

**ANNUAL REPORT OF ACTIVITIES CARRIED OUT BY THE AUDIT COMMITTEE**  
**IN 2013 AND PLAN OF ACTIVITIES FOR 2014**

**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 Regulations, 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 regulations of the approval process of significant transactions with related parties.

In accordance with article 423F of the Commercial Company 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 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 Regulations, 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 System of Qualified Reporting of Irregular Practices (“whistleblowing”), as discussed below.

In addition, in accordance with the terms defined in the above mentioned Service Order 111CA, 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 for 2013, as well as its plan of activities for 2014.

## **II – Activities carried out in 2013**

Given its importance, the Audit Committee has been overseeing the development of the process of combination of the businesses of PT and Oi, as discussed in the Memorandum of Understanding announced to the market on 02/10/2013, involving the proposed merger of PT, Oi and the Oi Holding Companies into a single Brazilian incorporated listed entity.

In addition, in carrying out its activities and in compliance with its duties and responsibilities, in 2013 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 Regulations 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 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' current External Auditor, which at the end of the 2011 audit completed the three mandates of the government bodies, and concluded that there are 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, the Audit Committee believes 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 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 2013, fixing the corresponding remuneration:

- Simplified audit procedures of the consolidated financial statements of the PT Group as of 31 March and 30 September 2013, 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 2013, involving a limited review of the accounts of the most significant subsidiaries in Portugal and of PT International Finance, B.V., as well as accompanying and review the limited review reports of the Oi and Contax Groups and UNITEL, carried out by other auditors.

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

In accordance with its Articles of Association and Regulations, the Audit Committee is exclusively responsible for the pre-approval of all the professional services contracted with External Auditors, namely tax consultancy and other services, periodic monitoring having 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, which in 2013 represented only 10% of total services contracted, was complied with; 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 the auditor's employees and rotation of the Partner Responsible of the audit company appointed to carry out the external audit of the consolidated financial statements of the PT Group.

The Audit Committee also reviewed the independence and scope, terms and conditions of the services rendered and assessed the work carried out by the effective Statutory Auditor of PT SGPS, elected by the Shareholders' General Meeting held on 27 April 2012. In that year the Audit Committee met the Statutory Auditor on a regular basis from which it obtained information periodically regarding the work attributed to it.

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

*(b) Supervision of the functions carried out by the External Auditor and 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 2013; (ii) Limited Review report on the consolidated financial statements for the half year ended 30 June 2013; (iii) Auditors' Report on the consolidated and separate financial statements for the year ended 31 December 2013; and (iv) audit report on the annual consolidated financial statements included in Form 20-F for 2013, as well as on the internal control system relating to the financial report prepared in accordance with PCAOB standards.

In accordance with its Company's Articles of Association and Regulations, the Audit Committee is also responsible for supervising the statutory audit procedures carried out by the Statutory Auditor of PT, which was performed 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 2013.

In this respect, in 2013 the Audit Committee represented the Company, for all purposes, to the Statutory Auditor and External Auditor, their respective reports having been reviewed by this Committee; as the Company's monitoring entity, the Audit Committee in 2013 also assessed and monitored performance of the functions of statutory auditor and external auditor. In order to assess the performance of the External Auditor, the Audit Committee made specific inquiries of the CEO, CFO and Corporate Internal Audit and Financial Reporting Directors, so as to obtain their opinion on the quality of professional performance of the External Auditor.

Considering the results of the work carried out, the Audit Committee believes that the External Auditor and Statutory Auditor acted adequately.

*(c) Supervision of the quality, integrity and effectiveness of the internal control and risk management systems and performance of the functions carried out by the Corporate Internal Audit Department*

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 observance of the applicable conditions of the laws, rules and articles of association.

The Company maintains an internal control and risk management system, the Executive Commission being responsible for its implementation, evaluation and compliance. The system complies with all the requirements of the methodology defined by COSO (*Committee of Sponsoring Organizations of the Treadway Commission*) and is subject to systematic assessment and review, being subject to regular audits by both the Corporate Internal Audit Department and the External Auditor; in addition, the PT Group's internal control and risk management system was subject to certification by the External Auditor for 2013 in accordance with Section 404 of SOX. No deficiencies classified as "Material Weaknesses" that could place in doubt either the effectiveness of the PT Group's internal control and risk management system or its adjustment to the needs of the PT Group were reported by the External or Internal Auditor.

In 2013 the Committee continued its work to (i) supervise the quality, integrity and effectiveness of the internal control and risk management system and (ii) monitor the improvements implemented to overcome the insufficiencies. In addition, the Audit Committee periodically discussed and analyzed

application of the system with PT SGPS' Executive Commission and, when considered necessary, with the management of the Group's PT's main subsidiaries.

In supervising the Internal Audit Function (AIC), the Audit Committee reviewed and approved the Corporate Internal Audit budget and reviewed the risks and audit plan proposed by it for 2014. The Audit Committee had quarterly meetings to accompany the work carried out, in addition to other meetings, as considered necessary, to review the main issues raised and implementation by the Executive Commission and all the applicable departments of the proposals and recommendations presented in the AIC reports.

*(d) System for reporting irregularities and compliance*

Since 2005 the Company has had a system, under the responsibility of the Audit Committee, for reporting irregularities, known as Qualified Reporting of Irregular Practices (whistleblowing) that ensures confidentiality and anonymity, in compliance with the rules established by SOX and other applicable legal requirements. 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.

In respect with the Qualified Reporting of Irregular Practices, the Audit Committee has received and forwarded irregularity reports. In 2013, the Audit Committee also had quarterly meetings with the Commission for Reviewing Qualified Reports (Núcleo de Análise de Participações Qualificadas - NAPQ) – responsible, but without decision making powers, for the treatment of reports – so that the Audit Committee can analyze and decide on the matters reported and introduce improvements and internal disclosure of the system.

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

The Audit Committee met periodically with the Executive Director responsible for the preparation and disclosure of financial information, together with those responsible in the Financial Reporting Department, 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 half year and year end information disclosed and its conformity with the applicable legal, regulatory and accounting requirements. In this respect, we note the adoption of IFRS 11 Joint Arrangements, whereby

investments in joint ventures (namely in Oi, in Contax and in Oi Holding Companies) are recorded retrospectively by the equity method, instead of proportionally consolidated, as previously permitted by IAS 31.

The Audit Committee also met with those responsible in the Financial Reporting Department and separately with the PT's External Auditor, as required by the American auditing standards, namely *PCAOB Auditing Standard n.º 16, Communications With Audit Committees* (which supersedes *PCAOB AU Section 310, Appointment of the Independent Auditor*, and *Section 380, Communications With Audit Committees*, for audits of fiscal years beginning on or after 15/12/2012), inquiring as to:

- (i) the conclusions of the audits of the consolidated financial statements for 2013, 2012 and 2011 to be included in form 20-F for 2013, to be provided to the U.S. SEC, carried out in accordance with the PCAOB standards, did not identify any report 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 2013, including the fact that such work did not identify any deficiency classified as a "Material Weakness".

In this respect, the Audit Committee also reviewed, in the interim and annual reports of the External Auditor, references relating to accounting principles and valuation criteria used, for recording significant, unusual and or non-recurring transactions and the significant judgments made in preparing 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, together with the PT Group's Corporate Internal Audit Department, External Auditor and Statutory Auditor:

- compliance with the current internal control standards applicable to the closing of the interim and year end accounts and financial report 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.

In compliance with the related legal requirements, the Audit Committee (a) participated in the meeting of the Executive Commission in which the annual consolidated and separate financial statements of 2013 were discussed and approved and (b) as required in item 5 Article 420 of the Commercial Company Code, it 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 Regulations, the Audit Committee issued a report on the Management's Report and consolidated and separate financial statements of 2013 to be submitted by the Board of Directors for approval by the Shareholders' General Meeting.

In carrying out its functions established in the Regulations and considering PT SGPS' position as an issuer of securities on the NYSE, the Audit Committee also: (i) reviewed the sections entitled "Item 5 - *Operating and Financial Review and Prospects*" e "Item 15 - *Controls and Procedures*" of *Form 20-F* for 2013 to be submitted to the U.S. SEC; (ii) reviewed the confirmation obtained from the U.S. SEC relating to the waiver from the financial statement filing requirements of Rule 3-09 of Regulation S-X with respect to PT's investment in UNITEL; (iii) 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 2013; and (iv) issuance by the Board of Directors of an opinion approving the inclusion of the annual audited consolidated financial statements in *Form 20-F*.

Supervision of the adequacy of the policies, procedures and accounting practices and valuation criteria adopted and compliance with them, as well as 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 Auditor, Statutory Auditor and Corporate Internal Auditors.

(f) *Other activities*



In 2013 the Audit Committee issued 2 Prior Opinions on Proposals for Related Party Transactions, referred to later, in accordance with the terms defined in Service Order 111CA of 23 February 2011, and 1 Opinion on Proposals of Amendments to the Internal Audit Mission (resulting from recommendations of the IIA and from the 2011 process of Certification), of the updating of its Organic Structure (resulting from the actual structure already implemented in AIC and from the need of clarification of responsibilities for the implementation of the model of risk management, attributed to AIC since 2009) and the formal appointment of DAIC's 2.<sup>nd</sup> Lines.

In addition to other interim work described in the Quarterly Reports presented to the Board of Directors, the Audit Committee met formally 12 times in 2013, 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 2013, the Audit Committee prepared a "Self-Assessment Guide" for this year which was provided to the Board of Directors.

### **III – Opinions Issued**

In 2013 the Audit Committee issued the following Opinions:

<u>Date</u>	<u>Purpose of the Audit Committee's Opinion</u>
26/02/2013	Self-Assessment of Scope and Activities Guide of the Audit Committee for 2012
27/02/2013	Disclosure of the Press Release and Consolidated Financial Statements for 2012
15/03/2013	Reports and opinions of the Audit Committee on the Managements' Report and Consolidated and Separate financial statements of 2012
17/04/2013	Opinion on the approval of the Inclusion of the Annual Consolidated financial statements of PT SGPS in Form 20-F for 2012, to be submitted to the U.S. SEC
29/04/2013	Mission and charter of the Internal Audit Function of the PT Group
22/05/2013	Oi – Cancellation of the agreement for the sharing of dividends attributable to the participation of PT in Telemar in excess of the percentage of 22,38%
22/05/2013	Disclosure of the Interim Consolidated Financial Statements and the Press Release for the First Quarter of 2013
12/08/2013	Disclosure of the Interim Consolidated Financial Statements and the Press Release for the First Half-year of 2013
24/10/2013	Management of Talent Second Edition; Assessments for 2013 and 2014 – Proposal of services presented by Heidrick & Struggles

12/11/2013	Disclosure of the Interim Consolidated Financial Statements and the Press Release for the Third Quarter of 2013
17/02/2014	Self-Assessment of Scope and Activities Guide of the Audit Committee for 2013
19/02/2014	Disclosure of the Press Release and Consolidated Financial Statements for 2013

<u>Date</u>	<u>Purpose of the Audit Committee's Opinion</u>
19/02/2014	Report and opinion of the Audit Committee on the Managements' Report and Consolidated financial statements for 2013
25/03/2014	Report and opinion of the Audit Committee on the Managements' Report and Separate financial statements for 2013 and the Proposal for the Application of the Annual Profits
28/04/2014	Opinion on the approval of the Inclusion of the Annual Consolidated financial statements of PT SGPS in Form 20-F for 2013, to be submitted to the U.S. SEC

#### **IV – Conclusions**

Considering the activities carried out and opinions issued, as explained above, the Audit Committee believes that throughout 2013 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 2014**

In 2014, the Audit Committee intends to continue to fully and effectively comply with its objectives, as well as with the scope of work and legal, statutory and regulatory rules 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 realized in 2013.

Lisbon, 28 April 2014

THE CHAIRMAN OF THE AUDIT COMMITTEE  
(João Manuel de Mello Franco)

THE MEMBERS  
(José Guilherme Xavier de Basto) (Mário João de Matos Gomes)

CC: STATUTORY AUDITOR PEDRO MATOS SILVA