

***FUNCTIONING AND REPORT OF ACTIVITIES OF THE
AUDIT AND
CONTROL COMMITTEE OF THE BOARD OF
DIRECTORS OF TELEFÓNICA, S.A.***

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AUDIT AND CONTROL COMMITTEE OF THE BOARD OF DIRECTORS OF TELEFÓNICA, S.A.

I. INTRODUCTION

The purpose of the present document is to describe the functioning of the Audit and Control Committee of Telefónica, S.A. (henceforth, the Company), highlighting, likewise, aspects related to its duties, powers and membership.

The Audit and Control Committee of the Board of Directors was created by resolution adopted by the said Board at its meeting on 29 January 1997, although there has been broad development of its duties, powers and activities subsequently, in accordance with changing legal requirements and recommendations on corporate governance, both national and international (referring especially to the Unified Good Governance Code, the Sarbanes-Oxley Law, and the rules of the New York Stock Exchange -NYSE-),

II. DUTIES AND POWERS OF THE COMMITTEE

The duties and powers of the Audit and Control Committee are laid out in article 39 of the Company Bylaws, and in greater detail in article 22 of the Regulations of the Board of Directors. Specifically, the primary function of the Audit and Control Committee is to aid the Board of Directors in its duties of supervision, and it shall enjoy at least the following competences:

- 1) To report, through its Chairman, to the shareholders at the General Shareholders' Meeting regarding matters raised therein in connection with the matters for which it is responsible.
- 2) To propose to the Board of Directors, for subsequent submission to the shareholders at the General Shareholders' Meeting, the appointment of the Auditor referred to in Section 264 of the Companies Act, as well as, if appropriate, the terms and conditions for hiring such Auditor, the scope of its professional duties and the revocation of its appointment or its re-appointment.
- 3) To supervise internal audit and, in particular:
 - a) To ensure the independence and efficiency of the internal audit function;
 - b) To propose the selection, appointment and removal of the person responsible for internal audit;
 - c) To propose the budget for such service;
 - d) To review the internal audit annual work plan and its annual activities report;
 - e) To receive periodic information on its activities; and

f) To verify that the senior executive officers take into account the conclusions and recommendations of its reports.

4) To supervise the process of preparing and submitting regulated financial information. With respect thereto, it shall be responsible for supervising the process of preparation and the integrity of the financial information relating to the Company and the Group, reviewing compliance with regulatory requirements, the proper determination of the scope of consolidation, and the correct application of accounting standards, informing the Board of Directors thereof.

5) To supervise the effectiveness of the Company's internal control system and risk management systems, and to discuss with the Auditor significant weaknesses in the internal control system detected during the audit. With respect thereto, it shall be responsible for proposing to the Board of Directors a risk control and management policy, which shall identify at least the following:

a) the types of risk (operational, technological, financial, legal and reputational) facing the company;

b) the setting of the risk level that the Company deems acceptable; the measures to mitigate the impact of the identified risks, should they materialize; and

c) the control and information systems to be used to control and manage the above-mentioned risks.

6) To establish and supervise a mechanism to allow employees to confidentially and anonymously report potentially significant irregularities, particularly any financial or accounting irregularities detected within the Company.

7) To establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the independence thereof, as well as any other matters relating to the audit procedure, and such other communications as may be provided for in auditing legislation and in technical auditing regulations. In any event, the Audit and Control Committee must receive, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as information regarding additional services of any kind provided to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of applicable law.

8) To issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion regarding the independence of the Auditor. This report must in all cases include an opinion on the provision of the additional services referred to in point 7) above.

It should be stated that, among the proposals submitted for approval by the Ordinary General Shareholders' Meeting of the Company, called for 11 and 12 June 2015, on first and second calls, respectively, there is included a modification of article 39 of the Company Bylaws relating to the Audit and Control Committee, so as to adapt it to art. 529 point quaterdecies of the Companies Act (Ley de Sociedades de Capital or LSC), on two essential questions: the composition of the Audit and Control Committee, and its duties.

As regards the composition of this Committee, it is necessary to reflect in the By-Laws the legal requirement that at least two of its members be independent Directors and that at least one Director be appointed taking into account his knowledge and experience in accounting matters.

As regards the purview of the Audit Committee, the changes in sections (i) through (vi) of paragraph 3 are merely stylistic in nature and are intended to conform the text to the legal provisions in force, but the content thereof remains substantially the same. It should be noted that an innovation is that section (vii) now also includes, as a power of the Audit and Control Committee, the power to report to the Board in advance on all matters contemplated by law.

To facilitate comparison between the current wording of Article 39 of the Bylaws and the resultant of the proposed modifications, it is included at the end of this document, as an Annex, and two columns, a literal transcription of both texts.

III. COMPOSITION OF THE COMMITTEE

With respect to its composition, and in accordance with article 39 of the Company Bylaws and article 22 of the Regulations of the Board of Directors, the Audit and Control Committee must be made up of a minimum of three Directors, designated by the Board of Directors. All members of the said Committee must be external or non-executive Directors. The Chairman of the Committee must always be independent, may serve no more than four years continuously, and may be reelected one year after the end of their chairmanship. The Board of Directors shall take into account the knowledge and experience of accounting, auditing and risk management possessed by those designated as members of the Committee.

The current composition of the Audit and Control Committee is as follows:

- Mr. Carlos Colomer Casellas (Chairman)
- Mr. Gonzalo Hinojosa Fernández de Angulo
- Mr. Alfonso Ferrari Herrero
- Mr. Antonio Massanell Lavilla
- Mr. Ignacio Moreno Martínez

The professional profiles of the members of the Audit and Control Committee are publicly available at the Corporate website of Telefónica, S.A.

http://www.telefonica.com/es/shareholders-investors/html/corporate_governance/compconsejo.shtml

The Secretary to this Committee is the General and Board Secretary of Telefónica, S.A., Mr. Ramiro Sánchez de Lerín García-Ovies, supported by the Vice General Counsel and Chief Legal Officer of the Group, Ms. María Luz Medrano Aranguren, and the Corporate Governance and Securities Market Director, Ms. Consuelo Barbé

Capdevila. Therefore, the General and Board Secretary advises on all juridical aspects relating to this Committee.

Similarly, and pursuant to Rule 10A 3, and in Section 303 of the Securities Exchange Commission (SEC) and the New York Stock Exchange (NYSE), respectively, in 2014 the composition of the Audit and Control Committee was notified to the NYSE, together with information about its members (with express indication of their knowledge and experience in matters of accounting and audit), it being concluded that all its members fulfill the requirements for independence set out in the cited Rule 10A 3.

IV. FUNCTIONING OF THE COMMITTEE

With regard to its operation, the Audit and Control Committee has an Annual Activity Plan and a Session Calendar, which details all the activities that the Committee should undertake throughout the financial year, in terms of the four axes about which its activity turns: i) External Auditor; ii) Internal Audit and Internal Control Systems; iii) Financial Information; and iv) The obligations for information and communication by the Committee to the Board of Directors, and to the relevant supervisory and official bodies.

The existence of the Annual Activity Plan and a Session Calendar allow the Audit and Control Committee to schedule its work for the whole financial year. Thus, it generally meets once per month, according to the Calendar, before the meeting of the Board of Directors of the Company and the presentation of the half-yearly and quarterly results, and as often as may be deemed necessary, when called by the Chairman.

These meetings last around two hours on average, dedicating its members an appropriate numbers of hours to the study and analysis of the issues to be discussed.

Regarding the attendance, each member of the Committee is subject to attendance control, a record being taken at the start of each session, and recorded in the corresponding Minutes.

With regard to preparing the Agenda for the sessions, it should be said that, under the coordination of the General Secretary and Secretary to the Board of Directors, a preparatory meeting is held among all the areas of the Company whose duties relate to the remit of the Committee, so as to propose and analyze the questions and issues which should be addressed at each session, taking the Annual Activity Plan as a guide. Subsequently, and after examination by the Chairman of the Committee, the session is called with the predetermined Agenda, together with attached documentation.

All meetings of the Audit and Control Committee discuss the different issues submitted for deliberation, or for decision where appropriate, in the due depth. The members intervene actively in the different debates and discussions, giving their opinion whenever they should see fit.

The deliberations of the Committee and the agreements and decisions adopted are documented in the corresponding Minutes for each session, written by the Secretary of the Committee at the end of the session and later distributed to all members for their assent and observations. Finally, the Minutes are submitted for approval as the first point on the Agenda for the following meeting of the Committee, and they are then signed by the Secretary and with the approval of the Chairman.

Moreover, regarding the rules governing the composition and adoption of resolutions by the Audit and Control Committee, the meetings are quorate when at least half of the members are present, directly or by proxy; and resolutions are adopted by simple majority of those present. In the event of a tie, the Chairman holds a casting vote.

Similarly, it should be said that, through the internal audit portal e-Audit (available on the Telefónica intranet), Directors belonging to the Committee can access all the documentation discussed at each of the sessions from the Internal Audit Service, which lets them track the information appropriately.

Finally, and as has been stated, the relations between the Audit and Control Committee and the Board of Directors of the Company are based on a principle of full transparency. On this point, the Committee informs the Board of Directors, at each of its monthly meetings, about the main matters discussed and the activities and work carried out by the Committee, and where the case requires it, proposes the adoption of the relevant resolutions by the Board of Directors.

V. ATTENDANCE AT MEETINGS

Apart from the members of the Audit and Control Committee, the sessions are generally attended by different members of the management team of Telefónica Group, engaged in duties of support and assistance to Committee members in the matters to be analyzed at the meeting. Specifically, Committee sessions are attended by representatives of the General and Board Secretary, Finance and Corporate Development, Internal Audit, Intervention & Inspection, Planning and Control, and Global Resources.

In addition to those just mentioned, and as required by the Committee itself, other managers of the Company and its Affiliates may participate, in order to discuss specific matters which affect their respective businesses or duties.

It is also usual for Committee meetings to be participated in by the representing partners of the External Auditor of the Company, Ernst & Young, S.L. The latter intervene to explain the work carried out, as well as to clarify, as required by the Committee, any questions which may arise during the sessions relating to the functions assigned to that firm.

VI. MATTERS DISCUSSED BY THE AUDIT AND CONTROL COMMITTEE IN 2014.

Among the matters which the Audit and Control Committee analyzes in its sessions, some correspond to legal requirements and others prompt the interest of the Committee because of their relation to its remit.

The principal questions analyzed by the Committee in 2014 were as follows:

On Financial Information.

1. Review of the Annual Accounts and Periodic Financial Information of the Company.

During the financial year 2014, the Committee, in accordance with the duties attributed to it, examined and analyzed the process of preparing the financial information of the Company.

2. Company Filings.

Likewise, in 2014, in different sessions, the Committee analyzed the filings made by the Company with the different Supervisory Bodies (20F, Registry Document, etc.).

On the External Auditor.

The Committee analyzed the issues related to the External Auditor (among these, the designation proposal and other related matters).

Similarly, in the Annual Work Plan for the Audit and Control Committee for 2014, there were reports on:

- i) The activity of the External Auditor in relation to the audit work (both the review of the annual and quarterly Financial Statements, and Internal Control), and other matters for review which arose (such as “*Comfort and Consent Letters*” for specific financing operations).
- ii) The reports, documents and communications to be facilitated, in their capacity as External Auditor, to the Audit and Control Committee itself in relation to the work carried out, which are required both by Spanish mercantile regulations, and the SEC or the “*Public Company Accounting Oversight Board*” (PCAOB).

On the matter of the emoluments of the External Auditors, the Committee was presented with the proposed estimate of fees for the audit firm Ernst & Young, S.L., corresponding to the financial year 2014, for their work on auditing the accounts and

related matters. Likewise, proposed emoluments for other firms of auditors who carry out work for Telefónica Group were presented.

The remuneration paid to the different companies making up the global organization EY, to which Ernst & Young, S.L., auditors to Telefónica Group during 2014, belongs, reached 21.30 million euros.

This sum has the following itemization:

Million euros	2014	2013
Audit services (1)	20.02	21.25
Audit-related services (2)	1.28	1.47
Total	21.30	22.72

(1) Audit services: services included under this heading are mainly the audit of the annual and reviews of interim financial statements, work to comply with the requirements of the Sarbanes-Oxley Act (Section 404) and the review of the 20-F report to be filed with the US Securities and Exchange Commission (SEC).

(2) Audit-related services: This heading mainly includes services related to the review of the information required by regulatory authorities, agreed financial reporting procedures not requested by legal or regulatory bodies and the review of corporate responsibility reports.

EY has not rendered tax services or any other service other than those mentioned above to Telefónica Group companies.

The expenses accrued in respect of the fees for services rendered to other auditors in 2014 amounted to 47.07 million euros, as follows:

Million euros	2014	2013
Audit services	1.17	1.11
Audit-related services	1.18	0.36
Fiscal services	7.29	7.59
Other kinds of services (consultancy, professional advice, etc.)	37.43	34.80
Total	47.07	43.86

On Internal Control.

1. Internal Control Systems of the Company.

During the sessions held, the Audit and Control Committee was informed in detail about the activities of the Internal Audit, Intervention and Inspection area of the Group, in relation to the Internal Control Systems of the Company.

The Committee was presented with the work carried out on the evaluation of internal control over financial reporting at Telefónica, S.A., as required by Section 404 of the Sarbanes-Oxley Law, and whose principal objective is the issue of certification accrediting the Internal Control of the Group, this certification being attached to the Document 20 F, together with the pertinent attestation of the External Auditor.

2. Work related to Corporate Internal Audit, Intervention and Inspection.

Similarly, the Committee analyzed the following work:

- The Internal Audit Management Plan.
- The Internal Audit reports and work on review of transversal processes.
- The Risk Management Systems.
- The work on inspection and possible fraud.

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ANNEX

CURRENT TEXT	PROPOSED AMENDMENT
<p>Article 39.- Audit and Control Committee</p> <p>1. An Audit and Control Committee shall be created within the Board of Directors, which shall be composed of such number of Directors as may be determined by the Board of Directors from time to time, although in no case may there be fewer than three Directors, to be appointed by the Board of Directors. All of the members of such Committee shall be external or non-executive Directors. At least one of them shall be an independent Director, who shall be appointed taking into account his knowledge and experience in accounting, auditing or both.</p> <p>2. The Chairman of the Audit and Control Committee, which position shall be held by an independent Director in all cases, shall be appointed by the Committee itself from among its members and shall hold office for four years, and may be re-elected after the passage of one year from ceasing to act as such.</p> <p>3. The Audit and Control Committee shall have the following powers, at a minimum:</p> <p>(i) To report, through its Chairman, to the shareholders at the General Shareholders' Meeting regarding matters raised therein in connection with the matters for which it is responsible.</p> <p>(ii) To propose to the Board of Directors, for subsequent submission to the shareholders at the General Shareholders' Meeting, the appointment of the Auditor referred to in Section 264 of the Companies Act, as well as, if</p>	<p>Article 39.- Audit and Control Committee</p> <p>1. An Audit and Control Committee shall be created within the Board of Directors, which shall be composed of such number of Directors as may be determined by the Board of Directors from time to time, although in no case may there be fewer than three Directors, to be appointed by the Board of Directors. All of the members of such Committee shall be external or non-executive Directors. At least one<u>two</u> of them shall be an independent Director, who must be independent Directors, <u>and one of them</u> shall be appointed taking into account his knowledge and experience in accounting, auditing or both.</p> <p>2. The Chairman of the Audit and Control Committee, which position shall be held by an independent Director in all cases, shall be appointed by the Committee itself from among its members and shall hold office for four years, and may be re-elected after the passage of one year from ceasing to act as such.</p> <p>3. The Audit and Control Committee shall have the following powers<u>duties</u>, at a minimum:</p> <p><u>(i)</u> To report, through its Chairman, to the shareholders at the General Shareholders' Meeting regarding matters raised therein in connection with the matters for which it is responsible.</p> <p><u>(ii)</u> To propose <u>To submit</u> to the Board of Directors, for subsequent submission to the shareholders at the General Shareholders' Meeting, the appointment</p>

CURRENT TEXT	PROPOSED AMENDMENT
<p>appropriate, the terms and conditions for hiring such Auditor, the scope of its professional duties and the revocation of its appointment or its re-appointment.</p> <p>(iii) To supervise the effectiveness of the Company's internal control system, the internal audit and the risk management systems as well as to discuss with the Auditor the significant weaknesses in the internal control system detected during the audit.</p> <p>(iv) To supervise the process of preparation and submission of regulated financial information.</p> <p>(v) To establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the independence thereof, as well as any other matters relating to the audit procedure, and such other communications as may be provided for in auditing legislation and in technical auditing regulations. In any event, the Audit and Control Committee must receive annually written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as information regarding additional services of any kind provided to such entities by the Auditor, or by the persons or entities related thereto, pursuant to the legislation in force.</p> <p>(vi) To issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion regarding the independence of the Auditor. This report must in all cases include an opinion on the provision of the additional services referred to in point (v) above.</p> <p>(vii) Any other powers granted to it under the Regulations of the Board of Directors.</p>	<p>of the Auditor referred to in Section 264 of the Companies Act, as well as, if appropriate the proposals for selection, appointment, re-election and replacement of the external auditor, as well as the terms and conditions <u>of the contract therewith, the scope of its professional duties and the revocation of its appointment or its re-appointment and regularly obtain from such external auditor information regarding the audit plan and the implementation thereof, in addition to preserving its independence in the performance of its duties.</u></p> <p><u>(iii)</u> To supervise the effectiveness of the Company's internal control system, the internal audit and the systems for management of risks, <u>including tax risks,</u> as well as to discuss with the Auditor the significant weaknesses in the internal control system detected during the audit.</p> <p><u>(iv)</u> To supervise the process of preparation and submission of regulated financial information.</p> <p><u>(v)</u> To establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the independence thereof, as well as any other matters relating to the audit procedure, and such other communications as may be provided for in auditing legislation and in technical auditing regulations. In any event, the Audit and Control Committee must receive annually written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as information regarding additional services of any kind provided to such entities by the Auditor, or by the persons or entities related thereto, pursuant to the legislation in force.</p> <p><u>(vi)</u> To issue on an annual basis,</p>

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	<p>prior to the issuance of the audit report, a report stating an opinion regarding the independence of the Auditor. This report must in all cases include an opinion on the provision of the additional services referred to in point (v) above.</p> <p><u>(vii) To report to the Board of Directors in advance on all matters contemplated by law, the By-Laws and the Regulations of the Board of Directors.</u></p> <p><u>(viii)</u> (vii)—Any other powers granted to it under the Regulations of the Board of Directors.</p>