AUDIT REPORT

* * * *

TELEFÓNICA, S.A.
Financial Statements and Management Report
for the year ended
December 31, 2007

ERNST & YOUNG

ERNST & YOUNG

Torre Picasso
Plaza Pablo Ruiz Picasso, 1
28020 Madrid

Teléfono: 915 727 200
Fax: 915 727 270
www.ey.com/es

Translation of a report and financial statements originally issued in Spanish. In the event of a discrepancythe Spanish-language version prevails (See Note 20)

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 consist of the balance sheet as of December 31, 2007, the profit and loss account 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 generally accepted auditing standards 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. In compliance with Spanish mercantile law, for comparative purposes, the Company's Directors have included for each of the captions presented in the balance sheet, the profit and loss account and the statement of source and application of funds, in addition to the figures of 2007, those of 2006. Our opinion refers only to the financial statements for 2007. On March 1, 2007 we issued our audit report on the 2006 financial statements, in which we expressed an unqualified opinion.

3. In our opinion, the accompanying 2007 financial statements give a true and fair view, in all material respects, of the net equity and financial position of Telefónica, S.A. at December 31, 2007 and of the results of its operations and of the source and application of funds for the year then ended, and contain the required information necessary for their adequate interpretation and understanding, in conformity with generally accepted accounting principles and criteria in Spain, applied on a basis consistent with those of the preceding year.

4. The accompanying management report for the year ended December 31, 2007 contains such explanations as the Directors consider appropriate concerning the situation of Telefónica, S.A., the evolution of its business and other matters, and is not an integral part of the financial statements. We have checked that the accounting information included in the report mentioned above agrees with the financial statements for the year ended December 31, 2007. 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.

José Luis Perelli Alonso

February 28, 2008

Ernst & Young, S.L.
Domicilio Social: Plaza Pablo Ruiz Picasso, 1. 28020 Madrid.
Inscrita en el Registro Mercantil de Madrid al Tomo 12749, Libro 0,
Folio 215, Sección 8ª, Hoja M-23123, Inscripción 116. C.I.F. B-78970506

TELEFÓNICA, S.A.

ANNUAL FINANCIAL STATEMENTS AND MANAGEMENT REPORT FOR 2007

TELEFÓNICA, S.A.
BALANCE SHEET AT DECEMBER 31

ASSETS (millions of euros)		2007	2006
A)	**NON-CURRENT ASSETS**	**71,348**	**74,333**
I.	**Intangible assets (Note 5)**	**97**	**76**
	Computer software	188	177
	Intellectual property	28	26
	Other intangible assets	103	64
	Accumulated amortization and provisions	(222)	(191)
II.	**Property, plant and equipment (Note 6)**	**765**	**742**
	Land and buildings	595	520
	Plant and machinery	200	126
	Furniture, tools and other items	36	22
	Other items of property, plant and equipment	58	42
	Property, plant and equipment under construction	22	144
	Accumulated depreciation and provisions	(146)	(112)
III.	**Long-term investments (Note 7)**	**70,486**	**73,515**
	Investments in Group companies	69,274	61,375
	Investments in associated companies	3,025	870
	Other investments	752	614
	Loans to Group and associated companies	10,281	12,501
	Other loans	49	178
	Long-term deposits and guarantees given	365	349
	Tax receivables (Note 14.2)	2,116	3,166
	Provisions	(15,376)	(5,538)
B)	**DEFERRED CHARGES (Note 8)**	**288**	**367**
C)	**CURRENT ASSETS**	**11,514**	**7,748**
I.	**Accounts receivable**	**584**	**314**
	Trade receivables	22	19
	Receivable from Group companies	212	222
	Receivable from associated companies	14	7
	Other accounts receivable	31	12
	Employee receivables	-	1
	Tax receivables (Note 14.2)	327	63
	Provision for bad debts	(22)	(10)
II.	**Short-term investments**	8,758	**6,154**
	Loans to Group and associated companies (Note 7.6)	8,216	5,915
	Short-term investment securities (Note 7.9)	542	239
III.	**Short-term treasury stock (Note 9)**	**232**	**261**
IV.	**Cash**	**1,913**	**981**
V.	**Prepayments and accrued income**	**27**	**38**
TOTAL ASSETS		**83,150**	**82,448**

The accompanying Notes 1 to 20 and Appendix I are an integral part of the balance sheet.

TELEFÓNICA, S.A.
BALANCE SHEET AT DECEMBER 31

	LIABILITIES (millions of euros)	2007	2006
A)	**SHAREHOLDERS' EQUITY (Note 9)**	**18,253**	**16,956**
I.	**Share capital**	**4,773**	**4,921**
II.	**Share premium**	**521**	**2,589**
III.	**Revaluation reserves**	**191**	**1,369**
IV.	**Reserves**	**7,800**	**1,251**
	Legal reserve	984	**984**
	Reserve for treasury stock	232	**261**
	Other reserves	6,584	**6**
V.	**Profit for the year**	**6,620**	**8,284**
VI.	**Interim dividend paid in the year**	**(1,652)**	**(1,458)**
B)	**PROVISIONS FOR LIABILITIES AND CHARGES (Notes 7 and 16)**	**1,969**	**1,568**
C)	**LONG-TERM LIABILITIES**	**42,276**	**49,264**
I.	**Debentures, bonds and other marketable debt securities (Note 10)**	**1,097**	**1,827**
	Non-convertible debentures and bonds	916	1,332
	Other marketable debt securities	181	495
II.	**Payable to credit institutions (Note 11)**	**8,435**	**10,755**
III.	**Payable to Group and associated companies (Note 12)**	**32,372**	**36,318**
IV.	**Other payables**	**8**	**7**
V.	**Taxes payable (Note 14.2)**	**364**	**212**
VI.	**Unpaid portion of investments in Group and associated companies (Note 7.1.b)**	-	**145**
D)	**CURRENT LIABILITIES**	**20,652**	**14,660**
I.	**Debentures, bonds and other marketable debt securities (Note 10)**	**1,691**	**2,098**
	Non-convertible debentures and bonds	421	500
	Other marketable debt securities	1,237	1,541
	Interest on debentures and other securities	33	57
II.	**Payable to credit institutions**	**671**	**329**
	Loans and other accounts payable (Note 11)	607	245
	Accrued interest payable	64	84
III.	**Payable to Group and associated companies (Note 12)**	**18,008**	**11,916**
IV.	**Trade accounts payable**	**95**	**132**
V.	**Other non-trade payables**	**187**	**185**
	Taxes payable (Note 14.2)	27	27
	Other non-trade payables (Note 15)	160	158
	TOTAL LIABILITIES	**83,150**	**82,448**

The accompanying Notes 1 to 20 and Appendix I are an integral part of the balance sheet.

TELEFÓNICA, S.A.
INCOME STATEMENT FOR THE YEARS ENDED DECEMBER 31

	DEBIT (millions of euros)	2007	2006
A)	**EXPENSES**		
	Personnel expenses (Note 16.2)	**156**	**197**
	Depreciation and amortization expense	**65**	**51**
	Property, plant and equipment (Note 6)	34	21
	Intangible assets (Note 5)	31	30
	Other operating expenses	**366**	**385**
	External services provided by Group companies (Note 16.8)	69	80
	External services	275	291
	Taxes other than income tax	17	14
	Other operating expenses	5	-
I.	**OPERATING PROFIT**	**-**	**-**
	Financial and similar expenses		
	From liabilities with Group companies (Notes 16.4 and 16.8)	2,585	2,149
	From other liabilities and similar expenses (Note 16.4)	541	574
	Change in provisions for writedown of short-term investments	-	(11)
	Amortization of deferred charges	69	63
	Exchange losses (Note 16.5)	1,193	1,031
II.	**FINANCIAL PROFIT**	**14,083**	**5,195**
III.	**INCOME FROM ORDINARY ACTIVITIES**	**13,724**	**4,706**
	Changes in provisions for securities investments (Note 7.3)	9,875	(231)
	Extraordinary expenses and losses (Note 16.7)	480	8
IV.	**EXTRAORDINARY INCOME**	**-**	**2,295**
V.	**PROFIT BEFORE TAXES**	**5,178**	**7,001**
	Corporate income tax in Spain (Note 14)	(1,475)	(1,293)
	Foreign taxes (Note 14)	33	10
VI.	**PROFIT FOR THE YEAR**	**6,620**	**8,284**

The accompanying Notes 1 to 20 and Appendix I are an integral part of the income statement.

TELEFÓNICA, S.A.
INCOME STATEMENT FOR THE YEARS ENDED DECEMBER 31

CREDIT (millions of euros)		2007	2006
B)	**REVENUES**		
	Net sales to Group companies (Note 16.1)	**90**	**28**
	Other operating revenues	**138**	**116**
	Non-core and other current operating revenues – Group companies (Note 16.1)	118	**98**
	Non-core and other current operating revenues – Non-Group companies	20	**18**
I.	**OPERATING LOSS**	**359**	**489**
	Revenue from equity investments	**15,335**	**6,835**
	Group companies (Note 16.8)	15,099	6,678
	Associated companies	211	50
	Non-Group companies	25	107
	Revenues from other securities and loans (Note 16.4)	**1,165**	**1,131**
	Group companies (Note 16.8)	1,002	1,033
	Other companies	163	98
	Exchange gains (Note 16.5)	**1,971**	**1,035**
II.	**FINANCIAL LOSS**	**-**	**-**
III.	**LOSSES ON ORDINARY ACTIVITIES**	**-**	**-**
	Gains on disposal of fixed assets (Note 16.6)	1,785	1,872
	Extraordinary revenues (Note 16.6)	24	200
IV.	**EXTRAORDINARY LOSS**	**8,546**	**-**
V.	**LOSSES BEFORE TAXES**	**-**	**-**
VI.	**LOSS FOR THE YEAR**	**-**	**-**

The accompanying Notes 1 to 20 and Appendix I are an integral part of the income statement.

TELEFÓNICA, S.A.

NOTES TO THE FINANCIAL STATEMENT FOR THE YEAR ENDED DECEMBER 31, 2007

(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 supplementary 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.

Merger of Telefónica, S.A. and Telefónica Móviles, S.A.

At their respective meetings held on March 29, 2006, the Boards of Directors of Telefónica, S.A. and Telefónica Móviles, S.A. approved a merger agreement, whereby Telefónica, S.A. would take over Telefónica Móviles, S.A., resulting in the dissolution without liquidation of Telefónica Móviles, S.A. and the block transfer of all its equity.

The merger agreement was approved at the General Shareholders’ Meetings of Telefónica Móviles S.A. and Telefónica, S.A. held on June 20 and June 21, 2006, respectively.

Pursuant to the agreement, Telefónica transferred shares from treasury stock to Telefónica Móviles shareholders at the exchange ratio established in the merger agreement of 4 Telefónica shares, par value of 1 euro, for every 5 Telefónica Móviles shares, par value of 0.50 euros. No additional cash payment was involved and no new shares were issued. Prior to the exchange, Telefónica Móviles, S.A. paid a dividend of 0.435 euros per share. This, coupled with the 0.205 euros per share dividend charged to 2005 profit, led to a total dividend of 0.64 euros per share, which was paid on July 21, 2006.

July 28, 2006 was the last trading day for Telefónica Móviles, S.A. shares, which were cancelled as a result of the merger. The merger was registered in the Madrid Mercantile Register on July 29, 2006, effective for accounting purposes from January 1, 2006.

The economic effects of the merger are dated from January 1, 2006. The main effects of this transaction are detailed in the accompanying notes to the annual financial statements. In addition, the main financial statements also include the amounts of the merger transaction in different columns.

(2) BASIS OF PRESENTATION

True and fair view

The accompanying annual financial statements were 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, as implemented by the Spanish Chart of Accounts in force at that date of these financial statements, and accordingly, give a true and fair view of the Company's equity, financial situation, results of operations and of the funds obtained and applied in 2007.

These annual financial statements will be submitted for approval by shares in the General Meeting, and it is expected that they will be approved with any changes. The annual financial statements for 2006 were approved at the General Shareholders' Meeting held on May 10, 2006.

Comparative information

There were no changes in the structure of the balance sheet or income statement with respect to the previous year. In addition, no material changes were made to accounting criteria with respect to 2006.

No additional significant events have taken place that prevent comparison of the figures for 2007 with those of 2006.

The figures in these annual financial statements and management report are expressed in millions of euros unless otherwise indicated.

New General Chart of Accounts

On November 20, 2007, Royal Decree 1514/2007 was published approving the new General Chart of Accounts (GCA). The new GCA went into effect on January 1, 2008 and its application is mandatory as of that date.

The Company is preparing a transition plan for adapting to the new accounting regulations, which includes, among other matters, analyzing the various differences in accounting criteria and principles, determining the date of the opening balance sheet, selecting the principles and criteria to be applied during the transition, and evaluating the necessary changes in procedures and information systems. The final accounting effects will be disclosed in the 2008 annual accounts.

(3) PROPOSED APPROPRIATION OF PROFIT

Telefónica, S.A. obtained 6,620 million euros of profit in 2007.

At its meeting of September 26, 2007, Telefónica, S.A.'s Board of Directors resolved to pay an interim dividend against 2007 profit of 0.35 euros per outstanding share carrying dividend rights. This dividend was paid on November 14, 2007, and the total amount paid was 1,652 million euros.

In addition, at its meeting of February 27, 2008, the Company's Board of Directors agreed to submit for approval at the Shareholders' Meeting the distribution of a final dividend charged to 2007 profit of a fixed amount of 0.40 euros per outstanding share carrying dividend rights, up to a maximum total amount of 1,909 million euros.

Accordingly, the Company's Board of Directors will submit the following proposed appropriation of 2007 profit for approval at the General Shareholders' Meeting:

	Millions of euros
Total distributable profit	6,620
Interim dividend (paid in November 2007)	1,652
Final dividend (maximum distributable amount of 0.40 euros per share for all shares into which the Company's share capital is divided: 4,773,496,485 shares)	1,909
Voluntary reserves	(minimum) 3,059
Total	**6,620**

(4) VALUATION CRITERIA

The main valuation criteria used in preparing the 2007 annual accounts were as follows:

a) Intangible assets

This heading includes mainly the following:

1. Computer software licenses, which are recorded at cost and amortized on a straight-line basis over 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 a period of three to 10 years, depending on the estimated useful life of the patent or trademark.

3. The goodwill arising from the 2005 merger of Telefónica, S.A. and Terra Networks, S.A. This goodwill is amortized on a straight-line basis. It is estimated to have a useful life of 10 years and is included in "Other intangible assets."

b) Property, plant and equipment

Property, plant and equipment are stated at cost.

Expenses incurred for expansion, remodeling or improvements which increase the productivity, capacity, or prolong the useful life of the asset are capitalized as an increase in the cost of the assets.

The interest and other financial expenses incurred during the construction of property, plant and equipment are also capitalized.

Repairs and maintenance expenses are charged to the income statement of the year incurred.

Property, plant and equipment are depreciated by the straight-line method at annual rates based on the following estimated useful lives:

	Years of estimated useful life
Buildings	40
Plant and machinery	3-25
Furniture, tools and other items	10
Other items of property, plant and equipment	4-10

c) Long-term investments

Investments in marketable securities are recorded as follows:

1. Listed securities (excluding shares in Group or associated companies).

   At the lower of cost or market value. Market value is taken to be the lower of the average official listing for the fourth quarter or the listed value at year end.

2. Investments in Group and associated companies.

   At the lower of acquisition cost or underlying book value of the holdings, adjusted by existing capital gains upon acquisition which prevail at a subsequent valuation date.

3. Other unlisted securities.

   At cost, net of the writedown provisions required to reduce them to their underlying book value, adjusted for the amount of the existing capital gains upon acquisition which prevail at the subsequent valuation date.

Unrealized losses (i.e. where cost is higher than market value) are recorded under "Provisions" (see Note 7.3). However, an additional provision is recorded with a debit (or credit in the case of reversal) to "Extraordinary income" (or "Extraordinary losses") to cover possible third-party liabilities arising from the negative net equity of investees. This provision is included in "Provisions for liabilities and charges" (see Notes 16.6 and 16.7).

Dividends are recorded as income as soon as their distribution is approved, and gains or losses on the disposal of holdings are recorded as income or expenses in the year in which they are realized.

As required under prevailing legislation, the Company has prepared separate consolidated annual accounts, drawn up in accordance with International Financial Reporting Standards (IFRS). The balances of the main headings of the Telefónica Group consolidated financial statements for 2007 are as follows:

Heading	Millions of euros
Total assets	105,873
Equity	
Attributable to equity holders of the parent	20,125
Attributable to minority interests	2,730
Revenue	56,441
Profit (loss) for the year	
Attributable to equity holders of the parent	8,906
Attributable to minority interests	213

d) Deferred charges

This heading basically includes the following items:

1. Interest on long-term promissory notes.

   This relates to the difference between the face value and the effective value of the promissory notes issued maturing over more than one year. This interest is charged to profit or loss based on financial criteria.

2. Debt issuance expenses.

   These relate to long-term debt issuance expenses and premiums on debentures and bonds, which are amortized by the interest method on the basis of the principal amounts outstanding.

3. Prepayments.

   These relate to payments made on the purchase of services not yet received at the balance sheet date.

e) Treasury stock

Treasury stock is valued at the lower of average cost, comprising the total amount paid for the shares, or market value. When these shares are acquired without any prior resolution having been adopted at the Shareholders' Meeting to use them to reduce share capital, it is considered that they can be used for subsequent sale or, alternatively, for a capital reduction. Accordingly, the market value is taken to be the lower of the average official market price or the related underlying book value. The allocated provision is recorded against the income statement for the difference between acquisition cost and the lower of the year-end market price or the average market price in the last quarter, and against reserves for the difference between this amount and the related underlying book value.

f) Foreign currency transactions

Fixed-income securities and receivables and payables denominated in foreign currencies are translated to euros at the prevailing exchange rates at the transaction date, and are adjusted to the year-end exchange rates.

Exchange differences are classified by currency and due date, and for this purpose all currencies that, although different, are officially convertible are grouped together.

Any positive net differences in each group of currencies are recorded under "Deferred income" on the liability side of the balance sheet, unless exchange losses for the Group have been charged to profit and loss in prior years, in which case the positive net differences are credited to income up to the limit of the negative net differences charged to income in prior years.

Deferred exchange gains are taken to income of the year in which they materialize, the corresponding credit/debit balances are cancelled in advance or as equal or higher exchange losses for each standard currency group are recognized.

g) Pensions and other commitments to employees

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 income as incurred.

h) Accounts payables

Accounts payable are recorded at repayment value, except in the case of zero-coupon debenture and bond issues, which are recorded in the balance sheet at issuance value plus the related accrued interest (see Note 10.3).

i) Derivatives

Transactions made to eliminate or significantly reduce exchange rate, interest and market risks on asset and liability positions or other transactions are considered hedges. The gains or losses arising during the life of these derivatives are taken to income using the same timing of recognition method as that used to recognize the gains or losses on the underlying hedged item or transaction.

Transactions that are not assigned to cover specific risks are not treated as hedging transactions. In transactions of this kind, which can arise because of hedges of risks at other Group companies and are not originally designated as hedges, the differences in market price are recorded when the transactions are cancelled or finally settled. However, if potential losses are anticipated at year end, the related provision is recorded, with a charge to the income statement.

j) Corporate income tax

The corporate income tax expense for each year is calculated on the basis of book profit before taxes, increased or decreased, as appropriate, by the permanent differences from taxable income. Allowances and deductions from gross tax payable, net of withholdings and prepayments on account, are deducted from the corporate income tax charge in the year in which they are taken. The difference between the accrued expense and the tax paid is due to revenue and expense recognition timing differences giving rise to deferred tax assets and liabilities (see Note 14).

k) Recognition of revenues and expenses

Revenues and expenses are recorded according to the accruals principle, that is, at the moment the goods or services represented by them take place, regardless of when actual payment or collection occurs.

In keeping with the principle of prudence, realized income is only recorded at the balance sheet date, while foreseeable risks and potential losses are recorded when known (see Note 16).

l) Provision for liabilities and charges

The Company records provisions for contingencies and expenses based on its best estimate in order to cover quantifiable probable or certain third-party liabilities arising from litigation in progress, indemnity payments and obligations or from expenses of undetermined amount, and collateral and other similar guarantees provided by the Company.

(5) INTANGIBLE ASSETS

The breakdown and movement in intangible asset accounts and the related accumulated amortization in 2007 and 2006 is as follows:

	Millions of euros				
	Balance at 12/31/06	**Additions**	**Disposals**	**Transfers**	**Balance at 12/31/07**
Cost:					
Computer software	177	6	(8)	13	188
Intellectual property	26	1	-	1	28
Other intangible assets	64	13	-	26	103
Intangible assets, gross	**267**	**20**	**(8)**	40	**319**
Accumulated amortization:					
Computer software	152	16	-	-	168
Intellectual property	23	1	-	-	24
Other intangible assets	14	14	-	-	28
Total accumulated amortization	**189**	**31**	-	-	**220**
Provisions	**2**	-	-	-	**2**
Intangible assets, net	**76**	**(11)**	**(8)**	**40**	**97**

	Millions of euros					
	Balance at 12/31/05	**Merger with Telefónica Móviles**	**Additions**	**Disposals**	**Transfers**	**Balance at 12/31/06**
Cost:						
Computer software	153	6	(8)	-	-	177
Intellectual property	20	5	-	-	-	26
Other intangible assets	62	-	-	-	-	64
Intangible assets, gross	**235**	**11**	**(8)**	-	-	**267**
Accumulated amortization:						
Computer software	124	6	-	-	-	152
Intellectual property	17	5	-	-	-	23
Other intangible assets	7	-	-	-	-	14
Total accumulated amortization	**148**	**11**	-	-	-	**189**
Provisions	**2**	-	-	-	-	**2**
Intangible assets, net	**85**	-	**(8)**	-	-	**76**

6) PROPERTY, PLANT AND EQUIPMENT

The breakdown and movement in this heading and related accumulated depreciation in 2007 and 2006 is the following:

	Millions of euros				
	Balance at 12/31/06	Additions	Disposals	Transfers	Balance at 12/31/07
Cost:					
Land and buildings	520	22	(1)	54	595
Plant and machinery	126	44	-	30	200
Furniture, tools and other items	22	14	-	-	36
Other items of property, plant and equipment	42	12	-	4	58
Property, plant and equipment under construction	144	6	-	(128)	22
Property, plant and equipment, gross	**854**	**98**	**(1)**	**(40)**	**911**
Accumulated depreciation:					
Buildings	62	12	-	-	74
Plant and machinery	19	17	-	-	36
Furniture, tools and other items	5	4	-	-	9
Other items of property, plant and equipment	22	1	-	-	23
Total accumulated depreciation	**108**	**34**	**-**	**-**	**142**
Provision	**4**	**-**	**-**	**-**	**4**
Property, plant and equipment, net	**742**	**64**	**(1)**	**(40)**	**765**

	Millions of euros					
	Balance at 12/31/05	Merger with Telefónica Móviles	Additions	Disposals	Transfers	Balance at 12/31/06
Cost:						
Land and buildings	214	-	54	-	252	520
Plant and machinery	6	5	69		46	126
Furniture, tools and other items	4	3	7	-	8	22
Other items of property, plant and equipment	29	5	2	-	6	42
Property, plant and equipment under construction	356	-	100	-	(312)	144
Property, plant and equipment, gross	**609**	**13**	**232**	**-**	**-**	**854**
Accumulated depreciation:						
Buildings	54	-	8	-	-	62
Plant and machinery	5	4	10	-	-	19
Furniture, tools and other items	2	2	1	-	-	5
Other items of property, plant and equipment	15	5	2	-	-	22
Total accumulated depreciation	**76**	**11**	**21**	**-**	**-**	**108**
Provision	**4**	**-**	**-**	**-**	**-**	**4**
Property, plant and equipment, net	**529**	**2**	**211**	**-**	**-**	**742**

"Additions" in 2007 and 2006 mostly relate to costs associated with the construction of the new Telefónica Group central offices (named "District C") in a business park development in Las Tablas (Madrid). "Land and buildings" includes 86 million euros related to the value of the land.

"Transfers" from property, plant and equipment under construction to other asset accounts relate to the start-up of the various phases of District C, which were fully operational at year end.

Firm commitments to acquire property, plant and equipment at December 31, 2007 amounted to 7 million euros.

Capitalized interest and other financial expenses incurred in the construction of property, plant and equipment in 2007 amounted to 1 million euros (4 million euros in 2006).

The Company has buildings with a total area of 550,413m² leased to other Telefónica Group companies. This is equivalent to an occupancy rate of 94% of total property available for lease. Revenue from property leases amounted to 31 million euros in 2007 (see Note 16.1), compared to 9 million euros in 2006.

In 2006, the Company recorded a gain of 7 million euros on the disposal of property, plant and equipment (see Note 16.6).

At December 31, 2007, 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.

(7) INVESTMENTS

7.1 The breakdown and movement in "Long-term investments" is the following:

	Millions of euros				
	Balance at 12/31/06	**Increases**	**Decreases**	**Transfers and other**	**Balance at 12/31/07**
Investments in Group companies	61,375	9,005	(1,094)	(12)	69,274
Investments in associated companies	870	2,315	(160)	-	3,025
Other investments	614	138	-	-	752
Loans to Group and associated companies	12,501	33	(755)	(1,498)	10,281
Other loans	178	3	(15)	(117)	49
Deposits and guarantees	349	28	(12)	-	365
Tax receivables (Note 14.2)	3,166	1,691	(2,458)	(283)	2,116
Total	**79,053**	**13,213**	**(4,494)**	**(1,910)**	**85,862**

	Millions of euros					
	Balance at 12/31/05	**Merger Telefónica Móviles, S.A.**	**Increases**	**Decreases**	**Transfers and other**	**Balance at 12/31/06**
Investments in Group companies	23,128	9,043	27,939	(5)	1,270	61,375
Investments in associated companies	1,098	5	1	(202)	(32)	870
Other investments	1,848	-	-	-	(1,234)	614
Loans to Group and associated companies	14,004	686	76	(378)	(1,887)	12,501
Other loans	1	123	54	-	-	178
Deposits and guarantees	6	338	5	-	-	349
Tax receivables (Note 14.2)	3,256	467	1,725	(2,155)	(127)	3,166
Total	**43,341**	**10,662**	**29,800**	**(2,740)**	**(2,010)**	**79,053**

Investments sold and acquired by Telefónica are as follows:

a) Acquisitions of equity investments and capital increases:

2007

Company	Millions of euros
Subsidiaries:	
O2 Europe Ltd	8,520
Telefónica International Wholesale Services America, S.A	407
Atento, N.V.	70
Telefónica Ingeniería de Seguridad, S.A.	6
Others	2
Total subsidiaries:	**9,005**
Associated companies:	
Telco, S.p.A.	2,314
Others	1
Total associated companies:	**2,315**
Other investments	
PT Multimedia, S.G.P.S., S.A.	136
Others	2
Total other investments	**138**

On December 20, 2007, Telefónica O2 Europe Plc (formerly O2 Plc) paid Telefónica, S.A. a dividend in kind entailing the transfer of 100% of the shares it held of O2 Europe Ltd. O2 Europe Ltd is the parent to a group of Telefónica companies in Germany. The valuation of the dividend at the transfer date was 8,500 million euros (see Note 16.8). In addition, on December 27, 2007, O2 Europe Ltd increased capital by 20 million euros via the issuance of 100 new shares.

On July 2, 2007, approval was given at the Extraordinary General Shareholders' Meeting of Telefónica International Wholesale Services America, S.A. to convert into equity the participating facility between this company at Telefónica, S.A., dated July 31, 2003, whose capital plus accrued interest amounted to 549 million US dollars (407 million euros). After this transaction, Telefónica, S.A. owned 80.56% of the share capital of Telefónica International Wholesale Services America, S.A.

On April 23, 2007, General de Participaciones Empresariales, S.L. (GPE), a subsidiary of Banco Bilbao Vizcaya Argentaria, S.A., announced its intention of exercising the put option granted by Telefónica on all the shares it owned in Atento N.V. at that date. As a result, on July 31, 2007, a purchase-sale contract was signed for Telefónica, S.A. to acquire 10,044 shares owned by GPE, representing 8.65% of Atento N.V.'s share capital, for 70 million euros. The acquisition price may be adjusted up to April 1, 2008, in accordance with certain conditions. After this operation, Telefónica, S.A. controlled 100% of the shares of Atento, N.V.

In addition, in July 2007 Telefónica, S.A. paid off before maturity two participating loans granted to Telefónica Ingeniería de Seguridad, S.A. for 5.5 million euros for their conversion into capital. Telefónica, S.A. owns 100% of the shares of this company.

On April 28, 2007, Telefónica, S.A., together with its partners Assicurazioni Generali S.p.A., Intesa Sanpaolo, S.p.A., Mediobanca S.p.A. and Sintonía, S.A. (Benetton), entered into a Co-Investment Agreement and Shareholders Agreement with a view to establishing the terms and conditions of their acquisition of an indirect shareholding in Telecom Italia S.p.A. through an Italian company, currently called Telco S.p.A., in which Telefónica has a 42.3% interest. Both agreements were modified on October 25, 2007 following the inclusion of the Assicurazioni Generali Group companies indicated hereafter and the Shareholders Agreement was further amended on November 19, 2007.

On October 25, 2007 Telco, S.p.A. acquired 100% of Olimpia, S.p.A., which held 17.99% of the voting shares of Telecom Italia, S.p.A. Also on that date, Assicurazioni Generali S.p.A. (together with its group companies Alleanza Assicurazioni S.p.A., INA Assitalia S.p.A., Volksfürsorge Deutsche Lebenversicherung A.G. and Generali Vie S.A.) and Mediobanca S.p.A. contributed a total share of 5.6% of Telecom Italia S.p.A.'s voting shares (4.06% and 1.54%, respectively) to Telco S.p.A.

On December 10, 2007, an agreement was reached to takeover and merge Olimpia S.p.A. into Telco S.p.A., making Telco S.p.A's entire stake in the voting shares of the Italian operator (23.6%) direct and leaving Telefónica with an indirect holding in the voting shares of Telecom Italia S.p.A. of 9.98% (6.88% of the dividend rights) for 2,314 million euros.

The Shareholders Agreement signed on April 28, 2007 contained a general clause whereby both Telefónica, at the shareholders meetings of Telco S.p.A. and Telecom Italia S.p.A, and the Telefónica directors appointed to the companies' respective boards, would abstain from participating in and voting at the meetings dealing with issues regarding the provision of telecommunications services by companies controlled by Telecom Italia S.p.A., in countries where there are legal or regulatory restrictions on the exercise of voting rights by Telefónica.

However, as indicated above, on November 19, 2007 the partners amended the Shareholders Agreement, as well as the bylaws of Telco S.p.A., to include the specific limitations imposed by the Brazilian telecommunications regulator, Agência Nacional de Telecomunicações ("ANATEL"), as initially posted on its website on October 23, 2007 and subsequently published on November 2, 2007 as ANATEL's "Ato" no. 68,276 dated October 31, 2007.

On November 7, 2007 Portugal Telecom, S.G.P.S., S.A. granted a dividend in kind whereby Telefónica, S.A. obtained the right to receive 0.176067 shares of PT Multimedia, S.G.P.S., S.A. (listed on the Lisbon Stock Exchange and whose main shareholder was Portugal Telecom) for each of the 90,150,075 shares of Portugal Telecom held by the Company. The valuation of the shares received upon their distribution was 9.18 euros per share. Accordingly, Telefónica, S.A. recorded dividend income of 160 million euros (see Note 16.9). The dividend received is subject to a 15% tax. As a result, the shares of PT Multimedia received by Telefónica, S.A. amounted to 14,838,497, representing 4.80% of the company's share capital, valued at 136 million euros.

2006

Company	Millions of euros
Subsidiaries:	
O2 Plc	24,888
Telefónica Móviles, S.A.	2,978
Others	73
Total subsidiaries:	**27,939**

In 2006, Telefónica, S.A. acquired 100% of the shares of British company O2 plc. The total acquisition cost was 26,154 million euros (17,887 million pounds sterling), of which 1,266 million euros (859 million pounds) was paid in 2005. The value of the investments acquired in 2005 was recorded under "Other investments" in the balance sheet at December 31, 2005, until the merger took effect in January 2006. It was then restated to "Investments in Group companies" and recorded under "Transfers" in the table of movements.

Under the terms of the merger agreement between Telefónica, S.A. and Telefónica Móviles, S.A. (see Note 1), Telefónica acquired 927,917,620 shares of Telefónica Móviles, S.A., representing 21.43% of its share capital, which formerly belonged to Telefónica Internacional, S.A. (a wholly-owned subsidiary of Telefónica). This intragroup transfer meant that Telefónica, S.A.'s investment in Telefónica Móviles, S.A. was now directly wholly-owned, thereby avoiding creating any indirect treasury stock holdings as a result of the merger.

The shares transferred were priced at 8.653 euros per share. The acquisition cost of these shares, after deducting the margin on the transaction generated and paid by Telefónica Internacional, S.A., was 2,956 million euros.

Another 2 million Telefónica Móviles S.A. shares were acquired for a total of 22 million euros. Following these acquisitions, the percentage investment in Telefónica Móviles, S.A. before the share exchange was 92.5% (see Note 7.4).

b) Disposals of investments

2007

Company	Millions of euros Gross book value
Subsidiaries	
Endemol Investment Holding, B.V.	842
Seguros de Vida y Pensiones Antares, S.A.	148
Ecuador Cellular Holdings, B.V.	77
Terra Lycos Intangibles, S.A.	19
Others	8
Total subsidiaries	**1,094**
Associated companies	
Portugal Telecom, S.G.P.S., S.A.	156
Others	4
Total associated companies	**160**

In May 2007, Telefónica, S.A. signed an agreement to sell its 99.7% holding in Endemol Investment Holding, B.V. to a newly created consortium. The sale was carried out on July 3, 2007, generating a capital gain of 1,776 million euros (see Note 16.6).

On May 31, 2007, a resolution was adopted at the General Shareholders' Meeting of Seguros de Vida y Pensiones Antares, S.A. to reduce capital by condoning the unpaid dividend liability to its shareholders. After this operation, Telefónica owned 94.67% of the share capital of Seguros de Vida y Pensiones Antares, S.A.

In 2007, Ecuador Cellular Holdings, S.A. reimbursed its sole shareholder, Telefónica, S.A. for contributions amounting to 77 million euros. In addition, Terra Lycos Intangibles, S.A. was liquidated during the year.

On December 18, 2007, Telefónica, S.A. disposed of 18,558,181 shares representing 1.64% of the share capital of Portugal Telecom, S.G.P.S., S.A. This lowered Telefónica, S.A.'s direct holding in Portugal Telecom to 7.14%.

2006

Company	Millions of euros Gross book value
Subsidiaries	
Telefónica Publicidad e Información, S.A.	4
Others	1
Total subsidiaries	**5**
Associated companies	
Sogecable, S.A.	12
Uno-e Bank, S.A.	190
Total associated companies	**202**

In April 2006, Telefónica, S.A. agreed to a takeover bid for its investment in Telefónica Publicidad e Información, S.A. by British telephone directories company Yell Group plc. In July 2006, Telefónica S.A. accepted the takeover bid presented by Yell at a price of 8.5 euros per share, tendering 216,269,764 shares representing its 59.905% stake in the company's share capital. This transaction generated a gain of 1,834 million euros, which was recorded under "Gains on disposal of fixed assets" (see Note 16.6).
In March 2006, Telefónica S.A. sold 590,656 shares in Sogecable S.A. for 22 million euros. This transaction generated a gain of 10 million euros, which was recorded under "Gains on disposal of fixed assets" (see Note 16.6).

Also, under the agreement signed January 10, 2003, between Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) and Terra Networks, S.A. (now Telefónica, S.A.), which created a liquidity mechanism (put options) on the shares owned by Terra Networks, S.A. in Uno-e Bank, S.A., Telefónica S.A. sold its investment in Uno-e Bank to BBVA at the option strike price stated in the agreement. This transaction had no impact on the income statement for the year.

c) Other transactions

2007

On December 21, 2007, Telefónica, S.A. incorporated, as its sole shareholder, the Spanish limited liability company Atento Holding, Inversiones y Teleservicios, S.A. The share capital of this company was set at 24 million euros, divided up into 60 million shares, issued with a share premium of 138 million euros, at 2.306133 euros per share. The shares were fully subscribed and paid via the contribution to the newly created wholly-owned company of the 116,112 shares representing 100% of the share capital of Atento, N.V. owned by Telefónica, S.A.

In addition, on December 21, 2007, a resolution was adopted at the Extraordinary Shareholders' Meeting of Telefónica Móviles Holding Uruguay, S.A, a wholly-owned subsidiary of Telefónica, S.A., to liquidate and wind up the company, assigning all the assets and liabilities of the company to the sole shareholder. As a result of this transaction, Telefónica, S.A. directly owns 62,700,000 shares, representing 32% of the share capital of Telefónica Móviles del Uruguay, S.A.

The assets and liabilities assigned to Telefónica, S.A. are as follows:

	Valuation
Shares of Telefónica Móviles del Uruguay, S.A.	13
Receivables from Group companies (Telefónica Móviles del Uruguay, S.A.)	9
Payables to Group companies (Telefónica Móviles del Uruguay, S.A.)	1

2006

On July 3, 2006, Telefónica de España S.A.U. and Terra Networks España S.A.U., both wholly owned subsidiaries of Telefónica S.A., merged. The transaction involved the merger and takeover of Terra Networks España, S.A.U. by Telefónica de España S.A.U. As a result, Terra Networks España, S.A.U. was dissolved without liquidation, and Telefónica de España, S.A.U. assumes all its rights and obligations. The gross acquisition cost of Terra Networks España, S.A.U. was 94 million euros, which was fully provisioned.

In 2006, there was a restructuring of the Company's wireless investments in Argentina. This culminated in the final quarter of 2006 with the Compañía de Radiocomunicaciones Móviles, S.A. and Telefónica Móviles Argentina, S.A. merger. Telefónica Móviles Argentina, S.A. took over Compañía de Radiocomunicaciones Móviles, S.A.'s operations once the Argentine securities exchange commission (*Comisión Nacional de Valores de Argentina*) lifted the merger conditions it had imposed on October 31, 2006. The merger took effect from January 1, 2006.

Also completed in 2006 was the merger between Telefónica Móviles Inversora, S.A. and Telefónica Móviles Argentina Holding, S.A., with effect from January 1, 2006. This corporate restructuring left Telefónica direct ownership of 15.4% of Telefónica Móviles Argentina, S.A., along with its 100% investment in the Telefónica Móviles Argentina Holding, S.A. holding company, which owns the remaining 84.6%.

7.2 The detail of subsidiaries, associated companies and investees is provided in Appendix I.

7.3 The breakdown and movement in provisions for long-term investments are as follows:

	Millions of euros				
	Balance at 12/31/06	**Change in provision**	**Decreases**	**Transfers and other**	**Balance at 12/31/07**
Investments in Group companies	5,530	9,876	(12)	(25)	15,369
Investments in associated companies	3	(1)	-	-	2
Other investments	5	-	-	-	5
Total investment writedown provisions	**5,538**	**9,875**	**(12)**	**(25)**	**15,376**

	Millions of euros					
	Balance at 12/31/05	Merger with Telefónica Móviles, S.A.	Change in provision	Decreases	Transfers and other	Balance at 12/31/06
Investments in Group companies	3,440	2,420	(156)	-	(174)	5,530
Investments in associated companies	86	1	(43)	(41)	-	3
Other investments	37	-	(32)	-	-	5
Total investment writedown provisions	**3,563**	**2,421**	**(231)**	**(41)**	**(174)**	**5,538**

The main provisions recorded for investments in Group companies in 2007 relate to the investment in Telefónica O2 Europe, Plc for 9,947 million euros arising from the dilution to this company's equity from the dividends paid to Telefónica, S.A. in 2007 for a total a mount of 11,272 million euros (see Notes 7.1.a and 16.8). The Company also allocated 91 million euros in 1997 to provisions for the investment in Telefónica de Contenidos, S.A. In addition, a charge of 436 million euros was recorded to extraordinary income in 2007 (506 million euros in 2006) due to the negative equity of Telefónica Móviles México, S.A. de C.V. (see Notes 4.c and 16.7).

Conversely, in 2007 provisions were reversed for the improvement in equity of Atento, N.V., Telefónica Móviles Argentina Holding and Telefónica O2 Czech Republic, for 60, 54 and 36 million euros, respectively.

The main provisions recorded for investments in Group companies in 2006 relate to the investments in Telefónica Móviles Puerto Rico Inc. (48 million euros), Ecuador Cellular Holding, BV (32 million euros) and Telefónica O2 Czech Republic, a.s. (98 million euros) which paid a dividend of 354 million euros to Telefónica, S.A. (see Note 16.8).

Meanwhile, some provisions were reversed in 2006, owing to the improvement in equity of other companies, mainly Telefónica de Contenidos (192 million euros), Telefónica Datacorp, S.A.U. (65 million euros) and the Atento Group (45 million euros).

In addition, after the Terra Networks España, S.A.U. and Telefónica de España, S.A.U. merger (see Note 7.1.c), the outlook for the new company led to the reversal of a provision for liabilities and charges recorded for the negative equity of Terra Networks España, S.A. This generated 336 million euros of extraordinary income. Additionally, 292 million euros was reversed from the provision recorded for Telefónica Móviles Argentina Holding, S.A. in 2006, of which 242 million was recorded as extraordinary income (see Note 16.6).

In 2006 the entire 36 million euro provision for the investment in Portugal Telecom, S.G.P.S., S.A was reversed from writedown provisions on "Investments in associated companies."

The reversals from investment writedown provisions on "Other investments" in 2006 included the 22 million euro provision recorded for Telefónica, S.A.'s stake in Banco Bilbao Vizcaya Argentaria, S.A.

"Retirements" recorded in 2007 and 2006 correspond to investments sold, liquidated or transferred in the course of the year (see 7.1 of this Note).

7.4 Impact on long-term investments of the merger of Telefónica, S.A. and Telefónica Móviles, S.A. (2006)

As indicated in Note 1, on July 29, 2006 the merger between Telefónica, S.A. y Telefónica Móviles, S.A. was registered in the Madrid Mercantile Register on January 1, 2006.

Telefónica transferred to Telefónica Móviles, S.A. shareholders 244,344,012 of its treasury share at the exchange ratio established in the merger agreement of four Telefónica S.A. shares for every five Telefónica Móviles, S.A. shares. The acquisition cost of the treasury stock transferred amounted to 3,179 million euros, was recorded as an increase in value of "Long-term investments."

The detail of Telefónica Móviles, S.A.'s contributions on January 1, 2006 to "Investments in Group companies," and the corresponding investment writedown provisions shown in the financial statements of Telefónica, S.A., was the following:

	Millions of euros		
	Acquisition cost	Investment writedown provisions	Additional provision for negative net book value of the investment (see Note 4.c)
Investments in Group companies			
Telefónica Móviles España, S.A.	933	-	-
TES Holding, S.A. de C.V.	161	(96)	-
Telefónica Móviles Argentina Holding, S.A.	790	(790)	(242)
Telefónica Móviles Inversora, S.A.	370	(33)	-
Compañía Radiocomunicaciones Móviles, S.A.	142	(5)	-
Telefónica Móviles Chile, S.A.	308	(9)	-
Telefónica Móviles Chile Inversiones, S.A.	10	(5)	-
TCG Holdings, S.A.	239	(104)	-
Redanil, S.A.	8	-	-
TEM eServices Latin America Inc.	3	-	-
Telefónica Móviles Perú Holding, S.A.A.	254	(31)	-
Telefónica Móviles México, S.A. de C.V.	1,176	(1.176)	(942)
Brasilcel, N.V.	2,179	-	-
Telefónica Móviles Soluciones y Aplicaciones, S.A.	11	(6)	-
Telefónica Móviles Puerto Rico, Inc.	63	(63)	(3)
Panamá Cellular Holding B.V.	238	(3)	-
Telefónica Móviles Holding Uruguay, S.A.	26	-	-
Telefónica Móviles Colombia, S.A.	116	(1)	-
Cellular Holdings (Central America), Inc.	38	-	-
Comtel Comunicaciones Telefónicas, S.A.	0	-	-
Telefónica Móviles Perú, S.A.	0	-	-
Ecuador Cellular Holding, B.V.	658	(75)	-
Guatemala Cellular Holding, B.V.	29	(3)	-
Inversiones Telefónicas Móviles Holding, S.A.	424	-	-
Latin American Cellular Holding, B.V.	1,227	(19)	-
Multi Holding Corporation	301	(1)	-
Telcel, C.A.	134	-	-
Others	1	-	-
Total Group companies	**9,839**	**(2,420)**	**(1,187)**
Investments in associated companies			
MobiPay Internacional, S.A.	5	(1)	-
Total associated companies	**5**	**(1)**	-

The effect of the inclusion of the investments of Telefónica Móviles, S.A. described above, combined with the retirement of Telefónica S.A.'s pre-merger investment in Telefónica Móviles, S.A. is shown in the "Merger with Telefónica Móviles, S.A." column of the tables of changes in long-term investments and investment writedown provisions.

7.5 Transactions protected for tax purposes.

Transactions carried out in 2007 and 2006 that are considered protected for tax purposes, as defined in Articles 83 and 94, of Chapter VII of Title VII of Legislative Royal Decree 4/2004 of March 5 approving the Revised Spanish Corporate Income Tax Law, are detailed in the following paragraphs. Transactions prior to 2006 were duly disclosed in prior years' financial statements.

2007

On December 21, 2007, the public deed was registered for the contribution of 100% of the shares of Dutch company Atento N.V. to Spanish company Atento Holding, Inversiones y Teleservicios, S.A. The share exchange was registered in the Mercantile Registry on January 15, 2008.

In addition, the following transactions protected for tax purposes involving subsidiaries belonging to the tax group headed by Telefónica, S.A also took place in 2007:

- In July 2007, the agreement for the merger of Maptel Networks, S.A. by Telefónica Soluciones de Informática y Comunicaciones, S.A. was executed. As a result of this merger the absorbing company Telefónica Soluciones de Informática y Comunicaciones, S.A. acquired by universal succession all the rights and obligations of Maptel Networks, S.A.

- On October 5, the agreement for the merger and takeover of Telefónica Cable Galicia, S.A.U. by Telefónica Cable, S.A. was executed. As a result of this merger, the absorbing company Telefónica Cable, S.A. acquired by universal succession all the rights and obligations of Telefónica Cable Galicia, S.A.U. The merger was registered in the Mercantile Registry in October 2007.

- On October 17, the agreement for the merger and takeover of Procesos Operativos, S.A. by Atento Teleservicios España, S.A.U. was executed. As a result of this merger, the absorbing company Atento Teleservicios España, S.A.U. acquired by universal succession all the rights and obligations of Procesos Operativos, S.A. The merger was registered in the Mercantile Registry on December 26, 2007.

- On November 2, the agreement for the merger and takeover of Fonditel Valores, Agencia de Valores, S.A.U. by Fonditel Gestión, Sociedad Gestora de Instituciones de Inversión Colectiva, S.A.U. was executed. The merger was registered in the Mercantile Registry on November 15, 2007.

2006

On July 29, 2006, the merger of Telefónica Móviles S.A into Telefónica S.A., which held 100% of the outstanding shares, was registered in the Mercantile Registry. As a result of this merger the surviving company Telefónica S.A. acquired by universal succession all the rights and obligations of Telefónica Móviles S.A.

On July 7, 2006, the merger and takeover of Terra Networks España, S.A. by Telefónica de España, S.A. was registered in the Mercantile Registry, with Telefónica de España, S.A. retaining by universal succession all the rights and obligations of Terra Networks España S.A.

On June 15, 2006, Telefónica Móviles, S.A. contributed 97.97% of Peruvian company Telefónica Móviles Perú Holding, S.A. to the Dutch company Latin American Cellular Holdings B.V. a wholly owned subsidiary of Telefónica Móviles, S.A. The transaction was carried out through a share exchange.

Finally, on May 31, 2006, Telefónica Móviles, S.A. contributed 91.54% of Venezuelan company Telcel, C.A. to the Dutch company Latin American Cellular Holdings, B.V., a wholly owned subsidiary of Telefónica Móviles, S.A. The transaction was carried out through a share exchange.

The following transactions protected for tax purposes involving subsidiaries belonging to the tax group headed by Telefónica, S.A also occurred in 2006:

- On September 22, the agreement for the takeover and merger of Telefónica Soluciones de Informática y Comunicaciones, S.L. by Telefónica DataCorp, S.A, its sole shareholder, was executed. As a result of this merger, the absorbing company Telefónica DataCorp., S.A. acquired by universal succession all the rights and obligations of Telefónica Soluciones de Informática y Comunicaciones, S.L. The merger was registered in the Mercantile Registry on November 28, 2006.

- On June 30, the takeover and merger of Telefónica Data España, S.A. by Telefónica de España, S.A. was registered in the Mercantile Registry, with Telefónica de España, S.A. obtaining all the rights and obligations of Telefónica Data España, S.A.

- On June 12, the takeover and merger of Sociedad General de Cablevisión Canarias, S.A. by Telefónica Cable, S.A. was registered in the Mercantile Registry, with Telefónica Cable, S.A. taking over by universal succession all the rights and obligations of Sociedad General de Cablevisión Canarias, S.A.

7.6 The breakdown of loans to Group and associated companies is as follows:

	Millions of euros			
	2007		2006	
Company	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Telefónica de España, S.A.U.	3,188	3,096	4,207	1,734
Telefónica Móviles España, S.A.U.	3,102	1,112	3,135	1,241
Telefónica Móviles México, S.A. de C.V.	2,330	682	2,445	452
Telefónica O2 Europe Plc	-	2,727	-	-
Telefónica de Contenidos, S.A.U.	1,221	81	1,329	40
Telefónica Internacional, S.A.	-	218	346	1,619
Telefónica Móviles Argentina, S.A.	284	85	490	33
Atento, N.V.	38	65	99	38
Telefónica International Wholesale Services America, S.A.	-	-	-	400
Comunicapital Inversiones, S.A.U.	-	-	54	-
Lotca, Servicios Integrales, S.A.U.	57	5	65	5
Terra Networks Asociadas, S.L.	16	19	35	1
Telefónica B2B Licencing Inc.	9	-	11	-
Telefónica Internacional Wholesale Services, S.L.	-	28	60	-
Inversiones Telefónica Móviles Holding Limitada	29	-	142	-
Telefónica Móviles El Salvador Holding, S.A. de C.V.	-	49	48	27
Latin America Cellular Holdings, B.V.	-	-	-	218
Panama Cellular Holdings, B.V.	-	5	-	40
Others	7	44	35	67
Total	**10,281**	**8,216**	**12,501**	**5,915**

As a consequence of the merger with Telefónica Móviles, S.A. (see Note 1), Telefónica, S.A. assumed all the loans granted to finance the wireless operators, including those to Telefónica Móviles España, S.A., Telefónica Móviles México, S.A. de C.V., Telefónica Móviles Argentina, S.A. and Latin America Cellular Holdings, B.V.

The main loans granted to Group companies are:

- 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 3,488 million euros at December 31, 2007, of which 2,791 million euros are long term and 697 million euros are short term.

  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.

- Financing granted to Telefónica Móviles España, S.A.U. mainly comprises a long-term 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. The loan matures on December 22, 2009.

- Financing granted to Telefónica Móviles México, S.A. de C.V. comprises:

  A 1,330 million euro loan, drawn down in full at December 31, 2007. The loan matures on December 31, 2011 and interest is linked to the 12M Euribor rate.

  Several loans in Mexican pesos, wholly drawn down for a total of 8,518 million pesos (533 million euros). These loans mature between 2009 and 2011 and bear a fixed interest rate.

  Two loans denominated in US dollars, totaling 685 million dollars (467 million euros). These loans mature in 2009 and interest is linked to the 12M Libor rate.

- Financing granted to Telefónica de Contenidos, S.A.U. mainly comprises a 1,142 million euro participating loan, fully drawn down at December 31, 2007, 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 detailed above.

- A multi-currency credit facility of 1,962 million US dollars granted to Telefónica Internacional, S.A., of which 318 million US dollars (216 million euros) had been drawn down at December 31, 2007. This facility matures April 15, 2008.

- Financing granted to Telefónica Móviles Argentina, S.A. comprises a number of US dollar-denominated loans, maturing between 2008 and 2017 and bearing a fixed interest rate.

- Financing granted to Atento, N.V. consists of the following:

  A participating loan for 75 million euros, repayable in 2013. The loan bears interest based on Atento, N.V.'s operating profit. The outstanding amount at December 31, 2007 was 45 million euros.

  Loan of 214 million euros to support Atento Holding's ability to pay its liabilities to its subsidiaries, bearing interest at market rates and maturing in 2008. The balance outstanding at December 31, 2007 was 57 million euros.

- The Company has also extended 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 14), mainly 2,350 million euros to Telefónica Móviles España, S.A. and 1,060 million euros to Telefónica de España, S.A.U., with short-term maturities.

At December 31, 2007, pending receipt is the interim dividend against 2007 profit by Telefónica O2 Europe Plc for 2,000 million pounds sterling (equivalent to 2,727 million euros), which will be paid in the first quarter of 2008.

"Loans to Group companies" includes accrued interest payable at December 31, 2007 amounting to 814 million euros (583 million euros at December 31, 2006).

Transfers under "Loans to Group and associated companies" in the table of movements in investments relate mainly to short-term movements required to meet the repayment schedules of the loans listed above.

7.7 Other loans

The heading mainly includes the cost of share options arranged in 2006 to cover the Telefónica, S.A. share option plan (see Note 16.2), amounting to 46 million euros.

7.8 Deposits and guarantees

The main components of this heading are the 335 million euros of guarantees of IPSE 2000, S.p.A. at December 31, 2007. These deposits will decrease in line with the respective obligations they guarantee.

7.9 Other short-term investments

This heading consists mainly of temporary cash surpluses placed in short-term investments. At December 31, 2006, it included 111 million euros pending payment on the sale of the investment in Uno-e Bank (see Note 7.1.b), which was collected in 2007.

(8) DEFERRED CHARGES

The detail of this heading and the related amortization schedule at December 31, 2007 and 2006 are as follows:

	Maturity						Balance at	Balance at
	2008	**2009**	**2010**	**2011**	**2012**	**Subsequent years**	**12/31/07**	**12/31/06**
Interest on long-term promissory notes	11	7	8	1	-	-	27	44
Debt issuance costs	67	34	29	25	23	30	208	271
Other deferred charges	20	10	7	6	6	4	53	52
Total	**98**	**51**	**44**	**32**	**29**	**34**	**288**	**367**

(9) SHAREHOLDERS' EQUITY

The amount and movements in this heading in 2007 and 2006 was the following:

	Balance at 12/31/05	Appropriation of 2005 profit	Distribution of dividends	Other movements	Balance at 12/31/06	Appropriation of 2006 profit	Distribution of dividends	Other movements	Balance at 12/31/07
Share capital	4,921	-	-	-	4,921	-	-	(148)	4,773
Share premium	1,671	-	-	918	2,589	-	-	(2,068)	521
Revaluation reserves	1,369	-	-	-	1,369	-	-	(1,178)	191
Legal reserve	920	64	-	-	984	-	-	-	984
Reserve for treasury stock	348	-	-	(87)	261	-	-	(29)	232
Other reserves	6	521	-	(521)	6	5,400	-	1,178	6,584
Profit (loss) for the year	1,754	(1,754)	-	8,284	8,284	(8,284)	-	6,620	6,620
Interim dividend	-	-	(1,458)	-	(1,458)	1,458	(1,652)	-	(1,652)
Total	**10,989**	**(1,169)**	**(1,458)**	**8,594**	**16,956**	**(1,426)**	**(1,652)**	**4,375**	**18,253**

a) Share capital

At December 31, 2007, Telefónica, S.A.'s share capital amounted to 4,773,496,485 euros and consisted of 4,773,496,485 fully paid ordinary shares of a single series, par value 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 October 2007, Telefónica, S.A. began taking steps to delist shares of Telefónica from the Paris and Frankfurt stock exchanges. This will take place in the first quarter of 2008.

At the Shareholders' meeting of Telefónica S.A. on June 21, 2006, the Board of Directors was authorized under Article 153.1.b) of the Spanish Corporation Law, to increase the Company's capital by up to 2,460 million euros, equivalent to half the Company's current capital stock, one or several times within a maximum of five years of that date, with no need for further meetings or authorization, where the Board considered it in the Company's interests, by issuing for this purpose the corresponding new common shares or shares of any other type permitted by law, at a fixed or variable premium and, in all cases, paid in cash with the possibility explicitly allowed of partial subscription for shares issued in accordance with Article 161.1 of the Corporation Law. The Board was also authorized to fully or partly disapply pre-emptive subscriptions rights under Article 159.2 of the Corporation Law and associated provisions.

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 the date of adoption of the related resolution. The fixed-income securities may be 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, 2007, the Board of Directors had exercised these powers, approving a program to issue corporate promissory notes for 2008.

In addition, on May 10, 2007, shareholders voted to authorize the derivative acquisition by the Board of Directors of treasury shares, for a consideration, up to the limits and pursuant to the terms and conditions established by the 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.

At December 31, 2007 and 2006, Telefónica, S.A. held the following shares of treasury stock:

	No. of shares	**Euros per share**		**Market Value**	**%**
		Acquisition price	**Market price**		
Treasury stock at 12/31/07	**64,471,368**	**16.67**	**22.22**	**1.433**	**1.35061%**
Treasury stock at 12/31/06	**75,632,559**	**14.04**	**16.12**	**1.219**	**1.53689%**

In 2007, the Company paid 2,392 million euros to acquire 149,099,044 of its own shares (including a 68 million euros premium on the share options arranged in 2007 and exercised in 2007) and sold 12,621,573 treasury shares at a total selling price of 210 million euros. As a result of these transactions, the Company recorded extraordinary income of 23 million euros (see Note 16.6) and a decrease in expenses of 11 million euros from the sale of treasury shares allocated to the share option plan for Endemol Group employees.

In addition, the Company used 147,633,912 shares of treasury stock at an acquisition cost of 2,202 million euros to reduce its share capital. Finally, 4,750 shares of treasury stock were delivered as part of the share option plan for Endemol Group employees (own shares were also sold to compensate).

The balance sheets at December 31, 2007 and 2006 include the cost of acquiring own shares (1,075 and 1,062 million euros, respectively) net of provisions of 843 and 801 million euros, respectively, recorded in accordance with current accounting regulations (see Note 4.e), against extraordinary results for the difference between the acquisition cost and market price and against "Unrestricted reserves" for the difference between the market price and the underlying book value. The movement in the provision charged to "Other reserves" in 2007 and 2006 were a credit of 42 million euros and a debit of 590 million euros, respectively. In 2006, the Company reserved a 38 million euro provision charged against extraordinary income (see Note 16.6).

The Company has set up the corresponding restricted reserve in the amount of the underlying book value of the shares comprising treasury stock.

Changes in subscribed capital and share premium in 2007

The movements in these headings in 2007 are as follows:

		Millions of euros	
	Number of Shares	Subscribed capital	Share premium
Balance at 12/31/06	**4,921,130,397**	**4,921**	**2,589**
Restricted reserve for treasury stock	-	-	29
Valuation of treasury stock	-	-	(43)
Capital reduction	(147,633,912)	(148)	(2,054)
Balance at 12/31/07	**4,773,496,485**	**4,773**	**521**

Authorization was given at the General Shareholders' Meeting of Telefónica, S.A. of May 10, 2007 to reduce the Company's share capital by 147,633,912 via the cancellation of own shares held in treasury stock. The capital decrease was carried out with a charge to voluntary reserves, with the corresponding amount released from the restricted reserve provided for in Article 79.3 of the Spanish Corporation Law, and reserve recorded for cancelled share capital for 147,633,912 euros (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 indicated in section 3 of Article 167 of the Spanish Corporation Law are met.

Changes in subscribed capital and share premium in 2006

The movements in these headings in 2006 are as follows:

		Millions of euros	
	Number of Shares	Subscribed capital	Share premium
Balance at 12/31/05	**4,921,130,397**	**4,921**	**1,671**
Restricted reserve for treasury stock	-	-	87
Valuation of treasury stock	-	-	1,111
Reserve for merger with Telefónica Móviles, S.A.	-	-	(280)
Balance at 12/31/06	**4,921,130,397**	**4,921**	**2,589**

As mentioned in Note 1, the proposed merger and takeover of Telefónica Móviles, S.A. by Telefónica, S.A. was approved at the General Shareholders' Meetings held on June 20 and 21, 2006, respectively. The merger deed was registered in the Madrid Mercantile Register on July 29, 2006, effective retrospectively, for financial purposes, from January 1, 2006. The effect of the merger on Telefónica, S.A.'s shareholders' equity was a 280 million euros decrease in "Share premium."

b) Legal reserve

According to the revised text of the Spanish Corporation Law, companies must transfer 10% of profits for the year to a legal reserve until this reserve reaches the equivalent to 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. Except for this purpose, until the legal reserve exceeds the limit of 20% of capital, it can only be used to offset losses, if there are no other reserves available.

c) Revaluation reserves

The balance of "Revaluation reserves" arose as a result of revaluations made from 1946 to 1987 and of the revaluation carried out pursuant to Royal Decree-Law 7/1996, of June 7. The balance of the revaluation reserve may be used, without incurring taxes, to offset any losses from future years or to increase capital. From January 1, 2007, the reserve may also be transferred to unrestricted reserves, provided that the capital gain is recorded. This capital gain will be considered realized for the amount of depreciation recorded or when the revalued assets have either been sold or eliminated from the accounting records. In this respect, an amount of 1,178 million euros corresponding to reserves subsequently considered unrestricted has been reclassified under "Other reserves."

d) Dividends

At its meeting of February 28, 2006, Telefónica, S.A.'s Board of Directors resolved to pay an interim dividend against 2005 profit of a gross 0.25 euros per share for each of the Company's outstanding shares carrying dividend rights. This dividend was paid on May 12, 2006, and the total amount paid was 1,169 million euros.

At its meeting of September 27, 2006, Telefónica, S.A.'s Board of Directors resolved to pay an interim dividend against 2006 profit of a gross 0.30 euros per share for each of the Company's outstanding shares carrying dividend rights. This dividend was paid on November 10, 2006, and the total amount paid was 1,458 million euros.

At its meeting held on February 28, 2007, the Company's Board of Directors agreed to propose to the Shareholders' Meeting the payment of a final dividend against 2006 profit of a gross 0.30 euros per share for each of the Company's outstanding shares carrying dividend rights. A total of 1,426 million euros was paid in May.

At its meeting of September 26, 2007, Telefónica, S.A.'s Board of Directors resolved to pay an interim dividend against 2007 profit of a fixed gross 0.35 euros for each of the Company's outstanding shares carrying dividend rights. This dividend was paid on November 14, 2007, and the total amount paid was 1,652 million euros.

In addition, at its meeting of February 27, 2008, the Company's Board of Directors agreed to submit for approval at the Shareholders' Meeting the distribution of an additional dividend charged to 2007 profit of a fixed amount of 0.40 euros gross per outstanding share carrying dividend rights, up to a maximum total amount of 1,909 million euros (see Note 3).

(10) DEBENTURES, BONDS AND OTHER MARKETABLE SECURITIES

10.1 The balances and movements in this heading at December 31, 2007 and 2006 are the following:

	Millions of euros		
	Non-convertible Debentures and bonds	**Other marketable debt securities**	**Total**
Balance at 12/31/05	**1,828**	**1,334**	**3,162**
New issues	-	2,885	2,885
Redemptions	-	(2,188)	(2,188)
Adjustments and other movements	4	5	9
Balance at 12/31/06	**1,832**	**2,036**	**3,868**
New issues	-	1,096	1,096
Redemptions	(500)	(1,725)	(2,225)
Adjustments and other movements	5	11	16
Balance at 12/31/07	**1,337**	**1,418**	**2,755**
Maturity			
Long-term	916	181	1,097
Short-term	421	1,237	1,658
Accrued interest pending maturity	33	-	33

10.2 The detail and main features of debentures and bonds outstanding at December 31, 2007 are as follows:

Debentures and bonds	Type of Interest rate	Maturity							
		% interest rate	2008	2009	2010	2011	2012	Subsequent years	TOTAL
DEBENTURES									
FEBRUARY 1990 SERIES C	FIXED	12.60	-	-	4	-	-	-	4
FEBRUARY 1990 SERIES F	ZERO COUPON	12.58	-	-	12	-	-	-	12
APRIL 99	FIXED	4.50	-	500	-	-	-	-	500
JUNE 99	FLOATING	5.16	-	300	-	-	-	-	300
JULY 99	ZERO COUPON	6.37	-	-	-	-	-	50	50
MARCH 00	FLOATING	5.30(*)	-	-	-	-	-	50	50
BONDS									
MARCH 98	FIXED	4.84	421	-	-	-	-	-	421
Total issues			**421**	**800**	**16**	**-**	**-**	**100**	**1,337**

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

10.3 Zero-coupon debentures and bonds are recognized in the balance sheet at their issue value plus the related accrued interest.

The detail of the maturities and redemption values of these debentures and bonds is as follows:

Issue	Redemption date	Redemption rate	Present value	Redemption value
DEBENTURES				
FEBRUARY 1990 SERIES F	02/26/2010	1,069.47%	12	15
JULY 99	07/21/2029	637.64%	50	191
Total			**62**	**206**

The remaining debentures and bonds have been stated at nominal value.

10.4 At December 31, 2007, Telefónica, S.A. has a program of promissory note issues of up to 2,000 million euros. The outstanding balance at year end was 1,230 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 principal outstanding at year end was 80 million euros.

In 2006, the Company acquired shares in O2 plc (see Note 7) payment for which was deferred through the arrangement of a 207 million pounds sterling (308 million euro) loan 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, 2007 amounted to 79 million pounds sterling (108 million euros).

10.5 The average interest rate in 2007 on debentures and bonds outstanding during the year was 4.90% (4.83% in 2006), and the average interest rate on corporate promissory notes was 4.57% (3.50% in 2006).

(11) PAYABLE TO CREDIT INSTITUTIONS

11.1 The balances of this heading at December 31, 2007 and 2006 are the following:

	Millions of euros					
	2007			**2006**		
Item	**Short-term**	**Long-term**	**Total**	**Short-term**	**Long-term**	**Total**
Loans and credits	556	8,150	8,706	188	9,736	9,924
Foreign-currency loans and credits	51	285	336	57	1,019	1,076
Total	**607**	**8,435**	**9,042**	**245**	**10,755**	**11,000**

11.2 Maturities at December 31, 2007 are as follows:

	Maturity						
Item	**2008**	**2009**	**2010**	**2011**	**2012**	**Subsequent years**	**Balance at 12/31/07**
Loans and credits	556	-	862	6,058	**39**	1,191	8,706
Foreign-currency loans and credits	51	256	27	-	-	2	336
Total	**607**	**256**	**889**	**6,058**	**39**	**1,193**	**9,042**

11.3 On April 21, 2006, Telefónica S.A. arranged a 700 million euro syndicated loan, denominated in euros and bearing interest linked to the Euribor rate. This loan was fully drawn down at December 31, 2006, thus there were no movements in 2007. It will be repaid in two equal installments, due April 2015 and 2017, respectively.

On February 20, 2006, the Company repaid 556 million euros on the last installment of the syndicated loan. Banco Santander Central Hispano acted as agent bank. This loan had been taken out in 1999 with a number of financial institutions for a total of 1,200 million euros.

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, 2006, this loan had been fully drawn down, so there were no movements in 2007.

On July 6, 2004, Telefónica arranged a 3,000 million euro 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, 2006 was 1,800 million euros and 1,152 million dollars. In 2007, the Company repaid 1,800 million euros and 850 million dollars, taking the total amount drawn down at December 31, 2007 to 302 million dollars.

On November 26, 2004, Telefónica, S.A. and several branches of ABN Amro Bank N.V. agreed to a credit facility, secured by the export credit agencies of Finland ("Finnvera") and Sweden ("EKN"), bearing fixed interest of 3.26% and with final maturity on November 15, 2010. This financing is to cover up to 85% of the purchases of network equipment to be made by Telefónica Móviles Group companies from Ericsson and Nokia. In 2006, a total of 153 million dollars was drawn down, leaving a total sum available at December 31, 2006, of 266 million dollars. In 2007, a total of 75 million dollars was repaid, leaving an outstanding balance at December 31, 2007 of 191 million dollars.

11.4 Average interest on loans and credits

The average interest rate in 2007 on loans and credits denominated in euros was 4.41% (3.27% in 2006) and on foreign-currency loans and credits was 4.97% (5.45% in 2006).

11.5 Unused credit facilities

The "Loans and credit" balances relate only to amounts drawn down.

At December 31, 2007, Telefónica had undrawn credit facilities amounting to 5,779 million euros.

(12) PAYABLE TO GROUP AND ASSOCIATED COMPANIES

12.1 The breakdown of this heading at December 31, 2007 and 2006 is as follows:

	Millions of euros					
	2007			2006		
	Long-term	Short-term	Total	Long-term	Short-term	Total
Loans	32,372	17,284	49,656	35,427	10,861	46,288
Accounts payable to Group companies for purchases and services	-	108	108	-	91	91
Accounts payable to subsidiaries due to taxation on consolidated basis	-	616	616	891	964	1,855
Total	**32,372**	**18,008**	**50,380**	**36,318**	**11,916**	**48,234**

Total financing raised by Telefónica S.A. through Telefónica Europe, B.V. at December 31, 2007 amounted to 13,805 million euros (18,885 million euros at December 31, 2006). This financing is arranged by these companies through a number of loans, paying market rates of interest calculated on a Euribor plus spread basis. The average interest rate in 2007 was 5.62% (4.80% in 2006).

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 (see Note 7.1.a), 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, 2007 was 4,279 million pounds sterling (5,834 million euros).

Total financing raised by Telefónica, S.A. through Telefónica Emisiones, S.A.U. at December 31, 2007 amounted to 16,206 million euros (12,642 million euros at December 31, 2006). This financing is arranged as loans from these companies on the same terms as those of the issuance programs. The average interest rate in 2007 was 5.08% (5.09% in 2006). The financing arranged includes, as a related cost, the fees or premiums charged to the income statement for the period corresponding to the financing (see Note 8).

Telefónica Emisiones, S.A.U. raised financing mainly by tapping the European and US capital markets, issuing a total amount in 2007 of 1,929 million euros, 8,000 million Czech crowns (equivalent to 301 million euros) and 2,300 million US dollars (equivalent to 1,562 million euros). In 2006, issues totaled 6,050 million euros, 1,750 million pounds sterling (equivalent to 2,606 million euros at the 2006 year-end exchange rate) and 5,250 million dollars (equivalent to 3,986 million euros at the 2006 year-end exchange rate)

Meanwhile, as at December 31, 2007, Telefónica, S.A. had raised financing from Telefónica Finanzas, S.A., in charge of the integrated cash management of the companies comprising the Telefónica Group, amounting to 14,737 million euros (9,807 million euros at December 31, 2006) in a series of loans earning market interest rates.

There were also loans at December 31, 2007 to Telefónica, S.A. by Telefónica Móviles España, S.A.U. for 3,404 million euros (from the merger with Telefónica Móviles, S.A.) and from Telefónica de España, S.A.U. for 1,042 million euros (1,042 million euros at December 31, 2006).

“Loans to Group companies” includes accrued and unpaid interest at December 31, 2007 amounting to 685 million euros (475 million euros at December 31, 2006).

12.2 The short-term accounts payable to Group companies for purchases and services are as follows:

	Millions of euros	
	2007	2006
Telefónica de España, S.A.U.	15	1
Telefónica de Contenidos, S.A.U.	11	11
Telefónica Móviles España, S.A.U.	3	6
Telefónica Móviles Argentina Holding, S.A.	4	11
Terra Lycos Intangibles, S.A.	-	14
Telefónica Investigación y Desarrollo, S.A.U.	27	11
Telefónica Gestión de Servicios Compartidos, S.A.U.	2	2
Telefónica Ingeniería de Seguridad, S.A.	3	8
Telefónica Internacional Wholesale Services, S.L.	-	5
Telefónica Soluciones de Informática y Comunicaciones, S.L.	16	5
Telefónica Servicios Audiovisuales, S.A.	4	-
Telefónica Móviles Puerto Rico, Inc	4	-
Other	19	17
Total	**108**	**91**

12.3 The balance of "Accounts payable to subsidiaries due to taxation on a consolidated basis" was 616 million euros at December 31, 2007 (1,855 million euros at December 31, 2006). This basically includes accounts payable to Group companies for their contribution of tax losses to the tax group headed by Telefónica, S.A. (see Note 14). The Company classifies this balance as short- or long-term on the basis of the projected maturity of the payments.

The main amounts are those relating to Telefónica Internacional, S.A. (423 million euros), Telefónica Móviles España, S.A.U. (65 million euros), Telefónica de Contenidos, S.A.U. (59 million euros) and Telefónica Data Corp, S.A.U. (42 million euros).

(13) DERIVATIVES

In 2007 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, 2007, the total outstanding balance of the derivatives portfolio was 78,089 million euros (68,078 million euros at December 31, 2006), of which 51,723 million euros related to interest rate risk and 26,366 million euros to exchange rate risk (48,968 million euros and 19,110 million euros, respectively, at December 31, 2006).

It should be noted that at December 31, 2007, Telefónica S.A. had arranged transactions with financial institutions to hedge interest and exchange rate risks for other Telefónica Group companies amounting to 532 million euros and 804 million euros, respectively (1,287 million euros and 3,072 million euros, respectively, at December 31, 2006). 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.

The breakdown of the portfolio by type of derivative at December 31, 2007, is the following:

Type of risk	Millions of euros				
	2007				
	Value in euros	Telefónica receives		Telefónica pays	
		Amount	Currency	Amount	Currency
Euro interest rate swaps	**23,388**				
Fixed to floating	13,319	13,319	EUR	13,319	EUR
Floating to fixed	7,677	7,677	EUR	7,677	EUR
Floating to floating	2,392	2,392	EUR	2,392	EUR
Foreign currency interest rate swap	**13,641**				
Fixed to floating	**8,314**				
GBP/GBP	954	700	GBP	700	GBP
USD/USD	7,269	10,700	USD	10,700	USD
JPY/JPY	91	15,000	JPY	15,000	JPY
Floating to fixed	3,282				
USD/USD	551	811	USD	811	USD
MXN/MXN	3	47	MXN	47	MXN
CZK/CZK	1,098	29,241	CZK	29,241	CZK
GBP/GBP	1,630	1,195	GBP	1,195	GBP
Floating to floating	2,045				
GBP/GBP	2,045	1,500	GBP	1,500	GBP
Exchange rate swaps	**15,762**				
Fixed to fixed	**2,683**				
EUR/CLP	183	176	EUR	134,106	CLP
USD/EUR	2,500	2,357	USD	2,500	EUR
Fixed to floating	**336**				
EUR/CLP	17	16	EUR	12,217	CLP
USD/EUR	224	200	USD	224	EUR
JPY/EUR	95	15,000	JPY	95	EUR
Floating to fixed	**1,125**				
EUR/BRL	111	112	EUR	288	BRL
EUR/MAD	88	90	EUR	1,000	MAD
USD/ARS	776	1,167	USD	3,598	ARS
USD/COP	116	149	USD	344,580	COP
USD/MXN	4	5	USD	58	MXN
USD/PEN	30	40	USD	132	PEN
Floating to floating	**11,618**				
EUR/CLP	15	14	EUR	10,646	CLP
EUR/CZK	1,289	1,150	EUR	34,321	CZK
EUR/GBP	4,084	4,460	EUR	2,995	GBP
EUR/USD	351	423	EUR	516	USD
USD/EUR	5,692	7,233	USD	5,692	EUR
USD/MXN	9	14	USD	152	MXN
JPY/EUR	178	30,000	JPY	178	EUR
Forwards	**8,467**				
ARS/USD	81	385	ARS	119	USD
EUR/CZK	1,487	1,480	EUR	39,592	CZK
EUR/GBP	38	40	EUR	28	GBP
EUR/USD	1,319	1,356	EUR	1,941	USD
GBP/EUR	3,825	2,743	GBP	3,825	EUR
PEN/USD	10	47	PEN	15	USD
USD/BRL	74	106	USD	193	BRL
USD/COP	255	3,729	USD	755,732	COP
USD/EUR	755	1,105	USD	755	EUR
USD/MXN	447	650	USD	7,147	MXN
USD/PEN	7	10	USD	30	PEN
GBP/USD	46	34	GBP	67	USD
COP/USD	19	58,709	COP	29	USD
MXN/USD	104	1,665	MXN	153	USD
Subtotal	**61,258**				

Notional amounts of structured products with options	EUR	Notional	
Interest rate options	**14,694**		
Caps & Floors	**13,154**		
External counterparties			
US DOLLAR	900	1,325	USD
EURO CURRENCY	9,732	9,732	EUR
GBP CURRENCY	2,522	1,850	GBP
Swaptions	**1,540**		
EURO CURRENCY	1,540	1,540	EUR
Currency options	**2,137**		
External counterparties			
USD/EUR	2,273	3,346	USD
USD/BRL	(136)	(200)	USD
Subtotal	**16,831**		
TOTAL	**78,089**		

The detail of the portfolio by type of derivative at December 31, 2006 is as follows:

Type of risk	Millions of euros				
	2006				
	Value in euros	Telefónica receives		Telefónica pays	
		Amount	Currency	Amount	Currency
Euro interest rate swaps	**24,997**				
Fixed to floating	11,135	11,135	EUR	11,135	EUR
Floating to fixed	13,412	13,412	EUR	13,412	EUR
Floating to floating	450	450	EUR	450	EUR
Foreign currency interest rate swap	**11,125**				
Fixed to floating	**7,503**				
GBP/GBP	745	500	GBP	500	GBP
USD/USD	6,758	8,900	USD	8,900	USD
Floating to fixed	**3,622**				
USD/USD	661	871	USD	871	USD
MXN/MXN	56	803	MXN	803	MXN
CZK/CZK	976	26,841	CZK	26,841	CZK
GBP/GBP	1,929	1,295	GBP	1,295	GBP
Exchange rate swaps	**12,247**				
Fixed to fixed	**2,822**				
USD/EUR	2,560	2,433	USD	2,560	EUR
EUR/CLP	262	243	EUR	183,405	CLP
Fixed to floating	**241**				
EUR/CLP	17	16	EUR	12,217	CLP
USD/EUR	224	200	USD	224	EUR
Floating to fixed	**1,234**				
EUR/BRL	102	103	EUR	288	BRL
EUR/MAD	90	90	EUR	1,000	MAD
USD/ARS	653	860	USD	2,634	ARS
USD/COP	263	330	USD	776,005	COP
USD/MXN	11	15	USD	153	MXN
USD/PEN	115	146	USD	483	PEN
Floating to floating	**7,950**				
EUR/CLP	15	14	EUR	10,646	CLP
EUR/CZK	1,248	1,150	EUR	34,321	CZK
EUR/GBP	1,408	1,373	EUR	945	GBP
EUR/USD	540	587	EUR	711	USD
USD/EUR	4,664	5,830	USD	4,664	EUR
USD/MXN	75	105	USD	1,070	MXN
Forwards	**6,335**				
EUR/USD	735	750	EUR	968	USD
USD/EUR	382	500	USD	382	EUR
EUR/CZK	601	589	EUR	16,522	CZK
EUR/GBP	1,689	1,676	EUR	1,134	GBP
GBP/EUR	1,975	1,333	GBP	1,975	EUR
USD/ARS	128	165	USD	516	ARS
ARS/USD	53	215	ARS	70	USD
USD/BRL	73	94	USD	206	BRL
BRL/USD	72	206	BRL	94	USD
USD/PEN	11	15	USD	48	PEN
PEN/USD	96	402	PEN	126	USD
USD/COP	93	119	USD	273,033	COP
USD/MXN	427	557	USD	6,114	MXN
Subtotal	**54,704**				

Notional amounts of structured products with options	EUR	Notional	
Interest rate options	**12,846**		
Caps & Floors	**12,767**		
External counterparties			
US DOLLAR	1,006	1,325	USD
EURO CURRENCY	11,239	11,239	EUR
GBP CURRENCY	522	350	GBP
Swaptions	**79**		
EURO CURRENCY	79	79	EUR
Currency options	**528**		
External counterparties			
USD/EUR	398	525	USD
USD/ARS	130	171	USD
Subtotal	**13,374**		
TOTAL	**68,078**		

The detail by average maturity is as follows:

	2007				
Hedged underlying item	**Amount**	**Up to 1 year**	**From 1 to 3 years**	**From 3 to 5 years**	**Over 5 years**
Loans	**21,819**	**10,394**	**4,428**	**4,757**	**2,240**
In national currency	13,588	6,157	3,677	3,110	644
In foreign currencies	8,231	4,237	751	1,647	1,596
Debentures and MTN bonds	**34,464**	**4,238**	**7,921**	**8,635**	**13,670**
In national currency	11,082	4,238	3,143	3,584	117
In foreign currencies	23,382	-	4,778	5,051	13,553
Liabilities	**21,806**	**12,980**	658	**4,389**	**3,779**
Swaps	9,702	2,594	658	4,525	1,925
Currency options	1,540	1,540	-	-	-
Interest rate options	2,137	419	-	(136)	1,854
Forward	8,427	8,427	-	-	-
Total	**78,089**	**27,612**	**13,007**	**17,781**	**19,689**

The hedged debentures and bonds relate to those issued by both Telefónica, S.A. and by Telefónica Europe, B.V.

The fair value of Telefónica, S.A.'s derivatives portfolio at December 31, 2007, was equivalent to a liability of 827 million euros (923 million euros at December 31, 2006). The detail by type of derivative is as follows:

	Millions of euros	
	2007	**2006**
Interest rate hedge (asset)	(402)	(254)
Exchange rate hedge (liability)	794	958
Interest and exchange rate hedge (liability)	435	219
Total liability	**827**	**923**

(14) TAX MATTERS

Pursuant to a Ministerial Order dated December 27, 1989, since 1990 Telefónica, S.A. has filed consolidated tax returns with certain Group companies. A total of 39 companies comprised the consolidated tax group in 2007.

On November 28, 2006, the Spanish Corporate Income Tax Law was amended to reduce the tax rate at that time (35%) to 32.5% for all years beginning on or after January 1, 2007 and to 30% for all years beginning on or after January 1, 2008.

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

Based on estimates of the taxable profit and the carrying value of deferred tax assets and liabilities on the balance sheet, the company quantified the impact of this change on the 2006 financial statements, recording a 58 million euro expense under "Corporate income tax." Due to the changes in estimates made as a result of operations during the year, an additional charge of 39 million euros was recorded in 2007.

14.1 Deferred tax assets and liabilities

The balance at December 31, 2007 and 2006 and movement in these headings is the following:

	Millions of euros		
	Deferred tax assets Long-term	**Deferred tax liabilities Long-term**	**Inter-company deferred tax liabilities Long-term**
Balance at December 31, 2005	**55**	**-**	**43**
Reversal	(135)	-	
Arising in the year	208	202	1
Merger with Telefónica Móviles, S.A.	459	-	1
Impact of change in corporate income tax rate	(47)	(29)	(6)
Balance at December 31, 2006	**540**	**173**	**39**
Reversal	(31)	-	-
Arising in the year	164	162	2
Impact of change in corporate income tax rate	(47)	(12)	-
Balance at December 31, 2007	**626**	**323**	**41**

Telefónica's deferred tax assets relate mainly to accounting provisions recorded for investments in companies with negative underlying book values.

The other inter-company timing differences relate to the effects of consolidated taxation.

14.2 Tax payables and tax receivables

The balances of these headings at December 31, 2007 and 2006 are as follows:

	Millions of euros	
	Balance at 12/31/07	Balance at 12/31/06
Taxes payable:		
Long-term tax payables:	*364*	*212*
Deferred tax liabilities	364	212
Short-term tax payables:	*27*	*27*
Personal income tax withholdings	4	3
Withholding on investment income, VAT and other	22	23
Accrued social security taxes	1	1
	391	**239**
Tax receivables:		
Long-term tax receivables: (Note 7)	*2,116*	*3,166*
Deferred tax assets	626	540
Tax loss carryforwards	99	1,272
Deductions and other (Note 14.3)	1,391	1,354
Short-term tax receivables:	*327*	*63*
Tax loss carryforwards	283	-
Withholdings	22	12
VAT and Canary Islands general indirect tax refundable	22	51
	2,443	**3,229**

At December 31, 2007 the tax Group had tax loss carryforwards pending application amounting to 3,382 million euros. Of this total, 187 million euros were generated in 2003 and 3,195 million euros in 2002. These losses must be applied within 15 years. The balance at December 31, 2007 includes tax credits carryforwards amounting to 382 million euros corresponding to tax losses of 1,245 million euros that have yet to be offset.

Unused tax loss carryforwards relate mainly to a negative adjustment made to the taxable base for corporate income tax on 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.

14.3 Reconciliation of book profit to taxable income and calculation of corporate income tax charge and the net tax refundable.

The calculation of the corporate income tax charge and the net tax refundable for 2007 and 2006 is based on the following.

	Millions of euros	
	2007	2006
Book profit before taxes	5,178	7,001
Permanent differences	(9,728)	(7,165)
Timing differences		
Arising in the year	480	79
Arising in prior years	(566)	(386)
Tax base	**(4,636)**	**(471)**
Gross tax payable	(1,507)	(165)
Tax credits capitalized	(35)	(1,282)
Corporate income tax refundable	**(1,542)**	**(1,447)**
Timing differences	28	107
Corporate income tax accrued in Spain	**(1,514)**	**(1,340)**
Foreign taxes	33	10
Impact of change in tax rate	39	58
Adjustments to prior year's corporate income tax expense	-	(11)
Corporate income tax	**(1,442)**	**(1,283)**

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.

In 2007, the Company recognized a tax benefit arising from the recognition of a higher tax loss carryforward amounting to 2,812 million euros generated on the disposal of the stake in Endemol Investment Holding, B.V. (see Note 7.1b) as a difference between the tax and book value of the Endemol shares at the time of disposal. The benefit recognized in "Corporate income tax" amounts to 914 million euros, presented in the table above under "Permanent differences."

Also included under "Permanent differences" is the accounting gain on this disposal of 1,776 million euros (see Note 7.1.b).

In 2007, the Company capitalized 35 million euros of tax credits, mainly for double taxation. The cumulative amount relates mainly to tax credits in connection with export activity tax credits and tax credits related to the reinvestment of capital gains. In 2006, the deduction for reinvestment arising from the capital gain on the sale of the stake in Telefónica Publicidad e Información, S.A. (see Note 16.6) was 359 million euros, equivalent to 20% of the income subject to tax (1,793 million euros), from which the reversal was made in accordance with legislation through holdings acquired in 2005.

Taxes incurred abroad relate mainly to corporate income tax for the Company's permanent establishment in Argentina and tax withholdings abroad.

14.4 On June 27, 2006, tax audits commenced at several companies included in tax group 24/90, of which Telefónica, S.A. is the parent company. The taxes subject to review are 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 (2002 to 2004). The inspections are not yet complete, but it is considered unlikely that the current actions of the tax authorities will give rise to significant additional liabilities.

In addition, the Company does not expect that any additional significant liabilities will arise from the other years open to inspection.

As a result of the tax inspection under way, Telefónica, S.A has open all tax years subsequent to 2002 for inspection of applicable taxes (except corporate income tax for 2001), as well as those for the last five years for all applicable taxes of its permanent establishment in Argentina.

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.

In April 2007, Telefónica, S.A. filed an administrative appeal before the National Court of Justice. The company also requested that the execution of the appealed settlements and penalties be suspended by providing the appropriate guarantees. On July 26, 2007 the lawsuit was formalized, with Telefónica, S.A. providing expert testimonies supporting its allegations. In December, the parties submitted the evidence on which their cases were based.

In relation to the sale by Terra Networks, S.A. (now Telefónica, S.A.) of it stake in Lycos Inc. in 2004, the Company began 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.

(15) OTHER NON-TRADE PAYABLES

This heading consists of compensation payable and other payables relating mainly to the construction of the Telefónica Group’s headquarters (see Note 6). It also includes provisions for commitments assumed that are due to be settled within the next 12 months.

(16) REVENUES AND EXPENSES

16.1 Operating revenue

In November 1990 Telefónica 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. Revenues received for this concept in 2007 and 2006 totaled 15 million euros and 20 million euros, respectively, and are recorded under "Net sales to Group companies."

Operating revenues also include income from property leases amounting to 31 million euros (9 million euros in 2006), mainly from the lease of office space in District C to several Telefónica Group companies (see Note 6).

"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 34 million euros (38 million euros in 2006) and to Telefónica de España, S.A.U. for 32 million euros (37 million euros in 2006).

16.2 Personnel expenses and employee benefits

The detail of "Personnel expenses" is as follows:

Concept	2007	2006
Wages and salaries	128	126
Pension plans (Note 4.g)	10	50
Social security costs, et al	18	21
Total	**156**	**197**

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) 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, 2007 and 2006, 795 and 782 employees, respectively, have signed up for the plan. The cost for the Company amounted to 2.87 million euros and 2.70 million euros in 2007 and 2006, respectively.

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 2007 (6 million euros in 2006). In 2006, it also recorded an expense of 39 million euros for extraordinary contributions. No provision was made for this plan as the funds are held in external funds.

Compensation systems linked to the share price

a) Telefónica S.A. share plan: "Performance Share Plan"

At the Shareholders' Meeting of Telefónica S.A. on June 21, 2006, 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 remuneration.

The Plan is initially intended to last seven years. It is divided into five cycles or 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 there will be no delivery.

The maximum number of shares assigned to Telefónica, S.A. senior executives in 2007 was 1,102,711 (1,275,552 shares in 2006). The average remaining vesting period on these shares at December 31, 2007, was two years.

When each phase matures, it is Telefónica, S.A. that is responsible for delivering the appropriate number of shares, determined as described above, to all the senior managers of Telefónica Group taking part in the plan. The share of the costs attributable to other Group companies, which employ the executives in the plan, will be recovered from these companies.

The Company therefore recorded a 4.7 million euro provision against personnel expenses in 2007 (1.6 million in 2006 for the period between the launch of the plan and year end).

To ensure the company had enough shares to meet its obligations at the end of the phase begun in 2006, Telefónica bought 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 (see Note 7.7), which in unit terms is 6.43 euros for each maximum number of shares for the Telefónica Group companies included in the plan. This value is consistent with the estimate of the cost of the phase begun in July 2006.

b) Terra Networks, S.A. (now Telefónica, S.A.) share option plan

The Terra Networks, S.A. share option plan was approved at the Shareholders' Meeting on October 1, 1999 and implemented by Board of Directors' resolutions adopted on October 18, 1999 and December 1, 1999.

The plan provides, through the exercise of the share options by their holders, for the ownership by the employees and executives of the Terra-Lycos Group companies of a portion of the capital of Terra Networks, S.A. up to a maximum of 14,000,000 shares of Terra Networks, S.A.

As a result of the Telefónica, S.A. and Terra Networks, S.A. merger approved at the General Shareholders' meeting held on May 31, 2005 and recorded in the Madrid Mercantile Register on July 16, 2005, Telefónica, S.A. took over responsibility for Terra Networks, S.A.'s outstanding share option plans.

Consequently, the options on Terra Networks, S.A. shares were automatically converted into options on Telefónica, S.A. shares at the exchange ratio used in the merger.

At December 31, 2007 all options outstanding were cancelled.

The movements in 2007 and 2006 are as follows:

	Number of options	Average strike price
Options outstanding at December 31, 2005	**117,900**	**28.28**
Options granted	13,278	22.70
Options expired/cancelled	(78,067)	31.12
Options outstanding at December 31, 2006	**53,111**	**22.70**
Options granted	-	-
Options expired/cancelled	(53,111)	22.70
Options outstanding at December 31, 2007	-	-

c) Share option plan of Terra Networks, S.A. (now of Telefónica, S.A.) resulting from the assumption of Lycos, Inc.'s share option plan

Under the agreements entered into for the acquisition of Lycos, Inc., it was agreed to exchange options on the shares of Lycos, Inc. for options on the shares of Terra Networks, S.A.

On June 8, 2000, a resolution was passed at the Shareholders' Meeting of Terra Networks, S.A. to take over Lycos, Inc.'s share option plan.

At the time of the sale of all the shares in Lycos, Inc in 2004, it was agreed that Terra Networks, S.A. would remain responsible for the obligations arising from share options on Terra Networks, S.A. shares to beneficiaries of Lycos, Inc. although Lycos, Inc. could carry out, on behalf of and at the expense of Terra Networks, S.A. whatever actions were necessary or convenient in relation to the exercise of the options by the beneficiaries.

After the merger of Terra Networks, S.A. into Telefónica, S.A., these options became options on Telefónica, S.A. shares.

At December 31, 2007, employees of Lycos, Inc. had been assigned options on 93,269 shares, at a post-merger weighted average strike price of 68.18 USD.

The movements in 2007 and 2006 are as follows:

	Number of options	Average exercise price (USD)	Average share price (USD)
Options outstanding at December 31, 2005	**527,425**	**59.57**	
Options exercised	(124,974)	14.37	15.68
Options expired/cancelled	(287,204)	76.15	
Options outstanding at December 31, 2006	**115,247**	**67.26**	
Options exercised	-	-	
Options expired/cancelled	(21,978)	63.38	
Options outstanding at December 31, 2007	**93,269**	**68.18**	

The detail of options outstanding at December 31, 2007 is as follows:

Range of strike prices (USD)	Number of options outstanding	Average exercise price (USD)	Average Remaining term to maturity (years)
54.90 – 68.90	72,682	58.25	2.30
74.65 – 136.13	20,587	103.22	1.74
Options outstanding at December 31, 2007	**93,269**	**68.18**	**2.17**

16.3 Average number of employees

Category	2007	2006
University graduates and other line personnel	631	722
Junior college graduates and technicians (draftsmen)	6	5
Supervisors, data processing and other assistants	174	189
Total	**811**	**916**

The total number of employees at December 31, 2007 was 797 (792 at December 31, 2006). The number of employees from Telefónica Móviles, S.A. who joined the Company in 2006 was 91.

The breakdown of average staff in 2007 by sex showed 425 women and 386 men, with 423 women and 374 men at December 31, 2007 (412 and 380, respectively at December 31, 2006). The breakdown by sex and category at December 31, 2007 is as follows:

Category	Women	Men	Total
University graduates and other line personnel	262	358	620
Junior college graduates and technicians (draftsmen)	4	2	6
Supervisors, data processing and other assistants	157	14	171
Total	**423**	**374**	**797**

16.4 Other finance costs for debt and similar expenses and revenues from other equity investments and loans

The detail of these headings is as follows:

	2007	2006
Issues	131	135
Euro loans and credits	1,667	1,313
Foreign currency loans and credits	1,328	1,275
Total finance costs on debt and similar expenses	**3,126**	**2,723**
Interest on loans to subsidiaries and associated companies (Note 16.8)	1,002	1,033
On long-term investments in other companies	156	88
Revenues from financial derivatives	7	10
Total revenues from other equity investments and loans	**1,165**	**1,131**

2,585 million euros and 2,149 million euros of the expenses related to interest on debts to Group companies in 2007 and 2006, respectively (see Note 16.8).

16.5 Exchange rate differences

The detail of exchange losses charged against income was as follows:

	2007	2006
Amortization of loans maturing in the year	9	57
Current operations and derivatives	1,184	974
Total	**1,193**	**1,031**

The detail of exchange gains taken to income is as follows:

	2007	2006
Amortization of loans maturing in the year	57	39
Current operations and derivatives	1,914	996
Total	**1,971**	**1,035**

The change in exchange gains and exchange losses in 2007 with respect to 2006 was due mainly to fluctuations in the US dollar/euro exchange rate (the dollar lost 10.54% in 2007 and 10.43% in 2006) and in the pound sterling/euro exchange (the euro appreciated 8.43% after depreciating 2.06% in 2006), which was offset by the effect of hedges arranged for this purpose.

16.6 Extraordinary income

This heading in the income statement relates to non-recurring revenues obtained by the Company during the year. The detail is as follows:

	2007	2006
Gains on disposal of assets	1,785	1,872
Gains on transactions with treasury shares (see Note 9.a)	23	48
Reversal of provisions for negative book value of investees	-	70
Reversal of provisions for treasury shares charged against income (see Note 9.a)	-	38
Other extraordinary income	1	44
Total	**1,809**	**2,072**

"Gains on disposal of assets" in 2007 mainly includes the gain on the sale of 99.7% of Endemol Investment Holding, B.V. amounting to 1,776 million euros (see Note 7.1.b).

In 2006, this heading mainly included the 1,834 million euro gain on the disposal of Telefónica Publicidad e Información, S.A. (see Note 7.1.b), and the 10 million euro gain on the sale of 590,656 Sogecable, S.A. shares (see Note 7.1.b). It also included the 7 million euro gain on the disposal of property, plant and equipment (see Note 6).

In 2006, 70 million euros was reversed from provisions for liabilities and charges in respect of the negative book value on Group investee companies (see Note 7.3).

16.7 Extraordinary expenses

The detail of extraordinary expenses was as follows:

	2007	2006
Provisions for negative book value of investees	440	-
Losses on disposal of fixed assets	4	2
Losses on transactions with own shares (see Note 9)	-	1
Other extraordinary expenses	36	5
Total	**480**	**8**

In 2007, a credit for 440 million euros was allocated to "Provisions for liabilities and charges" in respect of the negative book value on Group investee companies (see Note 7.3).

16.8 Transactions with Group companies

Telefónica's main transactions with Group companies in 2007 and 2006 are as follows:

	2007	2006
Dividends received	15,099	6,678
Accrued interest	1,002	1,033
Financial expenses (Note 16.4)	2,585	2,149
Acquisitions of goods and services from Telefónica Group companies	69	80

On December 20, 2007, Telefónica O2 Europe Plc (formerly O2 Plc) paid Telefónica, S.A. a dividend in kind entailing the transfer of 100% of the shares it held of O2 Europe Ltd., valued at 8,500 million euros (see Note 7.1.a). On the same date, Telefónica O2 Europe Plc resolved to pay Telefónica, S.A. an interim dividend charged against 2007 for 2,000 million pounds sterling (equivalent to 2,772 million euros) to be paid in the first quarter of 2008.

Dividends received in 2007 include the following: 1,363 million euros from Telefónica de España, S.A.U. (1,369 million euros in 2006), Telefónica Móviles España for 1,625 million euros (1,781 million euros in 2006), Telefónica O2 Czech Republic, a.s. for 397 million euros (354 million euros in 2006) and Latin America Cellular Holdings, B.V. for 403 million euros. In 2006, 2,988 million euros of dividends were received from Telefónica Internacional, S.A. and 183 million euros from Telcel, C.A.

Accrued interest in 2007 on financing granted to Group companies (see Note 7.6) included 293 million euros (336 million euros in 2006) on loans to Telefónica de España, S.A.U., 266 million euros (251 million euros in 2006) on loans to Telefónica Móviles México, S.A. de C.V., 220 million euros (223 million euros in 2006) on loans to Telefónica Móviles España, S.A.U. and 91 million euros (90 million euros in 2006) on the loans granted to Telefónica de Contenidos, S.A.U.

Total financial expenses in 2007 on financing received from Group companies (see Note 12) included 890 million euros to Telefónica Europe, B.V. (1,131 million euros in 2006), 773 million euros to Telefónica Emisiones, S.A. (409 million euros in 2006), 696 million euros to Telefónica Finanzas, S.A.U. (432 million euros in 2006) and 161 million euros to Telefónica Móviles España, S.A.U. (119 million euros in 2006).

16.9 Revenue from equity investments in associated companies

"Revenue from equity investments in associated companies" mainly relate to dividends received from the Telefónica, S.A.'s investment in Portugal Telecom, which amounted to 207 million euros in 2007 (47 million euros in 2006), of which 160 million euros correspond to shares of PT Multimedia, S.G.P.S., S.A. received as a dividend in kind (see Note 7.1.a).

(17) OTHER INFORMATION

a) Financial guarantees

At December 31, 2007 Telefónica, S.A. had provided guarantees for its subsidiaries and investees to secure their transactions with third parties (see Note 12.1) amounting to 31,973 million euros (33,722 million euros at December 31, 2006).

The main guarantees provided are for:

- Telefónica Emisiones, S.A.U., with an outstanding nominal value equivalent to 15,795 million euros, for outstanding bonds and debentures, of which the equivalent of 3,792 million euros was issued in 2007.

- Telefónica Europe, B.V., with an outstanding nominal value of 4,729 million euros for bonds and debentures (30,000 million yen equivalent to 182 million euros issued in 2007) and 4,221 million pounds sterling (equivalent to 5,755 million euros) for the outstanding balance on the syndicated loan arranged by Telefónica Europe, B.V. to finance the acquisition of O2 shares.

- The preferred shares issued by Telefónica Finanzas USA, LLC in December 2002 totaling 2,000 million euros.

- Telefónica Finanzas, S.A. related to financing from the European Investment Bank, which at December 31, 2007 amounted to the equivalent of 1,305 million euros.

- The peso bonds issued by Telefónica Finanzas México, S.A. de C.V., with an outstanding balance of 11,500 million Mexican pesos (equivalent to 719 million euros at the 2007 year-end exchange rate).

No significant losses are expected to arise for the Company in connection with these commitments.

b) Litigation

Telefónica, S.A. and its group companies are party to several lawsuits that are currently before the courts and the arbitration bodies of the various countries in which the Telefónica group is present.

Based on the reports of the Company's legal counsel, it is reasonable to assume that this litigation will not significantly affect the financial position or solvency of Telefónica, S.A., even in the event the company should lose. We highlight the following unresolved cases:

1) Procedures deriving from bankruptcy proceeding of Sistemas e Instalaciones de Telecomunicación, S.A.U. (Sintel).

Sintel, a former subsidiary of Telefónica, was declared bankrupt in 2001. As a result of the voluntary bankruptcy proceeding heard by Madrid Court of First Instance no. 42 (case 417/2001), two criminal proceedings commenced which affect Telefónica.

"Abbreviated" proceeding no. 273/2001 being heard before Central Examining Court no. 1, in relation to which, on September 24, 2002, Telefónica, S.A. and Telefónica de España, S.A. filed a civil suit for damages against the directors of Sintel and of Mastec Internacional, S.A.

Preliminary proceeding no. 362/2002, before Central Examining Court no. 1 for a possible offence of extortion. This proceeding was subsequently assimilated to the preliminary proceedings in case no. 273/2001 above.

The two proceedings were combined, in April 2004, the motion filed by counsel for Telefónica, S.A. to have the case dismissed was rejected and it was ruled that the preliminary proceedings should continue. So far no liability has been established and the plaintiffs' claim in this regard has been explicitly dismissed.

In its judgment of December 12, 2007, Examining Court no. 1 changed into an "Abbreviated" proceeding the suit for bankruptcy due to criminal negligence and against the Spanish Treasury, charging those responsible, managers and directors of Sintel, S.A. long after the sale of the company by Telefónica.

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

- 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.

  Both actions alleged mainly that the takeover bid by Telefónica was the result of non-compliance with the fiduciary commitments of this company, and of the Board of Directors of Terra Networks, S.A. Since the actions were brought, both have remained virtually inactive.

- The World Association of Shareholders of Terra Networks, S.A. (ACCTER) filed an appeal for judicial review No. 6/461/03 at the National Appellate Court -Telefónica appears as an intervening non-party- against the ruling of June 19, 2003 by the Spanish National Securities Market Commission (CNMV) authorizing the takeover offer by Telefónica, S.A. for Terra Networks.

  The appeal was rejected by the National Appellate Court via ruling issued January 27, 2006, against which ACCTER filed an administrative appeal. The Third Section of the Supreme Court has yet to rule on the admissibility of this appeal.

Proceedings derived from the merger

- On June 30, 2005, ACCTER and its President, on his own account, filed a complaint contesting the merger resolution adopted at the Shareholders' Meeting of Terra Networks, S.A. of June 2, 2005.

  The Court of First Instance rejected the claim and the plaintiffs filed an appeal which has yet to be resolved.

- On September 26, 2006, Telefónica and one of its directors were 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 by Telefónica with the shareholders of Terra in respect of the terms and conditions set forth in the Prospectus of the Initial Public Offering of shares of Terra Networks, S.A. The court date has been set for July 19, 2008.

3) Claim at the ICSID

As a result of the enactment by the Argentine government of Public Emergency and Exchange Rules Reform Law 25561, 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, were affected appreciably, since the Law renders 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 (ARS 1) to one US dollar (US$1).

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 July 6, 2004, the first hearing at the ICSID took place in Washington and a 90-day stay was ordered in an attempt to reach a settlement. Following the expiration of the stay without any settlement having been achieved, on December 6, 2004, Telefónica filed the “memorial” or claim with the ICSID together with the initial supporting testimonies. The Court is currently considering a plea filed by the Argentine government alleging that the matter is outside the jurisdiction of the arbitration court.

On February 15, 2006, Telefónica Argentina signed a memorandum of understanding with the Argentine government as a prerequisite to reaching an agreement to renegotiate the transfer contract approved by Royal Decree-Law 2332/90 pursuant to the provisions of Article 9º of Law 25,561.

Among other issues, this memorandum of understanding envisaged the suspension by Telefónica de Argentina, S.A. and Telefónica, S.A., for a period of 210 working days, of proceedings for all claims, appeals and demands planned or underway, with the administrative, arbitrational or legal courts of Argentina or abroad, which were based on events or measures taken as a result of the emergency situation established by Law Nº 25,561 with regard the Transfer Agreement and the license granted to the Company. The suspension came into force on October 6, 2006.

This preliminary agreement could put an end to the litigation.

As the initial stay expired, Telefónica requested a six-month extension starting October 5, 2007 which the Argentina government did not oppose. The courts agreed to extend the stay.

4) Appeal against the European Commission ruling of July 4, 2007 against Telefónica de España, S.A.U.'s broadband pricing policy.

On February 22, 2006, Telefónica S.A. was sent a statement of objections, initiating disciplinary proceedings for conduct that goes against Article 82 of EC Treaty rules. Subsequently, on July 9, 2007, the European Commission issued a decision, imposing a 152 million euro fine on Telefónica and Telefónica de España, S.A.U. 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. Telefónica de España and Telefónica both filed appeals to overturn the decision before the Court of First Instance of the European Communities. The Kingdom of Spain also lodged an appeal to overturn the decision.

5) 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 14).

c) Commitments

Agreements with Portugal Telecom (Brazil).

On January 23, 2001, Telefónica, S.A. and its subsidiary Telefónica Móviles, S.A. (merged with Telefónica, S.A. in 2006, see Note 1), and Portugal Telecom S.G.P.S., S.A. and its subsidiary PT Móveis, S.G.P.S., S.A. agreed to combine all their wireless telephony businesses in Brazil. They therefore undertook to contribute all their wireless telephony assets in Brazil to a joint venture, which, subject to the necessary regulatory authorizations, would be a subsidiary of the two groups, and in which they would each have a 50% ownership interest. In addition, under the terms of this agreement, the two parties expressed their interest in increasing their reciprocal ownership interests, subject to compliance with the applicable regulations and bylaws.

On October 17, 2002, Telefónica Móviles, S.A., and Portugal Telecom S.G.P.S., S.A. and its subsidiary PT Móveis S.G.P.S., S.A. entered into the definitive agreements (Shareholders' Agreement and Subscription Agreement) that implement the aforementioned agreement signed in January 2001. On December 27, 2002 (after having obtained the necessary authorizations), the two groups' holdings in their respective Brazilian wireless telephony operators were contributed to a Dutch joint venture, Brasilcel N.V., in accordance with the provisions of the aforementioned Subscription Agreement.

In accordance with the aforementioned definitive agreements, Telefónica, S.A. and the Portugal Telecom group will have the same voting rights at Brasilcel, N.V. This equality in voting rights will cease to exist if, as a result of capital increases at Brasilcel, N.V., the percentage ownership of either of the parties falls below 40% during an uninterrupted period of six months. In this event, Brasilcel N.V.'s governing bodies would deliberate with a simple majority. As for the quorum required to hold the Shareholders' Meeting, attendance by shareholders representing the majority of share capital would suffice.

Also, in accordance with the definitive agreements, the Portugal Telecom Group will be entitled to sell to Telefónica, S.A., which will be obliged to buy, its holding in Brasilcel, N.V. should there be a change in control at Telefónica, S.A., or at any other subsidiary of the latter that held a direct or indirect ownership interest in Brasilcel N.V. Similarly, Telefónica, S.A. will be 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 S.G.P.S., S.A., at PT Móveis S.G.P.S., S.A or at any other subsidiary of either company that held a direct or indirect ownership interest in Brasilcel N.V. The price will be determined on the basis of an independent appraisal (in 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.

d) Directors' 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 is responsible for setting the exact amount to be paid within the stipulated limits and distributing it among the directors. 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.

Therefore, the compensation of Telefónica's directors in their capacity as members of the Board of Directors and/or of the Standing Committee and 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. It should be noted that a resolution has been adopted whereby from September 2007, executive directors will not receive the fixed amounts established for their membership of the Board of Directors and Standing Committee, but only the corresponding amounts for discharging their executive duties as stipulated in their respective contracts.

In 2007, the members of the Board of Directors of Telefónica, S.A. earned the following total compensation for discharging their duties as such: fixed payments of 3,704,333 euros and attendance fees of 211,250 euros for attending the Board of Director's advisory committee meetings. It should also be noted that the compensation paid to Company directors sitting on the Boards of other Telefónica Group companies amounted to 405,192 euros. In addition, the six Company directors who are members of the Catalonia, Andalusia and Valencia advisory committees received a total 73,750 euros in 2007.

In addition, in their capacity as company executives, the executive directors César Alierta Izuel, Julio Linares López, José María Álvarez-Pallete López, Peter Erskine (who stepped down from his executive duties on December 31, 2007) and Antonio Viana-Baptista (who stepped down from his executive duties on January 31, 2008) received: 12,368,727 euros in salaries and variable compensation; 33,018 euros in contributions made to Company-sponsored pension plans and 126,302 euros of compensation in kind, which included other insurances (general medical and dental insurance), as well as life insurance premiums.

In addition, it should be noted that Peter Erskine received the following amounts: (i) 615,283 euros as periodic payment in cash relating to the commitments previously acquired by O2 plc in connection with his pension plan, this item set forth in the Document containing the Tender offer, (ii) 3,838,077 euros under the 2005 O2 Share Plan, which was likewise set forth in the Document containing the Tender offer, and (iii) in accordance with the conditions of O2 acquisition, 24,331,831 euros for stepping down from his executive duties, broken down as follows: variable compensation for 2007, a payment for the advance notice clause in his employment contract, a payment for his employment commitment in accordance with the terms of the Framework Agreement signed in relation to the takeover bid for O2 plc shares and the payment of the obligations acquired at the time by O2 plc regarding pension plans, this concept was included likewise in the takeover document. The bulk of this last payment was made in 2007, with the remainder paid in January 2008.

In order to make this information more transparent and easier to understand, the following table present the detail by concept, remuneration and benefits (in euros) paid to Telefónica directors in 2007:

Director	Board of Directors	Standing Committee	Board Committees		TOTAL
			Fixed compensation	Attendance fees	
Chairman					
César Alierta Izuel	290,000	96,667	0	0	386,667
Vice chairmen					
Isidro Fainé Casas	241,667	96,667	0	0	338,334
Gregorio Villalabeitia Galarraga (1)	137,500	55,000	22,500	20,000	235,000
Vitalino Manuel Nafría Aznar	186,667	0	7,000	3,750	197,417
Members					
Julio Linares López	95,000	63,333	8,667	7,500	174,500
José María Abril Pérez (2)	62,500	41,667	3,500	1,250	108,917
José Fernando de Almansa Moreno-Barreda	145,000	0	40,000	20,000	205,000
José María Álvarez-Pallete López	95,000	0	0	0	95,000
David Arculus	145,000	0	0	0	145,000
Maximino Carpio García (3)	145,000	96,667	40,833	26,250	308,750
Carlos Colomer Casellas	145,000	96,667	13,333	2,500	257,500
Peter Erskine	95,000	63,333	0	0	158,333
Alfonso Ferrari Herrero	145,000	0	60,333	26,250	231,583
Gonzalo Hinojosa Fernández de Angulo	145,000	0	73,667	35,000	253,667
Pablo Isla Álvarez de Tejera	145,000	0	50,500	17,500	213,000
Antonio Massanell Lavilla	145,000	0	47,000	23,750	215,750
Enrique Used Aznar (4)	145,000	0	60,333	27,500	232,833
Antonio Viana-Baptista	95,000	63,333	0	0	158,333

(1) Gregorio Villalabeitia Galarraga was a director of Telefónica until July 25, 2007, being replaced as Vicechairman by Vitalino Nafría Aznar.
(2) José María Abril Pérez was appointed direct of Telefónica on July 25, 2007.
(3) Maximino Carpio García was a director of Telefónica until December 19, 2007.
(4) Enrique Used Aznar was a director of Telefónica until December 19, 2007.

For a better understanding of the information provided above, the following table presents the amounts established for fixed compensation and attendance fees, where appropriate, of the Board of Directors, Standing and Advisory or Control Committees.

Board of Directors. Fixed payment for each director (euros):

Position	2007
Chairman	290,000
Vice chairmen	241,667
Directors:	
Executives	95,000
Non-independent external directors	145,000
Independent external directors	145,000
Other external directors	145,000

Directors do not receive any attendance fees for attending Board and Standing Committee meetings.

Standing Committee. Fixed payment for each director forming part of the Standing Committee, by position (euros):

Position	2007
Chairman	96,667
Deputy Chairman	96,667
Members	96,667

Directors do not receive any attendance fees for attending Board and Standing Committee meetings.

Other Board committees.

Fixed payment for each director forming part of one of the Board committees, by position (euros):

Position	2007
Chairman	26,667
Members	13,333

Total fees paid to directors in 2007 for attending meetings of the advisory or control committees (euros):

Committee	2007
Audit and Control	Attendance fee per meeting: 1,250 Number of meetings paid: 11
Appointments, Compensation, and Good Governance	Attendance fee per meeting: 1,250 Number of meetings paid: 10
Human Resources, Reputation and Corporate Responsibility	Attendance fee per meeting: 1,250 Number of meetings paid: 4
Regulation	Attendance fee per meeting: 1,250 Number of meetings paid: 11
Service Quality and Customer Service	Attendance fee per meeting: 1,250 Number of meetings paid: 4
International Affairs	Attendance fee per meeting: 1,250 Number of meetings paid: 5

In addition, the total compensation paid to César Alierta Izuel, Julio Linares López, José María Álvarez-Pallete López, Peter Erskine and Antonio Viana-Baptista for discharging their executive duties by component (in euros) is as follows:

Component	2007
Salary (1)	5,688,154
Variable compensation (2)	6,680,573
Compensation in kind	126,302
Contributions to pension plans	33,018

(1) It is stated for the record that in addition, Mr. Peter Erskine received the amount of 615,283 euros as periodic payment in cash relating to the commitments previously acquired by O2 plc. in connection with his pension plan, this item set forth in the Document containing the Tender offer.

(2) In addition, it is stated, for the record, that Mr. Peter Erskine received the following amounts: (i) in accordance with the conditions of O2 acquisition, 24,331,831 euros for relinquishing his status as a Company executive under the terms indicated above, and (ii) 3,838,077 euros under the 2005 O2 Share Plan, which was likewise set forth in the Document containing the Tender offer.

In addition, related to the "Performance Share Plan" authorized at the General Shareholders' Meeting of June 21, 2006 (see Note 20), the maximum number of shares corresponding to the first and second phases of the Plan will be given (on July 1, 2009 and July 1, 2010) to each of the executive directors of Telefónica, S.A. if all the terms established for such delivery are met, is as follows: César Alierta Izuel (129,183 shares in the first phase and 116,239 shares in the second); Julio Linares López (65,472 and 57,437 shares, respectively); José María Álvarez-Pallete López (62,354 and 53,204 shares, respectively); Antonio Viana-Baptista (62,354 and 53,204 shares, respectively). With respect to Peter Erskine (who was allocated 181,762 shares in the first phase and 151,863 shares in the second), he will receive, within the first three months of the year, the number of shares he is entitled to, if any, based on the period of each phase during which he was an executive of the Telefónica Group.

It should be noted that the non-executive directors do not receive and did not receive in 2007 any compensation in the form of pensions or life insurance, and they do not participate in the compensation plans linked to the market share price.

In addition, the Company does not grant and did not grant in 2007 any advances, loans or credits to the directors, or to its top executives, thus complying with the requirements of the

Sarbanes-Oxley Act passed in the U.S. which is applicable to Telefónica as a listed company in that market.

Meanwhile, the four senior executives[1] of the Company, excluding those that are also members of the Board of Directors, received a total for all items in 2007 of 4,813,277 euros.

In addition, the maximum number of shares corresponding to the first and second phases of the "Performance Share Plan" to be delivered to all the Company's senior executives if all the established terms are met is 157,046 shares and 130,911 shares, respectively.

In addition, with respect to the Pension Plan for directors (see Note 16.2), the total amount of contributions made by the Telefónica Group in 2007 was 1,707,237 euros for executive directors and 786,2621 euros for directors who held positions of senior executives at the Company in 2007.

Finally, we would note that the senior executive contracts, including those of executive directors, generally include a severance clause entailing three years of salary plus another year based on years of service at the Company. The annual salary on which the indemnity is based is the director's last fixed salary and the average amount of the last two variable payments received by contract.

e) Detail of the equity investments in companies engaging in an activity that is identical, similar or complementary to that of the Company and the performance of similar activities by the directors on their own behalf or on behalf of third parties

Pursuant to Article 127 ter. 4 of the Spanish Corporation Law, introduced by Law 26/2003 July 17, which amends Securities Market Law 24/1988 July 28, and the revised Spanish Corporation Law, in order to reinforce the transparency of listed corporations, details are given below of the companies engaging in an activity that is identical, similar or complementary to the corporate purpose of Telefónica, S.A., in which the members of the Board of Directors own equity interests, and of the functions, if any, that they discharge in them:

[1] For these purposes, Senior Executives are understood to be individuals who perform senior management functions in a company reporting directly to the management bodies, executive committees or CEOS, including the person in charge of the internal audit.

Director	Investee	Activity	Percentage of ownership %(1)	Position
David Arculus	Vodafone Group, Plc.	Telecommunications	< 0.01%	--
	British Sky Broadcasting Group, Plc.	Telecommunications	< 0.01%	--
	BT Group, Plc.	Telecommunications	< 0.01%	--
Isidro Fainé Casas	Abertis Infraestructuras, S.A.	Telecommunications	< 0.01%	Chairman
Antonio Viana-Baptista	PT Multimedia-Serviços de Telecomunicaçoes e Multimedia, S.G.P.S., S.A.	Internet	< 0.01%	--
	Portugal Telecom, S.G.P.S., S.A.	Telecommunications	< 0.01%	Director

(1) If the holding is less than 0.01% of the share capital,"< 0.01%" is shown.

The table below, in accordance with the same Law, gives details of activities carried out, on their own account or on behalf of third parties, by the various members of the Company Board of Directors that are identical, similar or complementary to the corporate purpose of Telefónica, S.A.

Name	Activity	Arrangement under which the activity is performed(2)	Company through which the activity is performed	Position held or functions performed
César Alierta Izuel	Telecommunications	On behalf of third parties	Telefónica O2 Europe, Plc. (3)	Director
	Telecommunications	On behalf of third parties	Telecom Italia, S.p.A.	Director
	Telecommunications	On behalf of third parties	China Netcom Group Corporation	Director
Isidro Fainé Casas	Telecommunications	On behalf of third parties	Abertis Infraestructuras, S.A.	Chairman

Name	Activity	Arrangement under which the activity is performed(2)	Company through which the activity is performed	Position held or functions performed
Julio Linares López	Telecommunications	On behalf of third parties	Telefónica de España, S.A.U.	Director
	Telecommunications	On behalf of third parties	Telefónica DataCorp, S.A.	Director
	Telecommunications	On behalf of third parties	Telefónica O2 Europe, Plc.	Director
	Telecommunications	On behalf of third parties	Telefónica O2 Czech Republic, a.s	1st Vice Chairman of Supervisory Board
	Television, telecommunications and audiovisual production services	On behalf of third parties	Sogecable, S.A.	Director
	Telecommunications	On behalf of third parties	Telecom Italia, S.p.A.	Director

Name	Activity	Arrangement under which the activity is performed(2)	Company through which the activity is performed	Position held or functions performed
Fernando de Almansa Moreno-Barreda	Telecommunications	On behalf of third parties	Telefónica Internacional, S.A.U.	Director
	Telecommunications	On behalf of third parties	Telefónica del Perú, S.A.A.	Director
	Telecommunications	On behalf of third parties	Telefónica de Argentina, S.A.	Director
	Telecommunications	On behalf of third parties	Telecomunicaçoes de Sao Paulo, S.A.	Director
	Telecommunications	On behalf of third parties	Telefónica Móviles México, S.A. de C.V.	Director
José María Alvárez-Pallete López (7)	Telecommunications	On behalf of third parties	Telefónica Internacional, S.A.	Executive Chairman
	Telecommunications	On behalf of third parties	Telefónica Móviles España, S.A.U.	Director
	Telecommunications	On behalf of third parties	Telefónica de España, S.A.U.	Director
	Telecommunications	On behalf of third parties	Telefónica Datacorp, S.A.U.	Director
	Telecommunications	On behalf of third parties	Telefónica O2 Europe, Plc (4)	Director
	Telecommunications	On behalf of third parties	Telefónica de Argentina, S.A. (8)	Director/Vice Chairman
	Telecommunications	On behalf of third parties	Telecomunicaçoes de Sao Paulo, S.A.	Director/Vice Chairman
	Telecommunications	On behalf of third parties	Compañía de Telecomunicaciones de Chile, S.A.	Acting Director
	Telecommunications	On behalf of third parties	Telefónica Móviles México, S.A. de C.V.	Director/Vice Chairman
	Telecommunications	On behalf of third parties	Colombia Telecomunicaciones, S.A. ESP	Director

Name	**Activity**	**Arrangement under which the activity is performed(2)**	**Company through which the activity is performed**	**Position held or functions performed**
José María Alvárez-Pallete López (7)	Telecommunications	On behalf of third parties	Telefónica del Perú, S.A.A.	Acting Director
	Telecommunications	On behalf of third parties	China Netcom Group Corporation.	Director
	Telecommunications	On behalf of third parties	Brasilcel, N.V.	Chairman of Supervisory Board
	Telecommunications	On behalf of third parties	Telefónica Móviles Colombia, S.A.	Director
David Arculus	Telecommunications	On behalf of third parties	Telefónica O2 Europe, Plc.	Director
Peter Erskine	Telecommunications	On behalf of third parties	Telefónica O2 Europe, Plc. (5)	Executive Chairman
	Telecommunications	On behalf of third parties	Telefónica O2 Czech Republic, a.s. (9)	Chairman of Supervisory Board
Alfonso Ferrari Herrero	Telecommunications	On behalf of third parties	Compañía de Telecomunicaciones de Chile, S.A.	Director
	Telecommunications	On behalf of third parties	Telefónica de Perú, S.A.A.	Director
	Telecommunications	On behalf of third parties	Telefónica Móviles Chile, S.A.	Director

Name	Activity	Arrangement under which the activity is performed(2)	Company through which the activity is performed	Position held or functions performed
Antonio Viana Baptista	Telecommunications	On behalf of third parties	Portugal Telecom, S.G.P.S., S.A. (6)	Director
	Telecommunications	On behalf of third parties	Telefónica O2 Europe, Plc.	Director

(2) Only assigned when the activity is carried out through a third party and, accordingly, through a company.
(3) On January 16, 2008, César Alierta Izuel stepped down from his post as director of Telefónica O2 Europe, Plc.
(4) On January 16, 2008, José María Álvarez-Pallete López stepped down from his post as director of Telefónica O2 Europe, Plc.
(5) On December 31, 2007, Peter Erskine stepped down from his post as director and executive chairman of Telefónica O2 Europe, Plc. Subsequently, on February 1, 2008, he was reappointed a director of the Company.
(6) On January 31, 2008, Antonio Viana-Baptista stepped down from his post as director of Portugal Telecom, SGPS, S.A.
(7) On February 12, 2008, José María Álvarez- Pallete López was appointed a director of Portugal Telecom, SGPS, S.A.
(8) On February 21, 2008, José María Álvarez-Pallete López stepped down from his post as director of Telefónica de Argentina, S.A. and became acting director.
On the same date, Francisco Javier de Paz Mancho was appointed director Telefónica de Argentina, S.A.
(9) On February 21, 2008, Peter Erskine stepped down from his post as member of the Supervisory Board of Telefónica O2 Czech Republic, a.s. and, therefore, his post as Chairman of this board.
On February 19, 2008 Francisco Javier de Paz Mancho was appointed director Telecomunicaçoes de Sao Paulo, S.A.

Pursuant to Article 114.2 of the Spanish Corporation Law, also introduced by Law 26/2003 of July 17, it is stated that in the year to which these annual financial statements refer, the directors, or persons acting on their behalf, did not perform any transactions with Telefónica or any other company in the Telefónica Group other than in the normal course of the Company’s business or that were not at arm’s length.

f) Auditors’ fees

Fees paid to the various companies forming part of the Ernst & Young International Group, to which Ernst & Young, S.L. (the auditors of Telefónica, S.A.) belongs, totaled 4.3 million euros and 3.6 million euros in 2007 and 2006, respectively, as follows.

	Millions of euros	
	2007	2006
Audit of financial statements	1.2	1.2
Other audit services	3.1	2.4
Non-audit work	0.0	0.0
TOTAL	**4.3**	**3.6**

g) Environmental matters

As head of the Telefónica Group, Telefónica, S.A. engages in activities relating to the ownership of shares and the provision of financing and corporate advisory services to various Group companies. In view of the business activities in which the Company engages, it has no environmental liabilities, expenses, assets, provisions or contingencies that could have a significant effect on its equity, financial situation and results. Consequently, the 2007 annual financial statements do not include specific details regarding environmental issues.

(18) EVENTS AFTER THE BALANCE SHEET DATE

Significant events affecting Telefónica taking place from December 31, 2007 to the date of preparation of these financial statements included:

EIB financing

On January 15, 2008 Telefónica Finanzas, S.A. paid off at maturity the balance on the 200 million euro loan taken out with the European Investment Bank (EIB) on January 9, 1998, guaranteed by Telefónica.

On January 17, 2008, Telefónica Finanzas, S.A. arranged a 75 million euro facility (Tranche B of the Telefónica Mobile Telephony II project) with a bank guarantee and counterguarantees by Telefónica maturing January 29, 2016.

On January 30, 2008 Telefónica Finanzas, S.A. drew down the amounts of the facilities arranged with the EIB on December 3, 2007 and January 17, 2008 of 375 and 75 million euros, respectively, comprising Tranches A and B of the Telefónica Mobile Telephony II project.

Dividend received from Telefónica O2 Europe, Plc.

On February 14, 2008, Telefónica O2 Europe Plc paid the interim dividend charged against 2007 profit granted to Telefónica, S.A. for 2,000 million pounds sterling.

(19) STATEMENT OF SOURCE AND APPLICATION OF FUNDS

APPLICATIONS OF FUNDS	2007	2006	SOURCES OF FUNDS	2007	2006
- Funds applied in operations	-	-	- Funds obtained from operations	5,145	4,851
- Start-up and debt arrangement expenses	-	44	- Long-term deferred tax liabilities	2,644	2,009
- Acquisition of fixed assets:			- Long-term debt	-	22,100
a) Intangible assets	19	17	- Disposal of fixed assets	3,816	2,414
b) Property, plant and equipment	98	232	- Transfer to short term of loans	1,615	1,709
c) Long-term investments	2,899	28,075			
- Capital reduction and distribution of treasury stock	2,203	-			
- Cash dividend	3,078	2,627			
- Long-term debt	7,130	-			
- Change in working capital due to inclusion of Telefónica Móviles, S.A. in 2006 (Note 1)	-	4,051			
TOTAL FUNDS APPLIED	**15,427**	**35,046**	**TOTAL FUNDS OBTAINED**	**13,220**	**33,083**
FUNDS OBTAINED IN EXCESS OF FUNDS APPLIED	-	-	**FUNDS APPLIED IN EXCESS OF FUNDS OBTAINED**	**2,207**	**1,963**
(INCREASE IN WORKING CAPITAL)			**(DECREASE IN WORKING CAPITAL)**		
	15,427	**35,046**		**15,427**	**35,046**

CHANGES IN WORKING CAPITAL

INCREASE IN WORKING CAPITAL	2007	2006
Accounts receivable	270	94
Short-term investments	2,604	-
Cash	932	959
Prepayments and accrued income	-	3
Accounts payable	-	1,240
TOTAL	**3,806**	**2,296**
CHANGE IN WORKING CAPITAL	**2,207**	**1,963**
	6,013	**4,259**

DECREASE IN WORKING CAPITAL	2007	2006
Accounts receivable	-	-
Short-term investments	-	3,498
Treasury shares	10	761
Prepayments and accrued income	11	-
Accounts payable	5,992	-
TOTAL	**6,013**	**4,259**
CHANGE IN WORKING CAPITAL	-	-
	6,013	**4,259**

The reconciliation of the balances of the income statement to the funds obtained from operations is as follows:

	Millions of euros	
	2007	**2006**
Profit for the year	**6,620**	**8,284**
Plus:		
Depreciation and amortization expense	65	51
Amortization of debt arrangement expenses	69	63
Short-term investment writedown provisions	-	(11)
Period provisions	401	520
Changes in provisions for securities investments	9,875	(231)
Losses on disposal of fixed assets	2	2
Losses on transactions with own shares	-	1
Less:		
Dividend in kind received	8,636	-
Gains on disposal of long-term investments	1,785	1,872
Gains on transactions with own shares	23	48
Reversal of provisions	-	621
Capitalized interest expense	1	4
Corporate income tax	1,442	1,283
Funds obtained from operations	**5,145**	**4,851**

(20) ADDITIONAL NOTE FOR ENGLISH TRANSLATION

These financial statements are presented on the basis of accounting principles generally accepted in Spain. Consequently, certain accounting practices applied by the Company may not conform with generally accepted principles in other countries.

APPENDIX I

**Details of subsidiaries,
associated companies and investees
at December 31, 2007**

DETAILS OF SUBSIDIARIES, ASSOCIATES AND INVESTEES AT December 31, 2007

Millions of euros

Subsidiaries and investments

	Ownership %	Capital	Reserves	Interim Dividend	Profit (loss)	Carrying Amount
Telefónica O2 Europe plc (UK) (1) (6) *Mobile communications services operator* *Wellington Street, Slough, SL1 1YP*	100.00%	12	16,169	(2,727)	2,418	26,153
O2 (Europe) Ltd. (UK) (1) *Mobile communications services operator* *Wellington Street, Slough, SL1 1YP*	100.00%	14	355	-	1,048	8,520
Telefónica Internacional, S.A. (SPAIN) (1) *International investment in Telecoms sector* *C/ Gran Vía, 28 - 28013 Madrid*	100.00%	2,839	1,354	-	964	8,132
Telefónica Móviles España, S.A.U. (SPAIN) (1) *Mobile communications services provider* *Plaza de la Independencia, 6 - Pta. 5 - 28001 Madrid*	100.00%	423	468	-	2,524	5,775
Telefonica O2 Czech Republic, a.s. (CZECH REPUBLIC) (1) (6) (10) *Telecoms services provider* *Olsanska 55/5 - Praga 3, 130 34*	69.41%	745	1,068	-	209	3,663
Telefónica de España, S.A.U. (SPAIN) (1) *Spanish Telecoms service provider* *Gran Vía, 28 - 28013 Madrid*	100.00%	1,024	1,880	-	2,282	3,034
Telefónica de Contenidos , S.A.U. (SPAIN) (1) *Multimedia services* *Jorge Manrique, 12 - 28006 Madrid*	100.00%	1,865	(1,678)	-	(10)	2,242
Brasilcel, N.V. (NETHERLANDS) (1) (6) *Joint Venture and mobile services holding company* *Strawinskylaan 3105 - 1077ZX - Amsterdam*	50.00%	-	6,560	-	91	2,179
Latin America Cellular Holdings, B.V. (NETHERLANDS) (1) *Holding company* *Strawinskylaan 3105, Atium 7th, Amsterdam*	100.00%	980	(403)	-	256	1,635
Telefónica Datacorp, S.A.U. (SPAIN) (1) *Telecoms services provider and operator* *Gran Vía, 28 - 28013 Madrid*	100.00%	700	36	-	6	1,343
Telefónica Móviles México, S.A. de C.V. (MEXICO) (1) (6) *Holding company* *Prolongación Paseo de la Reforma 1200 Col. Cruz Manca, Mexico City CP.05349*	100.00%	1,267	(2,256)	-	(544)	1,176
Telefónica Móviles Argentina Holding, S.A. (ARGENTINA) (1) *Holding company* *Ing Enrique Butty 240, piso 20-Capital Federal-Argentina*	100.00%	258	185	-	151	1,141
Ecuador Cellular Holdings, B.V. (NETHERLANDS) (1) *Holding company* *Strawinskylaan 3105, Atium 7th, Amsterdam*	100.00%	46	-	-	(1)	581
Inversiones Telefónica Móviles Holding Limitada (CHILE) (1) *Holding company* *Av El Bosque Sur 090, Los Condes, Santiago de Chile*	100.00%	428	(85)	-	160	424
Telefónica International Wholesale Services America, S.A. (URUGUAY) (1) *Broadband services provider* *Luis A. de Herrera, 1248 Piso 4 - Montevideo*	80.56%	469	17	-	(15)	407

Millions of euros

Subsidiaries and investments

	Ownership %	Capital	Reserves	Interim Dividend	Profit (loss)	Carrying Amount
Atento Holding, Inversiones y Teleservicios, S.A. (SPAIN) (1) *Telecoms services provider* *C/ Santiago de Compostela, 94 - 28.035 Madrid*	100.00%	24	138	-	-	373
Inversiones Telefónica Móviles Holding II Limitada (CHILE) (1) *Mobile communications services operator* *Avda. El Bosque Sur 090, Las Condes, Santiago de Chile*	100.00%	334	(43)	-	72	318
Multi Holding Corporation (PANAMA) (7) *Dormant company* *Edificio HSBC, Piso 11, Avd Samuel Lewis - Panamá*	100.00%	N/D	N/D	N/D	N/D	301
TCG Holdings, S.A. (GUATEMALA) (1) *Holding company* *Bulevar Los Próceres 5-56 Zona 10, Unicentro nivel 10 - Guatemala City*	100.00%	281	(169)	-	31	239
Panamá Cellular Holdings, B.V. (NETHERLANDS) *Holding company* *Strawinskylaan 3105, Atium 7th, Amsterdam*	100.00%	40	-	-	(2)	238
Telefónica International Wholesale Services, S.L. (SPAIN) (1) *International services provider* *Gran Vía, 28 - 28013 Madrid*	92.51%	230	7	-	(15)	213
Telefónica Móviles El Salvador Holding, S.A. de C.V. (EL SALVADOR) (1)) *Holding company* *Alameda Roosvelt y Avenida Sur. Torre Telefónica nivel 10 - San Salvador*	100.00%	127	(79)	-	21	161
Telefónica Móviles Argentina, S.A. (ARGENTINA) (1) *Holding company* *Ing Enrique Butty 240, piso 20-Capital Federal-Argentina*	15.40%	107	N/D	N/D	N/D	139
Telcel, C.A. (VENEZUELA) (1) *Operadora de comunicaciones móviles* *Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060*	0.08%	109	634	(264)	700	123
Telefónica Móviles Colombia, S.A. (COLOMBIA) (1) *Mobile communications operator* *Calle 100, Nº 7-33, Piso 15, Bogotá,Colombia*	22.44%	-	1,028	-	20	116
Telefónica Móviles Puerto Rico, Inc. (PUERTO RICO) *Holding vehicle for investments in Puerto Rico mobile operators* *Metro Office Park Calle Edificio #17, Suite 600 - 00968 Guaynabo*	100.00%	98	(98)	-	-	110
Ateseco Comunicación, S.A. (SPAIN) *Holding company* *C/ Gran Vía, 28 - 28.013 Madrid*	100.00%	6	43	-	1	108
Terra Networks Asociadas, S.L. (SPAIN) (4) *Holding company* *C/ Gran Vía, 28 - 28.013 Madrid*	100.00%	7	(28)	-	(3)	64
Seguros de Vida y Pensiones Antares, S.A. (SPAIN) (1) *Life insurance, pensions and health insurance* *Avda. General Perón, 38 Master II - 17º P. - 28020 Madrid*	89.99%	51	49	-	3	59
LE Holding Corporation (USA) *Holding company* *Corporation Trust Center, 1209 Orange Street - Wilmington, Delaware 19801*	100.00%	N/D	N/D	N/D	N/D	48
Telefónica Móviles Guatemala, S.A. (GUATEMALA) (1) *Wireless, wireline and radio paging communications services* *Bulevar Los Próceres 5-56 Zona 10, Unicentro nivel 11 - Guatemala City*	13.60%	279	12	-	(178)	38

Millions of euros

Subsidiaries and investments

	Ownership %	Capital	Reserves	Interim Dividend	Profit (loss)	Carrying Amount
Guatemala Cellular Holdings, B.V. (NETHERLANDS) (1) *Holding company* *Strawinskylaan 3105, Atium 7th, Amsterdam*	100.00%	19	-	-	-	29
Taetel, S.L. (SPAIN) (1) *Purchase, holding and sale of shares and investments in other companies* *Beatríz de Bobadilla, 3 - 28040 Madrid*	100.00%	28	6	-	1	28
Telefónica Gestión de Servicios Compartidos, S.A. (SPAIN) (4) *Management and administration services provider* *Gran Vía, 28 - 28013 Madrid*	100.00%	8	1	-	8	24
Telefónica Capital, S.A. (SPAIN) (3) *Finance Company* *Gran Vía, 28 - 28013 Madrid*	100.00%	7	63	-	9	18
Lotca Servicios Integrales, S.L. (SPAIN) (4) *Holding and operation of aircraft and aircraft leasing* *Gran Vía, 28 - 28013 Madrid*	100.00%	17	-	-	-	17
Comet, Compañía Española de Tecnología, S.A. (SPAIN) (3) *Promotion of business initiatives and holding of real estate assets* *Villanueva, 2 duplicado planta 1º Oficina 23 - 28001 Madrid*	100.00%	5	2	-	-	14
Telefónica Móviles del Uruguay, S.A. (URUGUAY) *Mobile communications services operator* *Plza de la Independencia 8, planta baja, Montevideo*	100.00%	6	27	-	15	13
Telefónica Finanzas, S.A. (TELFISA) (SPAIN) (1) *Integrated cash management, consulting and financial support for Group companies* *Gran Vía, 30 - 4ª Plta. - 28013 Madrid*	100.00%	3	17	-	5	13
Corporation Real Time Team, S.L. (SPAIN) *Internet design, advertising and consulting* *Claudio Coello, 32, 1º ext. - Madrid*	87.96%	0	N/D	N/D	N/D	12
Telefónica Móviles Soluciones y Aplicaciones, S.A. (CHILE) (1) *IT and communications services provider* *Avenida del Cóndor Nº720, piso 4, comuna de Huechuraba, de la Ciudad de Santiago de Chile*	100.00%	11	(5)	-	-	11
Centro de Investigación y Experimentación de la Realidad Virtual, S.L. (SPAIN) *Design of communications products* *Vía de Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta. Pozuelo de Alarcón - 28224 Madrid*	100.00%	-	N/D	N/D	N/D	10
Telefónica Ingeniería de Seguridad, S.A. (SPAIN) (2) *Security services and systems* *Condesa de Venadito, 1 - 28027 Madrid*	100.00%	1	-	-	2	9
Telefónica Investigación y Desarrollo, S.A. (TIDSA) (SPAIN) (3) *Telecommunications research activities and projects* *Emilio Vargas, 6 - 28043 Madrid*	100.00%	6	69	-	(12)	6
Venturini España, S.A. (SPAIN) (2) *Printing, graphic arts and direct marketing* *Avda. de la Industria, 17 Tres Cantos - 28760 Madrid*	100.00%	3	1	-	-	4
Casiopea Reaseguradora, S.A. (LUXEMBOURG) (1) *Reinsurance* *6D, route de Trèves, L-2633 Senningerberg, Luxembourg*	99.97%	4	191	-	17	3
Telefónica Finanzas Perú, S.A.C. (PERU) (1) *Integrated cash management, consulting and financial support for Group companies* *Lima*	100.00%	3	(0)	-	-	3

Millions of euros

Subsidiaries and investments

	Ownership %	Capital	Reserves	Interim Dividend	Profit (loss)	Carrying Amount
Telefónica del Perú, S.A.A. (PERU) (1) (6) (10) *Operator of local, domestic and international long distance telephony services in Peru* *Avda. Arequipa, 1155 Santa Beatríz - Lima*	0.15%	589	85	-	(15)	2
Telfisa Global, B.V. (NETHERLANDS) *Integrated cash management, consulting and financial support for Group companies* *Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX - Amsterdam*	100.00%	-	2	-	-	2
Telefónica de Centroamérica, S.L. (SPAIN) (8) *Dormant company* *Gran Vía, nº 28, Madrid*	100.00%	N/D	N/D	N/D	N/D	1
Telefónica Brasil Sul Celular Participaçoes, Ltda. (BRAZIL) (5) *Holding company* *Avda. Martiniano de Carvalho, 851, 20 andar, parte Sao Paulo, Sao Paulo*	1.12%	N/D	N/D	N/D	N/D	1
Telefónica (USA) Advisors, Inc. (USA) (8) *All the activities permitted by Delaware State law* *1013 Center Road, Wilmington - County of Newcastle - Delaware 19805*	100.00%	-	-	-	-	1
Comtel Comunicaciones Telefónicas, S.A. (VENEZUELA) (1) *Holding company* *Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060, Venezuela*	65.14%	19	1	-	3	-
Pléyade Peninsular, Correduría de Seguros y Reaseguros del Grupo Telefónica, S.A. (SPAIN) (3) *Distribution, promotion or preparation of insurance contracts, operating as a broker* *Avda. General Perón, 38 Master II - 17º P.- 28020 Madrid*	16.67%	-	1	-	3	-
Fisatel Mexico, S.A. de C.V. (MEXICO) (1) *Integrated cash management, consulting and financial support for Group companies* *Boulevard Manuel Avila Camacho, 24 - 16º Plta. - Lomas de Chapultepec - 11000 Mexico D.F.*	100.00%	-	1	-	-	-
Telefónica Participaciones, S.A. (SPAIN) (1) *Issuance of preferred securities and/or other debt financial instruments* *Gran Vía, 28 - 28013 Madrid*	100.00%	-	(0)	-	(0)	-
Telefónica Emisiones, S.A. (SPAIN) (1) *Issuance of preferred securities and/or other debt financial instruments* *Gran Vía, 28 - 28013 Madrid*	100.00%	-	(3)	-	1	-
Telefónica Europe, B.V. (NETHERLANDS) (1) *Fund raising in capital markets* *Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX - Amsterdam*	100.00%	-	9	(4)	2	-
Telco, S.p.A. (ITALY) *Holding company* *Galleria del Corso, 2 - Milan*	42.30%	5	-	-	-	2,314
Portugal Telecom, S.G.P.S., S.A. (PORTUGAL) (5) (6) (10) *Holding company* *Avda. Fontes Pereira de Melo, 40 - 1089 Lisbon*	7.14%	34	379	-	1,010	676
Aliança Atlântica Holding B.V. (NETHERLANDS) *Holder of 5,225,000 Portugal Telecom, S.A. shares* *Strawinskylaan 1725, 1077 XX Amsterdam*	50.00%	40	2	(2)	10	21
MobiPay Internacional, S.A. (SPAIN) *Provision of payment services through wireless telephony* *Avenida de Europa 20, Alcobendas, Madrid*	50.00%	12	(9)	-	(1)	5
Telefónica Factoring España, S.A. (SPAIN) (5) *Factoring* *Pedro Teixeira, 8 - 28020 Madrid*	50.00%	5	2	-	3	3

Millions of euros

Subsidiaries and investments

	Ownership %	Capital	Reserves	Interim Dividend	Profit (loss)	Carrying Amount
Torre de Collçerola, S.A. (SPAIN) (2) *Operation of a telecommunications mast and technical assistance and consulting services* *Ctra. Vallvidrera-Tibidabo, s/nº - 08017 Barcelona*	30.40%	6	1	-	-	2
Telefónica Factoring México, S.A. de C.V. SOFOM ENR (MEXICO) *Factoring* *Mexico City*	40.50%	2	-	-	-	1
Adquira Spain, S.A. (SPAIN) (2) *E-commerce* *Goya, 4, 4ª planta - Madrid*	20.00%	2	5	-	2	1
Telefónica Factoring Perú, S.A.C. (PERU *Factoring* *Lima*	40.50%	1	-	-	-	1
Telefónica Factoring Do Brasil, Ltd. (BRAZIL) (5) *Factoring* *Avda. Paulista, 1106*	40.00%	1	3	(3)	3	1
Banco Bilbao Vizcaya Argentaria, S.A. (SPAIN) (5) (6) (10) *Banking* *San Nicolás, 4 - 48005 Bilbao (Vizcaya)*	0.97%	1,837	21,641	(1,661)	6,126	556
PT Multimedia Serviços de Telecomunicaçoes e Multimédia, SGPS, S.A. (PORTUGAL) *Multimedia business* *Avda. 5 de Outubro, 208 - Lisbon*	4.80%	3	328	-	52	136
Sogecable, S.A. (SPAIN) (5) (6) (10) *Indirect management of public service television* *Gran via, 32 - 3ª Pta. - 28013 Madrid*	1.20%	277	(64)	-	62	35
Amper, S.A. (SPAIN) (5) (6) (10) *Development, manufacture and repair of telecommunications systems and equipment and related components* *Torrelaguna, 75 - 28027 Madrid*	6.10%	29	48	-	2	12
I-CO Global Communications (HOLDINGS) Limited (UK)	N/D	N/D	N/D		N/D	6
Other investments	N/A	N/A	N/A		N/A	7
TOTAL SUBSIDIARIES (Note 7)						69,274
TOTAL ASSOCIATES (Note 7)						3,025
TOTAL INVESTEES (Note 7)						752

(1) Audited by Ernst & Young.
(2) Audited by PriceWaterhouseCoopers.
(3) Audited by K.P.M.G. Peat Marwick.
(4) Audited by B.D.O. Audiberia
(5) Audited by Deloitte & Touche. En España Deloitte & Touche España, S.L..
(6) Consolidated figures
(7) Dormant company
(8) Company in liquidation.
(10) Companies listed on international markets at December 31, 2007.
N/D No data available.
N/A Not applicable.
Provisional figures for associates and investees.

MANAGEMENT REPORT

TELEFÓNICA, S.A.
2007

Telefónica Group results for 2007 once again reflect the Company's differentiated profile, supported by its capacity to deliver on strategy and continuously hit financial targets. The solid growth seen in 2007 shows the Group's potential for organic expansion, the high value of its geographical and business diversification, its efficient cost structure and the realization of synergies made possible by the integrated management of the Company.

The pace of commercial activity accelerated in the last quarter of 2007, thanks to successful marketing campaigns to attract and retain customers. As a result, Telefónica Group ended the year with a customer base of 228.6 million, up by 12.5% on December 2006.

Telefónica Spain has 46.4 million customers, a 5% increase on December 2006. Growth was driven by the expanding base of mobile and broadband customers and limited losses in wireline, where the year-on-year fall in customer numbers was the lowest since 2001 (-0.3%).

Telefónica Latin America increased the pace of growth in its customer base (134.1 million: +16.9% year-on-year), with big gains in broadband, a stong upward trend in mobile telephony and a near doubling of pay-TV subscribers since end-2006.

Telefónica Europe grew its customer base by 8.7% to nearly 42 million, boosted by strong trends in the mobile business, particularly the contract segment.

By access type, Telefónica Group had 169.2 million mobile customers in 2007, up by 16.6% on December 2006.

At December 31, 2007, the Group had more than 10.2 million retail broadband customers, with year-on-year growth of 28.9%. Demand remained strong for the Group's bundled ADSL, TV and voice offer, a key factor in developing the broadband market and securing the loyalty of the customer base. Retail broadband customers numbered over 4.5 million in Spain (+22.1% year-on-year), 5 million in Latin America (+33.2% year-on-year) and 670,000 in Europe outside Spain (+48.3%).

Pay TV customers totaled more than 1.7 million at end 2007, a 64.3% increase on the year, with the offering now available in Spain, the Czech Republic, Peru, Chile, Colombia and Brazil.

Looking forward, the Telefónica Group plans to continue with its strategy of making the customer the cornerstone of the Group by focusing on operating excellence, convergence and innovation as sources of competitive advantage and motivation for personnel. This global dimension poses a challenge for Telefónica to maximize the synergies derived from the inclusion of new companies so it can leverage economies of scale and offer customers higher quality service

Results of Telefónica, S.A.

The Company generated 6,620 million euros of profit in 2007, compared to 8,284 million euros in 2006.

Highlights of the 2007 income statement include:

- An operating loss of 359 million euros, which represents a 27% reduction on 2006, mainly due to increased billings for services provided to Telefónica Group subsidiaries.

- An increase in financial income to 14,083 million euros in 2007, compared to 5,195 million in 2006, reflecting an increase in dividends received from Group companies, mainly the 11,272 million euros from Telefónica O2 Europe plc.

- The combination of these two figures produced income from ordinary activities of 13,724 million euros, far outstripping the 4,706 million euros recorded in 2006.

- However, the company also recorded an extraordinary loss of 8,546 million euros compared to an extraordinary profit of 2,295 million euros in 2006. This was chiefly due to a 9,947 million euros impairment provision taken on the investment in Telefónica O2 Europe due in turn to the reduction in equity from the dividend paid to Telefónica, S.A. in 2007. On the positive side, the Company made a 1,776 million euro profit on the sale of 99.7% of Endemol Investment Holding, B.V.

Investment activity

The main investments made by Telefónica, S.A. in 2007 were as follows:

- In July 2007 Telefónica, S.A. acquired 10,044 shares representing it an 8.65% stake in Atento, N.V. for 70 million euros from a BBVA Group company. After this transaction, Telefónica, S.A.'s holding in Atento, N.V. was 100%.

- In October 2007, Telefónica, S.A. contributed 2,314 million euros to set up the Italian company Telco, S.p.A., of which it owns 42.3%. This company in turn owns approximately 23.6% of the voting shares in Telecom Italia, S.p.A..

- In addition, the Company continued work on Telefónica Group's new operational complex, "District C". As a result, additions to Telefónica, S.A.'s property, plant and equipment in 2007 totaled 99 million euros, compared with 232 million euros in 2006.

Financing

The following debt issues under Telefónica Emisiones, S.A.U.'s European Medium Term Note (EMTN) program, underwritten by Telefónica, S.A., registered on July 8, 2005 on the London Stock Exchange and renewed on July 3, 2007:

- Two issues on January 31, 2007, for 55 million euros and 24 million euros maturing December 31, 2021 and January 31, 2018, respectively.

- An issue on February 7, 2007, of bonds for 1,500 million euros maturing February 7, 2014.

- Another issue on March 30, 2007, for 350 million euros maturing March 30, 2009.

- A bond issue on June 19, 2007 for a total of 8,000 million Czech crowns divided up into three tranches: one for 2,400 million Czech crowns with a floating coupon maturing in 2010, one for 3,000 million Czech crowns with a fixed coupon maturing in 2012, and one for 2,600 million Czech crowns with a fixed coupon due in 2014.

On July 2, 2007, Telefónica Emisiones, S.A.U. issued 2,300 million dollars of US dollar-denominated bonds under the program filed with the Securities and Exchange Commission (SEC). The issue was divided up into three tranches, two bond tranches maturing in 2013 (750 million US dollars with a fixed coupon and 850 million US dollars with a floating coupon) and one in 2017 (700 million US dollars with a fixed coupon). The securities issued under this program are guaranteed by Telefónica.

On 19 July 2007, Telefónica Europe, B.V. (Telefonica Europe) issued bonds in the Japanese market guaranteed by Telefónica, S.A. for a total amount of 30,000 million Japanese yen maturing in 2012 divided into two tranches, one for 15,000 million yen with a fixed coupon and one for 15,000 million yen with floating rates.

On August 23, 2007 Telefonica Europe arranged a facility guaranteed by Telefónica, S.A., for 15,000 million Japanese yen divided up into three tranches with a 30-year maturity.

On December 3, 2007 Telefónica Finanzas, S.A., a subsidiary of Telefónica, S.A., took out a 375 million euro loan with the European Investment Bank (EIB) maturing 7 years from the date of receipt (Tranche A of the Telefonie Mobile Telephony II project). The loan is underwritten by Telefónica, S.A. and had not been drawn at December 31, 2007.

Meanwhile, Telefónica Europe, B.V. continued its issuance activity in 2007 under its European commercial paper (ECP) program, underwritten by Telefónica, S.A., with short-term issues maturing between one week and 364 days. At December 31, 2007, the final balance of outstanding commercial paper totaled 906.8 million euros (at face value).

Treasury shares

At the start of 2007 Telefónica held treasury shares of 1.53689%, made up of 75,632,559 shares, with a par value of 14.04 euros each, a balance of 1,062 million euros and a nominal value of 76 million euros.

In the course of 2007 the Company bought 149,099,044 and sold 12,621,573 of its own shares, generating extraordinary profit of 23 million euros.

Also, the Company used 147,633,912 treasury shares at an acquisition cost of 2,202 million euros to reduce its share capital.

In addition, 4,750 treasury shares were allocated in 2007 to the share option plan established for employees of the Endemol Group.

As a result of the transactions described above, at the close of 2007 the Company held 64,471,368 shares in treasury stock (representing 1.35061% of share capital) acquired at an average price of 16.67 euros per share, implying a total outlay of 1,075 million euros and total nominal value of 64 million euros. Pursuant to current accounting legislation, these shares were measured at their underlying book value and, consequently, a provision of 843 million euros was recorded.

Disclosures required under Article 116.bis of the Spanish Securities Market Law

Disclosures required under Article 116.bis of the Spanish Securities Market Law:

a. Capital structure

On December 31, 2007, the share capital of Telefónica, S.A. was 4,773,496,485 euros, represented by 4,773,496,485 fully paid ordinary shares of a single series, par value of 1 euro each, recorded under the book-entry system and traded on the Spanish electronic trading system ("Continuous Markets") 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 October 2007, Telefónica, S.A. began taking steps to delist its shares from the Paris and Frankfurt stock exchanges. This will take place in the first quarter of 2008.

At the time of writing, Telefónica, S.A. has no securities in issue that are convertible into Telefónica, S.A. shares.

b. Restrictions on the transfer of securities.

Nothing in the Company bylaws imposes any restriction or limitation on the free transfer of Telefónica, S.A. shares.

c. Major shareholdings

The table below lists shareholders who, at December 31, 2007, to the best of the Company's knowledge, had significant direct or indirect shareholdings in the Company as defined in Royal Decree 1362/2007 implementing the Spanish Securities Markets Law 24/1998 as it relates to the need for transparent information on issuers whose securities are listed for trading in an official secondary market or other regulated market of the European Union":

	Total		**Direct shareholding**		**Indirect shareholding**	
	%	**Shares**	**%**	**Shares**	**%**	**Shares**
BBVA (1)	6.258	298,717,001	6.257	298,699,855	0.000	17,146
la Caixa (2)	5.483	261,746,565	0.002	102,233	5.481	261,644,332

(1) Based on the information contained in Banco Bilbao Vizcaya Argentaria, S.A.'s 2007 Annual Report on Corporate Governance at December 31, 2007.

(2) Based on information provided by Caja de Ahorros y Pensiones de Barcelona, "la Caixa" as at December 31, 2007 for the 2007 Annual Report on Corporate Governance. The 5.481% indirect shareholding in Telefónica, S.A. Telefónica Group's is owned by Criteria CaixaCorp, S.A.

d. Restrictions on voting rights.

According to Article 21 of the Company's bylaws no shareholder can exercise votes in respect of more than 10 per cent of the total shares with voting rights outstanding at any time, irrespective of the number of shares they may own. This restriction on the maximum number of votes that each shareholder can cast refers solely to shares owned by the shareholder concerned and cast on their own behalf. It does not include additional votes cast on behalf of other shareholders who may have appointed them as proxy, who are themselves likewise restricted by the 10 per cent voting ceiling.

The 10 per cent limit described above also applies to the number of votes that can be cast either jointly or separately by two or more legal entity shareholders belonging to the same corporate group and to the number of votes that may be cast altogether by an individual or legal entity shareholder and any entity or entities that they directly or indirectly control and which are also shareholders.

e. Shareholder pacts

Telefónica, S.A. has received no communication notifying the existence of shareholder pacts that affect the exercise of voting rights at Shareholders' Meetings or that impose restrictions or conditions on the free transfer of Telefónica, S.A. shares.

f. Rules governing the appointment and replacement of Directors and the amendment of the Company's bylaws.

Appointment, reappointment and ratification.

Telefónica, S.A.'s bylaws state that the Board of Directors shall have between five and twenty Directors who are appointed by shareholders at the Shareholders' Meeting. The Board of Directors may, in accordance with the Spanish Corporation Law and the Company bylaws, provisionally co-opt Directors to fill any vacant seats.

The appointment of Directors to Telefónica, S.A. is as a general rule submitted for approval to the Shareholders' Meeting. Only in certain circumstances, when seats fall vacant after the conclusion of the General Meeting is it therefore necessary to co-opt Directors onto the board in accordance with the Spanish Corporation Law. Any such co-opted appointment is then ratified at the next Shareholders' Meeting.

Also, in all cases, proposals to appoint Directors must follow the procedures set out in the Company's Board of Directors' Rules and be preceded by the appropriate favorable report by the Appointments, Compensation and Good Governance Committee and in the case of independent Directors, by the corresponding proposal by the committee.

Therefore, in exercise of the powers delegated to it, the Appointments, Compensation and Good Governance Committee must report, based on criteria of objectivity and the best interests of the company, on proposals to appoint, re-appoint or remove Company Directors, taking into account the skills, knowledge and experience required of candidates to fill the vacancies.

As a result, in accordance with its Rules, the Board of Directors, exercising the rights to co-opt and propose appointments to the Shareholders' Meeting, shall ensure that external or non-executive Directors are in an ample majority over the executive Directors. Similarly, it shall ensure that independent Directors make up at least one third of the total Board members.

In all circumstances, where a Director is proposed to the Shareholders' Meeting for reappointment or ratification, the report of the Appointments, Compensation and Good Governance Committee, or in the case of independent Directors the proposal of this committee, shall include an assessment of the Director's past work and diligence in discharge of their duties during their period in office.

Also, both the Board of Directors and the Appointments, Compensation and Good Governance Committee shall ensure, in fulfilling their respective duties, that all those proposed for appointment as Directors should be persons of acknowledged solvency, competence and experience who are willing to devote the time and effort necessary to the discharge of their functions, with particular attention paid to the selection of independent Directors.

Directors are appointed for a period of five years, renewable for one or more subsequent five-year periods.

As with appointments, proposals for the reappointment of Directors must be preceded by the corresponding report by the Appointments, Compensation and Good Governance Committee, and in the case of independent Directors by the corresponding proposal by the committee.

Termination of appointment or removal

Directors' appointments shall end at the expiry of the period for which they were appointed or when shareholders at the General Shareholders' Meeting so decide in exercise of their powers under the law.

Also, in accordance with Article 12 of the Board Rules, Directors must submit their resignation to the Board of Directors and formalize their resignation in the following circumstances:

i) If they leave the executive post by virtue of which they sat on the Board or when the reasons for which they were appointed cease to apply.

ii) If their circumstances become incompatible with their continued service on the Board or prohibit them from serving on the Board for one of the reasons specified under Spanish law.

(iii) If they are severely reprimanded by the Appointments, Compensation and Good Governance Committee for failure to fulfill any of their duties as Director.

iv) If their continued presence on the Board could affect the credit or reputation of the Company in the markets or otherwise threaten the Company's interests.

The Board of Directors shall not propose the termination of the appointment of any independent Director before the expiry of their statutory term, except in the event of just cause, recognized by the Board on the basis of a prior report submitted by the Appointments, Compensation and Good Governance Committee. Just cause shall be specifically understood to include cases where the Director has failed to fulfill their duties as Board member.

The Board may also propose the termination of the appointments of independent Directors in the case of takeover bids, mergers or other similar corporate transactions that represent a change in the structure of the Company's capital.

Amendments to the Company bylaws.

The procedure for amending the bylaws is governed by Article 144 of the Spanish Corporation Law and requires any change to be approved by shareholders at the Shareholders' Meeting with the majorities stated in Article 103 of the same law. In accordance with the above, Article 14 of Telefónica, S.A.'s bylaws states that the power to amend Company's bylaws lies with shareholders acting at a General Shareholders' Meeting.

g. Powers of Directors and, specifically, powers to issue or buy back shares.

Powers of Directors.

The Chairman of the Company, as Executive Chairman, is delegated all powers by the Board of Directors except where such delegation is prohibited by Law, by the Company bylaws or by the Regulations of the Board of Directors, whose Article 5.4 establishes the powers reserved to the Board of Directors. Specifically, the Board of Directors reserves the powers, inter alia, to: (i) approve the general policies and strategies of the Company; (ii) evaluate the performance of the Board of Directors, its committees and the Chairman; (iii) appoint senior executives, as well as the remuneration of directors and senior executives; and (iv) decide strategic investments.

Meanwhile, the Chief Executive Officer has been delegated all the Board's powers to conduct the business and act as the senior executive for all areas of the Company's business, except where such delegation is prohibited by law, by the Company bylaws, or by the Regulations of the Board of Directors in its article 5.4.

In addition, the other executive Directors are delegated the usual powers of representation and administration appropriate to the nature and needs of their roles.

Powers to issue shares.

At the Ordinary Shareholders' Meeting of Telefónica, S.A. on June 21, 2006, the Board of Directors was authorized under Article 153.1.b) of the Spanish Corporation Law, to increase the Company's capital by up to 2,460 million euros, equivalent to half the Company's subscribed and paid share capital at that date, one or several times within a maximum of five years of that date. The Board of Directors has not exercised these delegated powers to date.

Also, at the General Shareholders' Meeting of Telefónica, S.A. on May 10, 2007, the Board of Directors was authorized under Articles 153.1.b) and 159.2 of the Spanish Corporation Law to issue bonds exchangeable for or convertible into shares in the Company, this power being exercisable one or several times within a maximum of five years of that date. The Board of Directors has not exercised this power to date.

Powers to buy back shares.

At the Ordinary Shareholders' Meeting of Telefónica, S.A. on May 10, 2007, the Board of Directors was authorized, in accordance with Articles 75 ff of the Spanish Corporation Law, to buy back its own shares either directly or via companies belonging to the Group. This authorization was granted for 18 months from that date and includes the specific limitation that at no point may the nominal value of treasury shares acquired, added to the those already held by Telefónica, S.A. and those held by any of the subsidiaries that it controls, exceed 5 per cent of the share capital at the time of acquisition.

h. Significant agreements outstanding that would come into force, be amended or expire in the event of a change of control following a takeover.

The Company has no significant agreements outstanding that would come into force, be amended or expire in the event of a change of control following a takeover.

i. Agreements between the Company and its directors, managers or employees that provide for compensation in the event of resignation or unfair dismissal or if the employment relationship should be terminated because of a takeover bid.

In general, the contracts of executive directors and some managers of the steering committee include a clause giving them the right to receive the economic compensation indicated below in the event that their employment relationship is ended for reasons attributable to the Company and/or due to objective reasons such as a change of ownership. However, if the employment relationship is terminated for a breach attributable to the executive director and director, the director will not be entitled to any compensation whatsoever. That notwithstanding, in certain cases the termination benefit to be received by the executive director o director, according to their contract, does not meet these general criteria, but rather are based on other circumstances of a personal or professional nature or on when the contract was signed. The agreed economic compensation for the termination of the employment relationship, where applicable, consists of three years of salary plus another year based on length of service at the Company. The annual salary on which the indemnity is based is the director's last fixed salary and the average amount of the last two variable payments received by contract.

Meanwhile, contracts that tie employees to the Company under a common employment relationship due to include indemnity clauses for the termination of their employment. In these cases, the employee is entitled to any indemnity set forth in prevailing labor legislation. This notwithstanding, contracts of some Company employees, depending on their level and seniority, as well as their personal or professional circumstances or when they signed their contracts, establish their right to receive compensation in the same cases as in he preceding paragraph, generally consisting of a year and a half of salary. The annual salary on which the indemnity is based is the last fixed salary and the average amount of the last two variable payments received by contract.

The risks and uncertainty facing the company

In addition to the general risks affecting any type of business activity, Telefónica Group's business is also impacted by both internal factors, which are mainly related to its international presence, and external factors common to its business activity.

In this sense, the most significant risks which the Group faces and that could affect its business, financial situation and results would be the following:

Risks inherent to the business sector in which the Group operates.

The risks derived from the business activities' particular characteristics are because it operates in a highly competitive, highly regulated sector, in which the policies of many countries are designed to encourage new competition.

The risks involved in providing this service under licence or concession, which implies not only the need to comply with the terms and conditions of these licences, with the corresponding risk of review or revocation in the case of breach, but that these licenses and their terms and conditions is subject to review by the corresponding regulatory authorities.

The risks from constant technological change, experienced by companies in the telecommunication services sector, require continuous efforts by the Company to anticipate and adapt to these changes in sufficient time, in terms of the services provided and the networks used.

The risks affecting other characteristics of the market in which the Group operates, such as a certain dependency on its network and equipment providers and the limitations which, specifically in the mobile telephone business, concern the limitation of the radio spectrum capacity.

Environmental issues and risks related to the possible impact of certain opinions which suggest that radio electric emissions could be hazardous to the health.

The risks specific to Telefónica Group.

Social-political risk (country risk) linked to the strong international presence of the Group, especially in Latin America, means the Company is affected by the risks typical of investment in economies in emerging countries, such as: the possibility that political changes may occur which can affect the economic or business conditions of the market in which they operate; the possible devaluation of local currency or the imposition of restrictions on capital movements; the effects of inflation and/or the possible devaluation of local currency; the possible state expropriation or nationalisation of assets; the possible imposition of excessive taxes or tax rates; the possible amendment of the terms under which the services in these markets are provided.

Risks of a financial nature, mainly related to exchange or interest rate risk management.

The risks involved in the investment models adopted in some countries, mainly in those carried out through joint ventures, in which Telefónica maintains a significant shareholding but not control.The risks inherent to business mergers and acquisitions, for example the acquisition in January 2006 of the British mobile telephone operator 02 and in April 2006 of Colombia Telecom).

The risks derived from a certain dependency on external financing sources, which in certain situations could limit the Company's capacity to access these funds or at least to obtain financing at acceptable interest rates.

The risks associated to litigation and other legal procedures.

Forecast business performance

Telefónica is an integrated telecommunications company with a presence in Spain, in most of Latin America, the United Kingdom, Germany, Czech Republic, Ireland, Slovak Republic and Morocco. We also have holdings in China Netcom and Telecom Italia which gives us the possibility of strategic agreements which we expect can only be positive for our shareholders as well as our customers.

In the past few years Telefónica has undergone a significant transformation, not only through its extensive geographical diversification and product mix but also by transforming its operational model to make it more efficient without losing sight of the customer and our ambitious growth plans. This operational model has centered on the integration of fixed and mobile business to have an integral business vision, of the processes and technology and it has been based on a regional focus which permits us to harness the synergies of scale without forgetting the importance of local management being the ones closest to the customer. We strive to lead the future of the sector by anticipating trends towards the new digital environment.

In Spain, Telefónica is intensifying its commercial product range focusing on providing better quality services, and improving distribution channels and networks, enabling us to raise levels of customer satisfaction. Through market segmentation, we offer bundled services to the residential market, with voice, broadband and TV services tailored to suit customer needs. In the business and company sector we offer integral solutions including voice, broadband, network connections, equipment, support and maintenance, and different value added services such as web hosting and domains, with the aim of achieving the best global product range adapted to business needs. Furthermore, we will continue to defend our mobile leadership supported by our customer loyalty. The big challenge, in both the fixed and mobile businesses, continues to be improving the penetration growth of broadband and for this we will continue to transform our networks increasing UMTS coverage and taking the first steps in fiber optics in the case of fixed business.

In Latin America, our strategy is based on a regional model that harnesses the synergies of scale without losing sight of the local customer management. The growth in Latin America will come mainly from the mobile business, which is why we will continue to make significant investments to improve capacity and coverage through the technological advancements in our networks. The fixed networks are also being improved to drive the increase of quality broadband penetration with integrated voice and TV.

In Europe we will continue to improve customer satisfaction by strengthening our mobile offering in the United Kingdom and ADSL in Germany. We will continue to support the mobile data business and to offer the best and most innovative products to our customers. An example of this is the iPhone in the United Kingdom and the launch of the Fonic brand in Germany to satisfy a niche in the market we had previously left uncovered. We will also invest further in increasing and developing our own networks with the aim of substantially improving profitability through efficient cost management. In the Czech Republic we will continue to take advantage of the opportunities from a totally integrated operation, while maintaining our solid position in the mobile sector.

We are therefore confident that this company will continue to offer an unbeatable combination of growth and profitability, which permits us to keep our promises to the shareholders and at the same time offer the best solutions to our customers.

Events subsequent to year end

Significant events affecting Telefónica taking place from December 31, 2007 to the date of preparation of these financial statements included:

EIB financing

On January 15, 2008 Telefónica Finanzas, S.A. paid off at maturity the balance on the 200 million dollar loan taken out with the European Investment Bank (EIB) on January 9, 1998, guaranteed by Telefónica.

On January 17, 2008, Telefónica Finanzas, S.A. arranged a 75 million euro facility (Tranche B of the Telefónica Mobile Telephony II project) with a bank guarantee and counterguarantees by Telefónica maturing January 29, 2016.

On January 30, 2008 Telefónica Finanzas, S.A. drew down the amounts of the facilities arranged with the EIB on December 3, 2007 and January 17, 2008 of 375 and 75 million euros, respectively, comprising Tranches A and B of the Telefónica Mobile Telephony II project.

Dividend received from Telefónica O2 Europe, Plc.

On February 14, 2008, Telefónica O2 Europe Plc paid the interim dividend charged against 2007 profit granted to Telefónica, S.A. for 2,000 million pounds sterling.