

D. Risk Control Systems

D.1. Give a general description of risk policy in the company and/or its group, detailing and evaluating the risks hedged by the system, as well as an explanation of how far these systems match the profile of each type of risk

Telefónica continually monitors the most significant risks in the main companies comprising its Group. To do so, the Company Model is applied regularly and equally in all the Group companies, which provides an evaluation of the importance of each of the risks that may affect the companies, as well as the degree of control over the same. Thus, the Group has a map that identifies the risks that require specific control and monitoring according to their importance. Likewise, the model matrix includes the operational processes in which each of the risks considered is managed, in order to evaluate the control systems established and to be reasonably sure that such risks will not arise.

Identification of these risks and processes is undertaken by the Directorate General of Internal Audit and Management Resources, which is responsible for internal Group audits, and regularly informs the Audit and Control Committee of Telefónica of the results of its work.

The 50 risks considered by the model are classified in the following categories:

I. Risks Related to Business Processes.

- I.1. Operational risks (risks that could affect the effectiveness and efficiency of operational processes and the provision of services, customer satisfaction and the reputation of Group companies).
- I.2. Integrity risks (internal and external risks)
- I.3. Management and human resources risks (management, administration and leadership; limits on authority, etc.).
- I.4. Technological risks
- I.5. Financial risks

II. Information Risks.

- II.1. Operating information
- II.2. Financial information
- II.3. Strategic evaluation

III. Risks Related to the Environment (competition; relations with shareholders; availability of resources; political, economic, statutory and tax environment; regulation and changes in the industry).

D.2. Indicate the control systems to assess, mitigate and reduce the main risks of the company and its group

The internal control framework adopted by the Telefónica Group is based on the COSO model, widely recognised in international financial circles, the objectives of which are:

- The efficiency and effectiveness of Company operations,
- Protection of its assets,
- The reliability of financial information, and
- Compliance with legislation and regulations.

In addition to the controls established in each of the Company's operational processes, the Group also has the following specific elements of control:

- An internal audit structure that encompasses the entire Telefónica Group and functions in keeping with the criteria and professional rules set out by the International Institute of Internal Auditors (in fact, Telefónica is the first Spanish company to obtain the quality certification from this body).
- The Consolidated Annual Accounts and the individual Annual Accounts of the companies with significant importance are subjected to external audits. Likewise, the external Accounts Auditor is entrusted with the task of making recommendations regarding internal controls in the more important Group companies.
- It should be pointed out that in 2005, the Board of Directors approved a Code of Ethics applicable to the Group's employees.
- Furthermore, to establish appropriate and consistent control systems at the Group, Telefónica has a set of regulations governing basic control issues. The main ones are:
 1. Regulations governing control of Company information and its financial/accounting information system. These are the following:
 - Registration, communication and control of financial/accounting information.
 - Regulations governing disclosure to the markets.
 - Rules of conduct for financial personnel.
 - Intra-group transactions.
 2. Regulations regarding external representation and the relationship between companies:
 - Centralized decision-making on Group transactions.
 - Payments: segregation of functions, joint signature of two persons, bank reconciliations, etc.
 - Purchase of goods and services: budgetary reserve, corporate procedure for awards, formalization of commitments, payment terms, etc.
 - Powers of attorney: to sign contracts, open accounts, dispose of funds, etc.
 3. Regulations governing activities of a personal nature:
 - Managers' travel and entertainment expenses: limits, substantiation, reimbursement, etc.
 - Regulations governing physical safety and security of information.
 4. Regulations governing environmental minimums: standards to be complied with at the Group when the law does not set a higher requirement.

- The Group has also an Intervention Unit to control the use of funds, the relevant transactions and operations, travel and hospitality expenses, implementation of basic controls in the processes of greatest risk, etc.

A channel for complaints was also put in place in 2005. It was created by the Audit and Control Committee of the Board of Directors to allow any employee of Group Telefónica to file complaints, on an entirely anonymous basis, if so desired, regarding the internal control of financial statements, accounting records or audits.

- Telefónica also has Units responsible for controlling certain specific risks: Risks and Insurance, Reputation, Regulation, Quality and Human Resources (labour risks).

Within the Group risks, and due to their particular relevance for investors and shareholders, it is important to emphasise the control system applied to the process of financial-accounting information. In Telefónica, this process is regulated by the following manuals, instructions and regulations:

- Manual of Rules for Evaluation and Accounting Policies
- Instructions for closing and external audits.
- Annual calendar of financial accounting information.
- Corporate Accounting Plan.
- Manual of the Subsidiary Information System (a technical-computing instrument for reporting financial-accounting information and consolidating financial statements).
- Rules of intra-group operations and internal control.

The efficiency of internal controls for the financial report is monitored on an annual basis both in the process of drawing up the financial statements and in the main processes through which information is entered into the accounting system. This practice is mandatory for Telefónica S.A. and for Group companies in their capacity as “SEC registrants.”

D.3. If any of the risks facing the group and/or its companies have materialized, indicate the circumstances and whether the established control systems worked adequately

The Telefónica Group has not detected any situations that could lead it to conclude that the basic objectives that define the internal control model have not been reasonably protected.

The internal control model used by Telefónica and its Group is subjected to continual monitoring such that when a risk appears or a control deficiency is found in any process that increases exposure above a reasonable level, the relevant action plans are drawn up incorporating the necessary improvements. The most important aspects of the action plans undertaken are reported to and monitored by the Audit and Control Committee until they are fully implemented.

D.4. Indicate whether there is a committee or other governing body in charge of establishing and supervising these control systems and explain its duties

The Board of Directors of Telefónica has constituted an Audit and Control Committee whose duties, competencies and rules of

operation are set out in the Articles of Association and in the Regulations of the Board of Directors. Such regulations comply with all legal requirements as well as with the recommendations for good corporate governance issued by both national and international bodies. One of the duties of this Committee is to be familiar with the financial information process and the internal Company control systems.

D.5. Identify and describe the processes for compliance with the regulations applicable to the company and/or its group

The great majority of the companies comprising the Telefónica Group operate in the telecommunications sector, which is subject to regulation in nearly all the countries where the Group is present. Amongst the basic objectives of the internal control model described above is objectives compliance with those laws and regulations that affect the Telefónica Group’s activities. In particular, the Group has units exercising specific control over this type of risks, especially through its legal services and in the area of corporate regulation.