

TELEFONICA S A
Form 6-K
February 23, 2017
[Table of Contents](#)

FORM 6-K
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16

of the Securities Exchange Act of 1934

For the month of February, 2017

Commission File Number: 001-09531

Telefónica, S.A.

(Translation of registrant's name into English)

Distrito Telefónica, Ronda de la Comunicación s/n,

28050 Madrid, Spain

3491-482 87 00

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

Form 20-F

Form 40-F

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

Yes

No

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

Yes

No

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

Yes

No

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

Table of Contents

Telefónica, S.A.

TABLE OF CONTENTS

Item	Sequential Page Number
1. Telefónica - 2016 Annual Accounts	
<u>Account Auditor's Report, Annual Financial Statements and Management Report of Telefónica, S.A., all for the Fiscal Year 2016.</u>	4
<u>Account Auditor's Report, Annual Financial Statements and Management Report of the Consolidated Group of Companies, all for the Fiscal Year 2016.</u>	267

Table of Contents

Telefónica, S.A. hereby submits the Individual Annual Accounts of Telefónica, S.A. and the Consolidated Annual Accounts of Telefónica S.A. and its Group of Subsidiaries for 2016 financial year, that have been filed with the Spanish National Securities Market Commission (Comisión Nacional del Mercado de Valores - CNMV).

The aforesaid Annual Accounts will be submitted for approval of the next Annual General Shareholders Meeting of the Company, the dates of which will be announced due course.

Madrid, February 23rd, 2017

Table of Contents

**AUDIT REPORT, ANNUAL FINANCIAL STATEMENTS, AND
MANAGEMENT REPORT OF TELEFÓNICA, S.A., ALL FOR THE
YEAR ENDED DECEMBER 31, 2016**

Table of Contents

Independent Audit Report

TELEFÓNICA, S.A.

Financial Statements and Management Report

for the year ended

December 31, 2016

Table of Contents

*Translation of a report and financial statements originally issued in Spanish. In the event of
discrepancy, the Spanish-language version prevails (See Note 24)*

INDEPENDENT AUDIT REPORT ON THE FINANCIAL STATEMENTS

To the Shareholders of

Telefónica, S.A.

Report on the financial statements

We have audited the accompanying financial statements of Telefónica, S.A., which comprise the balance sheet at December 31, 2016, and the income statement, the statement of changes in equity, the cash flow statement, and the notes thereto for the year then ended.

Directors' responsibility for the financial statements

The Directors are responsible for the preparation of the accompanying financial statements so that they give a true and fair view of the equity and financial position and the results of Telefónica, S.A., in accordance with the regulatory framework for financial information applicable to the Entity in Spain, identified in Note 2.a to the accompanying financial statements, and for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on the accompanying financial statements based on our audit. We conducted our audit in accordance with prevailing audit regulations in Spain. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation of financial statements by the Directors of the Company in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Table of Contents

Opinion

In our opinion, the accompanying financial statements give a true and fair view, in all material respects, of the equity and financial position of Telefónica, S.A. at December 31, 2016, and its results and cash flow for the year then ended, in accordance with the applicable regulatory framework for financial information in Spain, and specifically the accounting principles and criteria contained therein.

Report on other legal and regulatory requirements

The accompanying 2016 management report contains such explanations as the Directors consider appropriate concerning the situation of the Company, the evolution of its business and other matters; however, it is not an integral part of the financial statements. We have checked that the accounting information included in the aforementioned management report agrees with the 2016 financial statements. Our work as auditors is limited to verifying the management report in accordance with the scope mentioned in this paragraph, and does not include the review of information other than that obtained from the Company's accounting records.

ERNST & YOUNG, S.L.

/s/ Alicia Martínez Durán
Alicia Martínez Durán

February 23, 2017

Table of Contents

2016

TELEFÓNICA, S.A.

Annual financial statements and management report for the year ended December 31, 2016

Table of Contents

Index

<u>Balance sheet at December 31</u>	4
<u>Income statements for the years ended December 31</u>	6
<u>Statements of changes in equity for the years ended December 31</u>	7
<u>Cash flow statements for the years ended December 31</u>	8
<u>Note 1. Introduction and general information</u>	9
<u>Note 2. Basis of presentation</u>	10
<u>Note 3 Proposed appropriation of profit</u>	12
<u>Note 4. Recognition and measurement accounting policies</u>	13
<u>Note 5. Intangible assets</u>	16
<u>Note 6. Property, plant and equipment</u>	17
<u>Note 7. Investment properties</u>	19
<u>Note 8. Investments in group companies and associates</u>	21
<u>Note 9. Financial investments</u>	31
<u>Note 10. Trade and other receivables</u>	35
<u>Note 11. Equity</u>	36
<u>Note 12. Financial liabilities</u>	42
<u>Note 13. Bonds and other marketable debt securities</u>	44
<u>Note 14. Interest-bearing debt and derivatives</u>	46
<u>Note 15. Payable to group companies and associates</u>	50
<u>Note 16. Derivate financial instruments and risk management policies</u>	53
<u>Note 17. Income tax</u>	65
<u>Note 18. Trade, other payables and provisions</u>	70
<u>Note 19. Revenue and expenses</u>	73
<u>Note 20. Other information</u>	81
<u>Note 21. Cash flow analysis</u>	89

Table of Contents

<u>Note 22. Discontinued operations</u>	93
<u>Note 23. Events after the reporting period</u>	94
<u>Note 24. Additional note for English translation</u>	95
<u>Appendix I: Details of subsidiaries and associates at December 31, 2016</u>	96
<u>Annex II: Board and Senior Management Compensation</u>	101
<u>Management report 2016</u>	110
<u>Business Model</u>	110
<u>Economic results of Telefónica, S.A.</u>	112
<u>Investment activity</u>	113
<u>Share price performance</u>	116
<u>Research, development and innovation</u>	117
<u>Environment</u>	120
<u>Human rights</u>	122
<u>Responsible business and fiscal responsibility</u>	123
<u>Human Resources</u>	125
<u>Managing diversity</u>	127
<u>Liquidity and capital resources</u>	128
<u>Financing</u>	128
<u>Treasury shares</u>	130
<u>Risks and uncertainties facing the Company</u>	132
<u>Trend evolution</u>	145
<u>Events after the reporting period</u>	147
<u>Annual Corporate Governance Report for Listed Companies</u>	148

Table of Contents

Financial Statements

Telefónica, S.A.

Balance sheet at December 31

Millions of euros

	Notes	2016	2015 (*)
ASSETS			
NON-CURRENT ASSETS		76,817	62,177
Intangible assets	5	23	28
Software		9	8
Other intangible assets		14	20
Property, plant and equipment	6	205	222
Land and buildings		131	143
Plant and other PP&E items		53	62
Property, plant and equipment under construction and prepayments		21	17
Investment property	7	399	401
Land		94	94
Buildings		305	307
Non-current investments in Group companies and associates	8	68,211	50,300
Equity instruments		65,249	47,971
Loans to Group companies and associates		2,950	2,313
Other financial assets		12	16
Financial investments	9	5,016	5,073
Equity instruments		339	384
Loans to third parties			41
Derivatives	16	4,667	4,638
Other financial assets	9	10	10
Deferred tax assets	17	2,963	6,153
CURRENT ASSETS		6,443	22,809
Net assets held for sale	8		12,508
Trade and other receivables	10	447	594
Current investments in Group companies and associates	8	3,227	7,504
Loans to Group companies and associates		3,167	7,426
Derivatives	16	30	40
Other financial assets		30	38
Investments	9	1,942	2,060
Loans to companies		42	60
Derivatives	16	1,652	1,996
Other financial assets		248	4
Accruals		16	33

Cash and cash equivalents	811	110
TOTAL ASSETS	83,260	84,986

The accompanying Notes 1 to 24 and Appendix I and II are an integral part of these balance sheets

(*) Revised data, see Note 2

Telefónica, S.A. 4

Table of Contents

Financial Statements

Millions of euros

	Notes	2016	2015 (*)
Equity and liabilities			
EQUITY		20,277	23,136
CAPITAL AND RESERVES		20,943	23,926
Share capital	11	5,038	4,975
Share premium	11	3,227	3,227
Reserves	11	12,928	18,081
Legal		985	984
Other reserves		11,943	17,097
Treasury shares and own equity instruments	11	(1,480)	(1,656)
Profit for the year	3	24	5
Interim dividend	3		(1,912)
Other equity instruments	11	1,206	1,206
UNREALIZED GAINS (LOSSES) RESERVE	11	(666)	(790)
Available-for-sale financial assets		8	11
Hedging instruments		(674)	(801)
NON-CURRENT LIABILITIES		45,471	46,255
Non-current provisions	18	367	835
Non-current borrowings	12	7,249	8,610
Bonds and other marketable debt securities	13		800
Bank borrowings	14	4,427	4,825
Derivatives	16	2,684	2,847
Other debts		138	138
Non-current borrowings from Group companies and associates	15	37,274	36,683
Deferred tax liabilities	17	571	88
Long term deferred revenues		10	39
CURRENT LIABILITIES		17,512	15,595
Current provisions	18	121	43
Current borrowings	12	3,712	1,628
Bonds and other marketable debt securities	13	1,158	85
Bank borrowings	14	1,635	1,269
Derivatives	16	679	274
Other financial liabilities	14	240	
Current borrowings from Group companies and associates	15	13,146	13,217
Trade and other payables	18	486	619
Accruals		47	88
TOTAL EQUITY AND LIABILITIES		83,260	84,986

The accompanying Notes 1 to 24 and Appendices I and II are an integral part of these balance sheets

(*) Revised data, see Note 2

Telefónica, S.A. 5

Table of Contents

Financial Statements

Telefónica, S.A.

Income statements for the years ended December 31

Millions of euros	Notes	2016	2015 (*)
Revenue	19	2,710	5,936
Rendering of services to Group companies and associates		548	599
Rendering of services to non-group companies		59	4
Dividends from Group companies and associates		1,928	5,171
Interest income on loans to Group companies and associates		175	162
Impairment and gains (losses) on disposal of financial instruments		3,045	(5,309)
Impairment losses and other losses	8	2,049	(5,309)
Gains (losses) on disposal and other gains and losses	8	996	
Other operating income	19	46	91
Non-core and other current operating revenue - Group companies and associates		30	22
Non-core and other current operating revenue - non-group companies		16	69
Employees benefits expense	19	(310)	(315)
Wages, salaries and others		(281)	(284)
Social security costs		(29)	(31)
Other operational expense		(356)	(786)
External services - Group companies and associates	19	(109)	(135)
External services - non-group companies	19	(252)	(624)
Taxes other than income tax		5	(27)
Depreciation and amortization	5, 6 and 7	(38)	(46)
Gains (losses) on disposal of fixed assets		(4)	17
OPERATING PROFIT		5,093	(412)
Finance revenue	19	922	593
Finance costs	19	(2,996)	(2,804)
Change in fair value of financial instruments			(19)
Gain (loss) on available-for-sale financial assets recognized in the period	9 and 11		(19)
Exchange rate gains (losses)	19	(170)	(98)
Impairment and gains (losses) on disposal of financial instruments with third-parties	9.3 and 19.9	17	426
NET FINANCIAL EXPENSE		(2,227)	(1,902)
PROFIT BEFORE TAX	21	2,866	(2,314)
Income tax	17	(2,842)	2,319
PROFIT FOR THE YEAR CONTINUED OPERATIONS		24	5
Discontinued operations net of taxes	2 and 22		
PROFIT FOR THE YEAR		24	5

The accompanying Notes 1 to 24 and Appendices I and II are an integral part of these income statements

(*) Revised data, see Note 2

Telefónica, S.A. 6

Table of Contents

Financial Statements

Telefónica, S.A.

Statements of changes in equity for the years ended December 31

A) Statement of recognized income and expense

Millions of euros	Notes	2016	2015 (*)
Profit of the period		24	5
Total income and expense recognized directly in equity	11	368	580
From measurement of available-for-sale financial assets		13	467
From cash flow hedges		477	380
Income tax impact		(122)	(267)
Total amounts transferred to income statement	11	(244)	(306)
From measurement of available-for-sale financial assets		(17)	(481)
From cash flow hedges		(308)	56
Income tax impact		81	119
TOTAL RECOGNIZED INCOME AND EXPENSE		148	279

The accompanying Notes 1 to 24 and Appendices I and II are an integral part of these statements of changes in equity.

(*) Revised data, see Note 2

B) Statements of total changes in equity for the years ended December 31

Millions of euros	Share capital	Share premium and Reserves	Treasury shares	Profit for the year	Interim dividends	Other net equity instruments	Net unrealized gains (losses) reserve	Total
Balance at December 31, (*)	4,657	19,118	(1,587)	2,604	(1,790)	1,206	(1,064)	23,144

Total recognized income and expense	5	274	279
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Transactions with shareholders and owners	318	1,374	(69)	(1,912)	(289)
Dividends paid (Note 11)	111	(448)		(1,912)	(2,249)
Transactions with treasury shares or own equity instruments (net)		(75)	(1,510)		(1,585)
Other transactions with shareholders and owners		(17)	555		538
Other movements		2			2
Appropriation of prior year profit (loss)		814	(2,604)	1,790	
Balance at December 31, (*)	4,975	21,308	(1,656)	5	(1,912) 1,206 (790) 23,136

Total recognized income and expense			24		124	148
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Transactions with shareholders and owners	63	(3,247)	176		(3,008)
Capital decreases (Note 11)	(74)	(739)	813		
Dividends paid (Note 11)	137	(2,543)			(2,406)
Other transactions with shareholders and owners		35	(637)		(602)
Other movements		1			1
Appropriation of prior year profit (loss)		(1,907)	(5)	1,912	
Balance at December 31, 2016	5,038	16,155	(1,480)	24	1,206 (666) 20,277

The accompanying Notes 1 to 24 and Appendices I and II are an integral part of these statements of changes in equity.

(*) Revised data, see Note 2

Telefónica, S.A. 7

Table of Contents

Financial Statements

Telefónica, S.A.

Cash flow statements for the years ended December 31

Millions of euros	Notes	2016	2015 (*)
A) CASH FLOWS FROM OPERATING ACTIVITIES		3,193	2,451
Profit before tax		2,866	(2,314)
Adjustments to profit:		(2,855)	1,988
Depreciation and amortization	5,6 and 7	38	46
Impairment of investments in Group companies and associates	8	(2,049)	5,309
Change in long term provisions		24	81
Gains on the sale of financial assets		(992)	5
Losses on disposal of property, plant and equipment			(22)
Dividends from Group companies and associates	19	(1,928)	(5,171)
Interest income on loans to Group companies and associates	19	(175)	(162)
Net financial expense		2,227	1,902
Change in working capital		(132)	337
Trade and other receivables		43	165
Other current assets		39	(26)
Trade and other payables		(156)	222
Other current liabilities		(58)	(24)
Other cash flows from operating activities	21	3,314	2,440
Net interest paid		(1,868)	(1,801)
Dividends received		4,212	3,091
Income tax receipts		970	1,150
Other payments/proceeds from operating activities			
B) CASH FLOWS (USED IN)/FROM INVESTING ACTIVITIES		(1,563)	(2,867)
Payments on investments	21	(5,002)	(4,915)
Proceeds from disposals	21	3,439	2,048
C) CASH FLOWS USED IN FINANCING ACTIVITIES		(924)	(4,042)
Payments on equity instruments		(624)	(1,626)
Proceeds from financial liabilities	21	2,095	(3,227)
Debt issues		15,884	8,465
Repayment and redemption of debt		(13,789)	(11,692)
Capital increase			3,048
Dividends paid	21	(2,395)	(2,237)
D) NET FOREIGN EXCHANGE DIFFERENCE		(5)	(16)
E) NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		701	(4,474)
Cash and cash equivalents at January 1		110	4,584
Cash and cash equivalents at December 31		811	110

Notes 1 to 24 and Appendices I and II are an integral part of these cash flow statements.

(*) Revised data see Note 2

Telefónica, S.A. 8

Table of Contents

Financial Statements

TELEFÓNICA, S.A.

Annual financial statements for the ended December 31, 2016

Note 1. Introduction and general information

Telefónica, S.A. ("Telefónica" or the Company) is a public limited company incorporated for an indefinite period on April 19, 1924, under the corporate name of Compañía Telefónica Nacional de España, S.A. It adopted its present name in April 1998.

The Company's registered office is at Gran Vía 28, Madrid (Spain), and its Employer Identification Number (CIF) is A-28/015865.

Telefónica's basic corporate purpose, pursuant to Article 4 of its Bylaws, is the provision of all manner of public or private telecommunications services, including ancillary or complementary telecommunications services or related services. All the business activities that constitute this stated corporate purpose may be performed either in Spain or abroad and wholly or partially by the Company, either through shareholdings or equity interests in other companies or legal entities with an identical or a similar corporate purpose.

In keeping with the above, Telefónica is currently the parent company of a group that offers both fix and mobile telecommunications with the aim to turn the challenges of the new digital business into reality and being one of the most important players. The objective of the Telefónica Group is positioning as a Company with an active role in the digital business taking advantage of the opportunities of its size and industrial and strategic alliances.

The Company is taxed under the general tax regime established by the Spanish State, the Spanish Autonomous Communities and local governments, and files consolidated tax returns with most of the Spanish subsidiaries of its Group under the consolidated tax regime applicable to corporate groups.

Telefónica, S.A. 9

Table of Contents

Financial Statements

Note 2. Basis of presentation**a) True and fair view**

These financial statements have been prepared from Telefónica, S.A.'s accounting records by the Company's Directors in accordance with the accounting principles and standards contained in the Spanish GAAP in force approved by Royal Decree 1514/2007, on November 16 (PGC 2007), modified by Royal Decree 602/2016, dated December 2, 2016 and other prevailing legislation at the date of these financial statements, to give a true and fair view of the Company's equity, financial position, results of operations and of the cash flows obtained and applied in 2016.

The accompanying financial statements for the year ended December 31, 2016 were prepared by the Company's Board of Directors at its meeting on February 22, 2017 for submission for approval at the General Shareholders' Meeting, which is expected to occur without modification.

The figures in these financial statements are expressed in millions of euros, unless indicated otherwise, and therefore may be rounded. The euro is the Company's functional currency.

b) Comparison of information

In 2015 and 2016 there have not been significant transactions that should be taken into account in order to ensure the comparison of information included in the Annual Financial Statements of both years.

As a consequence of the sale agreement signed on March, 24, 2015 between Telefónica, S.A. and Hutchison 3G UK Investment Limited and Hutchison 3G UK Holdings (CI) Limited (together, "Hutchison") and according to PGC 2007 Valuation Rule N° 7, 11 caption, the figures related to the investment in Telefónica Europe, plc and the transactions with this company were classified as held for sale assets and discontinued operations, respectively, in 2015 Annual Financial Statements.

On May 11, 2016 the European Commission made public its decision to prohibit the transaction. Following this decision, the Board of Directors of Telefónica at its meeting on June 29, 2016 agreed that Telefónica will continue to explore different strategic alternatives for O2 UK, to be implemented when market conditions are deemed appropriate. Given that the execution of a sale transaction is less certain, following the submission of the financial information of the second quarter of 2016 Telefónica's operations in UK were no longer presented as discontinued operations and data related to the investment in Telefónica Europe, plc ceased to be classified as held for sale. Thus, items are presented line by line according to their nature in financial statements. Comparative financial statements have been amended accordingly with respect to those published in the financial statements for the year 2015. The impacts of this classification change are described in Note 22.

In accordance with PGC 2007 approved by Royal Decree 1514/2007, goodwill and intangible assets with indefinite useful life were not amortized. However, following the provisions of Royal Decree 602/2016, dated December 2, 2016, that modify PGC 2007, starting January 1, 2016 the Company amortizes goodwill and intangibles with indefinite useful lives on a systematic basis.

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Pursuant to the sole transitory provision of the mentioned Royal Decree 602/2016, in 2016 the Company elected to retrospectively amortize the carrying amount of goodwill and intangible assets with indefinite useful lives (see Note 5). Thus, amortization charges for all periods prior to 2015 have been recognized in reserves, on a straight-line basis and over a ten-year useful life starting January 1, 2008, which is the initial date of the period in which the currently in force PGC 2007 was first applied.

Telefónica, S.A. 10

Table of Contents

Financial Statements

Therefore, comparative information for earlier periods presented has been adjusted for application of these new requirements, as follows:

An increase in the intangible asset amortization with a charge to,

Initial balance of reserves as of December 31, 2015 amounting to 24 million euros, including a balance of 10 million euros related to the non-distributable reserve for goodwill amortization (see Note 11.c).

Amortization charge amounting to 3 million euros in the profit and loss account for the year ended December 31, 2015.

c) Materiality

These financial statements do not include any information or disclosures that, not requiring presentation due to their qualitative significance, have been determined as immaterial or of no relevance pursuant to the concepts of *materiality* or *relevance* defined in the PGC 2007 conceptual framework.

d) Use of estimates

The financial statements have been prepared using estimates based on historical experience and other factors considered reasonable under the circumstances. The carrying value of assets and liabilities, which is not readily apparent from other sources, was established on the basis of these estimates. The Company periodically reviews these estimates.

A significant change in the facts and circumstances on which these estimates are based could have an impact on the Company's results and financial position.

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the financial statements of the following year are discussed below.

Provisions for impairment of investments in Group companies and associates

Investments in group companies, joint ventures and associates are tested for impairment at each year end to determine whether an impairment loss must be recognized in the income statement or a previously recognized impairment loss be reversed. The decision to recognize an impairment loss (or a reversal) involves estimates of the reasons for the potential impairment (or recovery), as well as the timing and amount. In note 8.2 it is assessed the impairment of these investments.

There is a significant element of judgment involved in the estimates required to determine recoverable amount and the assumptions regarding the performance of these investments, since the timing and scope of future changes in the business are difficult to predict.

Deferred taxes

The Company assesses the recoverability of deferred tax assets based on estimates of future earnings, and of all the options available to achieve an outcome, it considers the most efficient one in terms of tax within the legal framework the Company is subject to. The ability to recover these taxes depends ultimately on the Company's ability to generate taxable earnings over the period for which the deferred tax assets remain deductible. This analysis is based on the estimated schedule for reversing deferred tax liabilities, as well as estimates of taxable earnings, which are sourced from internal projections and are continuously updated to reflect the latest trends.

The appropriate valuation of tax assets and liabilities depends on a series of factors, including estimates as to the timing and realization of deferred tax assets and the projected tax payment schedule. Actual income tax receipts and payments could differ from the estimates made by the Company as a result of changes in tax legislation or unforeseen transactions that could affect tax balances. The information about deferred tax assets and unused tax credits for loss carryforwards, whose effect has been registered when necessary in balance, is included in Note 17.

Telefónica, S.A. 11

Table of Contents

Financial Statements

Note 3. Proposed appropriation of profit

Telefónica, S.A. obtained 24 million euros of profit in 2016. Accordingly, the Company's Board of Directors will submit the following proposed appropriation of 2016 profit for approval at the Shareholders' Meeting:

Millions of euros**Proposed appropriation:**

Profit for the year	24
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Distribution to:

Legal reserve	2
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Interim Dividend	22
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Telefónica, S.A. 12

Table of Contents

Financial Statements

Note 4. Recognition and measurement accounting policies

As stated in Note 2, the Company's financial statements have been prepared in accordance with the accounting principles and standards contained in the Código de Comercio, which are further developed in the Plan General de Contabilidad currently in force (PGC 2007), as well as any commercial regulation in force at the reporting date.

Accordingly, only the most significant accounting policies used in preparing the accompanying financial statements are set out below, in light of the nature of the Company's activities as a holding.

a) Intangible assets

Intangible assets are stated at acquisition or production cost, less any accumulated amortization or any accumulated impairment losses.

Intangible assets are amortized on a straight-line basis over their useful lives. The most significant items included in this caption are computer software licenses, which are generally amortized on a straight-line basis over three years.

b) Property, plant and equipment and investment property

Property, plant and equipment is stated at cost, net of accumulated depreciation and any accumulated impairment in value.

The Company depreciates its property, plant and equipment once the assets are in full working conditions using the straight-line method based on the assets' estimated useful lives, calculated in accordance with technical studies which are revised periodically based on technological advances and the rate of dismantling, as follows:

Estimated useful life	Years
Buildings	40
Plant and machinery	3 - 25
Other plant or equipment, furniture and fixtures	10
Other items of property, plant and equipment	4 - 10

Table of Contents

Financial Statements

Investment property is measured and depreciated using the same criteria described for land and buildings for own use.

c) Impairment of non-current assets

Non-current assets are assessed at each reporting date for indicators of impairment. Where such indicators exist, or in the case of assets which are subject to an annual impairment test, the Company estimates the asset's recoverable amount as the higher of its fair value less costs to sell and its value in use. In assessing value in use, the estimated future post-tax cash flows deriving from the use of the asset or its cash generating unit, as applicable, are discounted to their present value, using a post-tax discount rate reflecting current market assessments of the time value of money and the risks specific to the asset, whenever the result obtained is the same that would be obtained by discounting pre-tax cash flows at a pre-tax discount rate.

Telefónica bases the calculation of impairment on the business plans of the various companies approved by the Board of Directors of Telefónica, S.A. to which the assets are allocated. The projected cash flows, based on strategic business plans, cover a period of five years not including the present year when the analysis is calculated. Starting with the sixth year, an expected constant growth rate is applied.

d) Financial assets and liabilities

Financial investments

All regular way purchases and sales of financial assets are recognized on the trade date, i.e. the date that the Company commits to purchase or sell the asset.

Investments in group companies, joint ventures and associates are classified into a category of the same name and are shown at cost less any impairment loss (see Note 4.c). Group companies are those over which the Company exercises control, either by exercising effective control or by virtue of agreements with the other shareholders. Joint ventures are companies which are jointly controlled with third parties. Associates are companies in which there is significant influence, but not control or joint control with third parties. Telefónica assesses the existence of significant influence not only in terms of percentage ownership but also in qualitative terms such as presence on the board of directors, involvement in decision-making, the exchange of management personnel, and access to technical information.

Financial investments which the Company intends to hold for an unspecified period of time and could be sold at any time to meet specific liquidity requirements or in response to interest rate movements and which have not been included in the other categories of financial assets defined in the PGC 2007 are classified as available-for-sale. These investments are recorded under Non-current assets, unless it is probable and feasible that they will be sold within 12 months.

Derivative financial instruments and hedge accounting

When Telefónica chooses not to apply hedge accounting criteria but economic hedging, gains or losses resulting from changes in the fair value of derivatives are taken directly to the income statement.

e) Revenue and expenses

Revenue and expenses are recognized on the income statement based on an accruals basis; i.e. when the goods or services represented by them take place, regardless of when actual payment or collection occurs.

The income obtained by the Company in dividends received from Group companies and associates, and from the interest accrued on loans and credits given to them, are included in revenue in compliance with the provisions of consultation No. 2 of BOICAC 79, published on September 30, 2009.

Telefónica, S.A. 14

Table of Contents

Financial Statements

f) Related party transactions

In mergers and spin-offs of businesses involving the parent company and its direct or indirect subsidiary, in cases of non-monetary contributions of businesses between Group companies, and in cases of dividends, the contributed assets are valued, in general, at their pre-transaction carrying amount in the individual financial statements, given that the Telefónica Group does not prepare its consolidated financial statements in accordance with the Standards on Preparing Consolidated Financial Statements (Spanish NOFCAC).

In these same operations, companies may also opt to use the consolidated values under International Financial Reporting Standards (IFRS) as adopted by the European Union, providing that the consolidated figures do not differ from those obtained under the NOFCAC. Lastly, the Company may also opt to use the values resulting from a reconciliation to the NOFCAC. Any accounting difference is recognized in reserves.

g) Financial guarantees

The Company has provided guarantees to a number of subsidiaries to secure their transactions with third parties (see Note 20.a). Where financial guarantees provided have a counterguarantee on the Company's balance sheet, the value of the counterguarantee is estimated to be equal to the guarantee given, with no additional liability recognized as a result.

Guarantees provided for which there is no item on the Company's balance sheet acting as a counterguarantee are initially measured at fair value which, unless there is evidence to the contrary, is the same as the premium received plus the present value of any premiums receivable. After initial recognition, these are subsequently measured at the higher of:

- i) The amount resulting from the application of the rules for measuring provisions and contingencies.
- ii) The amount initially recognized less, when applicable, any amounts taken to the income statement corresponding to accrued income.

h) Consolidated data

As required under prevailing legislation, the Company has prepared separate consolidated annual financial statements, drawn up in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The balances of the main headings of the Telefónica Group's consolidated financial statements for 2016 and 2015 are as follows:

Millions of euros		
Item	2016	2015 (*)
Total assets	123,641	120,329

Equity:

Attributable to equity holders of the parent	18,157	15,771
Attributable to minority interests	10,228	9,665
Revenue from operations	52,036	54,916
Profit for the year:		
Attributable to equity holders of the parent	2,369	616
Attributable to minority interests	30	135

(*) Amended data

Telefónica, S.A. 15

Table of Contents

Financial Statements

Note 5. Intangible assets

The movements in the items composing intangible assets and the related accumulated amortization in 2016 and 2015 are as follows:

2016

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INTANGIBLE ASSETS, GROSS	254	8	(33)	1	230
Software	132	3		5	140
Other intangible assets	122	5	(33)	(4)	90
ACCUMULATED AMORTIZATION	(226)	(13)	33	(1)	(207)
Software	(124)	(7)			(131)
Other intangible assets	(102)	(6)	33	(1)	(76)
Net carrying amount	28	(5)			23

2015

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INTANGIBLE ASSETS, GROSS	274	8	(30)	2	254
Software	129	2		1	132
Other intangible assets	145	6	(30)	1	122
ACCUMULATED AMORTIZATION	(240)	(16)	30		(226)
Software	(116)	(8)			(124)
Other intangible assets (*)	(124)	(8)	30		(102)
Net carrying amount	34	(8)		2	28

(*) Revised data, see Note 2

At December 31, 2016 and 2015 commitments exist to acquire intangible assets amounting to 1.4 and 0.2 million euros, respectively.

At December 31, 2016 and 2015, the Company had 140 million euros and 164 million euros, respectively, of fully amortized intangible assets.

After the merger of Terra Networks, S.A. with Telefónica, S.A., in 2006 the Company registered a goodwill, which was amortized on an annual basis until the entry into force of PGC 2007. As of December 31, 2007 that asset had a net carrying amount of 33.9 million euros. Subsequently, Telefónica, S.A. tested for impairment that asset every year,

which did not disclose any need to recognise a write-down. The Company has set aside 1.6 million euros annually (5% of the net carrying amount of the asset) of its profit to a non-distributable reserve for goodwill amortization. The balance of this reserve at December 31, 2015 was 12 million euros.

After the publication of Royal Decree 602/2016, on December, 2, 2016, modifying PGC 2007, the Company has amortized all its intangible assets with infinite useful life in a retrospective way since they had not been amortized when PGC 2007 entered into force. Retrospective amortization was obliged to revise 2015 figures of other intangible asset amortization, in the amounts detailed in Note 2.

Telefónica, S.A. 16

Table of Contents

Financial Statements

Note 6. Property, plant and equipment

The movements in the items composing property, plant and equipment and the related accumulated depreciation in 2016 and 2015 are as follows:

2016

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
PROPERTY, PLANT AND EQUIPMENT, GROSS	572	8		(11)	569
Land and buildings	232			(9)	223
Plant and other PP&E items	323	1		1	325
Property, plant and equipment under construction and prepayments	17	7		(3)	21
ACCUMULATED DEPRECIATION	(350)	(14)			(364)
Buildings	(89)	(3)			(92)
Plant and other PP&E items	(261)	(11)			(272)
Net carrying amount	222	(6)		(11)	205

2015

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
PROPERTY, PLANT AND EQUIPMENT, GROSS	557	24	(7)	(2)	572
Land and buildings	228	8	(4)		232
Plant and other PP&E items	322	3	(2)		323
Property, plant and equipment under construction and prepayments	7	13	(1)	(2)	17
ACCUMULATED DEPRECIATION	(332)	(20)	2		(350)
Buildings	(86)	(3)			(89)
Plant and other PP&E items	(246)	(17)	2		(261)
Net carrying amount	225	4	(5)	(2)	222

Firm commitments to acquire property, plant and equipment at December 31, 2016 and 2015 amounted to 3 million euros and 1 million euros, respectively. At December 31, 2016 and 2015, the Company had 205 million euros and 178 million euros, respectively, of fully depreciated items of property, plant and equipment.

Table of Contents

Financial Statements

Telefónica, S.A. has taken out insurance policies with appropriate limits to cover the potential risks which could affect its property, plant and equipment.

Property, plant and equipment includes the net carrying amount of the land and buildings occupied by Telefónica, S.A. at its Distrito Telefónica headquarters, amounting to 70 million euros and 68 million euros at the 2016 and 2015 year-ends, respectively. Also included is the net carrying amount of the remaining assets (mainly plant and property) of 30 and 37 million euros at December 31, 2016 and 2015, respectively. The land and buildings rented to other Group Companies have been included as Investment properties in Note 7.

Telefónica, S.A. 18

Table of Contents

Financial Statements

Note 7. Investment properties

The movements in the items composing investment properties in 2016 and 2015 and the related accumulated depreciation are as follows:

2016

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INVESTMENT PROPERTIES, GROSS	486			9	495
Land	94				94
Buildings	392			9	401
ACCUMULATED DEPRECIATION	(85)	(11)			(96)
Buildings	(85)	(11)			(96)
Net carrying amount	401	(11)		9	399

2015

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INVESTMENT PROPERTIES, GROSS	499		(13)		486
Land	94				94
Buildings	405		(13)		392
ACCUMULATED DEPRECIATION	(82)	(10)	7		(85)
Buildings	(82)	(10)	7		(85)
Net carrying amount	417	(10)	(6)		401

Investment properties mainly includes the value of land and buildings leased by Telefónica, S.A. to other Group companies at the Distrito Telefónica head offices in Madrid and the building of its headquarters in Barcelona, known as Diagonal 00 .

In October 2015 the sale of the building addressed in Don Ramón de la Cruz street (Madrid) was completed. This building had been rented as a whole to other Group companies. The profit from the sale of the asset amounting to 22 million euros was booked as Profit from the sale of fixed assets in the income statement.

In 2016, the Company has buildings with a total area of 311,128 square meters leased to several Telefónica Group and other companies, equivalent to an occupancy rate of 95.35% of the buildings it has earmarked for lease. In 2015, it had a total of 328,314 square meters leased, equivalent to an occupancy rate of 93.27% of the buildings earmarked for lease.

Table of Contents

Financial Statements

Total income from leased buildings in 2016 (see Note 19.1) amounted to 44 million euros (48 million euros in 2015). Future minimum rentals receivable under non-cancellable leases are as follows:

Millions of euros	2016 Future minimum recoveries	2015 Future minimum recoveries
Up to one year	40	44
Between two and five years	5	9
Over 5 years	1	1
Total	46	54

The most significant lease contracts held with subsidiaries occupying Distrito Telefónica have been renewed in 2016 for a non-cancellable period of 12 months. The figures also include non-cancellable lease revenue from Diagonal 00, the contracts for which expire in July 2017.

The main contracts of operating leases in which Telefónica, S.A. acts as lessee and there is no sub-lease are described in Note 19.5.

Telefónica, S.A. 20

Table of Contents

Financial Statements

Note 8. Investments in group companies and associates

8.1. The movements in the items composing investments in Group companies, joint ventures and associates in 2016 and 2015 are as follows:

2016

Millions of euros	Opening balance	Additions	Disposals	Transfers	Exchange losses	Dividends	Hedges of a net investment	Closing balance	Fair value
Equity instruments (Net) (1)	47,971	6,446	(236)	12,338		(619)	(651)	65,249	127,748
Equity instruments (Cost)	62,182	4,397	(285)	26,154		(619)	(651)	91,178	
Impairment losses	(14,211)	2,049	49	(13,816)				(25,929)	
Loans to Group companies and associates	2,313	1,853	(1,315)	191	(92)			2,950	2,985
Other financial assets	16	11		(15)				12	12
Total non-current investment in Group companies and associates	50,300	8,310	(1,551)	12,514	(92)	(619)	(651)	68,211	130,745
Loans to Group companies and associates	7,426	1,293	(5,400)	(181)	29			3,167	3,171
Derivatives	40	30	(40)					30	30
Other financial assets	38	6	(29)	15				30	30
Total current investments in Group companies and associates	7,504	1,329	(5,469)	(166)	29			3,227	3,231

(1) Fair value at December 31, 2016 of Group companies and associates quoted in an active market (Telefônica Brasil, S.A.) was calculated taking the listing of the investments on the last day of the year; the rest of the shareholdings are stated at the value of discounted cash flows based on those entities' business plans.

2015

Millions of euros	Opening balance	Additions	Disposals	Transfers	Exchange losses	Hedges of a net investment	Closing balance	Fair value
Equity instruments (Net) (1)	59,123	2,354	(340)	(13,166)			47,971	110,470
Equity instruments (Cost)	82,005	6,811	(340)	(26,294)			62,182	
Impairment losses	(22,882)	(4,457)		13,128			(14,211)	
Loans to Group companies and associates	3,227	124	(202)	(795)	(41)		2,313	2,337
Other financial assets	17	18		(19)			16	16
Total non-current investment in Group companies and associates	62,367	2,496	(542)	(13,980)	(41)		50,300	112,823
Loans to Group companies and associates	5,031	4,779	(3,108)	795	(71)		7,426	7,438
Derivatives	105	40	(105)				40	40
Other financial assets	32	19	(32)	19			38	38
Total current investments in Group companies and associates	5,168	4,838	(3,245)	814	(71)		7,504	7,516

- (1) Fair value at December 31, 2015 of Group companies and associates quoted in an active market (Telefônica Brasil, S.A.) was calculated taking the listing of the investments on the last day of the year; the rest of the shareholdings are stated at the value of discounted cash flows based on those entities' business plans.

Table of Contents

Financial Statements

The most significant transactions occurred in 2016 and 2015 as well as their accounting impacts are described below:

2016

As detailed in Note 2, following the decision of the European Commission to prohibit the sale of Telefónica Europe, plc to the Hutchison Whampoa Group, and as a consequence of the strategy approved by the Board of Directors of Telefónica at its meeting on June 29, 2016, the investment in the company which was previously considered as a Held for sale asset has been reclassified to the Long Term investment in Group companies and associates caption amounting to 12,501 million euros. The reclassification is shown in 2015 and 2016 charts of movements under the Transfers column.

During the first semester of 2016, Telefónica has decided to rearrange the assets related to infrastructures of the Group, including the telecommunication towers as well as the network of underwater and terrestrial optic fiber unifying the concept within the same holding company (Telxius Telecom, S.A.U.). In the framework of this reorganization the following investing transactions have been made by Telefónica, S.A.:

On January 29, 2016, Telefónica Internacional, S.A.U. sold at its net book value the 50% of its stake in Telefónica América, S.A. to Telefónica, S.A. After this transaction Telefónica, S.A. became the sole stakeholder of Telefónica America, S.A.U. On March 7th, 2016, the company's denomination was changed to Telxius Telecom, S.A.U. Telxius Telecom, S.A.U. was thus designated to be the parent company of the rearranged group of the above mentioned infrastructure entities.

On February 16, 2016 Telefónica Móviles España, S.A.U. carried out a partial split-off of Wireless Towers, S.L.U. (a newly-incorporated company renamed after as Telxius Torres España, S.L.U.) with the aim of placing in this new company the business line of ownership and exploitation of mobile phone towers. Telefónica, S.A. has recorded the split-off transaction at book value of the assets (214 million euros), and therefore it is not reflected in the chart of movements above.

On March 28, 2016 Telefónica International Wholesale Services América, S.A. executed a capital increase of 187 million dollars fully subscribed and paid pro-rata by the shareholders. The transaction implied a disbursement of 122 million euros for Telefónica, S.A., included as Additions in the 2016 chart of movements. The funds were used to compensate prior years' negative reserves before the nonmonetary contribution of the company to Telxius Telecom, S.A.U. The contribution was completed on March 31 at its book value (448 million euros), and therefore it is not reflected in the chart of movements above.

On March 30, 2016 Telxius Telecom, S.A.U. made a capital increase of 1,450 million euros fully subscribed and paid by the Company. On May 27, 2016 an additional capital increase was carried forward amounting to 502 million euros, also fully subscribed and paid by Telefónica, S.A. The total amount of these transactions

is shown as Additions in 2016 chart.

On March 31, 2016, Telxius entered into a purchase agreement to acquire all the shares of Telxius Torres España, S.L.U. from Telefónica, S.A. at fair value (1,210 million euros). The profit of the transaction amounts to 996 million euros in the income statement of Telefónica, S.A.

Telefónica, S.A. 22

Table of Contents

Financial Statements

On the other hand, with respect to the investment of Telefónica, S.A. in Colombia Telecomunicaciones, S.A., this company and its shareholders are analyzing the most appropriate steps to strengthen their equity position.

2015

Once the pertinent regulatory authorizations were obtained on April 27, 2015, and with the aim of raising the funds needed to complete the acquisition of Global Village Telecom, S.A. and its parent company GVT Participações, S.A. the General Shareholders Meeting of Telefônica Brasil, S.A. launched a capital increase of 15,812 million reales. Telefónica, S.A. subscribed 3,995 million reales (equivalent to 1,262 million euros). On the same date, and with the object of subscribing the above mentioned capital increase, SP Telecomunicações Participações, Ltda approved a capital increase of 3,223 million reales. Telefónica, S.A. paid 1,270 million reales (equivalent to 401 million euros).

On June 24, 2015 and in compliance with the undertakings assumed in the agreement entered into for the acquisition of Global Village Telecom, S.A. (GVT), it has, through its 100% subsidiary Telco TE S.p.A., delivered 1,110 million ordinary shares of Telecom Italia S.p.A. (representing 8.2% of its ordinary shares) to Vivendi, S.A. and has received from Vivendi, S.A. all the ordinary shares and part of the preferred shares of Telefônica Brasil S.A. that Vivendi S.A. received as consideration for the sale of GVT, which together represent 4.5% of the total share capital of Telefônica Brasil S.A. The fair value of Telecom Italia shares contributed to Vivendi has been calculated using the quoted price at the approval date amounting to 1,264 million euros. This same amount has been used to value the 4.5% additional investment in Telefônica Brasil, S.A.

On July 29, 2015, Telefónica, S.A. entered into an agreement with Vivendi, S.A. through which Telefónica has committed to deliver 46 million of its treasury shares in exchange for 58.4 million of Telefônica Brasil, S.A. shares, representing approximately 3.5% of the share capital of Telefônica Brasil, S.A. The execution of the agreement was performed on September 16, 2015 and valued at the quoted price of Telefónica's shares at that date, 538 million euros.

As a consequence of the aforementioned transactions, the direct stake of Telefónica, S.A. in Telefônica Brasil, S.A. was increased to 29.77% and the stake at SP Telecomunicações Participações, Ltda is 39.4% of its capital.

On June 18, 2015 the public deed of Telco, S.p.A.'s spin off transaction was filed to the Companies Register. As a result of the process, Telecom Italia, S.p.A. ordinary shares owned by Telco, S.p.A. (equivalent to a 22.3% of the company's share capital) were transferred to its stakeholders. Therefore, Telefónica, S.A. through a 100% owned newly incorporated subsidiary, Telco TE, S.p.A. received ordinary shares representing 14.72% of Telecom Italia's share capital. In this same spin off process, Telco TE, S.p.A. registered the part of the liability that Telco, S.p.A. owed its stakeholders, pro-rata their percentage of ownership. The net book value of assets and liabilities registered was 603 million euros and it is included as additions in the table of movements above (Note 9.3.).

On the other hand, Telco TE S.p.A. entered into a purchase agreement with a financing institution for the sale of 872 million ordinary shares of Telecom Italia S.p.A., representing 6.5% of the ordinary shares of this company, for an amount of 1,025 million euros.

Likewise, Telefónica has arranged several hedging instruments which will allow Telefónica to repurchase the shares of Telecom Italia S.p.A. that are necessary to meet its exchange obligations under the mandatory exchangeable bonds

for shares of Telecom Italia S.p.A., issued by Telefónica, S.A. in July 2014.

Telefónica, S.A. has therefore ended the divesting process of its indirect stake at Telecom Italia, S.p.A., in accordance with the regulatory and competence requirements.

Telefónica, S.A. 23

Table of Contents

Financial Statements

Other movements

The column **Dividends** contains mainly a distribution of reserves made by Telco TE, S.p.A. amounting to 603 million euros. These reserves were originated prior to the investment in the company.

Movement in **Transfers in Loans to Group Companies and Associates** both 2016 and 2015 mainly includes the reclassification between long-term and current loans in accordance with the loan maturity schedule.

In addition to the aforementioned reclassification of the investment in Telefónica Europe, plc, in 2015 **Transfers** figure under the caption of **Equity Instruments** the reclassification to **Held for sale assets** of the net carrying amount of the investment in Telefónica Gestión de Servicios Compartidos España, S.A.U. amounting to 8 million euros.

Impairment losses **Transfers** in both 2016 and 2015 corresponds to the reclassification of the negative carrying amount of certain investments amounting to -163 and 31 million euros, respectively.

In 2016 and 2015, Telefónica, S.A. bought and sold the following shareholdings:

a) Acquisitions of investments and capital increases (Additions):**Millions of euros**

Companies	2016	2015
Telefônica Brasil, S.A.		3,064
Sao Paulo Telecomunicações, Ltda		401
Telefónica Internacional, S.A.U.		2,157
Telxius Telecom, S.A.U.	1,952	
Telefónica de Contenidos, S.A.U.	733	
Telefónica Digital Holding, S.L.U.	301	399
Telefónica Móviles Argentina Group	327	
Telco TE, S.p.A		603
Telefónica Móviles México, S.A. de C.V.	548	110
Telefónica Global Technology, S.A.U.	202	
Other companies	334	77
Total Group companies and associates	4,397	6,811

2016

Additions related to Telxius Telecom, S.A.U. have been fully described at the beginning of this Note. **Other companies** includes the amount of the capital increase carried out by Telefónica International Wholesale Services América, S.A. amounting to 122 million euros also detailed at the beginning of this Note.

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On January 27, 2016 Telefónica de Contenidos, S.A.U. made a capital increase amounting to 733 million euros totally subscribed and paid by the Telefónica, S.A.

On April 5, 2016 and with the aim of financing its subsidiary Telefónica Digital UK, Telefónica Digital Holding, S.L.U. executed a capital increase of 301 million euros fully subscribed and paid by its shareholder Telefónica, S.A.

On May 1, 2016 Telefónica, S.A. has granted Telefónica Móviles Argentina Holdings, S.A. with credits over Telefónica Móviles Argentina, S.A. amounting to a total of 1,110 million Argentinian pesos, including nocional and accrued interests. On May 5, 2016 the Company has subscribed a capital increase launched by Telefónica Móviles Argentina, S.A., pro-rata its stake, with a disbursement of 174 million Argentinian pesos, equivalent to 11 million euros. In addition, on June 16, 2016, Telefónica, S.A. has made an irrevocable capital contribution of 280 million dollars (248 million euros) in Telefónica Móviles Argentina, S.A. After this contribution the Company has increased its stake from 15.4% to 21.1%.

In order to provide Telefónica México, S.A. de C.V. with the funds needed to cancel credit lines, in December 2016 the subsidiary has made a capital increase amounting to 548 million euros fully subscribed and paid by its sole stakeholder, Telefónica, S.A.

As of June 22, Telefónica, S.A. has capitalized all the equity loans given to its subsidiary Telefónica Global Technology, S.A.U. amounting to 202 million euros.

Telefónica, S.A. 24

Table of Contents

Financial Statements

2015

Transactions referring the investment increase in Telefônica Brasil, S.A. and Sao Paulo Telecomunicações, Ltda have been detailed at the beginning of this Note.

On June 25, 2015 Telefónica Internacional, S.A.U. made a capital increase with share premium reserve amounting to 2,157 million euros totally subscribed and paid by the Company.

With the object of regaining equity balance, on February 26, 2015 Telefónica Digital Holding, S.L.U. increased its share capital subscribed in full with a loan capitalization of 156 million euros and proceeds in cash amounting to 175 million euros. Moreover, on November 18, 2015 and with the aim of enabling the fulfillment of its financing needs, the company has executed a capital increase of 68 million euros subscribed and paid in full by Telefónica, S.A.

The amount in the above chart regarding Telco TE, S.p.A. has been explained at the beginning of the Note.

In order to provide Telefónica México, S.A. de C.V. with the funds needed to cancel short term payments, in November and December the subsidiary has made several capital increases amounting to 2,000 million mexican pesos (110 million euros) fully subscribed and paid by its sole stakeholder, Telefónica, S.A.

b) Disposals of investments and capital decreases:

Millions of euros			
Companies		2016	2015
Phenix Investments, S.A.			340
Telxius Torres España, S.L.U.		214	
Others		71	
Total Group companies and associates		285	340

2016

Disposal of Telxius Torres España, S.L.U. refers to the sale at fair value amount of this subsidiary to Telxius Telecom, S.A.U. as detailed at the beginning of the Note.

2015

The disposal in 2015 refers to the decrease and pay back of the share premium reserve of Phenix Investments, S.A.

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

At each year end, the Company re-estimates the future cash flows derived from its investments in Group companies and associates. The estimate is made based on the discounted cash flows to be received from each subsidiary in its functional currency, net of the liabilities associated with each investment (mainly net borrowings and provisions), considering the percentage of ownership in each subsidiary and translated to euros at the official closing rate of each currency at December 31.

Telefónica, S.A. 25

Table of Contents

Financial Statements

As a result of these estimations and the effect of the net investment hedge in 2016, a reversal of the impairment provision of 2,049 million euros was recognized (5,309 million euros of impairment in 2015, including the write down regarding Telefónica Europe, plc, which was previously recognized under the caption net assets held for sale). This amount derives mainly from the following companies:

- (a) reverse of the write down by 2,491 million euros for Telefônica Brasil, S.A. (1,872 million euros in 2015) and reverse of 705 million euros for Sao Paulo Telecomunicações, Ltda. (753 million euros in 2015).
- (b) write down, net of hedges, of 582 million euros for Telefónica Europe, plc (852 million euros, net of hedges, in 2015).
- (c) write down of 1,264 million euros for Telefónica México, S.A. de C.V. (233 million euros in 2015).
- (d) the total reversal of the write down of 1,133 million euros booked in 2015 for Telefónica Internacional, S.A.U. (this company was merged with Telefónica Latinoamérica Holding, S.L.), mainly due to the revaluation of the Brazilian Real which has a positive impact in the investments of 36,01% stake in Telefônica Brasil, S.A.
- (e) write down of 232 million euros for Telefónica Digital Holding, S.L.U. (267 million euros in 2015).

Main hypothesis used for the calculation of the discounted cash flows of investments

In the case of Brazil, revenues reflect the strength of Telefónica's leadership driven by its leadership and quality and capturing integration synergies; and in the United Kingdom, the drive of mobile data.

In addition, in Brazil favorable effects in the macro-finance scenario have been produced. Firstly, and most remarkable, the appreciation of the exchange rate has resolved into an increase in the value of the assets nominated in Brazilian reals by 18%. Secondly, the improvement in the macroeconomic environment of the country during the second semester of 2016, as well as the more stable political situation as a consequence of the government compromise to implement structural changes in the country, has significantly reduced the uncertainties about the economic sustainability in the middle and long term.

The operating income before depreciation and amortization (OIBDA) margin for Brazil is in line with the average of analysts' three year forecasts for peers in emerging markets, at approximately 36%, and also considers analysts' long-term opinions about Brazil. Over the term of the strategic plan, the operator will invest a percentage at the lower end of the range for its peers. However, this is also in line with the investment needs identified by analysts (17%). Discount rate of 11.3% is slightly lower than the rate used in 2015 (11.9%), in line with the expectations of the analysts' consensus. The perpetuity growth rate is in line with the Brazilian Central Bank's medium-term inflation target (4.5%, within a range of ± 1.5 p.p.) and is aligned with the analyst consensus for the Strategic Plan horizon (around 5%) and below the forecast nominal GDP growth rate (which oscillates around 7%). A conservative outlook has been maintained, in line with analysts' expectations.

Regarding the investment in México, the economic uncertainty and resultant financial volatility associated with the change of president in the United States of America (which have been concluded in a 16% exchange rate depreciation

of the Mexican Peso against euro in 2016 with a subsequent negative effect on revenues) and the changing competitive environment in the Mexican telecommunications market, have led to a slowdown in the growth forecast in the business plan of the operator and a set of efficiency ratios that have improved more slowly than in previous years. This new economic scenario requires a more conservative medium-term outlook to be taken in the valuation parameters. The after-tax discount rates increased from 9.05% in 2015 to 9.86% in 2016 as a result of the financial volatility mentioned earlier.

Telefónica, S.A. 26

Table of Contents

Financial Statements

With regard to United Kingdom, the long-term OIBDA margin for operations (26%) is somewhat lower than the average for European peers over a three year period in 34%. With respect to the ratio of CapEx over revenues, over the term of the strategic plan, in United Kingdom the ratio of invest at a percentage of revenue is aligned with the range for peers in the region (around 13%) and it is in line with analysts' estimations. The discount rate (7.1%) is considered to have greater market risk, due to the increase in uncertainty of British equity securities as a result of *Brexit*, however, this risk is in line with the estimates given by analysts. Accordingly, the currency which is the main variable used for external adjustments because of the great commercial dependence on Europe, has suffered a 16% depreciation against euro in 2016, and therefore a negative impact in the British net assets and cash flows nominated in euros. In the United Kingdom the perpetuity growth rate is a 0.8% in line with the analysts' consensus.

8.3. The detail of subsidiaries and associates is shown in Appendix I.**8.4. Transactions protected for tax purposes**

Transactions carried out in 2016 that qualify for special tax treatment, as defined in Articles 76 and 87, as applicable, of Chapter VII of Title VII of Legislative Royal Decree 27/2014 of November 27 approving the Spanish Corporate Income Tax Law, are detailed in the following paragraph. Transactions qualified for special tax treatment carried out in prior years are disclosed in the financial statements for those years.

On February 18, 2016 Telefónica Móviles España, S.A.U. spins off neutrally the activity branch of the towers in Spain, in favour of the company Wireless Towers España, S.L.U. In accordance with the accounting valuation principles, the asset subject to the spun-off is recognized at its net carrying amount, 214 million euros. The market value of the spun-off asset is 1,210 million euros.

On March 30, 2016, Telefónica, S.A., as stakeholder of Telefónica International Wholesale Services America, S.A., made a non-monetary contribution of the 73.14% of the shares of this company S.A. to the reserves of Telxius Telecom, S.A.U., which the Company also owned. The contribution transaction is governed by the tax neutral regime. In accordance with the accounting valuation principle the contribution is recognized at its net carrying amount (447 million euros). The market value of the contributed asset was 1,233 million euros.

On May 5, 2016, Telefónica Digital España, S.L., as sole stakeholder of Telefónica Digital Identity & Privacy S.L., approved the merger by absorption of this latter by the first, with the subsequent dissolution without liquidation of the absorbed company and the transfer en bloc of its assets and liabilities to Telefónica Digital España, S.L., which also acquires all its rights and obligations by universal succession. The deed of the merger was filed in the Madrid Companies Register on June 17, 2016.

On July 1, 2016, Telefónica, S.A. as stakeholder of Telefónica Global Technology, S.A., adopted the agreements to partially spin off this company in favour of Telefónica de España, S.A.U., which is also wholly-owned by the Company. Through the spin-off it is transferred en bloc the independent unit of production, consisting of the maintenance and operation of the Data Center in Alcalá de Henares, as well as its infrastructure, just as the one located in the Data Center in Julián Camarillo street, and the services delivery. Telefónica, S.A. as sole stakeholder of both companies, recognizes a net carrying amount of 152 million euros, the partial spin-off transaction of the cost in TGT and the capital increase in Telefónica de España, S.A.U. The spin-off was notarized on September 1, 2016.

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On September 26, 2016, filed in the Madrid Companies Register on October 7, 2016, Telefónica Internacional, S.A.U. (absorbed) merged with Telefónica Latinoamérica Holding, S.L. (absorbing). In accordance with the accounting principles the merged asset is recognized at its net carrying amount (9,722 million euros) in Telefónica, S.A. There is no appreciation. The transaction was governed by the Special Regime.

Telefónica, S.A. 27

Table of Contents

Financial Statements

8.5. The breakdown and maturity of loans to Group companies and associates in 2016 and 2015 are follows:

2016

Millions of euros

Company	2017	2018	2019	2020	2021	2022 and Final balance, subsequent current and	
						years	non-current
Telefónica Móviles España, S.A.U.	88	400					488
Telefónica Móviles México, S.A. de C.V.		796					796
Telefónica de Contenidos, S.A.U.	386						386
Telefónica de España, S.A.U.	259		550				809
Telxius Telecom, S.A.U.	8				140	560	708
Telefónica Latinoamérica Holding, S.L.	2,099						2,099
Other companies	327	139	59	176	17	113	831
Total	3,167	1,335	609	176	157	673	6,117

Telefónica, S.A. 28

Table of Contents

Financial Statements

2015**Millions of euros**

Company	2016	2017	2018	2019	2020	2021 and subsequent years	Final balance, current and non-current
Telefónica Móviles España, S.A.U.	710		400				1,110
Telefónica Móviles México, S.A. de C.V.	255	623					878
Telefónica de Contenidos, S.A.U.	419						419
Telefónica de España, S.A.U.	371	165		550			1,086
Telefónica Global Technology, S.A.U.	18			17	68	97	200
Telfin Ireland, Ltd.	455						455
Telefónica Internacional, S.A.U.	3,632						3,632
Telefónica Latinoamérica Holding, S.L.	1,039						1,039
Other companies	416	69	178	29	55	62	809
Total	7,426	857	578	596	123	159	9,739

The main loans granted to Group and associated companies are described below:

The financing extended to Telefónica Móviles España, S.A.U. in 2016 consists of a loan for 400 million euros, with maturity date in 2018, and formalised in 2013 to enable this company to meet its payment obligations. These credits have 1 million euros of accrued interest receivable.

Moreover, 87 million euros of taxes are receivable from this subsidiary for its tax expense declared in the consolidated tax return (68 million euros in 2015).

At December 31, 2016 and 2015, the account receivable with Telefónica Móviles México, S.A. de C.V. amounts to 11,697 million Mexican pesos, equivalent to 538 and 623 million euros, respectively. This consideration is recognised as non-current pursuant to the expected collection date at the reporting date. At December 31, 2016, accrued interest receivable totals 258 million euros (255 million euros in 2015), which forms part of the non-current balance receivable.

At December 31, 2016, the account receivable with Telefónica de Contenidos, S.A.U. consist of a 340 million-euro participating loan awarded in 2013 and maturity date in May 2016 that has been extended until May 2017 with the same principal amount and conditions, all of which has been drawn

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down. Interest on this loan is calculated according to the performance of Telefónica de Contenidos, S.A.U. At December 31, 2016 and 2015, no accrued interest is outstanding.

In addition, 46 million euros of taxes are receivable from this subsidiary for its tax expense declared in the consolidated tax return (no amounts were outstanding for this concept in 2015).

Telefónica, S.A. 29

Table of Contents

Financial Statements

The 2016 balance for Telefónica de España, S.A.U. consists of a 550 million euros credit facility granted and drawn down in full in November 2014 and maturing in 2019, and a credit facility of 165 million euros maturing in 2017. Additionally, there is also a balance of 93 million euros comprising tax receivables from the subsidiary for its tax expense declared in the consolidated tax return (370 million euros in 2015) and accrued interest of 1 million euros.

On May 27, 2016 with the aim of enabling the necessary funds for restructuring the infrastructure business line of the Group as described above, the Company has granted its subsidiary Telxius Telecom, S.A.U. with a credit of 560 million euros at a fix interest rate and maturity in 2026 and a credit of 140 million euros and an interest rate referred to euribor maturing 2021.

In addition, 8 million euros of taxes are receivable from this subsidiary for its tax expense declared in the consolidated tax return.

In 2015 the outstanding balance of Telefónica Internacional, S.A.U. included dividends distributed and not paid by 3,529 million euros. In July and November 2016 parcial payments have been received of 328 and 1,500 million euros, respectively. On January 1, 2016 the company has merged with Telefónica Latinoamérica Holding, S.L., and this last one being the merged company. As of December 31, 2016 there are unpaid dividends from both companies amounting to 2,041 million euros. Moreover, 58 million euros of taxes are receivable from this subsidiary for its tax expense declared in the consolidated tax return (103 million euros in 2015).

On December, 30, 2015, General Shareholders Meeting of Telfin Ireland, Ltd. approved a dividend distribution totaling 455 million euros. This amount has been received in 2016.

In 2016, under Other companies it is included a long term tax receivable with Telefónica Emisiones, S.A.U. amounting to 96 millon euros due to the limitation of the deductibles financial expenses (calculated in the tax group).

The Company has also extended 446 million euros (597 million euros in 2015) of loans in connection with the taxation of Telefónica, S.A. as the head of the tax group pursuant to the consolidated tax regime applicable to corporate groups (see Note 17). The most significant amounts have already been disclosed through this Note. All these amounts fall due in the short term.

Disposals of current loans to group companies and associates includes the cancellation of balances receivable from subsidiaries on account of their membership of Telefónica, S.A. s tax group totaling 597 million euros (825 million euros in 2015).

Total accrued interest receivable at December 31, 2016 included under Current loans to group companies and associates amounted to 2 million euros (271 million euros in 2015).

8.6. Other financial assets with Group companies and associates

This includes rights to collect amounts from other Group companies related to share-based payment plans involving Telefónica, S.A. shares offered by subsidiaries to their employees maturing in 2017 and 2018 (see Note 19.3).

Telefónica, S.A. 30

Table of Contents

Financial Statements

Note 9. Financial investments

9.1. The breakdown of Financial investments at December 31, 2016 and 2015 is as follows:

2016

Millions of euros	Assets at fair value					Assets at amortized cost							Total carrying amount	Total fair value
	Measurement hierarchy					Subtotal assets at amortized cost								
Available-for-sale financial assets	Financial assets held for trading	Hedges	Subtotal assets at fair value	Level 1: quoted prices in active markets	Level 2: observable inputs data	Level 3: unobservable inputs data	Loans and receivables	Other financial assets	Subtotal assets at amortized cost	Subtotal liabilities at fair value				
Non-current financial investments	339	1,757	2,910	5,006	339	4,667		10	10	10	5,016	5,016		
Equity instruments	339			339	339							339	339	
Derivatives (Note 16)		1,757	2,910	4,667		4,667						4,667	4,667	
Loans to third parties and other financial assets								10	10	10		10	10	
Current financial investments		716	936	1,652		1,652		42	248	290	290	1,942	1,716	
Loans to third parties								42	248	290	290	290	64	
Derivatives (Note 16)		716	936	1,652		1,652						1,652	1,652	
Total financial investments	339	2,473	3,846	6,658	339	6,319		42	258	300	300	6,958	6,732	

Telefónica, S.A. 31

Table of Contents

Financial Statements

2015

Millions of euros	Assets at fair value						Assets at amortized cost						Total carrying amount	Total fair value
	Measurement hierarchy													
	Level 2: Estimates based on Level 3: other observable inputs						Level 1: market data							
	Subtotal assets at Level 1: market data						Subtotal assets at amortized cost							
	Available-for-sale financial assets	Financial assets held for trading	Hedges	fair value	Subtotal assets at Level 1: market data	observable inputs	market data	Loans receivables	Other financial assets	Subtotal assets at amortized cost	Subtotal liabilities at fair value			
Non-current financial investments	384	2,339	2,299	5,022	384	4,638		41	10	51	51	5,073	5,073	
Equity instruments	384			384	384							384	384	
Derivatives (Note 16)		2,339	2,299	4,638		4,638						4,638	4,638	
Loans to third parties and other financial assets								41	10	51	51	51	51	
Current financial investments		590	1,406	1,996		1,996		60	4	64	64	2,060	2,060	
Loans to third parties								60	4	64	64	64	64	
Derivatives (Note 16)		590	1,406	1,996		1,996						1,996	1,996	
Total financial investments	384	2,929	3,705	7,018	384	6,634		101	14	115	115	7,133	7,133	

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

The calculation of the fair values of the Company's financial debt instruments required an estimate for each currency of a credit spread curve using the prices of the Company's bonds and credit derivatives.

Telefónica, S.A. 32

Table of Contents

Financial Statements

9.2 Held-for-trading financial assets and hedges

These two categories include the fair value of outstanding derivative financial instruments at December 31, 2016 and 2015 (see Note 16).

9.3 Available-for-sale financial assets.

This category mainly includes the fair value of investments in listed companies (equity instruments) over which the Company does not have significant control or influence. The movement of items composing this category at December 31, 2016 and 2015 are as follows:

December 31, 2016

Millions of euros	Opening balance	Additions	Disposals	Other movements	Fair value adjustments	Closing balance
Banco Bilbao Vizcaya Argentaria, S.A.	298			(9)	(6)	283
Other companies	86	35	(68)		3	56
Total	384	35	(68)	(9)	(3)	339

December 31, 2015

Millions of euros	Opening balance	Additions	Disposals	Other movements	Fair value adjustments	Closing balance
Banco Bilbao Vizcaya Argentaria, S.A.	347			(10)	(39)	298
Telco, S.p.A.	73		(603)	15	515	
Other companies	63	32			(9)	86
Total	483	32	(603)	5	467	384

Banco Bilbao Vizcaya Argentaria, S.A.

The impacts shown in the column Fair value adjustments on both years include the fair value adjustment, net of tax effect of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA). These impacts are registered in the Equity of the Company (Note 11.2.). The effect, recorded both in 2016 and 2015 under other movements, relates to the sale of rights to scrip dividends that the bank distributed in both years.

At December 31, 2016 Telefónica, S.A.'s investment in BBVA represents 0.67% of that company's share capital.

Telco, S.p.A.

The revaluation in the quotation of Telecom Italia, S.p.A.'s shares since January 2015 until the spin off date is shown under 'Fair Value adjustments' column of the charts above. In June 2015, the spin off deed of Telco, S.p.A. was filed to the Companies Register. After this spin off, the net book value of the assets and liabilities of the company that according to the percentage of ownership corresponded pro-rata to Telefónica, S.A., were transferred to a newly incorporated subsidiary, Telco TE, S.p.A. as indicated in Note 8. This transaction is registered as 'Disposal' in 2015 chart of movements and has originated a financial revenue of 500 million euros.

Telefónica, S.A. 33

Table of Contents

Financial Statements

9.4 Other financial assets and loans to third parties

The breakdown of investments included in this category at December 31, 2016 and 2015 is as follows:

Millions of euros	2016	2015
Other non-current financial assets:		
Loans to third parties		41
Guarantees given	10	10
Other non-current financial assets		
Other current financial assets:		
Loans to third parties	42	60
Other current financial assets	248	4
Total	300	115

Other current financial assets includes 240 million euros of the collateral funds reinvested in BBVA (see Notes 12 and 20).

9.4.1 Loans to third parties

In June 2015, when the sale of the shares of Telecom Italia, S.p.A. was completed (see Note 8), Telefónica arranged several hedging instruments which will allow Telefónica to repurchase the shares of Telecom Italia, S.p.A. that are necessary to meet its exchange obligations under the mandatory exchangeable bonds for shares of Telecom Italia S.p.A. (see Note 13). This Equity Swap contract envisages a premium for Telefónica, S.A. that it is being quarterly cashed until the contract vesting in 2017. The pending amounts are registered in the balance sheet according to its maturity schedule and amounting to 41 million euros as short term at December 31, 2016. As of December 31, 2015 there were 41 million euros as long term loans to third parties and 55 million euros as short term loans to third parties.

Telefónica, S.A. 34

Table of Contents

Financial Statements

Note 10. Trade and other receivables

The breakdown of Trade and other receivables at December 31, 2016 and 2015 is as follows:

Millions of euros	2016	2015
Trade receivables	3	10
Trade receivables from Group companies and associates	247	295
Other receivables	16	1
Employee benefits receivable		2
Tax receivables (Note 17)	181	286
Total	447	594

Trade receivables from Group companies and associates mainly includes amounts receivable from subsidiaries for the impact of the rights to use the Telefónica brand and the monthly office rental fees (see Note 7).

Trade receivables and Trade receivables from Group companies and associates in 2016 and 2015 include balances in foreign currency equivalent to 117 million and 150 million euros, respectively. In both years these amounts relate entirely to receivables in US dollars.

These balances gave rise to exchange losses in the income statement of approximately 3 million euros in 2016 (22 million euros of exchange gains in 2015).

Telefónica, S.A. 35

Table of Contents

Financial Statements

Note 11. Equity**11.1 Capital and reserves****a) Share capital****2016**

On October 11, 2016, the deed of a share capital decrease was registered, cancelling 74,627,988 of own shares, reducing the company's share capital by 74,627,988 euros.

On December 7, 2016, the deed of a share capital increase of 137,233,781 euros ordinary shares with a par value of 1 euro each were issued, with a charge to reserves; as part of the scrip dividend shareholder remuneration deal. Share capital amounts to 5,037,804,990 euros subsequent to this increase.

At December 31, 2016, Telefónica, S.A.'s share capital amounted to 5,037,804,990 euros and consisted of 5,037,804,990 fully paid ordinary shares of a single series, par value of 1 euro, all recorded by the book-entry system and traded on the Spanish electronic trading system (Continuous Market), where they form part of the Ibex 35 Index, on the four Spanish Stock Exchanges (Madrid, Barcelona, Valencia and Bilbao) and listed on the London and Buenos Aires Stock Exchanges, and on the New York and Lima Stock Exchanges, through American Depositary Shares (ADSs).

2015

On April 20, 2015, the public deed evidencing the share capital increase granted by Telefónica, S.A. was registered with the Commercial Registry of Madrid for a nominal value of 281,213,184 euros recorded as share capital . The difference with the effective amount issued, amounting 3,048,350,914.56 euros was recorded as Share premium.

On July 24, 2015, the public deed of the share capital reduction was registered, cancelling 74,076,263 of the own shares, reducing the company's share capital by 74,076,263 euros.

On December 10, 2015, the public deed of a share capital increase of 110,857,946 euros was executed, during which 110,857,946 ordinary share with a par value of 1 euro each were issued, with a charge to reserves, as part of the scrip dividend shareholder remuneration deal. Share capital amounts to 4,975,199,197 euros subsequence to this increase.

Authorizations by Shareholders Meeting

With respect to authorizations given regarding share capital, on June 12, 2015, authorization was given at the Annual Shareholders Meeting of Telefónica, S.A. for the Board of Directors, at its discretion and in accordance with the Company's needs, to increase the Company's capital, once or several times, within a maximum period of five years from that date, up to a maximum nominal increase of 2,469,208,757 euros, equivalent to half of Telefónica, S.A.'s share capital at that date, by issuing and placing new shares, (with or without a share premium), and, in all cases, in exchange for cash, expressly considering the possibility that the new shares may not be fully subscribed. The Board of

Directors was also empowered to exclude, partially or fully, pre-emptive subscription rights under the terms of Section 506 of the Spanish Enterprises Act. However, the power to exclude preemptive rights is limited to 20% of the Company's share capital on the date of adoption of this resolution.

Furthermore, on May 30, 2014, shareholders voted to authorize the acquisition by the Board of Directors of Telefónica, S.A. treasury shares, up to the limits and pursuant to the terms and conditions established at the Shareholders' Meeting, within a maximum period of five years from that date. However, it specified that in no circumstances could the par value of the shares acquired, added to that of the treasury shares already held by Telefónica, S.A. and by any of its controlled subsidiaries, exceed the maximum legal percentage at any time (currently 10% of Telefónica, S.A.'s share capital).

Telefónica, S.A. 36

Table of Contents

Financial Statements

In addition, at the May 30, 2014 Shareholders Meeting of Telefónica, S.A., authorization was given for the Board of Directors to issue debentures, bonds, notes and other fixed-income securities and hybrid instruments, including preferred shares at one or several times within a maximum period of five years from that date. These securities may be in the form of debentures, bonds, promissory notes or any other kind of fixed-income security, or debt instruments of similar category or hybrid instruments whatever may be the forms admitted in law, plain or, in the case of debentures, bonds and hybrid instruments convertible into shares of the Company and/or exchangeable for shares of any of the Group companies, or any other company. This delegation also includes warrants or other similar securities that might give the right to directly or indirectly subscribe or acquire shares of the Company, whether newly issued or outstanding, and which may be paid for by physical delivery or by offset. The aggregated amount of the issuance(s) of securities approved under this delegation of powers may not exceed, at any given time, the sum of 25,000 million euros or the equivalent in another currency. For promissory notes, the outstanding balance of promissory notes issued under this authorization will be calculated for purposes of the aforementioned limit. Also for purposes of the foregoing limit, in the case of warrants, the sum of the premiums and exercise prices of the warrants for each issuance that is approved under this delegation shall be taken into account.

At December 31, 2016 and 2015, Telefónica, S.A. held the following treasury shares:

	Euros per share				
	Number of	Acquisition	Trading price	Market value (1)	%
	shares	price			
Treasury shares at 12/31/16	141,229,134	10.48	8.82	1,246	2.80339%
Treasury shares at 12/31/15	141,639,159	11.69	10.24	1,450	2.84690%

(1) Millions of euros

The movement in treasury shares of Telefónica, S.A. in 2016 and 2015 is as follows:

	Number of shares
Treasury shares at 12/31/14	128,227,971
Acquisitions	138,036,450
Disposals	(47,824,300)
PIP II share plan delivery (see Note 19.3)	(2,724,699)
Share redemption	(74,076,263)
Treasury shares at 12/31/15	141,639,159
Acquisitions	77,087,297
Disposals	(2,869,334)
Share redemption	(74,627,988)
Treasury shares at 12/31/16	141,229,134

Table of Contents

Financial Statements

Acquisitions

The amount of the acquisitions of treasury shares in 2016 and 2015 was 668 million euros and 1,654 million euros, respectively.

Share redemption and disposals

On October 13, 2016, pursuant to the resolution of the share capital reduction, by the cancellation of own shares, adopted by the Annual General Shareholders Meeting of Telefónica held on May 12, 2016, the public deed of this share capital reduction was registered in the Madrid Mercantile Registry (Registro Mercantil). Therefore, 74,627,988 of the own shares of Telefónica, S.A. totalling 813 million euros have been cancelled.

On July 24, 2015, pursuant to the resolution of the share capital reduction, by the cancellation of own shares, adopted by the Annual General Shareholders Meeting of Telefónica held on June 12, 2015, the public deed of this share capital reduction was registered in the Madrid Mercantile Registry (Registro Mercantil). Therefore, 74,076,263 of the own shares of Telefónica, S.A. totalling 886 million euros have been cancelled.

Treasury shares sold, including share plans redemptions, in 2016 and 2015 amount to 26 million euros and 593 million euros, respectively.

The main treasury share sale transaction in 2015 was the agreement entered by Telefónica, S.A. with Vivendi, S.A. through which Telefónica has committed to deliver 46.0 million of its treasury shares, in exchange for 58.4 million preferred shares of Telefónica Brasil, S.A. The impact in equity amounted to 555 million euros.

On June 30, 2016 the third phase of the Telefónica, S.A. long-term incentive plan called Performance and Investment Plan 2013-2016 (PIP 2013-2016) ended. No shares were delivered to Telefónica Group Management (see Note 19).

On June 30, 2015, the second phase of the Telefónica, S.A. long-term incentive plan called Performance and Investment Plan 2012-2015 (PIP 2012-2015) ended. According to the level of Total Shareholder Return (TSR) achieved, 77%, 2,724,699 shares were delivered (see Note 19).

The Company also has a derivative instrument, to be settled by offset, on a nominal value equivalent to 35.2 million of Telefónica shares in 2016 (33.8 million shares in 2015), recognized in both years under Current interest-bearing debt in the accompanying balance sheet.

b) Legal reserve

According to the text of the Corporate Enterprises Act, companies must transfer 10% of profit for the year to a legal reserve until this reserve reaches at least 20% of share capital. The legal reserve can be used to increase capital by the amount exceeding 10% of the increased share capital amount. Except for this purpose, until the legal reserve exceeds the limit of 20% of share capital, it can only be used to offset losses, if there are no other reserves available. At December 31, 2015 the balance of this reserve amounted to 984 million euros. The General Shareholders Meeting held on May 12, 2016 approved the allocation of 1 million euros in this caption. After the capital increase carried

forward in 2016, the Company needs to increase the legal reserve by 23 million euros. The proposed appropriation of profit (see Note 3) includes an allocation of 2 million euros.

c) Other reserves

Other reserves includes:

The Revaluation reserve which arose as a result of the revaluation made pursuant to Royal Decree-Law 7/1996 dated June 7. The revaluation reserve may be used, free of tax, to offset any losses incurred in the future and to increase capital. From January 1, 2007, it may be allocated to unrestricted reserves, provided that the capital gain has been realized. The capital gain will be deemed to have been realized in respect of the portion on which the depreciation has been recorded for accounting purposes or when the revalued assets have been transferred or derecognized. In this respect, at the end of 2016 and 2015, an amount of 8 million euros corresponding to revaluations reserves subsequently considered unrestricted has been reclassified to Other reserves in both periods. The balance of this reserve at December 31, 2016 and 2015 was 85 million euros and 93 million euros, respectively.

Telefónica, S.A. 38

Table of Contents

Financial Statements

Reserve for cancelled share capital: In accordance with Section 335.c) of the Corporate Enterprises Act and to render null and void the right of opposition provided for in Section 334 of the same Act, whenever the Company decreases capital it records a reserve for cancelled share capital for an amount equal to the par value of the cancelled shares, which can only be used if the same requirements as those applicable to the reduction of share capital are met. In 2015 and 2016 new reserves for cancelled capital share amounting to 74 million euros, in both years have been created. The cumulative amount of the reserve for cancelled share capital at December 31, 2016 and 2015 was 731 and 656 million euros, respectively.

Pursuant to the provisions of Royal Decree 1514/2007, since 2008, after the distribution of profits for each year, the Company set aside a non-distributable reserve of 2 million euros for goodwill amortization. Pursuant to the provisions of Royal Decree 602/2016 of December 2, 2016, the goodwill amortization amounting to 10 million euros has been registered with a counterpart in this reserve (see Note 2).

In addition to the restricted reserves explained above, Other reserves includes unrestricted reserves from gains obtained by the Company in prior years.

d) Dividends**Dividend distribution in 2016**

Approval was given at the Shareholder's Meeting of Telefónica S.A. of May 12, 2016 to pay a dividend with a charge to unrestricted reserves of a fixed gross 0.40 euros per outstanding share carrying dividend rights. The dividend was paid in full on May 19, 2016, and the total amount paid was 1,906 million euros.

On November 11, 2016 the Executive Commission of Telefónica, S.A.'s Board of Directors approval to pay a scrip dividend amounting to approximately 0.35 per share consisting of the assignment of free allotment rights with an irrevocable purchase commitment by the Company, and a subsequent capital increase with a charge to reserves by such amount as may be determined pursuant to the terms and conditions of the resolution, by means of the issue of new ordinary shares having a par value of one euro, to fulfill said allotments. The payment was paid on December 7, 2016, with and impact in equity amounting to 500 million euros.

The shareholders of 70.01% of the free-of-charge allotment rights were entitled, therefore, to receive new shares of Telefónica, S.A. Thus, the final number of shares issued in the capital increase was 137,233,781 shares with a nominal value of 1 euro each.

Dividend Distribution in 2015

Approval was given at the Board of Directors Meeting of April 29, 2015 to pay a gross 0.4 euros dividend per outstanding share against 2015 profit. This dividend was paid on May 12, 2015 and the total gross amount paid was 1,912 million euros.

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At its meeting held on November 13, 2015, the Executive Commission of Telefónica, S.A.'s Board of Directors agreed to carry out the execution of the increase in paid-up capital, related to the shareholders compensation by means of a scrip dividend, approved by the Annual General Shareholder's Meeting held on June 12, 2015.

Telefónica, S.A. 39

Table of Contents

Financial Statements

Thus, each shareholder received one free allotment right for each Telefónica share held. Such free allotment rights were traded on the Continuous Market in Spain during a period of fifteen calendar days. Once this trading period ended, the shareholders of 20.01% of the free-of-charge allotment rights accepted the irrevocable purchase commitment assumed by Telefónica, S.A. Cash payment to these shareholders was made on December 7, 2015, representing an impact in equity of 337 million euros.

The shareholders of 79.99% of the free-of-charge allotment rights were entitled, therefore, to receive new shares of Telefónica, S.A. Nevertheless, Telefónica, S.A. has waived the subscription of new shares corresponding to its treasury shares, so the final number of shares issued in the capital increase was 110,857,946 shares with a nominal value of 1 euro each.

e) Other equity instruments

On September 24, 2014, Telefónica Participaciones, S.A.U., issued 1,500 million euros of bonds necessarily convertible into new and/or existing shares of Telefónica, S.A. at a nominal fixed interest rate of 4.9%, due on September 25, 2017, guaranteed by Telefónica, S.A. The notes could be converted at the option of the noteholders or the issuer at any time from the 41st day after the Issue Date up to the 25th trading day prior to the Maturity Date. The minimum conversion price of the notes will be equal to 11.9 euros per share and the maximum conversion price will be equal to 14.5775 euros per share, resulting in a premium equal to 22.5% over the minimum conversion price.

On the same date, Telefónica, S.A. issued bonds with the same amount and characteristics of the previously detailed bond and a derivative instrument (warrant) in order to hedge the conversion price of the bonds. These bonds were wholly acquired by Telefónica Participaciones, S.A.U. In the balance sheet of Telefónica, S.A. the present value of the coupons was recorded as debt (See Note 15), the warrant was accounted as long term liabilities to group companies (see Note 16) and the remaining amount of 1,206 million euros has been recorded as other net equity instruments .

11.2 Unrealized gains (losses) reserve

The movements in the items composing Unrealized gains (losses) reserve in 2016 and 2015 are as follows:

2016

Millions of euros	Opening balance	Valuation at market	Tax effect of additions	Amounts transferred to income statement	Tax effect of transfers	Closing balance
Available-for-sale financial assets (Note 9.3)	11	13	(3)	(17)	4	8
Cash flow hedges (Note 16)	(801)	477	(119)	(308)	77	(674)

Total	(790)	490	(122)	(325)	81	(666)
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Telefónica, S.A. 40

Table of Contents

Financial Statements

2015

Millions of euros	Amounts transferred to					Closing balance
	Opening balance	Valuation at market value	Tax effect of additions	income statement	Tax effect of transfers	
Available-for-sale financial assets (Note 9.3)	20	467	(130)	(481)	135	11
Cash flow hedges (Note 16)	(1,084)	380	(137)	56	(16)	(801)
Total	(1,064)	847	(267)	(425)	119	(790)

Telefónica, S.A. 41

Table of Contents

Financial Statements

Note 12. Financial liabilities

The breakdown of Financial liabilities at December 31, 2016 and 2015 is as follows:

2016

	LIABILITIES AT FAIR VALUE				LIABILITIES AT AMORTIZED COST			
	MEASUREMENT		Level		MEASUREMENT		Level	
			Level 3:				Level 3:	
			2: Estimates				2: Estimates	
			Estimates not				Estimates not	
			based on				based on	
			other				other	
			directly				directly	
			observable				observable	
			inputs				inputs	
			market				market	
			data				data	
			payables				payables	
Millions of euros	Financial liabilities held for trading	Hedges	Subtotal financial liabilities at fair value	Level 1 quoted prices	Level 2 observable inputs	Level 3 unobservable inputs	Subtotal liabilities at fair value	TOTAL CARRYING AMOUNT
								FAIR VALUE
Non-current financial liabilities	1,721	963	2,684		2,684		41,839	44,523
Payable to Group companies and associates							37,274	40,680
Bank borrowings							4,427	4,430
Derivatives (Note 16)	1,721	963	2,684		2,684			2,684
Other financial liabilities							138	138
Current financial liabilities	628	51	679		679		16,179	16,858
Payable to Group companies and associates							13,146	13,233
Bank borrowings							1,635	1,637
Bonds and other marketable debt securities							1,158	1,164
Derivatives (Note 16)	628	51	679		679			679
Other financial liabilities							240	240
Total financial liabilities	2,349	1,014	3,363		3,363		58,018	61,381

Table of Contents

Financial Statements

2015

LIABILITIES AT FAIR VALUE								
MEASUREMENT BASED AT AMORTIZED COST								
Level 3:								
2: Estimates								
Estimates not based on other directly observable inputs								
on other directly observable inputs								
Trade								
payable and								
Subtotal								
liabilities								
at fair value								
AMOUNT								
FAIR VALUE								
Millions of euros	Financial liabilities held for trading	Hedges	Subtotal financial liabilities at fair value	Level 1 market inputs	Level 2: Estimates not based on other directly observable inputs	Trade payable and	Subtotal liabilities at fair value	TOTAL CARRYING AMOUNT
Non-current financial liabilities	2,361	486	2,847	2,847	42,446	44,868	45,293	47,715
Payable to Group companies and associates					36,683	39,109	36,683	39,109
Bank borrowings					4,825	4,805	4,825	4,805
Bonds and other marketable debt securities					800	816	800	816
Derivatives (Note 16)	2,361	486	2,847	2,847			2,847	2,847
Other financial liabilities					138	138	138	138
Current financial liabilities	236	38	274	274	14,571	13,853	14,845	14,127
Payable to Group companies and associates					13,217	12,502	13,217	12,502
Bank borrowings					1,269	1,265	1,269	1,265
Bonds and other marketable debt securities					85	86	85	86
Derivatives (Note 16)	236	38	274	274			274	274
Total financial liabilities	2,597	524	3,121	3,121	57,017	58,721	60,138	61,842

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

The calculation of the fair values of the Company's financial debt instruments required an estimate for each currency of a credit spread curve using the prices of the Company's bonds and credit derivatives.

The entire amount of Other financial liabilities relates to the received deposit of 240 million as collateral guarantees with BBVA (see Note 9 and 20).

Telefónica, S.A. 43

Table of Contents

Financial Statements

Note 13. Bonds and other marketable debt securities

13.1 The balances and movements in issues of debentures, bonds and commercial paper at December 31, 2016 and 2015 are as follows:

2016

Millions of euros	Non-convertible debentures and bonds	Other marketable debt securities	Total
Opening balance	820	65	885
Additions		374	374
Disposals		(69)	(69)
Revaluation and other movements	(32)		(32)
Closing balance	788	370	1,158
Details of maturities:			
Non-current			
Current	788	370	1,158

2015

Millions of euros	Non-convertible debentures and bonds	Other marketable debt securities	Total
Opening balance	902	6	908
Additions		83	83
Disposals	(50)	(24)	(74)
Revaluation and other movements	(32)		(32)
Closing balance	820	65	885
Details of maturities:			
Non-current	800		800
Current	20	65	85

The balance of Non-convertible debentures and bonds in 2016 is referred to Telefónica's bond issuance made on July 24, 2014 amounting to 750 million euros. The bonds were mandatorily exchangeable into ordinary shares of Telecom Italia, S.p.A, maturing on July 24, 2017. The bonds might be exchanged in advance of the transfer of the shares, except under certain circumstances where the company might opt to redeem the bonds in cash. Under "revaluation and other movements" it is included the payment of the coupon for that issuance amounting to 45 million euros in 2016.

In March 2015, in accordance with its maturity schedule, the Company cancelled the bonds issued in 2000. This movement is included as Disposals in the column of Non-convertible debentures and bonds of the 2015 chart of movements.

Telefónica, S.A. 44

Table of Contents

Financial Statements

Maturities of the nominal amounts of debenture and bond issues at December 31, 2016 and 2015 are as follows:

2016

Millions of euros			Maturity						
Name	Interest rate	% interest rate	2017	2018	2019	2020	2021	Subsequent years	TOTAL
DEBENTURES AND BONDS:									
Bonds exchangeable into Telecom Italia shares	FIXED	6.00%	750						750
Total issues			750						750

2015

Millions of euros			Maturity					Subsequent	
Name	Interest rate	% interest rate	2016	2017	2018	2019	2020	years	TOTAL
DEBENTURES AND BONDS:									
Bonds exchangeable into Telecom Italia shares	FIXED	6.00%		750					750
Total issues				750					750

13.2 At December 31, 2016, Telefónica, S.A. had a corporate promissory note program registered with the CNMV, with the following features:

Millions of euros	Amount	Nominal amount of the			Placement
		Placement system	Promissory notes	Terms of the Promissory notes	
500 million; can be increased to 2,000 million		Auctions	100,000 euros	30, 60, 90, 180, 365, 540 and 731 days Between 3 and	Competitive auctions
		Tailored	100,000 euros	731 days	Specific transactions

At December 31, 2016 the outstanding balance on this promissory note program was 370 million euros (65 million euros in 2015).

13.3 The average interest rate during 2016 on debentures and bonds outstanding during the year was 6.01% (5.96% in 2015) and the average interest rate on corporate promissory notes was 0.045% (0.14% in 2015).

Telefónica, S.A. 45

Table of Contents

Financial Statements

Note 14. Interest-bearing debt and derivatives

14.1 The balances at December 31, 2016 and 2015 are as follows:

December 31, 2016**Millions of euros**

Item	Current	Non-current	Total
Loans with financial entities	1,635	4,427	6,062
Derivative financial liabilities (Note 16)	679	2,684	3,363
Total	2,314	7,111	9,425

December 31, 2015**Millions of euros**

Item	Current	Non-current	Total
Loans with financial entities	1,269	4,825	6,094
Derivative financial liabilities (Note 16)	274	2,847	3,121
Total	1,543	7,672	9,215

14.2 The nominal values of the main interest-bearing debts at December 31, 2016 and 2015 are as follows:

Description	Value Date	Maturity Date	Currency	Limit	Balance
				12/31/16 (millions)	(million of euros)
Structured Financing (*)	05/03/11	07/30/21	USD	200	190
Structured Financing (*)	02/22/13	01/31/23	USD	669	635
Structured Financing (*)	08/01/13	10/31/23	USD	532	505
Syndicated facility (1)	02/18/14	02/18/21	EUR	3,000	
Bilateral	06/26/14	06/26/18	EUR	1,500	1,500
Syndicated facility (2)	02/19/15	02/19/22	EUR	2,500	550
Bilateral	06/30/15	06/30/20	EUR	200	200
Syndicated facility (3)	11/17/15	02/15/19	EUR	1,500	
Structured Financing (*)	12/11/15	03/11/26	USD	737	324
Structured Financing (*)	12/11/15	03/11/26	EUR	492	240

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Bilateral loan	02/23/16	02/23/19	EUR	100	100
Bilateral loan	02/23/16	02/23/21	EUR	100	100
Loan	03/08/16	03/08/21	EUR	300	300
Bilateral loan	10/24/16	03/19/19	EUR	300	300

- (1) Extended for 12 additional months of the syndicated facility signed in February 2014.
 - (2) Extended for 12 additional months of the syndicated facility signed in February 2015.
 - (3) On November 15, 2016 an amendment was signed extending the maturity for 12 additional months of the syndicated facility and an early repayment of 1,500 million euros was made.
- * Facilities with amortization schedule.

Telefónica, S.A. 46

Table of Contents

Financial Statements

Description	Value Date	Maturity Date	Currency	Limit 12/31/15 (millions)	Balance (million of euros)
Structured financing *	05/03/11	07/30/21	USD	247	226
Structured financing *	02/22/13	01/31/23	USD	786	722
Structured financing *	08/01/13	10/31/23	USD	618	447
Syndicated facility	02/18/14	02/18/19 ⁽¹⁾	EUR	3,000	700
Bilateral *	06/26/14	06/26/18 ⁽²⁾	EUR	1,500	1,500
Syndicated facility	02/19/15	02/19/20 ⁽³⁾	EUR	2,500	500
Bilateral	06/30/15	06/30/20	EUR	200	200
Syndicated facility	11/17/15	02/17/18	EUR	3,000	
Structured financing *	12/11/15	03/11/26	USD	750	
Structured financing *	12/11/15	03/11/26	EUR	500	

* Facilities with amortization schedule.

(1) The parties could mutually agree to extend the maturity to as late as 2021.

(2) On 06/25/15 an amendment was signed modifying the maturity date and including an amortization schedule. On 07/01/15 an early repayment for 500 million euros was made.

(3) The parties could mutually agree to extend the maturity to as late as 2022.

Telefónica, S.A. 47

Table of Contents

Financial Statements

14.3 Maturities of balances at December 31, 2016 and 2015 are as follows:

December 31, 2016

Items	Maturity					Subsequent years	Closing balance
	2016	2017	2018	2019	2020		
Loans with financial entities	1,635	1,159	702	380	965	1,221	6,062
Derivative financial liabilities (Note 16)	679	298	348	1,003	515	519	3,363
Total	2,314	1,457	1,050	1,383	1,480	1,740	9,425

December 31, 2015

Items	Maturity					Subsequent years	Closing balance
	2016	2016	2017	2018	2019		
Loans with financial entities	1,269	174	1,596	1,065	872	1,118	6,094
Derivative financial liabilities (Note 16)	274	658	330	256	799	804	3,121
Total	1,543	832	1,926	1,321	1,671	1,922	9,215

14.4 Interest-bearing debt arranged or repaid in 2016 mainly includes the following:

Description	Limit	Currency	Outstanding balance	Arrangement date	Maturity date	Drawdown	Repayment
	12/31/2016 (millions)		12/31/2016 (million euros)			2016 (million euros)	2016 (million euros)
Telefónica, S.A.							
Structured financing ^(*)	669	USD	635	02/22/13	01/31/23		(111)
Structured financing ^(*)	532	USD	505	08/01/13	10/31/23	124	(82)
Syndicated facility ⁽¹⁾	3,000	EUR		02/18/14	02/18/21	1,280	(1,980)
Syndicated facility ⁽²⁾	2,500	EUR	550	02/19/15	02/19/22	300	(250)
Syndicated facility ⁽³⁾	1,500	EUR		11/17/15	02/15/19	3,070	(3,070)

Structured financing (*)	737	USD	324	12/11/15	03/11/26	337	(12)
Structured financing (*)	492	EUR	240	12/11/15	03/11/26	248	(8)
Bilateral loan	100	EUR	100	02/23/16	02/23/19	100	
Bilateral loan	100	EUR	100	02/23/16	02/23/21	100	
Loan	300	EUR	300	03/08/16	03/08/21	300	
Bilateral loan	300	EUR	300	10/24/16	03/19/19	300	

(1) Extended for 12 additional months of the syndicated facility signed in February 2014.

(2) Extended for 12 additional months of the syndicated facility signed in February 2015.

(3) On November 15, 2016 an amendment was signed extending the maturity for 12 additional months of the syndicated facility and an early repayment of 1,500 million euros was made.

(*) Facility with amortization schedule.

14.5 Average interest on loans and borrowings

The average interest rate in 2016 on loans and borrowings denominated in euros was 0.566% and 2.066% for foreign-currency loans and receivables.

The average interest rate in 2015 on loans and borrowings denominated in euros was 0.557% and 2.099% for foreign-currency loans and receivables.

Table of Contents

Financial Statements

14.6 Unused credit facilities

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

At December 31, 2016 and 2015, Telefónica had undrawn credit facilities amounting to 10,302 million euros and 11,705 million euros, respectively.

Financing arranged by Telefónica, S.A. at December 31, 2016 and 2015 is not subject to compliance with financial ratios (covenants).

Telefónica, S.A. 49

Table of Contents

Financial Statements

Note 15. Payable to group companies and associates**15.1 The breakdown at December 31, 2016 and 2015 is as follows:****December 31, 2016**

Millions of euros	Non-current	Current	Total
Loans	37,218	12,365	49,583
Trade payables to Group companies and associates	6	239	245
Derivatives (Note 16)	18	202	220
Payable to subsidiaries due to taxation on a consolidated basis	32	340	372
Total	37,274	13,146	50,420

December 31, 2015

Millions of euros	Non-current	Current	Total
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