

TELEFONICA 1985-89 SELECTED OPERATING DATA

TELEPHONE SERVICE

Service parameters	31-12-85	31-12-86	31-12-87	31-12-88	31-12-89
Local lines in service (thousands)	9,340.5	9,785.3	10,236.4	10,971.6	11,797.2
Ibercom lines in service (thousands)	—	—	21.6	68.9	145.9
Automatic trunk circuits (thousands)	228.8	244.3	257.0	311.8	387.7
International circuits (thousands)	9.6	9.9	10.8	11.7	13.3
European service automation %	99.0	99.3	99.5	99.6	99.7
International service automation %	84.0	86.0	88.5	91.8	93.4
Plant					
Local lines installed (thousands)	10,313	10,645	11,085	11,981	13,160
Digital	184	345	635	1,297	2,582
(% total)	1.8	3.3	5.7	10.8	19.6
Conventional and semi-electronic	10,079	10,271	10,434	10,684	10,578
(% total)	98.2	96.7	94.3	89.2	80.4
Trunk lines (thousands)	935	969	1,066	1,356	1,831
Analog	871	866	869	904	964
(% total)	93.2	89.4	81.5	66.7	52.6
Digital	64	103	197	452	867
(% total)	6.8	10.6	18.5	33.3	47.4

BASIC INFRASTRUCTURE

	31-12-85	31-12-86	31-12-87	31-12-88	31-12-89
Coaxial cable (km)	10,112	10,379	10,454	10,454	10,531
Fibre-optics cable (km)	93	227	1,159	3,664	8,018
Trunk pair cable (km)	44,979	46,095	49,040	53,140	56,492
Subscriber networks (pair km-thousands)	33,626	35,465	38,295	41,833	47,003

TRENDS IN USAGE PER LINE AND DEMAND FOR NEW LINES

	1985	1986	1987	1988	1989
Average growth in usage per line	3.4	5.0	8.2	8.6	5.1
Applications for new lines (Telephone and Ibercom)	756,164	963,037	1,135,406	1,356,364	1,494,397
(% annual growth rate)	(2.3)	27.4	17.9	19.5	10.2
Applications for Ibercom lines	—	9,085	42,243	67,305	100,252

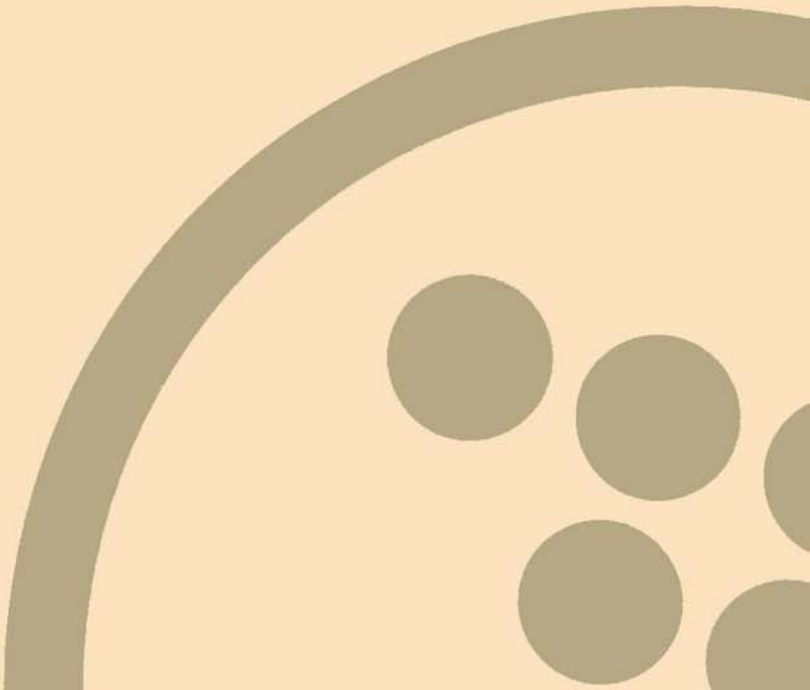
TRENDS IN DATA TRANSMISSION SERVICES

	31-12-85	31-12-86	31-12-87	31-12-88	31-12-89
Data transmission (D/T) circuits	28,950	31,152	32,715	34,632	37,345
Year-on-year growth (%)	8.6	7.6	5.0	5.8	7.8
Telephone network connections for D/T	45,080	58,175	77,090	123,831	169,672
Year-on-year growth (%)	81.8	29.0	32.5	60.6	37.0
Iberpac network connections	23,810	27,632	34,059	45,626	55,879
Year-on-year growth (%)	18.7	16.0	23.3	34.0	22.5

INTERNATIONAL BROADCASTING

	1985	1986	1987	1988	1989
Radio (thousands of minutes)	295	407	347	387	480
TV (thousands of minutes)	44	54	44	73	129

**Financial
Review**



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- Selected financial data
- Telefónica and the Spanish economy
- Management's discussion

SELECTED FINANCIAL DATA

(In millions of ptas., unless otherwise stated)

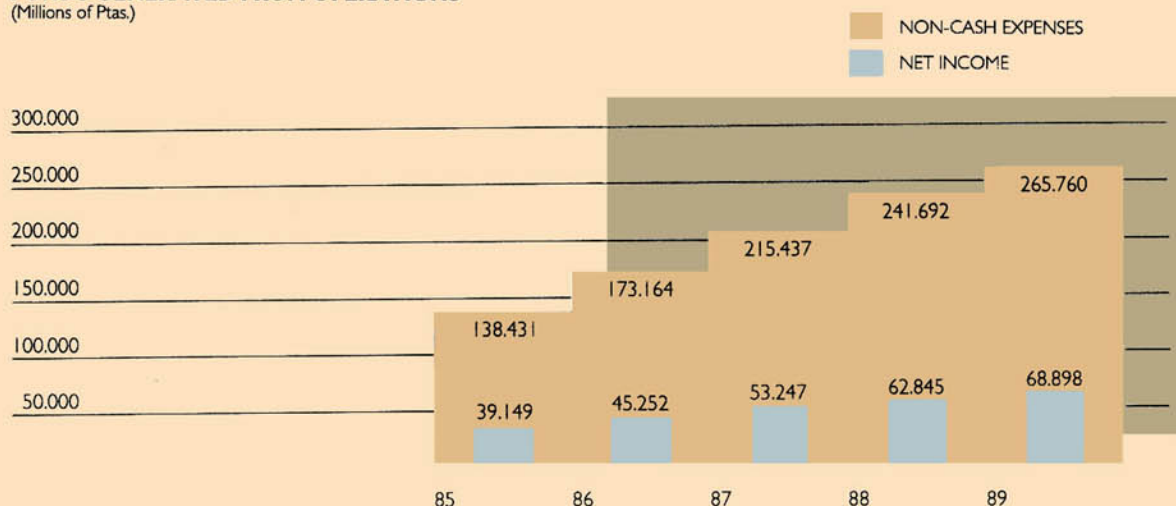
	1985	1986	1987	1988	1989	1989\$ (in millions)
Operating revenue	409,415	468,011	540,727	612,536	710,904	6,479.3
Operating expenses	200,464	216,349	240,151	275,468	325,051	2,962.6
Financial expenses	77,209	77,781	84,094	84,866	104,935	956.4
Depreciation and amortization	116,964	138,204	164,442	203,851	219,885	2,004.1
Net income	39,149	45,252	53,247	62,845	68,898	627.9
Gross cash flow	177,580	218,416	268,684	304,537	334,658	3,050.1
Share capital	360,468	411,793	415,368	460,620	462,482	4,215.1
Shareholders' equity	947,804	1,090,016	1,220,727	1,317,696	1,362,546	12,418.4
Medium and long-term debt	659,545	632,056	683,186	746,812	889,211	8,104.3
Capital expenditure*	188,681	211,514	260,183	357,815	583,762	5,320.5

Exchange rate (29-12-89): 1\$ = 109.72 ptas.

* Including Advances to suppliers.

FUNDS GENERATED FROM OPERATIONS

(Millions of Ptas.)



Telefónica and the Spanish economy

1989 was, once again, a year of rapid expansion for Spain's economy, reflected in the 4.9% rise in G.D.P. and the 7.7% surge in domestic demand in real terms, including an increase of 5.5% in private consumption and 13.6% in gross capital formation.

The continuing boom in Spain's economy had a favourable effect on reducing the imbalance within the public sector. The Spanish State had gross savings and the Public Sector Deficit stood at 2.1% of G.D.P., almost one point down on the previous year's recorded figure. The high performance level was also reflected in the improvement in employment, which showed a net increase of 4.1%.

The heavy pressure of demand on domestic production capacity led to both a sharp decline in the external account and to renewed inflationary trends.

As regards foreign demand, 1989 saw a current account deficit of over \$11,000 million (3.1% of G.D.P.). However, the continuing appeal of Spain's economy to the foreign investor, attracting capital inflows of over \$16,500 million, resulted in a basic balance surplus of \$6,000 million, with accumulated reserves of \$4,500 million.

In 1989, the consumer price index rose by 6.9%, 1.1 points more than in 1988. Despite this rise, which was in line with the worldwide inflationary climate, there was no significant worsening in Spain's inflation differential, vis à vis her main trading partners. The main aim of the economic policy implemented to combat this imbalance was to reduce the pressure of domestic demand by imposing heavy credit restrictions and high interest rates. These measures, together with the integration of Spain's currency into the European Monetary System, helped to stabilize the peseta exchange rate. Within the economic framework outlined above, Telefónica significantly increased its rate of investment. Capital expenditure in fixed assets grew by 63%, representing 5.3% of Spain's gross capital formation.

The rise in capital expenditure was accompanied by a considerable increase in the company's gross value added, with a 12.5% real increase. There was also an improvement in the relative participation of Telefónica's gross operating profits and gross savings in the national economy. These represented 2% and 2.5% of the total respectively.

As regards price trends, the average increase in Telefónica's tariffs (3.4%) was well below the interannual rise in the consumer price index and contributed to holding back inflationary tendencies during the year.

Telefónica and the Spanish Economy

(as a % of the national total)

	1985	1986	1987	1988	1989(1)
Gross value added	1.51	1.50	1.55	1.52	1.56
Wages and related benefits	1.24	1.21	1.18	1.19	1.24
Gross operating profit	1.84	1.90	2.02	1.91	1.97
Gross savings	2.32	2.32	2.59	2.41	2.51
Gross capital formation	3.53	3.38	3.47	3.85	5.30
PRICES					
G.D.P. deflator	8.5	10.9	5.9	6.2	6.9
Telefónica (2)	6.2	6.5	4.6	1.0	2.7

(1) Provisional figures.

(2) Average yearly effect on service prices due to tariff increases.

Management's discussion

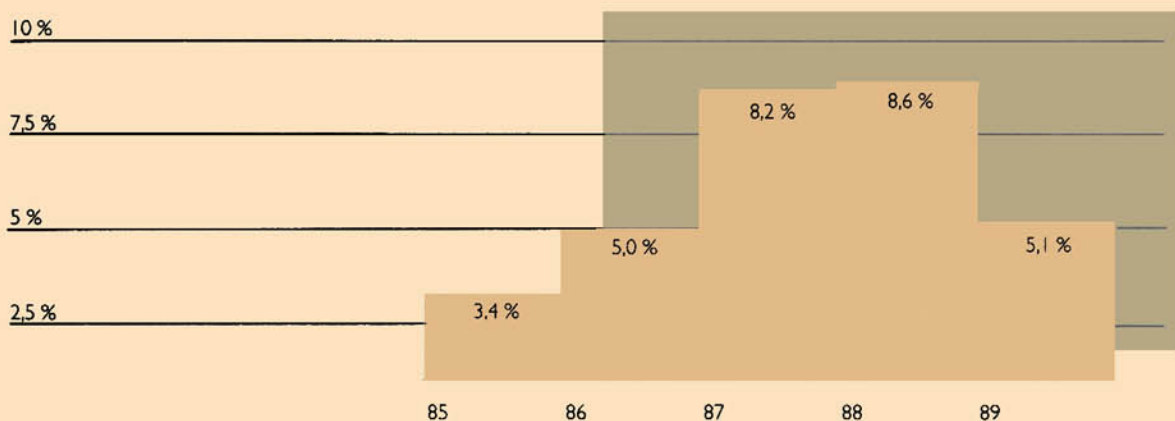
From a financial point of view, fiscal 1989 brought Telefónica an operating revenue of 710,904 million pesetas (a growth of 16.1%), which in turn resulted in a pre-tax income of 93,073 million pesetas, 10.7% more than in 1988. After applying provision for corporate tax, net income amounted to 68,898 million pesetas, representing a 9.6% growth over the previous year.

These results enable us to submit for approval by the General Meeting of Shareholders the proposal to set aside 50,869 million pesetas for the payment of dividends and increase reserves by 18,029 million pesetas, 16.8% more than in 1988.

The above proposal for the distribution of the 1989 profits will lead to a dividend pay-

TELEPHONE USAGE

(% increase in average usage per line)



out ratio of 73.8% and will substantially strengthen the Company's equity base and hence its expansion capacity.

Earnings per share stood at 74.5 pesetas, representing a growth of 5.5% with respect to 1988 levels. This trend can be explained by the 3.9% increase in the average number of shares, arising from the conversion of bonds and equity notes during the latter half of 1988.

In 1989, the local levy and local property taxes charged to Telefónica amounted to 13,450 million pesetas, with an increase of 10.2% over the previous year.

TAXES

The provision for corporate tax rose by 13.8% in 1989 to 24,175 million pesetas. This amount represents an effective corporate tax rate of 26% (25.3% in 1988), once the tax deductions for investments and other items included under the current tax regime have been taken into consideration.

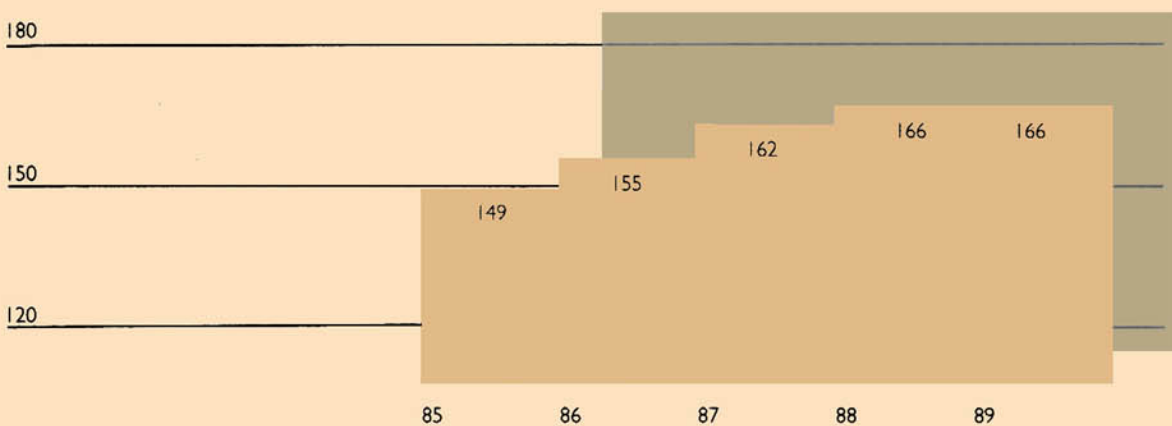
There was a particularly dynamic surge in operating revenue. This rose by 16.1% over 1988 to reach the figure of 710,904 million pesetas.

OPERATING REVENUE

This positive trend took place with an average rise of 3.4% in service charges. Since this rise comes into force from March 12, the effect on the year's operating revenue is 2.7%. Consequently, in 1989, the real growth in operating revenue amounted to 13.4%, arising from the increases both in usage of the different services and in the number of subscribers to Telefónica's networks.

Looking at the various revenue components, particularly notable was the 35.3% in-

LINES IN SERVICE PER EMPLOYEE



crease in revenue from connection fees. Overall, revenue from services rose by 15.3%, as opposed to 13.0% in 1988.

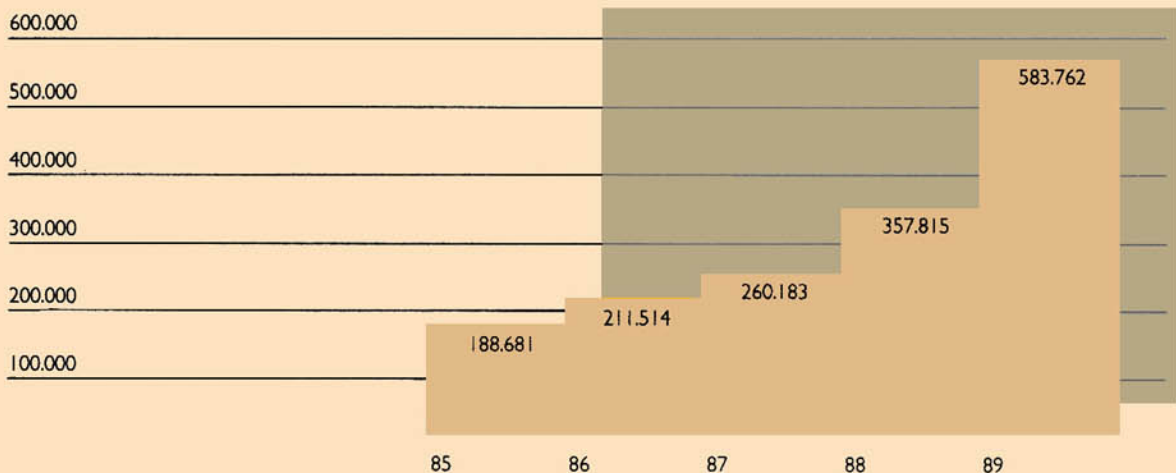
Domestic automatic service, which, similar to last year, accounted for 44.3% of total operating revenue, rose by 15.9% in 1989 to reach the figure of 314,984 million pesetas. Revenue from subscriber service charges represented 25.9% of operating revenue, reaching 184,001 million pesetas, with a 10.4% growth over the previous year. The international service revenue increased by 10.7% to 96,902 million pesetas (13.6% of operating revenue). In real terms, international traffic witnessed a significant growth, fully compensating for the 7% reduction in international service charges, agreed in March 1989.

Revenue from data and image transmission rose to 69,230 million pesetas, 32.1% up on the previous year's rate, and accounted for 9.7% of operating revenue. Mobile services also witnessed an exceptional growth of 89.6%, although the turnover of 4,583 million pesetas is still relatively modest. Finally, there was a positive trend in revenue from directories and yearbooks, which rose by 18.4% over 1988, to stand at 7,299 million pesetas.

As in previous years, the energetic growth in operating revenue during 1989 took place within a context marked by the upward trends in applications for new lines and telephone usage. There were 1,394,145 requests for basic telephone lines, 8% more than in 1988, and 100,252 applications for Ibercom lines for business communications. In the basic service, net applications, after deducting cancellations, rose to 1,048,547, also a rise of 8% over the previous year. Average usage per line grew by 5.1%. This represented a slow down in the growth rate compared to the high level of the previous year (8.6% increase).

In order to meet the demand for services and network usage, in 1989 Telefónica

CAPITAL EXPENDITURE
(Millions of Ptas.)



stepped up its capital expenditure programme. Expenditure in fixed assets and advances for plant amounted to 583,762 million pesetas, 63% more than the previous year. This outstanding expansion in capital expenditure enabled the Company to install 1,471,696 local lines, representing an increase of 51.7%, compared to 1988. As a result of these new installations, we were able to satisfy 1,083,883 requests for lines, 12% more than in 1988, and also boost the number of local digital lines installed to 19.6% (10.8% in 1988). The expenditure programme also enabled us to cut the waiting list to 503,249 applications, 7% less than at the end of 1988. On a final note, a substantial part of capital expenditure went towards upgrading the quality of the networks, including the installation of 415,301 digital trunk lines, 63% up on the 1988 figure.

Operating revenue

(In millions of ptas., unless otherwise stated)

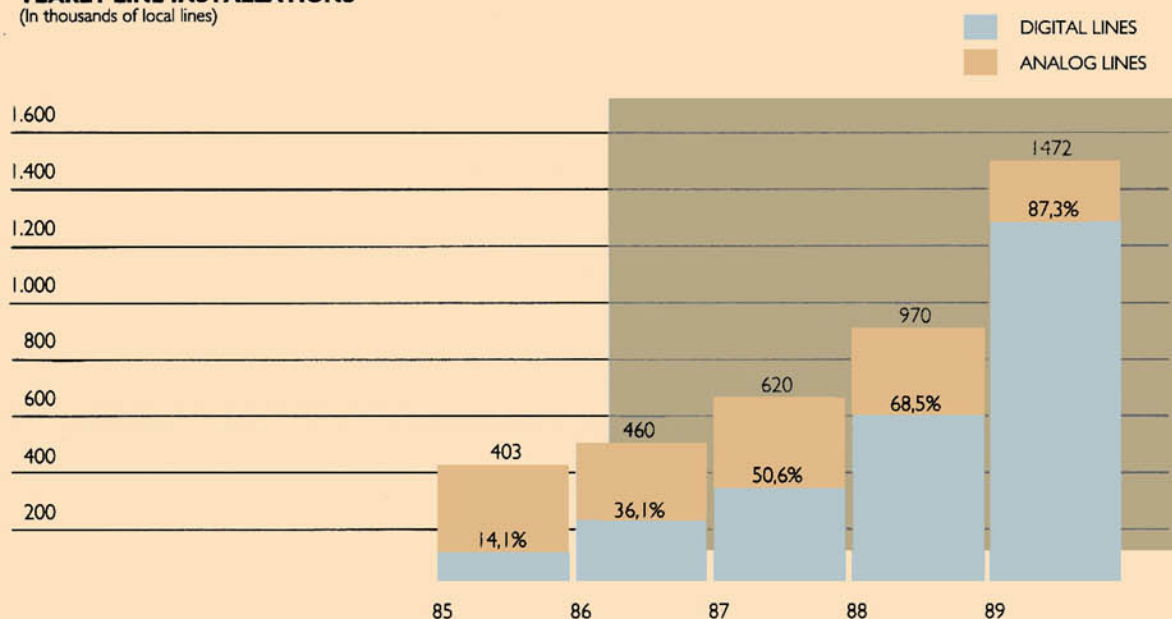
Description	1985	1986	1987	1988	1989	1989 \$ (in millions)	% Increase	
							over 88	85-89*
Subscriber service charges	126,834	141,894	157,073	166,726	184,001	1,677.0	10.4	9.7
Data and image transmission	32,252	35,859	43,052	52,393	69,230	631.0	32.1	21.0
Domestic automatic service	163,063	196,526	236,491	271,770	314,984	2,870.8	15.9	17.9
Trunk calls through operator	2,186	1,882	1,597	1,249	988	9.0	(20.9)	(18.0)
International service	57,505	61,787	72,948	87,497	96,902	883.2	10.7	13.9
Mobile land and maritime services	1,595	1,634	1,646	2,417	4,583	41.8	89.6	30.2
Directories and yearbooks	10,071	10,216	7,598	6,164	7,299	66.5	18.4	(7.7)
REVENUE FROM SERVICES	393,506	449,798	520,405	588,216	677,987	6,179.3	15.3	14.6
Connection fees and other items	15,909	18,213	20,322	24,320	32,917	300.0	35.3	19.9
OPERATING REVENUE	409,415	468,011	540,727	612,536	710,904	6,479.3	16.1	14.8

Exchange rate (29-12-89): 1\$ = 109.72 ptas.

* 85-89 compound rate.

YEARLY LINE INSTALLATIONS

(In thousands of local lines)



OPERATING EXPENSES

Operating expenses rose by 18% over the previous year, excluding the effect of local taxes and internal expenditure capitalized in fixed assets. The main component was personnel expenses, which increased by 17.1% over 1988, to reach 253,439 million pesetas.

This trend in personnel expenses was due to the fact that salary increases for the year were more than initially budgeted because the rate of inflation exceeded the official target. A further factor was the increase in workforce numbers by 1,930 permanent staff and 3,163 temporary workers. At the end of 1989, the total Telefónica workforce consisted of 71,155 employees (66,062 in 1988), of which 5,099 were temporary (1,936 the previous year).

The activities carried out during the past financial year were also reflected in the ex-

Results - Profit

(In millions)

Description	1985		1986		1987	
	Amount	% Struct.	Amount	% Struct.	Amount	% Struct.
+ Revenue from operations	409,415	100.0	468,011	100.0	540,727	100.0
- Operating expenses	200,464	(49.0)	216,349	(46.2)	240,151	(44.4)
- Local taxes	-	-	-	-	-	-
+ Internal expenditure capitalized in fixed assets	51,863	12.7	53,512	11.4	57,571	10.6
= Operating margin	260,814	63.7	305,174	65.2	358,147	66.2
+ Interest during construction	6,452	1.6	6,580	1.4	8,373	1.5
+ Financial revenue	7,283	1.8	5,228	1.1	7,598	1.4
- Financial expenses	77,209	(18.9)	77,781	(16.6)	84,094	(15.5)
- Exchange losses	9,277	(2.3)	11,050	(2.4)	10,294	(1.9)
- Depreciation and amortization	116,964	(28.6)	138,204	(29.5)	164,442	(30.4)
= Gross operating income	71,099	17.4	89,947	19.2	115,288	21.3
- Provision for investments depreciation	-	-	-	-	-	-
- Other provisions and charges	12,190	(3.0)	23,910	(5.1)	40,701	(7.5)
+ Net extraordinary items	3,675	0.9	6,071	1.3	9,735	1.8
= Income before tax	62,584	15.3	72,108	15.4	84,322	15.6
- Provision for corporate tax (state levy 1984 to 1987)	23,435	(5.7)	26,856	(5.7)	31,075	(5.7)
= Net income	39,149	9.6	45,252	9.7	53,247	9.9
+ Net income	39,149	9.6	45,252	9.7	53,247	9.9
+ Depreciation and amortization	116,964	28.6	138,204	29.5	164,442	30.4
+ Provisions and charges	21,467	5.2	34,960	7.5	50,995	9.4
+ Non-depreciated dismantled plant	-	-	-	-	-	-
= Gross cash flow (funds generated from operations)	177,580	43.4	218,416	46.7	268,684	49.7

Exchange rate (29-12-89): 1\$ = 109.72 ptas.

* 85-89 compound rate.

penses included under the item subcontractors, supplies and services, which stood at 71,109 million pesetas, a 21.3% rise over the previous year. In addition, local taxes rose 13,450 million pesetas, a 10.2% increase over 1988. Finally, internal expenditure capitalized in fixed assets grew by 8.4%, well below the growth rate in personnel expenses. This trend is due to the fact that staff efforts are increasingly dedicated to network conservation and maintenance tasks.

The above-mentioned trends in operating revenue and expenses gave rise to a 13.7% increase in the operating margin. This reached the figure of 433,474 million pesetas, representing 61% of last year's operating revenue.

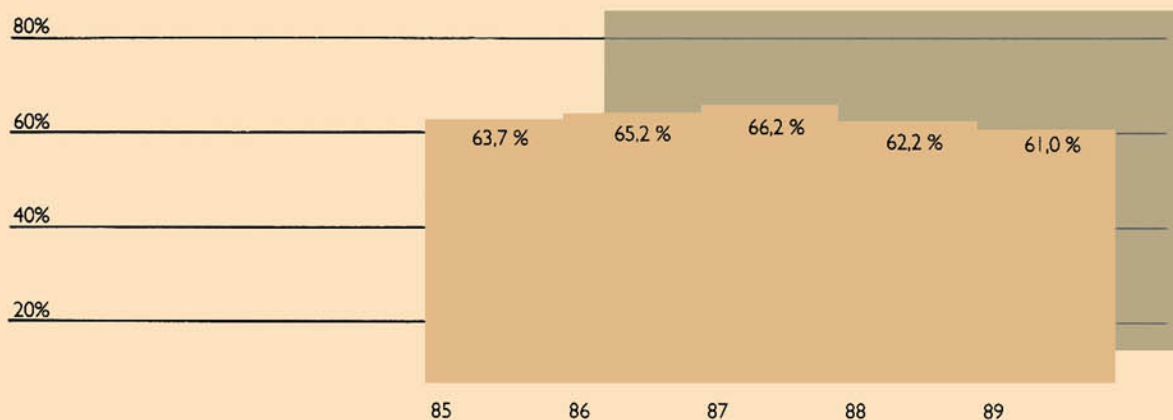
OPERATING MARGIN

margins 1985/1989

(of Ptas.)

1988		1989		Increases (%)		
Amount	% Struct.	Amount	% Struct.	1989\$ (in millions)	Over 88	85-89*
612,536	100.0	710,904	100.0	6,479.3	16.1	14.8
275,468	(45.0)	325,051	(45.7)	2,962.6	18.0	12.8
12,210	(2.0)	13,450	(1.9)	122.6	10.2	—
56,336	9.2	61,071	8.6	556.6	8.4	4.2
381,194	62.2	433,474	61.0	3,950.7	13.7	13.5
—	—	—	—	—	—	—
8,880	1.5	11,726	1.7	106.9	32.0	12.6
84,866	(13.9)	104,935	(14.8)	956.4	23.6	8.0
12,046	(2.0)	7,331	(1.0)	66.8	(39.1)	(5.7)
203,851	(33.2)	219,885	(30.8)	2,004.1	7.9	17.1
89,311	14.6	113,049	15.9	1,030.3	26.6	12.3
254	(0.1)	187	(0.1)	1.7	(26.4)	—
16,145	(2.6)	24,679	(3.5)	224.9	52.9	19.3
11,176	1.8	4,890	0.7	44.6	(56.2)	7.4
84,088	13.7	93,073	13.1	848.3	10.7	10.4
21,243	(3.5)	24,175	(3.4)	220.3	13.8	N/S
62,845	10.3	68,898	9.7	627.9	9.6	15.2
62,845	10.3	68,898	9.7	627.9	9.6	15.2
203,851	33.2	219,885	30.8	2,004.1	7.9	17.1
28,445	4.6	32,197	4.5	293.4	13.2	10.7
9,396	1.5	13,678	1.9	124.7	45.6	—
304,537	49.6	334,658	47.0	3,050.1	9.9	17.2

OPERATING MARGIN / OPERATING REVENUE (%)



OTHER EXPENSES

In 1989, financial expenses amounted to 104,935 million pesetas, representing a 23.6% rise over the previous year. This trend reflects the considerable investments made by Telefónica over the last two years with the consequent drop in self-financing levels. This has led to higher debt levels at a moment when interest rates are high and access to certain financial market sectors is limited, with consequent repercussions on the year's financial expenses.

As regards provisions, of particular note was the 39.1% fall in the provision for exchange losses. This was due to last year's positive trends in the peseta exchange rate against the different currencies which make up our foreign debt. Other provisions and charges reflected the Company's continuing prudent financial strategy of recent years, with an increase of 52.9% compared to 1988.

Plant depreciation and amortization of deferred charges rose by 7.9% to total 219,885 million pesetas. Average plant depreciation rate remained close to 7%, which was the maximum authorized rate granted to the Company for tax purposes in fiscal 1989.

Financial revenue went up by 32% during last year, to reach a figure of 11,726 million pesetas. Net extraordinary items witnessed a fall of 56.2% to 4,890 million pesetas. The reason for this trend lies in the low income from disposal of industrial holdings, as opposed to previous years, and to the significant write-off of dismantled plant pending depreciation carried out in 1989, to a value of 13,678 million pesetas, 45.6% more than in 1988. This item is accounted for as an extraordinary expense though, being an accelerated depreciation item by its very nature, it can be added to the depreciation of fixed assets, raising total depreciation and amortization during 1989 to 233,563 million pesetas, 9.5% up on the previous year.

FINANCIAL REVENUE AND EXTRAORDINARY ITEMS

Funds generated from operations totalled 334,658 million pesetas, which is 9.9% more than 1988. In relative terms, gross cash flow per share rose to 361.8 pesetas, 5.7% up on the previous year. The main component of funds generated from operations was depreciation and amortization, which, including the write-off of dismantled plant pending depreciation, represented 69.8% of gross cash flow.

FUNDS GENERATED

Financial ratios

(Figures in %, unless otherwise indicated)

	1985	1986	1987	1988	1989
Operating margin/Operating revenue	63.7	65.2	66.2	62.2	61.0
Net financial expenses/Operating revenue	15.5	14.1	12.6	12.4	13.1
Transfer to provisions/Operating revenue	5.2	7.5	9.4	4.6	4.5
Operating margin/Av. net plant (1)	17.3	18.4	19.6	19.0	19.1
Fixed assets coverage (2)	55.6	59.4	60.4	60.6	53.9
Guarantee ratio (3)	59.0	63.3	64.1	63.8	60.5
Self-financing ratio (4)	63.2	74.0	76.0	61.0	41.9
Financial debt ratio (5)	43.8	39.7	38.1	37.9	43.4
Debt repayment capacity (years) (6)	3.8	3.1	2.7	2.6	3.1
Gross cash flow/Net financial expenses (times)	2.8	3.3	3.9	4.0	3.6

(1) Operating margin/Average net fixed assets.

(2) Shareholders' equity/Net fixed assets.

(3) Shareholders' equity/Permanent capital.

(4) Net income + amortization + depreciation + net provisions - dividends/capital expenditure in fixed assets + advances for plant + stocks for fixed assets.

(5) Interest bearing debt/Interest-bearing debt + shareholders' equity - deferred charges - deferred exchange losses.

(6) Total debt/Gross cash flow.

CAPITAL EXPENDITURE AND FINANCING

The total amount of capital expenditure in tangible and intangible fixed assets and investments carried out by Telefónica during 1989 reached the figure of 602,788 million pesetas, of which 96.8% (583,762 million pesetas) corresponded to capital expenditure in fixed assets and advances for plant (94.1% in 1988). Including operating capital expenditure in stocks for fixed assets, Telefónica total capital expenditure rose to 600,983 million pesetas, 228,023 million more than in 1988.

In 1989, gross investments in affiliates totalled 9,284 million pesetas. However, since there were also reductions in investments which reached a higher figure, the net result was negative by 3,575 million pesetas.

The major boost in Telefónica's 1989 capital expenditure programme resulted in a moderate rate of self-financing (41.9%), which led to significant external financing. The financial debt ratio therefore grew by 5.5 points during the year. At the end of 1989, the interest-bearing debt represented 43.4% of the Company's real capital employed.

The above trend was reflected in the financial ratios. These show the extent of Telefónica's external financing during last year, aimed at satisfying more promptly Spain's telecommunications requirements.

FINANCIAL DEBT RATIO (%)



Balance sheets 1985/1989

(After profit distribution, in millions of pesetas,
unless otherwise stated)

ITEMS	1985	1986	1987	1988	1989	1989\$ (in millions)
Fixed assets	1,703,265	1,835,197	2,020,623	2,174,398	2,529,330	23,052.6
Property, plant and equipment	2,568,812	2,828,586	3,162,385	3,462,255	3,985,031	36,320.0
Depreciation of fixed assets	(982,606)	(1,097,404)	(1,234,045)	(1,373,388)	(1,527,442)	13,921.3
Property, plant and equipment —net	1,586,206	1,731,182	1,928,340	2,088,867	2,457,589	22,398.7
Net intangible assets	5,042	3,997	718	6,281	10,665	97.2
Investments	32,987	38,755	51,859	52,684	48,922	445.9
Deferred charges	12,898	12,424	10,722	12,268	10,112	92.2
Unrealised exchange losses	66,132	48,839	28,984	14,298	2,042	18.6
Current assets	103,122	113,596	126,059	162,731	197,324	1,798.4
Consumable inventories	3,699	5,692	4,146	6,512	8,320	75.8
Accounts receivable	86,078	100,010	114,882	148,699	181,788	1,656.8
Cash and banks	7,981	2,332	2,772	2,044	936	8.5
Other current assets and prepayments	5,364	5,562	4,259	5,476	6,280	57.3
Assets = Liabilities and shareholders' equity	1,806,387	1,948,793	2,146,682	2,337,129	2,726,654	24,851.0
Shareholders' equity (1)	947,804	1,090,016	1,220,727	1,317,696	1,362,546	12,418.4
Paid-in share capital	360,468	411,793	415,368	460,620	462,482	4,215.1
Reserves and provisions	587,336	678,223	805,359	857,076	900,064	8,203.3
Medium and long term debt (2)	659,545	632,056	683,186	746,812	889,211	8,104.3
Debt in pesetas	450,717	532,927	603,694	617,730	693,490	6,320.5
Debt in foreign currency	208,828	99,129	79,492	129,082	195,721	1,783.8
Permanent capital (1 + 2)	1,607,349	1,722,072	1,903,913	2,064,508	2,251,757	20,522.7
Current liabilities	199,038	226,721	242,769	272,621	474,897	4,328.3
Short term debt	168,171	187,585	206,321	233,187	419,330	3,821.8
Accruals	30,867	39,136	36,448	39,434	55,567	506.5
Unused credit facilities (In memorandum accounts)	121,300	97,965	92,789	102,090	29,979	273.2

Exchange rate (29-12-89): 1\$ = 109.72 ptas.

Statement of changes in financial position

(After profit distribution)

(In millions of pesetas, unless otherwise stated)

	1985	1986	1987	1988	1989	1989\$ (in millions)
Gross cash flow	177,580	218,416	268,684	304,537	334,658	3,050.1
Reserves	3,369	2,157	4,444	26,117	10,623	96.8
Share capital increases	32,084	36,047	–	45,252	1,862	17.0
M & L.T. Debt	154,267	204,803	177,028	233,579	282,500(a)	2,574.7
– Domestic	139,370	168,827	165,710	155,249	204,012(b)	1,859.4
– Foreign	14,897	35,976	11,318	78,330	78,488(c)	715.3
Total sources and applications of funds	367,300	461,423	450,156	609,485	629,643	5,738.6
Capital expenditure and investments	195,726	218,458	284,773	380,273	602,788	5,493.9
– Capital expenditure	188,681	211,514	260,183	357,815	583,762	5,320.5
– Fixed assets	187,881	205,592	262,582	353,728	564,887	5,148.4
– Advances for plant	800	5,922	(2,399)	4,087	18,875	172.0
– Intangible assets	1,778	1,866	4,398	6,234	5,380	49.0
– Investments in affiliates	48	5,051	14,808	1,079	(3,575)	(32.6)
– Stocks for fixed assets	5,219	27	5,384	15,145	17,221	157.0
Deferred charges and exchange losses	(5,882)	(7,307)	(7,959)	(8,099)	(5,947)	(54.2)
Applications of provisions	55,056	61,774	66,752	62,022	65,435	596.4
Repayment and redemption of M. & L.T. debt	147,587	205,534	110,335	168,470	135,052	1,230.9
– Domestic	86,900	67,014	89,758	141,212	128,252	1,168.9
– Foreign	60,687	138,520	20,577	27,258	6,800	62.0
Variation in working capital	(25,187)	(17,036)	(3,745)	6,819	(167,685)	(1,528.3)
Variation in unused credit facilities	29,271	(16,976)	(5,533)	(1,586)	(28,752)	262.0

Exchange rate (29-12-89): 1\$ = 109.72 ptas.

NOTES

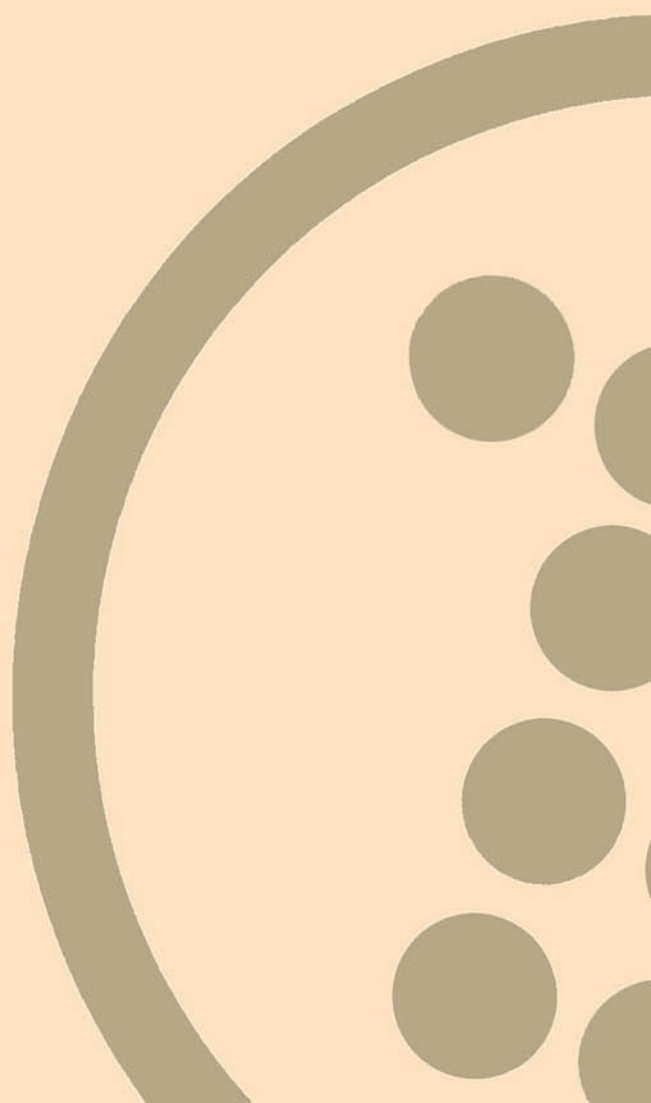
The difference between the Variation in working capital indicated in this table and that audited is as follows:

Total variation in working capital	(167,685)
Increased in 1989 dividends	<u>3,462</u>
TOTAL	(164,223)

(a) This amount includes time period adjustments for Promissory Notes, Zero Coupon Bonds and Eurobonds repayment premium, which figure in the audited statement of changes in financial position as self-financing, in accordance with the following breakdown:

Debenture interest	951 (b)
Promissory Note interest	3,116 (b)
Eurobonds repayment premium	<u>1,106 (c)</u>
TOTAL	5,173

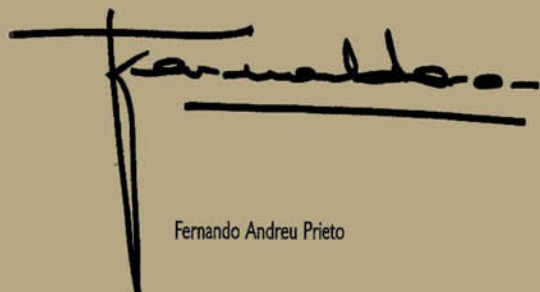
**Audited
financial
statements**



Auditing Shareholders' Report

Fernando Andreu Prieto and Miguel Angel Herrera Chamorro, appointed auditors of the 1989 accounts by the Annual General Meeting of Shareholders held on June 30, 1989, have examined the independent auditors' report issued by the firms Price Waterhouse and Audiberia, S.A. and the report of the Spanish Auditors, and propose that the Annual General Meeting approve the Annual Report, Balance Sheet, Statement of Income and Statement of Changes in Financial Position of Telefónica de España, S.A.

And in testimony thereof, we sign this Report in Madrid, third of May, 1990.



Fernando Andreu Prieto



Miguel Ángel Herrera Chamorro

Spanish Statutory Auditors' Report

Mr. Pedro RODRIGUEZ SAN ROMAN and Mr. Enrique FERNANDEZ PEÑA, auditors and full members of the Institute of Spanish Auditors, in compliance with the mandate received from the Management Committee of Telefónica de España, S.A., have examined the Balance Sheet of the Company at December 31, 1989 and the Statement of Income for that year and the corresponding notes thereto.

In the said examination and in order to audit the 1989 accounts, we have taken into account the working reports prepared in previous years by the firms Price Waterhouse and Audiberia, S.A., all in accordance with Telefónica.

The said review has given rise to this Report 10/90, which is issued with the remarks and observations listed below.

1. General remarks

- 1.1 The figures contained in the enclosed Balance Sheet and Statement of Income, come from the general ledger and auxiliary records of Telefónica, in accordance with the general account groupings shown in detail in the annual financial statements.
- 1.2 The Company's Balance Book number 3, legalized on May 30, 1973, under the number 8,756, shows the trial balances for the year.
- 1.3 The Company's Day Book number 24, legalized on November 17, 1983, under the number 28,608, shows the summary of the entries made each month, in accordance with the account groupings mentioned in 1.1.
- 1.4 Under the new Telefónica Tax Law 15/1987 of July 30 and the Royal Decree 1334/1988 of November 4, which develops it in part, as from January 1, 1988, Telefónica is subject to a new tax regime and specifically to Corporate Tax. Accounting standards applied in the preparation of the financial statements therefore adhere to the accounting principles contained in the General Accounting Plan.

2. Comments on the Balance Sheet

2.1 Fixed assets

This item increased by 600,983 million pesetas in 1989. This figure includes charges for work carried out on the Company's own fixed assets (labour, materials and other) amounting to 61,071 million pesetas.

The elements acquired prior to January 1, 1988 have been valued at the replacement price at December 31, 1987, under article 3 of the Law of December 31, 1945, with the intervention of a mixed committee composed of members of the Telefónica Government Delegation, the Ministry of Finance and Telefónica. Additions as from January 1, 1988 are valued at acquisition price plus installation costs, which includes direct labour and materials, as well as an assigned proportion of indirect costs which does not include financial expenses.

2.2 Accumulated depreciation and amortization of assets

The relevant credit items charged to the 1989 Profit and Loss Account amount to 215,226 million pesetas. The overall percentage of the average value of depreciable plant was 6.99%.

2.3 Net shareholdings in companies

Investments in the Telefónica group are valued charging to the Profit and Loss Account the capital loss between the amount recorded in Telefónica and the respective book value of the issuing company.

Dividends are recorded as income at the moment of payment (658 million in 1989) and profit from securities as income in the year of disposal of the shares.

2.4 Deferred exchange losses

In 1989, accumulated exchange losses of foreign currency borrowings will be charged to the Profit and Loss Account at the moment of amortization, preamortization or extinction of the contractual relation.

In the next two years, we anticipate charges of 5,521 and 5,240 million pesetas respectively.

2.5 Accounts receivable

The caption "Subscribers" includes ex-subscribers where debt collection is doubtful, with a total balance of 5,872 million pesetas. The accumulated balance in the "Provision for bad debts" account is 6,834 million pesetas, with the surplus covering other accounts receivable pending classification.

2.6 Share capital

Telefónica, as authorized by the General Meeting of Shareholders, increased share capital by a total of 1,862 million pesetas of nominal value, for the conversion of bonds to shares at an average rate of 789 pesetas for each share of 500 pesetas of nominal value.

2.7 Statutory/legal reserve

The legal reserve is regulated by the Law of September 19, 1942, under which all companies must assign ten percent of their profits, to reach a balance equivalent to a fifth of the paid-up capital. Telefónica was exempt from this obligation under the State Contract (Condition 7), which established that, instead, the Company provide funds for a Statutory Reserve as from 1946.

Furthermore, the regulation laid down in the Law of September 19, 1942 was included in the Limited Companies Act of July 17, 1951.

Following the repeal of Condition 7 and hence the cancellation of the compulsory Statutory Reserve provision —which was in place of the Legal Reserve— the General Meeting of Shareholders, on the proposal of the Executive Committee, agreed to transfer the accumulated balance in the Statutory Reserve of 16,005 million pesetas to the new account named "Legal Reserve". From 1988, this account is regulated by the Law of 17 July, 1951, under which Telefónica was formerly exempt, prior to the repeal of Condition 7 of the State Contract.

The provision approved in the distribution of 1988 profits was 8,409 million pesetas, which brings the balance on this account to 24,414 million pesetas at December 31, 1989.

2.8 Revaluation surplus and other reserves

The share premium account increased by 1,075 million pesetas, as a result of the capital increases from the conversion of bonds to shares, reaching a figure of 32,752 million pesetas. The Voluntary Reserve increased by 7,028 million pesetas, due to the transfer made in the distribution of 1988 profits, bringing the balance to 48,628 million pesetas at December 31, 1989.

The remaining amount under this caption of 653,780 million pesetas, practically all corresponds to the Revaluation Reserve. Of this sum, 311,642 million pesetas are from revaluations from 1984 to 1987 and 342,138 million pesetas from revaluations of previous years. The possible application of these amounts is regulated by the Royal Decree 1334/1988 of November 4.

2.9 Debentures, bonds and promissory notes

Debentures amounting to 38,000 million pesetas were issued in 1989 and amortization and conversion operations reached the figure of 39,422 million pesetas.

2.10 Pensions

Telefónica employees benefit from a social welfare system with pensions which are substitutory for and complementary to those provided by the Spanish State Social Security system. These pensions are covered by the "Institución Telefónica de Previsión (ITP)", a mutual pension fund with independent legal status created under the Law of December 6, 1941 and the regulations pertaining thereto of May 26, 1943 concerning Social Service Mutual Funds.

The circumstances and explanations relating to this matter are described in Note 15 of the financial statements.

The judgements of independent legal counsel confirm Telefónica's compliance with all of its contractual obligations relating to ITP and confirm the nonexistence of any legal responsibility for Telefónica other than that stated in Note 15.

3. Comments on the Statement of Income

3.1 Income

The estimates of income at the end of the 1988 and 1989 financial periods are correct.

3.2 Costs and expenses

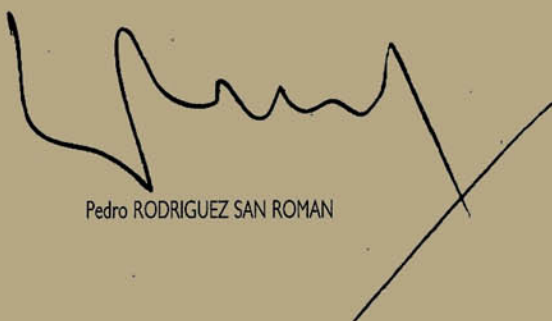
The costs and expenses attributed by the Company are those accounted for.

As a consequence of the above and on the basis of the verifications made, together with the reports of the firms Price Waterhouse Auditores and Audiberia, S.A., we hereby issue the following:

REPORT

As a result of the examination carried out, it is our professional opinion that the Balance Sheet and the Statement of Income of Telefónica de España, S.A. (Telefónica) and the Notes thereto attached, present fairly the financial position of Telefónica at December 31, 1989 and the results of its operations during the year, in accordance with accounting principles generally accepted in Spain and with the requirements of the legislation governing the activities of Telefónica, which are consistent with those of the preceding year.

Madrid, March 26, 1990.



Pedro RODRIGUEZ SAN ROMAN



Enrique FERNANDEZ PEÑA

Independent Auditors' Report

To the Board of Directors
Telefónica de España, S.A.
Madrid

1. We have examined the balance sheet of Telefónica de España, S.A. (Telefónica) at December 31, 1989, the statements of profit and loss and of changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards.
2. As indicated in Note 1 to the financial statements, tariffs corresponding to the services provided by Telefónica are submitted to the Spanish Government for approval, with the prior intervention of the Government Delegate in the Company and agreement of the Price Control Board. Consequently, Telefónica falls within the group of regulated entities whose peculiarities permit that income and expenses may be attributable to each period not only on the accrual basis but also when the related specific concepts of revenue and cost are computed as part of the approved tariffs. On this basis, the recovery of the amounts invested or deferred in the assets of the Company, will depend upon the adequate future consideration, in tariffs, of these concepts.
3. Notes 15 and 16 to the financial statements include a detailed explanation of the characteristics of the pension scheme by which the employees of Telefónica are covered through the mutual pension fund "Institución Telefónica de Previsión" (ITP), as well as the current going concern problems, negotiations held and the Company's present position in respect of these.
There exist opinions of independent legal counsel which reconfirm Telefónica's compliance with all its contractual obligations to ITP, as well as the legal independence of the latter as regards Telefónica and the nonexistence of any other subsidiary responsibility for Telefónica than that stated in Note 15.
4. In our opinion, the financial statements referred to in paragraph 1 present fairly the financial position of Telefónica de España, S.A. at December 31, 1989 and the results of its operations and changes in financial position for the year then ended, in conformity with accounting principles generally accepted in Spain, and as explained in paragraph 2, those required or permitted by the specific regulations governing Telefónica's activities, applied on a basis consistent with that of the preceding year. Accounting principles which are of significance in the preparation of the financial statements are described in Note 2.
5. These financial statements and related notes were originally issued in the Spanish language; the translation into English is solely for the convenience of international readers.

Price Waterhouse Auditores, S.A.



Augusto San Segundo
Partner

Audiberia, S.A.



Juan Manuel Osorio
Partner

Madrid, March 8, 1990

TELEFONICA DE ESPAÑA, S.A.
BALANCE SHEETS AT DECEMBER 31,
(before distribution of profits)
(In millions of pesetas)

ASSETS	1989	1988
FIXED ASSETS (Note 3)	2,457,589	2,088,867
Land	40,467	38,640
Buildings and power equipment	273,858	249,043
Telephone installations	3,028,974	2,790,858
Other fixed assets	43,805	37,209
	3,387,104	3,115,750
Accumulated depreciation	(1,527,442)	(1,373,388)
	1,859,662	1,742,362
Fixed assets under construction:		
Construction in progress	490,166	274,840
Advances to suppliers	40,041	21,166
Stocks for fixed assets	67,720	50,499
	608,127	376,505
INTANGIBLE ASSETS	10,665	6,281
Research and development and others	25,785	20,405
Accumulated amortization	(15,120)	(14,124)
	10,665	6,281
INVESTMENTS	48,922	52,684
Net shareholdings in companies (Note 4)	37,527	32,775
Loans to Group companies	7,475	16,131
Loans to employees	2,637	2,963
Guarantees and deposits	1,283	815
	48,922	52,684
DEFERRED CHARGES	10,112	12,268
DEFERRED EXCHANGE LOSSES (Note 5)	2,042	14,298
INVENTORIES	8,320	6,512
ACCOUNTS RECEIVABLE	181,788	148,699
Subscribers (Note 6)	160,756	126,645
Provision for bad debts (Note 6)	(6,834)	(4,677)
Miscellaneous receivables	30,176	28,586
Provision for bad debts	(2,310)	(1,855)
	181,788	148,699
CASH AND BANKS	936	2,044
Cash and banks	872	407
Funds in transit and others	64	1,637
	936	2,044
OTHER CURRENT ASSETS AND PREPAYMENTS	6,280	5,476
Total	2,726,654	2,337,129
MEMORANDUM ACCOUNTS (Note 17)		
Unused credit facilities	29,979	102,090
Others	90,969	59,466
	120,948	161,556

Notes 1 to 19 form an integral part of these statements.

TELEFONICA DE ESPAÑA, S.A.

LIABILITIES AND SHAREHOLDERS' EQUITY

	1989	1988
SHAREHOLDERS' EQUITY	1,222,149	1,203,774
Share capital (Note 7)	462,482	460,620
Reserves: (Note 8)		
Statutory and legal reserve	24,414	16,005
Revaluation surplus and other voluntary reserves	735,160	727,057
Unappropriated profit	93	92
	<u>759,667</u>	<u>743,154</u>
DEFERRED INCOME	11,122	4,682
Capital Grant	8,880	2,348
Non-reimbursable contributions for rights of use and others	2,242	2,334
	<u>111,246</u>	<u>93,802</u>
PROVISIONS (Note 9)	111,246	93,802
LONG TERM DEBT	889,211	746,812
Debentures and bonds (Note 10)	319,027	319,055
Loans and credit facilities (Note 11)	472,416	337,908
Loans from the Institución Telefónica de Previsión (ITP)	59,834	57,297
Notes payable to suppliers	1,995	2,832
Collective insurance for employees (Note 16)	35,939	29,720
	<u>368,461</u>	<u>185,780</u>
SHORT TERM DEBT	368,461	185,780
Loans and credit facilities (Note 11)	144,154	39,797
Suppliers	140,893	67,408
Notes payable to suppliers	1,841	2,959
Taxes payable (Note 12)	4,025	6,287
Company income tax provision (Note 2.2.k)	15,186	21,243
Social Security payable	6,768	5,887
Other creditors (Note 13)	49,864	36,071
Dividends payable	5,730	6,128
	<u>55,567</u>	<u>39,434</u>
ACCRUALS (Note 14)	55,567	39,434
NET INCOME		
Net income for the year after Company income tax	<u>68,898</u>	<u>62,845</u>
Total	<u>2,726,654</u>	<u>2,337,129</u>
MEMORANDUM ACCOUNTS (Note 17)		
Unused credit facilities	29,979	102,090
Other	90,969	59,466
	<u>120,948</u>	<u>161,556</u>

Notes 1 to 19 form an integral part of these statements.

TELEFONICA DE ESPAÑA, S,A,
STATEMENTS OF INCOME FOR THE YEARS ENDED DECEMBER 31,
(In millions of pesetas)

	1989	1988
INCOME	710,904	612,536
Revenue from services	677,987	588,216
Connection fees and other	32,917	24,320
COSTS AND EXPENSES	646,820	553,372
Salaries and related costs	253,439	216,481
Subcontractors, supplies and services	71,109	58,627
Taxes (Note 1.3)	13,953	12,570
Provision for contingencies	—	
Provision for pension funds	17,500	14,815
Other charges	7,179	1,330
Exchange losses (Note 5)	7,331	12,046
Financial expenses	104,935	84,866
Sundry expenses	12,560	5,122
Depreciation of fixed assets	216,471	200,294
Amortization of deferred charges	3,414	3,557
Internal expenditure capitalized in fixed assets	(61,071)	(56,336)
PROFIT BEFORE OTHER INCOME	64,084	59,164
OTHER INCOME	28,989	24,924
Financial	11,726	8,880
Other	17,263	16,044
INCOME BEFORE COMPANY INCOME TAX	93,073	84,088
PROVISION FOR COMPANY INCOME TAX (Note 1.3)	(24,175)	(21,243)
NET INCOME AFTER COMPANY INCOME TAX	68,898	62,845

Notes 1 to 19 form an integral part of these statements.

**STATEMENTS OF CHANGES IN FINANCIAL POSITION FOR THE YEARS
ENDED DECEMBER 31
(Before distribution of profits) (*)
(In millions of pesetas)**

	1989		1988
SOURCES:			
Net income for the year after the Company			
Income Tax	68,898		62,845
Depreciation and amortization	216,471		200,294
Amortization of deferred charges	3,414		3,557
Non amortized dismantled plant	13,678		9,396
Disposals of installed terminals non amortized	482		3,414
Allocations to provisions assets	30,009		31,665
	<hr/>		<hr/>
Funds provided by operations	332,952		311,171
Shareholders' contribution:	2,937		65,612
Issuance of share capital	1,862	45,252	
Share premium	1,075	20,360	
	<hr/>	<hr/>	
Deferred income	6,440		2,343
Investments in affiliates	2,626		—
Disposals of fixed assets	12,859		10,040
Debentures and bonds issued	38,000		55,635
Foreign currency loans	77,511		53,479
Other loans, credit facilities and notes payable	161,816		119,832
	<hr/>		<hr/>
TOTAL SOURCES	635,141		618,112
APPLICATIONS			
Dividends	47,407		45,643
Additions to fixed assets	564,887		353,728
Other additions:	52,018		41,688
Advances to suppliers of fixed assets	18,875	4,087	
Intangible assets	5,380	6,234	
Investments in affiliates	9,284	11,119	
Stocks for fixed assets	17,221	15,145	
Deferred charges	1,258	5,103	
	<hr/>	<hr/>	
Debentures and bonds redeemed	39,422		67,303
Repayment of foreign currency loans	6,062		19,695
Repayment of other loans, credit facilities and notes payable	89,568		81,472
	<hr/>		<hr/>
TOTAL APPLICATIONS	799,364		609,529
NET VARIATION	(164,223)		8,583
COMPRISING:			
Inventories	1,808		2,366
Accounts receivable	33,089		33,817
Cash and banks	(1,108)		(728)
Prepayments	804		1,217
Short term liabilities	(183,081)		(25,101)
Accruals	(16,133)		(2,986)
Dividend accounts	398		(2)
	<hr/>		<hr/>
TOTAL	(164,223)		8,583

(*) These statements have been prepared in accordance with the classification of short and long term debts as described in Note 2.2.j.
Notes 1 to 19 form an integral part of these statements.

TELEFONICA DE ESPAÑA, S.A.

PROPOSAL FOR DISTRIBUTION OF NET INCOME FOR THE YEAR 1989

	Millions of pesetas
Unappropriated profit brought forward from previous year	93
Net income for the year before Company Income Tax	93,073
Provision for Company Income Tax	<u>(24,175)</u>
Total available for distribution after Company Income Tax	<u>68,991</u>
 PROPOSED DISTRIBUTION	
5% Interim dividend on shares No 1 to 924,963,451 payable as from January 31, 1990	23,122
6% Final dividend on shares No 1 to 924,963,451 pending approval	<u>27,747</u>
To dividends	50,869
To legal reserve	9,307
To voluntary reserve	8,720
Unappropriated profit carried forward	<u>95</u>
Total proposed distribution	<u>68,991</u>

NOTES TO THE FINANCIAL STATEMENTS AT DECEMBER 31, 1988 AND 1989

NOTE I - ACTIVITY AND CONTRACT WITH THE STATE

1.1 Conditions of the State Contract

The Telecommunications Law, dated December 18, 1987, stipulates that Telefónica will continue to provide the basic communication services (final and transmission) on a monopoly basis during an initial concession of 30 years and requires the Spanish State to enter into a new contract with Telefónica. On December 31, 1989, the new contract is in a stage of formalization, continuing in force the conditions of the previous state contract, defined by the Law of December 31, 1945 and the Decree of October 31, 1946 where the contract regulating the conditions of the concession was approved. For this reason, Telefónica is a limited liability company regulated by the specific rules of this contract.

1.2 Regulation of tariffs

According to the State Contract, tariffs will be reviewed at Telefónica's request when, for two consecutive years, they do not give a sufficiently high yield to cover all operating expenses including depreciation of Company installation and properties, to accumulate and maintain the statutory reserve referred to in Condition 7 of the State Contract or any other required by law and obtain an amount of net income in each fiscal year of not less than 5% of the paid-in share capital plus reserves as defined in the State Contract.

1.3 Fiscal status

According to the Telefónica Taxation Law, dated July 30, 1987 and Royal Decree 1334/1988 of November 4, which develops it, as from January 1, 1988, Telefónica is subject to the general taxation laws and regulations. The Law also provides that Telefónica will be subject to certain specific local property taxes ("Contribución Territorial Rústica Urbana") substituting all other local and regional taxes with a yearly cash compensation equivalent to two per cent of gross revenues from invoicing.

NOTE 2 - BASES OF PRESENTATION AND SIGNIFICANT ACCOUNTING PRINCIPLES

2.1 Bases of presentation

- a) *The financial statements have been prepared on the basis of the accounting records of Telefónica for each year, prior to the distribution of profits, including as short term debt the income tax provision. The distribution of 1989 profits is therefore subject to approval by the Shareholders at the Annual General Meeting.*
- b) *Except as otherwise indicated, amounts shown in the Notes to the financial statements are expressed in millions of pesetas.*

2.2 Significant accounting principles

a) Accounting standards

The financial statements were prepared in accordance with generally accepted accounting principles applied in Spain.

b) Fixed assets and method of depreciation

Fixed assets acquired before December 31, 1987 are valued at replacement cost as at that date, including voluntary revaluations carried out in accordance with Article 3 of the Law of December 31, 1945 and with the approval of the Finance Ministry.

From January 1, 1988, property additions are valued at cost including installation cost, direct labour and materials used, together with an allocatable share of overheads.

When equipment is retired from service the gross book value and amount of accumulated depreciation are removed from plant and equipment and depreciation reserves, considering as loss the difference between the net book value of the dismantled plant and its recovery value.

The annual depreciation charge is calculated using the straight-line method based on the useful lives of the assets.

Fixed assets maintenance and repair costs not representing an increase of value or improvement are expensed when incurred.

c) Intangible assets and amortization

Intangible assets include costs incurred in developing new product lines capable of being marketed or utilized in the telephone network. Finished projects with possibility of commercial or industrial use are amortized over five years and rejected projects are written off immediately.

The acquired rights to use of equipment and plant owned by others are also included under this heading as well as the cost of licences for the indefinite use of software. These assets are amortized on a straight-line basis over 25 and 3 years respectively.

d) Investments - net shareholdings in companies

The financial statements do not present the consolidated financial position of Telefónica and its majority-owned subsidiaries. Consolidation exercises have been carried out, the results of which show no significant impact on the Company's financial statements.

Until 1987, the carrying values of shareholdings in subsidiary and associated companies were adjusted against the related revaluation reserve, on the basis of the proportional equity value of these companies, using the balance sheets as at December 31 of the previous fiscal year, as approved by the Shareholders at their Annual General Meeting. Beginning in 1988, new investments are recorded at cost, including the related expenses as well as the stock rights, if applicable. Only reductions in the proportional equity value are recognised, such losses being charged against income. Dividends are recorded as revenue when received, as are capital gains obtained from sales of investments.

e) Deferred charges

Debenture issue expenses are amortized based on the respective principals outstanding at each year end, whereas issuance expenses of bonds converted to share capital and expenses related to the issuance of share capital are amortized on a straight line basis over five years from the date of each share capital increase or conversion.

f) Valuation of foreign currency accounts

Foreign currency accounts are translated to pesetas at the end of the year at the official exchange rate quoted by the Bank of Spain. Unrealized exchange gains or losses are recorded in the deferred exchange losses account and are charged to expenses each year, as realized, in accordance with the repayment of the foreign currency debt to which they relate.

Given the nature and characteristics of Telefónica as a regulated price and services company and the tariff review mechanisms, the unrealized exchange losses due to repaid debts from 1985 to 1987 will be recognized in accordance with the initial maturity schedule. The fixing of tariffs each year takes into consideration the recovery of these deferred expenses. As from 1988, accumulated exchange gains or losses from foreign currency are recognized when payments are made or the contractual obligations are terminated.

g) Inventories and stocks for fixed assets

Inventories and stocks are generally valued at their weighted average cost.

h) Revenue from services

Revenue from services is accounted for on the accrual basis. Thus, at the end of each year adjustments are recorded to defer prepayments with respect to services that are invoiced every two months in advance and to accrue for unbilled services.

i) Retirement pensions and endowment insurance

Retirement pensions of Telefónica's employees are covered by the Institución Telefónica de Previsión (ITP), whose relationship with the Company is described in Note 15.

Endowment insurance is accrued against income by applying the actuarially calculated coefficients to the base-salaries paid; these coefficients include current and past service costs (Note 16).

j) *Short and long-term debts*

For the purposes of the balance sheet, debts are classified according to their maturity dates, from the time they are contracted and up to settlement, as follows:

Short-term - Maturity up to 18 months.

Long-term - Maturity over 18 months.

The corresponding notes disclose the maturities within the 12 months from the balance sheet dates, and those subsequent to 12 months (Notes 10 and 11).

k) *Company income tax*

Consistent with general practice in Spain, the income tax provision is an estimate of the amount to be paid without considering deferred or advanced taxes resulting from timing differences between book profits and taxable income.

NOTE 3 - FIXED ASSETS

3.1. *The composition by type of fixed asset and accumulated depreciation, is as follows:*

	1989	1988	Years of useful life
Land	40,467	38,640	
Buildings	204,125	187,430	40
Accumulated depreciation	(62,087)	(57,299)	
Power equipment	69,733	61,613	18-19
Accumulated depreciation	(36,532)	(33,099)	
Exchange equipment	1,055,904	964,891	18-23
Accumulated depreciation	(480,569)	(430,376)	
Transmission equipment	376,085	326,460	13-16
Accumulated depreciation	(210,182)	(187,012)	
Local and trunk networks	1,394,321	1,324,934	18-22
Accumulated depreciation	(608,185)	(569,263)	
Subscriber sets and other related installations	202,664	174,573	4-8
Accumulated depreciation	(110,982)	(81,012)	
Furniture, office and other equipment	43,805	37,209	5-10
Accumulated depreciation	(18,905)	(15,327)	
Fixed assets in service	3,387,104	3,115,750	
Accumulated depreciation	(1,527,442)	(1,373,388)	
Net book amount	1,859,662	1,742,362	
Construction in progress	490,166	274,840	
Advances to suppliers of fixed assets	40,041	21,166	
Stocks for fixed assets	67,720	50,499	
Total net book amount	2,457,589	2,088,867	

3.2 *Annual variations were as follows:*

	1989	1988
Additions for the year	600,983	372,960
Dismantled plant (Note 2.2 b)	73,812	68,445
Unamortized dismantled plant	13,678	9,396
Depreciation charge for the year	215,226	200,212
Average rate of depreciation applied	6.99%	6.96%
Stocks for fixed assets:		
Reserve for obsolescence	6,236	7,302

- 3.3 As at December 31, 1989, of the total balance of "Subscriber sets and other related installations", sets amounting to Ptas. 11,550 million (in 1988, 12,426 million), Ptas. 6,355 million net of accumulated depreciation (in 1988, Ptas. 7,828 million) became subject to sale in accordance with the Ministry Order dated December 2, 1987. During the year, equipment and other assets were sold for gross amounts of Ptas. 876 million and Ptas. 3,519 million, respectively (Ptas. 482 million and Ptas. 2,626 million net of accumulated depreciation).
- 3.4 Service and operating conditions require Telefónica to maintain a permanent investment programme to ensure a service with the most up-to-date and efficient equipment. The investment budget for 1990 amounts to Ptas. 663,600 million, of which Ptas. 633,000 million is to be invested in fixed assets and the remainder largely in companies. The continuous and long-term nature of Telefónica's investments means that a part of this budget is related to the completion of projects initiated in previous years.
- 3.5 According to the State Contract, Telefónica's fixed assets used to provide telephone services cannot be mortgaged.
- 3.6 At December 31, 1989, assets amounting to Ptas. 196,891 million were subject to legal regulations (mainly inspection by the relevant authorities) derived from Decree Law 19/1961 and Law 61/1978, which regulate the benefits obtained for the reduction of withholding tax on interest on loans and borrowings indicated in Notes 10 and 11.
- 3.7 Insurance policies contracted by Telefónica cover all assets owned by the Company with the exception of the deductibles applicable to local and trunk networks and the subscriber sets, to which corresponding self-insurance provisions are applied.
- 3.8 Revaluations made to date, in accordance with the criteria discussed in Note 2.2 b) have yielded the following results:

Year	Fixed assets	Accumulated depreciation	Revaluation reserve
From 1946 to 1984	1,088,936	569,817	519,119
1985	123,808	48,534	75,274
1986	109,439	43,960	65,479
1987	133,135	47,804	85,331
Total	1,455,318	710,115	745,203

- 3.9 The useful lives of the different elements of Telefónica's fixed assets are calculated based on technical studies carried out by the Company, periodically revised on the basis of technological development and the renewal program. These useful lives are as described in Note 3.1.

NOTE 4 - INVESTMENTS

- 4.1 The details of net shareholdings in companies at December 31, are as follows:

	1989	1988
Group companies	31,948	28,476
Other investments	5,579	4,299
Total	37,527	32,775

"Other investments" consists of the Company's participation in telecommunication satellites (Intelsat, Eutelsat and Inmarsat).

4.2 The information presented in the following table under the titles "Share Capital, reserves and allocated income" and "income before tax" have been prepared on the basis of the financial statements of the individual companies in the Telefónica Group at December 31, 1989.

Company name	Share capital	Telefónica holding %	Telefónica book value
Sistemas e Instalaciones de Telecomunicación S.A. (SINTEL)	1,100	100	2,935
Telefonía y Finanzas S.A. (TELFISA)	500	100	2,099
Telecomunicaciones Marinas S.A. (TEMASA)	1,376	100	1,264
ENTEL, S.A.	650	100	1,179
Compañía Española de Tecnología S.A. (COMET)	1,100	100	1,098
Telefónica Investigación y Desarrollo S.A. (TIDSA)	1,000	100	1,000
Telefónica Internacional de España S.A.	2,946	100	890
TS-1 Telefónica de Servicios S.A.	1,000	100	860
Compañía Publicitaria Exclusivas Telefónicas S.A. (CETESA)	434	97.33	696
Casiopea Reaseguradora S.A.	498	100	498
Seguros de Vida y Pensiones Antares S.A.	720	100	420
Servicios de Teledistribución S.A.	210	99.14	293
Cabinas Telefónicas S.A. (CABITEL)	200	100	200
Control Electrónico Integrado S.A. (THM)	320	80.25	82
Playa de Madrid S.A.	40	100	54
Te einfomática y Comunicaciones S.A. (TELYCO)	50	100	50
Telefónica North America Inc.	1	100	1
Urbana Ibérica S.A.	330	100	—
Total subsidiaries			<u>13,619</u>
Fujiitsu España S.A.	8,000	40	3,500
Alcatel Standard Eléctrica S.A.	25,975	21.14	3,229
Hispasat, S.A.	20,000	25	1,250
Sistemas Técnicos de Loterías del Estado, S.A.	1,300	49	633
Torre de Collserola S.A.	1,000	35	219
Industria Electrónica de Comunicaciones S.A. (INDELEC)	600	30	150
Total associates			<u>8,981</u>
Telettra S.p.A.	4,816	10	3,990
ATT Microelectrónica S.A.	12,480	20	2,496
Amper S.A.	6,883	7.60	1,560
European Silicon Structures	8,366	3.43	460
Telettra Española S.A.	2,800	10	400
Other investments			442
Total others			<u>9,348</u>
Total Group			<u>31,948</u>

(*) 1988 information.

Share Capital, reserves and allocated income at December 31 1989	1989 income before tax profit (loss)	Activity
5,548	1,496	Telecommunication cable and line laying and equipment installation.
1,621	(699)	Investment management.
1,722	463	Surveying, laying and repairing submarine cables.
2,613	1,147	Development and implementation of projects in data processing.
759	(349)	Promotion and investment in new companies.
1,287	200	Research and development.
916	4	Export of telecommunication equipment and resources.
376	(494)	Marketing of value added services.
933	168	Promotion of advertising services for directories, telephone booths and others.
498	—	Reinsurance.
445	27	Life insurance and pension funds.
321	45	Marketing of teledistribution equipment (music, voice, image, data, etc.)
731	193	Collection, cleaning and maintenance of public telephones.
115	33	Security systems engineering.
135	4	Recreational and social activities.
769	311	Promotion and marketing of telephone and telematic equipment.
1	—	Financial operations.
188	261	Real estate activities.
<u>18,978</u>		
4,267	1,311*	Data transmission and data processing equipment.
4,840	2,636	Manufacture of telephone and telegraph transmission and exchange systems.
1,250	—	Exploitation of a Telecommunications satellite.
638	11	Installation, maintenance and exploitation of lottery systems through terminal games.
218	(2)	Communications Tower.
503	627	Manufacture of portable and mobile communications equipment.
<u>11,716</u>		
2,515	4,141*	Manufacturing, assembling and installation of telecommunications equipment.
2,874	(6,366)	Design, manufacture, assembling and marketing of high technology integrated circuits.
2,283	1,640	Development, manufacture and repair of telephone and telematic terminals. Manufacture of components (hybrid and flexible circuits).
458	— *	Manufacture and marketing of integrated circuits.
1,428	13,150	Development, manufacture and installation of electronic telecommunications equipment.
442		
<u>10,000</u>		
<u>40,694</u>		

- 4.3 In 1989, after transferring its piped music operations to the newly created company "Servicios de Teledistribución, S.A., Telefónica sold its interest in Comercial de Servicios Electrónicos, S.A. (COSESA) as well as its interest in Hispano Radio Marítima, S.A., resulting in a total profit of Ptas. 759 million.
- 4.4 A provision of Ptas. 187 million was made for the reduction in the value of the investment portfolio as indicated in Note 2.2.d).
- 4.5 The most relevant operations recorded during the year between Telefónica and Group Companies were as follows:

	1989	1988
Dividends received	658	258
Purchases of goods and services by Telefónica	273,384	164,092

Balances of suppliers and notes payable to suppliers include Ptas. 27,068 million corresponding to intercompany transactions (in 1988, Ptas. 21,716 million).

NOTE 5 - DEFERRED EXCHANGE LOSSES

The components of the balance and amortization schedule are as follows:

	Maturities				Balance 31-12-89	Balance 31-12-88
	1990	1991	1992	Subsequent		
Unrealized exchange losses (subject to exchange rate fluctuation)						
–Deferred unrealized losses	217	5	1,001	2,160	3,383	5,299
–Deferred unrealized gains	(54)	(9)	(8)	(13,954)	(14,025)	(9,967)
Total	163	(4)	993	(11,794)	(10,642)	(4,668)
Deferred realized exchange losses (corresponding to early repayment of loans)	5,358	5,244	630	1,452	12,684	18,966
Total	5,521	5,240	1,623	(10,342)	2,042	14,298

Details of the charge to expenses for the year are as follows:

	1989	1988
Repayment of loans and other debts	7,189	11,931
Services charges in foreign currency and other	142	115
Total	7,331	12,046

NOTE 6 - SUBSCRIBERS

The balances at December 31, comprise the following:

	1989	1988
Subscribers services billed:		
Private subscribers	18,816	12,524
Public entity subscribers	36,268	26,969
Ex-subscribers	5,872	4,088
Other pending classification	1,145	291
	62,101	43,872
Unbilled services	98,655	82,773
	160,756	126,645
Provision for bad debts	(6,834)	(4,677)
Total	153,922	121,968

During 1989, cancellation of bad debts amounted to Ptas. 3,963 million (in 1988, 2,911 million).

NOTE 7 - SHARE CAPITAL

All the outstanding shares of the Company have been fully subscribed and paid-in, and are bearer shares of Ptas. 500 par value each. Telefónica shares are listed on the four Spanish Stock Exchanges, as well as the Stock Exchanges of Frankfurt, London, Paris, Tokyo and New York.

At December 31, 1989, the State has an approximate 32.4% (32.5% in 1988) direct shareholding, together with a further interest estimated at 3.9% (3.2% in 1988) through official institutions. Under Spanish legislation, total foreign shareholdings cannot exceed 25% of the share capital.

The table below reflects the movements of share capital:

	Number of shares	Par value	Price as a percentage of par value	Paid-in
Balance December 31, 1988	921,240,693	460,620		
Issue of January, 1989	3,571,252	1,786	156.477%	2,794
Issue of July, 1989	151,506	76	188.581%	143
Balance December 31, 1989	924,963,451	462,482		
Issue of January, 1989	1,994,626	997	171.687%	1,712

All of the above issuances were in connection with convertible bonds.

NOTE 8 - RESERVES

Reserves are as follows:

	31-12-1988	Distribution of profits 1988	Share capital issued in 1989	Transfers	31-12-1989
Revaluation reserve	653,780	-	-	-	653,780
Share premium	31,677	-	1,075	-	32,752
Statutory reserve	16,005	-	-	(16,005)	-
Legal reserve	-	8,409	-	16,005	24,414
Voluntary reserve	41,600	7,028	-	-	48,628
Unappropriated profit	92	1	-	-	93
Total	743,154	15,438	1,075	-	759,667

The General Meeting of Shareholders held on June 30, 1989 approved the transfer of the statutory reserve balance (constituted in accordance with the State Contract, conditions 7 and 24) to the legal reserve account.

The revaluation reserve which has been established in accordance with the policy as indicated in Note 2.2.b, can be used to offset future losses or to issue additional share capital once checked and approved. The balance of the revaluation reserve can be transferred to freely distributable reserves within five years from the date of the last revalued balance sheet.

The company may make free use of the remainder reserves whenever operating or financial requirements make this necessary.

NOTE 9 - PROVISIONS

The composition of the provisions is as follows:

	1989	1988
Self-insurance for damages in plant	4,435	4,491
Contingencies	55,667	55,667
Eventual contributions to the employee benefit systems (Note 15.2)	18,829	18,829
Provision for constituting a pension fund (Note 15)	32,315	14,815
Total	111,246	93,802

NOTE 10 - DEBENTURES AND BONDS

10.1 Composition and movements:

	Balance 31-12-88	New issues	Repayments	Revaluations and other movements	Balance 31-12-89
Debentures and bonds:					
Non-convertible	260,450	38,000	(35,637)	950	263,763
Convertible and/or exchangeable	29,073	-	(3,785)	131	25,419
Debentures and bonds in foreign currency	29,532	-	-	313	29,845
Total	319,055	38,000	(39,422)	1,394	319,027

The main characteristics of the debentures and bonds issued by Telefónica in 1989 are:

Type of issue	Date	Amount	Interest rate	Final repayment
Non-Convertible Debentures	July 1989	10,000	12%	15 years
Non-Convertible bonds	October 1989	20,000	12,75%	7 years
Non-Convertible Debentures	December 1989	8,000	Variable-MIBOR	10 years

10.2 Schedule of redemption

	Maturities				Total 31-12-89
	1990	1991	1992	Subsequent	
Amount	39,800	36,339	52,545	190,343	319,027

10.3 Additional information:

	1989	1988
Interest expense	36,611	39,096
Accrued interest at December 31	13,605	13,930
Issues subject to fiscal benefits:		
Debentures	45,986	73,328
Debentures in foreign currency	28,454	29,117

The average cost of the debentures and bonds outstanding is 11.48% for 1989 (12.04% in 1988).

10.4 Foreign currency debentures amount to Deutsche Marks 100 million and to US dollars 200 million.

Outstanding debentures are valued at the official closing exchange rate of each currency at year end quoted by the Bank of Spain. The exchange differences credited in 1989 to the unrealized exchange losses account amounted to Ptas. 663 million. (In 1988 there was a charge of Ptas. 2,179 million).

10.5 Conversion options of convertible bonds, corresponding to the December 1986 issue, were exercised in January, 1990 in the amount of Ptas. 1,712 millions.

NOTE 11 - LOANS AND CREDIT FACILITIES

11.1 As discussed in Note 2.2 j), these accounts are classified in the balance sheet according to maturity dates at the time they are contracted. The balances at December 31 are as follows:

	1989			1988		
	Long term	Short term	Total	Long term	Short term	Total
Commercial paper (face value)	50,000	107,672	157,672	23,243	37,974	61,217
Less:						
Deferred interest on commercial paper	(27,391)	(9,132)	(36,523)	(1,770)	(1,010)	(2,780)
	22,609	98,540	121,149	21,473	36,964	58,437
Loans in foreign currencies	163,925	-	163,925	96,869	-	96,869
Loans and credit facilities	278,680	45,614	324,294	212,862	2,833	215,695
Other loans	7,202	-	7,202	6,704	-	6,704
Total	472,416	144,154	616,570	337,908	39,797	377,705

11.2 The maturities are as follows:

	Maturities				Balances 31-12-89
	1990	1991	1992	Subsequent	
Loans in foreign currencies	574	-	3,242	160,109	163,925
Loans and credit facilities	71,441	60,236	19,690	172,927	324,294
Other loans	-	-	-	7,202	7,202
Commercial paper	107,072	5,600	-	45,000	157,672
Total	179,087	65,836	22,932	385,238	653,093

11.3 Additional information:

	Financial charges		Interest accrual (Deferral)		Interest rates	
	1989	1988	1989	1988	1989	1988
Loans in foreign currency	10,350	4,760	2,109	746	3.94-12.50%	1.0625-12.50%
Loans and credit facilities	37,385	20,515	7,235	2,866	10.95-17.38%	10.5625-17%
Commercial paper	9,095	6,761			11.56-16%	10.19-17%
Long term			(27,391)	(1,770)		
Short term			(9,132)	(1,010)		

11.4 The loans and credit facilities accounts reflect only amounts actually borrowed. Unused facilities are included in the memorandum accounts (see Note 17).

11.5 At December 31, 1989, of the total foreign currency loans, Ptas. 49,412 million are covered by the fiscal benefits of Decree Law 19/1961 and Law 61/1978.

11.6 In accordance with the accounting criteria mentioned in Note 2.2 f), the amount of exchange differences arising from these loans in 1989 resulted in a charge to the account of unrealized exchange losses of Ptas. 4,395 million (in 1988, Ptas. 868 million).

11.7 The composition of foreign currency debt is shown below:

Millions	1989	1988
US Dollars	375.0	231.0
Deutsche Marks	255.5	50.0
Swiss Francs	153.3	261.0
Dutch Florins	71.7	20.0
Yens	17,000.0	10,000.0
French Francs	650.0	650.0
ECU'S	504.6	190.0

11.8 Loans denominated in foreign currencies include:

– A multiple financing operation amounting to US dollars 250 million represented as at December 31, 1989 by Telefónica's notes in euro commercial paper amounting to US dollars 125 million with maturities of less than six months and US dollars 125 million in a line of credit supporting the euro commercial paper notes with the same maturity terms. When they become due, the Company may opt to:

- issue new euro commercial paper
- use the credit facility to refinance the amounts due; or
- repay the notes without using such credit facility.

– A loan agreement with the subsidiary Telefónica North America, Inc., with a limit of US dollars 125 million. As at December 31, US dollars 125 million were drawn down. This loan derives from a commercial paper program, supported by a subsidiary credit line issued to the US subsidiary and guaranteed by Telefónica.

– A loan granted by the European Investment Bank made through the Spanish Official Credit Institute (I.C.O.) amounting to ECU's 1,200 million, repayable in 15 years, with a grace period in the first 5 years. Repayment being in 20 half-yearly installments. Interest is fixed during the first 5 years and revisable at the end of the 5th and 10th years. The loan also has a multicurrency option.

As at December 31, 1989, the first tranche, amounting to the equivalent ECU's 800 million (ECU's 505 million, French Francs 650 million, Swiss Francs 153 million, Dutch Florins 62 million and Deutsche Marks 206 million) has been drawn down. In February, 1990 ECU's 400 million of the second tranche of the loan were drawn down.

11.9 Commercial paper is accounted for at face value, less interest deferred at December 31. Interest costs are accounted for over the period during which the commercial paper is outstanding, with the charge to results being calculated using the capital outstanding method. The charges attributable to expenses in future periods are as follows:

	1990	1991	1992	Subsequent	Total
Interest on commercial paper - long term	3,043	3,145	3,158	18,045	27,391
Interest on commercial paper - short term	9,097	35	-	-	9,132

NOTE 12 - TAXES PAYABLE

The balances at December, 31 comprise the following:

	1989	1988
Payroll withholding tax	4,614	3,756
Value Added Tax refund	(2,002)	(226)
Tax withholdings on dividends and interest and other	1,413	2,757
Total	4,025	6,287

NOTE 13 - OTHER CREDITORS

These comprise the following groups of accounts:

	1989	1988
Staff bonus provision	13,091	10,991
Telephone service interchange	7,273	7,252
Guarantees and deposits	7,023	3,135
Accrued charges	10,057	10,238
Local taxes	1,894	1,129
Other creditors	10,526	3,326
Total	<u>49,864</u>	<u>36,071</u>

NOTE 14 - ACCRUED EXPENSES AND DEFERRED INCOME

These are disclosed as follows:

	1989	1988
Accrued interest	28,960	17,541
Services billed in advance	15,698	12,850
Deferred income - Value Added Tax (transitory rules)	-	1,926
Other	10,909	7,117
Total	<u>55,567</u>	<u>39,434</u>

NOTE 15 - PENSIONS

15.1 Telefonica's employees benefit from pensions that substitute and complement those provided in Spain by the Social Security, and from a Group Endowment Insurance scheme (the latter is explained in Note 16).

All benefits, other than the Group Endowment Insurance, are provided by the "Institución Telefónica de Previsión" (ITP), a mutual pension fund created under the "Ley de Montepíos y Mutualidades de Previsión Social" (Social Service Mutual Fund Law) of December 6, 1941 and the regulations pertaining thereto of May 26, 1943. In accordance with such legal framework, ITP is an entity with a completely independent legal status, and as such is governed by its own regulations as approved by the Sub-secretary of Social Security on January 28, 1977.

Benefits provided by ITP to its members are of various types, as detailed in Article 4 of the ITP's Revised Text of Regulations, and mainly include retirement pensions, permanent disability, widowhood and pension bonus payments. Pension benefits are calculated in relation to length of service, applying a percentage scale to the pension-base salary, up to a limit of 90% of such base salary.

The members covered by this plan comprise approximately 11,795 retired persons (pensioners) and 69,920 members currently on the payroll, whose current contributions represent 4.3% of their total gross salary (pension-base salary).

To meet the above-mentioned combination of benefits ITP relies principally on the profits earned on its assets, and on the contributions of Telefonica and its members. During 1989 the contributions of Telefonica amounted to Ptas. 15,463 million (in 1988, Ptas. 13,019 million) and those of its employees Ptas. 7,388 million (in 1988 Ptas. 6,220 million).

The financial policy of ITP is governed by the regulations in force and requires the establishment of the necessary reserve funds in order to meet the benefits of its retired members. Studies carried out show a shortfall in reserves and the insufficiency of income to cover medium and long-term commitments.

15.2 Telefonica has a provision of Ptas. 18,829 million charged in 1982 against the revaluation surplus and which, as indicated in Note 9, was originally set up unilaterally on the part of Telefonica for, if it should decide in the future, covering eventual shortages in the complementary pension benefits that have to be met by ITP.

15.3 Telefonica has shown its willingness to collaborate in the configuration of a future scheme that would make its workers' social service system viable. Consequently, negotiations have been held since 1985 without a final agreement being reached. The contribution offered by Telefonica during this negotiation process have been properly accrued at December 31, 1989 and 1988.

Should a final agreement be reached, Telefonica will not accept, as a consequence thereof, and or as a consequence of the contributions that it may have to make as compensation for integrating its workers in the Social Security, any obligation that would involve any modification to its shareholders' equity at December 31, 1989 or involve a significant impact on its prospective future profitability.

15.4 The new pension funds regulation includes the possibility, by applying the transitory provisions of the Law 39/1988 of December 29, of transforming the former pension scheme into a Pension Fund. Certain conditions and time periods have to be fulfilled to obtain the fiscal benefits of this Law.

In accordance with the transitory provision 19 of the same Law, Telefonica has recorded a provision of Ptas. 17,500 million (in 1988, 14,815 million) for the possible creation of a Pension Fund.

Should the alternative finally agreed upon in the negotiation process not be that of a pension fund, the company's income tax payable would be increased by the corresponding amount. The term for the possible creation of a Pension Fund expires in November, 1990.

NOTE 16 - ENDOWMENT INSURANCE

Telefónica's employees have the right, on reaching 65 years of age, whether still at work or retired, to receive a single payment for endowment insurance, the amount of which depends on the situation of each employee.

To cover payment of these benefits, funds have been established and placed both with an insurance company and in Telefónica that, at December 31, 1989, amounted to Ptas. 1,690 million and Ptas. 35,939 million, respectively. In 1989 the Company made provision for a total of Ptas. 9,060 million to these funds (in 1988, Ptas. 8,480 million).

Based on the actuarial calculations that have been carried out on the basis of charging these benefits throughout the average working life of the employees, the effect is as follows:

- a) The annual charge for the year 1989, approximately 4.4% of the overall payroll cost, is sufficient to cover this objective.
- b) At December 31, 1989 the present value of the future commitments, calculated at an interest rate of 8% applied on current salaries, amounts to approximately Ptas. 97,000 million (in 1988, Ptas. 89,000 million).

In order to obtain the tax deductibility of the expense in this fiscal year, the provision in 1989 of Ptas. 9,060 million is considered provisionally to be included within the alternatives permitted in Transitory Provision 19 of Law 39/1988 and Ministry Order dated May 22, 1989 (in 1988, 8,480 million). In the event that this provision, for whatever reason, is not finally incorporated into a system of Pension Funds in accordance with the Law (see Note 15.4 above), Company income tax payable would be increased at such time by the corresponding amount.

NOTE 17 - MEMORANDUM ACCOUNTS

The detail of balances at December 31, is as follows:

	1989	1988
Unused credit facilities: (Note 11.4)		
Available credit - long-term	18,178	72,090
Floating rate credit facilities	11,500	30,000
Available credit - short-term	301	-
	<u>29,979</u>	<u>102,090</u>
Guarantees of financial operations	2,917	2,917
Guarantees granted to employees	3,656	4,080
Pending tax benefits	50,702	31,712
Others	33,694	20,757
	<u>90,969</u>	<u>59,466</u>
TOTAL	<u>120,948</u>	<u>161,556</u>

Guarantees of financial operations refers primarily to guarantees given by the Company to banks in connection with financial operations of group companies.

NOTE 18 - TAXATION

Years opened to tax inspection are as follows:

- Company's income tax: 1988 and 1989.
- Local taxes: 1988 and 1989.
- Value added tax: from 1986 to 1989.
- Capital transfer tax: 1988 and 1989.
- Interest withholding tax: from 1984 to 1989.
- Withholding on account personal income tax: from 1984 to 1989.

In 1989 the provision for Company's Income Tax amounts to Ptas. 24,175 million. This amount is obtained after applying right to file fiscal adjustments and reducing tax liability due to deductions and allowances.

Telefónica, as parent company of the group, has applied and obtained from the Spanish Tax Authorities, the right to file consolidated income tax returns during the next three years. This concession is subject to compliance with certain requirements of the Law (Decree Law 15/1977 of February 25 and Law 18/82 of May 26).

NOTE 19 - SUBSEQUENT EVENTS

Conversations are being held by Telefónica International, a subsidiary of Telefónica, for the acquisition of a 50% interest in "Compañía de Teléfonos de Chile" (C.T.C.).

RECONCILIATION OF NET INCOME AND SHAREHOLDERS' EQUITY AS REPORTED IN THE SPANISH STATUTORY ACCOUNTS WITH NET INCOME AND SHAREHOLDERS' EQUITY IN ACCORDANCE WITH INTERNATIONAL ACCOUNTING STANDARDS (IAS) AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (US GAAP)

Certain accounting practices applied by Telefónica in its financial statements prepared for use in Spain, together with others required or allowed under the Conditions of Concession of Telefónica as a regulated entity (Note 2.2a)*, may not conform with International Accounting Standards (IAS) nor with generally accepted accounting principles in the United States (US GAAP).

As a result of Telefónica's shares being traded in various foreign stock exchanges, including, since the middle of 1987, the New York Stock Exchange, the Company is requested to adjust its net income and shareholders' equity based on different accounting principles.

The most significant differences between these accounting practices are summarized below:

Present practice for local Spanish purposes

1. Intangible assets (see note 2.2 c)*
2. Short and long term debt (see note 2.2 j)*
3. Foreign currency accounts (see notes 2.2 f and 5)*
4. Income tax (see note 1.3)*
5. Property, plant and equipment (see notes 2.2 b and 3)*
6. Investments (see notes 2.2 d and 4)*
7. Costs of new equity capital (see notes 2.2 e)*
8. Income per share is not required to be in the financial statements nor in any other obligatory financial information
9. Endowment insurance (see note 2.2 i)*
10. Allowance for funds during construction

Treatment for IAS purposes

Research and development costs are expenses as incurred. The effect is shown below.

Short and long term debt is classified on the basis of twelve months from the balance sheet date. Notes 10 and 11 show the classification on this basis.

IAS n.º 21 establishes a different treatment. However, in view of Telefónica's special position as a regulated entity, the treatment in the accounts is considered appropriate.

Deferred taxes arising from timing differences between income and taxable income must be accounted for.

Treatment for US GAAP purposes

Revaluation of fixed assets is not permitted. Property, plant and equipment and related accumulated depreciation are stated at historical cost values.

Investments in subsidiaries should generally be accounted for as follows:

- More than 50% holding:
Consolidated or equity method of accounting.
- Between 20% and 50% holding:
Equity method of accounting.
- Less than 20% holding:
At the lower of cost value or net realizable value.

US GAAP requires expenses of raising capital to be deducted from the proceeds of the new capital.

Per share computations are required to be shown.

From January 1, 1989 the FASB n.º 87 has been applied to record the costs for past services.

Interest accrued up to the time when the assets are placed in service are accounted for.

The total effect on the statement of income and on the statement of changes in shareholders' equity is as follows (in millions of pesetas)

	1988	1989
Net income for the year as reported in the Spanish statutory accounts at December 31	62,845	68,898
Adjustments for IAS purposes:		
Research and development expenses - Net effect between prior write-offs and current amortization	(5,479)	(3,772)
Self-insurance and other	1,979	295
Deferred taxes due to adjustments	2,024	1,214
Approximate net income for the year in accordance with IAS	61,369	66,635
Adjustments for US GAAP purposes:		
Reversal of depreciation of revalued portion of fixed assets	61,432	58,907
Reversal of amortization of costs of new equity capital	950	1,203
Adjustment of investments to net equity value	329	751
Adjustment of endowment insurance cost	(1,476)	(330)
Allowance for funds during construction	14,969	26,306
Less amount due to effect of fixed assets revaluations, of the retired plant not depreciated	3,574	5,853
Deferred taxes due to adjustments	(4,792)	(9,092)
Approximate net income for the year in accordance with US GAAP	136,355	150,233
Approximate net income per share in accordance with US GAAP	155.86	163.27
Shareholders' equity as reported in the Spanish statutory accounts at December 31	1,203,774	1,222,149
Net income for the year	62,845	68,898
	1,266,619	1,291,047
Adjustments for IAS purposes:		
Investments	(1,085)	(734)
Research and development written-off	(5,483)	(9,255)
Release of provisions	30,745	30,689
Deferred taxes due to adjustments	2,024	3,238
Approximate shareholders' equity in accordance with IAS	1,292,820	1,314,985
Adjustments for US GAAP purposes:		
Reversal of net effect of revaluation of fixed assets related accumulated depreciation	(416,588)	(357,681)
Costs of new equity capital	(4,352)	(3,251)
Adjustments of investments to equity value	(11,103)	7,443
Accrual of past service costs of endowment insurance	(1,276)	(1,606)
Allowance for funds during construction	14,969	41,275
Less amount due to effect of fixed assets revaluations, of the retired plant not depreciated	3,574	9,427
Deferred taxes due to adjustments	(4,792)	(13,884)
Approximate shareholders' equity in accordance with US GAAP	873,252	996,708

Shareholder's rights and all dividend distributions are based on the financial statements as drawn up for local Spanish statutory purposes.

* Notes in brackets refer to the financial statements on pages 46 to 57 of this Annual Report.