



**ANNUAL REPORT OF THE ACTIVITIES CARRIED OUT BY THE AUDIT COMMITTEE IN 2014  
AND OF ITS PLAN OF ACTIVITIES FOR 2015**

**I – Introduction**

The scope of activities of the Audit Committee of Portugal Telecom, SGPS, S.A. (“PT SGPS” or “the Company”) are defined (a) in its Charter, which comply with all the items defined in legal, statutory and regulatory national rules applicable to this statutory corporate body and also respond to all the responsibilities in the imperative rules applicable to foreign private issuers in the United States of America, as well as (b) with Service Order (*Ordem de Serviço*) 111CA of 23 February 2011, which changed the regulation of the process of approval of significant transactions with related parties.

In accordance with article 423F of the Portuguese Commercial Companies Code (*Código das Sociedades Comerciais* – “CSC”) the responsibilities of the Audit Committee, as a supervising body of the Company, are as follows: (a) propose to the shareholders’ general meeting the appointment of the Statutory Auditor (*Revisor Oficial de Contas* - “ROC”) and monitor its independence and the statutory audit process; (b) monitor the process of preparing and disclosing financial information; (c) annually prepare a report of its monitoring activities and give an opinion on the Consolidated and Separate Financial Statements and on the Proposals presented by the Board of Directors; (d) monitor the Company’s management and verify the compliance with the law and Articles of Association; and (e) monitor the effectiveness of the risk management, internal control and internal audit systems.

Also, in accordance with the Company’s Articles of Association and the Audit Committee’s Charter, the Committee must supervise the following matters: (a) the qualifications and independence of the External Auditors; (ii) the quality, integrity and effectiveness of the internal control system; (iii) the quality and integrity of the financial information included in the Annual Report; and (iv) compliance by the Company with the applicable legal and regulatory requirements, as well as with the recommendations and guidelines issued by the competent entities.



The Audit Committee has, also, the responsibility for the management of the Qualified Reporting of Irregular Practices System (*“whistleblowing”*), as discussed below.

In addition, in accordance with the terms defined in the above mentioned Service Order 111CA, and with specified exclusions, the approval of significant transactions with related parties depends upon a favourable opinion of the Audit Committee.

Therefore the Audit Committee presents its annual report on its activities with reference to fiscal 2014, as well as its plan of activities for fiscal 2015.



## II – Activities carried out with reference to fiscal 2014

In the course of 2014, and given its special importance, the Audit Committee continued to oversee the development of the process of the planned combination of the businesses of PT and Oi, as discussed in the Memorandum of Understanding announced to the market on 02/10/2013, with the adjustments resulting from the Exchange Agreement and the Call Option Agreement signed on 08/09/2014 and from the Amendment announced to the market on 31/03/2015, on which the parties agreed on a new model of corporate and management structure for Oi, and it should be noted that such business combination has meanwhile been jeopardized by Oi's decision to sell PT Portugal, which was also approved by the General Shareholders Meeting of PT SGPS.

As soon as the Audit Committee of PT SGPS became aware of the existence of significant investments, made by various companies of PT Group, in financial instruments issued by Rio Forte Investments, S.A.'s (an entity of the Espírito Santo Group), which were not repaid on maturity, the Audit Committee initiated an analyses of this matter and prepared three reports for the Board of Directors, dated 10/07, 25/07 and 05/08/2014; pursuant to the discussion of this matter, on 07/08/2014, the Board of Directors of PT SGPS decided to engage PriceWaterhouseCoopers (PwC) to proceed with an independent review of the procedures and acts related to such investments, with the assistance of the Audit Committee. A synthesis of the conclusions of this independent review was included in a Press Release dated 08/01/2015.

In addition, in carrying out its activities and in compliance with its duties and responsibilities, in 2014 the Audit Committee carried out an extensive series of activities, including:

(a) *Appointment and supervision of the qualifications, performance and independence of the Company's External Auditors and Statutory Auditors*

In accordance with the Company's Articles of Association and the Charter of the Audit Committee, the Audit Committee is responsible for appointing and establishing the remuneration of the External



Auditor, and to present a proposal to appoint the Statutory Auditor of PT SGPS to the Shareholders' General Meeting, and also to verify the independence of the External Auditor and the Statutory Auditor.

In accordance with Recommendation III.1.3 of CMVM's Company Governance Code (2010) (*Código de Governo das Sociedades*) companies must rotate their external auditors at the end of three mandates (when they are for three years), and their possible maintenance beyond that period must be based on a specific opinion of the Audit Committee that expressly considers the conditions of independence of the External Auditor and the advantages and costs of its substitution.

Therefore, for purposes of CMVM' Recommendation and following the verifications already made by PT SGPS' Audit Committee in the beginning of 2011, in 2012 the Audit Committee reviewed the appointment history, qualifications, specialization, independence and professional relationship and possible advantages and costs of substituting PT SGPS' External Auditor, which at the end of the 2011 audit completed three mandates of the government bodies, and the Audit Committee concluded that there were valid and sufficient bases to maintain the External Auditor responsible for the external audit of the PT Group's consolidated financial statements. On this basis, in 2012, the Audit Committee concluded that the above mentioned Recommendation III.1.3 of CMVM's Corporate Governance Code has been complied with, and so the Audit Committee decided to renew the corresponding mandate of the External Auditor for the years 2012 to 2014.

Considering the assessment of the qualifications and work performed and independence of the Company's External Auditor, the Audit Committee decided to extend the audit contract of the annual consolidated accounts of the PT Group, entered into with Deloitte & Associados, SROC, SA, for the following work for 2014, establishing the corresponding remuneration:

- Simplified audit procedures of the consolidated financial statements of the PT Group as of 31 March and 30 September 2014, involving the identification and analysis of the accounting impact of significant unusual and or non-recurring transactions; and



- Limited review of the consolidated financial statements of PT Group as of 30 June 2014.

As a result of the resignation of Deloitte & Associados, SROC, SA as External Auditor of the Company for the financial year of 2014, presented on December 18, 2014, the Audit Committee approved on 07/01/2015, the engagement of KPMG & Associados - SROC, SA to discharge such responsibilities, under the terms of the related proposal for professional services dated 05/01/2015. Pursuant to KPMG & Associados - SROC, S.A. letter dated 06/02/2015, informing PT that it was unable to accept such appointment; the Audit Committee continued to pursue the actions considered adequate in the circumstances, and, on 16/03/2015, confirmed the engagement of BDO & Associados, SROC, Lda. to conduct an integrated audit of PT SGPS for 2014, as well as the audit of the Company's related statutory stand alone and consolidated financial statements.

As defined in OROC's Articles of Association and the U.S. SEC regulations, the Audit Committee obtained direct confirmation from the External Auditor of its compliance with the applicable independence criteria, and inquired the External Auditor as to independence whenever considered necessary.

In accordance with the Company's Articles of Association and the Audit Committee's Charter, the Audit Committee is fully responsible for the pre-approval of all professional services contracted with the External Auditors, namely of tax consultancy and other services, and periodic monitoring has been made of the work and fees contracted. In this respect, the Audit Committee noted that: (i) the ratio defined for contracting non-audit or audit related services was complied with, which in 2014 represented only 1% of total services contracted,; and (ii) the contracting of such services complied with the rules defined.



In addition, the Audit Committee supervised the compliance with the rules of the U.S. SEC and NYSE, which condition the hiring by the Company of auditor's employees and the rotation of the Partner in Charge of the external audit of the consolidated financial statements of the PT Group.

The Audit Committee also reviewed the independence and the scope, terms and conditions of the services rendered and assessed the quality of the work carried out by the effective Statutory Auditor of PT SGPS, elected by the Shareholders' General Meeting held on 27 April 2012. During the year, the Audit Committee met with the Statutory Auditor on a regular basis and obtained periodic information regarding the discharge of his responsibilities.

Considering the results of the above activities, the Audit Committee considers that the Company's External Auditor and the Statutory Auditor acted with independence.

*(b) Supervision of the functions carried out by the External Auditor and the Statutory Auditor*

In this regard, the Audit Committee analyzed and approved the work plans of the External Auditor and held periodic meetings with it to assess the work performed and analyze its results, having obtained from the External Auditor: (i) reports on the simplified audit procedures of the PT Group's consolidated financial statements as of 31 March and 30 September 2014; (ii) Limited Review report on the consolidated financial statements for the half year ended 30 June 2014; (iii) Auditors' Report on the consolidated and separate financial statements for the year ended 31 December 2014; and (iv) audit report on the annual consolidated financial statements included in Form 20-F for 2014, as well as on the internal control system relating to financial reporting prepared in accordance with PCAOB standards.



In accordance with the Company's Articles of Association and the Audit Committee's Charter, the Audit Committee is also responsible for supervising the statutory audit procedures carried out by the Statutory Auditor of PT SGPS, which was performed namely by the attendance of meetings with the Statutory Auditor and PT's External Auditor, as well as with the Auditors/External Auditors of the most significant subsidiaries of PT Group, the realization of periodic meetings and discussion of the work plans and the review and discussion of the contents of the statutory audit reports on the consolidated and separate financial statements of PT SGPS for 2014.

Therefore, in 2014 the Audit Committee represented the Company, for all purposes, before the Statutory Auditor and the External Auditor, and reviewed their respective reports; as the Company's monitoring entity, in 2014 the Audit Committee also assessed and monitored the performance of the functions of the Statutory Auditor and the External Auditor and the Audit Committee is of the opinion that the External Auditor and the Statutory Auditor acted adequately.

*(c) Supervision of the quality, integrity and effectiveness of the internal control and risk management systems and of the performance of the Internal Audit function*

The quality, integrity and effectiveness of the internal control and risk management systems are, in the opinion of the Audit Committee, the main guarantors of the quality and integrity of the financial information provided by the Company's management, as well as of the observance of the provisions of the applicable laws, regulations and articles of association.

The Company maintains an internal control and risk management system, and the Board of Directors is responsible for its implementation, evaluation and compliance. The system complies with the requirements of the methodology defined by COSO (*Committee of Sponsoring Organizations of the Treadway Commission*) and is subject to systematic assessment and review, and is subject to regular audits by both the Internal Audit and the External Auditors.



The failure, in July 2014, of Rio Forte (an entity of the Espírito Santo Group) to repay on maturity PT's investments in Rio Forte's financial instruments and its repercussions lead the Board of Directors of PT SGPS to engage an independent entity (PriceWaterhouseCoopers – "PwC") to review the procedures and acts related to the investments in Rio Forte's financial instruments, as well as all relevant matters related with cash investments in Espírito Santo Group's entities.

Although the Company's internal control and risk management systems were, generally, considered adequate, in what regards the entering of investments in financial instruments issued first by ESI and subsequently by Rio Forte, the procedures and controls in force within the Group were not strong enough to prevent such investments to occur or to require their approval by the Board of Directors following the pre-approval opinion of the Audit Committee, or their adequate and complete disclosure. The Board of Directors is conducting an overall review of the Company's internal control, risk management and *whistleblowing* systems and procedures, to prevent the new occurrence of such a situation, and also to adapt such systems and procedures to the new Company profile, after Oi's capital increase and the changes introduced to the Business Combination announced on October 2, 2013.

As far as the internal control system is concerned, we highlight that it was certified by the Company's previous Independent Auditors in 2014, by reference to the year of 2013, on the basis of the methodology defined by *COSO (Committee of Sponsoring Organizations)*, in accordance with the requirements of *Section 404* of the *Sarbanes-Oxley Act* and, and that a similar review is still in course with reference to 31/12/2014.

*(d) System for reporting irregularities and compliance*

The Company maintains, since 2005, and under the direct functional responsibility of the Audit Committee, a system for the reporting of irregularities, known as Qualified Reporting of Irregular Practices ("*whistleblowing*"), which ensures confidentiality and anonymity, as required by *SOX* and





other applicable legal provisions. The system covers acts or omissions attributable to the PT Group's employees that could have an impact on the financial statements or in the information sent to CMVM or the *U.S. SEC* or that could harm the Group's assets.

Within the System of Qualified Reporting of Irregular Practices, the Audit Committee has been ensuring the receiving and forwarding of irregularities' reports. In 2014, the Audit Committee also had quarterly meetings with "Núcleo de Análise de Participações Qualificadas – NAPQ", responsible, without decision making powers, for the treatment of qualified reports – so that the Audit Committee can analyze and decide on the matters reported, as well as, to introduce improvements to the system and to its internal disclosure.

*(e) Supervision of the quality and integrity of the interim and year-end financial information*

The Audit Committee met periodically with the officers responsible for the preparation and disclosure of financial information, as well as with the Company's External and Internal Auditors and PT SGPS' Statutory Auditor, having reviewed the adequacy of the unaudited quarterly information and of the half year and year end information disclosed and its conformity with the applicable legal, regulatory and accounting requirements. These procedures included meeting separately with the PT's External Auditors, as required by the American auditing standards, namely *PCAOB Auditing Standard n.º 16, Communications With Audit Committees*, inquiring as to:

- (i) the conclusions of the audits of the consolidated financial statements for 2014, 2013 and 2012 to be included in Form 20-F for 2014, to be filed with the U.S. SEC, carried out in accordance with the PCAOB standards, including the fact that such work, did not identify any opinion qualifications, and,
- (ii) the main conclusions of the work relating to the internal control system over the financial reporting process, carried out in accordance with the PCAOB standards, under *SOX 2014*,



including the fact that such work did not identify any deficiency classified as a "Material Weakness".

In this respect, the Audit Committee also reviewed both the interim and the annual reports of the External Auditors, any references to the accounting principles and valuation criteria used, to the recording of significant, unusual and or non-recurring transactions and to significant judgments made in the preparation of the financial statements.

In addition to this work relating directly to the preparation and disclosure of financial information, in the area of supervision of the internal control system and compliance therewith, the Audit Committee reviewed the following with the Internal Audit, the External Auditors and PT SGPS's Statutory Auditor:

- compliance with the current internal control standards applicable to the closing of the interim and year end accounts and financial reporting and the scope, planning and resources involved in the preparation and disclosure of the financial information; and
- questions or requests for clarification raised with the Company by the regulators of the financial markets, namely the *U.S. SEC* and the CMVM, as well as the responses presented and the status of open items.

In compliance with the related legal requirements, the Audit Committee (a) participated in the meeting of the Board of Directors in which the annual consolidated and separate financial statements of 2014 were discussed and approved and (b) as required in item 5 of Article 420 of the Commercial Companies Code, verified that the report on the structure and corporate governance practices disclosed, included the items applicable to the PT Group referred to in Article 245-A of the Securities Market Code (*Código dos Valores Mobiliários*).

Also, in accordance with the duties of the Audit Committee established in the Company's Articles of Association and in its Charter, the Audit Committee issued its annual reports on the Management's



Report and the consolidated and the separate financial statements for year 2014, to be submitted by the Board of Directors for approval by the Shareholders' Annual General Meeting.

In carrying out its functions established in its Charter, and considering PT SGPS' position, during 2014, as an issuer of securities on the *NYSE*, the Audit Committee also: (i) reviewed the section entitled "Operating and Financial Review and Prospects" of Form 20-F for 2014 to be submitted to the *U.S. SEC*; (ii) reviewed the Company's procedures in the area of the annual certification of the CEO and CFO relating to Form 20-F, in the context of general supervision of the Company's internal control system carried out in 2014; and (iii) issued its opinion to the Company's Board of Directors recommending the approval of the inclusion of the annual audited consolidated financial statements in Form 20-F.

It should be noted that the supervision of the adequacy of the policies, procedures and accounting practices and valuation criteria adopted and compliance with them, as well as of the regularity and quality of the Company's accounting and financial information was carried out essentially through review and discussion of the audit reports issued by the PT SGPS' External Auditors, Statutory Auditor and Internal Auditors.

*(f) Other activities*

In the course of 2014, the Audit Committee issued 1 Pre-approval Opinion on the proposal for the PT SGPS's subscription of a capital increase in Oi, to be realized in kind with the contribution of "PT Assets", as required by Internal Ruling n.º 111CA, dated February 23, 2011.

In addition to other interim work described in the Quarterly Reports presented to the Board of Directors, the Audit Committee met formally 14 times in 2014, having as a rule monthly meetings, having prepared minutes of the meetings with descriptions of the main activities carried out and respective conclusions and/or decisions.



At the conclusion of the activities carried out in 2014, the Audit Committee prepared a "Self-Assessment Guide" for this year which was provided to the Board of Directors.



### III – Reports and Opinions Issued

With reference to 2014, the Audit Committee issued the following Reports and Opinions:

<u>Date</u>	<u>Purpose of the Audit Committee's Report and Opinion</u>
17/02/2014	Self-Assessment Guide of the Scope and Activities of the Audit Committee for 2013
19/02/2014	Disclosure of the Press Release and Consolidated Financial Statements for 2013
19/02/2014	Reports and opinions of the Audit Committee on the Managements' Report and Consolidated and Separate financial statements for 2013
24/02/2014	Opinion on the proposal for the PT SGPS's subscription of a capital increase in Oi, to be realized in kind with the contribution of "PT Assets"
28/04/2014	Opinion on the approval of the Inclusion of the Annual Consolidated financial statements of PT SGPS in <i>Form 20-F</i> for 2013, to be filed with the <i>U.S. SEC</i>
12/05/2014	Disclosure of the Interim Consolidated Financial Statements and the Press Release for the First Quarter of 2014
10/07/2014	Investment of cash surplus in GES (RIO FORTE)
<u>Date</u>	<u>Purpose of the Audit Committee's Report and Opinion</u>
25/07/2014	Investment of cash surplus in GES
05/08/2014	Investment of cash surplus in GES
28/08/2014	Disclosure of the Interim Consolidated Financial Statements for the First Half-year of 2014
27/11/2014	Disclosure of the Interim Consolidated Directors' Report and Financial Statements for the Third Quarter of 2014
20/02/2015	Self-Assessment Guide of the Scope and Activities of the Audit Committee for 2014
30/04/2015	Disclosure of the Consolidated Directors' Report and Financial Statements for 2014
30/04/2015	Reports and Opinions of the Audit Committee on the Consolidated and the Standalone Annual Reports and Accounts for the Fiscal Year of 2014
14/05/2015	Opinion on the approval of the Inclusion of the Annual Consolidated financial statements of PT SGPS in <i>Form 20-F</i> for 2014, to be filed with the <i>U.S. SEC</i>



#### **IV – Conclusions**

Considering the activities carried out and Reports and Opinions issued, as explained above, the Audit Committee believes that throughout 2014 it carried out the necessary activities to comply with its competencies, duties and responsibilities, having the means necessary for that purpose, not having found any constraints or limitations to its work.



### **V – Plan of activities for 2015**

For 2015, and for the period from 01/01/2015 to 29/05/2015, date of the proposed adoption of new Articles of Association of PT SGPS, involving the extinction of the Audit Committee, this Committee intends to continue to fully and effectively comply with its objectives, as well as with the scope of work and the legal, statutory and regulatory requirements applicable to this statutory corporate body, both national and those relating to foreign private issuers in the United States of America, carrying out a plan of activities similar to that adopted in 2014.

Lisbon, May 14, 2015

THE CHAIRMAN OF THE AUDIT COMMITTEE

(José Guilherme Xavier de Basto)

THE MEMBERS

(Alfredo José Silva de Oliveira Baptista)

(Mário João de Matos Gomes)

CC: STATUTORY AUDITOR PEDRO MATOS SILVA