

TELEFONICA S A
Form 6-K
March 30, 2009

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FORM 6-K
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Report of Foreign Private Issuer
Pursuant to Rule 13a-16 or 15d-16
of the Securities Exchange Act of 1934
For the month of March, 2009
Commission File Number: 001-09531
Telefónica, S.A.
(Translation of registrant's name into English)
Distrito C, 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 ☐ Form 40-F ☐

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

Yes ☐ No ☐

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

Yes ☐ No ☐

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

Yes ☐ No ☐

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

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1. Telefónica 2008 Annual Accounts	
<u>Account Auditor's Report, Annual Accounts and Management Report of Telefónica, S.A., all for the Fiscal Year 2008</u>	
<u>Account Auditor's Report, Annual Accounts and Management Report of the Consolidated Group of Companies, all for the Fiscal Year 2008</u>	

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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 2008 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 at the next Annual General Shareholders Meeting of the Company, the dates of which will be announced in due course.

Madrid, March 30th, 2009

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AUDIT REPORT

TELEFÓNICA

Financial Statements and Management Report

for the year ended

December 31, 2008

ERNST & YOUNG

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ERNST & YOUNG

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Translation of a report and financial statements originally issued in Spanish. In the event of discrepancy the Spanish-language version prevails (See Note 22)

AUDIT REPORT ON THE FINANCIAL STATEMENTS

To the Shareholders of
Telefónica, S.A.

1. We have audited the financial statements of Telefónica, S.A., which comprise the balance sheet at December 31, 2008 and the income statement, the statement of changes in equity, the cash flow statement and the notes thereto for the year then ended, the preparation of which is the responsibility of the Company's Directors. Our responsibility is to express an opinion on the aforementioned financial statements taken as a whole, based upon work performed in accordance with auditing standards generally accepted in Spain, which require the examination, through the performance of selective tests, of the evidence supporting the financial statements and the evaluation of their presentation, of the accounting principles applied and of the estimates made.

2. The accompanying 2008 financial statements are the first prepared by the Directors under the Spanish GAAP enacted by Royal Decree 1514/2007. In this regard, in accordance with section one of Transitional Provision Four of said Royal Decree, these financial statements have been considered as first-time financial statements and, therefore, no comparative figures are included. Under heading "Issues relating to the transition to new accounting principles" of note 2.b to the financial statements, are provided the balance sheet and income statement included in the approved 2007 financial statements, which were prepared in accordance with generally accepted accounting principles and standards in force in Spain at that time. In addition, there is an explanation of the main differences between the accounting criteria applied in 2007 and those currently applicable, as well as the quantification of the impact on equity at January 1, 2008 (the date of transition) caused by the change in accounting criteria. Our opinion refers only to the financial statements for 2008. On February 28, 2008 we issued our audit report on the 2007 financial statements, prepared in conformity with generally accepted accounting principles and standards in force in Spain for that year, in which we expressed an unqualified opinion.

3. In our opinion, the accompanying 2008 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, 2008 and of the results of its operations, changes in equity and cash flow for the year then ended, and contain the required information necessary for their adequate interpretation and understanding, in conformity with the applicable accounting principles and standards generally accepted in Spain.

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

Inscrita en el Registro Mercantil de Madrid al

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

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

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ERNST & YOUNG

4. The accompanying 2008 management report contains such explanations as the Directors consider appropriate concerning the situation of Telefónica, S.A., 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 2008 financial statements. Our work as auditors is limited to verifying the management report in accordance with the scope mentioned in this paragraph, and does not include the review of information other than that obtained from the Company's accounting records.

ERNST & YOUNG, S.L.

/s/ José Luis Perelli Alonso
José Luis Perelli Alonso

March 6, 2009

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**TELEFÓNICA, S.A.
ANNUAL FINANCIAL STATEMENTS AND MANAGEMENT
REPORT FOR THE YEAR ENDED DECEMBER 31, 2008**

Table of Contents**TELEFÓNICA, S.A.****BALANCE SHEET AT DECEMBER 31***(Millions of euros)*

ASSETS	Note	2008
NON-CURRENT ASSETS		76,768
Intangible assets	5	81
Patents, licenses, trademarks, et al.		4
Software		15
Other intangible assets		62
Property, plant and equipment	6	404
Land and buildings		178
Plant and other PP&E items		207
Property, plant and equipment under construction and prepayments		19
Investment property	7	336
Land		65
Buildings		271
Investment in group companies and associates	8	69,889
Equity instruments in group companies and associates		63,795
Loans to group companies and associates		6,070
Other financial assets with group companies and associates		24
Non-current financial investments	9	4,253
Investment in other companies		383
Loans to third parties		25
Derivatives	16	3,458
Other financial assets		387
Deferred tax assets	17	1,805
CURRENT ASSETS		11,673
Trade and other receivables	10	546
Investments in group companies and associates	8	9,512
Loans to group companies and associates		9,383
Derivatives		101
Other financial assets		28
Current financial investments	9	1,002
Loans to companies		46
Derivatives	16	956
Accruals		8
Cash and cash equivalents		605
Cash and cash equivalents		605
TOTAL ASSETS		88,441

The accompanying Notes 1 to 22 and Appendix I are an integral part of this balance sheet.

Table of Contents**TELEFÓNICA, S.A.****BALANCE SHEET AT DECEMBER 31***(Millions of euros)*

EQUITY AND LIABILITIES	Note	2008
EQUITY		27,326
CAPITAL AND RESERVES		27,477
Share capital	11	4,705
Share premium	11	460
Reserves	11	24,087
Legal reserve		984
Other reserves		23,103
Treasury shares and own equity instruments	11	(2,179)
Profit for the year	3	2,700
Interim dividend	3	(2,296)
UNREALIZED GAINS (LOSSES) RESERVE	11	(151)
Available-for-sale financial assets		(229)
Hedging instruments		78
NON-CURRENT LIABILITIES		41,317
Provisions		42
Other provisions		42
Borrowings	12	9,761
Debentures, bonds and other marketable debt securities	13	288
Interest-bearing debt	14	7,225
Derivatives	16	2,241
Other financial liabilities		7
Payables to group companies and associates	15	30,955
Deferred tax liabilities	17	559
CURRENT LIABILITIES		19,798
Provisions		5
Borrowings	12	3,059
Debentures, bonds and other marketable debt securities	13	1,567
Interest-bearing debt	14	788
Derivatives	16	704
Payables to group companies and associates	15	16,568
Trade and other payables		164
Accruals		2
TOTAL EQUITY AND LIABILITIES		88,441

The accompanying Notes 1 to 22 and Appendix I are an integral part of this balance sheet.

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Table of Contents**TELEFÓNICA, S.A.****INCOME STATEMENT FOR THE YEAR ENDED DECEMBER 31**

<i>(Millions of euros)</i>	Note	2008
Revenue from operations	18.1	363
Rendering of services group companies and associates		357
Rendering of services non-group companies		6
Other operating income	18.2	109
Non-core and other current operating revenues group companies and associates		93
Non-core and other current operating revenues non-group companies		16
Personnel expenses	18.3	(167)
Wages, salaries		(150)
Social security costs and other personnel expenses		(17)
Other operating expenses		(384)
External services group companies and associates	18.5	(78)
External services non-group companies	18.5	(290)
Taxes other than income tax		(16)
Depreciation and amortization	5, 6 y 7	(72)
OPERATING PROFIT		(151)
Finance revenue	18.6	8,227
From equity investments		7,176
In group companies and associates		7,135
In third parties		41
From marketable securities and other financial instruments		1,051
Of group companies and associates		891
Of third parties		160
Finance costs	18.7	(3,027)
Borrowings from group companies and associates		(2,652)
Third-party borrowings		(342)
Provision discount adjustment		(33)
Change in fair value of financial instruments		5
Trading portfolio and other securities		(6)
Gains on available-for-sale financial assets recognized in the period		11
Exchange gains (losses)	18.8	(57)
Impairment and gains (losses) on disposal of financial instruments	18.9	(4,219)
Impairment losses and losses	8.2	(4,182)
Gains (losses) on disposal and other gains and losses		(37)
NET FINANCE REVENUE		929
PROFIT BEFORE TAX	20	778
Income tax	17.2	1,922
PROFIT FOR THE YEAR		2,700

The accompanying Notes 1 to 22 and Appendix I are an integral part of this income statement.

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Table of Contents**TELEFÓNICA, S.A.****STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED DECEMBER 31****A) STATEMENT OF RECOGNIZED INCOME AND EXPENSE**

<i>(Millions of euros)</i>	Note	2008
Profit for the period		2,700
Income and expense recognized directly in equity	11.2	(405)
From measurement of financial instruments		(390)
Available-for-sale financial assets		(390)
From cash flow hedges		(189)
Tax effect		174
Amounts transferred to income statement	11.2	27
From measurement of financial instruments		(11)
Available-for-sale financial assets		(11)
From cash flow hedges		50
Tax effect		(12)
TOTAL RECOGNIZED INCOME AND EXPENSE		2,322

The accompanying Notes 1 to 22 and Appendix I are an integral part of this statement of recognized income and expense.

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TELEFÓNICA, S.A.

B) TOTAL STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED DECEMBER 31

	Share	Share		Treasury	Retained	Profit	Interim	Net unrealized gains (losses)	
(Millions of euros)	capital	premium	Reserves	shares and own equity instruments	earnings	for the year	dividend	reserve	TOTAL
Balance in financial statements at December 31, 2007	4,773	521	7,991		6,620		(1,652)		18,253
Impact of transition to new accounting principles (Note 2.b)		1,075	12,962	(1,074)				227	13,190
Balance at January 1, 2008	4,773	1,596	20,953	(1,074)	6,620		(1,652)	227	31,443
Total recognized income and expense						2,700		(378)	2,322
Transactions with shareholders and owners	(68)	(1,136)	(1,875)	(1,105)			(2,296)		(6,480)
Capital decreases	(68)	(1,136)		1,204					
Dividends paid			(1,869)				(2,296)		(4,165)
Transactions with treasury shares or own equity instruments (net)			(6)	(2,309)					(2,315)
Appropriation of prior year profit			4,968		(6,620)		1,652		
Other changes in equity			41						41
Balance at December 31, 2008	4,705	460	24,087	(2,179)		2,700	(2,296)	(151)	27,326

The accompanying Notes 1 to 22 and Appendix I are an integral part of this total statement of changes in equity.

Table of Contents**TELEFÓNICA, S.A.****CASH FLOW STATEMENT FOR THE YEAR ENDED DECEMBER 31**

<i>(Millions of euros)</i>	Notes	2008
A) CASH FLOWS FROM OPERATING ACTIVITIES		8,068
Profit before tax		778
Adjustments to profit:		(857)
Depreciation and amortization		72
Gains on disposal of consolidated companies	8.1	(3)
Impairment of investments in group companies and associates	8.2	4,182
Impairment of investments in non-group companies		1
Losses on disposal of financial assets, securities portfolio		39
	18.6 y	
Net financial expense	18.7	(5,148)
Change in working capital		(301)
Trade and other receivables		(250)
Other current assets		(16)
Trade and other payables		(96)
Other current liabilities		(4)
Other non-current assets and liabilities		65
Other cash flows from operating activities	20	8,448
Net interest paid		(2,644)
Dividends received		8,248
Income tax receipts (payments)	20	2,844
B) CASH FLOWS FROM INVESTING ACTIVITIES		(762)
Payments on investments	20	(2,983)
Proceeds from disposals	20	2,221
C) CASH FLOWS FROM FINANCING ACTIVITIES		(8,935)
Proceeds from/(payments on) equity instruments	11.a	(2,224)
Proceeds from/(payments on) financial liabilities	20	(2,547)
Dividends paid	11.d	(4,165)
D) NET FOREIGN EXCHANGE DIFFERENCE		321
E) NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		(1,308)
Cash and cash equivalents at January 1		1,913
Cash and cash equivalents at December 31		605
Notes 1 to 22 and Appendix I are an integral part of this cash flow statement.		

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TELEFÓNICA, S.A.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2008**

(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

The accompanying 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 Commercial Code, developed in Spanish GAAP in force 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 2008.

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.

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b) Comparison of information

In accordance with the first final first provision of Law 16/2007, dated July 4, on the adaptation of commercial legislation on accounting for international harmonization based on EU regulations, Spanish GAAP has been altered considerably. The new principles were approved by Royal Decree 1514/2007 of November 16. Telefónica is required to apply the new accounting principles (known as PGC 2007) in the preparation and presentation of its separate financial reporting for the year beginning January 1, 2008. Therefore, the financial statements for the year ended December 31, 2008 have been prepared in accordance with the new recognition and measurement policies.

The Company has considered January 1, 2008 to be the transition date, and therefore has not included comparative figures in these annual financial statements.

The financial statements for the year ended December 31, 2007, approved by the shareholders of Telefónica, S.A. in their ordinary general meeting held on April 22, 2008, were prepared in accordance with accounting principles and valuation criteria generally accepted in Spain at that time (former accounting principles).

Issues relating to the transition to new accounting principles

The first transitional provision of RD 1514/2007 prescribes the procedure for the first-time application of the new accounting principles in the preparation of the financial statements for the year beginning on or after January 1, 2008. In general, the criteria contained in the new principles must be applied retroactively, with certain exceptions.

The starting point is the preparation of an opening balance sheet applying the new principles at the *transition date*. This date is the beginning of the first period presented under the new principles; which in the case of Telefónica is January 1, 2008. Pursuant to rules established in the first transitional provision, Telefónica has elected to measure all assets and liabilities in accordance with the previous accounting principles except for financial instruments, which are measured at fair value.

The fair value of financial assets designated as at Fair value through profit or loss amounted to 4,414 million euros (see Note 9.2). These assets are derivatives and in accordance with the former principles do not appear in the balance sheet in the financial statements for the year ended December 31, 2007. The opening balance at January 1, 2008 showed an amount for derivatives of 1,667 million euros.

In accordance with the fourth transitional provision of Royal Decree 1514/2007 of November 16 approving the new accounting principles, following is a description of the main differences between the accounting policies applied in 2007 and 2008, and between the balance sheet and income statement included in the financial statements for the year ended December 31, 2007, which were prepared under the accounting policies in force at that time, and those included in the financial statements for 2008.

Table of Contents**1. Description of the main differences between the accounting policies applied in 2007 and 2008**

The preparation of financial statements under the new accounting principles results in a series of modifications to the presentation and measurement standards applied by the Company until December 31, 2007, as certain of the new principles and requirements are substantially different to those applied previously.

The main differences between the accounting principles applied in the year ended December 31, 2008 (new accounting principles) and those applied in the preparation of the financial statements for the year ended December 31, 2007 (former accounting principles), and their impact on equity at January 1, 2008, are described below.

Reconciliation of equity at January 1, 2008 under the former and new accounting policies

<i>(Millions of euros)</i>	Equity
At December 31, 2007 under former accounting principles	18,253
Provisions for impairment of investments in group companies, joint ventures and associates (Note 8.2)	13,162
Treasury shares	(232)
Measurement of financial instruments at fair value and debt at amortized cost, net of tax effect	182
Measurement of other investments	51
Share-based payments/equity settled transactions	24
Other adjustments	3
Total adjustments	13,190
Equity under at January 1, 2008 under new accounting principles	31,443

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

Under the new policies, impairment losses on investments in group companies, joint ventures and associates are measured as the difference between the carrying amount of the investment and its recoverable amount, which is the greater 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).

Only of special purpose vehicles with scant operations, where drawing up a business plan is not feasible, Telefónica, S.A. continues to measure impairment loss as the difference between cost and the carrying amount of their equity at acquisition unless there is better evidence to the contrary, in accordance with the criteria of PGC 2007.

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The difference between the policies for measuring impairment of investments in Group companies, joint ventures and associates led to the reversal of investment provisions recognized in the balance sheet of 14,373 million euros, with a related tax effect of 1,211 million euros, resulting in a net increase in equity at January 1, 2008 of 13,162 million euros.

Treasury shares

Under the former accounting principles, treasury shares were classified as an asset (unless the shares were to be cancelled subject to an agreement approved at the General Shareholders Meeting prior to their acquisition) and carried at the lower of cost, market value or underlying carrying amount, written down as appropriate. Under the new accounting principles, treasury shares are recognized with a deduction from equity, while transactions with treasury shares are recognized in equity, not the income statement.

Accordingly, the net balance Short-term treasury stock at December 31, 2007 of 232 million euros has been reclassified to Equity Treasury shares and own equity instruments at January 1, 2008 under the new accounting principles.

Financial instruments

Under the former accounting principles, financial assets, including derivatives, were carried at the lower of cost or market value, while financial liabilities were carried at repayment value. Financial assets were removed from the balance sheet when they were sold, transferred or at maturity.

Under the PGC 2007, financial assets and liabilities are classified into certain categories which determine whether they are measured at fair value or amortized cost. In addition, certain unrealized gains and losses on financial instruments are taken directly to equity until the related instrument is derecognized or impaired. In addition, the PGC 2007 establishes very strict criteria for derecognizing financial assets, based on an assessment of the risk and rewards of ownership of the transferred asset. The application of hedge accounting criteria requires fulfilling very specific requirements.

The application of the new criteria for measuring derivative financial instruments led to an increase of 182 million euros in equity at January 1, 2008.

Measurement of other investments

Under the former accounting principles, minority interests in listed companies in which the Company did not have control or significant influence were measured at the lower of cost or market. Declines in value where cost exceeded market value were taken to the income statement. Meanwhile, increases in market value above cost were not recognized.

Under the new accounting principles, investments in listed companies in which the Company does not have control or significant influence are classified as available-for-sale investments and measured at each reporting date at fair value. Any increases or decreases in fair value are recognized in equity and not in the income statement until the investment is derecognized or impaired.

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The application of the new accounting criteria for available-for-sale investments led to an increase in equity, net of the corresponding tax effect, of 51 million euros at January 1, 2008.

Share-based payment for employees of subsidiaries with Telefónica, S.A. shares

In accordance with the former accounting principles, the obligations to deliver treasury shares of Telefónica, S.A. to employees of other Group subsidiaries pursuant to the terms of the Performance Share Plan (see Note 18.3) were considered a liability for the company delivering the treasury shares. In accordance with the new accounting principles, these obligations are taken to equity of the parent as an increase in unrestricted reserves until the delivery date.

The application of the new accounting policies for share-based payment involving treasury shares led to an increase in equity at January 1, 2008 of 24 million euros.

Income tax expense

Under the former accounting principles, the accounting treatment of deferred tax items is income-statement oriented, taking into consideration temporary differences between accounting income and taxable income. Conversely, under the PGC 2007 deferred taxes are recognized based on balance sheet analysis and the temporary differences considered are those generated as a result of the difference between the tax bases of assets and liabilities and their respective carrying amounts.

All the preceding adjustments are shown net of their tax effect.

2. Balance sheet and income statement included in the annual financial statements for the year ended December 31, 2007

For an easier comparison of the financial statements prepared under the former accounting principles and those prepared under the PGC 2007, the Company has included the latest financial statements prepared under the former principles.

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ASSETS (<i>millions of euros</i>)	2007
A) NON-CURRENT ASSETS	71,348
I. Intangible assets	97
Computer software	188
Industrial property	28
Other intangible assets	103
Accumulated amortization and provisions	(222)
II. Property, plant and equipment	765
Land and buildings	595
Plant and machinery	200
Furniture, tools and other items	36
Other items of property, plant and equipment	58
Property, plant and equipment under construction	22
Accumulated depreciation and provisions	(146)
III. Long-term investments	70,486
Investments in group companies	69,274
Investments in associates	3,025
Other investments	752
Loans to group companies and associates	10,281
Other loans	49
Long-term deposits and guarantees given	365
Tax receivables	2,116
Provisions	(15,376)
B) DEFERRED CHARGES	288
C) CURRENT ASSETS	11,514
I. Accounts receivable	584
Trade receivables	22
Receivable from group companies	212
Receivable from associates	14
Other accounts receivables	31
Tax receivables	327
Provision for bad debts	(22)
II. Short-term investments	8,758
Loans to group companies and associates	8,216
Short-term investment securities	542
III. Short-term treasury stock	232
IV. Cash	1,913
V. Prepayments and accrued income	27
TOTAL ASSETS (A + B + C)	83,150

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LIABILITIES (millions of euros)	2007
A) SHAREHOLDERS EQUITY	18,253
I. Share capital	4,773
II. Share premium	521
III. Revaluation reserves	191
IV. Reserves	7,800
Legal reserve	984
Reserve for treasury stock	232
Other reserves	6,584
V. Profit for the year	6,620
VI. Interim dividend paid in the year	(1,652)
B) PROVISIONS FOR LIABILITIES AND CHARGES	1,969
C) LONG-TERM LIABILITIES	42,276
I. Debentures, bonds and other marketable debt securities	1,097
Non-convertible debentures and bonds	916
Other marketable debt securities	181
II. Payable to credit institutions	8,435
III. Payable to group and associated companies	32,372
IV. Other payables	8
V. Taxes payable	364
D) CURRENT LIABILITIES	20,652
I. Debentures, bonds and other marketable debt securities	1,691
Non-convertible debentures and bonds	421
Other marketable debt securities	1,237
Interest on debentures and other securities	33
II. Payable to credit institutions	671
Loans and other accounts payables	607
Accrued interest payable	64
III. Payable to group and associated companies	18,008
IV. Trade accounts payable	95
V. Other non-trade payables	187
Taxes payable	27
Other non-trade payables	160
TOTAL LIABILITIES (A + B + C + D)	83,150

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DEBIT (millions of euros)	2007
A) EXPENSES	
Personnel expenses	156
Depreciation and amortization expense	65
Property, plant and equipment	34
Intangible assets	31
Other operating expenses	366
External services provided by group companies	69
External services	275
Taxes other than income tax	17
Other operating expenses	5
I. OPERATING PROFIT	
Financial and similar expenses	
From liabilities with group companies	2,585
From other liabilities and similar expenses	541
Amortization of deferred charges	69
Exchange losses	1,193
II. FINANCIAL PROFIT	14,083
III. INCOME FROM ORDINARY ACTIVITIES	13,724
Changes in provisions for securities investments	9,875
Extraordinary expenses and losses	480
IV. EXTRAORDINARY INCOME	
V. PROFIT BEFORE TAXES	5,178
Corporate income tax in Spain	(1,475)
Foreign taxes	33
VI. PROFIT FOR THE YEAR	6,620
CREDIT (millions of euros)	2007
B) REVENUES	
Net sales to group companies	90
Other operating revenues	138
Non-core and other current operating revenues group companies	118
Non-core and other current operating revenues non-group companies	20
I. OPERATING LOSS	359
Revenue from equity investments	15,335
Group companies	15,099
Associated companies	211
Non-group companies	25
Revenues from other securities and loans	1,165
Group companies	1,002
Other companies	163
Exchange gains	1,971
II. FINANCIAL LOSS	
III. LOSSES ON ORDINARY ACTIVITIES	
Gains on disposal of fixed assets	1,785
Extraordinary revenues	24

IV. EXTRAORDINARY LOSS	8,546
V. LOSSES BEFORE TAXES	
VI. LOSS FOR THE YEAR	

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c) Use of estimates

The Directors have prepared the financial statements 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. However, given the uncertainty inherent in them, the need may arise to make significant adjustments to the carrying amounts of assets and liabilities affected in future periods should changes occur in the assumptions or circumstances on which the resulting values were based.

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet 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 a material 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.

Table of Contents**(3) PROPOSED APPROPRIATION OF PROFIT**

Telefónica, S.A. obtained 2,700 million euros of profit in 2008. Accordingly, the Company's Board of Directors will submit the following proposed appropriation of 2008 profit for approval at the Shareholders' Meeting:

	<i>Millions of euros</i>
Proposed appropriation:	
Profit for the year	2,700
Appropriation to:	
Interim dividend (paid in November 2008)	2,296
Goodwill reserve	2
Voluntary reserves	402
At its meeting of September 24, 2008, Telefónica, S.A.'s Board of Directors resolved to pay an interim dividend against 2008 profit of a fixed gross 0.5 euros for each of the Company's outstanding shares carrying dividend rights. This dividend was paid on November 12, 2008, and the total amount paid was 2,296 million euros.	
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.	

	<i>Millions of euros</i>
Liquidity statement at September 19, 2008	
Income from January 1 through August 31, 2008	3,720
Mandatory appropriation to reserves	1
Distributable income	3,719
Proposed interim dividend (maximum amount)	2,352

Cash position at September 19, 2008

Funds available for distribution:	
Cash and cash equivalents	2,410
Unused credit facilities	5,578
Proposed interim dividend (maximum amount)	(2,352)
Difference	5,636
To ensure its liquidity requirements are met for 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 2008 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.

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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 their recoverability is assessed 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 three 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

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

Cost includes external and 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 cost due to the use of the assets.

The costs of expansion, modernization or improvement leading to increased productivity, capacity, or efficiency or to a lengthening of the useful lives of assets are capitalized when 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).

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The Company depreciates its property, plant and equipment once its 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
Furniture, tools and other items	10
Other items of property, plant and equipment	4 - 10

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

c) Impairment of non-current assets

Non-current assets, including property, plant and equipment, goodwill and other intangible assets are evaluated at each balance sheet 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 using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where 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 five years. For longer periods, 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 profit or loss and the depreciation charge is adjusted in future periods to the asset's revised carrying amount. Impairment losses relating to goodwill cannot be reversed in future periods.

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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 charges 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 charges are recognized in 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, associates and available-for-sale financial assets. Where 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. Group companies are those over which the Company controls, 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.

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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 twelve 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. Listed securities on active markets: Fair value is considered to be the quoted market price at the closing date.
2. Unlisted securities: 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 determined reliably, these investments are carried at cost.

Loans and receivables includes financial asset, 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 recognitions, 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 for impairment is recorded when there is objective evidence that the Company will not collect the debts. The amount of the provision 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.

The Company assesses at each balance sheet date whether a financial asset is impaired. If there is objective evidence that an impairment of a financial asset carried at amortized cost occurred, the amount of the loss is measured as the difference between the asset's carrying amount and 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 (or fair value when it can be measured reliably). If in a subsequent period the impairment loss decreases as a result of a subsequent event, the loss is reversed up to the asset's amortized cost had no impairment loss been recognized upon reversal. Such a reversal is recognized in the income statement of that year.

For equity instruments included in 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 fair value and any changes in fair value are taken to equity.

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Recoverable amount for estimating impairment of investments in group companies, joint ventures and associates is the higher of the investment's net 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 assumed an obligation to pay the cash flows received from the asset to a third party.
3. 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 in the balance sheet comprise 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 balance sheet 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.

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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 an unrecognized firm commitment, or
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 net investment in a foreign operation.

A hedge of the foreign currency risk in a firm commitment is accounted for as either 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 being 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 from a net investment in a foreign operation is accounted for in a similar manner to fair value hedges for the foreign currency component. 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.

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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 hedging 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 retroactively, 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.

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 adjusted at 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.

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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 balance sheet 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 carryforward of unused tax losses.

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 balance sheet date.

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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 balance sheet 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 balance sheet date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax liabilities on investments in subsidiaries, branches, associates and joint ventures are not recognized if the parent company is in a position to control the timing of the reversal and if the reversal is unlikely to take place in the foreseeable future.

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.

l) Related party transactions

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

m) Financial guarantees

The Company has provided guarantees to a number of subsidiaries to secure their transactions with third parties (see Note 19 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 on provisions and contingencies, and ii) The amount initially recognized less, when applicable, any amounts taken to the income statement corresponding to accrued income.

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As required under prevailing legislation, the Company has prepared separate consolidated annual accounts, 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 2008 are as follows:

Item	Millions of euros
Total assets	99,896
Equity:	19,562
Attributable to equity holders of the parent	17,231
Attributable to minority interests	2,331
Revenues from operations	57,946
Profit for the year:	7,826
Attributable to equity holders of the parent	7,592
Attributable to minority interests	234

(5) INTANGIBLE ASSETS

The movements in the items composing intangible assets and the related accumulated amortization in 2008 are as follows:

(Millions of euros)	Balance at January 1	Additions and allowances	Disposals	Transfers	Balance at December 31
INTANGIBLE ASSETS, GROSS	317	7	(15)	16	325
Patents, licenses, trademarks, et al.	28			1	29
Software	188	7	(14)	15	196
Other intangible assets	101		(1)		100
ACCUMULATED AMORTIZATION	(220)	(28)	4		(244)
Patents, licenses, trademarks, et al.	(24)	(1)			(25)
Software	(168)	(17)	4		(181)
Other intangible assets	(28)	(10)			(38)
Net carrying amount	97	(21)	(11)	16	81

Proceeds from disposals of intangible assets in 2008 were not material for the Company's income statement. At December 31, 2008, there were no commitments to acquire intangible assets. At December 31, 2008, the Company had 186 million euros of fully amortized intangible assets.

Table of Contents**(6) PROPERTY, PLANT AND EQUIPMENT**

6.1 The movements in the items composing property, plant and equipment and the related accumulated depreciation in 2008 are as follows:

<i>(Millions of euros)</i>	Balance at January 1	Additions and allowances	Disposals	Transfers	Balance at December 31
PROPERTY, PLANT AND EQUIPMENT, GROSS	549	33	(4)	(16)	562
Land and buildings	236	3			239
Plant and other PP&E items	291	14	(4)	3	304
Property, plant and equipment under construction	22	16		(19)	19
ACCUMULATED DEPRECIATION	(127)	(33)	2		(158)
Buildings	(59)	(2)			(61)
Plant and other PP&E items	(68)	(31)	2		(97)
Net carrying amount	422		(2)	(16)	404

Firm commitments to acquire property, plant and equipment at December 31, 2008 amounted to 7 million euros.

In 2008, no interest or other borrowing costs incurred in the construction of property, plant and equipment were capitalized.

At December 31, 2008, the Company had 24 million euros of fully depreciated 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.

At the end of 2008, this includes the net carrying amount of assets (mainly plant and property) related to the new central offices in the Las Tablas business park, called Distrito C, of 182 million euros. Also included is the net carrying amount of the land and buildings occupied by Telefónica, S.A. at the central offices of Distrito C of 98 million euros.

(7) INVESTMENT PROPERTIES

7.1 The movements in the items composing investment properties and the related accumulated depreciation in 2008 are as follows:

<i>(Millions of euros)</i>	Balance at January 1	Additions and allowances	Disposals	Transfers	Balance at December 31
INVESTMENT PROPERTIES, GROSS	358	3			361

Land	65		65
Buildings	293	3	296
ACCUMULATED DEPRECIATION	(15)	(10)	(25)
Buildings	(15)	(10)	(25)
Net carrying amount	343	(7)	336

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The Company has buildings with a total area of 322,422 m² leased to several Telefónica Group and other companies, equivalent to an occupancy rate of 98.3% of the buildings it has earmarked for lease.

Investment properties mainly includes the value of land and buildings leased by Telefónica, S.A. to other Group companies at the central offices of Distrito C in Madrid.

Total income from leased buildings amounted to 41 million euros in 2008 (see Note 18.1). Future minimum rentals receivable under non-cancellable leases are as follows:

<i>(Millions of euros)</i>	Future minimum payments	Present value
Up to one year	38	37
Between one and five years	74	66
Total	112	103

The main contract in which Telefónica, S.A. acts as lessee is described in Note 18.5.

(8) INVESTMENTS IN GROUP COMPANIES AND ASSOCIATES

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

<i>(Millions of euros)</i>	Balance at January 1	Additions	Disposals	Transfers	Exchange gains (losses)	Dividends	Hedges of net investment	Balance at December 31	Fair value
Non-current:									
- Equity instruments (Net) (1):	69,394	(3,801)	(95)			(194)	(1,509)	63,795	63,871
Equity instruments (Cost)	72,299	381	(95)			(194)	(1,509)	70,882	
Impairment losses	(2,905)	(4,182)						(7,087)	
- Loans to group companies and associates	10,289	264	(174)	(4,218)	(91)			6,070	6,070
- Other financial assets		24						24	24
Total investments in group companies and associates	79,683	(3,513)	(269)	(4,218)	(91)	(194)	(1,509)	69,889	69,965
Current:									
- Loans to group companies and associates	8,183	5,723	(8,659)	4,218	(82)			9,383	9,383
- Derivatives	55	96	(50)					101	101
- Other financial assets		28						28	28

**Investments in
group companies
and associates**

8,238	5,847	(8,709)	4,218	(82)		9,512	9,512
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- (1) Fair value at 12/31/08 of Group companies and associates quoted in an active market (Telefónica de Perú, S.A.A., Telefónica Móviles Perú and Telefónica O2 Czech Republic, a.s.) was calculated taking the listing of the investments on the last day of the year, and for the rest of the shareholdings at carrying amount.

Dividends received by Telefónica, S.A. in 2008 related to profits generated by subsidiaries prior to the acquisition date are deducted from the equity instruments related to the investments. These amounts come from Telefónica O2 Czech Republic, a.s. (178 million euros) and LE Holding Corp (16 million euros).

Disposals of current assets loans to group companies and associates includes the payment of dividends approved in 2007 and received in 2008. Also included is the cancellation of balances receivable from subsidiaries for belonging to Telefónica, S.A.'s tax group on debts with them (3,434 million euros).

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Telefónica, S.A. has arranged hedges of net investments in foreign operations for its investments in Telefónica O2 Europe, Ltd. and Telefónica O2 Czech Republic, a.s. for 1,509 million euros.

In 2008, Telefónica, S.A. bought and sold the following shareholdings:

- a) Acquisitions of shareholdings and capital increases:

Companies	<i>Millions of euros</i>
Subsidiaries:	
Telefónica O2 Europe, Ltd.	224
Telefónica Móviles Colombia, S.A.	155
Other	
Total subsidiaries	379
Associates:	
Other	2
Total associates:	2

In 2008, Telefónica, S.A. agreed to increase Telefónica O2 Europe, Ltd.'s capital by 224 million euros to raise financing for Telefónica Deutschland GmbH, a subsidiary of Telefónica O2 Europe, Ltd.

On January 17, 2008, Telefónica Móviles Colombia, S.A. issued an offer of subscription for the portion of its unsubscribed capital (499,000,000 new shares with par value of 1 peso). The new shares were fully subscribed by Telefónica, S.A. for a total of 155 million euros. As a result, Telefónica, S.A.'s stake in this company increased to 49.4%.

- b) Disposals of shareholdings and capital decreases:

Companies	<i>Millions of euros</i>
Subsidiaries:	
Telefónica Internacional Wholesale Services América, S.A.	58
Others	2
Total subsidiaries:	60
Associates:	
Portugal Telecom, S.G.P.S., S.A.	34
Adquira Spain, S.A.	1
Total associates:	35

On October 1, 2008, in the General Meeting of Shareholders of Telefónica Internacional Wholesale Services, S.A. for a partial reduction of capital by 75 million US dollars. As a result, Telefónica, S.A.'s stake in this company decreased from 80.56% to 78.22%.

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Pursuant to the requirements of Portugal Telecom, S.G.P.S.'s bylaws regarding maximum shareholdings, on December 18, 2008 Telefónica, S.A. reduced its stake in the company by 0.476% to 8.51%. This transaction led to a gain of 1.8 million euros, recognized in the income statement.

On May 6, 2008 Telefónica, S.A. transferred its stake in Telefónica Compras Electrónicas, S.L. to Telefónica Gestión de Servicios Compartidos, S.A., recognizing a gain of 2 million euros. On the same date, Telefónica, S.A. transferred its stake in Adquira Spain, S.A. to Telefónica Compras Electrónicas, S.L., recognizing a gain of 0.5 million euros.

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

On January 1, 2008, Telefónica, S.A. revised the recoverable amount of its investments in Group companies and associates (see Note 2 b), estimating the future cash flows derived from them. These revisions uncovered unrealized gains in the equity of these companies. Accordingly, at the transition date the investment portfolio provisions, net of the related tax effect, were reversed for an amount of 13,162 million euros (see Note 2 b).

This amount was reversed, with a balancing entry in the reserve for the first-time application in accordance with the rules for transition to the new accounting principles. This reserve is recorded as other reserves in the company's equity (see Note 11 c).

At December 31, 2008, Telefónica, S.A. re-estimated 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 and translated to euros at the official closing rate of each currency at that date.

The re-estimations of these amounts with respect to the opening balance sheet uncovered the need to write down the values of the shareholdings in Telefónica O2 Holding, Ltd., Telco, S.p.A. and Portugal Telecom, S.P.G.S. (see Note 18.9).

The write-down to the stake in Telefónica O2 Holding, Ltd. was due to the 23% depreciation of the pound sterling, although this was in part offset by Telefónica, S.A.'s hedges of its net investment in foreign operations.

The write-down to the stake in Telco, S.p.A. entails the write-down made by Telco, S.p.A. of its 10.36% ownership of the voting shares of Telecom Italia, S.p.A. (7.15% of the dividend rights). This impact was calculated taking into account the estimated synergies to be obtained, mainly in its European operations through the alliances reached with Telecom Italia, S.p.A.

8.3 The detail of the subsidiaries and associated companies is shown in Appendix I.

8.4 Transactions protected for tax purposes.

Transactions carried out in 2008 that are considered protected for tax purposes, as defined in Articles 83 or 94, as applicable, of Chapter VIII of Title VII of Legislative Royal Decree 4/2004 of March 5 approving the Revised Spanish Corporate Income Tax Law, are detailed in the following paragraphs.

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Only one transaction of this type involving subsidiaries belonging to the tax Group headed by Telefónica, S.A took place in 2008:

On October 28, 2008, the agreement for the merger and takeover of Viajar.com Viajes, S.L. and Terra Business Travel, S.A. by Red Universal de Marketing y Bookings Online, S.A. (RUMBO) was executed. As a result of this merger, the absorbing company, Red Universal Marketing y Bookings Online, S.A. (RUMBO), acquired all the rights and obligations of the absorbed companies.

8.5 The breakdown and maturity of loans to Group companies and associates is as follows:

Company (millions of euros)	2009	2010	2011	2012	2013	2014 and subsequent years	Final balance, current and non-current
Telefónica de España, S.A.U.	3,731				2,093		5,824
Telefónica Móviles España, S.A.U.	4,142						4,142
Telefónica Móviles México, S.A. de C.V.	794		2,092				2,886
Telefónica de Contenidos, S.A.U.	6				1,142	79	1,227
Telefónica Internacional, S.A.	493						493
Telefónica Móviles Argentina, S.A.	113				28	241	382
Telefónica Móviles Chile Inversiones, S.A.		284					284
Others	104	13	40	3	52	3	215
Total	9,383	297	2,132	3	3,315	323	15,453

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 (on January 1, 1999), that bears interest at 6.80% and had an outstanding balance of 3,187 million euros at December 31, 2008, of which 2,093 million euros are long term and 698 million euros are short term.

The year ended 2006 featured the takeover and merger of Terra Networks España, S.A.U. by Telefónica de España, S.A.U., both wholly owned direct subsidiaries of Telefónica, S.A. As a result, Terra Networks España, S.A.U. was dissolved without liquidation, and Telefónica de España, S.A.U. assumed the 397 million euro participating loan granted by Telefónica, S.A. to Terra Networks España, S.A.U. The loan matures on November 15, 2009 and bears interest linked to the Euribor rate.

In 2008, Telefónica de España, S.A.U. resolved to pay an interim dividend against profit for the year totaling 1,800 million euros. This amount is recognized under Current assets Loans to Group companies and associates.

Financing granted to Telefónica Móviles España, S.A.U. comprises a participating loan dated October 1, 2002, for 3,102 million euros, paying annual fixed interest plus a floating interest rate based on the performance of the company. This loan falls due on December 22, 2009 and therefore has been reclassified to Current Loans to companies.

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On December 1, 2008, Telefónica, S.A. decided to modify the currency in which it should repay the principle, accrued interest payable and any other item related to the loans granted to Telefónica Móviles México, S.A. de C.V. The exchange rate applied in the conversion of former euro-denominated loans into US dollars was published by the Bank of Mexico on November 28, 2008. The conditions regarding interest and maturity of the loans are the same. At December 31, 2008, the total amount drawn (loan principle) was 38,252 million Mexican pesos, equivalent to 2,030 million euros. Loans to group companies and associates also includes 856 million euros of accrued interest payable on the loans.

Financing granted to Telefónica de Contenidos, S.A.U. mainly comprises a 1,142 million euro participating loan, fully drawn down at December 31, 2008, which bears interest based on Telefónica de Contenidos, S.A.U.'s business performance. In addition, Telefónica, S.A. granted a new participating loan of 79 million euros maturing in 2015 to provide Telefónica de Contenidos, S.A.U. with funding to cover the financial charges linked to the participating loan mentioned above.

A loan was granted to Telefónica Internacional, S.A.U. on April 15, 2008 for 1,000 million euros, of which 408 million euros had been drawn down at December 31, 2008. The loan matures on April 14, 2009 and interest is linked to the 3M Euribor rate.

Financing granted to Telefónica Móviles Argentina, S.A. comprises a number of US dollar-denominated loans, maturing between 2009 and 2015 and bearing a fixed interest rate.

Financing granted to Telefónica Móviles Chile Inversiones, S.A. was arranged on November 4, 2008 as a result of the loan granted by Telefónica Internacional Chile, S.A. to Telefónica, S.A. for 284 million euros. This loan falls due in 2010 and bears interest linked to the 3M Euribor rate.

The Company has also extended 1,859 million euros of loans in connection with the taxation of Telefónica, S.A. as the head of the tax Group pursuant to the consolidated tax regime applicable to corporate groups (see Note 17), mainly 1,039 million euros to Telefónica Móviles España, S.A.U. and 795 million euros to Telefónica de España, S.A.U., both falling due in the short term.

Loans to Group companies includes accrued interest receivable at December 31, 2008 amounting to 922 million euros. Transfers under Loans to group companies and associates in the table of movements in investments relate mainly to short-term movements required to meet the repayment schedules of the loans listed above.

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 (see Note 18.3).

Table of Contents**(9) FINANCIAL INVESTMENTS**

9.1 The breakdown of Financial investments at December 31, 2008 is as follows:

<i>(Millions of euros)</i>	Equity instruments	Loans to third parties	Derivatives	Other financial assets	TOTAL	Fair value
Non-current financial investments	383	25	3,458	387	4,253	4,254
Financial assets at fair value through profit or loss			1,185		1,185	1,185
Held for trading			1,185		1,185	1,185
Loans and receivables		25		387	412	413
Available-for-sale assets	383				383	383
Measured at fair value	383				383	383
Hedging derivatives (Note 16)			2,273		2,273	2,273
Current financial investments	0	46	956	0	1,002	1,052
Financial assets at fair value through profit or loss			675		675	675
Held for trading			675		675	675
Loans and receivables		46			46	96
Hedging derivatives (Note 16)			281		281	281
Total financial investments	383	71	4,414	387	5,255	5,306

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.

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

9.2 Financial assets at fair value through profit or loss

This category includes the fair value of outstanding derivative financial instruments at December 31, 2008 (see Note 16).

9.3 Available-for-sale 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, 2008 is as follows:

<i>(Millions of euros)</i>	Balance at January 1	Disposals	Fair value adjustments	Balance at December 31
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Banco Bilbao Vizcaya Argentaria, S.A.	607		(293)	314
Sogecable, S.A.	45	(46)	1	
Amper, S.A.	19		(11)	8
Zon Multimedia Serviços de Telecomunicações e Multimedia, SGPS, S.A.	142		(87)	55
Other equity investments	6			6
Total	819	(46)	(390)	383

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Among these are the investment held by Telefónica, S.A. in Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) since 2000 representing 0.97% of its share capital.

On May 9, 2008, Telefónica, S.A. announced its decision to accept the takeover bid launched by Promotora de Informaciones, S.A. (PRISA) for Sogecable, S.A. Proceeds from this disposal amounted to 11 million euros.

Given the poor situation of financial markets, at year-end the Company assessed the securities in its portfolio of listed available-for-sale assets individually for impairment. The analysis did not uncover the need to recognize any impairment losses.

In 2008, changes recognized in the equity of Telefónica, S.A. to the fair value of available-for-sale assets, net of the tax effect, amounted to 273 million euros (see Note 11.2).

9.4 Other financial assets and loans to third parties

The breakdown of investments included in this category at December 31, 2008 is as follows:

<i>(Millions of euros)</i>	2008
Other non-current financial assets	
Loans to third parties	25
Prepayments	1
Guarantees given	386
Other current financial assets	
Loans to third parties	46
Total	458

9.4.1 Loans to third parties

Loans to third parties, both non-current and current, includes the cost of options arranged in 2006 and 2008 to cover shared-based payment schemes involving Telefónica, S.A. shares (phases I and III, respectively) for 71 million euros (see Note 18.3). The hedges arranged in 2006 have been reclassified to current, as the first phase of the share option plan ended in June 2009.

9.4.2 Guarantees given

Guarantees given under non-current assets mainly comprises deposits made to cover the guarantees provided for Ipse 2000 S.p.A., which totaled 375 million euros at December 31, 2008. These deposits will decrease in line with the respective obligations they guarantee.

Potential future payments related to this guarantee have counterguarantees by other Telefónica Group companies and therefore do not pose a risk for Telefónica, S.A. (see Note 19 c).

Table of Contents**(10) TRADE AND OTHER RECEIVABLES**

The breakdown of Trade and other receivables at December 31, 2008 is as follows:

<i>(Millions of euros)</i>	2008
Trade receivables	14
Trade receivables from group companies and associates	474
Other receivables	19
Receivables from employees	1
Current income tax assets (Note 17)	38
Total	546

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 line rental fees (see Note 7.2).

Trade receivables and Trade receivables from group companies and associates include balances in foreign currency equivalent to 78 million euros (68 million euros of US dollars and 9 million euros of Brazilian reais).

These balances gave rise to exchange gains in the income statement of approximately 1 million euros in 2008.

(11) EQUITY**11.1 Capital and reserves****a) Share capital**

At December 31, 2008, Telefónica, S.A.'s share capital amounted to 4,704,996,485 euros and consisted of 4,704,996,485 fully paid ordinary shares of a single series, par value of 1 euro, all recorded by the book-entry system and traded on the Spanish electronic trading system (Continuous Market), where they form part of the Ibex 35 Index, on the four Spanish Stock Exchanges (Madrid, Barcelona, Valencia and Bilbao) and listed on the New York, London, Paris, Frankfurt, Tokyo, Buenos Aires, Sao Paulo and Lima Stock Exchanges. In the first quarter of 2008, Telefónica, S.A. completed the procedure to delist its shares from the Paris and Frankfurt stock exchanges begun in 2007.

With respect to authorizations given regarding share capital, on June 21, 2006, authorization was given at the General Shareholders Meeting of Telefónica, S.A. for the Board of Directors 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 153.1 b) of the Spanish Corporation Law (authorized capital) up to a maximum increase of 2,460 million euros, equivalent to half of the Company's share capital at that date, by issuing and placing new ordinary shares, be they ordinary or of any other type permitted by the Law, with a fixed or variable premium, with or without pre-emptive subscription rights and, in all cases, in exchange for cash, and expressly considering the possibility that the new shares may not be fully subscribed in accordance with the terms of Article 161.1 of the Spanish Corporation Law. The Board of Directors was also empowered to disapply, partially or fully, pre-emptive subscription rights under the terms of Article 159.2 of the Spanish Corporation Law and related provisions.

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In addition, at the May 10, 2007 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. As at December 31, 2008, the Board of Directors had exercised these powers, approving a program to issue corporate promissory notes for 2008 and 2009.

In addition, on April 22, 2008, shareholders voted to authorize the acquisition by the Board of Directors of treasury shares, for a consideration, up to the limits and pursuant to the terms and conditions established at the General Shareholders Meeting, within a maximum period of 18 months from that date. However, it specified that in no circumstances could the par value of the shares acquired, added to that of the treasury shares already held by Telefónica, S.A. and by any of its controlled subsidiaries, exceed 5% of Telefónica's share capital.

Finally, on July 15, 2008, the deed of capital reduction formalizing the implementation by the Company's Board of Directors of the resolution adopted by the General Shareholders Meeting on April 22, 2008, was executed. Capital was reduced through the cancellation of treasury shares previously acquired by the Company as authorized by the General Shareholders Meeting. As a result, 68,500,000 Telefónica S.A. treasury shares were cancelled and the Company's share capital was reduced by a nominal amount of 68,500,000 euros. Article 5 of the Corporate Bylaws relating to the amount of share capital was amended accordingly to show 4,704,996,485 euros. At the same time, a reserve was recorded for the cancelled shares described in the section on Other reserves of this same Note. The cancelled shares were delisted on July 23, 2008.

At December 31, 2008, Telefónica, S.A. held the following treasury shares:

		Euros per share		Market	
	No of shares	Acquisition	Trading price	value (1)	%
<i>Treasury shares at 12/31/08</i>	125,561,011	16.68	15.85	1,990	2.66867%

(1) Millions of
euros

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The movement in treasury shares of Telefónica, S.A. in 2008 is as follows:

	No. of shares
Treasury shares at 12/31/07	64,471,368
Acquisitions	129,658,402
Disposals	(68,759)
Share cancellation	(68,500,000)
Treasury shares at 12/31/08	125,561,011

The amount paid to acquire treasury shares in 2008 was 2,225 million euros. Meanwhile, sales of treasury shares during the year amounted to 1 million euros.

At December 31, 2008, Telefónica, S.A. held put options on 6 million treasury shares.

b) Legal reserve

According to the revised text of Spanish Corporation 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, 2008 this reserve has been duly set aside.

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, an amount of 19 million euros corresponding to revaluations reserves subsequently considered unrestricted has been reclassified to

Other reserves. The balance of this reserve at December 31, 2008 was 172 million euros.

Reserve for cancelled share capital: In accordance with Article 167.3 of the Spanish Corporate Law and to render null and void the right of opposition provided for in Article 166 of 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. In 2008, a reserve for cancelled share capital amount to 68 million euros was recorded. The cumulative amount of this reserve at December 31, 2008 was 357 million euros.

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In addition to the two restricted reserves explained above, Other reserves includes unrestricted reserves for gains obtained by the Company in prior years and a reserve for the first-time application of the new accounting principles (see Note 2 b of Issues relating to the transition to new accounting principles).

d) Dividends

At its meeting of February 25, 2009, the Company's Board of Directors agreed to propose to the General Shareholders Meeting the payment of a dividend against 2008 profit with a charge to reserves of a gross amount of 0.5 euros per outstanding share carrying dividend rights, up to a maximum total amount of 2,352 million euros.

Dividends paid in 2008

At its meeting held on April 22, 2008, the Company's Board of Directors agreed to pay an additional dividend charged against 2007 profit of a gross 0.40 euros per share. A total of 1,869 million euros was paid in May 2008.

In addition, as indicated in Note 3, in November an interim dividend against 2008 profit of a gross 0.50 euros per share was paid, entailing a total payment of 2,296 million euros.

11.2 Unrealized gains (losses) reserve

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

<i>(Millions of euros)</i>	Balance at January 1	Measurement	Tax effect of additions	Amounts transferred to income statement	Tax effect of transfers	Balance at December 31
Available-for-sale financial assets						
(Note 9.3)	51	(390)	117	(11)	4	(229)
Cash flow hedges (Note 16)	176	(189)	57	50	(16)	78
Total	227	(579)	174	39	(12)	(151)

(12) FINANCIAL LIABILITIES

The breakdown of Financial liabilities at December 31, 2008 is as follows:

<i>(Millions of euros)</i>	Debentures, bonds and other marketable debt	Interest- bearing debt	Derivatives	Other financial liabilities	Payables to group companies and associates	Total	Fair value
Non-current financial liabilities	288	7,225	2,241	7	30,955	40,716	38,059
Loans and borrowings	288	7,225		7	30,955	38,475	35,818
Financial liabilities at fair value through			443			443	443

profit or loss							
Held for trading			443			443	443
Hedging derivatives			1,798			1,798	1,798
Current financial liabilities	1,567	788	704	164	16,568	19,791	19,794
Loans and borrowings	1,567	788		164	16,568	19,087	19,090
Financial liabilities at fair value through profit or loss			564			564	564
Held for trading			564			564	564
Hedging derivatives			140			140	140
Total financial liabilities	1,855	8,013	2,945	171	47,523	60,507	57,853

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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.

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

(13) BONDS AND OTHER MARKETABLE DEBT SECURITIES:

13.1 The accounting balances and movements in issues of debentures, bonds and commercial paper at December 31, 2008 are as follows:

<i>(Millions of euros)</i>	Non-convertible debentures and bonds	Other marketable debt securities	Total
Balance at January 1	1,505	1,371	2,876
New issues		1,745	1,745
Redemptions	(421)	(2,264)	(2,685)
Revaluation and other movements	(87)	6	(81)
Balance at December 31	997	858	1,855
Maturity			
Non-current	173	115	288
Current	824	743	1,567

Maturities of the nominal amounts of debentures and bonds issues are as follows:

Name	Type of interest rate	% interest rate	Maturity					Subsequent years	TOTAL
			2009	2010	2011	2012	2013		
DEBENTURES AND BONDS:									
FEBRUARY 1990 SERIES C	FIXED	12.6		4					4
FEBRUARY 1990 SERIES F	ZERO COUPON (**)	12.58		14					14
APRIL 99	FIXED	4.5	500						500
JUNE 99	FLOATING ZERO COUPON	6.04	300						300
JULY 99	(**)	6.37						54	54

MARCH 00	FLOATING	5,09(*)			50	50
Total issues			800	18	104	922

(*) *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 actual values.*

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13.2 The detail of the maturities and redemption values of zero-coupon debentures and bonds is as follows:

Issue	Redemption date	Redemption rate	Present value	Redemption value
DEBENTURES AND BONDS:				
FEBRUARY 1990 SERIES F	2/26/2010	1069.47%	14	15
JULY 99	7/21/2029	637.64%	54	191
Total			68	206

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

13.3 At December 31, 2008, Telefónica, S.A. had a promissory note program for issuance of up to 2,000 million euros. The outstanding balance at year end was 741 million euros.

With respect to the transaction with La Estrella, S.A. de Seguros consisting of the issuance of bearer promissory notes, on February 15, 2001 Telefónica, S.A. issued 74 bearer promissory notes with a face value of 126 million euros and final maturity in February 2011. The nominal amount outstanding at year end was 74 million euros, equivalent to an outstanding balance of 54 million euros on the year-end balance sheet.

In 2006, the Company acquired shares in O2, plc., payment for which was deferred through the arrangement of a 207 million pounds sterling (308 million euros) Loan Notes program. This program, enacted under UK law, gives the seller of the shares rights to of a security that pays semi-annual interest and the option to collect the principal on demand at the interest payment dates (June 30 and December 31) until December 31, 2010 when the program ends. The outstanding balance of the program at December 31, 2008 amounted to 60 million pounds sterling (63 million euros).

13.4 The average interest rate in 2008 on debentures and bonds outstanding during the year was 5.14% and the average interest rate on corporate promissory notes was 4.62%.

(14) INTEREST-BEARING DEBT AND DERIVATIVES

14.1 The balances at December 31, 2008 are as follows:

Item (millions of euros)	Current	Non-current	Total
Loans and borrowings	535	7,128	7,663
Foreign currency loans and borrowings	253	97	350
Derivative financial liabilities (Note 16)	704	2,241	2,945
Total	1,492	9,466	10,958

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14.2. The nominal values of the main interest-bearing debts at year-end 2008 are as follows:

Description	Value date	Maturity date	Currency	Limit 31-12-08	Balance (million currency)	Balance (million euros)
ECAS structured facility 3bn syndicated loan BS	26/11/04	15/11/10	USD	377	115	83
acquisition 6bn syndicated loan	06/07/04	06/07/09	USD	3,000	302	217
Cesky acquisition	28/06/05	28/06/11	EUR	6,000	6,000	6,000
Syndicated loan savings banks	21/04/06	21/04/17	EUR	700	700	700

14.3 Maturities of balances at December 31, 2008 are as follows:

Item (millions of euros)	Maturity					Subsequent years	Balance at December 31
	2009	2010	2011	2012	2013		
Loans and borrowings	535		5,135	601		1,392	7,663
Foreign-currency loans and borrowings	253	65				32	350
Derivative financial liabilities (Note 16)	704	1,209	121	40	52	819	2,945
Total	1,492	1,274	5,256	641	52	2,243	10,958

14.4 On April 21, 2006, Telefónica, S.A. arranged a 700 million euros syndicated loan, denominated in euros and bearing interest linked to the Euribor rate. In 2008, there were no movements in this loan, which will be repaid in two equal installments, in April 2015 and 2017, respectively.

On June 28, 2005 Telefónica, S.A. arranged a syndicated loan with 40 national and international financial institutions for 6,000 million euros, maturing on June 28, 2011. The loan is denominated in euros and can be drawn either in this currency or in US dollars, sterling, yen, swiss francs or any other currency subject to prior agreement by the banking institutions. At December 31, 2008, this loan was fully drawn down.

On July 6, 2004, Telefónica arranged a 3,000 million euros syndicated loan with several Spanish and foreign banks. This loan matures in five years (July 6, 2009) and bears interest of Euribor/Libor plus a spread based on the Company's credit rating. The total balance drawn down at December 31, 2008 was 302 million dollars, equivalent to 217 million euros.

On November 26, 2004, Telefónica, S.A. and several branches of ABN Amro Bank N.V. formalized a credit facility, secured by the export credit agencies of Finland (Finnvera) and Sweden (EKN), bearing fixed interest of 3.26%, with a limit of 377 million euros and final maturity on November 15, 2010. This financing will cover up to 85% of the purchases of network equipment to be made by Telefónica Móviles Group companies from Ericsson and Nokia. In 2008, a total of 76 million dollars was repaid, leaving an outstanding balance at December 31, 2008 of 115 million dollars, equivalent to 83 million euros.

14.5 Average interest on loans and borrowings

The average interest rate in 2008 on loans and borrowings denominated in euros was 4.68% and on foreign-currency loans and receivables was 3.56%.

14.6 Unused credit facilities

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

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At December 31, 2008, Telefónica had undrawn credit facilities amounting to 4,762 million euros.

Financing arranged by Telefónica, S.A. at December 31, 2008 is not subject to compliance with any financial covenants.

(15) PAYABLES TO GROUP COMPANIES AND ASSOCIATES

15.1 The breakdown at December 31, 2008 is as follows:

<i>(Millions of euros)</i>	Non-current	Current	Total
Loans	30,576	16,118	46,694
Trade payables to group companies and associates	14	66	80
Derivatives (Note 16)	44	65	109
Payable to subsidiaries due to taxation on consolidated basis	321	319	640
Total	30,955	16,568	47,523

The maturity of these loans at year end is as follows:

Company <i>(Millions of euros)</i>	2009	2010	2011	2012	2013	2014 and subsequents years	Final balance, current and non current
Telefónica Emisiones, S.A.	1,503	1,338	2,939	622	2,548	8,821	17,771
Telefónica Europe, B.V.	2,274	1,796		4,382	2,380	1,499	12,331
Telefónica Móviles España, S.A.U.		1,402	2,000				3,402
Telefónica Finanzas, S.A.	11,822		300			549	12,671
Otras	519						519
Total	16,118	4,536	5,239	5,004	4,928	10,869	46,694

The carrying amount of financing raised by Telefónica, S.A. through Telefónica Europe, B.V. at December 31, 2008 was 12,331 million euros. This financing entails a number of loans paying market rates of interest calculated on a Euribor plus spread basis. The average interest rate in 2008 was 5.78%.

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 at 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. The outstanding balance on this loan at December 31, 2008 was 3,978 million pounds sterling, equivalent to 4,176 million euros.

The carrying amount of financing raised by Telefónica, S.A. through Telefónica Emisiones, S.A.U. at December 31, 2008 was 17,771 million euros. This financing is arranged as loans from these companies on the same terms as those of the issuance programs. The average interest rate in 2008 was 5.00%. 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 their effective rate.

Telefónica Emisiones, S.A.U. raised financing in 2008 mainly by tapping the European and US capital markets, issuing 1,250 million euros worth of bonds.

Meanwhile, at December 31, 2008, 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, amounting to 12,671 million euros in a series of loans earning market interest rates.

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There were also loans at December 31, 2008 given to Telefónica, S.A. by Telefónica Móviles España, S.A.U. amounting to 3,402 million euros.

The financing received by Telefónica, S.A. from Telefónica de España, S.A.U. was cancelled on January 28, 2008.

Part of the amount owned by Telefónica, S.A. to Telefónica Emisiones, S.A.U. and with Telefónica Europe, B.V. is measured at fair value at December 31, 2008 resulting from fair value hedges.

Loans to group companies includes accrued and unpaid interest at December 31, 2008 amounting to 638 million euros.

- 15.2 The balance of Payable to subsidiaries due to taxation on a consolidated basis amounting to 640 million euros at December 31, 2008, includes payables to group companies for their contribution of 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. (444 million euros), Telefónica Móviles España, S.A.U. (93 million euros), Telefónica de Contenidos, S.A.U. (33 million euros) and Telefónica Datacorp, S.A.U. (14 million euros).

(16) DERIVATIVE FINANCIAL INSTRUMENTS AND RISK MANAGEMENT POLICIES

a) Derivative financial instruments

In 2008 the Company continued to use derivatives both to limit interest and exchange rate risks on otherwise unhedged positions and to adapt its debt structure to market conditions.

At December 31, 2008, the total outstanding balance of derivative transactions was 95,891 million euros, of which 70,999 million euros related to interest rate risk and 24,892 to foreign currency risk.

It should be noted that at December 31, 2008, Telefónica, S.A. had arranged transactions with financial institutions to hedge interest and exchange rate risks for other Telefónica Group companies amounting to 101 million euros and 1,225 million euros, respectively. These external transactions are matched by parallel intragroup arrangements, with identical terms and maturities, and therefore involve no risk for Telefónica, S.A. 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.

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The breakdown of Telefónica, S.A.'s derivatives at December 31, 2008, their fair value at year-end and the expected maturity schedule is as follows:

Type of risk <i>Millions of euros</i>	Value in Euros	2008 Telefónica receives		Telefónica pays	
		Amount	Currency	Amount	Currency
Euro interest rate swaps	48,099				
Fixed to floating	17,389	17,389	EUR	17,389	EUR
Floating to fixed	29,148	29,148	EUR	29,148	EUR
Floating to floating	1,562	1,562	EUR	1,562	EUR
Foreign currency interest rate swap	11,896				
Fixed to floating	8,408				
GBP/GBP	525	500	GBP	500	GBP
JPY/JPY	119	15,000	JPY	15,000	JPY
USD/USD	7,764	10,805	USD	10,805	USD
Floating to fixed	3,488				
CZK/CZK	977	26,305	CZK	26,305	CZK
GBP/GBP	1,255	1,195	GBP	1,195	GBP
MXN/MXN	1	28	MXN	28	MXN
USD/USD	1,255	1,746	USD	1,746	USD
Exchange rate swaps	15,173				
Fixed to fixed	2,684				
EUR/CLP	135	159	EUR	119,057	CLP
EUR/CZK	109	122	EUR	2,936	CZK
USD/EUR	2,440	2,282	USD	2,440	EUR
Floating to fixed	657				
EUR/BRL	89	115	EUR	288	BRL
EUR/MAD	88	90	EUR	1,000	MAD
USD/ARS	478	743	USD	2,296	ARS
USD/MXN	2	3	USD	35	MXN
Fixed to floating	319				
JPY/EUR	95	15,000	JPY	95	EUR
USD/EUR	224	200	USD	224	EUR
Floating to floating	11,513				
EUR/CLP	43	51	EUR	37,911	CLP
EUR/CZK	1,165	1,050	EUR	31,385	CZK
EUR/GBP	2,882	4,080	EUR	2,745	GBP
GBP/EUR	2,029	1,550	GBP	2,029	EUR
JPY/EUR	178	30,000	JPY	178	EUR
USD/EUR	5,211	6,700	USD	5,211	EUR
USD/MXN	5	8	USD	91	MXN
Forwards	7,397				
ARS/USD	102	694	ARS	143	USD
EUR/CLP	119	122	EUR	105,000	CLP
EUR/CZK	1,470	1,589	EUR	39,592	CZK
EUR/GBP	437	477	EUR	417	GBP
EUR/MXN	28	28	EUR	535	MXN
EUR/USD	2,215	2,265	EUR	3,083	USD

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GBP/EUR	1,860	1,585	GBP	1,860	EUR
GBP/USD	74	53	GBP	103	USD
MXN/USD	48	858	MXN	66	USD
USD/BRL	119	157	USD	388	BRL
USD/EUR	594	794	USD	594	EUR
USD/GBP	37	53	USD	36	GBP
USD/MXN	294	418	USD	5,543	MXN
Spot	11				
EUR/GBP	8	8	EUR	7	GBP
USD/GBP	3	5	USD	3	GBP
Subtotal	82,576				

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with options****Interest rate options****Caps & Floors***External counterparties*

USD	655	911	USD
EUR	8,774	8,774	EUR
GBP	1,575	1,500	GBP

Swaptions

EUR			EUR
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Currency options*External counterparties*

USD/EUR	2,295	3,194	USD
ARS/USD	16	23	USD

Subtotal**TOTAL**

The breakdown by average maturity is as follows:

Hedged underlying item	Amount	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
With underlying instrument					
Promissory notes	500		500		
Loans	26,092	11,386	5,333	5,575	3,798
In national currency	21,034	9,522	3,991	4,977	2,544
In foreign currencies	5,058	1,864	1,342	598	1,254
Debentures and bonds	47,942	10,884	17,179	5,140	14,739
In national currency	18,791	7,326	7,232	3,242	991
In foreign currencies	29,151	3,558	9,947	1,898	13,748
Without underlying	21,357	9,796	5,899	1,968	3,694
Swaps	11,735	2,266	5,706	1,788	1,975
Spots	11	11			
Currency options	2,311	271	183	138	1,719
Forwards	7,300	7,248	10	42	
Total	95,891	32,066	28,911	12,683	22,231

The debentures and bonds hedged relate to those issued by Telefónica, S.A., as well as those issued by Telefónica Europe, B.V. and Telefónica Emisiones, S.A.U.

The fair value of Telefónica, S.A.'s derivatives portfolio at December 31, 2008 was equivalent to an asset of 1,469 million euros.

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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 taken on to finance its business, (iii) investments in companies, and (iv) other financial instruments related to the above commitments.

The main market risks affecting the Group are as follows:

1. Foreign currency risk

Exchange rate risks arise mainly from two sources. The first is Telefónica's international presence, through its investments and businesses in countries that use currencies other than the euro. These are largely in Latin America, but also in the Czech Republic and the UK. The second is debt denominated in currencies other than that of the country where the business is conducted or the home country of the company taking on the debt.

2. Interest rate risk

This arises from changes in (i) financial expenses on floating rate debt (or short-term debt likely to be renewed), due to changes in interest rates and (ii) the value of long-term liabilities at fixed interest rates.

3. Share price risk

This arises from 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.

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, there is so-called country risk (which overlaps with market and liquidity risks). This refers to the possible decline in assets, cash flows generated or 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 with a view to reducing changes in cash flows and the income statement, or offsetting them with opposite changes in debt. In this way, it attempts to protect the group's solvency, facilitate financial planning and take advantage of investment opportunities.

Telefónica uses derivatives to manage risks, basically on exchange rates, interest rates and shares.

Exchange rate

The fundamental objective of the exchange rate risk management policy is to offset (at least partly) potential losses of cash flows caused by declines in exchange rates vis-à-vis the euro, with savings on the lower euro value of foreign-denominated debt (from currency depreciation). The degree of hedging varies depending on the type of investment.

To protect its investment in the Czech Republic, the Company has net positions denominated in Czech crowns, which at December 31, 2008 amounted to nearly 75% of the original cost of the investment.

The risk-management objective for pounds sterling is to have sterling borrowings of close to 2 times the OIBDA of the Telefónica Europe business unit in the UK, in line with the Telefónica Group's net debt OIBDA ratio, so as to reduce its sensitivity to changes in the pound sterling/euro exchange rate.

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The 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 it has open positions. Such exposure can arise for any of three reasons: (i) a thin market for local derivatives or difficulty in obtaining financing in local currency which does not allow for a low-cost hedge to be arranged, (ii) financing through intra-group loans, where the accounting treatment of exchange rate risk is different from that for financing through capital contributions, (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 exchange rate risk exposure at the Group level. If the exchange rate position affecting the income statement at the end of December 31, 2008 were constant in 2009 and Latin American currencies depreciated against the US dollar and the rest of the currencies against the euro by 10%, the impact on the Group's income statement would be a negative 107 million euros. Nonetheless, the Group dynamically manages its exposure to such changes to mitigate their impact. For Telefónica, S.A., the impact of the same 10% depreciation would be an increase in profit of 16 million euros.

Interest rate risk

Telefónica's financial expenses are exposed to changes in interest rates. In 2008, the rates applied to the largest volumes of short-term debt were mainly based on the Euribor, the Czech crown Pribor and the dollar Libor. Company 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. To illustrate the sensitivity of Group borrowing costs to variability in short-term interest rates at December 31, 2008, assuming a 100 basis point rise, the interest rates in all currencies in which there are financial positions and no change in the currency make-up and balance of the position at year end, the finance cost would increase by 178 million euros. For Telefónica, S.A., assuming on financing arranged with external counterparties, the same change would lead to an increase in finance costs of 16 million euros.

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.

Telefónica, S.A. has a portfolio of holdings in companies exposed to the risk of changes in their share prices (see Notes 8 and 9).

In February 2008, Telefónica announced a plan to buy back up to 100 million shares, representing approximately 2.095% of its share capital at that time. In October 2008, Telefónica announced the extension of this program by 50%, or another 50 million shares. Telefónica manages the share price risk of the share buyback programs by setting the timetable for execution in accordance with the pace of cash flow generation, the share price and other market conditions, while complying with applicable legal, regulatory and bylaw limits.

At December 31, 2008, Telefónica, S.A. held 125,561,011 treasury shares. The liquidation value of the treasury shares could increase or decrease depending on variations in the Telefónica share price.

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Liquidity risk

Telefónica seeks to match the schedule for its debt maturity payments to its capacity to generate cash flows to meet these maturities, allowing some flexibility. In practice, managing liquidity at the Telefónica Group as a whole means monitoring two key criteria:

1. Group debt must have a longer average maturity than the time it will take to earn the cash to pay it (assuming internal projections are met, and all cash flows generated go to pay down debt rather than on dividends or acquisitions).
2. The Group must be able to pay all commitments over the next 12 months without accessing new borrowing or tapping the capital markets (although including firm credit lines arranged with banks), assuming budget projections are met.

The principal financing transaction in 2008 (to ensure compliance with the management criteria indicated above) consisted of an issue of 1,250 million euros worth of five-year bonds with an annual coupon of 5.58% (equivalent to 94 basis points above the benchmark 5-year mid-swap rate).

Country risk

Telefónica has 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 its Latin American companies such that any potential asset impairment would be accompanied by a reduction in liabilities,
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

Telefónica, S.A. trades in derivatives with creditworthy counterparties. Therefore, the Company trades with credit entities with senior debt ratings of at least A. The contracts arranged with these include netting agreements, whereby debtor or creditor positions can be offset in case of bankruptcy, limiting the risk to the net position. The Company's maximum exposure to credit risk is initially represented by the carrying amounts of the financial assets (Notes 8 and 9) and the guarantees given (Note 19).

Capital management

Telefónica's finance department, which is in charge of the Group's capital management, takes into consideration several factors when determining the Company's capital structure.

The first is the consideration of cost of capital at all times to achieve a combination that optimizes this. For this, the company monitors the financial markets and updates to standard industry approaches for calculating cost of capital (WACC, weighted average cost of capital) in determining this variable. The second, a gearing ratio that enables the Company to obtain and maintain the desired credit rating over the medium term, and with which Telefónica can use to match its potential cash flow generation and the alternative uses of this cash flow at all times.

These general arguments are rounded off with other considerations and specifics, such as country risk in the broadest sense, tax efficiency and volatility in cash flow generation, when determining the Group's financial structure.

Hedging policy

The Group's derivatives policy emphasizes the following points:

Derivatives based on a clearly identified underlying.

Matching of the underlying to the individual conditions of one side of the derivative.

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Ability to measure the derivative at fair value using the valuation techniques available to the Company.

Sale of options only when there is an underlying exposure.

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 a net investment in a foreign operation.

There is no reason to suppose management of accounting hedges will be static, with an unchanging hedging relationship lasting right through to maturity. In fact, hedging relationships may change to allow appropriate management that serves the stated principles of stabilizing cash flows, stabilizing net financial income/expense and protecting the share capital.

The risk management guidelines are dictated by the Telefónica Group's Corporate Finance Department. The Corporate Finance Department may allow exceptions to this policy where this can be justified, normally when the market is too thin for the volume of transactions required or on clearly limited and small risks.

The breakdown of the Company's derivatives with counterparties not belonging to the Telefónica Group at December 31, 2008, their fair value at year-end and the expected maturity schedule is as follows:

(Millions of euros)
Notional amount (maturity)

	Fair value at December 31	2009	2010	2011	Subsequent years	TOTAL
Derivatives						
Interest rate hedges	(611)	2,031	1,748	503	72	4,354
<i>Cash flow hedges</i>	182	2,028	494	1,749	3,505	7,776
<i>Fair value hedges</i>	(793)	3	1,254	(1,246)	(3,433)	(3,422)
Foreign currency hedges	543	891	2,380	788	3,689	7,748
<i>Cash flow hedges</i>	543	891	2,380	788	3,689	7,748
<i>Fair value hedges</i>	0	0	0	0	0	0
Interest and exchange rate hedges	(17)	0	224	0	258	482
<i>Cash flow hedges</i>	(17)	0	224	0	258	482
<i>Fair value hedges</i>	0	0	0	0	0	0
Hedge of net investment	(531)	(2,830)	(517)	(1,124)	(751)	(5,222)
Derivatives not designated as hedges	(853)	7,274	(614)	(1,182)	(164)	5,314
<i>Interest rate</i>	(270)	8,569	(303)	(1,105)	(1,100)	6,061
<i>Foreign currency</i>	(381)	(875)	(145)	(12)	1,026	(6)
<i>Interest and exchange rate</i>	(202)	(420)	(166)	(65)	(90)	(741)

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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 comprised 39 companies in 2008.

<i>(Millions of euros)</i>	Balance at December 31
Tax receivables:	1,843
<i>Deferred tax assets:</i>	<i>1,805</i>
Deferred income tax (income)	41
Other temporary differences, assets	567
Long-term tax loss carryforwards	356
Deductions and other	841
<i>Current tax receivables (Note 10):</i>	<i>38</i>
Withholdings	23
VAT and Canary Islands general indirect tax refundable	15
Tax payable:	581
<i>Deferred tax liabilities:</i>	<i>559</i>
Deferred income tax (expense)	551
Other temporary differences, liabilities	8
<i>Current tax payable:</i>	<i>22</i>
Personal income tax withholdings	3
Withholding on investment income, VAT and other	18
Social security	1

The tax group had tax loss carryforwards at December 31, 2008 amounting to 3,324 million euros. These losses must be applied within 15 years.

The balance at December 31, 2008 includes unused tax credits amounting to 356 million euros corresponding to unused tax losses of 1,187 million euros.

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 as a result of 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. In this respect, 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.

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17.1 Deferred tax assets and liabilities

The balances and movements in Deferred tax assets and Deferred tax liabilities for Telefónica, S.A. at December 31, 2008 are as follows:

<i>(Millions of euros)</i>	Tax credits	Temporary differences, assets	Deductions	Total deferred tax assets	Deferred tax liabilities
Balance at January 1	380	629	1,390	2,399	1,646
Arising in the year	971	1,863	47	2,881	139
Reversal	(33)	(608)		(641)	
Transfers to Tax Group's net position	(962)		(568)	(1,530)	
Other movements		(1,276)	(28)	(1,304)	(1,226)
Balance at December 31	356	608	841	1,805	559

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

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 2008 is as follows.

<i>(Millions of euros)</i>	2008
Accounting profit before tax	778
Permanent differences	(7,096)
Permanent differences arising from first-time application of PGC 2007	82
Temporary differences:	3,086
Arising in the year	3,577
Arising in prior years	(491)
Tax base	(3,150)
Gross tax payable	(945)
Tax credits capitalized	(25)
Corporate income tax refundable	(970)
Temporary differences for tax valuation	(926)
Tax effect of first-time application of PGC 2007	(24)
Other effects	(12)
Corporate income tax accrued in Spain	(1,932)
Foreign taxes	10
Income tax	(1,922)
Current income tax	(945)
Deferred income tax	(977)

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The permanent differences relate mainly to changes in investment writedown provisions recorded by the tax Group companies included in the consolidated corporate income tax return, to dividends received from tax group companies or foreign companies taxed at source and to the writedown provisions related to dividends paid by subsidiaries up to the amount of the dividend recorded as non-deductible income at Telefónica, S.A. and to non-deductible provisions.

Within the scope of Law 4/2008 dated December 23, with respect to corporate income tax, Telefónica, S.A. has elected to apply the arrangements of the 29th transitional provisions of this law. In this respect, under the terms of this provision the Company has included two-thirds of the net tax impact of accounting adjustments arising from the first-time application of the new accounting principles.

In 2008, the Company capitalized 25 million euros of tax credits, mainly for double taxation. The cumulative amount and year end principally reflects tax credits in connection with export activity tax credits and deductions for export activities (818 million euros). In 2008, 367 million euros were applied in relation to deductions on reinvestment of capital gains and 138 million euros to double taxation.

Taxes incurred abroad relate mainly to corporate income tax borne in relation to withholdings made abroad.

- 17.3 On July 4, 2008, the tax inspection of Tax Group 24/90, of which Telefónica, S.A. is the parent company, was concluded. The taxes subject to review were corporate income tax for the years 2001 to 2004, 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 year 2002 to 2004.

In addition to the above, the Company has proposed additional adjustments to the tax amounts considered by Telefónica Móviles in 2002 (of 2,125 million euros) of approximately 346 million euros in the tax payable. Telefónica has filed an appeal with the Central Administrative Economic Court to dispute the assessment derived from the tax audit, as the Company considers the tax returns to have been prepared in accordance with applicable tax legislation. Therefore, no liability for this issue was reflected in the financial statements.

No material liabilities arose as a result of the inspection of the other items and financial years, and the Company has not and will not file any appeal.

Telefónica, S.A is open to inspection all the taxes since 2005, as well as those for the last six years for taxes applicable to its permanent establishment in Argentina.

The Company does not expect that any additional material liabilities will arise from the years open to inspection.

Meanwhile, the Courts have yet to rule on the appeal filed in relation to the assessments arising from the inspection of corporate income tax for the years 1998 to 2000. These assessments, which were signed in disagreement in October 2004 and July 2005, gave rise to settlement agreements and imposed fines on Telefónica, S.A. The total amount appealed is 140 million euros.

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In 2007, Telefónica, S.A. filed an administrative appeal before the National Court of Justice, requesting that the execution of the settlements and penalties appealed be suspended by providing the appropriate guarantees. Upon conclusion of the trial period, Telefónica presented in writing its conclusions on September 1, 2008.

In relation to the sale by Terra Networks, S.A. (now Telefónica, S.A.) of its stake in Lycos, Inc. in 2004, the Company began procedures to recognize a higher tax loss of up to 7,418 million euros because of measuring as acquisition value for tax purposes, the market value of Lycos, Inc. shares received, 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.

(18) REVENUE AND EXPENSES

18.1 Revenue from operations

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 2008, Rendering of services to group companies included 274 million euros for this item.

Telefónica, S.A. has signed contracts, with effect from January 1, 2008, to provide management support services to Telefónica de España, S.A.U, Telefónica Móviles España, S.A.U., Telefónica O2 Holding Limited and Telefónica Internacional, S.A.U. Revenue received for this concept in 2008 amounted to 25 million euros, recognized under Services rendered to Group companies.

In November 1990, Telefónica, S.A. and Telefónica Argentina, S.A. entered into a management agreement which regulates the consultancy and advisory services provided by Telefónica and the price of such services. Revenue received for this concept in 2008 amounted to 5 million euros, recognized under Services rendered to Group companies.

Operating revenues also include property rental income amounting to 41 million euros, mainly from the lease of office space in Distrito C to several Telefónica Group companies (see Note 7.1).

- 18.2 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 mainly includes billings to Telefónica Móviles España, S.A.U. for 41 million euros and to Telefónica de España, S.A.U. for 28 million euros.

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18.3 Personnel expenses and employee benefits

The breakdown of Personnel expenses is as follows:

<i>(Millions of euros)</i>	2008
Wages and salaries	144
Pension plans (Note 4.h)	6
Social security costs, et al	17
Total	167

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, 2008, 1,496 employees had signed up for the plan. 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 in 2008 amounted to 2.75 million euros.

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 6 million euros in 2008.

In 2008, some executives left this Plan, leading to the reversal of part of the initial extraordinary contributions amounting to 3 million euros.

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

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The main share-based payment plan is the following:

Telefónica, S.A. share plan: Performance Share Plan

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, if targets are met, from July 1, 2009) and the fifth phase begins on July 1, 2010 (with any shares earned 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 years of the 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.

The maximum number of the shares issuable in each of the three outstanding phases at December 31, 2008 is as follows:

	Number of shares	Unit value	End date
1 st phase July 1, 2006	6,530,615	6.43	June 30, 2009
2 nd phase July 1, 2007	5,556,234	7.72	June 30, 2010
3 rd phase July 1, 2008	5,286,980	8.39	June 30, 2011

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Of the total number of shares, those corresponding to Telefónica, S.A. employees, by phase, are as follows:

	Number of shares	Unit value	End date
1 st phase July 1, 2006	1,276,751	6.43	June 30, 2009
2 nd phase July 1, 2007	1,102,711	7.72	June 30, 2010
3 rd phase July 1, 2008	1,248,067	8.39	June 30, 2011

This plan is equity-settled via the delivery of shares to the executives, with a balancing entry for the 11 million euros of employee benefits expense recorded in 2008 made in equity.

The cost of the shares granted to employees of Group subsidiaries is recognized under Reserves and amounts to 52 million euros. As Telefónica, S.A. will reinvoice these amounts to its subsidiaries, related receivable is recognized under Other non-current financial assets (phases II and III) and Other current financial assets (phase I) (see Note 8).

To ensure the Company has enough shares to meet its obligations at the end of the phase commenced in 2006, Telefónica purchased an instrument from a financial institution that will deliver to Telefónica, at the end of the phase, a number of shares determined using the same measure of success as the plan, i.e. an instrument that mirrors the features of the plan. The cost of this instrument was 46 million euros, which in unit terms is 6.43 euros per share (see Note 9.4.1).

For the third phase, Telefónica has arranged a financial instrument under the same conditions as for the first phase, earmarking up to a maximum of 2,500,000 shares (see Note 9.4.1). The cost of the financial instrument is 25 million euros, equivalent to 9.96 euros per option.

18.4 Average number of employees in 2008 and number of employees at year end

Professional category	Employees at 12/31/08			Average no. of employees 2008		
	Women	Men	Total	Women	Men	Total
General managers and chairmen		5	5		5	5
Directors	39	140	179	42	141	183
Managers	76	89	165	77	90	167
Project Managers	85	67	152	88	66	154
University graduates and experts	79	50	129	80	51	131
Administration, clerks, advisors	125	6	131	133	14	147
Total	404	357	761	420	367	787

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18.5 External services

The items composing Finance revenue are as follows:

<i>(Millions of euros)</i>	2008
Rent	11
Repairs and maintenance	5
Independent professional services	96
Bank charges	49
Marketing and advertising	144
Utilities	11
Other expenses	52
Total	368

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, renewable for another five. In addition to rent, the lessor charges the lessee community expenses. Future minimum rentals payable under non-cancellable leases are as follows:

<i>(Millions of euros)</i>	Future minimum payments	Present value
Up to one year	5	5
Between one and five years	20	17
More than five years	51	29
Total	76	51

18.6 Finance revenue

The items composing Finance revenue are as follows:

<i>(Millions of euros)</i>	2008
Dividends from group and joint-venture companies	7,135
Dividends from other companies	41
Interest received from loans to group companies	891
Other financial revenues	160
Total	8,227

Dividends from group companies and associates mainly includes the following dividends received: 2,486 million euros from Telefónica Móviles de España, S.A., 4,002 million euros from Telefónica de España, S.A.U., 267 million euros from Telefónica O2 Czech Republic, a.s, and 314 million euros from Latin American Holding Corporation, B.V.

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In addition, Revenue from equity investments in associates mainly relates to dividends received from Telefónica, S.A.'s investment in Portugal Telecom, which 2008 amounted to 46 million euros.

Interest on loans to group companies includes the return obtained on loans made to subsidiaries to carry out their business (see Note 8.5). Noteworthy is the interest income from Telefónica Móviles México, S.A. de C.V. (259 million euros), Telefónica de España, S.A.U. (250 million euros) and Telefónica Móviles España, S.A.U. (222 million euros).

Other finance revenue mainly includes interest income of 157 million euros.

18.7 Finance costs

The breakdown of Finance costs is as follows:

Finance costs

<i>(Millions of euros)</i>	2008
Interest on payables to group companies and associates	2,652
Finance costs payable to third parties net of gains (losses) on interest rate of financial hedges	339
Other finance costs	36
Total	3,027

The main amounts of Interest on borrowings from and payables to group companies and associates correspond to Telefónica Emisiones, S.A.U. (836 million euros), Telefónica Europe, B.V. (747 million euros) and Telefónica Finanzas, S.A. (777 million euros).

18.8 Exchange differences:

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

<i>(Millions of euros)</i>	2008
On current operations	4
On loans and borrowings	1,521
On hedging derivatives	1,964
On other items	87
Total	3,576

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

<i>(Millions of euros)</i>	2008
On current operations	334
On loans and borrowings	650
On hedging derivatives	2,470
On other items	65
Total	3,519

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The change in exchange gains and losses in 2008 was due mainly to fluctuations in the US dollar/euro exchange rate (the dollar gained 5.78% in 2008) and in the pound sterling/euro exchange (the pound depreciated 23% in 2008), which was offset by the effect of hedges arranged for this purpose.

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

At the end of 2008, Telefónica, S.A. tested its investments in group companies and associates for impairment (see Note 8.2). As a result, it recognized impairment losses of 3,769 million euros for the stake in Telefónica O2 Holdings Limited and 233 million euros for the stake in Telco, S.p.A.

In addition, an impairment loss of 178 million euros on the stake in Portugal Telecom was recognized in the income statement.

The impairment loss on the stake in Telefónica O2 Holdings, Ltd. shown is after the impact of hedges of the net investment.

(19) OTHER INFORMATION

a) Financial guarantees

At December 31, 2008, Telefónica, S.A. had provided financial guarantees for its subsidiaries and investees to secure their transactions with third parties amounting to 31,272 million euros. These guarantees are measured in the Company's financial statements as indicated in Note 4 m).

The main Group companies receiving these financial guarantees are:

Telefónica Emisiones, S.A.U., in relation to guarantees given for issues of debentures and bonds in international markets, the outstanding carrying amount of which at December 31, 2008 was 16,827 million euros. The main change in 2008 was due to the issue in June of five-year bonds for a nominal amount of 1,250 million euros under the EMTN program and the maturity of a bond for nominal amount of 300 million euros on October 30, 2008.

Telefónica Europe, B.V., in relation to guarantees given for debentures and bonds issues in international markets, the outstanding carrying amount of which at December 31, 2008 was 5,064 million euros, for the European commercial paper program, with an outstanding balance of 840 million euros, the syndicated loan granted by various institutions for the O2 acquisition, with an outstanding carrying amount of 4,203 million euros, and other guaranteed bank borrowings for 119 million euros. Changes in the year were mainly due to fluctuations in exchange rates and transactions with commercial paper.

Telefónica Emisiones, S.A.U. and Telefónica Europe, B.V. are wholly owned subsidiaries of Telefónica, S.A., which underwrites all their issues.

Telefónica Finanzas México, S.A. de SOFOM, E.N.R. in relation to guarantees given for the peso bonds in circulation, the outstanding carrying amount of which at December 31, 2008 was 617 million euros.

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Telefónica Finance USA, LCC, in relation to the guarantee provided for the issue of preferred shares in 2002, the outstanding carrying amount of which was 1,939 million euros at December 31, 2008.

Telefónica Finanzas, S.A. in relation to financing from the European Investment Bank for investment projects in Spain, which at December 31, 2008 had an outstanding carrying amount of 1,297 million euros: (a) in the mobile telecommunications network; (b) in the design, acquisition, construction and startup of telephony equipment; and (c) in the Telefónica Group's research and development activities. During the year, financing for a nominal amount equivalent to approximately 502 million euros matured and 450 million euros were drawn down.

b) Litigation

Telefónica is party to several lawsuits or proceedings that are currently in progress in law courts and administrative and arbitration bodies. It is reasonable to assume that this litigation or cases will not materially affect the Company's financial position or solvency, regardless of the outcome. In this respect, we would highlight that the assessment made by the Company takes into consideration reports by legal counsel on each litigation and case.

Among unresolved cases in which Telefónica is a party (see Note 17 for details of tax-related cases), we would highlight the following:

1. Procedures deriving from the voluntary bankruptcy proceeding initiated by Sistemas e Instalaciones de Telecomunicaciones, S.A.U. (SINTEL)

Sintel, a subsidiary of Telefónica until its sale to the Mastec Group in April 1996, was declared bankrupt in 2001 following a proceeding hearing by the Madrid Court of First Instance. As a result of the company's insolvency and liquidation, two criminal proceedings were initiated affecting, among individuals and corporate entities, Telefónica. These were subsequently added to single preliminary proceedings before Federal Examining Court number 1.

After a lengthy process, on December 12, 2007, the court ruled that the case be dismissed and that actions against all the Telefónica directors initially charged be filed, acquitting them of any responsibility. The criminal proceeding for the offence of criminal insolvency and crimes against the Treasury continued only for directors and executives of Sintel, S.A. in office after the sale of the company by Telefónica. This ruling was appealed.

In its judgment of January 16, 2009, Section 4 of the Criminal Court of the Spanish National Court of Justice rejected all the appeals filed against the initial partial dismissal of the cause. Accordingly, the directors involved, as well as Telefónica and Telefónica de España, S.A.U. were cleared of responsibility.

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2. Contentious proceedings in connection with the takeover bid for Terra Networks, S.A. and its subsequent merger with Telefónica

Proceedings derived from the takeover bid

- 2.1 On May 29, 2003, certain Terra Networks, S.A. shareholders filed two class actions with the Supreme Court of New York State against Telefónica, Terra Networks, S.A. and certain directors of Terra Networks, S.A.

These actions alleged mainly that the Telefónica offer was below the intrinsic value of Terra Networks, S.A. shares. Since the actions were brought, both have remained inactive.

- 2.2 The World Association of Shareholders of Terra Networks, S.A. (ACCTER) filed an appeal for judicial review at the National Appellate Court against the ruling of June 19, 2003 by the Spanish National Securities Market Commission (CNMV) authorizing the takeover offer by Telefónica for Terra Networks, S.A. Telefónica appears as an intervening non-party in the procedure.

The appeal was rejected by the National Court via ruling issued on via ruling issued on January 24, 2006, against which ACCTER filed an administrative appeal. This appeal was rejected via ruling issued November 25, 2008 by the Third Section of the Supreme Court of Administrative Appeals, with the appellants charged for the court costs.

Proceedings derived from the merger

- 2.3 On June 30, 2005, ACCTER and its President, on his own account, filed a complaint contesting the merger resolution adopted at the General Shareholders Meeting of Terra Networks, S.A. held on June 2, 2005. The Court of First Instance rejected the claim via ruling on July 14, 2006.

ACCTER and its President appealed this new ruling, which was again rejected by the Barcelona Regional Court in a ruling issued April 7, 2008.

- 2.4 On September 26, 2006, Telefónica was notified of the claim filed by former shareholders of Terra Networks, S.A. (Campoaguas, S.L., Panabeni, S.L. and others) alleging breach of contract in respect of the terms and conditions set forth in the Prospectus of the Initial Public Offering of shares of Terra Networks, S.A. dated October 29, 1999. The case was heard on November 27, 2008, with a judgment to follow in due course.

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3. Claim before the Center for Settlement of Investment Disputes (ICSID) against the Argentine government

As a result of the enactment by the Argentine Government of Public Emergency and Exchange Rules Reform Law 25,561, of January 6, 2002, Telefónica considered that the terms and conditions of the Share Transfer Agreement approved by Decree 2332/90 and the Pricing Agreement ratified by Decree 2585/91, both of which were executed by the Company with the Argentine government had been affected appreciably, since the Law rendered ineffective any dollar or other foreign currency adjustment clauses, or indexation clauses based on price indexes of other countries, or any other indexation mechanism in contracts with the public authorities. The law also required that prices and rates derived from such clauses be denominated in pesos at an exchange rate of one peso to one US dollar.

Accordingly, since negotiations with the Argentine Government were unsuccessful, on May 14, 2003, Telefónica filed a request for arbitration with the International Center for Settlement of Investment Disputes (ICSID) pursuant to the Agreement for the Promotion and Reciprocal Protection of Investments between the Argentine Republic and the Kingdom of Spain. On December 6, 2004, Telefónica filed the Memorial or claim with the ICSID. The ICSID Court is currently considering a plea filed by the Argentine government alleging that the matter is outside its jurisdiction.

On February 15, 2006, Telefónica Argentina, S.A. signed a memorandum of understanding with the Argentine government as a prerequisite to reaching an agreement to renegotiate the transfer contract pursuant to the provisions of Article 9 of Law 25,561. This memorandum of understanding could put an end to the litigation.

Among other issues, the Memorandum of Understanding envisaged the suspension by Telefónica de Argentina, S.A. and Telefónica, S.A. for a period of 210 working days, of all claims, appeals and demands planned or underway, with the administrative, arbitral or legal courts of Argentina or abroad, which were based on events or measures taken as a result of emergency situation established by Law N° 25,561 with regard to the Transfer Agreement and the license granted to Telefónica Argentina. This suspension became effective on October 6, 2006 and has been extended on several times for periods of six months, the last of which was authorized by the ICSID on October 6, 2008.

4. Appeal for judicial review against the ruling of the Central Economic-Administrative Tribunal dated February 15, 2007 rejecting several economic-administrative claims filed by Telefónica against assessments from the National Inspection Office of the Spanish Treasury related to consolidated taxes in 1998, 1999 and 2000.

See Note 17.3.

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5. 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 imposing a fine of approximately 152 million euros for breach of 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, S.A.U. filed an appeal to overturn the decision before the Court of First Instance of the European Communities. 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, to which Telefónica has submitted its comments.

c) Commitments

Agreements with Portugal Telecom (Brazil)

In accordance with the agreements signed between the Telefónica Group and the Portugal Telecom Group governing their 50/50 joint venture, Brasilcel N.V., which groups together their cellular businesses in Brazil, the Portugal Telecom group is entitled to sell to Telefónica, S.A., which is obliged to buy, its holding in Brasilcel, N.V. should there be a change in control at Telefónica or at any of its subsidiaries that hold a direct or indirect ownership interest in Brasilcel, N.V.

Similarly, Telefónica is entitled to sell to the Portugal Telecom group, which will be obliged to buy, its holding in Brasilcel, N.V. if there is a change of control at Portugal Telecom, SGPS, S.A., at PT Móveis, SGPS, S.A or at any of their subsidiaries that hold a direct or indirect ownership interest in Brasilcel N.V.

The price in both cases will be determined on the basis of an independent appraisal (under the terms provided for in the definitive agreements) performed by investment banks, selected using the procedure established in these agreements. The related payment could be made, at the choice of the group exercising the put option, in cash or in shares of the wireless telephony operators contributed by the related party, making up the difference, if any, in cash.

Guarantee provided for Ipse 2000 S.p.A.

At December 31, 2008, the Telefónica Group had provided guarantees for the Italian company Ipse 2000 S.p.A. (holder of a UMTS license in Italy), in which it owns an indirect stake through Telefónica Móviles de España, S.A. and Solivella B.V., for the 365 million euros payable to the Italian government in connection with the grant of the license.

Telefónica, S.A. (together with the other strategic partners of Ipse 2000 S.p.A) arranged a counterguarantee for a bank which, in turn, issued a bank guarantee for the Italian authorities as security for the deferred payment of the UMTS license.

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In the wake of the decision by the Italian government to revoke the UMTS license granted to Ipse 2000 S.p.A., the Company considered that, the contractual conditions governing payment of the license having changed, Ipse was no longer obliged to pay the remaining amount and, the principal obligation no longer existing, the bank guarantee and the partners' counterguarantee (cash collateral) had become extinct. Consequently, the Company lodged an appeal against the government to keep the guarantee from being executed and to return the cash collateral to the shareholders in their respective investments.

On June 15, 2008, the civil court in Rome rejected Ipse 2000 S.p.A. claims, forcing the company to pay for its license in full. Similarly, the State Council rejected the company's appeal against the Italian government's refusal to allow Ipse 2000 S.p.A. to return the additional 5Mhz of spectrum for 826 million euros and to revoke its license.

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 paid by the Company to its directors shall be determined at the General Shareholders' Meeting and shall remain in force until a resolution is adopted at the Shareholders' Meeting to amend it. The Board of Directors shall determine the exact amount to be paid within such limit and the distribution thereof among the Directors. In this respect, 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 Directors' Advisory or Control committees. In addition, the compensation provided for in the preceding paragraphs, deriving from membership on the Board of Directors, shall be 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.

Therefore, the compensation paid to Telefónica, S.A. Directors in their capacity as members of the Board of Directors, the Standing Committee 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. In this respect, it was also agreed that from September 2007, executive directors would not receive the fixed amounts established for their directorships, but only receive the corresponding amounts for discharging their executive duties as stipulated in their respective contracts.

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The following table presents the fixed amounts established for membership to Telefónica Board of Directors, Standing Committee and Advisory or Control committees (in euros).

Position	Board of Directors	Standing Committee	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	