 | N/A | N/A | 139 |
| Telefónica Móviles Guatemala, S.A. (GUATEMALA)<br><br>*Provision of wireless, wireline and radio paging communications services*<br><br>*Bulevar Los Próceres 20-09 Zona 10. Edificio Iberoplaza. Guatemala City* | 13.60% | 86.38% | | | 3 | | | 38 |
| Telefónica Gestión de Servicios Compartidos, S.A. (ARGENTINA)<br><br>*Management and administrative services rendered*<br><br>*Av. Ing. Huergo 723 PB Buenos Aires* | 4.99% | 95.00% | | 1 | | 1 | | |
| Telefónica de Argentina, S.A. (1) (ARGENTINA) (*)<br><br>*Telecommunications service provider* | 1.80% | 98.20% | 185 | 232 | | 232 | 140 | 23 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| *Av. Ingeniero Huergo, 723, PB  Buenos Aires* | | | | | | | |
| Telefónica del Perú, S.A.A. (PERU) (1) (*) | | | | | | | |
| *Operator of local, domestic and international long distance telephony services in Peru* | 0.15% | 98.18% | 691 | 262 | 121 | 120 | 2 |
| *Avda. Arequipa, 1155 Santa Beatríz  Lima* | | | | | | | |

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| Name and corporate purpose | % Ownership Direct | % Ownership Indirect | Share capital | Reserves | Dividends received | Income (loss) From operations | Income (loss) For the year | Gross carrying amount |
|---|---|---|---|---|---|---|---|---|
| Telcel, C.A. (VENEZUELA) (1)<br>*Wireless operator*<br>*Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060* | 0.09% | 99.91% | 414 | 722 | | 870 | 738 | 123 |
| Telefónica Factoring España, S.A. (SPAIN)<br>*Factoring*<br>*Pedro Teixeira, 8 28020 Madrid* | 50.00% | | 5 | 2 | 3 | 8 | 6 | 3 |
| Telco, S.p.A. (ITALY)<br>*Holding company of a stake in Telecom Italia*<br>*Galleria del Corso, 2 Milan* | 46.18% | | 2,186 | 1,051 | | (1) | (1,127) | 2,315 |
| Telefónica Factoring México, S.A. de C.V. SOFOM ENR (MEXICO)<br>*Factoring*<br>*Mexico City* | 40.50% | 9.50% | 2 | | | | 1 | 1 |
| Telefónica Factoring Perú, S.A.C. (PERU)<br>*Factoring Lima* | 40.50% | 9.50% | 1 | 1 | | | 1 | 1 |
| Telefónica Factoring Colombia, S.A. (COLOMBIA)<br>*Factoring Bogota* | 40.50% | 9.50% | 1 | 1 | | 1 | | 1 |
| Telefónica Factoring Chile, S.A.<br>*Factoring*<br>*Santiago City* | 40.50% | 9.50% | | 1 | | 1 | | |
| Telefónica Factoring Do Brasil, Ltd. (BRAZIL)<br>*Factoring*<br>*Avda. Paulista, 1106 Sao Paulo* | 40.00% | 10.00% | 1 | (1) | 3 | (2) | 9 | 1 |
| Jubii Europe N.V. (*) (formerly Lycos Europe, N.V.)<br>*Internet portal In liquidation*<br>*Richard Holkade 36, 2033 PZ Haarlem Netherlands* | 32.10% | | N/A | N/A | | N/A | N/A | 15 |
| Torre de Collçerola, S.A. (SPAIN)<br>*Operation of a telecommunications mast and technical assistance and consulting services*<br>*Ctra. Vallvidrera-Tibidabo, s/nº 08017 Barcelona* | 30.40% | | 6 | | | | | 2 |

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| Name and corporate purpose | % Ownership Direct | Indirect | Share capital | Reserves | Dividends received | Income (loss) From operations | For the year | Gross carrying amount |
|---|---|---|---|---|---|---|---|---|
| Other investments | | | | 341 | 518 | | 18 | 340 |
| | | | **Total Group companies and associates** | | | | | **86,956** |

*(1) Consolidated data*
*(*) Companies listed on international stock exchanges at December 31, 2011*
*N/A No data available*

**MANAGEMENT REPORT**

**TELEFÓNICA, S.A.**

**2011**

**ECONOMIC RESULTS**

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

Against this backdrop and with the aim of reinforcing its growth story, actively participating in the digital world and capturing all the opportunities afforded by its scale and industrial and strategic alliances, a new organizational structure was approved in September. This new structure, which will become fully operational in 2012, will be as follows:

This new organization should bolster Telefónica s place in the digital world, enabling it to tap any growth opportunities arising in this environment, drive innovation, strengthen the product and services portfolio and maximize the advantages afforded by its large customer bases in an increasingly connected world. In addition, the creation of a Global Resources operating unit ensures the profitability and sustainability of the business by leveraging economies of scale and driving Telefónica s transformation into a fully global company.

Telefónica Europe s and Telefónica Latin America s objective is to shore up the results of the business and generate sustainable growth through available capacity, backed by the Global Corporation. The three differentiated segments Telefónica Spain, Telefónica Europe and Telefónica Latin America have been maintained for the presentation of this report as the organizational change took place virtually at the end 2011.

The growth strategy for the next few years is geared towards:

- Improving the customer experience to continue increasing the number of accesses.
- Leading growth:
  - Boosting the penetration of smart phones in all markets to accelerate the growth of mobile data, unlocking the value of increased data usage.
  - Defending the competitive position with a focus on fixed broadband, offering faster speeds, bundled offers and full IP voice and video services.
  - Leveraging growth opportunities arising in an increasingly digital environment, e.g. video, OTT, financial services, cloud computing.
- Continuing efforts to transform the operating model:
  - Increasing network capacity in key markets through technological advances or acquisitions of spectrum.
  - Accelerating the transformation primarily through the systems area.

Progressing towards becoming a more on-line company.

Maximizing economies of scale to boost efficiency.

The Telefónica Group has operations in Spain, the United Kingdom, Germany, the Czech Republic, Ireland and Slovakia in Europe, as well as in Brazil, Mexico and several countries in Central America, Venezuela, Colombia, Peru, Argentina, Chile, Uruguay and Ecuador in Latin America.

Telefónica also has an industrial alliance with Telecom Italia and a strategic alliance with China Unicom, having increased its stake in China Unicom to 9.6% in 2011. In addition, the Partners Program was created in 2011 in line with the objective of unlocking the value of Telefónica s scale. Three operators have already signed up for this program (Bouygues, Etisalat and Sunrise). This initiative makes a host of services available to selected operators under commercial terms that allow the partners to leverage Telefónica s scale and to cooperate in key business areas (e.g. roaming, services to multinationals, procurement, handsets).

In addition to the explanation of 2011 results, the Telefónica Group holds significant direct and indirect stakes (of over 5% in all cases) in listed telecommunications companies other than in those in which it has control. These are: China Unicom, Telecom Italia, S.A., Zon Multimedia, S.p.A. and Hispasat, S.A.

***Results of Telefónica, S.A.***

Telefónica, S.A. obtained net profit of 4,910 million euros in 2011. Highlights of the 2011 income statement include:

Growth in revenue from operations year on year, primarily due to the following:

- Most of the contracts signed in 2008 for use of the Telefónica brand entailing royalties stipulated an increasing percentage for the years 2008 to 2011. The 2011 income statement included 618 million euros of revenue from royalties for use of the brand (518 million in 2010).

- Dividends received from Group companies and associates: the main amounts of which relate to Telefónica Europe, plc. (715 million euros), Telefónica de España, S.A.U. (2,430 million euros) and Telefónica Móviles España, S.A.U. (1,980 million euros).

- Interest income on loans to Group companies and associates, the main amounts of which relate to interest from Telefónica Móviles México, S.A. de C.V. of 145 million euros (188 million euros in 2010) and Telefónica de España, S.A.U. of 83 million euros (130 million euros in 2010).

Net financial expense totaled 2,314 million euros in 2011, compared to 1,711 million euros in 2010. This was mainly due to finance costs with Group companies and associates, of which the largest came from Telefónica Europe, B.V. amounting to 373 million euros (454 million euros in 2010) and Telefónica Emisiones, S.A.U. totaling 1,395 million euros (1,286 million euros in 2010).

***Investment activity***

***2011***

On March 25, 2011 the Boards of Directors of each of the subsidiaries controlled by Telefónica, Vivo Participações and Telesp, approved the terms and conditions of a restructuring process whereby all shares of Vivo Participações that were not owned by Telesp were exchanged for Telesp shares, at a rate of 1.55 new Telesp shares for each Vivo Participações share. These shares then became the property of Telesp, whereby Vivo Participações then became a wholly owned subsidiary of Telesp. The restructuring process was approved by the shareholders of Vivo Participações at the Extraordinary General Shareholders Meeting held on April 27, 2011 and by the shareholders of Telesp at the Extraordinary General Shareholders´ Meeting held on the same date following authorization by the Brazilian telecommunications regulator, Anatel.

At that date, Telefónica, S.A. held a direct stake of approximately 60% in Vivo Participaçoes, Ltda., valued at 13,021 million euros, subsequent to the liquidation by absorption of Portelcom Participaçoes, S.A., PTelecom Brasil, S.A. and Telefónica Brasil Sul Celular Participaçoes, Ltda.

On June 14, 2011, the Boards of Directors of Vivo Participações and Telesp approved a restructuring plan whose objective was to simplify the corporate structure of both companies and foster their integration, eliminating Vivo Participações from the corporate chain through the incorporation of its total equity into Telesp, and concentrating all mobile telephony activities in Vivo, S.A. (now a direct subsidiary of Telesp).

This deal was submitted for consideration by the Brazilian telecommunications regulator and finally approved at the General Shareholders Meetings of both companies on October 3, 2011. The company arising from the merger changed its name to Telefónica Brasil, S.A.

Following the share exchange, a partial contribution was made to Sao Paulo Telecommunicaçoes (SPT), leaving the direct stake in Telesp at 24.68%. All the aforementioned transactions were performed at the carrying amounts.

On June 27, 2011, Telefónica, S.A. performed a capital increase of 1,285 million Mexican pesos (76 million euros). In October 2011, several more capital increases were carried out, totaling 1,832 million Mexican pesos (100 million euros).

In late 2010, the Telefónica Group was awarded a mobile telephone license in Costa Rica. Until that date, the Group had no operations in that country. To operate under this license, on February 14, 2011 Telefónica, S.A. incorporated the company Azules y Platas, S.A., with 2 million US dollars. The Company made an additional contribution to equity of 6 million euros on February 15, 2011, as well as a capital increase of 170 million US dollars on June 26, 2011. The euros value of the three aforementioned capital increases is 127 million euros. On September 22, 2011 the change of name of this company, to Telefónica de Costa Rica, S.A., was formally entered in the pertinent mercantile registry.

On September 26, 2011, Telefónica, S.A. injected a further 80 million euros of equity into Casiopea Re, S.A.

In 2011, equity swap contracts were partially cancelled through the sale of 33 million shares in Portugal Telecom, generating gains of 13 million euros. These gains were recognized under the income statement caption Gains (losses) on disposal and other gains and losses . Given that the listed price of these shares dropped considerably in the second half of the year, the Company made a financial provision amounting to 135 million euros, recognized under the income statement caption Impairment and gains (losses) on disposal of financial instruments . In October 2011, in view of the adverse outlook published for this stock by financial analysts, the Company decided to extend the equity swap contracts and reclassified the net carrying amount of the direct stake in Portugal Telecom (which continued to be 2.02%) and the remaining portion of the equity swap contracts, totaling both stakes, direct and indirect an amount of 235 million euros, to Available-for-sale assets .

At each year end, the Company reviews its subsidiaries business plans and cash flows derived there from and, based on the value of each company, estimates whether to recognize an impairment of these investments. In 2011, a write-down of 1,606 million euros was recognized as a result of this review. This amount reflects the net effect of the following: (a) the reversal of the impairment loss recorded for Telefónica Europe, plc. (1,279 million euros), less 120 million euros for the effect of the net investment hedge; (b) the write-down of 2,085 million euros in Telefónica Móviles México, S.A. de C.V.; (c) the write-down of 629 million euros made in Telco, S.p.A. to reflect the decrease in value of the stake in Telecom Italia, along with the effect of recovering part of the operational synergies during the year.

In 2011, Telefónica, S.A. adjusted the cost of its investment in Banco Bilbao Vizcaya Argentaria, S.A. by 80 million euros, in order to bring the cost per share in line with the fair value. This adjustment was taken directly to the income statement, under Gain (loss) on available-for-sale financial assets recognized in the period , with no impact on the statement of recognized income and expenses.

***2010***

On February 10, 2010 Irish company Telfin Ireland Ltd. was incorporated by means of a 919 million euro contribution by Telefónica, S.A. (its sole shareholder). On April 28, 2010, Telefónica, S.A. injected a further 243 million euros of equity into this company. Then on May 21, 2010, Telefónica, S.A. injected a further 1,379 million euros and on June 24, 2010 another 869 million euros. These funds were used by Telfin Ireland, Ltd. to finance other Group companies in transactions performed during 2010.

On July 28, 2010 Telefónica, S.A. and Portugal Telecom, SGPS, S.A. reached an agreement for the acquisition by Telefónica, S.A. of 50% of the share capital of Brasilcel, N.V. (a company in which Portugal Telecom and Telefónica had equal joint interests until that date, and which held approximately 60% of the share capital of the Brazilian company Vivo Participações, S.A.). The agreed acquisition price was 7,500 million euros, of which the last 2,000 million euros were paid on October 31, 2011. On the purchase date, the company declared its intention to absorb in a single act Brasilcel, N.V. This agreement also established inter alia that Portugal Telecom waived the declared dividend payable by Brasilcel, N.V. amounting to 49 million euros, which was recognized as a reduction in the cost of this acquisition. Taking into account the conditions established, the discounted price at which this acquisition was recognized was 7,419 million euros.

Subsequently, on September 28, 2010 the two boards of directors approved the merger of Telefónica and Brasilcel, N.V., which was recognized on that date. This merger was entered in the Mercantile Registry on December 21, 2010 and gave rise to a reserve of 3,602 million euros, reduced by 49 million euros corresponding to the aforementioned dividends. The net amount by which Telefónica, S.A. s equity was affected by this transaction was therefore 3,553 million euros.

In 2010, Telefónica, S.A. took the stake in Banco Bilbao Vizcaya Argentaria, S.A. of 191 million euros and in Zon Multimedia Serviços de Telecomunicaçoes e Multimedia, S.G.P.S., S.A. of 52 million euros to profit and loss. These transfers were recognized in Gain (loss) on available-for-sale financial assets recognized in the period .

**SHARE PRICE PERFORMANCE**

The sovereign debt crisis across Europe, which led to Portugal s bailout and Greece s application for a second rescue package, lingering doubts regarding financial stability in the rest of the European peripherals and pressure from rating agencies caused Europe s main stock indices to retreat in 2011 (AthexComposite: -51.9%; PSI-20: -27.6%; FTSEMIB: -25.2%; EStoxx-50 -17.1%; CAC-40 -17.0%; DAX -14.7%; Ibex-35 -13.1% and FTSE-100 -5.6%).

Shaping market performance in 2011 was the sovereign debt crisis, especially in southern Europe. For instance, Spain s benchmark 10-year bond ended 2011 yielding 5.1% (5.5% at the end of 2010), leaving the spread with the German bund at 325.9 basis points (248.9bp at the end of 2010). Portugal s bond spread at year end stood at 1,153.3bp (compared to 363.bp at the end of 2010), Italy s at 528bp (compared to 185.1bp) and Greece s at 3,313.5bp (compared to 950.9bp).

Telefónica s share price closed 2011 down 21.1% at 13.39 euros per share. It underperformed its European sector benchmark index by 6.2%, mostly due to macroeconomic risk in Spain given the country s high exposure to southern Europe, and to Vodafone s 7.9% gain given its large index weight. Europe s other main operators also ended the year poorly, with France Telecom down by 22.2%, KPN by 15.3%, Telecom Italia by 14.6% and Deutsche Telekom by 8.2%. Telefónica s total return, however, was only 12.1% lower including the dividends paid in 2011 (0.75 euros per share on May 6, 2011 and 0.77 euros per share on November 7, 2011).

At the end of 2011, Telefónica was the world s seventh largest telecommunications company by market cap (61,089 million euros) and 65th among the 100 largest companies in the world of any kind.

Daily trading volume in Telefónica shares on Spain s continuous market was 56.4 million shares in 2011 (59.8 million shares in 2010).

**RESEARCH, DEVELOPMENT AND INNOVATION**

Telefónica remains firmly committed to technological innovation as a core means to generating competitive advantages, anticipating market trends and the differentiation of its products. By introducing new technologies and developing new products and business processes, the Group seeks to become more effective, efficient and customer-oriented.

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

- developing new products and services in order to win market share;
- boosting its customers loyalty;
- driving revenue growth;
- enhancing innovation management;
- improving business practices;
- increasing the quality of its infrastructure services to improve customer service and reduce costs;
- promoting global products;
- supporting open innovation; and
- creating value from the technology generated.

In 2011, the technological innovation projects being undertaken focused on sustainable innovation, process efficiency, creation of new revenue streams, customer satisfaction, consolidation of the Group s operations in new markets, and technological leadership.

Technical innovation activities are a key part of Telefónica s strategy of creating value through broadband communications and services, the IP network, wireless networks and new generation networks (fiber optic).

In 2011, projects were being undertaken to promote greater access to information technology, new services focused on new internet business models, advanced user interfaces, mobile television and other broadband services. These initiatives, among others, were built on the basis of rapid identification of emerging technologies that could have a relevant impact on the Group s businesses and the testing of these technologies in new services, applications and platform prototypes.

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

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

- Natural P2P communication of the future, using the Internet, Web 2.0 and smart phones.
- Video and multimedia services (combining text, audio, images and video) offering a user experience in all connected devices.
- Advanced solutions in emerging ITC businesses such as e-health, and remote patient support or monitoring.
- M2M (machine-to-machine) service management associated with energy efficiency and mobility.
- Cloud computing, which makes intensive use of resources available on the Web to develop, publish, commercialize and distribute applications.
- Making use of user communication profiles to exploit opportunities to operate different products and business models (marketing campaigns, target marketing, contextual services, churn reduction, cross-selling, etc.)
- Network and architecture services as a new global infrastructure shared by all business lines to cut operating and maintenance costs, on which the Group can roll out new services and provide greater capacity amid increasing demand for mobile data, video content and the shift from people-based Internet to an object-based Internet.

At December 31, 2011, Telefónica I+D had 653 employees and collaborated with skilled professionals from over 80 companies and more than 50 universities.

Research and development costs at Telefónica amounted to 983 million euros and 797 million euros in 2011 and 2010, respectively, representing 1.6% and 1.3% of the Group s consolidated revenue, respectively. These figures were calculated using guidelines of the Organization for Economic Co-operation and Development (OECD).

Telefónica registered 95 patents in 2011, of which 57 were registered with the Spanish Patent Office and 38 with patent offices in the European Union, the US and with other international patent offices.

**FINANCING**

The main financing transactions undertaken in the bonds market in 2011 are as follows:

Under Telefónica Emisiones, S.A.U. s European Medium Term Note ( EMTN ), Telefónica, S.A. guaranteed the issue of debt instruments for a global amount of 2,370 million euros, with the following features:

| Issue date | Maturity date | Amount (nominal) | Currency of issue | Coupon |
|---|---|---|---|---|
| 02/07/2011 | 02/07/2017 | 1,200,000,000 | EUR | 4.750% |
| 03/21/2011 | 02/07/2017 | 100,000,000 | EUR | 4.750% |
| 11/03/2011 | 02/03/2016 | 1,000,000,000 | EUR | 4.967% |
| 11/04/2011 | 11/04/2016 | 7,000,000,000 | JPY | 2.8247% |

Under Telefónica Emisiones, S.A.U. s debt issue program registered with the United States Securities Exchange Commission (SEC), Telefónica, S.A. guaranteed the issues of debt instruments for a global amount equivalent to 2,750 million US dollars (equivalent to approximately 2,125 million euros), with the following features:

| Issue date | Maturity date | Amount (nominal) | Currency of issue | Coupon |
|---|---|---|---|---|
| 02/16/2011 | 02/16/2016 | 1,250,000,000 | USD | 3.992% |
| 02/16/2011 | 02/16/2021 | 1,500,000,000 | USD | 5.462% |

The main financing transactions carried out in the banking market in 2011 are the following:

On May 3, 2011, Telefónica, S.A. signed a long-term line of credit for an aggregate amount of 376 million US dollars at a fixed rate and guaranteed by the Finnish Export Credits Guarantee Board (Finnvera). This line of credit is structured into four tranches: a tranche of 94 million US dollars maturing on January 30, 2020, another of 90 million US dollars maturing on July 30, 2020, a third of 94 million US dollars maturing on January 30, 2021, and a fourth of 98 million US dollars maturing on July 30, 2021. At December 31, 2011, none of this credit had been drawn down; and

On May 12, 2011 Telefónica, S.A. signed an amendment to the syndicated loan agreement entered into on July 28, 2010 whereby it was agreed that, in exchange for the additional payment of certain fees and an upward adjustment to applicable interest rates, of the 5,000 million euros that would initially mature in July 2013, 2,000 million euros would be extended for another year, i.e. until July 2014, and another 2,000 million for a further three years, i.e. until July 2016. At December 31, 2011, this line of credit had been drawn down by 8,000 million euros (6,000 million euros at December 31, 2010).

**TRANSACTIONS WITH TREASURY SHARES**

At December 31, 2011 and 2010, Telefónica, S.A. held the following treasury shares:

| | | Euros per share | | | |
|---|---|---|---|---|---|
| | Number of shares | Acquisition price | Trading price | Market value (1) | % |
| ***Treasury shares at 12/31/11*** | 84,209,363 | 15.68 | 13.39 | 1,127 | 1.84508% |

*(1) Millions of euros*

| | | Euros per share | | | |
|---|---|---|---|---|---|
| | Number of shares | Acquisition price | Trading price | Market value (1) | % |
| ***Treasury shares at 12/31/10*** | 55,188,046 | 17.01 | 16.97 | 937 | 1.20920% |

*(1) Millions of euros*

The movement in treasury shares of Telefónica, S.A. in 2010 and 2011 is as follows:

| | Number of shares |
|---|---|
| **Treasury shares at 12/31/09** | **6,329,530** |
| Acquisitions | 52,650,000 |
| Disposals | (827,047) |
| Delivery PSP Phase II (Note 19.3) | (2,964,437) |
| **Treasury shares at 12/31/10** | **55,188,046** |
| Acquisitions | 55,979,952 |
| Disposals | (24,058,446) |
| Delivery PSP Phase III (Note 19.3) | (2,900,189) |
| **Treasury shares at 12/31/11** | **84,209,363** |

Furthermore, at December 31, 2011, one Telefónica, S.A. share is held by Telefónica Móviles Argentina, S.A. (16,896 treasury shares held by Telefónica Móviles Argentina, S.A. at December 31, 2010).

The amount paid to acquire treasury shares in 2011 and 2010 was 822 million euros and 897 million euros, respectively.

On June 30, 2011 and July 4, 2011, following the end of the third phase of the Performance Share Plan (PSP), a total of 2,446,104 treasury shares were added, corresponding to two financial instruments arranged by the Company to meet its obligations to deliver treasury shares to managers and executives. The gross number of shares linked to the Plan amounted to 4,166,304 shares, with a net 2,900,189 shares finally delivered (32.6 million euros).

On June 30, 2010, subsequent to the maturing of the second phase of the Performance Share Plan (PSP) a total of 2,964,437 treasury shares were delivered at a price of 16.93 euros per share (50.1 million euros).

Expanding on the existing strategic alliance, on January 23, 2011, Telefónica, S.A. and China Unicom (Hong Kong) Limited ( China Unicom ) signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party.

In 2011, Telefónica acquired through its subsidiary Telefónica Internacional, S.A.U. 2011 282,063,000 shares of China Unicom amounting to 358 million euros. In recognition of China Unicom s stake in Telefónica, approval was given at Telefónica s General Shareholders Meeting held on May 18, 2011 for the appointment of a board member named by China Unicom.

Treasury shares sold in 2011 and 2010 amounted to 445 million euros and 14 million euros, respectively. The sales for 2011 included 371 million euros in respect of the Strategic Partnership Agreement with China Unicom, referred to above.

At the date of authorization for issue of these financial statements, Telefónica held 234 million call options on treasury shares subject to physical settlement (190 million and 160 million options on treasury shares at December 31, 2011 and 2010, respectively).

The Company also holds a derivative on approximately 26 million Telefónica shares, subject to net settlement, recognized under Derivative financial liabilities (current) on the balance sheet.

## RISKS AND UNCERTAINTIES FACING THE COMPANY

The Telefónica Group s business is conditioned by a series of intrinsic risk factors that affect exclusively the Group, as well as a series of external factors that are common to businesses of the same sector. The risks described below are the most significant:

***Group-related risks***

*Country risk (investments in Latin America).* At December 31, 2011, approximately 48.5% of the Telefónica Group s assets were located in Latin America. In addition, approximately 46.5% of its revenues from operations for 2011 were derived from its Latin American operations. At December 31, 2011 approximately 54.5% of its assets and 49.0% of the income from the Latin American segment were derived from its Brazil transactions. The Telefónica business is especially sensitive to any of the risks related to Latin America described in this section, particularly if they affect or arise in Brazil.

The Group s investments and operations in Latin America could be affected by a series of risks related to economic, political and social factors in these countries, collectively denominated country risk, including risks related to the following:

- government regulation or administrative polices, as well as the terms of licenses and concessions under which the Telefónica Group operates, may change unexpectedly and negatively affect the economic conditions or business environment in which it operates, and, therefore, the Group s interests in such countries;

- inflation may rise, currencies may be devalued or may depreciate or currency restrictions and other restraints on transfer of funds may be imposed;

- governments may expropriate or nationalize assets or increase their participation in the economy and companies;

- economic downturns, political instability and civil disturbances may negatively affect the Telefónica Group s operations in such countries.

*Foreign currency and interest rate risk.* The Telefónica Group s business is exposed to various types of market risks, above all the impact of changes in interest rates or foreign currency exchange rates.

The Telefónica Group uses a variety of strategies to manage this risk, mainly through the use of financial derivatives, which themselves are also exposed to risk. These risk management strategies may not achieve the desired effect, while these hedges are exposed to counterparty risk.

*Dependence on external sources of financing.* The performance, expansion and improvement of networks, the development and distribution of the Telefónica Group s services and products, as well as the development and implementation of new technologies or the renewal of licenses require a substantial amount of financing.

The evolution of financial markets in terms of liquidity, cost of credit, access and volatility, continues to be overshadowed by persisting uncertainty regarding certain factors such as the pace of the economic recovery, the health of the international banking system or the increasing concerns regarding the burgeoning deficits of some European countries. Worsening conditions in international financial markets due to any of these factors may make it more difficult and more expensive for the Telefónica Group to refinance its debt at December 31, 2011, average net debt maturing in the next six years is approximately 6,850 million euros per year or take on additional debt if necessary.

In addition, the capacity to raise capital in the international capital markets would be impaired in terms of access and cost if Telefónica s credit ratings were downgraded. Nonetheless, after the downgrade to the long-term credit rating, funds were raised in the capital markets through Telefónica Emisiones, S.A.U. in 2011 for an aggregate amount of 4,495 million euros. In February 2012, it tapped the European market with a 1,500 million euro issue of bonds maturing February 21, 2018 with an annual coupon of 4.797%.

Moreover, the current market conditions could make it harder to renew existing undrawn bilateral credit lines, 24% of which, at December 31, 2011 initially mature prior to December 31, 2012. Finally, the current financial situation could make it more difficult and costly to raise additional equity capital from shareholders.

***Risks related to the Group s industry***

*Current global economic situation.* The Telefónica Group s business is impacted by general economic conditions in each of the countries in which it operates. The uncertainty about whether the economic recovery will continue may negatively affect the level of demand of existing and prospective customers, as customers may no longer deem critical the services offered by the Group. The main macroeconomic factors that could have an adverse impact on consumption and, accordingly, demand for services and the Telefónica Group s results include the dearth of credit as banks adjust their balance sheets, trends in the labor market, further erosion of consumer confidence, with an immediate increase in saving rates, or needs for greater fiscal adjustment, which would undermine household income levels. This risk is high in Europe, but basically negligible in the rest of the countries where the Telefónica Group operates.

Similarly, the sovereign debt crisis in certain Euro Area countries and rating downgrades in some of these should be taken into account. Any further deterioration in sovereign debt markets or greater restrictions on credit in the banking sector could have an adverse impact on Telefónica s ability to raise financial and/or obtain liquidity. This could have an adverse impact on the Group s businesses, financial position, results or cash flow.

In addition, there could be other possible follow-on effects from the economic crisis on the Group s business, including insolvency of key customers or suppliers.

*Highly regulated markets.* As a multinational telecommunications company that operates in regulated markets, the Telefónica Group is subject to different laws and regulations in each of the jurisdictions in which it provides services and in which supranational regulators such as the European Union and national, state, regional and local authorities intervene to varying degrees and as appropriate. This regulation is strict in the countries in which the Company holds a dominant position.

In Europe, wholesale mobile network termination rates came down in 2011. There were considerable reductions in many of the countries where the Group operates, notably in the UK (with a final reduction scheduled for 2015 and a decrease in prices compared to the end of 2010 of over 83%) and Germany (cuts of over 50% since December 2010). In Spain, in December 2011, the regulator (CMT) launched a public consultation on mobile network call termination rates, proposing a reduction of between 75% and 80%.

Other services with regulated prices include SMS and call roaming. In this case, a declining scale for maximum wholesale and retail prices is in place, with Telefónica already having been forced to cut the maximum prices of voice calls, text messages and wholesale roaming prices by 2012 by 11.43%, 36.36% and 60%, respectively, from those in force in mid 2011. In July, the European Commission released a proposal for a review of the Roaming Regulation aimed at achieving a long-term solution. According to this proposal, from July 2014, mobile operators would be forced to separate the sale of roaming services from their domestic services. This would allow users to choose a different operator for calls made in other Member States. The proposal includes a transitional period during which the current maximum prices would be applied until the structural measure is implemented. Retail data roaming prices would also include new caps.

Finally, regarding net neutrality, the Commission released a report on net neutrality in which it maintains the non-regulatory alternative. It did, however, pose the need to know and supervise operators traffic management practices. Moreover, the Commission turned to BEREC to draft a set of guidelines for transparency and minimum quality of service standards.

Nevertheless, regulators could also adopt at any time measures or additional requirements to reduce roaming prices and fixed and/or mobile termination rates, and force Telefónica to provide third-party access to its networks.

Moreover, in Latin America there is a move to review and reduce mobile network termination prices. For instance, reductions have been approved in Mexico and Chile of 61% and 60%, respectively. In Brazil, in October 2011, the regulator (Anatel) approved the fixed-mobile rate adjustment regulation, which entails a gradual reduction of these rates by applying a CPI- factor. This reduction factor is 18% in 2012, 12% in 2013 and 10% in 2014. The absolute decrease in public rates must be passed on to mobile interconnection rates (VU-M). In addition, there is a trend toward reductions in termination rates in Peru, Venezuela and Colombia.

Meanwhile, the regulatory landscape in Europe has changed as a consequence of the approval in 2009 of the European Union s common regulatory framework, which had to be transposed into national law by Member States by May 2011. At the date of preparation of this document, of the countries in which the Telefónica Group operates, Spain and Germany had yet to transpose this community law. The regulatory principles established suggest that the new frameworks in each Member State could result in increased regulatory pressure on the local competitive environment. This framework supports the possibility of national regulators, in specific cases and under exceptional conditions, establishing the functional separation between the wholesale and retail businesses of operators with significant market power and vertically integrated operators, whereby they would be required to offer equal wholesale terms to third-party operators that acquire these products.

The recommendation on the application of the European regulatory policy to next-generation broadband networks drawn up by the European Commission could play a key role in the incentives for operators to invest in net fixed broadband networks in the short and medium term, thus affecting the outlook for the business and competition in this market segment. The European Commission is currently recording the respective recommendations on cost accounting and non-discrimination which could apply more regulatory pressure to fixed operators.

Meanwhile, as the Group provides most of its services under licenses, authorizations or concessions, it is vulnerable to economic fines for serious breaches and, ultimately, revocation or failure to renew these licenses, authorizations or concessions or the granting of new licenses to competitors for the provisions of services in a specific market.

The Telefónica Group pursues their renewal to the extent provided by the contractual conditions, though it cannot guarantee that it will always complete this process successfully or under the most beneficial terms for the Group. In many cases it must satisfy certain obligations, including, among others, minimum specified quality standards, service and coverage conditions and capital investment. Failure to comply with these obligations could result in the imposition of fines or even revocation or forfeiture of the license, authorization or concession.

In addition, since the Telefónica Group holds a leading market share in many of the countries where it operates, the Group could be affected by regulatory actions of antitrust or competition authorities. These authorities could prohibit certain actions, such as making further acquisitions or continuing to engage in particular practices or impose fines or other penalties on the Company, which, if significant, could result in loss of market share and/or in harm to future growth of certain businesses.

*Highly competitive markets and markets subject to constant technological development.* The Telefónica Group operates in markets that are highly competitive and subject to constant technological development. Therefore, it is subject to the effects of actions by competitors in these markets and its ability to anticipate and adapt to constant technological changes taking place in the industry.

To compete effectively with these competitors, the Telefónica Group needs to successfully market its products and services and respond to both commercial actions by competitors and other competitive factors affecting these markets, anticipating and adapting promptly to technological changes, changes in consumer preferences and general economic, political and social conditions. Failure to do so appropriately could have an adverse impact on the Telefónica Group s financial position, operating results and cash flow.

New products and technologies arise constantly, while the development of existing products and technologies can render obsolete the products and services the Telefónica Group offers and the technology it uses. This can force Telefónica to investment in the development of new products, technology and services so it can continue to compete effectively with current or future competitors. This can reduce the revenue margins it obtains. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are arising from mobile internet.

One technology that telecommunications operators, including Telefónica (in Spain and Latin America), are focused on is the new FTTx-type network, which offers broadband access using optical fiber with superior services, e.g. internet speed of up to 100mb or HD television services. However, hefty investment is required to deploy these networks, which entails fully or partially substituting the copper of the access loop with fiber optics. As things stand now, scant demand for the capabilities offered by these new networks to end users could make it difficult to quantify the return on investment and justify the high investment.

In addition, many of these network upgrade tasks and the ability to offer new products or services are not entirely under the Telefónica Group s control and could be constrained by applicable regulation.

*Limitations on spectrum capacity could be costly and curtail growth*. Telefónica s mobile operations in a number of countries may rely on the availability of spectrum. The Company s failure to obtain sufficient or appropriate capacity and spectrum coverage, and assume the related costs of obtaining this capacity, could have an adverse impact on the quality of services and on the Company s ability to provide new services, potentially adversely affecting the Group s financial position and results of operations.

Specifically, in Germany, the regulator launched a public consultation to identify demand for spectrum in the 900 MHz and 1800 MHz frequencies from 2017. A decision in this respect is expected for 2013. Regarding the allocation of new spectrum and the related costs, in 2011, additional spectrum was awarded in Spain covering all bands attributed to mobile services for a total costs for all blocks of approximately 842 million euros.

*Supplier failures*. As a mobile and fixed telephony operator and provider of telecommunications services and products, the Telefónica Group, like other companies in the industry, depends upon a small number of major suppliers for essential products and services, mainly network infrastructure and mobile handsets. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own shortages and business requirements.

If these suppliers fail to deliver products and services to the Telefónica Group on a timely basis, it could jeopardize network deployment and expansion plans, which in some cases could adversely affect the Telefónica Group s ability to satisfy its license terms and requirements or have an adverse impact on the Telefónica Group s businesses and the results of its operations.

*Risks associated with unforeseen network interruptions*. Unanticipated network interruptions as a result of system failures whether accidental or otherwise, including due to network, hardware or software failures, which affect the quality of or cause an interruption in the Telefónica Group s service, could lead to customer dissatisfaction, reduced revenues and traffic, costly repairs, penalties or other measures imposed by regulatory authorities and could harm the Telefónica Group s reputation.

Telefónica attempts to mitigate these risks through a number of measures, including backup systems and protective systems such as firewalls, virus scanners and building security. However, these measures are not always effective. Although the Telefónica Group carries business interruption insurance, its insurance policy may not provide coverage in amounts sufficient to compensate for potential losses.

*Electromagnetic radio emissions and possible health risks.* Currently, there is significant public concern regarding alleged potential effects of electromagnetic fields, emitted by mobile telephones and base stations, on human health.

This social concern has caused certain governments and administrations to take measures that have hindered the deployment of the infrastructures necessary to ensure quality of service and affected the deployment criteria of new networks.

In May 2011, the specialized body of the World Health Organization in research on cancer (IARC) recently classified electromagnetic fields of mobile telephony as possibly carcinogenic, a classification which also includes products such as coffee and pickled foods. The World Health Organization subsequently indicated, in its fact sheet no. 193 published in June 2011, that to date it cannot be confirmed that the use of a mobile telephone has adverse effects on health, although it was announced that in 2012 a formal assessment of this risk will be conducted, taking into account all scientific evidence available.

Regardless of the scientific evidence that may be obtained and even though the Telefónica Group has considered these risks and has a action plan of the various countries in which it provides services to assure compliance of codes of good practices and relevant regulations, this concern, which may affect the capacity to capture or retain customers or may discourage the use of the mobile telephone, should not be ruled out.

The adoption of new measures by governments or administrations or other regulatory interventions in this respect that may also arise in the future may adversely affect the Group s business, financial position, results and cash flow.

*Risk of asset impairment.* The Telefónica Group reviews on an annual basis, or more frequently where the circumstances require, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future cash flows expected, including, in some cases synergies included in acquisition cost. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to the estimates made and recognize impairment losses in goodwill, intangible assets or fixed assets. Although the recognition of impairments of property, plant and equipment, intangible assets and financial assets result in a non-cash charge on the income statement, it could adversely affect the Telefónica Group s results of operations. In this respect, the Telefónica Group has taken impairment losses on certain of its investments, affecting the results of the year when they were made. In 2011, an impairment loss was recognized on the stake in Telco, S.p.A. which, coupled with the impact of the recovery of part of the operational synergies considered in the investment, resulted in a negative impact of 629 million euros.

***Other risks***

*Litigation and other legal proceedings*. Telefónica and Telefónica Group companies are party to lawsuits and other legal proceedings in the ordinary course of their businesses, the financial outcome of which is unpredictable. An adverse outcome in, or any settlement of, these or other proceedings could result in significant costs and may have a material adverse effect on the Telefónica Group s business, financial condition, results of operations and cash flow.

**TREND EVOLUTION**

Telefónica is an integrated diversified telecommunications group that offers a wide range of services, mainly in Spain, Europe, and Latin America. Its activity is based upon providing fixed and mobile services, Internet and data, pay TV and value added services, among others. The Group s operations in 25 countries, managed through a regional organization geared towards certain businesses in global units, enable it to leverage its strong local positioning, as well as the advantages afforded by its scale, two features that have been reinforced by the opportunities arising from its holdings in and strategic alliances with China Unicom and Telecom Italia.

As a multinational telecommunications company that operates in regulated markets, Telefónica is subject to different laws and regulations in each of the jurisdictions in which it provides services. It can expect the regulatory landscape to continue to change in Europe as a consequence of the revised regulations resulting from the implementation of the review of the common regulatory framework currently in place in the European Union. In addition, it may also face pressure from regulatory initiatives in some European countries regarding tariffs, the reform of rights of spectrum use and allocation, issues related to the quality of service, and the regulatory treatment of new broadband infrastructure deployments.

Telefónica faces intense competition in most of its markets, and is therefore subject to the effects of actions taken by its competitors. The intensity of the competition may deepen, which could have an impact on tariff structures, consumption, market share and commercial activity and negatively affect the number of customers, revenues and profitability.

However, Telefónica is in a strong competitive position in most of the markets where it operates, enabling it to continue taking advantage of the growth opportunities that arise in these markets, such as by boosting both fixed and mobile broadband services and by furthering the development of services beyond connectivity, information technology services and related businesses. In this respect, Telefónica seeks to lead the industry by anticipating trends in the new digital environment.

As a result, Telefónica embarked on a restructuring in September 2011 with the aim of reinforcing its growth story, actively participating in the digital world and capturing the most of the opportunities afforded by its scale and industrial alliances. This new organization gave rise to two cross-cutting areas, Telefónica Digital and Telefónica Global Resources, in addition to the Telefónica Europe and Telefónica Latin America segments. This structure should bolster Telefónica s place in the digital world, enabling it to tap any growth opportunities arising in this environment, drive innovation, strengthen the product and services portfolio and maximize the advantages afforded by its global customer bases in an increasingly connected world. In addition, the creation of a Global Resources operating unit ensures the profitability and sustainability of the business by leveraging economies of scale and driving Telefónica s transformation into a fully global company. Telefónica Europe s and Telefónica Latin America s objective is to shore up the results of the business and generate sustainable growth through available capacity, backed by the Global Corporation.

In Spain, following the commercial positioning carried out at the end of 2011, Telefónica will continue to intensify its commercial commitment to offering quality services, increasing the effectiveness of its sales channels and further improving the quality and features of its networks to increase customer satisfaction through targeted commercial offerings that ensure the best response to their communications needs. In this respect, the Group will continue to boost innovation to offer the best products and services, drive the mobile and fixed broadband growth and bundling services to provide the best integrated communications solution in the market.

Efficiency will continue to play a very important role in all areas of management, both in commercial and operational areas, including systems, networks and processes. Telefónica will focus on its customers and their satisfaction, while continuing to remain committed to ensuring Telefónica Spain remains the best place to work.

In Latin America, Telefónica s strategy is based on a regional model that captures growth and efficiency of scale without losing sight of the local management of the client. The mobile business will continue to play a fundamental role as an engine of regional growth. That is why Telefónica will continue to improve the capacity and coverage of its networks, adapting its distribution channel to enhance the quality of its offerings both in voice and data in order to keep and attract high-value customers. Regarding the fixed telephony business, Telefónica will encourage the increase of broadband speed and expand the supply of bundled services. Meanwhile, Telefónica will further advance efficiency, in operational and commercial terms, and attempt to achieve further synergies by implementing global, regional and local projects.

In Europe, customers will remain at the center of the Group s strategy and management priorities in the region in order to guarantee a high level of customer satisfaction with its services. With the objective of offering customers the best value, Telefónica will boost the mobile and fixed broadband services, adding new products and services to its current services. In such a competitive market such as presently prevails, efforts will focus on reinforcing the Group s market positioning. Another objective in coming years is to improve operating efficiency, for which Telefónica will roll out several local and regional initiatives, with the support of Telefónica Global Resources.

In summary, in the context of intense competition and regulatory pressure on pricing, Telefónica will continue strengthening its business model to make it more efficient and capture the synergies arising from the integrated approach of businesses, processes and technologies, while the Group will focus even more on the customer.

**EVENTS AFTER THE REPORTING PERIOD**

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

On January 5, 2012, Telefónica Europe, B.V. arranged financing guaranteed by Telefónica, S.A. with China Development Bank (CDB) for an aggregate amount of 375 million US dollars (equivalent to approximately 290 million euros) at a floating rate and maturing in 2022. This financing was paid on February 15, 2012.

On February 7, 2012, Telefónica Emisiones, S.A.U., as part of the European Medium Term Note ( EMTN ) registered with the Financial Services Authority (FSA) in London and updated on June 20, 2011, extended the issue of bonds made on February 7, 2011 for an initial aggregate amount of 1,200 million euros maturing on February 7, 2017, by 120 million euros. These bonds are guaranteed by Telefónica, S.A.

On February 21, 2012, Telefónica Emisiones, S.A.U., as part of the European Medium Term Note ( EMTN ) registered with the Financial Services Authority (FSA) in London and updated on June 20, 2011, issue bonds for an aggregate amount of 1,500 million euros maturing on February 21, 2018. These bonds are guaranteed by Telefónica, S.A.

**ANNUAL CORPORATE GOVERNANCE REPORT**

**LISTED LIMITED COMPANIES**

ISSUER S PARTICULARS

YEAR ENDED: 31-12-2011

COMPANY TAX ID NO. (CIF): A-28015865

Corporate name: TELEFÓNICA, S.A.

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**ANNUAL CORPORATE GOVERNANCE REPORT FOR LISTED LIMITED COMPANIES**

For a better understanding of this model report and how to fill it out, and its subsequent preparation, please read the instructions provided at the end.

A OWNERSHIP STRUCTURE

**A.1 Complete the following table on the company s share capital:**

| Date of last modification | Share capital ( ) | Number of shares | Number of voting rights |
|---|---|---|---|
| 28-12-2009 | 4,563,996,485.00 | 4,563,996,485 | 4,563,996,485 |

Indicate whether different types of shares exist with different associated rights:

**No**

**A.2 List the direct and indirect holders of significant ownership interests in your organization at year-end, excluding directors:**

| Name or corporate name of shareholder | Number of direct voting rights | Number of indirect voting rights (*) | % of total voting rights |
|---|---|---|---|
| Banco Bilbao Vizcaya Argentaria, S.A. | 257,947,943 | 269,194 | 5.658 |
| Caja de Ahorros y Pensiones de Barcelona, la Caixa | 0 | 246,898,917 | 5.410 |
| Blackrock, Inc. | 0 | 177,257,649 | 3.884 |

| Name or corporate name of indirect shareholder | Through: name or corporate name of direct shareholder | Number of direct voting rights | % of total voting rights |
|---|---|---|---|
| Banco Bilbao Vizcaya Argentaria, S.A. | BBVA Broker Correduria de Seguros y Reaseguros, S.A. | 12,000 | 0.000 |
| Banco Bilbao Vizcaya Argentaria, S.A. | BBVA Seguros, S.A. de Seguros y Reaseguros | 257,194 | 0.006 |
| Caja de Ahorros y Pensiones de Barcelona, la Caixa | Caixabank, S.A. | 246,855,309 | 5.409 |
| Caja de Ahorros y Pensiones de Barcelona, la Caixa | VidaCaixa, S.A. de Seguros y Reaseguros | 43,608 | 0.001 |
| Blackrock, Inc. | Blackrock Investment Management (UK) | 177,257,649 | 3.884 |

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

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

| Name or corporate name of director | Number of direct voting rights | Number of indirect voting rights (*) | % of total voting rights |
|---|---|---|---|
| Mr. César Alierta Izuel | 4,228,033 | 78,000 | 0.094 |
| Mr. Isidro Fainé Casas | 495,827 | 0 | 0.011 |
| Mr. José María Abril Pérez | 92,160 | 98,609 | 0.004 |
| Mr. Julio Linares López | 408,128 | 1,840 | 0.009 |
| Mr. Alfonso Ferrari Herrero | 571,364 | 18,999 | 0.013 |
| Mr. Antonio Massanell Lavilla | 2,286 | 0 | 0.000 |
| Mr. Carlos Colomer Casellas | 16,664 | 63,190 | 0.002 |
| Mr. David Arculus | 10,500 | 0 | 0.000 |

| Name or corporate name of director | Number of direct voting rights | Number of indirect voting rights (*) | % of total voting rights |
|---|---|---|---|
| Mr. Francisco Javier de Paz Mancho | 53,852 | 0 | 0.001 |
| Mr. Gonzalo Hinojosa Fernández de Angulo | 85,476 | 436,000 | 0.011 |
| Mr. Ignacio Moreno Martínez | 12,387 | 0 | 0.000 |
| Mr. José Fernando de Almansa Moreno-Barreda | 19,349 | 0 | 0.000 |
| Mr. José María Álvarez-Pallete López | 317,297 | 0 | 0.007 |
| Mr. Luiz Fernando Furlán | 10,100 | 0 | 0.000 |
| Ms. María Eva Castillo Sanz | 94,600 | 0 | 0.002 |
| Mr. Pablo Isla Álvarez de Tejera | 8,601 | 0 | 0.000 |
| Mr. Peter Erskine | 69,259 | 0 | 0.002 |

**% of total voting rights held by the Board of Directors** **0.158**

Complete the following tables on share options held by directors.

| Name or corporate name of director | Number of direct share options | Number of indirect share options | Equivalent number of shares | % of total voting rights |
|---|---|---|---|---|
| Mr. César Alierta Izuel | 344,613 | 0 | 344,613 | 0.008 |
| Mr. César Alierta Izuel 2 | 100,000 | 0 | 10,000,000 | 0.002 |
| Mr. César Alierta Izuel 3 | 249,917 | 0 | 390,496 | 0.005 |
| Mr. Julio Linares López | 258,460 | 0 | 258,460 | 0.006 |

| Name or corporate name of director | Number of direct share options | Number of indirect share options | Equivalent number of shares | % of total voting rights |
|---|---|---|---|---|
| Mr. Julio Linares López 2 | 149,950 | 0 | 234,298 | 0.003 |
| Mr. Carlos Colomer Casellas | 63,508 | 0 | 0 | 0.001 |
| Mr. José María Álvarez-Pallete López | 156,642 | 0 | 156,642 | 0.003 |
| Mr. José María Álvarez-Pallete López 2 | 79,519 | 0 | 124,249 | 0.002 |

**A.4 Indicate, as applicable, any family, commercial, contractual or corporate relationships between owners of significant shareholdings, insofar as these are known by the company, unless they are insignificant or arise from ordinary trading or exchange activities.**

**A.5 Indicate, as applicable, any commercial, contractual or corporate relationships between owners of significant shareholdings, and the company and/or its group, unless they are insignificant or arise from ordinary trading or exchange activities.**

**Type of relationship:**

Corporate

**Brief description:**

Joint shareholding with Telefónica Móviles España, S.A.U. in Mobipay España, S.A.

**Name or company name of related party**

Banco Bilbao Vizcaya Argentaria, S.A.

**A.6 Indicate whether any shareholders agreements have been notified to the company pursuant to article 112 of the Securities Market Act (Ley del Mercado de Valores). Provide a brief description and list the shareholders bound by the agreement, as applicable.**

**Yes**

**% of share capital affected:**

0.87

**Brief description of the agreement:**

In accordance with the provisions of article 112, section 2 of the Securities Market Act 24/1988, of July 28 (currently replaced by article 531 section 1 of the revised text of the Corporate Enterprises Act approved by Royal Legislative decree 1/2010, of 2 July), on 22 October 2009, the Company notified the Spanish Securities Commission in writing that on September 6, 2009 it had entered into a mutual share exchange agreement between Telefónica and China Unicom (Hong Kong) Limited, whose clauses 8.3 and 9.2 are considered a shareholder agreement as per article 530 of the Corporate Enterprises Act. By virtue of these clauses, Telefónica may not, while the strategic alliance agreement is in force, offer, issue or sell a significant number of its shares or any convertible security or security that confers the right to subscribe or acquire a significant number of shares of Telefónica, S.A. to any of the main competitors of China Unicom (Hong Kong) Limited. In addition, China Unicom (Hong Kong) Limited undertook not to sell, use or transfer, directly or indirectly, for a period of one year its share in Telefónica s voting share capital (excluding intragroup transfers). This undertaking is without effect, the aforementioned period of one year having expired.

At the same time, both parties also assumed similar obligations with respect to the share capital of China Unicom (Hong Kong) Limited.

This mutual share exchange agreement, which includes the shareholder agreement, was filed with the Madrid Mercantile Registry on November 24, 2009.

**Members of the shareholders agreement:**

China Unicom (Hong Kong) Limited

Telefónica, S.A.

Indicate whether the company is aware of the existence of any concerted actions among its shareholders. Give a brief description as applicable.

**No**

Expressly indicate any amendments to or termination of such agreements or concerted actions during the year.

Expanding on the existing strategic partnership, on January 23, 2011, Telefónica, S.A. and China Unicom (Hong Kong) Limited ( China Unicom ) signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. Telefónica agreed to acquire through its subsidiary Telefónica Internacional, S.A.U. a number of China Unicom shares to the value of 500 million US dollars from third parties, within nine months from the agreement date. In recognition of China Unicom s stake in Telefónica, the latter commits to proposing the appointment of a board member nominated by China Unicom in the next General Shareholders Meeting, in accordance with prevailing legislation and the Company s Bylaws. The General Shareholders Meeting held on 18 May 2011 duly approved the appointment of China Unicom s nominee, Mr. Chang Xiaobing, as member of the Board of Directors.

China Unicom completed the acquisition of Telefónica shares on January 28, 2011, giving it ownership of 1.37% of the Company s capital.

The Telefónica Group purchased China Unicom shares during 2011 to the amount of 358 million euros. At 31 December 2011 the Telefónica Group held a 9.57% stake in the company.

**A.7 Indicate whether any individuals or bodies corporate currently exercise control or could exercise control over the company in accordance with article 4 of the Spanish Securities Market Act. If so, identify.**

**No**

**A.8 Complete the following tables on the company s treasury shares.**

**At year-end:**

| Number of shares held directly | Number of shares held indirectly (*) | % of total share capital |
|---|---|---|
| 84,209,363 | 1 | 1.845 |

**(*) Through:**

| Name or corporate name of direct shareholder | Number of shares held directly |
|---|---|
| Telefónica Móviles Argentina, S.A. | 1 |
| **Total:** | **1** |

Give details of any significant changes during the year, in accordance with Royal Decree 1362/2007.

| Date of notification | Total number of direct shares acquired | Total number of indirect shares acquired | % of total share capital |
|---|---|---|---|
| 06/07/2011 | 46,623,681 | 164,444 | 1.016 |

| | |
|---|---|
| **Gain/(loss) on treasury shares sold during the year (thousands of euros)** | **3,473** |

**A.9 Give details of the applicable conditions and time periods governing any resolutions of the General Shareholders Meeting authorizing the Board of Directors to purchase and/or transfer the treasury shares.**

At the General Shareholders Meeting of Telefónica of June 2, 2010, shareholders renewed the authorization granted by the General Shareholders Meeting of June 23, 2009, for the derivative acquisition of treasury shares, either directly or through Group companies, in the terms literally transcribed below:

To authorize, pursuant to the provisions of Section 75 et seq. of the Spanish Companies Act [Ley de Sociedades Anónimas, or LSA for its initials in Spanish], the derivative acquisition by Telefónica, S.A. either directly or through any of the subsidiaries of which it is the controlling company at any time and as many times as it deems appropriate, of its own fully- paid shares through purchase and sale, exchange or any other legal transaction.

The minimum price or consideration for the acquisition shall be equal to the par value of the shares of its own stock acquired, and the maximum acquisition price or consideration for the acquisition shall be equal to the listing price of the shares of its own stock acquired by the Company on an official secondary market at the time of the acquisition.

Such authorization is granted for a period of 5 years as from the date of this General Shareholders Meeting and is expressly subject to the limitation that the par value of the Company s own shares acquired pursuant to this authorization added to those already held by Telefónica, S.A. and any of its controlled subsidiaries shall at no time exceed the maximum amount permitted by the Law at any time, and the limitations on the acquisition of the Company s own shares established by the regulatory Authorities of the markets on which the shares of Telefónica, S.A. are traded shall also be observed.

It is expressly stated for the record that the authorization granted to acquire shares of its own stock may be used in whole or in part to acquire shares of Telefónica, S.A. that it must deliver or transfer to directors or employees of the Company or of companies of its Group, directly or as a result of the exercise by them of option rights, all within the framework of duly approved compensation systems referencing the listing price of the Company s shares.

To authorize the Board of Directors, as broadly as possible, to exercise the authorization granted by this resolution and to implement the other provisions contained therein; such powers may be delegated by the Board of Directors to the Executive Commission, the Executive Chairman of the Board of Directors, the Chief Operating Officer or any other person expressly authorized by the Board of Directors for such purpose.

To deprive of effect, to the extent of the unused amount, the authorization granted under Item IV on the Agenda by the Ordinary General Shareholders Meeting of the Company on June 23, 2009

**A.10 Indicate, as applicable, any restrictions imposed by Law or the company s bylaws on exercising voting rights, as well as any legal restrictions on the acquisition or transfer of ownership interests in the share capital.**

Indicate whether there are any legal restrictions on exercising voting rights:

**No**

| | |
|---|---|
| Maximum percentage of legal restrictions on voting rights a shareholder can exercise | 0 |

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Indicate whether there are any restrictions included in the bylaws on exercising voting rights.

**No**

| | |
|---|---|
| Maximum percentage of restrictions under the company s bylaws on voting rights a shareholder can exercise | 0 |

Indicate if there are any legal restrictions on the acquisition or transfer of share capital.

**No**

**A.11 Indicate whether the General Shareholders Meeting has agreed to take neutralization measures to prevent a public takeover bid by virtue of the provisions of Act 6/2007.**

**No**

If applicable, explain the measures adopted and the terms under which these restrictions may be lifted.

## B COMPANY MANAGEMENT STRUCTURE

### B.1 Board of Directors

#### B.1.1. List the maximum and minimum number of directors included in the bylaws.

| | |
|---|---|
| Maximum number of directors | 20 |
| Minimum number of directors | 5 |

#### B.1.2 Complete the following table with board members details.

| Name or corporate name of director | Representative | Position on the board | Date of first appointment | Date of last appointment | Election procedure |
|---|---|---|---|---|---|
| Mr. César Alierta Izuel | | Chairman | 29 -01-1997 | 10-05-2007 | Vote at General Shareholders Meeting |

| Name or corporate name of director | Representative | Position on the board | Date of first appointment | Date of last appointment | Election procedure |
|---|---|---|---|---|---|
| Mr. Isidro Fainé Casas | | Vice Chairman | 26-01-1994 | 18-05-2011 | Vote at General Shareholders Meeting |
| Mr. José María Abril Pérez | | Vice Chairman | 25-07-2007 | 22-04-2008 | Vote at General Shareholders Meeting |
| Mr. Julio Linares López | | Chief Operating Officer | 21-12-2005 | 18-05-2011 | Vote at General Shareholders Meeting |
| Mr. Alfonso Ferrari Herrero | | Director | 28-03-2001 | 18-05-2011 | Vote at General Shareholders Meeting |
| Mr. Antonio Massanell Lavilla | | Director | 21-04-1995 | 18-05-2011 | Vote at General Shareholders Meeting |
| Mr. Carlos Colomer Casellas | | Director | 28-03-2001 | 18-05-2011 | Vote at General Shareholders Meeting |
| Mr. Chang Xiaobing | | Director | 18-05-2011 | 18-05-2011 | Vote at General Shareholders Meeting |
| Mr. David Arculus | | Director | 25-01-2006 | 18-05-2011 | Vote at General Shareholders Meeting |
| Mr. Francisco Javier de Paz Mancho | | Director | 19-12-2007 | 22-04-2008 | Vote at General Shareholders Meeting |
| Mr. Gonzalo Hinojosa Fernández de Angulo | | Director | 12-04-2002 | 10-05-2007 | Vote at General Shareholders Meeting |
| Mr. Ignacio Moreno Martínez | | Director | 14-12-2011 | 14-12-2011 | Cooption |
| Mr. José Fernando de Almansa Moreno-Barreda | | Director | 26-02-2003 | 22-04-2008 | Vote at General Shareholders Meeting |
| Mr. José María Álvarez-Pallete López | | Director | 26-07-2006 | 10-05-2007 | Vote at General Shareholders Meeting |

| Name or corporate name of director | Representative | Position on the board | Date of first appointment | Date of last appointment | Election procedure |
|---|---|---|---|---|---|
| Mr. Luiz Fernando Furlán | | Director | 23-01-2008 | 22-04-2008 | Vote at General Shareholders Meeting |
| Ms. María Eva Castillo Sanz | | Director | 23-01-2008 | 22-04-2008 | Vote at General Shareholders Meeting |
| Mr. Pablo Isla Álvarez de Tejera | | Director | 12-04-2002 | 10-05-2007 | Vote at General Shareholders Meeting |
| Mr. Peter Erskine | | Director | 25-01-2006 | 18-05-2011 | Vote at General Shareholders Meeting |

| | |
|---|---|
| **Total number of directors** | 18 |

Indicate any board members who left during this period.

| Name or corporate name of director | Status of the director at the time | Leaving date |
|---|---|---|
| Mr. Vitalino Manuel Nafría Aznar | Proprietary | 14-12-2011 |

**B.1.3 Complete the following tables on Board members and their respective categories:**

**EXECUTIVE DIRECTORS**

| Name or corporate name of director | Committee proposing appointment | Post held in the company |
|---|---|---|
| Mr. César Alierta Izuel | Nominating, Compensation and Corporate Governance Committee | Executive Chairman |
| Mr. Julio Linares López | Nominating, Compensation and Corporate Governance Committee | Chief Operating Officer (C.O.O.) |
| Mr. José María Álvarez-Pallete López | Nominating, Compensation and Corporate Governance Committee | Chairman Telefónica Europe |

| | |
|---|---|
| **Total number of executive directors** | 3 |
| **% of the board** | 16.667 |

**EXTERNAL PROPRIETARY DIRECTORS**

| **Name or corporate name of director** | **Committee proposing appointment** | **Name or corporate name of significant shareholder represented or proposing appointment** |
|---|---|---|
| Mr. Isidro Fainé Casas | Nominating, Compensation and Corporate Governance Committee | Caja de Ahorros y Pensiones de Barcelona, la Caixa |
| Mr. José María Abril Pérez | Nominating, Compensation and Corporate Governance Committee | Banco Bilbao Vizcaya Argentaria, S.A. |
| Mr. Antonio Massanell Lavilla | Nominating, Compensation and Corporate Governance Committee | Caja de Ahorros y Pensiones de Barcelona, la Caixa |
| Mr. Chang Xiaobing | Nominating, Compensation and Corporate Governance Committee | China Unicom (Hong Kong) Limited |
| Mr. Ignacio Moreno Martínez | Nominating, Compensation and Corporate Governance Committee | Banco Bilbao Vizcaya Argentaria, S.A. |

| | |
|---|---|
| **Total number of proprietary directors** | 5 |
| **% of the board** | 27.778 |

**INDEPENDENT EXTERNAL DIRECTORS**

| **Name or corporate name of director** | **Profile** |
|---|---|
| Mr. Alfonso Ferrari Herrero | Industrial Engineer. Formerly Executive Chairman of Beta Capital, S.A. and senior manager at Banco Urquijo. |
| Mr. Carlos Colomer Casellas | Graduate in Economics. Chairman of the Colomer Group. |
| Mr. David Arculus | Graduate in Engineering and Economics. Director of Pearson, Plc., Chairman of Numis, Plc., and Aldemore Bank, Plc. |

| Name or corporate name of director | Profile |
|---|---|
| Mr. Francisco Javier de Paz Mancho | Graduate in Information and Advertising. Law Studies. IESE Business Management Program. Formerly Chairman of the State- owned company MERCASA. |
| Mr. Gonzalo Hinojosa Fernández de Angulo | Industrial Engineer. Formerly Chairman and CEO of Cortefiel Group. |
| Mr. Luiz Fernando Furlán | Degrees in chemical engineering and business administration, specializing in financial administration. From 2003 to 2007 he was Minister of Development, Industry and Foreign Trade of Brazil. |
| Ms. María Eva Castillo Sanz | Degrees in Business, Economics and Law. Previously Head of Merrill Lynch s Private Banking operations in Europe, the Middle East, & Africa (EMEA). |
| Mr. Pablo Isla Álvarez de Tejera | Law Graduate. Member of the Body of State Lawyers (on sabbatical). Chairman and CEO of Inditex, S.A. |

| | |
|---|---|
| **Total number of independent directors** | 8 |
| **% of the board** | 44.444 |

**OTHER EXTERNAL DIRECTORS**

| Name or corporate name of director | Committee proposing appointment |
|---|---|
| Mr. José Fernando de Almansa Moreno-Barreda | Nominating, Compensation and Corporate Governance Committee |
| Mr. Peter Erskine | Nominating, Compensation and Corporate Governance Committee |

| | |
|---|---|
| **Total number of other external directors** | 2 |
| **% of the board** | 11.111 |

List the reasons why these cannot be considered proprietary or independent directors and detail their relationships with the company, its executives or shareholders.

| Name or corporate name of director | Reasons | Company, executive or shareholder with whom the relationship is maintained |
|---|---|---|
| Mr. Peter Erskine | On December 31, 2007, Mr. Peter Erskine resigned from his managerial post in the Telefónica Group and therefore went from being an Executive Director to being classified in the Other external directors category. | Telefónica, S.A. |
| Mr. José Fernando de Almansa Moreno-Barreda | Mr. de Almansa was appointed a Member of the Board of Directors of Telefónica, S.A. with the qualification of independent Director, on February 26, 2003, following a favorable report from the Nominating, Compensation and Corporate Governance Committee. | |
| | In accordance with the criteria established in the Unified Code on Good Governance with regard to the qualification of Directors and taking into account the concurrent circumstances in this specific case, the Company considers that Mr. Almansa belongs to the category of other external directors , for the following reasons: | BBVA Bancomer |
| | He is an Acting Director (independent and non-proprietary) of Grupo Financiero BBVA Bancomer, S.A. de C.V. (controlling company of BBVA Group related to financial services in Mexico) and of BBVA Bancomer, S.A., and has never had an executive role. | |
| | He was the CEO of the Mexican company Servicios Externos de Apoyo Empresarial, S.A. de C.V., belonging to the BBVA Group, until March 2008. | |

List any changes in the category of each director which have occurred during the year.

**B.1.4 Explain, when applicable, the reasons why proprietary directors have been appointed upon the request of shareholders who hold less than 5% of the share capital.**

| Name or corporate name of shareholder | Reasons |
|---|---|
| China Unicom (Hong Kong) Limited | As explained in section A.6 of this report, on January 23, 2011, expanding on their existing strategic partnership, Telefónica, S.A. and China Unicom (Hong Kong) Limited ( China Unicom ) signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. Telefónica also agreed to propose the appointment of a board member nominated by China Unicom in the next General Shareholders Meeting, in accordance with prevailing legislation and the Company s Bylaws.<br><br>The General Shareholders Meeting held on 18 May 2011 approved the appointment of China Unicom s nominee, Mr. Chang Xiaobing, as member of the Board of Directors in accordance with the addendum to the Strategic Partnership Agreement signed in January 2011. This commitment to China Unicom is a consequence of the Strategic Partnership, which is intended to strengthen Telefónica s position in the global communications market. |

Provide details of any rejections of formal requests for board representation from shareholders whose equity interest is equal to or greater than that of other shareholders who have successfully requested the appointment of proprietary directors. If so, explain why these requests have not been entertained.

**No**

**B.1.5 Indicate whether any director has resigned from office before their term of office has expired, whether that director has given the board his/her reasons and through which channel. If made in writing to the whole board, list below the reasons given by that director.**

**Yes**

| Name of director | Reasons for resignation |
|---|---|
| Mr. Vitalino Manuel Nafría Aznar | Mr. Vitalino Manuel Nafri Aznar tendered his voluntary resignation verbally to the Chairman of the Board of Directors, citing personal reasons. The rest of the Board was duly notified at the meeting held on 14 December, 2011. |

**B.1.6 Indicate what powers, if any, have been delegated to the Chief Executive Officer.**

**Mr. César Alierta Izuel Executive Chairman (Chief Executive Officer):**

The Chairman of the Company, as the Chief Executive Officer, has been expressly delegated all the powers of the Board of Directors, except those that cannot be delegated by Law, by the Company Bylaws, or by the Regulations of the Board of Directors which establish, in Article 5.4, the competencies that the Board of Directors reserves itself, and may not delegate.

Article 5.4 specifically stipulates that the Board of Directors reserves the power to approve: (i) approve the general policies and strategies of the Company; (ii) evaluate the performance of the Board of Directors, its Committees and the Chairman; (iii) appoint Senior Executives, as well as the remuneration of Directors and Senior Executives; and (iv) decide strategic investments.

**Mr. Julio Linares López Chief Operating Officer:**

The Chief Operating Officer has been delegated those powers of the Board of Directors related to the management of the business and the performance of the highest executive functions over all the Company s business areas, except those which cannot be delegated by Law, under the Company Bylaws or according to the Regulations of the Board of Directors.

**B.1.7 List the directors, if any, who hold office as directors or executives in other companies belonging to the listed company s group.**

| Name or corporate name of director | Corporate name of the group company | Post |
|---|---|---|
| Mr. Alfonso Ferrari Herrero | Telefónica Chile, S.A. | Acting Director |
| | Telefónica del Perú, S.A.A. | Director |
| Mr. Francisco Javier de Paz Mancho | Atento Inversiones y Teleservicios, S.A.U. | Chairman |
| | Telefónica Brasil, S.A. | Director |
| | Telefónica de Argentina, S.A. | Director |

| Name or corporate name of director | Corporate name of the group company | Post |
|---|---|---|
| Mr. José Fernando de Almansa Moreno-Barreda | Telefónica Brasil, S.A. | Director |
| | Telefónica de Argentina, S.A. | Director |
| | Telefónica del Perú, S.A.A. | Director |
| | Telefónica Móviles México, S.A. de C.V. | Director |
| Mr. José María Álvarez- Pallete López | Telefónica Czech Republic, a.s. | Chairman of Supervisory Board |
| | Telefónica DataCorp, S.A.U. | Director |
| | Telefónica de Argentina, S.A. | Acting Director |
| | Telefónica del Perú, S.A.A. | Director |