

Notes to the Consolidated Financial Statements 2007

(1) ACTIVITIES OF GROUP COMPANIES

Red Eléctrica de España, S.A., (hereinafter the Parent company or the Company) was incorporated in 1985. The principal activities carried out by the Parent company are the transmission of electricity, operation of the system and management of the transmission grid, coordination of international electricity exchanges and the administration of international electricity agreements.

The Red Eléctrica Group, together with the Parent company as the head of the same, acquires, holds and manages foreign securities, provides consulting, engineering and construction services outside the Spanish electricity system, wins funds, carries out financial transactions and provides financial services to the Group companies through its investees (Appendix I).

In addition, in December 2007, in accordance with Law 17/2007 of 4 July 2007, which amends Law 54/1997 on the Electricity Sector, Red Eléctrica de España TSO, S.L.U. (hereinafter REE TSO) was incorporated with share capital of Euro 6 thousand and was dormant during the year. This company is wholly-owned by the Parent company (Appendix I).

(2) BASIS OF PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS

a) General information

The consolidated financial statements have been prepared by the Directors of the Parent company to present fairly the consolidated equity and the consolidated financial position at 31 December 2007, the results of the operations, and changes in consolidated equity and cash flows of the Group for the year then ended.

The consolidated financial statements are expressed in thousands of euro and have been prepared in accordance with International Financial Reporting Standards adopted by the European Union (IFRS-EU), in accordance with EC Regulation 1606/2002 of the European Parliament and Council and the interpretations (IFRIC) endorsed by the European Union.

All mandatory accounting principles which would have a significant effect on the preparation of these consolidated financial statements have been applied.

These consolidated financial statements, prepared by the Directors of the Company at the Board meeting held on 27 March 2008, have been prepared on the basis of the individual accounting records of the Company and other companies which comprise the Red Eléctrica Group (Appendix 1). The companies prepare their financial statements in accordance with the accounting principles in effect in the country where they operate. Therefore the consolidated financial statements include certain adjustments and reclassifications made to bring the accounting principles followed by the Group companies in preparing their financial statements into line with EU- IFRS. Similarly, the accounting policies of the consolidated companies are changed when it is necessary to ensure consistency with the accounting policies adopted by the Company.

The consolidated financial statements for 2006 were approved by the shareholders at their annual general meeting held on 31 May 2007. The consolidated financial statements for 2007 are pending approval at the General Shareholders' Meeting. Nonetheless, the directors of the Company consider that those consolidated financial statements will be approved without changes.

b) New EU-IFRS and IFRIC interpretations

The Group has adopted the following accounting standards (EU-IFRS) that have no effect on the Group's financial position since they only entail additional disclosure:

- IFRS 7, "Financial Instruments; disclosures", which requires disclosures enabling users to assess the significance of financial instruments and the nature and scope of the risks that such financial instruments entail.
- Changes to IAS 1 "Presentation of Financial Statements" which requires new disclosures which enable users to assess the objectives, policies and procedures to manage capital.

The adoption of the remaining new standards and interpretations (IFRIC 8 and IFRIC 9), approved and published, which came into effect on 1 January 2007, has not had a significant impact on these consolidated financial statements.

With respect to the new accounting standards, changes to existing standards and interpretations (IFRIC 7, IFRIC 10, IFRIC 11, IFRS 8, IAS 1, IAS 23, IAS 27, IFRS 2, IFRS 3, IAS 32, IFRIC 12, IFRIC 13 and IFRIC 14) to be applied to the years commencing 1 January 2008, the Group does not expect them to have significant effects on the consolidated financial statements.

c) Accounting estimates and assumptions

The preparation of the financial statements under IFRS requires Group management to make judgements, estimates and assumptions that affect the application of standards and the reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The consolidated financial statements for 2007 include the estimates of management of the Group and consolidated companies on the value of assets, liabilities, income, expenses and commitments recognised, which were subsequently ratified by the Board of Directors. These estimates mainly comprise:

- Estimated recovery of assets. The calculation of impairment of assets is based on discounted cash flows according to the financial projections used by the Group. The discount rate used is the weighted average cost of capital, taking into account the country- risk premium.
- Estimates of the useful lives of property, plant and equipment.
- Assumptions used in the actuarial calculations.
- As a general rule, liabilities are accounted for when an obligation is likely to give rise to an indemnity or payment. The Group assesses and estimates the necessary amounts to be paid in the future, including additional amounts relating to income taxes, contractual obligations, the settlement of outstanding litigations or other liabilities. Those estimates are subject to interpretations of current events and circumstances, projections of future events and estimates of the financial effects of those events.

With respect to the disciplinary proceedings instigated by the Generalitat de Catalunya in relation to the power cut of 23 July 2007 which interrupted the electricity supply in Barcelona and which at the year end is in the preliminary investigation stage, the Company has not recorded any liability or provision as the circumstances required for recognition have not arisen. There are legal arguments, reasons and significant evidence, on the basis of the information available, to consider that the process will end in a firm and definitive judgement which will not have major economic consequences for Red Eléctrica de España.

In addition, the Company has arranged insurance policies to cover possible third- party claims which may be filed in the ordinary course of its activities.

Although estimates were based on the best information available at 31 December 2007, future events may require these estimates to be modified (increased or decreased) in subsequent years. Any change in accounting estimates would be recognised prospectively in the corresponding consolidated income statement in accordance with IFRS.

d) Basis of consolidation

Consolidation of the results generated by entities for which control was acquired during the year is carried out taking into consideration only those results relating to the period between the date of acquisition and the close of that year.

Details of the type of companies consolidated and the respective methods of consolidation are as follows:

Subsidiaries

Subsidiaries are entities controlled by the Parent company. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Control is presumed to exist when the Parent company owns, directly or indirectly through subsidiaries, 50% or more of the voting rights. Control also exists when the Parent company owns half or less of the voting rights of an entity where there is power over more than half of the voting rights by virtue of an agreement with other investors or where it has power to cast the majority of votes at the meetings of the Board of Directors and control of the entity is by that Board.

The financial statements of subsidiaries are fully consolidated.

Associates

Associates are entities over which the Company has significant influence but not control or joint control. Usually significant influence in an investee (direct or indirect) is when a company holds an interest equal to or more than 20% of the voting rights.

Investments in associates are accounted for by the equity method of accounting, that is, at the percentage share in the equity of the associate once dividends received from the associate and other balances have been eliminated less impairment of individual shareholdings (in the event of transactions with associates the corresponding profit and loss should be eliminated to the extent of the Group's interest in the associate).

Any excess of cost of acquisition over the fair value of identifiable net assets of the associate attributable to the Group on the acquisition date is considered as goodwill and recognised in the consolidated balance sheet under associates. If the cost of acquisition is less than the fair value of the part of the fair value of the identifiable net assets of the associate held by the Group on the acquisition date (i.e. discount on acquisition) the difference is recognised directly in the income statement in the period of acquisition.

Information on consolidated subsidiaries and associates of the Company, the consolidation or valuation methods applied in the preparation of the accompanying consolidated financial statements and other information are included in Appendix 1.

The financial statements of each Group company are expressed in the functional currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in euro, which is the Parent company's functional and presentation currency.

The financial year end closing dates of the financial statements of the subsidiaries and associates coincide with those of the Parent company.

The operations of the Company and subsidiaries have been consolidated in accordance with the following basic principles:

- The accounting principles and criteria used by the Group companies have been brought into line with those used by the Parent company.
- The financial statements of foreign companies have been translated by applying the year-end exchange rates at the date of the balance sheet for assets and liabilities and the average exchange rate for the period for income and expenses.
- Exchange rate differences resulting from translation to euro are recognised in the consolidated balance sheet at the year end as a separate component of equity named Conversion differences.
- All significant balances and transactions between fully consolidated companies have been eliminated in the consolidation.
- Margins on sales of capitalised goods and services between Group companies are eliminated when the relevant operations are carried out.

e) Changes in the consolidated Group

In July 2007 the company Tenedora de acciones de Redesur, S.A. (hereinafter Tenedora) was dissolved and thereafter all shares in Red Eléctrica del Sur, S.A. (hereinafter Redesur) have been held directly by REI (note 8).

In December 2007, in accordance with Law 17/2007 of 4 July 2007, Red Eléctrica de España TSO, S.L. was incorporated with share capital of Euro 6 thousand and was dormant during the year. This company is wholly-owned by the Parent company.

(3) INDUSTRY REGULATION

Electricity sector in Spain

The electricity sector is regulated by Law 54/1997, of 27 November 1997, on the Electricity Sector, as partly amended by Law 17/2007, of 4 July 2007. This Law on the Electricity Sector recognises that electricity transmission is a natural monopoly due to the economies of scale provided by the single grid. The deregulation of transmission is arranged through generalised third-party access to the grid, which is available to the various parties to the electricity system and consumers in exchange for the payment of access tariffs. Remuneration for this activity is established by the Administrations and is determined based on the costs of investment, operation and facility maintenance, as well as other necessary costs incurred in operations.

In addition to transmission, the Parent company has been assigned the functions of system operator and transmission grid manager under the Law.

In the performance of its Spanish electricity system operator activities, the Company's main function is to ensure the continuity and security of electricity supply and the correct coordination of the production and transmission system, by carrying out its functions in coordination with the operators and players of the Mainland Electricity Energy Market under principles of transparency, objectivity and independence. The Company has also been assigned the functions of settlement, communication of payments and collections and the management of guarantees related to the guarantee of supply and the effective diversion of generation and consumption units.

Additionally, the Company has also been attributed the operation of the island and off-mainland electricity systems in the Balearic Islands, Canary Islands, Ceuta and Melilla.

In its capacity as transmission grid manager, the Parent company is in charge of the development and extension of the high voltage network, and must ensure that it is maintained and improved in accordance with consistent and coherent criteria. It is also responsible for the administration of power transmission between external systems using the Spanish grid, as well as withholding access to the grid when capacity is insufficient.

Law 54/1997 deregulated intra—EU and international electricity exchanges, which may be carried out freely by agents. The Company, in its capacity as system operator, is responsible for short-term exchanges aimed at ensuring supply quality and safety, as well as the administration of long-term intra-EU and international electricity contracts concluded by the Company. Law 17/2007 authorises the Company to assign the rights under these contracts.

Law 17/2007, of 4 July 2007, whereby Law 54/1997, of 27 November 1997 on the Electricity Sector, was amended in order to adapt it to Directive 2003/54/EC, of the European Parliament and Council, of 26 June 2003, on common standards for the domestic electricity market, lays down numerous and substantial changes to Law 54/1997, affecting all activities aimed at electricity supply and the functions of the different bodies regulating the electricity sector.

Of the changes that have a direct effect on the activities carried out by the Parent company, noteworthy is the creation of the function of sole transmission operator and its assignment to Red Eléctrica, that will carry it out together with the functions of system operator and transmission grid manager. In order to bring the sole transmission operator function into effect, the Law lays down that companies owning transmission facilities should transfer these facilities to the Company within a maximum of three years.

Law 17/2007 lays down that Red Eléctrica de España, S.A. will set up within one year of its entry into force a wholly-owned subsidiary which will carry out the functions of system operator, transmission grid manager and transmission operator. This company will be set up through the contribution of all tangible assets and personnel devoted to the performance of such activities. All provisions concerning the system operator and transmission grid manager of the Electricity Sector Law will be applied to this subsidiary, REE TSO, which was incorporated in

December 2007. Similarly, this Law contains limits to the shareholdings which may be held in Red Eléctrica de España, S.A., which are set at a maximum of 5%, while voting rights are limited to 3% for all shareholders, except for companies carrying out activities in the electricity sector (or with interests in the capital of such companies of more than 5%), for which the limit to voting rights is set at 1%. The 4% limit with respect to the sum of direct or indirect holdings of operators carrying out activities in the electricity sector is maintained. These shareholding limitations with respect to the Parent company are not applicable to SEPI which will, in any event, hold a shareholding of at least 10%. At 31 December 2007 SEPI holds a significant investment in the Parent company amounting to 20% of share capital.

International electricity sector

The Red Eléctrica Group, through Red Eléctrica Internacional, S.A.U. (hereinafter REI), has investments in the electricity sector internationally, namely, in Bolivia and Peru.

Both of these countries have deregulated their electricity industry and use a regulation model supported by regulated tariffs for transmission.

(4) ACCOUNTING PRINCIPLES

The main accounting principles used in the preparation of these consolidated financial statements are as follows:

a) Property, plant and equipment

Property, plant and equity mainly comprise electricity plants which are measured, as appropriate, at production or acquisition cost. Cost includes, where applicable, the following items:

- Finance costs on external financing solely accrued during the construction period.
- Operating costs, directly related to the construction of property, plant and equipment in projects controlled or managed by Group companies.

It is the policy of Group companies to transfer work in progress to property, plant and equipment in operation once it is brought into service and provided that the assets are in condition for use.

Enlargement or improvement expenses which lead to an increase in productivity or capacity or lengthen the useful lives of the assets are stated as an increase in the carrying value of the asset.

Repair and maintenance costs of property, plant and equipment which do not increase productivity, do not improve performance or lengthen its useful life are recognised in the consolidated income statement when incurred.

Property, plant and equipment is depreciated on a straight-line basis over its estimated useful life, which reflects the period in which the companies expect to use the asset, applying the following rates:

	Annual rate
Buildings	2%-10%
Electrical energy technical installations	2.5%-7.14%
Other installations, machinery, tooling, furnishings and other fixed assets	4%-25%

b) Investment properties

Investment property is measured at acquisition cost. The market value of the Group's investment property is broken down in note 6 to the accompanying consolidated financial statements.

Investment property is depreciated on a straight-line basis over its estimated useful life, which reflects the period in which the companies expect to use the asset.

c) Intangible assets

Intangible assets are stated at acquisition cost and tested and adjusted on a regular basis for impairment. The assets included under this heading are as follows:

Computer applications

Software licences are capitalised based on their acquisition cost and preparation for use.

Software maintenance costs are expensed as incurred. Software is amortised on a straight-line basis over a period of between three and five years from the installation date of each program.

Development expenses

Development expenses are recognised as an expense as incurred. Costs incurred in development projects (associated with the design and testing of new products or upgrades) are capitalised when there is evidence of the project's technical success and economic feasibility and where expenditure attributable to the asset during the development can be measured reliably. Capitalised development costs with a finite useful life are amortised on a straight-line basis over a period not exceeding five years from commencement of the project.

d) Financial assets

The Group classifies financial assets, except those investments accounted for using the equity method and those held for sale, in the following two categories:

Credits and receivables, are non-derivative financial assets with fixed or determinable payments which are not listed on an active market and with respect to which there is no intention to trade in the short term. They are classified as current assets except for assets maturing in more than 12 months of the balance sheet date which are classified as non-current assets.

Credits are initially recognised at fair value, including transaction costs incurred on inception and subsequently measured at amortised cost. Amortised cost mainly comprises the amount extended less any repaid principal, plus accrued interest receivable.

Receivables are initially recognised at fair value and subsequently at amortised cost using the effective interest rate method. Furthermore, current advances generally deriving from multi-year contracts or commitments are considered accounts receivable and taken to the income statement over the period during which such contracts or commitments are in effect.

Available-for-sale financial assets, are investments which the Company intends to hold for an unspecified period of time and which may be sold, on the basis of specific liquidity needs or changes in interest rates. They are classified as non-current assets unless their liquidation is planned in less than one year and this is feasible. These financial assets are stated at fair value, which is understood to be their quoted price at the year end for those securities quoted on an active market. The gains or losses resulting from fluctuations in fair value at the year end are recognised directly in equity and accumulated to the time of settlement or adjustment of value owing to impairment, at which time they are taken to the income statement. Dividends from shareholdings in capital classed as available for sale are taken to the consolidated income statement at the time the Company becomes entitled to receive them.

e) Inventories

Inventories of materials and replacement parts are measured at the lower of acquisition cost, which is determined using the lower of the average weighted price method and market value.

Group companies review the net realisable value of inventories at each year end, recognising value adjustments where cost exceeds market or where doubts exist over their use. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in net realisable value because of changed economic circumstances, the amount of the write-down is reversed.

f) Cash and cash equivalents

Cash and cash equivalents include cash on hand, demand deposits in credit institutions and other highly liquid short-term investments.

g) Impairment of assets

Group companies analyse the recoverability of non-current assets at the year end each year and whenever some event or change in circumstances indicates that the carrying value may not be recoverable. If the recoverable amount of an asset is less than its carrying value, an impairment loss is recognised immediately. The impairment loss is therefore the difference between the carrying value of an asset and its recoverable value.

h) Share capital and dividends

Share capital consists of ordinary shares. The issue costs of new shares, net of taxes, are deducted from equity.

The interim dividend reduces equity for the year to which it relates, on the basis of the resolution of the Board of Directors. Complementary dividends are not charged to equity until approved by the shareholders at their Annual General Meeting.

i) Other non-current liabilities**Employee benefits****(i) Pension commitments**

The Group has defined contribution plans establishing the pension amounts employees receive upon retirement, normally based on one or more factors such as age, length of service or remuneration. Under the defined contribution plan, the Group pays set contributions to an external entity and has no legal or implicit obligation to make further contributions if the fund lacks sufficient assets to satisfy payments to employees for services rendered in the current and prior years.

(ii) Other long-term employee benefits

Other long-term employee benefits include defined benefit plans other than pensions such as: electricity and healthcare for serving and retired Parent company employees and length-of-service bonuses in the Bolivian company TDE. Expected costs of benefits are recognised over the term of employment of personnel. These commitments are measured annually by qualified independent actuaries. Changes in actuarial assumptions are debited or credited to the consolidated income statement as soon as they occur. The total cost of past services is recognised immediately.

Government grants and non-current advances

Outright capital grants received from government agencies to finance the acquisition of assets are recorded by the Group, once the relevant investments have been made and it is assured that the grant will be received.

The Group recognises grants under other gains in the income statement for each year over the term in which depreciation of the related asset is charged.

Non-current advances generally received in connection with multi-year contracts or commitments are taken to net revenues or other gains on a straight-line basis over the term of the contracts or commitments.

j) Provisions

The Group makes provisions for the amount required to settle present contractual obligations, legal or implicit, deriving from past events provided that the Group expects that it will probably have to settle them through the outflow of resources and the amount involved can be reliably estimated. Provision is made when the liability or commitment is incurred.

Provisions are valued at the present value of the cash outflows which are expected to be necessary to settle the obligation using a rate before taxes which reflects the current market assessment of the temporary interest rate and specific risks of the obligation. The increase in the provision as a result of the passage of time is recognised as an interest expense.

k) Borrowings

Loans, obligations and similar are initially reflected at the amount of cash received, net of the costs incurred in the transaction. In subsequent periods, these financing obligations are valued at amortised cost, using the effective interest rate method, except for those transactions for which hedging has been arranged.

Borrowings are classed as current liabilities unless they mature in more than 12 months from the balance sheet date or include tacit renewal clauses.

l) Foreign currency transactions

Foreign currency transactions are translated into euro using the exchange rate prevailing at the date of the transaction. Differences between the value at which foreign currency balances were recorded and the exchange rate prevailing at the date of collection or payment are recognised in the consolidated income statement.

Fixed-income securities and credits and debits in foreign currency at 31 December are translated to euro at the closing exchange rate. Foreign exchange differences arising on translation are taken to exchange gains and losses in the consolidated income statement, as appropriate.

Operations in foreign currency which the Group has hedged using financial derivatives or other hedging instruments are stated according to the principles described in Derivative instruments and hedges.

m) Financial derivatives and hedging operations

Financial derivatives are initially recognised at fair value at the contract date (acquisition cost) in the consolidated balance sheet and subsequently the gain or loss on measurement to fair value is accounted for. The method used to recognise the resulting gain or loss depends on whether the derivative has been designated as a hedge and if so, the nature of the item hedged.

The total fair value of derivatives is classified as non-current assets or liabilities if the time remaining to maturity of the hedged item is more than 12 months and as current assets or liabilities if the time remaining to maturity of the hedged item is less than 12 months.

The Group classifies some derivatives as fair value hedging of recognised assets or liabilities or as a firm commitment (fair value hedges) or as hedging of highly foreseeable transactions (cash flow hedges as hedging of net investment in foreign operations).

The Group documents the relation between the hedging instruments and the assets or liabilities hedged at inception, as well as the purpose of the risk management and the strategy to carry out hedging transactions. The Group also documents its assessment, both at inception and on an on-going basis, of whether the derivatives used in the hedge are highly efficient to offset changes in fair value or cash flows from the items hedged.

The fair value of various derivatives used for hedging purposes is set out in note 17. Movements in equity are set out in note 11.

- For cash flow hedges, the effective part of changes in fair value of the derivatives which are designated and classed as cash flow hedges is recognised in equity. The gain or loss on the non-effective part is recognised directly in the consolidated income statement.
- For fair value hedges, changes in the fair value of derivatives designated as hedges are recognised in the consolidated income statement. Similarly, changes in the fair value of the hedged item in relation to the risk hedged are also recognised in the consolidated income statement. Therefore hedge accounting accelerates the recognition of income and expense of the hedged item in order to offset the effect of the derivative on the income statement.
- Net investment hedges on foreign operations are recorded in a similar manner to cash flow hedges. Any gain or loss on the hedge related to the effective part of the hedge is recognised in equity. The gain or loss on the non-effective part is recognised directly in the consolidated income statement. Accumulated gains and losses in equity are included in the income statement when the foreign operation is sold.

When a hedging instrument matures or is sold or when the requirements for its accounting as a hedge are not met, the gain or loss accumulated to such time in equity continues to be recorded in equity and is recognised as and when changes in the cash flows from the hedged item are recognised in the consolidated income statement. When the forecast transaction is not expected to arise, the accumulated gain or loss in equity is recognised in the consolidated income statement.

The market price of different financial derivative instruments is calculated as follows:

- The fair value of derivatives quoted on official markets is measured at its closing quotation price.
- For derivatives not quoted on organised markets, the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, relating to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models refined to reflect the issuer's specific circumstances.

n) Trade payables

Trade payables are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method.

o) Income and expense

Income and expense are recorded on an accruals basis, i.e. in the period in which the income or expense deriving from the goods or services in question is earned or incurred rather than the period in which the cash is actually received or disbursed.

Where the Parent company acts as an intermediary in international exchange, purchases and sales of electricity are made on account of the system and the Company receives a margin for the intermediation activity which is recorded under services rendered in the consolidated income statement.

Interest income is recognised using the effective interest rate method.

Income from dividends is recognised when the collection right is established.

p) Tax situation

Income tax expense / (income) for the year comprises current and deferred tax. Income tax, both current and deferred, is recognised in the income statement and in determining net profit or loss for the year, except if it relates to items recognised directly in equity or a business combination.

Current tax is the estimated tax payable on taxable income for the year using tax rates prevailing at the balance sheet date and any adjustment to tax payable in respect of previous years.

Deductions and credits relating to economic events arising in the year are recorded as a reduction in the accrued income tax expense unless there are doubts as to their realisation.

Deferred tax and the corporate income tax expense are calculated and accounted for using the liability method, on differences between assets and liabilities for financial reporting purposes and the amounts used for tax purposes. This method comprises the determination of deferred tax assets and liabilities for differences between the carrying value of assets and liabilities at the amounts for tax purposes, using tax rates which are expected to come into effect when these tax assets are realised and tax liabilities are settled.

Deferred tax assets are recognised to the extent that future tax profits are expected to arise against which to offset temporary differences.

Deferred income tax is recognised on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

q) Earnings per share

Earnings per share are calculated on the net profit attributable to the Parent company and a weighted average number of ordinary shares outstanding during the year, excluding the average number of Parent company shares held.

In the case of the consolidated financial statements of the Red Eléctrica group at 31 December 2007 and 2006, basic earnings per share agree with diluted earnings since there have been no operations during those years which may change this figure.

r) Insurance

The Red Eléctrica Group has contracted various insurance policies to cover the risks to which companies are subject through their activities. These risks mainly comprise damages to the Group companies' electricity plants and potential claims for third party damages which could arise from the Group's activities. Insurance premium expenses are recognised in the consolidated income statement on an accruals basis. Income to be recovered from insurance companies deriving from claims is reflected in the consolidated income statement using the matching principle.

s) Environment

Expenses deriving from business actions taken to protect and improve the environment are recorded as an expense in the year incurred. When they relate to acquisitions of property, plant and equity the purpose of which is to minimise the environmental impact and protect and improve the environment, they are recorded as an increase in the value of fixed assets.

t) Assets held for sale

Current assets are classed as assets held for sale and are recognised at their carrying value less cost of sale if they are expected to be sold within one year.

u) Share-based payments

The Parent company and REI have implemented a share acquisition plan under which managers are able to receive shares from the Company as part of their ordinary annual remuneration. The valuation of such share-based remuneration is based on the closing price of the Company's share at the time of delivery. The expense deriving from this plan is reflected under Staff costs in the consolidated income statement. All shares delivered derive from the Company's treasury shares.

(5) PROPERTY, PLANT AND EQUIPMENT

The movement in 2007 and 2006 in property, plant and equipment and the relevant accumulated depreciation and impairment is as follows:

**GRUPO RED ELÉCTRICA · Movements in Property, plant & equipment
at 31 December 2007 and 2006 (in thousands of euros)**

	31 December 2005	Additions	Variations rate of exchange
Cost			
Land and buildings	63,999	314	(837)
Electrical energy facilities	5,636,093	16,212	(18,656)
Other facilities, machinery, tooling, furnishings and other fixed assets	90,220	2,868	(236)
Electrical energy technical installations in progress	356,278	507,630	(398)
Advances and tangible assets in progress	21,111	2,314	(527)
Total cost	6,167,701	529,338	(20,654)
Accumulated amortisation			
Buildings	(10,745)	(1,265)	262
Electrical energy facilities	(1,923,086)	(235,776)	8,407
Other facilities, machinery, tooling, furnishings and other fixed assets	(59,435)	(9,966)	146
Total accumulated depreciation	(1,993,266)	(247,007)	8,815
Value impairment	(5)	(11,756)	1
Net value	4,174,430	270,575	(11,838)

The main additions in 2007 and 2006 relate to the electricity transmission grid in Spain.

During 2007 the companies have capitalised as an increase in the value of Property, plant and equipment finance expenses amounting to Euro 9,104 thousand (Euro 7,809 thousand at 31 December 2006) at an average cost of 4.15% (2.86% in 2006).

Operating expenses directly related to construction in progress of property, plant and equipment capitalised in 2007 amount to Euro 5,355 thousand (Euro 8,656 thousand in 2006).

Impairment records the adjustments to carrying value of those facilities where construction has been interrupted mainly for reasons beyond the Company's control (note 21-e).

At 31 December 2007 the Group companies have no commitments for the acquisition of operational facilities. The companies' commitments basically relate to the agreements for the acquisition of materials and services for the construction of electricity facilities as part of the ordinary activity of the Group companies.

Disposals reductions and write-downs	Transfers	31 December 2006	Additions	Variations rate of exchange	Disposals reductions and write-downs	Transfers	31 December 2007
-	1,222	64,698	1,104	(763)	(552)	(491)	63,996
(423)	404,405	6,037,631	47,724	(18,015)	(719)	380,532	6,447,153
(3)	4,955	97,804	244	(247)	(257)	7,772	105,316
(799)	(393,642)	469,069	485,145	(1,120)	-	(367,925)	585,169
-	(15,159)	7,739	93,506	(123)	-	(20,484)	80,638
(1,225)	1,781	6,676,941	627,723	(20,268)	(1,528)	(596)	7,282,272
-	(239)	(11,987)	(1,189)	259	-	-	(12,917)
115	-	(2,150,340)	(236,335)	9,287	-	-	(2,377,388)
43	-	(69,212)	(11,234)	160	254	-	(80,032)
158	(239)	(2,231,539)	(248,758)	9,706	254	-	(2,470,337)
-	-	(11,760)	(11,639)	-	-	-	(23,399)
(1,067)	1,542	4,433,642	367,326	(10,562)	(1,274)	(596)	4,788,536

(6) INVESTMENT PROPERTY

Movements in 2007 and 2006 in investment property owned by the Group are described below:

GRUPO RED ELÉCTRICA · Movements in investment properties at 31 December 2007 and 2006 (in thousands of euros)

	31 December 2005	Additions	Variations rate of exchange	Transfers	31 December 2006	Additions	Variations rate of exchange	Transfers	31 December 2007
Cost									
Investment properties	4,160	-	(52)	(1,136)	2,972	-	(48)	(78)	2,846
Total cost	4,160	-	(52)	(1,136)	2,972	-	(48)	(78)	2,846
Accumulated amortisation									
Investment properties	(494)	(10)	27	239	(238)	(61)	16	34	(249)
Total accumulated depreciation	(494)	(10)	27	239	(238)	(61)	16	34	(249)
Net value	3,666	(10)	(25)	(897)	2,734	(61)	(32)	(44)	2,597

Transfers in 2007 relate to properties which are expected to be sold in 2008 and are classified as available for sale. Transfers for 2006 relate to investment properties owned by the Parent company for its own use.

Investment property has a market value of approximately Euro 3 million.

(7) INTANGIBLE ASSETS

Movements in 2007 and 2006 in intangible assets and accumulated amortisation are as follows:

**GRUPO RED ELÉCTRICA · Movements in Intangible assets
at 31 December 2007 and 2006 (in thousands of euros)**

	31 December 2005	Additions	Differences on exchange
Cost			
Development expenses and computer applications	38,451	259	(167)
Total cost	38,451	259	(167)
Accumulated amortisation			
Development expenses and computer applications	(29,765)	(2,829)	129
Total accumulated amortisation	(29,765)	(2,829)	129
Net value	8,686	(2,570)	(38)

(8) INVESTMENTS CARRIED UNDER THE EQUITY METHOD

Movements in 2007 and 2006 in investments carried under the equity method are as follows:

**GRUPO RED ELÉCTRICA · Movements in investments carried under the equity method
at 31 December 2007 and 2006 (in thousands of euros)**

	31 December 2005	Additions	Equity consolidation method	Dividends
Redesur, Redinsur y Tenedora de acciones de Redesur	7,142	618	847	(510)

In July 2007 the Tenedora was wound up. As a result, REI owns a direct holding in Redesur.

Disposals for 2007 relate to the capital decrease carried out in Redesur with the return of contributions to shareholders amounting to USD 6,000 thousand.

Additions for 2006 relate to the acquisition by REI of an additional 6.25% in Tenedora.

(9) INVENTORIES

Details of inventories at 31 December 2007 and 2006 in the accompanying consolidated balance sheet are as follows:

	thousands of euros	
	2007	2006
Inventories	38,641	34,756
Value adjustments	(6,414)	(5,782)
	32,227	28,974

Transfers	31 December 2006	Additions	Differences on exchange	31 December 2007
(645)	37,898	1,221	(157)	38,962
(645)	37,898	1,221	(157)	38,962
-	(32,465)	(2,644)	140	(34,969)
-	(32,465)	(2,644)	140	(34,969)
(645)	5,433	(1,423)	(17)	3,993

Exchange differences	Other	31 December 2006	Equity consolidation method	Exchange differences	Disposals	Other	31 December 2007
(753)	(140)	7,204	664	(812)	(1,362)	(244)	5,450

(10) CURRENT TRADE AND OTHER RECEIVABLES

At 31 December 2007 and 2006 this heading in the accompanying consolidated balance sheet breaks down as follows: Receivables mainly comprise amounts pending invoicing and/or receivable in respect of electricity transmission and system operation activities.

	thousands of euros	
	2007	2006
Receivables	298,137	264,326
Current receivables	-	450
Amounts due from associates	1,463	77
	299,600	264,853

(11) EQUITY**a) Capital risk management**

The Group's objectives in relation to capital management are to safeguard its capacity to continue as a going concern, secure a return for shareholders, maintain an optimal capital structure and reduce costs.

In order to maintain or adjust the capital structure, the Group could adjust the amount of the dividends payable to shareholders, reimburse capital to shareholders or issue new shares.

The Group monitors capital in accordance with the financial leverage ratio in line with general practice in the sector. This ratio is calculated as net financial debt divided between net assets (understood as the Group's equity plus net financial debt). The net financial debt is calculated as follows:

The credit rating granted by Moody's and Standard & Poors has remained consistent in 2007 at A2 and AA, respectively.

	thousands of euros	
	2007	2006
Long-term loans	2,593,727	2,502,226
Current payables	42,443	123,318
Exchange rate derivative	72,211	32,211
Cash and cash equivalents	(11,337)	(13,374)
Net borrowings	2,697,044	2,644,381
Equity	1,202,828	1,022,031
Leverage ratio	69.2%	72.1%

b) Share capital

At 31 December 2007 and 2006 the share capital of the Parent company comprises 135,270,000 fully subscribed and paid-in bearer shares, with a par value of Euro 2 each which carry equal voting and dividend rights. The Parent company's shares have been listed on the four Spanish stock exchanges since 7 July 1999 after the public offering for their sale.

At 31 December 2007 and 2006 Sociedad Estatal de Participaciones Industriales (SEPI) holds 20% of the share capital in the Parent company.

c) Other reserves

This heading comprises statutory reserves including the Euro 247,022 thousand appropriated to the 1996 revaluation reserve on revaluation of property, plant and equipment by the Parent company. This reserve may be used, without being taxed, to offset tax losses, increase share capital or, following 10 years after its recording, appropriated to unrestricted reserves, in accordance with Royal Decree -Law 2607/1996.

d) Other reserves

- Retained earnings

This heading includes:

- Legal reserve

Companies in Spain are obliged to transfer 10% of profits each year to the legal reserve until this reserve reaches an amount of at least 20% of share capital. This reserve is not distributable to shareholders and may only be used to offset losses in the event that no other reserves are available. Under certain conditions it may be used to increase share capital. At 31 December 2007 and 2006 it amounts to Euro 54,199 thousand.

- Voluntary reserves

This heading includes the voluntary reserves of the Parent company, profit for the year, reserves in consolidated companies and first application reserves. All of these items are freely available. At 31 December 2007 and 2006 they amount to Euro 648,489 thousand and Euro 519,865 thousand, respectively.

- Treasury shares

At 31 December 2007 the Parent company holds treasury shares representing 0.22% of the Parent company's share capital amounting to 295,165 shares, with an overall par value of Euro 590 thousand and an average acquisition price of Euro 41.77 per share (at 31 December 2006, 1,645,183 shares, which represented 1.22% of share capital, with an overall par value of Euro 3,290 thousand and an average acquisition price of Euro 32.20 per share).

The Parent company has complied with the requirements of Article 75.2 and Additional Provision Two of the Spanish Companies Act, which establishes that the par value of acquired shares listed on official secondary markets, together with those already held by the Parent company and its subsidiaries must not exceed 5% of the share capital. The subsidiaries do not hold treasury shares or shares in the Parent company.

These shares are recognised as a decrease in the Group's equity of Euro -12,331 thousand and Euro - 52,986 thousand, at 31 December 2007 and 2006, respectively.

- Conversion differences

This heading includes translation differences in respect of foreign subsidiaries (mainly the Bolivian company TDE), which at 31 December 2007 and 2006 amount to Euro -10,115 thousand and Euro 2,976 thousand, respectively.

- Other valuation adjustments

This heading includes variations resulting from derivative financial instruments. At 31 December 2007 and 2006 they amount to Euro 39,653 thousand and Euro 12,213 thousand, respectively.

- Interim dividends and proposed distribution of Parent company dividends

Interim dividends approved by the Board of Directors in 2007 and 2006 are recorded as a decrease in Group equity at 31 December 2007 and 2006, respectively.

On 20 December 2007 the Board of Directors of the Parent company agreed to pay an interim dividend against 2006 profits amounting to Euro 0.3868 per share, which was payable as from 2 January 2008 (Euro 0.3250 per share on account from 2006 profits). The interim dividend approved at 31 December 2007 and 2006 amounts to Euro -52,208 thousand and Euro -43,428 thousand, respectively (note 20).

The Parent company's Board of Directors has also proposed to the shareholders at their Annual General Meeting the distribution of a complementary dividend of Euro 0.7003 per share, resulting in a total dividend for 2007 of Euro 1.0871 per share (Euro 0.8984 per share in 2006).

Movements in each of the items included in Other reserves are as follows:

e) Minority interests

Minority interests recorded under equity in the accompanying consolidated balance sheet reflects the shareholding of minority shareholders in the Bolivian companies TDE and Cybercia, S.A.. At 31 December 2007 and 2006 they amount to Euro 55 thousand and Euro 58 thousand, respectively.

GRUPO RED ELÉCTRICA · Movement other reserves at 31 December 2007 and 2006 (in thousands of euros)

	31 December 2005			31 December 2006			31 December 2007		
	Additions	Disposals		Additions	Disposals		Additions	Disposals	
Legal reserve	54,199	-	-	54,199	-	-	54,199	-	-
Voluntary reserves	410,708	109,157	-	519,865	128,624	-	648,489	-	-
Treasury shares	(3,823)	(167,761)	118,598	(52,986)	(162,044)	202,699	(12,331)	-	-
Translation differences	2,635	(5,611)	-	(2,976)	(7,139)	-	(10,115)	-	-
Measurement of financial derivatives	562	11,651	-	12,213	27,440	-	39,653	-	-
Interim dividend	(36,588)	(43,428)	36,588	(43,428)	(52,208)	43,428	(52,208)	-	-
	427,693	(95,992)	155,186	486,887	(65,327)	246,127	667,687		

(12) PROVISIONS

Movements in this heading in the consolidated balance sheet in 2007 and 2006 are as follows:

GRUPO RED ELÉCTRICA · Movement in provisions at 31 December 2007 and 2006 (in thousands of euros)

	31 December 2005				31 December 2006				31 December 2007			
	Additions	Applications	Reversals and differences on exchange		Additions	Applications	Reversals and differences on exchange		Additions	Applications	Reversals and differences on exchange	
Provisions	34,618	2,186	(15,555)	(2,083)	19,166	5,628	(1,413)	(1,298)	22,083	-	-	-
	34,618	2,186	(15,555)	(2,083)	19,166	5,628	(1,413)	(1,298)	22,083			

This heading mainly records the amounts provided each year by Group companies to cover the possible unfavourable outcome of third-party claims.

Additions in 2007 mainly result from the fact that REI has recorded a provision for Euro 4,094 thousand to cover the liabilities which may, if appropriate, result from the assessments which may presumably be raised in relation to the deduction for exports relating to the investment in TDE in 2002. Of the total amount provisioned, Euro 3,321 thousand relates to the deduction applied and Euro 773 thousand to late-payment interest.

Applications in 2006 were largely due to the payments under a voluntary redundancy plan.

(13) OTHER NON-CURRENT LIABILITIES

Details of this heading in the accompanying consolidated balance sheet in 2007 and 2006 are as follows:

	thousands of euros	
	2007	2006
Commitments with personnel	40,454	38,266
Grants	93,591	81,898
Non-current advance collections	263,061	245,831
Other non-current liabilities	212	212
	397,318	366,207

Commitments with personnel reflect future obligations (medical insurance and electricity) which are based on actuarial studies and entered into by the Parent company with its employees on their retirement, and a provision made for TDE to cover a length- of- service bonus.

Movements in obligations with personnel in 2007 and 2006 are as follows:

GRUPO RED ELÉCTRICA · Movements in Commitments with personnel at 31 December 2007 and 2006 (in thousands of euros)									
	31 December 2005	Additions	Applications	Reversals and exchange differences	31 December 2006	Additions	Applications	Reversals and exchange differences	31 December 2007
Commitments with personnel	30,831	8,437	(792)	(210)	38,266	4,208	(1,877)	(143)	40,454
	30,831	8,437	(792)	(210)	38,266	4,208	(1,877)	(143)	40,454

In 2007 and 2006 additions result mainly from the annual accrual and development of the actuarial assumptions used. These additions are recognised under Staff costs or Finance costs, in accordance with their nature. Staff costs recognised in 2007 in the consolidated income statement amount to Euro 2,328 thousand (Euro 6,170 thousand in 2006). Finance costs recognised in 2007 in the income statement amount to Euro 1,880 thousand (Euro 2,267 thousand in 2006).

Details of the actuarial assumptions used by the Parent company in 2007 to make these provisions are as follows:

	Medical insurance	Electrical energy
Discount rate	5.1%	5.1%
Cost growth	4.0%	3.3% (2008) 3.5% (from 2008)
Survival table	PERM/F 2000 New business	

Capital grants mainly include the amounts received by the Parent company for the construction of electricity plants. They are released to income for the year over the useful lives of the relevant facilities and are recorded under Other gains in the consolidated income statement.

Movements in grants in 2007 and 2006 are as follows:

**GRUPO RED ELÉCTRICA · Movements in capital grants
at 31 December 2007 and 2006 (in thousands of euros)**

	31 December 2005	Additions	Applications	31 December 2006	Additions	Disposals and applications	31 December 2007
Capital grants	84,116	1,138	(3,356)	81,898	15,289	(3,596)	93,591
	84,116	1,138	(3,356)	81,898	15,289	(3,596)	93,591

Non-current receivables mainly include revenues deriving from agreements for the construction of electricity plants amounting to Euro 168,362 thousand in 2007 (Euro 146,402 thousand in 2006). Similarly, it includes revenue deriving from the assignment of the use of telecommunication network capacity deriving from the agreements signed with various telecommunication operators amounting to Euro 69,834 thousand at 31 December 2007 (Euro 73,889 thousand at 31 December 2006) (note 26).

At 31 December 2007 and 2006 this heading also includes the portion attributable to the Parent company of the compensation paid by EDF on the adaptation of the electricity supply contracts signed on 8 January 1997 which amounts to Euro 23,625 thousand.

(14) BONDS AND OTHER MARKETABLE SECURITIES ISSUED AND BANK LOANS

Details of bonds and other marketable securities and bank loans at 31 December 2007 and 2006 are as follows:

	Face value (Thousands of euros)		Fair value (Thousands of euros)	
	2007	2006	2007	2006
Issues in dollars	339,171	379,140	347,834	380,893
Issues in euro	847,990	898,985	855,766	930,665
Euro bank loans	1,386,775	1,281,736	1,399,042	1,298,992
Bank loans in foreign currency	62,234	65,683	62,109	62,461
Total	2,636,170	2,625,544	2,664,751	2,673,012

The fair value of bank loans and bonds and other marketable securities has been estimated in full using a valuation technique based on the discounting of future cash flows at the market interest rates in force at each date.

At 31 December 2007 accrued interest payable on these loans amounts to Euro 22,501 thousand (Euro 22,488 thousand in 2006).

At 31 December 2007 issues in euro comprise Eurobonds of Euro 846,446 thousand issued by Red Eléctrica de España Finance, BV in relation to the Eurobond framework programme (Euro 845,816 thousand in 2006) and Euro 339,171 thousand (USD 500,000 thousand covered in euro) obtained in private placement issues in the United States (USPP). At 31 December 2007 this heading also includes issues of short-term promissory notes amounting to Euro 1,544 thousand (Euro 53,169 thousand in 2006).

At 31 December 2007 bank loans include a new syndicated credit facility, which at 31 December is drawn down in an amount of Euro 898,049 thousand (Euro 817,622 thousand in 2006). The limit amounts to Euro 900,000 thousand and the credit facility matures in 2012. Similarly, this heading includes long-term loans and credit facilities amounting to Euro 510,057 thousand (Euro 464,114 thousand in 2006).

Details of maturity of these issues and bank loans at 31 December 2007 are as follows:

	Thousands of euros					2013 and later
	2008	2009	2010	2011	2012	
USD issues	-	-	-	-	-	339,171
Euro issues	1,544	-	-	-	-	846,446
Euro bank payables	34,181	23,528	19,926	24,336	923,735	361,069
USD bank loans	5,932	6,069	6,214	6,365	6,525	30,343
Swiss franc bank loans	786	-	-	-	-	-
	42,443	29,597	26,140	30,701	930,260	1,577,029

The average interest rate in 2007 was 4.22% (3.88% in 2006).

At 31 December 2007 Group companies have contracted credit facilities with a long-term credit limit available for draw down of Euro 225,000 thousand (Euro 80,000 thousand at 31 December 2006) and a short-term limit of Euro 246,001 thousand (Euro 289,663 thousand at 31 December 2006).

At 31 December 2007 the Parent company has a Spanish Securities and Exchange Commission registered programme to issue promissory notes up to a maximum limit of Euro 250,000 thousand (Euro 250,000 thousand at 31 December 2006).

(15) FINANCIAL RISK MANAGEMENT POLICY

The Group's financial risk management policy establishes principles and guidelines to ensure that the relevant risks which

could affect the aims and activities of the Red Eléctrica Group, are identified, analysed, evaluated, managed and controlled and that these processes are carried out systematically and consistently.

The main guidelines which comprise this policy may be summarised as follows:

- Risk management should be fundamentally proactive and also directed towards the middle and long-term, taking into account possible scenarios in an ever-increasing global environment.
- Risks should generally be managed in accordance with coherent criteria, distinguishing between the importance of the risk (probability/impact) and the investment and resources required to reduce it.
- Financial risk management should seek to avoid undesired variations in the Group's base value and not to generate extraordinary profits.

The Group's financial managers are responsible for managing financial risks to ensure consistency with the Group's strategy and to coordinate the management of risk across the various Group companies, identifying the main financial risks and defining the actions to be taken, based on establishing different financial scenarios.

The methodology for identifying, measuring, monitoring and controlling risks as well as management indicators and measure and control tools specific to each risk, is documented in the financial risk manual.

The financial risks to which the Group is exposed are as follows:

- **Market risk**

Market risks reflect market variations such as prices, interest and exchange rates, credit facility conditions and other variables which affect short, middle and long-term financial costs.

Management of these risks is carried out both on liability operations, currency, maturity and interest rates and through the use of hedging instruments which allows the aforementioned financial structure to be modified. Particularly noteworthy market risks are:

(i) Interest rate risk

Interest rate variations change the fair value of assets and liabilities which accrue interest at a fixed rate and the future flows of assets and liabilities linked to a variable interest rate. The management of interest rates mainly aims to maintain the structure of the debt ratio between the fixed and hedged rate and risks linked to variable interest rates at approximately 70%-30%. The structure at 31 December 2007 is as follows:

	Thousands of euros	
	Fixed rate	Variable rate
Long term issues	1,257,828	-
Long term bank loans	720,599	715,810
Short term issues	-	1,544
Short term bank loans	-	12,600
Total payable	1,978,427	729,954
Percentage	73%	27%

The structure reflects a very low risk profile with reduced exposure to interest rate variations. The impact of the rise in variable interest rates on the rest of the debt has been offset in the consolidated income statement by the increase in income deriving from the remuneration of new investments, which takes into account Spanish Treasury 10 year bond levels at the time of their entry into service.

The interest rate risk to which the Group is exposed at 31 December 2007 mainly affects equity for the year as a result of changes in the fair value of derivative financial instruments while profit for the year remains unchanged. Set out below is a sensitivity analysis of that risk:

The sensitivity of fair value has been estimated using a valuation technique based on discounted future cash flows at market interest rates prevailing at 31 December 2007.

Impact on consolidated net worth (thousand euro)	Variation in market rates			
	2007		2006	
	+0.10%	-0.10%	+0.10%	-0.10%
INTEREST RATE HEDGE				
- cash flow coverage				
interest rate Swaps	2,009	(2,023)	1,518	(2,023)
INTEREST RATE AND EXCHANGE RATE HEDGE				
- cash flow coverage				
Cross Currency Swap	511	(521)	650	(665)

(ii) Exchange rate risks

Exchange riskmanagement comprises translation risks which the company is subject to on consolidation of its subsidiaries and / or assets located in countries where the functional currency is not the euro and to transaction risks derived from collection and payment of cash in currencies in other than the euro.

In order to eliminate the exchange risk in USPPs , the Company has arranged cash flow hedges through cross currency swaps for the principal and interest covering the amount and entire duration of the same to October 2005 (note 17).

In order to mitigate the translation risk of the assets located in countries whose functional currency is not the euro, the Group finances part of such investments in the functional currency. Therefore at 31 December 2007 any increase or decrease in the dollar/ euro exchange rate of 10% with respect to the December closing would have generated an increase or decrease in equity of approximately Euro 3 million (Euro 4 million at 31 December 2006).

- Credit risk

The characteristics of income from electricity transmission and electrical systems operation and the solvency of the electrical system agents mean that the level of risk is not relevant to the Group's principal activities. Credit risk management for the Group's other activities is mainly carried out through the control instruments to reduce or delimit such risk.

In any event, the credit risk is supported through policies containing requirements in relation to the credit standing of the counterparty and additional guarantees are called for, where necessary.

At 31 December approximately 1% of balances are past due although the companies consider that there is no recoverability risk.

- Liquidity risk

Liquidity risks arise due to differences between amounts and the collection and payment dates of the different assets and liabilities of the Group companies.

Maintaining a significant volume of funds available during the year contributes positively to the strengthening of the Group's financial structure and contributes an additional guarantee of liquidity.

These risks are mainly managed by the controlling of the temporary financial debt structure, setting maximum net volume limits for each defined period.

Group borrowings have an average maturity of 7 years at 31 December 2007.

The Group's liquidity position for 2008 is based on its strong capacity to generate cash, supported by short-term credit lines not drawn down amounting to Euro 471,001 thousand.

(16) OTHER FINANCIAL ASSETS AND LIABILITIES

The breakdown of Other financial assets and Other financial liabilities, both current and non-current, of the Red Eléctrica Group at 31 December 2007 and 2006 is as follows:

	thousands of euros	
	2007	2006
OTHER NON-CURRENT FINANCIAL ASSETS:		
Long-term securities portfolio	96,701	53
Financial instruments at fair value (note 17)	17,343	11,718
Long term loans	874	1,258
Total non-current financial assets	114,918	13,029
CURRENT FINANCIAL ASSETS:		
Short-term equity investments	-	618
Other short-term loans	991	1,053
Financial instruments at fair value (note 17)	1,285	-
Total current financial assets	2,276	1,671
OTHER NON-CURRENT FINANCIAL LIABILITIES:		
Financial instruments at fair value (note 17)	(26,496)	(20,627)
Total non-current financial liabilities	(26,496)	(20,627)

The Long-term securities portfolio mainly relates to the 5% shareholding that the Parent company has in Redes Energéticas Nacionais, SGPS, S.A. (hereinafter REN), the holding company that comprises the operation and exploitation

of the electricity transmission assets and various gas infrastructures in Portugal. This shareholding was acquired in 2007 and the transaction price was linked to market value deriving from a public share offering on the stock market and amounted to Euro 98,822 thousand. The provision for the impairment of that investment amounts to Euro 2,168 thousand at 31 December 2007 and is recorded directly in the Group's equity.

The valuation of this shareholding is subject to the quotation price of the share and therefore any variations in the price generate movements in Consolidated equity.

(17) DERIVATIVE FINANCIAL INSTRUMENTS

The Red Eléctrica Group contracts derivatives in compliance with its financial risk management policy. Details of the derivatives contracted by the Group at 31 December 2007 and 2006 are as follows:

	Principal covered	Maturity date	thousands of euros				
			2007		2006		
			Current Asset	Non-current Asset	Liability	Non-current Asset	Liability
INTEREST RATE COVERAGE:							
- Cash flow coverage							
Interest rate swap	350,000 euros	To 2012	1,285	10,772	-	10,494	-
Interest rate swap	200,000 euros	To 2015	-	6,571	-	1,185	-
- Fair value hedges							
Interest rate swap	3,005 euros	To 2008	-	-	-	39	(35)
INTEREST RATE AND EXCHANGE RATE COVER:							
- Cash-flow hedging (Cross currency swap)	USD 500,000	To 2035					
Interest rate hedging			-	-	45,715	-	11,619
Exchange rate hedging			-	-	(72,211)	-	(32,211)
			1,285	17,343	(26,496)	11,718	(20,627)

At 31 December 2007 interest rate hedges cover debts for a nominal amount of Euro 553,005 thousand (Euro 428,005 thousand at 31 December 2006) and interest rate and exchange rate hedges for a nominal amount of USD 500,000 thousand (USD 500,000 thousand in 2006).

The breakdown of non-current derivative financial instruments by maturity at 31 December 2007 is as follows:

	thousands of euros					Total
	2009	2010	2011	2012	2013 and subsequent years	
INTEREST RATE COVERAGE:						
- Cash flow coverage						
Interest rate swap	-	2,564	4,484	3,724	-	10,772
Interest rate swap	-	-	-	-	6,571	6,571
	-	2,564	4,484	3,724	6,571	17,343
INTEREST RATE AND EXCHANGE RATE COVER:						
- Cash-flow hedging (Cross currency swap)						
Interest rate hedging	-	-	-	-	45,715	45,715
Exchange rate hedging	-	-	-	-	(72,211)	(72,211)
	-	-	-	-	(26,496)	(26,496)

(18) TRADE AND OTHER PAYABLES

Details of trade and other payables in the accompanying consolidated balance sheet at 31 December 2007 and 2006 are as follows:

	thousands of euros	
	2007	2006
Trade payables	5,334	5,178
Creditors for services rendered	83,963	64,022
Current advances	29,086	23,489
Bills payable	58,703	49,644
	177,086	142,333

Creditors for services relate mainly to amounts payable for engineering, construction and maintenance work and changes to electricity facilities by the Parent company.

Bills payable mainly record the balance reflected by the Parent company at 31 December 2007 and 2006 in relation to amounts payable to creditors on confirming for the services provided.

(19) OTHER CURRENT LIABILITIES

Details of this heading in the accompanying consolidated balance sheet at 31 December 2007 and 2006 are as follows:

	thousands of euros	
	2007	2006
Dividends payable	52,208	43,428
Fixed-asset suppliers and other payables	570,798	376,447
	623,006	419,875

The increase in the Fixed asset creditor balance and other payables is mainly due to the increase in investments for the construction of property, plant and equipment and balance payable to the Spanish electricity system deriving from the system of payment for power capacity.

(20) TAX SITUATION

The tax group of which Red Eléctrica de España, S.A. is the Parent company has filed consolidated tax returns in Spain since 2002. The tax payable is distributed among the companies forming the tax group based on the agreements established between the Group companies, adapted to the Resolutions of the Spanish Institute of Accountants and Auditors (ICAC) of 9 October 1997 and 15 March 2002.

Legislation applicable in their respective countries is applied to companies that do not form part of the tax group.

At 31 December 2007 the tax group is made up of REI and REE TSO in addition to the Parent company.

A reconciliation of the statutory tax rate prevailing in Spain to the effective tax rate applicable to the Group is as follows:

	thousands of euros	
	2007	2006
Consolidated accounting results for the year before taxes	361,598	280,857
Permanent differences and consolidation adjustments	(193)	2,392
Consolidated tax base for accounting purposes	361,405	283,249
Tax at current rate in each country	120,576	98,175
Deductions	(1,884)	(1,834)
Corporate income tax	118,692	96,341
Changes in tax rate (Law 35/2006)	(150)	(15,642)
Corporate income tax	118,542	80,699

Law 35/2006, of 28 November 2006, which came into effect on 1 January 2007, which amends the Corporate Income Tax Act and reduces the general tax rate from 35% to 32.5% in 2007 and 30% as from 2008, triggered net accounting income in 2006 of Euro 15,642 thousand which relates to the tax effect on results that that restatement has had on the balance of deferred tax assets and liabilities reflected by the Group companies.

Current balances payable to and receivable from public bodies at 31 December 2007 and 2006 are as follows:

	thousands of euros	
	2007	2006
CURRENT DEBTOR BALANCES		
VAT refundable	158	273
Taxes refundable	1,074	1,030
Incorrectly paid taxes refundable	8,081	6,510
Total Current tax assets	9,313	7,813
CURRENT CREDITOR BALANCES		
VAT payable	7,132	262
Other taxes payable	2,502	3,173
Corporate income tax payable	41,956	31,193
Total Current tax liabilities	51,590	34,628

Balances receivable from the Treasury for income record in 2007 and 2006 the amounts refundable to the Parent company in respect of environmental taxes paid and against which appeals have been filed, the outcome of which has been favourable to Red Eléctrica.

Deferred tax assets and liabilities at 31 December 2007 and 2006 are as follows:

	thousands of euros	
	2007	2006
DEFERRED TAX ASSETS		
Retirements and commitments with employees	17,610	18,117
Capital grants	3,995	3,646
Other	21,423	17,158
Total deferred tax assets	43,028	38,921
DEFERRED TAX LIABILITIES		
Accelerated depreciation	48,440	47,068
Non-deductible assets	72,165	77,819
Other	33,770	19,137
Total deferred tax liabilities	154,375	144,024

In 2006 tax losses from Red de Alta Tensión, S.A. (hereinafter Redalta) and Infraestructuras de Alta Tensión, S.A. (hereinafter Inalta), which were acquired by the Parent company effective 1 January 2006, were applied.

Additionally, the Group companies' tax returns for the last four tax years for the principal taxes to which they are subject are open to inspection, except for corporate income tax in the Parent company and its tax group for which returns are open to inspection since 2002. Because of the different interpretations which may be afforded to tax regulations, additional liabilities could arise as a result of the inspection of the years open to inspection. Nonetheless, the directors do not expect that these liabilities should they arise would significantly affect the Group's consolidated financial statements.

(21) INCOME AND EXPENSES

a) Net turnover

Details of this heading in the consolidated income statement for 2007 and 2006 are as follows:

	thousands of euros	
	2007	2006
Transmission services rendered in Spain	938,300	856,473
Transmission services rendered in Bolivia	20,364	19,896
System operation services	35,685	36,532
Other services rendered and sales	36,561	36,361
	1,030,910	949,262

Income from transmission services rendered is fixed annually by Royal Decree (for 2007, Royal Decree 1634/2006 of 29 December 2006 whereby electricity rates were established).

Income from transmission services in Bolivia is set annually by the *Superintendencia de Electricidad*.

Income from system operation services rendered, set annually by Royal Decree (for 2007, Royal Decree 1634/2006, of 29 December 2006), corresponds exclusively to Spain.

Other services and sales mainly include those services and sales deriving from the Group's different activities such as the assignment of the use and maintenance of telecommunication networks, international consulting work, engineering, construction and maintenance work and changes to electrical facilities requested by third parties, and net income recognised due to the contribution of energy and power under import and export contracts between EDF and the Parent company.

b) Other operating revenue

This heading in the accompanying consolidated income statement mainly includes income from insurance companies indemnities for claims and faults covered by the policies arranged.

c) Materials consumed and other operating expenses

Details of this heading in the accompanying consolidated income statement for 2007 and 2006 are as follows:

	thousands of euros	
	2007	2006
Supplies	60,951	36,390
Other operating costs	183,794	181,069
	244,745	217,459

Materials and other operating expenses mainly reflect expenses deriving from the repair and upkeep of electricity facilities. In addition, this heading records, inter alia, IT, advisory, rental and other services.

d) Staff costs

Details of staff costs in the consolidated income statement for 2007 and 2006 are as follows:

	thousands of euros	
	2007	2006
Wages and salaries	60,775	58,671
Social Security contributions	14,178	12,367
Contributions to pension funds and similar commitments	1,086	1,035
Other items and welfare expenses	12,335	12,829
	88,374	84,902

Group companies have capitalised staff costs amounting to Euro 4,281 thousand at 31 December 2007 and Euro 7,608 thousand at 31 December 2006.

The pension plans adopted by Group companies are voluntary defined contribution pension plans. These pension plans have been inscribed in the Pension fund in accordance with prevailing legislation.

Current employees

The average headcount of the Group in 2007 and 2006, distributed by professional category, is as follows:

	2007	2006
Management team	123	120
Senior qualified staff	397	390
Qualified staff	490	484
Clerical and technical personnel	445	432
	1,456	1,426

The distribution of the Group's final headcount at 31 December by gender and category is as follows:

	2007			2006		
	Male	Female	Total	Male	Female	Total
Management team	110	17	127	103	14	117
Senior qualified staff	276	121	397	268	125	393
Qualified staff	431	67	498	424	67	491
Clerical and technical personnel	339	107	446	332	109	441
	1,156	312	1,468	1,127	315	1,442

e) Net loss on asset impairment

In 2007 and 2006 this heading mainly records the value adjustment on certain electrical installations of the Parent company, the construction of which has been brought to a standstill for reasons beyond the Company's control. In 2006 this item also reflected the impairment of goodwill relating to TDE.

f) Net profit/(loss) on disposal of non-current assets

In 2007 the net profit on asset disposals amounts to Euro 1,244 thousand (Euro 114 thousand in 2006).

(22) BALANCES AND TRANSACTIONS WITH ASSOCIATES AND RELATED PARTIES

Balances and transactions with associates

All transactions with associates have been carried out at market prices. The principal transactions carried out by Group companies with companies consolidated under the equity method in 2007 and 2006 are as follows:

GRUPO RED ELÉCTRICA · Transactions with companies consolidated under the equity method during the years ended 31 December 2007 and 2006 (thousand euro)

	2007				2006			
	Balances		Transactions		Balances		Transactions	
	Debtor	Creditor	Expenses	Income	Debtor	Creditor	Expenses	Income
Red Eléctrica del Sur S.A. (Redesur)	1,463	171	11	738	77	227	11	709
Red Internacional de Comunicaciones del Sur, S.A. (Redinsur)	-	-	-	-	-	-	5	-
Total	1,463	171	11	738	77	227	16	709

Balances and transactions with related parties

Related-party transactions are immaterial and have been completed under arm's length conditions.

(23) REMUNERATION OF MEMBERS OF THE BOARD OF DIRECTORS

In 2007 and 2006 the members of the Board of Directors of the Parent company and Group companies accrued total remuneration of Euro 2,479 thousand and Euro 2,374 thousand, respectively. The aforementioned amounts include estimated performance linked bonuses and the salaries of directors who are also employees of the Group. A breakdown of remuneration in accordance with the information model introduced by the National Securities Market Commission, which was approved in Circular 4/2007 of 27 December 2007 for the Annual Corporate Governance Report, is as follows:

- Remuneration from the Parent company:

	thousands of euros	
	2007	2006
Salary item:		
Fixed remuneration	391	396
Variable remuneration	1,269	1,232
Per diem expenses	808	746
Contributions life insurance and pension plans	11	-
Total remuneration	2,479	2,374

Total remuneration by type of Director is as follows:

	thousands of euros	
	2007	2006
Type of Director:		
Executive	772	755
Eternal domanial	517	490
External independent	1,190	1,129
Total remuneration	2,479	2,374

Total remuneration accrued by the members of the Board of Directors of Red Eléctrica de España, S.A. in 2007, by Director, is as follows:

	thousands of euros For the parent company				Total
	Fixed remuneration	Variable remuneration	Per diems	Life insurance and Pension plans	
D. Luis M ^a Atienza Serna	391	289	81	11	772
D. Pedro Rivero Torre	-	98	90	-	188
D. Juan Gurbindo Gutiérrez (1)	-	98	81	-	179
D. Antonio Garamendi Lecanda	-	98	91	-	189
D. Manuel Alves Torres (1)	-	98	81	-	179
D. José Riva Francos	-	98	54	-	152
D. José Manuel Serra Peris	-	98	58	-	156
D. Rafael Suñol Trepas	-	98	61	-	159
D ^a . de los Ángeles Amador Millán	-	98	72	-	170
D. Francisco Javier Salas Collantes	-	98	81	-	179
D. Martín Gallego Málaga	-	98	58	-	156
Total remuneration accrued	391	1,269	808	11	2,479

(1) Amounts received by Sociedad de Participaciones Industriales (SEPI)

The Company has also established a three year performance- linked remuneration plan for Managers, including the executive director, and which will be paid, if appropriate, at the end of 2008.

The Executive director contract contains clauses regarding guarantees and safeguards in respect of dismissal or changes in control. This contract has been approved by the Committee of Appointments and Remuneration and the Board of Directors of the Parent company. These clauses follow usual market practice and include clauses regarding termination of employment and indemnities of one year unless applicable legislation requires a greater indemnity to be paid.

At 31 December 2007 and 2006 no loans, advances or guarantees to members of the Board of Directors of the Parent company are reflected in the consolidated balance sheet. Nor are there at that date any pension commitments with members of the Board of Directors.

In 2007 and 2006 the members of the Board of Directors have performed no extraordinary operations or transactions under conditions other than market, directly or through intermediaries, with the Company or Group companies.

Details of the interests held by the members of the Parent company at 31 December 2007 in the share capital of companies with a similar or complementary activity to that of Red Eléctrica de España, S.A., as well as the posts they hold and functions they perform and where applicable, the direct or indirect performance of identical, similar or comple-

mentary activities to that of the Parent company are included in Appendix II, in accordance with the correspondence received from the directors of the Parent company.

(24) MANAGEMENT REMUNERATION

In 2007 short-term senior management remuneration and life insurance and pension plan contributions amounted to Euro 872 thousand and Euro 27 thousand, respectively (Euro 1,357 thousand and Euro 29 thousand in 2006) and are reflected as Staff costs in the consolidated income statement. The Company has also established a three year performance-linked remuneration plan for these managers, which will be paid, if appropriate, at the end of 2008.

Senior managers who have provided their services in 2007 are as follows:

Name	Position
Carlos Collantes Pérez-Ardá	General Manager, Transport
Esther M ^a Rituerto Martínez	General Manager, Administration and Finance
Alberto Carbajo Josa	General Manager, Operations

At 31 December 2007 and 2006 no loans or advances have been granted to these managers.

There are guarantee or safeguard clauses for two of these managers in the event of dismissal. The clauses of the contracts follow usual market practice and include clauses regarding termination of employment and indemnities of up to two years unless the applicable legislation requires a greater indemnity to be paid. These contracts containing such clauses are approved by the Committee of Appointments and Remuneration and the Board of Directors of the Parent company.

(25) SEGMENT REPORTING

The Red Eléctrica Group's core activity is the transmission of electricity and operation of the electricity system in Spain as TSO which accounts for 96% of the Group's consolidated turnover and total assets. Other activities, consulting activities and electricity transmission services outside Spain, account for the remaining 4% of such turnover and total assets. It has therefore not been considered relevant to provide information by activity or geographical segment.

(26) GUARANTEES AND OTHER OBLIGATIONS WITH THIRD PARTIES AND OTHER CONTINGENT LIABILITIES

At 31 December 2007 the principal long-term contracts and commitments to which Group companies are party are as follows:

- Contracts between EDF and the Parent company for the import and export of electricity until 2010. The power quotas established in these two contracts range from 550 to 300 MW until maturity.
- Contracts signed with different telecommunication operators for the assignment of use of capacity, management and maintenance of the telecommunication network, maturing in the period 2016 to 2027.

At 31 December 2007 the Group has bank guarantees in favour of third parties amounting to Euro 11,171 thousand (Euro 9,656 thousand in 2006).

Additionally, REI secures the loan that the Bolivian company TDE has with International Finance Corporation (hereinafter IFC). The commitments entered into by REI with IFC include maintaining both a minimum shareholding in TDE and effective control of that company and being secondarily liable for the payments to be made to IFC.

(27) ENVIRONMENTAL INFORMATION

During 2007 Group companies incurred ordinary expenses of Euro 15,388 thousand to protect and improve the environment (Euro 9,323 thousand in 2006). These expenses relate mainly to the application of preventive and corrective measures at facilities in operation. They also include the maintenance of environmental management systems, sundry environmental communication and training activities, environmental research projects and expenses relating to the organisational unit especially devoted to these tasks.

Similarly, in 2007 environmental impact studies and environmental supervision have been conducted at the newly constructed electrical facilities valued at Euro 2,087 thousand (Euro 6,305 thousand in 2006 which mainly included the environmental actions deriving from the construction of the second electricity interconnection between Spain and Morocco).

Group companies are involved in no litigations relating to environmental protection or improvements which may give rise to significant contingencies. Similarly, in 2007 and 2006 the Group companies have received no significant environmental grants.

(28) OTHER INFORMATION

The Group's auditor has been PricewaterhouseCoopers Auditores, S.L. since 2006. Remuneration accrued in respect of items related to the audit of the accounts of the Group companies in 2007 amounts to approximately Euro 102 thousand (Euro 98 thousand in 2006). Remuneration accrued by companies directly and indirectly related to the auditors for professional services other than the audit of the accounts, which do not affect the Group companies' strategy or general planning amount to approximately Euro 8 thousand in 2007 (Euro 77 thousand in 2006).

(29) EVENTS AFTER 31 DECEMBER 2007

There have been other significant events after the year end to the date of preparation of these Consolidated Financial Statements.

(30) EARNINGS PER SHARE

Details of earnings per share for 2007 and 2006 are as follows:

	2007	2006
Net profit (thousands of euros)	243,049	200,154
Number of shares (shares)	135,270,000	135,270,000
Average number of own shares (shares)	856,824	271,860
Basic profit per share (euro)	1.81	1.48
Diluted profit per share (euro)	1.81	1.48

At 31 December 2007 and 2006 the Group has not performed any operations which would result in any differences arising between basic earnings per share and diluted earnings per share.

(31) SHARE -BASED PAYMENTS

The Parent company has implemented a share acquisition plan under which managers are able to receive shares from the Company as part of their ordinary annual remuneration. The expense deriving from this plan is reflected under Staff costs in the consolidated income statement. All shares delivered relate to the Parent company's treasury shares. Such remuneration is valued at the quotation price of the Company's share at the share delivery date. This programme amounts to Euro 990 thousand in 2007 (Euro 370 thousand in 2006).

Appendix I

GRUPO RED ELÉCTRICA · Breakdown of shareholdings
at 31 December 2007 (thousand euro)

Company - Registered offices - Main activity	Percentage ownership held by parent company		Net book value in holding company
	Direct	Indirect	
A) FULLY CONSOLIDATED COMPANIES			
Red Eléctrica Internacional, S.A.U. (REI)	100%	-	56,300
- Paseo Conde de los Gaitanes, 177. Alcobendas (Madrid)			
- International holdings. Rendering of consultancy, engineering and construction services. Electrical activities outside Spanish electrical system.			
Transportadora de Electricidad, S.A. (TDE)	-	99.94% (1)	70,469
- C/ Colombia, N° O0655, casilla, N° 640. Cochabamba (Bolivia)			
- Transmission of electrical energy			
Cybercia, S.R.L. (CYBERCIA)	-	75% (2)	21
- C/ Colombia, N° O0655, casilla, N° 640. Cochabamba (Bolivia)			
- Business and services in general			
Red Eléctrica de España Finance, B.V. (RBV)	100%	-	2,000
- Claude Debussylaan, 24. Amsterdam (Holland)			
- Financing activities			
Red Eléctrica Andina, S.A.C. (REA)	-	100% (1)	3
- Juan de la Fuente, 453. Lima (Perú).			
- International holdings. Rendering of consultancy, engineering and construction services. Electrical activities outside Spanish electrical system.			
Red Eléctrica de España TSO, S.L. (REE TSO)	100%	-	6
- Paseo Conde de los Gaitanes, 177. Alcobendas (Madrid)			
- Legal compliance activities imposed on Red Eléctrica de España, S.A. under Law 17/2007			
B) COMPANIES CONSOLIDATED BY EQUITY METHOD			
Red Eléctrica del Sur, S.A. (REDESUR)	-	33.75% (1)	4,878
- Juan de la Fuente, 453. Lima (Perú).			
- Transmission of electrical energy			
Red Internacional de Comunicaciones del Sur, S.A. (REDINSUR)	-	27.64% (3)	47
- Juan de la Fuente, 453. Lima (Perú).			
- Telecommunications			

(1) Holding through Red Eléctrica Internacional

(2) Holding through TDE

(3) Holding through Redesur

This Appendix is an integral part of Note 1 to the consolidated Financial Statements

Appendix II

GRUPO RED ELÉCTRICA · Information on Members of the Board of Directors at 31 December 2007

Members of the Board of Directors	Direct or indirect holdings of the Parent Company's Directors in the capital of companies engaging in activities which are identical, analogous or complementary to those making up the Parent Company's objects	Positions and duties discharged by the Directors in companies outside the Red Eléctrica Group engaging in activities which are identical, analogous or complementary to those making up the Parent Company's objects
D. Luis M ^a Atienza Serna	-----	Director of Redes Energéticas Nacionales, SGPS, S.A. (REN)
D. Pedro Rivero Torre	-----	Director of Operador del Mercado Ibérico de Energía - Polo Español, S.A. Chairman of Unesa
D. Juan Gurbindo Gutiérrez	-----	-----
D. Antonio Garamendi Lecanda	-----	-----
D. Manuel Alves Torres	-----	-----
D. José Riva Francos	853 shares in Iberdrola, S.A.	-----
D. José Manuel Serra Peris	3,932 shares in Iberdrola, S.A. 3,254 shares in Gas Natural, S.A.	-----
D. Rafael Suñol Trepas	-----	-----
D ^a . María de los Ángeles Amador Millán	-----	-----
D. Francisco Javier Salas Collantes	-----	-----
D. Martín Gallego Málaga	-----	-----

None of the members of the Board of Directors has carried out on his own or third-party account any activities of any activity analogous or complementary to the kind of activity which makes up the Company's objects.