Annual report

Standalone financial statements

2008

Portugal Telecom, SGPS, SA

Public Company- Avenida Fontes Pereira de Melo, 40 •1069-300 Lisboa - Share capital: Euro 26,895,375
Registered in the Conservatory of the Commercial Registry of Lisbon and Collective Person under no. 503 215 058

Annual report 2008

Management Report

Introduction

The 2008 consolidated annual report of Portugal Telecom provides a detailed explanation of its consolidated activity and the evolution of its businesses during 2008 and, as such, we propose to the shareholders the analysis of that report in conjunction with this report.

The standalone financial statements of Portugal Telecom, SGPS, S.A. ("Company" or "Portugal Telecom") were prepared in accordance with the accounting policies generally accepted in Portugal ("PGAAP"), while the consolidated financial statements were prepared in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRS"), which are applicable to the listed companies in the European Union. The reconciliation of the shareholders' equity as at 31 December 2008 and net income for the year then ended, attributable to the Company's shareholders, between the standalone (under PGAAP) and the consolidated financial statements (under IFRS), is as follows (amounts in Euro million):

	Net income	Shareholders' equity
PGAAP	**489**	**1,202**
Financial instruments (IAS 32 and 39)	(8)	(133)
Post-retirement benefits (IAS 19)	33	(985)
Goodwill and licenses amortization (IAS 36 and 38)	67	221
Sale and Lease Back transactions (IAS 17)	2	(39)
Asset retirement obligation (IAS 16)	(1)	(24)
Start-up and research and development expenses (IAS 38)	(1)	(6)
Revenue recognition (IAS 18)	1	-
IFRS	**582**	**236**

Business overview

The services rendered by the Company, on a standalone basis, are exclusively related to management services rendered to Group companies and amounted to Euro 17 million in 2008. The reduction in 2008 is primarily explained by the settlement, in August 2008, of the management service contract entered into with Vivo, S.A. in previous years.

Legal information

- There are no amounts due to the Portuguese State and the Social Security.
- The Company and its board and supervisory members did not enter into any material businesses or transactions, except for those mentioned in Note 45 of the 2008 Consolidated Annual Report.
- Following the approval at the General Meeting held on 27 April 2007 and for the purposes of the execution of the share buyback program, the Company reduced its share capital in 24 March 2008 and 10 December 2008 by Euro 2,496,145 and Euro1,382,480, respectively, through the cancellation of 83,204,823 and 46,082,677 treasury shares, respectively. As at 31 December 2008, the share capital of Portugal Telecom amounted to Euro 26,895,375, with each share having a nominal value of three cents of Euro.

Proposal for application of profits and distribution of reserves

Considering that:

- The net income for the year ended 31 December 2008 amounted to Euro 488,717,970; and
- The legal reserve recorded in the balance sheet as at 31 December 2008 represents at least 20% of the share capital, and therefore complies with the number 1 of the article 295.º of the Portuguese Securities Code.

The Board of Directors proposes:

- That, considering the net income for the year ended 31 December 2008 of Euro 488,717,970, increased by free reserves amounting to Euro 26,776,717.5, be paid to the shareholders a total of Euro 515,494,687.5, corresponding to 57.5 Euro cents per share, with respect to the total number of issued shares;
- That, as it is not possible to determine precisely the number of own shares that will be held in treasury on the date of the above mentioned payment without limiting the Company's capacity of intervention, the distribution of the overall amount of Euro 515,494,687.5 as provided for in the paragraph above, calculated on the basis of a unit amount per share issued (in this case, 57.5 Euro cents per share), be executed as follows:

  a) Each share issued be paid the unit amount of 57.5 Euro cents;

  b) The amount corresponding to the shares that belong to the Company itself on the day of the payment of the above mentioned amount (calculated on said unit amount of 57.5 Euro cents per share issued) not be paid, but be transferred to retained earnings.

- That, considering the shares resulting from the conversion of exchangeable bonds issued may grant the right to the payment mentioned above:
  a) Each share resulting from the conversion of convertible bonds and entitled to a dividend be paid the said unit amount of 57.5 Euro cents;
  b) The payment to each share resulting from the conversion of convertible bonds be carried out by using the retained profits that are available after the payment mentioned above.

2008 events and recent developments

The 2008 events and recent developments are described in the 2008 Consolidated Annual Report of Portugal Telecom.

Lisbon, 17 February 2009

The Board of Directors

Henrique Granadeiro, Chairman of the Board of Directors

Zeinal Bava, Chief Executive Officer

Luís Pacheco de Melo, Executive Director, Chief Financial Officer

António Caria, Executive Director

Rui Pedro Soares, Executive Director

Santiago Fernández Valbuena, Non-Executive Director

José María Álvarez-Pallete López, Non-Executive Director

Joaquim Goes, Non-Executive Director

Amílcar de Morais Pires, Non-Executive Director

Francisco Marques Bandeira, Non-Executive Director

Jorge Tomé, Non-Executive Director

Nuno de Almeida e Vasconcellos, Non-Executive Director

Rafael Mora Funes, Non-Executive Director

João de Mello Franco, Non-Executive Director

Thomaz Paes de Vasconcellos, Non-Executive Director

José Xavier de Basto, Non-Executive Director

Franquelim Alves, Non-Executive Director

Gerald McGowan, Non-Executive Director

Francisco Pereira Soares, Non-Executive Director

Fernando Soares Carneiro, Non-Executive Director

Luís de Azevedo Coutinho, Non-Executive Director

Financial Statements

PORTUGAL TELECOM, SGPS, S.A.

BALANCE SHEETS
AS AT 31 DECEMBER 2008 AND 2007
(Amounts stated in Euro)

Assets	Notes	2008 Gross assets	2008 Amortization and adjustments	2008 Net assets	2007 Net assets
FIXED ASSETS:					
Intangible fixed assets:					
Research and development expenses	8, 10	7,305,329	(7,305,329)	-	1,416,072
Industrial property and other rights	8, 10	626,704	(607,957)	18,747	130,595
Goodwill	9, 10	136,197,176	(45,723,135)	90,474,041	108,038,797
		144,129,209	(53,636,421)	90,492,788	109,585,464
Tangible fixed assets:					
Buildings and other constructions	10	111,715	(77,580)	34,135	71,373
Transport equipment	10	1,270,880	(712,596)	558,284	755,908
Tools and dies	10	574	(574)	-	-
Administrative equipment	10	892,942	(845,593)	47,349	78,399
Other fixed tangible assets	10	1,045,754	(49,121)	996,633	1,017,513
		3,321,865	(1,685,464)	1,636,401	1,923,193
Financial investments:					
Investments in Group companies	10.16	1,739,221,801	-	1,739,221,801	1,165,893,321
Loans granted to Group companies	10.16	9,368,252,297	-	9,368,252,297	8,194,754,736
Investments in associated companies	10.16	54,749,893	(1,995,192)	52,754,701	56,463,287
Loans granted to associated companies	10.16	38,516,979	(3,198,311)	35,318,668	35,318,668
Investments in other companies	10.16	1,356,188	-	1,356,188	1,357,288
Advances for investments	10	2,117,000	-	2,117,000	1,797,000
		11,204,214,158	(5,193,503)	11,199,020,655	9,455,584,300
CURRENT:					
Accounts receivable:					
Group companies	16	277,323,663	-	277,323,663	533,136,586
Affiliated companies and shareholders		-	-	-	8,505,831
Advances to suppliers		88,563	-	88,563	93,202
State and other public entities	49	129,915,108	-	129,915,108	92,837,650
Other debtors		21,151,823	(37,249)	21,114,574	9,228,742
		428,479,157	(37,249)	428,441,908	643,802,011
Short-term investments:					
Other short-term investments	51	-	-	-	158,905,836
Other treasury investments	51	-	-	-	728,184,115
		-	-	-	887,089,951
Bank deposits and cash:					
Bank deposits	55	324,727,073	-	324,727,073	53,590,287
Cash	55	2,000	-	2,000	2,000
		324,729,073	-	324,729,073	53,592,287
Accruals and deferrals:					
Accrued income	52	34,638,331	-	34,638,331	36,226,321
Prepaid expenses	52	2,660,190	-	2,660,190	1,179,034
Deferred taxes	6	17,833,899	-	17,833,899	19,409,462
		55,132,420		55,132,420	56,814,817
Total amortization			(55,321,885)		
Total adjustments			(5,230,752)		
Total assets		12,160,005,882	(60,552,637)	12,099,453,245	11,208,392,023

The accompanying notes form an integral part of the balance sheet as at 31 December 2008.

Financial Director | The Board of Directors

PORTUGAL TELECOM, SGPS, S.A.

BALANCE SHEETS
AS AT 31 DECEMBER 2008 AND 2007
(Amounts stated in Euro)

Shareholders' Equity and Liabilities	Notes	2008	2007
SHAREHOLDERS' EQUITY			
Share capital	35,36,40	26,895,375	30,774,000
Adjustments to shareholders' equity of subsidiaries and associates	40	393,744,049	189,792,584
Reserves:			
Legal reserve	40	6,773,139	6,773,139
Other reserves	40	137,381,149	471,331,125
Retained earnings	40	148,823,527	774,802,104
Net income for the year	40	488,717,970	613,450,573
Total shareholders' equity		1,202,335,209	2,086,923,525
LIABILITIES:			
Provisions	34	176,769,590	192,076,247
Accounts payable - non current:			
Bonds	48	750,000,000	-
Bank loans	48	477,644,528	497,696,079
Other loans	48	1,490,700,000	1,233,500,000
Fixed asset suppliers	15	251,987	499,864
		2,718,596,515	1,731,695,943
Accounts payable - current:			
Bank loans	48	110,051,551	123,269,695
Other loans	48	686,326,163	323,688,504
Accounts payable trade		4,939,385	8,802,570
Accounts payable trade - invoices in conference		226,774	197,492
Group companies	16	718,130,468	172,329,770
Other shareholders		665,485	665,485
Fixed asset suppliers		303,548	336,369
State and other public entities	49	114,774,600	165,457,909
Other creditors		132,548	433,143
		1,635,550,522	795,180,937
Accruals and deferrals:			
Accrued expenses	52	68,487,317	74,474,208
Deferred income	52	6,297,714,092	6,328,041,163
		6,366,201,409	6,402,515,371
Total liabilities		10,897,118,036	9,121,468,498
Total shareholders' equity and liabilities		12,099,453,245	11,208,392,023

The accompanying notes form an integral part of the balance sheet as at 31 December 2008.

Financial Director

The Board of Directors

PORTUGAL TELECOM, SGPS, S.A.

PROFIT AND LOSS STATEMENTS (BY NATURE)
FOR THE YEARS ENDED 31 DECEMBER 2008 AND 2007

(Amounts stated in Euros)

	Notes	2008		2007	
COSTS AND LOSSES					
Supplies and external services			6,761,638		8,688,961
Wages and salaries:					
Remuneration		11,483,308		11,939,544	
Social Security charges and other		444,330	11,927,638	405,003	12,344,547
Depreciation and amortization	10	1,823,606		2,305,517	
Provisions	34	5,260,937	7,084,543	5,538,857	7,844,374
Taxes		1,210,634		1,023,346	
Other operating costs		154,504	1,365,138	279,409	1,302,755
(A)			27,138,957		30,180,637
Goodwill amortization	45	10,151,618		28,479,418	
Losses in Group and associated companies	45	32,927,094		39,638,338	
Interest and other financial costs:					
Related to Group companies	45	5,757,009		24,924,951	
Other	45	134,460,331	183,296,052	150,325,610	243,368,317
(C)			210,435,009		273,548,954
Extraordinary costs	46		9,547,422		19,304,623
(E)			219,982,431		292,853,577
Income tax	6		(14,318,693)		(5,902,679)
(G)			205,663,738		286,950,898
Net income			488,717,970		613,450,573
			694,381,708		900,401,471
INCOME AND REVENUES					
Services rendered			16,641,249		23,607,657
Supplementary income			97,442		57,682
(B)			16,738,691		23,665,339
Return from short-term investments	45	35,862		2,748,064	
Gains in Group and associated companies	45	524,341,777		623,136,904	
Other interest and financial income:					
Related to Group companies	45	53,151,661		15,397,243	
Other	45	29,783,160	607,312,460	173,732,025	815,014,236
(D)			624,051,151		838,679,575
Extraordinary income	46		70,330,557		61,721,896
(F)			694,381,708		900,401,471
Operating income:	(B)-(A)		(10,400,266)		(6,515,298)
Net financial income:	(D-B)-(C-A)		424,016,408		571,645,919
Current income:	(D)-(C)		413,616,142		565,130,621
Income before tax:	(F)-(E)		474,399,277		607,547,894
Net income	(F)-(G)		488,717,970		613,450,573

The accompanying notes form an integral part of the profit and loss statement (by nature) for the year ended 31 December 2008.

Financial Director

The Board of Directors

PORTUGAL TELECOM, SGPS, S.A.

PROFIT AND LOSS STATEMENTS (BY FUNCTIONS)

FOR THE YEARS ENDED 31 DECEMBER 2008 AND 2007

(Amounts stated in Euro)

	Note 54	2008	2007
Services rendered	a)	16,641,249	23,607,657
Costs of services rendered	b)	(14,770,742)	(26,853,282)
Gross profit		1,870,507	(3,245,625)
Other operating income and revenue		98,666	4,798,806
Administrative costs		(419,896)	(555,449)
Other operating costs	c)	(10,179,695)	(24,087,980)
Operating profit		(8,630,418)	(23,090,248)
Net financing costs	d)	(57,282,519)	13,878,707
Gains (losses) in subsidiaries and associated companies	e)	531,464,808	551,883,099
Gains (losses) on other investments	f)	35,862	41,428,162
Current profit		465,587,733	584,099,720
Income tax	g)	23,130,237	29,350,853
Net income		488,717,970	613,450,573
Earnings per share		0.55	0.60

The accompanying notes form an integral part of profit and loss statement (by fuction) for the year ended 31 December 2008.

Financial Director

The Board of Directors

PORTUGAL TELECOM, SGPS, S.A.

CASH FLOW STATEMENTS
FOR THE YEARS ENDING 31 DECEMBER 2008 AND 2007

(Amounts stated in Euros)

	Notes:	2008	2007
OPERATING ACTIVITIES:			
Collections from clients	55.a)	30,437,731	-
Payments to suppliers		(9,856,235)	(48,392,416)
Payments to employees		(11,798,477)	(18,967,661)
Cash flows from operations		8,783,019	(67,360,077)
Receipts(Payments) relating to income taxes	55.b)	(63,250,312)	24,508,235
Receipts(Payments) relating to indirect taxes and other		(9,729,954)	6,186,520
Cash flows generated before extraordinary activities		(64,197,247)	(36,665,322)
Receipts(payaments) relating to extraordinary activities		(65,345)	2,244,394
Cash flows from operating activities (1)		(64,262,592)	(34,420,928)
INVESTING ACTIVITIES:			
Cash receipts resulting from:			
Short-term financial applications	55.c)	1,320,287,460	19,029,581,345
Financial investments	55.d)	1,151,896,135	1,760,344,579
Tangible and intangible fixed assets		417,861	559,814
Loans granted	55.e)	372,271,602	102,555,095
Interest and related income		43,242,313	60,306,829
Dividends	55.f)	542,970,970	100,216,244
Other investing activities	55.g)	-	126,822,568
		3,431,086,341	21,180,386,474
Payments resulting from:			
Short-term financial applications	55.c)	(433,197,509)	(18,608,024,640)
Financial investments	55.h)	(615,877,664)	(23,137,150)
Tangible and intangible fixed assets		(78,825)	(237,042)
Loans granted	55.i)	(1,407,161,946)	-
		(2,456,315,944)	(18,631,398,832)
Cash flow from investing activities (2)		974,770,397	2,548,987,642
FINANCING ACTIVITIES:			
Cash receipts resulting from:			
Loans obtained	55.j)	43,407,158,455	13,758,956,767
Other financing activities	40	7,472,641	19,700,022
		43,414,631,096	13,778,656,789
Payments resulting from:			
Loans obtained	55.k)	(42,311,194,716)	(14,571,366,084)
Lease rentals (principal)		(658,130)	(903,921)
Interest and related expenses		(150,634,077)	(153,859,588)
Dividends	40	(541,967,947)	(536,206,838)
Acquisition of treasury shares	40	(1,049,745,618)	(1,050,271,924)
Other financing activities		-	(10,240,689)
		(44,054,200,488)	(16,322,849,044)
Cash flow from financing activities (3)		(639,569,392)	(2,544,192,255)
Change in cash and cash equivalents (4)=(1)+(2)+(3)		270,938,413	(29,625,541)
Effect of exchange differences		198,373	(2,251,187)
Cash and cash equivalents at the beginning of the period	55.l)	53,592,287	85,469,015
Cash and cash equivalents at the end of the period	55.l)	324,729,073	53,592,287

The accompanying notes form an integral part of the cash flow statement fot the year ended 31 December 2008.

Financial Director

The Board of Directors

PORTUGAL TELECOM, SGPS, S.A.

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2008

(Amounts in Euro)

Introduction

Portugal Telecom, SGPS, S.A. ("Portugal Telecom" or "Company") and its subsidiaries and associated companies (Note 16), which represent its corporate Group ("Portugal Telecom Group" or "Group"), operating primarily in the telecommunications sector, in Portugal and in other countries.

These financial statements, which are related to the Company on a standalone basis, were prepared in accordance with accounting principles generally accepted in Portugal, and, as such, the financial investments were accounted for under the equity method, as explained in Note 3.c). The Company prepared and presented separately its consolidated financial statements, which include the financial statements of the companies controlled by Portugal Telecom. In these standalone financial statements, the shareholders' equity as at 31 December 2008 and the net income for the year then ended include the effect of the consolidation of the shareholders' equity and net income of the Company's subsidiaries, based on their respective financial statements, but do not include the effect of the fully consolidation of their assets, liabilities, costs and revenues.

The consolidated financial statements of Portugal Telecom have been prepared, since 2005, in accordance with International Financial Reporting Standards ("IFRS"), as adopted by the European Union. Therefore, the shareholders' equity as at 31 December 2008 and 2007 and the net income for the years then ended, which are included in the consolidated financial statements of Portugal Telecom, differ from the amounts presented in these standalone financial statements.

a) Shareholders

As a result of the privatization process between 1 June 1995 and 4 December 2000, the Portugal Telecom's share capital is held mainly by private shareholders. As at 31 December 2008, the Portuguese State and its controlled entities owned, directly or indirectly, 9.66% of the capital of Portugal Telecom, including the 500 Class A shares (Note 36), which grant it special rights.

b) Listed shares

The shares of Portugal Telecom are listed on the Euronext and on the *NYSE - New York Stock Exchange*.

3. Basis of presentation and main accounting policies

The standalone financial statements of Portugal Telecom were prepared in accordance with the accounting principles established under the Official Accounting Plan (POC) and other Portuguese legislation, and, in some circumstances, in accordance with the International Financial Reporting Standards; the standalone financial statements were prepared in accordance with the principle of historic costs and with the accounting principles of prudence, going concern assumption, accrual basis, consistency, materiality and substance over form.

The notes of this report use the numeration defined by the POC for presentation of standalone financial statements. Certain notes were not included in this report because they are not applicable to the Company or because its presentation is not considered relevant for the analysis of the standalone financial statements.

The principal valuation criteria used in the preparation of these financial statements was as follows:

a) Intangible fixed assets

Intangible fixed assets include primarily goodwill arising from the acquisition of equity investments in Group and associated companies, which is amortized in accordance with the criteria mentioned in Note 9.

a) Tangible fixed assets

Tangible fixed assets are stated at acquisition cost and are amortized on a straight line basis from the month they are incorporated or available for use.

The depreciation rates correspond to the following estimated average economic useful lives (in years):

Buildings and other constructions	3 -5
Transport equipment	4
Administrative equipment	3 – 8
Other tangible fixed assets	3 – 8

c) Financial investments

Financial investments in Group and associated companies are recorded under the equity method of accounting, being initially recorded at acquisition cost, which is increased or decreased by the difference between that value and the value corresponding to the Company’s proportion in the equity of those companies at the acquisition date. That difference, if positive, is recorded as goodwill and amortized over the recoverable period of the investment, and, if negative, is recorded under shareholders' equity under caption "Adjustments to capital of subsidiaries and associates".

In accordance with the equity method of accounting, financial investments are adjusted for the Company's share in net income and other changes in shareholders' equity, which are recorded under financial income or costs, and as adjustments to capital of subsidiaries and associates, respectively. Dividends distributed by subsidiaries and associated companies are deducted from financial investments when they are attributed. Additionally, the accumulated losses that exceed the total investment amount are recorded under the caption "Provisions for losses in financial investments" (Note 34).

Gains resulting from the disposal of subsidiaries and associated companies within the Group are deferred or reversed until the date these investments are disposed of to a third party. Whenever these gains are deferred, its recognition in earnings is recorded under the caption "Extraordinary income", in the same proportion that the goodwill recorded by the acquirer is amortized.

Additional capital contributions and loans granted to Group and associated companies are recorded at nominal value, reduced by adjustments for estimated losses if applicable.

The financial investments in other companies (investments lower then 20%) are recorded at acquisition cost or at nominal value, for loans granted, reduced by adjustments for estimated losses if applicable.

d) Finance leasing

Fixed assets acquired under finance lease contracts, which meet the conditions of Accounting Directive no. 25, as well as the corresponding liabilities, are recorded in the balance sheet and are amortized in accordance with the useful life referred in Note 3.b). The capital and interest components of the rents related to the finance lease contracts are recorded as a reduction to responsibilities and as financial costs, respectively (Note 15).

e) Accruals and deferrals

The Company records its revenue and expenses as they are generated or incurred, regardless of when they are received or paid.

f) Balance classification

Realizable assets and liabilities due over a period greater than one year from the balance sheet date are classified under non-current assets and non-current liabilities, respectively.

g) Vacation pay and vacation subsidy

Vacation pay and vacation subsidies are recorded as a cost for the period in which the employee acquires the right to receive them. Consequently, the amount of vacation pay and subsidies due and unpaid at the balance sheet date has been estimated and included under the caption “Accruals and deferrals” (Note 52).

h) Income tax

From the year 2000, Portugal Telecom adopted the special taxation regime for Groups of companies, which applies to all companies in which it holds, directly or indirectly, at least 90% of the capital stock and that, simultaneously, are located in Portugal and are subject to corporate income tax. Any gain generated as a result of the adoption of this regime is recorded in earnings under the caption “Gains in Group and associated companies” (Note 45.d). The companies which are not under this regime are subject to corporate income tax on a standalone basis, based on the respective taxable profits and tax rates.

The income tax recorded in the financial statements was assessed in accordance with the terms of Accounting Directive no. 28. In assessing the cost of income tax for the year, besides the current tax determined on the basis of profit before-tax adjusted for in accordance with tax legislation, it is also considered the effects resulting from temporary differences between the income before tax and the taxable earnings arising in that year or in the preceding ones, as well as the effect of reportable tax losses at the balance sheet date.

Deferred tax assets are only recorded when there is a reasonable expectation of sufficient future fiscal profits which allow their use, or when there is deferred tax liabilities whose reversal is expected to occur in the same period in which those deferred tax assets will be reversed.

The current or deferred income tax related to transactions recorded directly in reserves or retained earnings, is also recorded directly in those same captions, without any impact in the net income for the period.

Deferred tax assets and liabilities are computed and evaluated annually, using the taxation rates which are expected to be in force at the date of reversal of these temporary differences, and other relevant changes in the fiscal legislation.

i) Foreign currency balances and transactions

All assets and liabilities expressed in foreign currency and for which no agreement on fixing the exchange rate exists, were converted into Euros using the exchange rates applicable at the balance sheet date (Note 4).

Favourable and unfavourable exchange rate differences arising from the differences between exchange rates in force at the date of the respective transactions and those applying on the date of collection, payment or balance sheet date have been recorded as income and costs in the statements of profit and loss (Note 45).

For purposes of the application of the equity method of accounting, the exchange rate differences arising from the conversion into Euros of the financial statements of subsidiaries and associated companies presented in foreign currency is made through the following exchange rates:

- Exchange rate at the balance sheet date, for the conversion of assets and liabilities;
- Average exchange rate of the period, for the conversion of the statements of profit and loss and cash flows; and
- Historical exchange rates, for the conversion of the captions of shareholders' equity.

The exchange rate differences arising from the conversion into Euros of the financial statements of subsidiaries and associated companies presented in foreign currency have been included in shareholders' equity under the caption "Adjustments to shareholders' equity of subsidiaries and associates" (Note 40).

j) Financial instruments and risk management

Financial instruments include primarily interest and exchange rate swaps and equity swaps over own shares. The interest rate and exchange rate swaps are contracted to reduce the exposure to fluctuations in interest and exchange rates, following the policy of hedging financial liabilities. In addition, Portugal Telecom also enters into *forwards* and exchange rate options (Note 53).

The gains or losses resulting from derivative instruments which are hedging the risks mentioned above, are recorded in earnings in order to compensate the losses and gains related to the respective assets and liabilities. If the instruments are not hedging those risks, or are not related to any specific risk, they are recorded at fair value at the balance sheet date, with gains and losses related to the change in the fair value recorded in earnings.

Fees received or paid, as well as other expenses incurred in connection with these transactions, are recognized in earnings through the period of these transactions.

Equity swaps over own shares were contracted in connection with the share buyback program, with the purpose of allowing a more flexible execution of the program. The equity swaps over shares of subsidiaries were contracted in line with the management policy of exposure to financial investments.

4. Rates Used for Conversion of Balances into Foreign Currency

Assets and liabilities as at 31 December 2008 and results for the year then ended denominated in foreign currencies were translated to Euros on the basis of the following exchange rates:

Designation	Code	Final exchange rate	Average exchange rate
US Dollar	USD	1.3917	1.4708
British Pound	GBP	0.9525	0.9525
Brazilian Real	BRL	3.2436	2.6737

6. Taxes

(a) The Company is subject to corporate income tax ("IRC"), at a normal rate of 25%, added by a municipal tax up to a maximum of 1.5%, resulting in an aggregate tax rate of 26.5%.

In the year ended 31 December 2008, the taxable profit of the Company was estimated in accordance with the special taxation regime for groups of companies ("tax consolidation"), including the following companies: PT Comunicações, S.A. ("PT Comunicações"); TMN – Telecomunicações Móveis Nacionais, S.A. ("TMN"); PT Prime, S.A. ("PT Prime"); PT Contact – Telemarketing e Serviços de Informação, S.A. ("PT Contact"); PT Imobiliária, S.A. ("PT Imobiliária"); PT Ventures, SGPS, S.A. ("PT Ventures"); PT Inovação, S.A. ("PT Inovação"); PT Móveis, SGPS, S.A. ("PT Móveis"); PT Pro - Serviços Administrativos e de Gestão Partilhados, S.A. ("PT Pro"); PT-Sistemas de Informação, S.A. ("PT SI"); PT Compras - Serviços de Consultoria e Negociação, S.A. ("PT Compras"); PT Participações SGPS, S.A. ("PT Participações"); PT Investimentos Internacionais – Consultoria Internacional, S.A. ("PT II"); PT Prestações – Mandatária de Aquisições e Gestão de Bens, S.A. ("PT Prestações"); PT Portugal, SGPS, S.A. ("PT Portugal"); PT Rede Fixa, SGPS, S.A. ("PT Rede Fixa"); PT Centro Corporativo, S.A. ("PT Centro Corporativo"); and Infonet Portugal – Serviços de Valor Acrescentado, Lda. ("Infonet").

(b) In accordance with the prevailing legislation, taxation returns are subject to review and correction by the fiscal authorities during a period of four years (five years for Social Security, with a period of ten years formerly applying for payments and contributions for years prior to 2001), except where there have been tax losses, fiscal benefits have been granted, or there are inspections, claims or challenges under way; in such cases these periods may be extended or suspended, depending on the circumstances. Based upon the information supplied by its fiscal advisory services, the Board of

Directors considers that any corrections to the tax returns that might result from reviews carried out by the tax authorities will not have a significant effect on the financial statements as at 31 December 2008, considering the provisions record and the actual expectations to resolve the current situations (Note 34).

(c) In relation to the Value Added Tax, the Company uses the effective allocation method in order to compute the deductible tax.

(d) The detail of balances and movements occurred in deferred taxes during the year ended 31 December 2008 was as follows:

	Opening balance	Net income	Ending balance
Deferred tax assets			
Provisions	910,608	(910,608)	-
Financial instruments	15,255,254	(664,955)	14,590,299
Other	3,243,600	-	3,243,600
	19,409,462	(1,575,563)	17,833,899

The reconciliation between the nominal tax rate and the income tax recorded in the profit and loss statement is as follows:

Income before taxes	474,399,277
Nominal tax rate	26.5%
Estimated tax charge	125,715,808
Permanent differences (a)	(140,899,998)
Adjustments to tax payable	30,183
Other	835,314
	(14,318,693)
Income tax has the following composition:	
Income tax-current (Note 49)	(15,894,256)
Deferred taxes	1,575,563
	(14,318,693)

(a) The detail of permanent differences is as follows:

Effect of applying the equity method of accounting (Notes 45.b and 45.d)	(477,214,088)
Recognition of deferred capital gains (Note 46)	(48,465,493)
Gain related to the tax consolidation regime (Note 45.d)	(14,200,595)
Goodwill amortization (Note 45)	10,151,618
Adjustments to the provision for income taxes of the previous year (Note 46)	1,604,790
Other	(3,574,336)
	(531,698,104)
Nominal tax rate	26.5%
	(140,899,998)

7. Average number of employees

In 2008, the average number of employees working for the Company, which includes employees of other Group companies, is as follows:

Effective personnel	20
Personnel on term contract	1
	21
Personnel on loan from other entities	3
	24

The responsibilities with post retirement benefits related to employees from other Group companies were recorded directly by those companies and the respective cost was then invoiced to Portugal Telecom and included under the caption “Wages and salaries”.

8. Research and development expenses and industrial property and other rights

As at 31 December 2008 and 2007, these captions are as follows:

	2008	2007
Research and development expenses:		
Studies and projects	7,305,329	7,305,329
Accumulated amortization	(7,305,329)	(5,889,257)
	-	1,416,072
Industrial property and other rights:		
Software user licenses	433,050	433,050
Other	193,654	193,654
Accumulated amortization	(607,957)	(496,109)
	18,747	130,595

9. Goodwill

As at 31 December 2008, the detail of goodwill is as follows (Note 10.a):

	Gross amount	Accumulated amortization	Net amount
Páginas Amarelas	89,338,063	(27,918,145)	61,419,918
UOL	46,859,113	(17,804,990)	29,054,123
	136,197,176	(45,723,135)	90,474,041

Goodwill resulting from acquisitions of financial investments is depreciated on a straight line basis during the expected period of recovery of the investment, which is 20 and 10 years for Páginas Amarelas and UOL, respectively.

10. Fixed assets

a) Intangible and tangible fixed assets

During 2008, the movements in intangible and tangible fixed assets, as well as in the respective accumulated depreciation, were as follows:

	Gross assets					
	Opening balance	Increases	Disposals	Foreign currency translation adjustments	Transfers and write-offs	Closing balance
Intangible fixed assets:						
Research and development expenses	7,305,329	-	-	-		7,305,329
Industrial property and other rights	626,704	-	-	-		626,704
Goodwill (Note 9)	147,879,918	-	-	(11,682,742)		136,197,176
	155,811,951	-	-	(11,682,742)	-	144,129,209
Tangible fixed assets:						
Buildings and other constructions	111,715	-	-	-	-	111,715
Transport equipment	1,726,406	377,073	(757,127)	-	(75,471)	1,270,880
Tools and dies	574	-	-	-	-	574
Administrative equipment	892,942	-	-	-	-	892,942
Other tangible fixed assets	1,045,754	-	-	-	-	1,045,754
	3,777,391	377,073	(757,127)	-	(75,471)	3,321,865

	Accumulated depreciation					
	Opening balance	Increases	Disposals	Foreign currency translation adjustments	Transfers and write-offs	Closing balance
Intangible fixed assets:						
Research and development expenses	5,889,257	1,416,072	-	-	-	7,305,329
Industrial property and other rights	496,109	111,848	-	-	-	607,957
Goodwill (Notes 9 and 45)	39,841,121	10,151,618	-	(4,269,604)	-	45,723,135
	46,226,487	11,679,538	-	(4,269,604)	-	53,636,421
Tangible fixed assets:						
Buildings and other constructions	40,342	37,238	-	-	-	77,580
Transport equipment	970,498	206,518	(427,620)	-	(36,800)	712,596
Tools and dies	574	-	-	-	-	574
Administrative equipment	814,543	31,051	-	-	-	845,593
Other tangible fixed assets	28,241	20,879	-	-	-	49,121
	1,854,198	295,686	(427,620)	-	(36,800)	1,685,464

b) Financial investments

During 2008, the movements in financial investments were as follows:

	Opening balance	Increases (i)	Disposals (ii)	Adjustments and transfers	Reductions (iii)	Equity method (iv)
Financial investments:						
Investments in Group companies (Note 16)	1,165,893,321	423,934,479	(14,054,333)	258,957	-	704,042,402
Loans granted to Group companies (Note 16)	8,194,754,736	1,299,925,329	(19,067,500)	-	(107,360,268)	-
Investments in associated companies (Note 16)	58,458,479	-	-	-	-	(1,626,503)
Loans granted to associated companies (Note 16)	38,610,734	-	-	(93,755)	-	-
Investments in other companies (Note 16)	1,357,288	-	-	(1,100)	-	-
Advances for investments	1,797,000	320,000	-	-	-	-
	9,460,871,558	1,724,179,808	(33,121,833)	164,102	(107,360,268)	702,415,899
Adjustments for financial investments	(5,287,258)	-	-	93,755	-	-
	9,455,584,300	1,724,179,808	(33,121,833)	257,857	(107,360,268)	702,415,899

(i) The increase in the caption “Investments in Group companies” includes Euro 391,625,528 related to the acquisition, in January 2008, of a 78% stake in Africatel previously held by PT Ventures , for an amount of Euro 374,993,712 (Note 55.h). The difference between the shareholders’ equity of Africatel at the acquisition date and the purchase price acquisition was recognized in earnings (Note 46).

In addition, the increases in the caption "Investments in Group companies" include Euro 32,308,951 related to a share capital increase in PT Ventures (Note 55.h).

The increases in the caption "Loans granted to Group companies" are as follows:

Additional paid in capital contributions (Note 55.h):	
PT Portugal	198,000,000
PT Inovação	2,500,000
PT II	1,000,000
Loans granted (Note 55.i):	
PT Comunicações	744,000,000
PT Pro	14,000,000
PT Inovação	9,000,000
Acquisitions :	
Loans granted to Africatel (Note 55.i)	329,670,329
Additional paid in capital contributions to Africatel (Note 55.h)	1,755,000
	1,299,925,329

The increase in the caption "Advances for investments" is related to an advance of Euro 320,000 for a share capital increase in PT Ásia (Note 55.h).

(ii) The disposals of investments in Group companies are related to the disposal, in September 2008, of a 3% stake in Africatel, for an amount of Euro 13,359,362 (Note 55.d). As a result, the interest of Portugal Telecom in Africatel is now 75%.

The movements related to disposals occurred in the caption "Loans to Group companies" include (1) the reduction in the additional paid in capital contributions granted to Africatel by an amount of Euro 67,500 (Note 55.d), following the disposal of a 3% stake in this company, and (2) the disposal of loans granted to PT Wi-Fi amounting to Euro 19,000,000 (Note 55.d), following the disposal of this company to TMN.

(iii) The reductions in the caption "Loans to Group companies" include: (1) the repayment of additional paid in capital contributions by PT Ventures and PT Participações amounting to Euro 45,760,268 (Note 55.d) and Euro 54,600,000 (Note 55.d), respectively; and (2) the repayment of loans granted to PT SI amounting to Euro 7,000,000 (Note 55.e).

(iv) The movements in financial investments related to the application of the equity method of accounting were recorded under the following captions:

Increases:	
Gains in Group and associated companies (Note 45.d)	509,364,516
Adjustments to shareholders' equity of subsidiaries and associates (Note 40)	800,583,578
Reductions:	
Losses in Group and associated companies (Note 45.b)	(27,691,159)
Adjustments to shareholders' equity of subsidiaries and associates (Note 40)	(579,841,036)
	702,415,899

(v) The dividends paid by Group and associated companies are as follows (Note 55.f):

PT Portugal	503,366,459
PT Inovação	18,559,349
PT Finance	17,287,733
Páginas Amarelas	1,997,960
PT Centro Corporativo	1,522,894
Previsão	116,591
UOL	84,122
	542,935,108

c) Recoverable amount of financial investments

As at 31 December 2008, Portugal Telecom, based on the business plans of its subsidiaries and associated companies, believes that the carrying value of its financial investments in Group and associated companies (including goodwill net of accumulated depreciation) does not exceed the respective fair value.

15. Finance leases

As at 31 December 2008, the Company had transport equipment under finance lease contracts, with the related liabilities for the remaining lease payments being as follows:

	Capital		Interest		Total
	Short-term	Medium and long term	Short-term	Medium and long term	
2009	302,061	-	20,519	-	322,580
2010	-	173,509	-	8,483	181,992
2011	-	78,479	-	2,267	80,746
	302,061	251,987	20,519	10,750	585,318

16. Group and associated companies

As at 31 December 2008, the main financial information related to Group and associated companies was as follows:

Company name		Address	Shareholders' equity	Net Income	Percentage of participation	Financial investment (Note 10)	Provision (Note 34)
Investments in group companies							
PT Portugal	(a)	Av. Fontes Pereira de Melo, nº 40 - Lisbon	8,770,128,626	387,077,924	100%	836,128,626	-
PT Prime Tradecom	(b)	R. Entrecampos, nº 28 - Lisbon	871,351	75,228	66%	-	3,359,572
PT Ventures	(c)	Av. Fontes Pereira de Melo, nº 40 - Lisbon	344,379,426	71,595,249	100%	221,179,427	-
PT Brasil		R.Sampaio Viana, 277-5º Paraíso - S.Paulo, Brazil	34,936,453	4,396,323	99.98%	34,929,466	-
PT Ásia		Rua Pedro José Lobo, 1-3 Macau	(11,425,515)	(217,325)	95.92%	-	10,959,354
PT Inovação	(d)	R. Engº José Ferreira Pinto Basto - Aveiro	13,452,755	9,342,281	100%	8,458,766	-
PT SI	(e)	Urb., Tagusparque –Parque da Ciência e Tecnologia de Oeiras, Lote 35 - Oporto Salvo - Oeiras	10,931,480	(521,865)	99.80%	-	5,087,294
Portugal Telecom Europa		Blue Tower – 324 – Av. Louise, BTE 16º floor - Belgium - 1050 Brussels	171,656	-	98.67%	169,373	-
PT Pro	(f)	R. Entrecampos, nº 28 - Lisbon	26,773,444	(3,386,805)	100%	-	60,812,468
PT Participações	(g)	Av. Fontes Pereira de Melo, nº 40 - Lisbon	30,056,109	12,493,215	100%	9,781,999	-
Africatel Holdings B.V	(h)	Naritaweg 165, Telestone 8, 1043 BW Amsterdam, Netherlands	446,201,373	(36,027,053)	75%	332,963,530	-
PT Imobiliária		R. Tenente Espanca, nº 35 - Lisbon	26,386,900	436,916	100%	26,386,900	-
Previsão – Sociedade Gestora de Fundos de Pensões, S.A.		R. Entrecampos, nº 28 - Lisbon	4,268,343	49,915	82.05%	3,502,133	-
Portugal Telecom Internacional Finance B.V.		Strawinkylaan 3105, 7º floor - Amsterdam, Netherlands	264,959,569	12,848,200	100%	264,959,569	-
PT Compras	(i)	R. Entrecampos, nº 28 - Lisbon	1,235,129	727,016	100%	-	37,784,871
PT II	(j)	Av. Fontes Pereira de Melo, nº 40 - Lisbon	190,567	(539,578)	100%	-	19,309,433
PT Rede Fixa		Av. Fontes Pereira de Melo, nº 40 - Lisbon	33,024	(5,314)	100%	33,024	-
PT Centro Corporativo		Av. Fontes Pereira de Melo, nº 40 - Lisbon	728,988	630,133	100%	728,988	-
						1,739,221,801	137,312,992
Investments in associated companies							
Páginas Amarelas		Av.Republica, 50, 6º Lisbon	12,354,303	7,123,424	24.88%	3,073,161	-
SGPICE		Rua Mouzinho da Silveira, 32, 7º- Lisbon	(8,454,288)	(10,135)	11.11%	-	939,271
UOL		São Paulo - Brazil	224,093,505	39,387,679	22.17%	49,681,540	-
Sportinveste Multimédia,SGPS,SA	(k)	Lg. Lagoa, nº15 A Linda-a-Velha	(2,079,643)	(1,158,294)	50%	-	17,122,412
INESC					26.36%	1,995,192	-
						54,749,893	18,061,683
Adjustments for financial investments (Note 10.b)						(1,995,192)	
						1,791,976,502	155,374,675

(a) The shareholders' equity of this company includes additional paid in capital contributions amounting to Euro 7,934,000,000.

(b) The shareholders' equity of this company includes additional paid in capital contributions amounting to Euro 5,961,612, of which Euro 4,261,612 were granted by Portugal Telecom.

(c) The shareholders' equity of this company includes additional paid in capital contributions amounting to Euro 123,200,000.

(d) The shareholders' equity of this company includes additional paid in capital contributions amounting to Euro 4,993,989.

(e) The shareholders' equity of this company includes additional paid in capital contributions amounting to Euro 16,028,970.

(f) The shareholders' equity of this company includes additional paid in capital contributions amounting to Euro 87,585,912.

(g) The shareholders' equity of this company includes additional paid in capital contributions amounting to Euro 20,274,110.

(h) The shareholders' equity of this company includes additional paid in capital contributions amounting to Euro 2,250,000, of which Euro 1,687,500 were granted by Portugal Telecom.

(i) The shareholders' equity of this company includes additional paid in capital contributions amounting to Euro 39,020,000.

(j) The shareholders' equity of this company includes additional paid in capital contributions amounting to Euro 19,500,000.

(k) The shareholders' equity of this company includes additional paid in capital contributions amounting to Euro 32,165,181, of which Euro 30,023,168 were granted by Portugal Telecom.

As at 31 December 2008, the caption "Investments in other companies" is as follows (Note 10.b):

Taguspark	1,296,875
Other	59,313
	1,356,188

As at 31 December 2008, loans granted to Group companies were as follows (Note 10.b):

Additional paid in capital contributions granted:	
PT Portugal	7,934,000,000
PT Ventures	123,200,000
PT Pro	87,585,912
PT Compras	39,020,000
PT Participações	20,274,110
PT II	19,500,000
PT SI	16,028,970
PT Inovação	4,993,989
PT Prime Tradecom	4,261,612
Africa PT BV	1,687,500
	8,250,552,093
Loans granted:	
PT Comunicações	744,000,000
Africa PT BV	329,670,330
PT Inovação	22,600,000
PT PRO	14,000,000
PT Ásia	5,201,546
PT Prime Tradecom	2,228,328
	1,117,700,204
	9,368,252,297

Loans granted to group companies don't bear interest and don't have a repayment schedule defined.

As at 31 December 2008, loans granted to associated companies were as follows (Note 10.b):

Sportinveste Multimédia (a)	35,318,668
INESC (b)	3,198,311
	38,516,979
Adjustments for financial investments	(3,198,311)
	35,318,668

(a) This caption includes additional paid in capital contributions amounting to Euro 30,023,168 and loans of Euro 5,295,500.

(b) This loan was fully adjusted for as at 31 December 2008.

As at 31 December 2008, short-term accounts receivable from Group companies were as follows:

Accounts receivable from Group companies related to the tax consolidation regime (a)	12,978,675
Accounts receivable from Group companies related to the centralized cash management (b)	
PT Comunicações	138,093,672
TMN	48,304,726
Africatel	28,269,207
PT Contact	12,318,987
PT Ventures	7,649,887
PT Brasil	5,233,822
PT II	4,163,569
PT Finance	3,479,386
PT Móveis	3,296,608
PT Compras	3,243,304
PT Asia	3,087,710
PT Centro Corporativo	2,170,968
Other	5,033,143
	264,344,988
	277,323,663

(a) This caption includes income tax payable by the companies included in the tax consolidation regime amounting to Euro 142,007,975 (Note 49), net of payments on account made by these companies amounting to Euro 129,029,300 (Note 55.b).

(b) As from March 2006, the Company has centralized all cash receipts and payments of Group companies located in Portugal and that are fully owned by Portugal Telecom.

As at 31 December 2008, short-term accounts payable to Group companies were as follows:

Advance received for the disposal of financial investments to Africatel (Note 55.d) (a)	712,109,005
Accounts payable to Group companies related to the centralized cash management (b)	
PT Prime	4,542,006
PT PRO	734,868
PT Prestações	93,594
Other	650,995
	718,130,468

(a) This caption is related to an advance made by Africatel to PT Ventures for the disposal of certain investments held by the latter, namely Unitel and Cabo Verde Telecom. Following the acquisition by Portugal Telecom, in January 2008, of the total investment in Africatel, previously held by PT Ventures, as explained in Note 10.b, Portugal Telecom has also acquired the liability related to this advance.

(b) As from March 2006, Portugal Telecom has centralized all cash receipts and cash payments of Group companies located in Portugal and that are fully owned by Portugal Telecom.

18. Guarantees granted to Group companies

As at 31 December 2008, Portugal Telecom had issued bank and other guarantees in favour of other entities as follows:

- Guarantee given to the Tax Authorities in favour of Companhia Portuguesa Rádio Marconi, S.A., now incorporated in PT Comunicações, related to additional tax liquidations of income tax amounting to Euro 16,500,043;
- Guarantee given to the Tax Authorities in favour of PT Comunicações, related to an additional tax liquidation of value added tax of the year 2000 amounting to Euro 1,084,093;
- Bank guarantees given to the Tax Authorities, corresponding to additional tax liquidations amounting to Euro 1,283,422 and Euro 3,310,805, related to the value added tax of the years 2001 and 2002, respectively;
- Bank guarantee given to the Tax Authorities in favour of PT Investimentos, now incorporated in Portugal Telecom, corresponding to an additional tax liquidation amounting to Euro 827,911, related to the value added tax of the year 2001;
- Guarantee given to the Tax Authorities in favour of PT Comunicações, corresponding to additional tax liquidations amounting to Euro 816,680, related to the value added tax of the year 2001, and Euro 996,940, related to the income tax of the year 2002;
- Guarantee given to the Tax Authorities in favour of PT Comunicações, corresponding to additional tax liquidations amounting to Euro 222,289, related to the income tax of the year 2003, and Euro 2,179,095, related to the value added tax of the year 2003;
- Guarantee given to the Tax Authorities in favour of PT Comunicações, corresponding to additional tax liquidations amounting to Euro 1,175,787 and Euro 3,172,887, related to the value added tax of the years 2002 and 2004, respectively;
- Guarantee given to the Tax Authorities in favour of PT Comunicações, corresponding to an additional tax liquidation amounting to Euro 2,345,032, related to the income tax of the year 2004;
- Guarantee given to the Tax Authorities in favour of PT Comunicações, related to contributions to Caixa Geral de Aposentações amounting to Euro 2,320,258;
- Bank guarantee given to the Labour Court of Cascais, related to a lawsuit amounting to Euro 378,380.

Additionally the Company has also granted a guarantee for a promissory note subscribed by Mobitel in favour of Banco Espírito Santo, related to a credit line of 17 million American dollars ("USD"), of which USD 16,850,000 were outstanding as at 31 December 2008, corresponding to Euro 12,107,494.

19. Market value of current assets

As at 31 December 2008 there were no significant differences between the amounts of current assets, computed in accordance with the valuation criteria adopted by the Company (Note 3), and the respective market value, which would not be covered by the corresponding adjustments.

29. Payables with maturity over more than five years

As at 31 December 2008, the amounts due to third parties with maturity over more than five years amounted to Euro 1,427,992,857 (Note 48.d).

34. Movements in provisions

During 2008, the movements in provisions were as follows:

	Opening balance	Increases	Reductions	Other	Disposals	Closing balance
Provisions:						
Taxes (a)	14,629,184	5,256,656	(239,855)	1,389,808	-	21,035,793
Other provisions:						
Litigations	-	4,281	-	-	-	4,281
Losses in financial investments (Note 16) (b)	173,655,967	5,890,248	(5,779,799)	-	(18,391,741)	155,374,675
Other (c)	3,791,096	-	(3,436,255)	-	-	354,841
	177,447,063	5,894,529	(9,216,054)	-	(18,391,741)	155,733,797
	192,076,247	11,151,185	(9,455,909)	1,389,808	(18,391,741)	176,769,590

(a) The increase occurred in this caption is related to the assessment made by the Company regarding tax contingencies resulting from inspections made by the Tax Authorities during 2008.

In addition, during 2007, Portugal Telecom received a tax inspection report for the years 2004 and 2005, raising questions to the deductibility of certain financial costs incurred by TMN in 2004 and 2005 amounting to Euro 100 million and Euro 97 million, respectively. In 2008, Portugal Telecom received a tax liquidation related to the year 2004 regarding this matter, confirming the position previously stated by the tax authorities in the above mentioned tax inspection report. As at 31 December 2008, Portugal Telecom strongly disagrees with this liquidation and the related tax inspection reports and considers, based on the opinion of its tax advisers, that there are solid arguments to oppose the position of the tax authorities.

(b) The provision for losses in financial investments is related to the application of the equity method of accounting, reflecting Portugal Telecom's share in the negative shareholders' equity of Group and associated companies. The increases and reductions occurred in 2008 were as follows:

Increases:	
Losses in Group and associated companies (Note 45.b)	5,235,935
Adjustments to shareholders' equity of subsidiaries and associates (Note 40)	654,313
	5,890,248
Reductions:	
Gains in Group and associated companies (Note 45.d)	(776,666)
Adjustments to shareholders' equity of subsidiaries and associates (Note 40)	(3,133)
Share capital increase in PT Pro (Note 55.h)	(5,000,000)
	(5,779,799)

In January 2008, the Company disposed of the financial investment in PT Wi-Fi to TMN, for an amount of Euro 50,000 (Note 55.d). As a result, the Company has recorded a capital gain of Euro 18,441,741, related to the difference between the disposal price and the carrying value of this investment, which was a negative amount of Euro 18,391,741. As this is a transaction between Group companies, the capital gain was deferred and is being recognized in earnings on the same proportion as the goodwill recorded by TMN is amortized (Note 52).

(c) The reduction in this caption relates to the reversal of a provision amounting to Euro 3,436,255, which was recorded in 2007 to cover certain risks related to the spin-off process of PT Multimédia.

35. Share capital decreases

As approved at the Shareholders' Meeting of 27 April 2007 and for the purposes of the execution of the share buyback program, the Company:

- Acquired 83,204,823 treasury shares on 24 March 2008 for an amount of Euro 711,917,017 and, under the terms of the same resolution of the Shareholders' Meeting, reduced its share capital by Euro 2,496,145, through the cancelation of those shares (Note 40);
- Acquired 46,082,677 treasury shares on 10 December 2008 for an amount of Euro 337,828,601 and, under the terms of the same resolution of the Shareholders' Meeting, reduced its share capital by Euro 1,382,480, through the cancelation of those shares (Note 40).

As a result, the share capital of Portugal Telecom as at 31 December 2008 amounted to Euro 26,895,375 (Notes 36 and 40).

36. Share capital

As at 31 December 2008, the Company's share capital amounted to Euro 26,895,375 (Notes 35 and 40) and was represented by 896,512,000 ordinary shares and 500 Class A shares, each with a nominal value of 3 cents of Euro.

The following matters may not be approved in a General Shareholders' Meeting against the majority of the votes corresponding to Class A shares:

- Authorization for the acquisition of ordinary shares representing more than 10% of the share capital by shareholders that directly or indirectly perform competing activities to those of the companies within a dominant relation with Portugal Telecom;
- Amendments to the by-laws and share capital increases, as well as the limitation or suppression of pre-emptive rights and the establishing of standards for share capital increases to be resolved by the Board of Directors;
- Issuing of bonds or other securities, establishing the issue value for these securities to be resolved by the Board of Directors and limitation or suppression of pre-emptive rights in the issuing of bonds convertible into shares, as well as establishing the standards for the issuing of bonds of such nature to be resolved by the Board of Directors;
- The passing of resolutions on the application of the financial year results, in the case of dividend distribution to the shareholders in a percentage higher than 40% of distributable profits;
- Election of the Board of the General Shareholders' Meeting;
- Approval of the general goals and fundamental principles of the Company's policies;
- Definition of the general principles of the policy of shareholdings in companies, as well as, in the cases where those principles require prior General Shareholders' Meeting authorization, the passing of resolutions on the respective acquisitions and sales; and
- Moving the Company's registered offices within the municipality of Lisbon or to a neighbouring municipality.

In addition, the election of one third of the total number of Directors, including the Chairman of the Board of Directors, requires the approval of a majority of the votes of the Class A shares.

40. Shareholders' equity

During 2008, the movements in this caption were as follows:

	Opening balance	Increases	Reductions	Closing balance
Share capital (Notes 35 and 36)	30,774,000	-	(3,878,625)	26,895,375
Treasury shares (Note 35)				
Nominal value	-	3,878,625	(3,878,625)	-
Issued premium	-	1,045,866,993	(1,045,866,993)	-
Adjustments to shareholders' equity of subsidiaries and associates	189,792,584	800,714,715	(596,763,250)	393,744,049
Legal reserve	6,773,139	-	-	6,773,139
Other reserves	471,331,125	1,053,624,243	(1,387,574,219)	137,381,149
Retained earnings	774,802,104	87,956,027	(713,934,604)	148,823,527
Net income	613,450,573	488,717,970	(613,450,573)	488,717,970
	2,086,923,525	3,480,758,573	(4,365,346,889)	1,202,335,209

Share capital

During 2008, the Company has made two share capital reductions amounting to Euro 2,496,145 and Euro 1,382,480, as described in Note 35.

Treasury shares

On 24 March 2008, the Company acquired 83,204,823 treasury shares for an amount of Euro 711,917,017, and subsequently reduced its share capital by an amount of Euro 2,496,145, through the cancellation of those shares (Note 35).

On 10 December 2008, the Company acquired 46,082,677 treasury shares for an amount of Euro 337,828,601, and subsequently reduced its share capital by an amount of Euro 1,382,480, through the cancellation of those shares (Note 35).

Adjustments to shareholders' equity of subsidiaries and associates

The change in this caption is mainly related to: (i) changes in the shareholders' equity of Group companies, not resulting from the net income or loss for the year, which are primarily related to the impact of the translation of financial statements of subsidiaries located in Brazil and of affiliates that have investments in Brazil, and of the revaluation of certain tangible fixed assets at PT Comunicações (real estate and ducts infrastructure) amounting to Euro 791 million, net of the related tax effect; (ii) the difference between the 2007 earnings from affiliated companies, resulting from the application of the equity method of accounting, and the earnings distributed by those companies during 2008, which was recognized under the caption "Retained earnings"; and (iii) the distribution of reserves or earnings not attributed in previous years.

During 2008, the movements in this caption were as follows:

	Positive variations	Negative variations	Total
Equity method (a)	800,586,711	(580,495,349)	220,091,362
Foreign currency translation adjustments on goodwill (Note 10.a)	-	(7,413,138)	(7,413,138)
Distribution of reserves by subsidiaries	-	(8,854,763)	(8,854,763)
Earnings not attributed by subsidiaries	15,044	-	15,044
Other	112,960	-	112,960
	800,714,715	(596,763,250)	203,951,465

(a) The movements related to the application of the equity method of accounting were recorded under the following captions:

	Positive variations	Negative variations	Total
Financial investments (Note 10)	800,583,578	(579,841,036)	220,742,542
Provision for negative financial investments (Notes 3.c) and 34.b)	3,133	(654,313)	(651,180)
	800,586,711	(580,495,349)	220,091,362

Legal reserve

Portuguese law and the Company's bylaws requires that at least 5% of each year's profits must be allocated to a legal reserve until this reserve equals the minimum requirement of 20% of share capital. This reserve is not available for distribution unless the company is liquidated, but may be incorporated in share capital or used to absorb losses, once all other reserves and retained earnings have been exhausted. As at 31 December 2008, the legal reserve is already fully incorporated, in accordance with legislation in force.

Other reserves

The movements in this caption during 2008 were as follows:

	Opening balance	Positive variations	Negative variations	Closing balance
Free reserves	462,395,786	-	(337,828,601)	124,567,185
Concession reserve	5,843,644	-	-	5,843,644
Reserves for treasury shares	-	1,049,745,618	(1,049,745,618)	-
Reserves for cancelled treasury shares	3,091,695	3,878,625	-	6,970,320
	471,331,125	1,053,624,243	(1,387,574,219)	137,381,149

Following the acquisitions of treasury shares occurred in 2008 (Note 35), the reserve for treasury shares was increased through a reduction of retained earnings, for the acquisition of March 2008, and a reduction of free reserves, for the acquisition of December 2008. After the cancellation of these shares and the subsequent share capital reductions, the reserves for treasury shares were reduced through the cancellation of treasury shares, and a reserve for treasury shares cancelled was created for the amount of the share capital reduction.

Retained earnings

The changes in this caption during 2008 were as follows:

	Positive variations	Negative variations	Total
Allocation of the net income for the year 2007	71,482,626	-	71,482,626
Dividends from equity swaps over own shares	7,472,641	-	7,472,641
Reserves for treasury shares	-	(711,917,017)	(711,917,017)
Tax related to dividends from equity swaps over own shares (Note 49)	-	(1,980,250)	(1,980,250)
Distribution of reserves by subsidiaries	8,854,763	-	8,854,763
Earnings not attributed by subsidiaries	-	(15,044)	(15,044)
Other	145,997	(22,293)	123,704
	87,956,027	(713,934,604)	(625,978,577)

Net income

As approved in the General Shareholders Meeting held on 28 March 2008, the net income for the year 2007 amounting to Euro 613,450,573 was allocated as follows:

Dividends paid	541,967,947
Retained earnings	71,482,626
	613,450,573

43. Remuneration of the Company's Management

During the years ended 31 December 2008 and 2007, the remunerations of executive and non-executive board members, were as follows:

	2008		2007	
	Fixed	Variable	Fixed	Variable
Executive board members	2,880,269	3,336,953	4,039,271	9,173,300
Non-executive board members	1,323,867	-	991,284	-
Supervisory board	581,714	-	502,844	-
	4,785,850	3,336,953	5,533,400	9,173,300

Following the changes in corporate governance occurred in the second quarter of 2008, the Chairman no longer has the function of Chief Executive Officer. During the third quarter of 2008, one executive board member left the Company and no one was appointed to replace him. In addition, following the changes in corporate governance occurred in June 2007, there was a change in the composition of the supervisory board.

In 2007, the variable component of remunerations of the Board of Directors, in addition to the performance plan remunerations, include extraordinary payments to board members, namely indemnities, termination payments, extraordinary bonus proposed by reference shareholders and approved by the Remunerations Committee, and hiring bonus. In 2007, indemnities amounted to approximately Euro 500 thousand.

During the years ended 31 December 2008 and 2007, fixed remuneration of key employees of Portugal Telecom's management amounted to Euro 7,621,652 and Euro 7,093,734, respectively, and variable remuneration amounted to Euro 3,521,633 and Euro 4,554,000, respectively.

In addition to the above mentioned remunerations, Executive Board members and key employees are also entitled to fringe benefits that are primarily utilized in their daily functions, in connection with a policy defined for the Portugal Telecom Group, and some of them are also entitled to post retirement benefits under the plans of PT Comunicações.

45. Net financial income

During the years ended 31 December 2008 and 2007, net financial income was as follows:

	2008	2007
Costs and losses:		
Interest expenses (a)	130,813,114	133,744,596
Losses in Group and associated companies (b)	32,927,094	39,638,338
Goodwill amortization (Notes 6 and 10)	10,151,618	28,479,418
Foreign currency exchange losses	4,972,746	4,618,215
Other financial expenses	4,431,480	36,887,750
	183,296,052	243,368,317
Net financial income	424,016,408	571,645,919
	607,312,460	815,014,236
Income and revenues:		
Interest income (c)	74,301,135	58,623,150
Gains in Group and associated companies (d)	524,341,777	623,136,904
Income from other companies (Note 55 f)	35,862	2,748,064
Foreign currency exchange gains	5,403,747	3,435,868
Other financial income (e)	3,229,939	127,070,250
	607,312,460	815,014,236

(a) In 2008, this caption consists of:

Interest from bank loans, external commercial paper and other financial instruments	105,614,415
Interest from internal commercial paper	18,692,757
Interest from loans obtained from Group companies	5,757,009
Interest from bonds	740,985
Other interest	7,948
	130,813,114

(b) In 2008, losses in Group and associated companies, resulting from the application of the equity method of accounting, through the recognition of the Company's proportion in the respective net losses, were recorded under the following captions:

	Financial investments (Note 10.b)	Provisions for financial investments (Note 34)	Total
Africatel	27,685,845	-	27,685,845
PT PRO	-	3,386,805	3,386,805
Sportinvest Multimédia	-	579,147	579,147
PT II	-	539,578	539,578
PT SI	-	520,821	520,821
PT Ásia	-	208,458	208,458
PT Rede Fixa	5,314	-	5,314
SGPICE	-	1,126	1,126
	27,691,159	5,235,935	32,927,094

(c) In 2008, this caption consists of:

Interest from loans granted to Group companies	53,151,661
Interest from short-term investments	18,542,403
Interest from bank deposits	1,283,223
Other interest income	1,323,848
	74,301,135

(d) In 2008, gains in Group and associated companies, resulting from the application of the equity method of accounting, through the recognition of the Company's proportion in the respective net profits, were recorded under the following captions:

	Financial investments (Note 10.b)	Provisions for financial investments (Note 34)	Total
PT Portugal	387,077,924	-	387,077,924
PT Ventures	71,595,249	-	71,595,249
PTI Finance, BV	12,848,200	-	12,848,200
PT Participações	12,493,215	-	12,493,215
PT Inovação	9,342,281	-	9,342,281
UOL	8,732,248	-	8,732,248
PT Brasil	4,395,444	-	4,395,444
Páginas Amarelas	1,771,952	-	1,771,952
PT Compras	-	727,016	727,016
PT Centro Corporativo	630,133	-	630,133
PT Imobiliária	436,916	-	436,916
PT Prime Tradecom	-	49,650	49,650
Previsão	40,954	-	40,954
	509,364,516	776,666	510,141,182
Effect of the tax consolidation (Notes 6 and 49) (i)			14,200,595
			524,341,777

(i) This amount reflects the deduction by the Company of the tax losses from affiliated companies included in Portugal Telecom's tax consolidation perimeter (Note 3.h).

(e) During 2007, this caption included mainly a gain of Euro 94,477,028 resulting from the financial settlement of equity swaps over PT Multimédia shares and a gain of Euro 32,188,194 (Note 55.g) related to the financial settlement of equity swaps over own shares.

46. Net extraordinary income

Net extraordinary income in 2008 and 2007 were as follows:

	2008	2007
Costs and losses:		
Donations	-	2,603,770
Losses on fixed assets	694,971	-
Insufficient provision for income taxes of the previous year (Note 6)	1,604,790	-
Other extraordinary costs	7,247,661	16,700,853
	9,547,422	19,304,623
Net extraordinary gains	60,783,135	42,417,273
	70,330,557	61,721,896
Income and revenues:		
Gains on fixed assets (a)	65,185,663	47,912,788
Reductions of provisions	3,769,865	-
Excessive provision for income taxes of the previous year	-	13,582,857
Other extraordinary income	1,375,029	226,251
	70,330,557	61,721,896

(a) In 2008, this caption includes mainly: (i) Euro 48,465,493 (Notes 6 and 52) related to the recognition of deferred capital gains related to the disposals of financial investments to Group companies, and (ii) a gain of Euro 16,631,816 related to the acquisition from PT Ventures participation of its 78% interest in Africatel (Note 10.b), which was recognized in earnings as PT Ventures recorded a loss by the same amount. In 2007, this caption includes a capital gain of Euro 35,698,600 related to the disposal of the investment in Banco Espírito Santo.

47. Required legal information

As a result of Article 21º of the decree-law nº 411/91 of October 17, the Company states that there are no outstanding liabilities with the tax authorities or Social Security.

48. Loans obtained

As at 31 December 2008 and 2007, loans obtained were as follows:

	2008		2007	
	Short-term	Medium and long term (d)	Short-term	Medium and long term (d)
Bonds:				
Exchangeable bonds (a)	-	750,000,000	-	-
Bank loans (b):				
External loans	110,051,551	477,644,528	123,269,695	497,696,079
Other loans:				
External loans (c)	37,700,000	1,490,700,000	-	1,233,500,000
Internal loans (d)	648,626,163	-	323,688,504	-
	686,326,163	1,490,700,000	323,688,504	1,233,500,000
	796,377,714	2,718,344,528	446,958,199	1,731,196,079

(a) Exchangeable bonds

In 2008, the Company issued 15,000 convertible bonds with a nominal value of Euro 50,000 each, carried out through a private subscription that was fully subscribed by its subsidiary PT Finance.

The issuance was held to support the issuance of exchangeable bonds into fully paid ordinary shares of Portugal Telecom, carried out by PT Finance in July 2007, denominated "Euro 750,000,000.00, 4.125 per cent. Exchangeable Bonds due 2014 exchangeable for new and/or existing ordinary shares of Portugal Telecom, SGPS, SA" ("Exchangeable Bonds"), in order to enable PT Finance to satisfy conversion requests that eventually may be made as from 3 January 2009, by the owners of exchangeable bonds. The conditions for the issuance of these convertible bonds replicate the terms of the Exchangeable Bonds.

(b) Bank loans

As at 31 December 2008 and 2007, bank loans were obtained from the European Investment Bank ("EIB") and the Kreditantsalt Für Wiederaufbau (KFW), and are denominated in Euros (directly or indirectly through currency swaps).

As at 31 December 2008, the Company has presented the following guarantees to third parties, in connection with these loans:

Bank garantees in favour of the European Bank	175,714,286
Garantee from the Portuguese State in favour of KFW	3,294,254

As at 31 December 2008 and 2007, the Company's bank loans bear interest at annual interest rates that vary between:

	2008	2007
Maximum interest rate	5.00%	5.20%
Minimum interest rate	3.00%	3.00%

Additionally, the Company is borrower, jointly with PT Comunicações and PT Finance, in six Revolving Credit Facilities, totalling Euro 1,465,000,000, with maturities between 2011 and 2013. As at 31 December 2008, the Company had not used any amount under these contracts.

(c) External loans

As at 25 June 1999, the Company issued a commercial paper program, subscribed by PT Finance, up to the amount of Euro 1,000,000,000. Following the changes made during 2008, the maximum amount of the program is now Euro 2,500,000,000. In 2008, the Company issued, under this program, a total amount of Euro 599,400,000, which is primarily related to: (i) the issuance by PT Finance, on 24 March 2005, of Global Medium Term Notes ("GMTNs") totalling Euro 1,000,000,000, with a maturity of 7 years and an annual interest rate of 3.75%; (ii) the issuance by PT Finance, on 16 June 2005, of GMTNs in the total amount of Euro 500,000,000, with a maturity of 20 years and an annual interest rate of 4.5%; and (iii) the Revolving Credit Facility contracted on 24 June 2004 with an available amount of Euro 300,000,000 and a maturity of eight years.

As at 1 June 2000, the Company issued another commercial paper programme, subscribed by PT Finance, up to Euro 1,350,000,000. Following the changes made, the maximum amount of the program as at 31 December 2008 amounted to Euro 3,000,000,000. As at 31 December 2008, the Company issued under this program a total amount of Euro 929,000,000, related mainly to: (i) a Revolving Credit Facility contracted on 24 June 2004, with an available amount of Euro 300,000,000 and a maturity of eight years; (ii) the GMTNs issued by PT Finance on 24 March 2005 amounting to Euro 1,000,000,000, with a maturity of 7 years and an annual interest rate of 3.75%, (iii) the GMTNs issued by PT Finance on 24 March 2005 amounting to Euro 500,000,000, with a maturity of 12 years and an annual interest rate of 4.375%; (iv) the GMTNs issued by PT Finance on 7 August 2008 amounting to Euro 50,000,000, with a maturity of 5 years and an annual interest rate calculated based on the 3-month Euribor rate and a margin of 1.50%; and (v) the GMTNs issued by PT Finance on 23 December 2008 amounting to Euro 200,000,000, with a maturity of 2 years and an annual interest rate calculated based on the 3-month Euribor rate and a margin of 2.25%.

(d) Internal loans

The Company maintains short-term commercial paper programs, amounting to a total of Euro 975,000,000, of which an amount of Euro 875,000,000 is underwritten. As at 31 December 2008, the Company had used an amount of Euro 648,626,163 under these programs. This amount bears interest at an annual average rate of 3.27%.

(e) Medium and long-term debt

As at 31 December 2008, medium and long-term debt matures on the following years:

2010	310,051,550
2011	113,515,035
2012	742,445,905
2013	124,339,181
2014 and following years (Note 29)	1,427,992,857
	2,718,344,528

(f) Covenants

As at 31 December 2008, the Company and its subsidiaries had several covenants related to its indebtedness, which had been fully complied with as at that date are as follows:

- **Change in control**

  The exchangeable bonds, the credit facilities amounting to Euro 1,465 million and the loans obtained from EIB totalling Euro 577 million as at 31 December 2008, grant the right to the lenders of demanding the repayment of all amounts due in the case of any change in the control of Portugal Telecom.

- **Credit rating**

  Certain loan agreements with the EIB, totalling Euro 291 million as at 31 December 2008, stated that Portugal Telecom may be asked to present a guarantee acceptable by the EIB if, at any time, the long-term credit rating assigned by the rating agencies to Portugal Telecom is reduced from the current rating (BBB- by S&P, Baa2 by Moody's and BBB by Fitch). In addition, the pricing conditions applicable to the commercial paper programs may be revised in case the credit rating assigned to Portugal Telecom is changed.

- **Control/disposal of subsidiaries**

  Certain credit facilities amounting to Euro 865 million states that Portugal Telecom must, directly or indirectly, maintain majority ownership and control of each material subsidiary. Material subsidiaries are those companies whose total assets are equal or exceed 10% of total consolidated assets or whose total revenues are also equal or exceed 10% of total consolidated revenues.

- **Disposals of assets**

  The credit facility amounting to Euro 100 million and the EIB loans totalling Euro 577 million as at 31 December 2008 include certain restrictions regarding the disposal of assets by Portugal Telecom.

- **Financial ratios**

  Certain credit facilities amounting to Euro 1,015 million require that the ratio Consolidated Net Debt/EBITDA should not be higher than 3.5. Other credit facilities amounting to Euro 150 million requires that the ratio Consolidated Net Debt/EBITDA should not be higher than 4.0. In addition, the pricing conditions applicable to certain facilities in the total amount of Euro 1,315 million may be changed depending on the ratio Consolidated Net Debt/EBITDA. Finally, certain loan agreements with the EIB, totalling Euro 111 million as at 31 December 2008, state that Portugal

Telecom may be asked to present a guarantee acceptable by the EIB if the ratio Consolidated Net Debt/EBITDA, as defined in the agreements, is higher than 3.5.

- **Negative Pledge**

The Global Medium Term Notes, the exchangeable bonds, the revolving credit facilities and one of the commercial paper programmes are subject to negative pledge clauses, which restrict the pledge of security interests in the assets of companies included in the consolidation.

49. State and other public entities

As at 31 December 2008 and 2007, the balances with these entities were as follows:

	2008		2007	
	Accounts receivable	Accounts payable	Accounts receivable	Accounts payable
Current income taxes	129,108,205	114,506,097	92,734,114	164,873,961
Value added tax	790,410	16,149	87,043	94,374
Personnel income tax	16,493	208,974	16,493	396,987
Social security	-	40,746	-	92,587
Other taxes	-	2,634	-	-
	129,915,108	114,774,600	92,837,650	165,457,909

As at 31 December 2008 and 2007, the net balance of corporate income tax has the following composition:

	2008	2007
Current income taxes	113,915,667	163,840,084
Withholding taxes	(4,917,861)	(3,262,828)
Payments on account (Note 55.b)	(123,645,778)	(87,067,557)
Income taxes payable (receivable)	45,864	(1,369,852)
Income taxes payable (receivable), net	(14,602,108)	72,139,847

The reconciliation between the current income tax payable as at 31 December 2008 and the current income tax reflected in the profit and loss statement is as follows:

Current income taxes from subsdiaries (Note 16)	142,007,975
Current income taxes from Portugal Telecom (Note 6)	(15,894,256)
Current income taxes recognised in shareholders' equity related to equity swaps (Note 40)	1,980,250
Gain related to the tax consolidation (Note 45)	(14,200,595)
Other	22,293
	113,915,667

51. Short-term investments

As at 31 December 2007, this caption included primarily applications made by the Company in short-term investments and fixed income. As these applications matured, they were converted into bank deposits.

52. Accruals and deferrals

As at 31 December 2008 and 2007, the balances of these captions were as follows:

	2008	2007
Accrued income:		
Unbilled revenues to Group companies (a)	17,037,195	30,176,934
Accrued interest	17,471,622	6,018,521
Other	129,514	30,866
	34,638,331	36,226,321
Prepaid expenses:		
Financial expenses	2,367,885	748,523
Other	292,305	430,511
	2,660,190	1,179,034
Accrued expenses:		
Financial expenses	8,747,152	10,381,641
Charges for vacations pay, vacation subsidies and other payroll costs	7,983,407	7,883,810
Other supplies and external services	1,125,878	2,991,456
Other (b)	50 630 880	53 217 301
	68,487,317	74,474,208
Deferred income:		
Capital gains resulting from intercompany transactions (c)	6,296,281,016	6,326,304,765
Other	1,433,076	1,736,398
	6,297,714,092	6,328,041,163

(a) As at 31 December 2008, this caption includes management fees for services rendered to Vivo between January and August 2008, under the management fee contract entered into with this entity in previous years, which terminated in August 2008.

(b) As at 31 de December de 2008, this caption included Euro 43,306,174 related to the fair value of exchange rate derivatives (Note 53).

(c) As at 31 December de 2008, this caption included the following deferred capital gains related to the disposal of financial investments to Group companies (Note 3.c): (i) Euro 5,625,920,451 related to the disposal, in 2006, of PT Comunicações and TMN to PT Portugal, and (ii) Euro 670,360,565 related to the disposal, in 2007, of PT.com and PT Prime to PT Comunicações and, in 2008, of PT Wi-Fi to TMN (Note 34). The deferred capital gains related to the disposal to PT Portugal are not being recognized in earnings, as this company accounts for its financial investments under the cost method, instead of the equity method. The remaining capital gains are being recognized in earnings on the same proportion as the goodwill is amortized in PT Comunicações and TMN and, as a result, Portugal Telecom has recognized a gain of Euro 48,465,493 (Note 46) in 2008.

53. Financial instruments and risk management

As at 31 December 2008, the Company had entered into several derivative financial instruments, primarily with the purpose of minimize the risk of exposure to exchange and interest rate fluctuations.

Derivative financial instruments are entered into after a careful analysis of associated risks and rewards to this type of operation, taking into consideration information obtained from different institutions. These transactions are subject to previous approval from the Company's Executive Committee. The positions held by the Company, as well as the relevant financial markets, are regularly monitored. The fair value of these derivatives is determined on a regular basis in order to assess the fair value of these instruments and the related financial implications.

Interest rate risk

As at 31 December 2008, the portfolio of interest rate derivatives consisted of interest rate swaps denominated in Euros, which were entered into with the purpose of eliminating the risk of changes in the interest rates from loans obtained. As at 31 December 2008, the nominal value of these instruments amounted to Euro 79 million, with an average maturity of 3.5 years.

Interest rate and foreign currency exchange risk

As at 31 December 2008, Portugal Telecom had a currency swap with exchange and interest rate components, entered into with the purpose of eliminating the exposure to the change in the Euro/US Dollar exchange rate, resulting from a loan denominated in U.S. Dollars contracted in previous years. As at that date, the nominal value of this instrument amounted to 32 million American Dollars, with an average maturity of 3.0 years.

Following the cancellation of the interest component related to currency swaps, Portugal Telecom maintains exchange rate options and forward contracts to exchange Euros for American Dollars. As at 31 December 2008, the net amount of such contracts amounted to Euro 200 million, with an average maturity of 0.3 years.

Equity derivatives

Portugal Telecom had contracted in previous years with financial institution equity swaps over 1.83% of its share capital, before the share capital reduction of 31 December 2007. As at 31 December 2008, the total nominal value of these contracts amounted to Euro 178.1 million.

Fair value of financial instruments

As at 31 December 2008 and 2007, the fair value of derivative financial instruments and the corresponding carrying value are as follows (amounts in Euro million):

	2008		2007	
	Carrying value	Fair value	Carrying value	Fair value
Financial instruments:				
Interest rate	(1.3)	(3.6)	-	(1.3)
Exchange rate (Note 52)	(43.3)	(43.3)	(46.5)	(46.5)
Exchange rate and interest rate	(7.0)	(7.5)	(11.1)	(10.8)
	(51.6)	(54.4)	(57.6)	(58.6)
Equity derivatives:				
Own shares	(0.2)	(60.3)	(1.3)	(10.6)
	(0.2)	(60.3)	(1.3)	(10.6)

54. Profit and loss by functions

The Profit and Loss Statement by Functions ("PLSF") was prepared in accordance with Accounting Directive n.º 20, and the following aspects are worth being mentioned:

a) The caption "Services rendered" from PLSF includes the technical administration services and management fees with Vivo SA, which ended in August 2008 and was not renewed.

b) The caption "Cost of services rendered" from PLSF includes primarily amounts recorded under the captions "Supplies and external services", "Extraordinary costs", "Wages and salaries" and "Depreciation and amortization" of the Profit and Loss Statement by Nature ("PLSN"), excluding the amortization of goodwill resulting from the acquisition of financial investments, which is recorded in the PLSF under the caption "Gains (losses) in subsidiaries and associated companies".

c) The caption "Other operating costs" from the PLSF includes primarily amounts recorded under the captions "Supplies and external services" and "Taxes" of the PLSN, and contributions and donations to several organizations in the telecommunications field.

d) The caption "Net financing costs" from PLSF includes mainly the following income and costs recorded under the caption "Net financial income" of the PLSN:

	2008	2007
Interest income (Note 45)	74,301,135	58,623,150
Interest expenses (Note 45)	(130,813,114)	(133,744,596)
Other financial income (Note 45)	3,229,939	127,070,250
Other financial expenses (Note 45)	(4,431,480)	(36,887,750)
Foreign currency exchange gains (Note 45)	5,403,747	3,435,868
Foreign currency exchange losses (Note 45)	(4,972,746)	(4,618,215)
	(57,282,519)	13,878,707

e) The caption "Gains (losses) in subsidiaries and associated companies" from the PLSF includes mainly the following income and costs recorded under the captions "Net financial income" and "Net extraordinary income" of the PLSN:

	2008	2007
Gains in Group and associated companies (Note 45.d) (i)	510,141,182	610,873,614
Losses in Group and associated companies (Note 45)	(32,927,094)	(39,638,338)
Goodwill amortization (Note 45)	(10,151,618)	(28,479,418)
Losses on disposals of investments in subsidiaries (Note 46)	(694,971)	-
Gains on disposals of investments in subsidiaries (Note 46)	65,097,309	9,127,241
	531,464,808	551,883,099

(i) The difference between this caption and the gains in Group and associated companies presented in the PLSN is related to the gain resulting from the tax consolidation amounting to Euro 14,200,595 (Note 45.d), which is included under the caption "Income tax" of the PLSN (Note 6).

f) In 2007, the caption "Gains (losses) on other investments" from PLSF includes primarily a gain of Euro 35,698,600 (Note 46) related to the disposal of the financial investment in Banco Espírito Santo.

g) The caption "Income tax" of the PLSF includes the following:

	2008	2007
Income tax included in the PLSN (Note 6)	14,318,693	5,902,679
Gain on the tax consolidation (Notes 6 and 45.d)	14,200,595	12,263,290
Excessive (insufficient) provision for income taxes of the previous year (Note 46)	(1,604,790)	13,582,857
(Increase) decrease of the provision for income taxes (Note 34)	(5,016,801)	(2,102,602)
Other	1,232,540	(295,371)
	23,130,237	29,350,853

55. Cash flow statement

The cash flow statement was prepared based on the provisions of Accounting Directive n.º 14, with the following aspects being worth mentioning:

a) Collections from clients

During 2008, the Company received Euro 30 million related to technical administration and management services rendered to Vivo in the second half of 2006 and in the year 2007, under the terms of the contract entered in to with this company in previous years.

b) Receipts (payments) relating to income taxes

In 2008, this caption has the following composition:

Collections from subsdiaries related to payments on account (Note 16)	129,029,300
Payments relating to income tax of 2007	(63,861,181)
Payments on account related to 2008 (Note 49)	(123,645,778)
Other	(4,772,653)
	(63,250,312)

c) Cash receipts resulting from short-term financial applications

This caption included mainly payments related to new short-term investments and cash receipts from the repayment of these applications. The reduction in payments and receipts in 2008, as compared to 2007, results from the conversion into bank deposits of the applications that reached their maturity in 2008.

d) Cash receipts resulting from financial investments

In 2008, this caption has the following composition:

Additional paid in capital contributions (Note 10.b):	
PT Participações	54,600,000
PT Ventures	45,760,268
PT Wi-Fi	19,000,000
Africatel	67,500
	119,427,768
Disposals of financial investments:	
Disposal of a 3% stake in Africatel (Note 10.b)	13,359,362
Disposal of PT Wi-Fi to TMN (Note 34)	50,000
	13,409,362
Other cash receipts from financial investments:	
Transfer of the contract with Africatel for the disposal of financial investments (Note 16)	712,109,005
PT Comunicações (i)	306,950,000
	1,019,059,005
	1,151,896,135

(i) This caption is related to the disposal of PT.Com, PT Prime and PT Corporate to PT Comunicações in 2007, following which this amount was outstanding as at 31 December 2007.

e) Cash receipts resulting from loans granted

In 2008, this caption has the following composition:

Shot-term intercompany loans:	
PT Comunicações	307,000,000
PT SI (Note 10.b)	7,000,000
PT Ásia	300,000
INESC	93,755
	314,393,755
Intercompany loans - centralized cash management:	
PT Prime	37,744,897
PT Centro Corporativo	10,226,515
PT SI	7,422,878
PT Pro	2,110,082
PT Prestações	316,628
Pro Share	56,847
	57,877,847
	372,271,602

f) Cash receipts resulting from dividends

In 2008, this caption corresponds to dividends received from the following companies:

PT Portugal (Note 10.b)	503,366,459
PT Inovação (Note 10.b)	18,559,349
PT Finance BV (Note 10.b)	17,287,733
Páginas Amarelas (Note 10.b)	1,997,960
PT Centro Corporativo (Note 10.b)	1,522,894
Previsão (Note 10.b)	116,591
UOL (Note 10.b)	84,122
Taguspark (Note 45)	35,862
	542,970,970

g) Cash receipts resulting from other investing activities

In 2007, this caption includes mainly Euro 94,477,028 (Note 45) related to the cash settlement of equity swaps over shares of PT Multimedia and Euro 32,188,194 related to the cash settlement of equity swaps over Portugal Telecom's own shares (Note 45).

h) Payments resulting from financial investments

In 2008, this caption has the following composition:

Additional paid in capital contributions granted (Note 10.b):	
PT Portugal	198,000,000
PT Inovação	2,500,000
Africatel	1,755,000
PT II	1,000,000
	203,255,000
Payments of financial investments:	
Acquisition of a 78% stake in Africatel (Note 10.b)	374,993,712
Share capital increase at PT Ventures (Note 10.b)	32,308,951
Share capital increase at PT Pro (Note 34)	5,000,000
Share capital increase at PT Ásia (Note 10.b)	320,000
	412,622,664
	615,877,664

i) Payments resulting from loans granted

In 2008, this caption has the following composition:

Short-term intercompany loans:	
PT Comunicações	307,000,000
Loans:	
PT Comunicações	3,491,616
Other loans (Note 10.b):	
PT Comunicações	744,000,000
Africatel	329,670,330
PT Pro	14,000,000
PT Inovação	9,000,000
	1,096,670,330
	1,407,161,946

j) Cash receipts resulting from loans obtained

In 2008, this caption has the following composition:

External loans:	
Commercial paper	42,567,158,455
Exchangeable bonds	750,000,000
Bank loans	90,000,000
	43,407,158,455

k) Payments resulting from loans obtained

In 2008, this caption has the following composition:

External loans:	
Short-term commercial paper	41,947,320,796
Bank loans	123,269,695
	42,070,590,491
Intercompany loans - In-house cash:	
TMN	102,769,861
PT Comunicações	90,626,545
PT Ventures	24,254,225
PT II	5,176,038
PT Compras	4,641,153
PT Portugal	3,784,009
PT Inovação	3,084,486
PT Contact	1,613,823
Directel	1,571,355
PT Móveis	1,198,557
PT Prime Tradecom	833,491
PT Imobiliária	641,962
PT Participações	367,607
PT Rede Fixa	41,113
	240,604,225
	42,311,194,716

l) Cash and cash equivalents

As at 31 December 2008 and 2007, this caption has the following composition:

	2008	2007
Bank deposits and cash:		
Bank deposits	324,727,073	53,590,287
Cash	2,000	2,000
	324,729,073	53,592,287

56. Subsequent events

There were no relevant subsequent events after 31 December 2008.

57. Note added for translation

These financial statements are a translation of the financial statements originally issued in Portuguese, in accordance with generally accounting principles in Portugal. In case of discrepancies, the originally version issued in Portuguese prevails.

Qualified Holdings

Pursuant to the terms of subparagraph b) of no.8 of article 8 of Portuguese Securities Market Commission ("CMVM") Regulation no. 5/2008, PT provides the following information regarding qualified holdings (held by third parties) in PT share capital as of the date of this report:

- On 17 December 2008, Telefónica, S.A. held directly a total of 76,327,500 PT shares representing 8.51% of the share capital and voting rights in PT. In addition, Telesp, S.A. (Fixed) and Aliança Atlântica Holding B.V. (companies controlled by Telefónica or that belong to Telefónica Group), held respectively 7,994,250 and 5,329,500 PT shares, equivalent to 0.89% and 0.60% of the share capital and voting rights in PT. In Global terms, Telefónica's qualified holding in PT totalled 89,651,250, corresponding to 10.0% of PT's share capital and voting rights.

- On 31 December 2008, Brandes Investments Partners, L.P. ("Brandes") held, on behalf of its clients, a total of 84,975,020 PT shares representing 9.48% of PT's share capital, being authorised to exercise voting rights over a total of 67,379,815 PT shares, representing 7.52% of the share capital and voting rights in PT.

- On 31 December 2008, Banco Espírito Santo Group ("BES") held directly and indirectly 9.34% of the share capital and voting rights in PT. BES holding in PT, calculated in conformity with the terms of no. 1 of article 20 of the Portuguese Securities Code ("CVM") is set out in the following table:

Entities	**No. of Shares**
Banco Espírito Santo, S.A.	59,873,605
Held by BES Pension Fund	11,001,601
Held by companies in a control or group relationship with BES	4,218
Held by members of the management and supervisory boards of BES	60,318
Held by holders of voting rights with whom BES has entered into a voting agreement	12,280,82
Total	**83,694,971**

- On 31 December 2008, Caixa Geral de Depósitos Group ("CGD") held directly and indirectly 7.28% of the share capital and voting rights in PT. CGD holding in PT, calculated in conformity with the terms of no. 1 of article 20 of the CVM is set out in the following table:

Entities	**No. of Shares**
Caixa Geral de Depósitos, S.A.	55,099,150
Companhia de Seguros Fidelidade - Mundial, S.A.	9,595,147
Império Bonança - Companhia de Seguros, S.A.	18,065
CGD Pension Fund	586,555
Total	**65,298,917**

- On 12 March 2007, a Ongoing Strategy Investments, SGPS, S.A. ("Ongoing", company 99.99% owned by Ms. Isabel Maria Alves Rocha dos Santos) held a total of 22,600,000 PT shares, corresponding to 2.00% of the share capital and voting rights in PT. In addition, Insight Strategic Investments - SGPS, S.A. ("Insight", company 99.99% owned by Ongoing) held a total of 37,804,969 PT shares, corresponding to 3.35% of the share capital and voting rights in PT. In Global terms, the qualified holding of Ongoing, and the respective majority shareholder of this company, in PT totalled 60,404,969, corresponding to 5.35% of PT's share capital and voting rights. Taking into consideration the current share capital, Ongoing's qualified holding would represent 6.74% of PT's share capital and corresponding voting rights.

- On 15 de December 2008, PT reported that Barclays Group, as from 5 December 2008, held directly and indirectly 2.54% of the share capital and voting rights in PT. Barclays Group holding in PT, calculated in conformity with the terms of no. 1 of article 20 of the CVM is set out in the following table:

Entities	**No. of Shares**
Barclays Capital Securities Ltd	20,804,961
Barclays Capital Inc	1.166.027
Barclays Global Investors Japan Ltd	1.371.804
Barclays Bank Trust Co Ltd	8.000
Gerrard Investment Management Ltd	4.007
Barclays Bank Plc	129.977
Barclays Life Assurance Co Ltd	174.834
Barclays Bank (Suisse) SA	29.233
Barclays Fundos	235.400
Total	**23.924.243**

Taking into consideration the current share capital, Barclays Group's qualified holding would represent 2.67% of PT's share capital and corresponding voting rights.

- On 5 June 2007, Grupo Visabeira SGPS, S.A. ("Visabeira Group", company 83.52% owned by Mr. Fernando Campos Nunes) held a total of 11,523,213 PT shares, corresponding to 1.02% of the share capital and voting rights in PT. In addition, Visabeira Investimentos Financeiros, SGPS, S.A. (company 100% owned by Visabeira Estudos e Investimentos, S.A., which was 100% owned by Visabeira Serviços, SGPS, S.A., which in turn was 100% owned by the Visabeira Group) held a total of 11,144,260 shares, corresponding to 0.99% of the share capital and voting rights in PT. In Global terms, the qualified holding of Visabeira Group, and the respective majority shareholder of this company, in PT totalled 22,667,473, corresponding to 2.01% of PT's share capital and voting rights. Taking into consideration the current share capital, Visabeira Group's qualified holding would represent 2.53% of PT's share capital and corresponding voting rights.

- On 4 April 2008, Controlinveste Comunicações, SGPS, S.A. ("Controlinveste", company controlled by Olivedesportos – Publicidade, Televisão e Media, S.A., which is controlled by Sportinveste, SGPS, S.A., which in turn is controlled by Controlinveste, SGPS, S.A., and which in turn is controlled by Mr. Joaquim Francisco Alves Ferreira de Oliveira) held a total of 20,421,247 PT shares, corresponding to 2.17% of the share capital and voting rights in PT. Taking into consideration the current share capital, Controlinveste's qualified holding would represent 2.28% % of PT's share capital and corresponding voting rights.

- On 10 April 2008, Taube Hodson Stonex Partners LLP ("Taube") held a total of 19,401,182 PT shares representing 2.06% of the share capital and voting rights in PT. Taking into consideration the current share capital, Taube's qualified holding would represent 2.16% % of PT's share capital and corresponding voting rights.

- On 30 December 2008, Ontario Teachers' Pension Plan Board held a total of 17,938,889 PT shares representing 2.001% of the share capital and voting rights in PT.

Notwithstanding the table of the qualified holdings communicated to the Company until 31 December 2008, in January 2009, Banco Bilbao Vizcaya Argentaria, S.A. ("BBVA") informed PT on the reduction of its holding to 0.76% of PT's share capital and corresponding voting rights.

List of the holdings pursuant to the terms of article 447 of the Portuguese Commercial Companies Code

Pursuant to the terms of article 447 of the Portuguese Commercial Companies Code, PT provides the following information regarding the holdings of the members of the Board of Directors and the Statutory Auditor of PT as of the date of this report:

Board of Directors (including the members of the Audit Committee)

- Henrique Granadeiro owns 150 PT shares.
- Zeinal Bava owns 63,161 PT shares. His spouse owns 75 PT shares.
- Luís Pacheco de Melo owns 45 PT shares.
- António Caria owns 486 PT shares.
- Rui Pedro Soares owns 50 PT shares.
- José María Álvarez-Pallete owns 100 PT shares.
- Franquelim Alves does not own any PT shares or shares in other companies in a controlling or Group relationship.
- Francisco Marques Bandeira owns 483 PT shares.
- José Xavier de Basto does not own any PT shares or shares in other companies in a controlling or Group relationship.
- Fernando Soares Carneiro does not own any PT shares or shares in other companies in a controlling or Group relationship.
- Luís de Azevedo Coutinho does not own any PT shares or shares in other companies in a controlling or Group relationship.
- Santiago Fernández Valbuena owns 100 PT shares.
- João de Mello Franco and his spouse own 13,308 PT shares.
- Joaquim Goes owns 2,437 PT shares.
- Gerald McGowan does not own any PT shares or shares in other companies in a controlling or Group relationship.

- Rafael Mora Funes does not own any PT shares or shares in other companies in a controlling or Group relationship. His spouse owns 501 PT shares.

- Amílcar de Morais Pires owns 2,146 PT shares.

- Francisco Pereira Soares does not own any PT shares or shares in other companies in a controlling or Group relationship.

- Jorge Tomé does not own any PT shares or shares in other companies in a controlling or Group relationship.

- Nuno de Almeida e Vasconcellos owns 11,190 PT shares. On 10 October 2008, he acquired 1,300 PT shares, through transactions carried out on the spot regulated market Eurolist by Euronext Lisbon, at a unit price of Euro 5.29. Ongoing, in which Nuno de Almeida e Vasconcellos is the Chairman of the Board of Directors, held a total of 22,600,000 PT shares. In addition, Insight (99.99% owned by Ongoing) held a total of 37,804,969 PT shares, as mentioned above in the qualified holdings section.

- Thomaz Paes de Vasconcellos does not own any PT shares or shares in other companies in a controlling or Group relationship.

Statutory Auditor

- Pedro Matos Silva, Statutory Auditor, does not own any PT shares or shares in other companies in a controlling or Group relationship.

- Mário Gomes, alternate Statutory Auditor, does not own any PT shares or shares in other companies in a controlling or Group relationship.

Report and Opinion of the Audit Committee

AUDIT COMMITTEE REPORT
TO THE STANDALONE FINANCIAL STATEMENTS AND ANNUAL REPORT
FOR THE YEAR OF 2008

1 – Introduction

Pursuant to the terms and for the purpose of paragraph g) to Article 423-F of the Portuguese Companies Act and Article 28 of the By-laws, the Audit Committee of Portugal Telecom, SGPS, SA ("PT SGPS") hereby presents its report on the Standalone Financial Statements and Annual Report for the year ended December 31st, 2008 and its recommendation on the proposal for application of profits and distribution of reserves of the Board of Directors. The financial statements included in the Standalone Annual Report, refer to the Company's activity at an individual level and were prepared in accordance with accounting policies generally accepted in Portugal. The Company has prepared, in accordance with applicable legislation, consolidated financial statements prepared in accordance with International Financial Reporting Standards as adopted by the European Union, published separately.

2 – Supervisory activities

Within its responsibilities and for the purpose of complying with its functions as a supervisory body, the Audit Committee has supervised the quality and integrity of the financial information disclosure processes.

The Audit Committee has held meetings with those responsible for the preparation of the Standalone Report of PT SGPS and of the major subsidiaries, with the Independent Auditors and with the Statutory Auditor and analyzed the principal questions raised in the closing of the accounts and in the preparation of the management report. In addition, the Audit Committee has reviewed the Accounts Certificate ("*Certificação Legal de Contas*") issued by the Statutory Auditor and the Independent Auditors' Report, both referring to the aforementioned standalone financial statements approved by the Board of Directors, which do not include any reserves.

The Audit Committee has overseen the management and the evolution of the Company's businesses and its compliance with the applicable legal, regulatory and accounting rules.

In particular, the Audit Committee has monitored the execution, and analyzed the impact on the financial condition, of the following measures, implemented as a result of the shareholders remuneration policy approved at the Company's General Shareholders Meeting held on March 28th, 2008:

- A distribution of dividends in cash of 0.575 Euros per share relating to 2007 and paid on April 24th, 2008;
- Changes to the Company's share capital, in particular the share capital reductions effected on March 24th, 2008 of 2,496,145 Euros through the cancellation of 83,204,823 treasury shares, and on December 10th, 2008 of 1,382,480 Euros through the cancellation of 46,082,677 treasury shares in the context of the execution of the share buyback program approved at the General Shareholders Meeting, which was fully completed.

The Audit Committee has analyzed and given a favorable opinion on the proposal of the Board of Directors, of November 12th, 2008, relating to future share capital increase(s) of PT SGPS to be executed by the Boars of Directors pursuant to the applicable laws and for the purposes and to the extent required to satisfy conversion requests made pursuant to the issuance by PT SGPS of 15,000 convertible bonds (convertible into PT SGPS shares) in the total amount of 750 million Euros, to be fully subscribed for by Portugal Telecom International Finance, B.V., under the terms approved in the General Shareholders Meetings held on April 27th , and June 22nd, 2007. The Audit Committee supervised and issued a favorable opinion on the decision of the Board of Directors of its subsidiary PT Comunicações, SA to chang the accounting principle relating to real estate and duct networks from historical cost to market value for real estate and to construction cost for ducts. As a result of this change, Shareholders equity increased by 790,686,788 Euros.

The Audit Committee has also supervised the qualifications, independence and work of the Company's Independent Auditors and Statutory Auditor as well as of the quality, integrity and effectiveness of PT SGPS's internal control and risk management system and its internal audit function.

As far as the internal control system is concerned, we highlight that it was certified by the Company's Independent Auditors in 2008, by reference to the year of 2007, in accordance with the requirements of *Section 404* of the *Sarbanes-Oxley Act* and on the basis of the methodology defined by *COSO (Committee of Sponsoring Organizations).*

The aforementioned supervisory activities will be further detailed in the Audit Committee's Activities Report relating to the year of 2008 disclosed on the Company's website.

3 - Opinion on the Standalone Financial Statements and Annual report for 2008 and recommendation on the proposal for application of profits and distribution of reserves.

Taking into consideration the above-mentioned factors:

A- In our opinion, the standalone report for the year ended December 31st, 2008, including the balance sheet, the income statements by nature and by function, the cash flow statements and the attached notes related to the year then ended comply with the applicable accounting and legal provisions and the By-laws. The Audit Committee therefore recommends approval of those financial statements at PT SGPS's General Shareholders Meeting;

B- The Audit Committee recommends that the PT SGPS General Shareholders Meeting approve the proposal for application of profits and distribution of reserves of the Board of Directors, pursuant to the terms of Item Number 3 of the agenda.

Lisbon, 18 February, 2009

THE CHAIRMAN

(João Manuel de Mello Franco)

THE MEMBERS

(Thomaz Paes de Vasconcellos)

(José Guilherme Xavier de Basto)

Statutory Auditor's Report

P. MATOS SILVA,
GARCIA JR, P. CAIADO
& ASSOCIADOS
SOCIEDADE DE REVISORES OFICIAIS DE CONTAS, LDA.

STATUTORY AUDITORS' OPINION ON THE STAND ALONE FINANCIAL STATEMENTS

INTRODUCTION

1. We have examined the stand alone financial statements of Portugal Telecom, SGPS, S.A. ("Company") for fiscal year 2008, comprising the balance sheet as of December 31, 2008 (which reflect total assets of 12.099.453.245 Euros and a total equity of 1.202.335.209 Euros, including a net income for the year of 488.717.970 Euros), and the statements of profit and loss and cash flows and the notes to financial statements for the year then ended. These financial statements relate to the standing alone activity of the Company and have been prepared in accordance with accounting principles generally accepted in Portugal.

RESPONSIBILITIES

2. The Board of Directors is responsible for the preparation of financial statements which present a true and fair view of the state of affairs, results of operations and cash flows of the Company, for the adoption of adequate policies and accounting criteria and for the maintenance of an appropriate system of internal control, as well as for the disclosure of any relevant facts that have influenced its operations, financial position and results of operations.

3. It is our responsibility to report our independent professional opinion, based on our audit of such financial statements.

Sócios: Pedro Matos Silva, José Garcia Júnior, António Pires Caiado, João Paulo Ferreira, Luísa Maria Rebordão, Sandra Simões

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Capital social: 8.000 €uros - Contribuinte N.º 501 801 804 - Inscrição na O.R.O.C. com o n.º 44
Inscrição no Registo de Auditores da Comissão do Mercado de Valores Mobiliários n.º 1054

SCOPE

4. Our examination was made in accordance with generally accepted Portuguese Statutory Auditing Standards, which require our audit to be planned and performed in order to provide reasonable assurance that the financial statements are free from material misstatements. Therefore, our audit included examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements, and assessment of the significant estimates, which were based on judgements and criteria defined by the Board of Directors, used in the preparation of the financial statements, assessment of the adequacy of the accounting policies adopted and related disclosures, in the circumstances, examination of the adequacy of the going concern basis of preparation of the financial statements, and evaluation of the overall adequacy of the presentation of the financial statements.

5. Our examination also included the checking of the agreement of the financial information included in the Directors' Report with the financial statements.

6. We consider that the audit that we performed provides a reasonable basis for the expression of our opinion.

OPINION

7. In our opinion, the stand alone financial statements mentioned above, give a true and fair view, in all material respects, of the financial condition of Portugal Telecom, SGPS, S.A. as of December 31, 2008, and of its results of operations and cash flows for the year then ended, in accordance with accounting principles generally accepted in Portugal.

EMPHASIS OF A MATTER

8. Without affecting our opinion expressed in the preceding paragraph, it should be noted that:

- As referred to in Note 3.c) to Financial Statements, financial investments in subsidiaries and associated companies are carried in the balance sheet under the equity method of accounting; as explained in Note 40 to Financial Statements, in 2008 the subsidiary PT Comunicações, S.A. recorded a revaluation of its real estate, as well as of its ducts infra-structure used in operations, as well as of its ducts network, which, consequently, resulted in an increase of total assets and equity of Portugal Telecom, SGPS, S.A. of approximately 790.687.000 Euros.

Lisbon, February 18, 2009

P. Matos Silva, Garcia Jr., P. Caiado & Associados
Sociedade de Revisores Oficiais de Contas
representada por

Pedro Matos Silva

Independent Auditor's Report

Deloitte.

Deloitte & Associados, SROC S.A.
Inscrição na OROC nº 43
Registo na CMVM nº 231

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AUDITORS' REPORT

(Translation of a report originally issued in Portuguese)

Introduction

1. Pursuant to the article 245 of Portuguese Securities market Code, we hereby present our Auditors' Report on the financial information contained in the Board of Directors' Report and the financial statements of Portugal Telecom, SGPS, S.A. ("the Company"), for the year ended December 31, 2008, which comprise the balance sheet that presents a total of 12,099,453,245 Euros and shareholders' equity of 1,202,335,209 Euros, including a net profit of 488,717,970 Euros, the income statement by nature and by functions, the statement of cash flows for the year then ended and the corresponding notes.

Responsibilities

2. The Company's Board of Directors is responsible for: (i) the preparation of financial statements that present a true and fair view of the financial position of the Company, the results of its operations and its cash flows; (ii) the preparation of historical financial information in accordance with generally accepted accounting principles that is complete, true, timely, clear, objective and licit, as required by the Portuguese Securities Market Code; (iii) the adoption of adequate accounting policies and criteria and the maintenance of an appropriate system of internal control and; (iv) the disclosure of any significant facts that have influenced its operations, financial position or results of operations.

3. Our responsibility is to audit the financial information contained in the accounting documents referred to above, including verifying that, in all material respects, the information is complete, true, timely, clear, objective and licit, as required by the Portuguese Securities Market Code, and to issue a professional and independent report based on our work.

Scope

4. Our audit was performed in accordance with the Auditing Standards *("Normas Técnicas e as Directrizes de Revisão/Auditoria")* issued by the Portuguese Institute of Statutory Auditors ("*Ordem dos Revisores Oficiais de Contas*"), which require that the audit be planned and performed with the objective of obtaining reasonable assurance about whether the financial statements are free of material misstatement. An audit includes verifying, on a sample basis, evidence supporting the amounts and disclosures in the financial statements and assessing the significant estimates, based on judgments and criteria defined by the Board of Directors, used in their preparation. An audit also includes assessing the adequacy of the accounting policies used and their disclosure, taking into consideration the circumstances, verifying the applicability of the going concern concept, assessing the adequacy of the overall presentation of the financial statements and assessing that, in all material respects, the information is complete, true, timely, clear, objective and licit. An audit also includes verifying that the information included in the Board of Directors' Report is consistent with the financial statements. We believe that our audit provides a reasonable basis for expressing our opinion.

Deloitte.

Deloitte & Associados, SROC S.A.
Inscrição na OROC nº 43
Registo na CMVM nº 231

Opinion

5. In our opinion, the financial statements referred to in paragraph 1, present fairly in all material respects for the purposes explained in paragraph 6, the financial position of Portugal Telecom, SGPS, S.A. as of December 31, 2008 and the results of its operations and its cash flows for the year then ended, in conformity with generally accepted accounting principles in Portugal and the financial information contained therein is, under terms of the definitions included in the auditing standards referred to in paragraph 4 above, complete, true, timely, clear, objective and licit.

Emphasis of a matters

6. The financial statements referred to in paragraph 1 refer to the Company's operations on an individual basis and were prepared in conformity with generally accepted accounting principles in Portugal for approval and publication in accordance with current legislation. As explained in Note 3 c) the investments in group and associated companies are recorded in accordance with the equity method. The Company prepared, in accordance with current legislation, consolidated financial statements in conformity with the International Financial Reporting Standards ("IFRS") as adopted in the European Union, for separately approval and publication.

7. As mentioned to in Note 40 of the notes to the financial statements, the subsidiary PT Comunicações, S.A. revalued during 2008 its real estate and its ducts infra-structure related with the operations, previously recorded at cost. The impact of this change in the Company's financial statements, consisted of increasing assets and shareholder's equity by, approximately, 790,687,000 Euros.

Lisbon, 18 February 2009

DELOITTE & ASSOCIADOS, SROC S.A.
Represented by Manuel Maria Reis Boto