PORTUGAL TELECOM SGPS SA
Form 6-K
April 04, 2012
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

Report of Foreign Private Issuer
Pursuant to Rule 13a-16 or 15d-16 of the
Securities Exchange Act of 1934

For the month of March 2012

Commission File Number 1-13758

PORTUGAL TELECOM, SGPS, S.A.

(Exact name of registrant as specified in its charter)

Av. Fontes Pereira de Melo, 40
1069 - 300 Lisboa, Portugal

(Address of principal executive office)

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

Form 20-F x Form 40-F o

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

Yes o No x

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Annual Report

2011

Portugal Telecom, SGPS, S.A.

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

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Annual Report

2011

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Management Report

Introduction

Portugal Telecom, SGPS, S.A. (Portugal Telecom or Company) and its subsidiaries, jointly controlled entities and associated companies which represent its corporate Group (Portugal Telecom Group or Group), operate primarily in the telecommunications sector, in Portugal, Brasil and several other countries in Africa and Asia. The Group disposed of its former investment in Vivo in September 2010, and concluded the acquisition of the investments in Oi and Contax in March 2011. The consolidated annual report of the Company provides a detailed explanation of its consolidated activity and the evolution of its businesses for the year ended 31 December 2011 and, as such, we propose to the shareholders the analysis of that report in conjunction with this report.

Business overview

Apart from management of investments, the Company did not conduct any other business activity.

Legal Information

- There are no outstanding amounts overdue to the Portuguese State and the Portuguese Social Security System.

- The Company with the members of its Board of Directors and Audit Committee did not enter into any material businesses or transactions, except for those mentioned in Note 48 of the 2011 Consolidated Annual Report.

Proposal for application of profits

Considering that:

A) Net profit for the year ended 31 December 2011 amounted to Euro 342,259,821;

B) On 3 November 2010, the Board of Directors of Portugal Telecom approved a new shareholder remuneration policy which include, namely, the payment of an ordinary dividend of Euro 0.65 per share for the fiscal year ended 31 December 2011, representing an increase of 13% in relation to the Company s initial commitment of Euro 0.575 per share for the same period (subject to approval by the General Shareholder s Meeting);

C) Also in line with that shareholder remuneration policy, the Board of Directors of Portugal Telecom deliberated, in December 2011, to proceed with an advance over 2011 profits amounting to Euro 192,750,187.50, although the total amount paid to shareholders on 4 January 2012 was Euro 184,799,868.

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The Board of Directors proposes that:

1. Considering the net income for the year amounting to Euro 342,259,821 and the amount of Euro 184,799,868 already paid as an advance over 2011 profits, increased by Euro 232,522,984.50 included in the caption of retained earnings, we propose that, in addition to the advance over 2011 profits deliberated in December 2011, a total of Euro 389,982,937.50 be paid to shareholders, corresponding to Euro 0.435 per share, in respect of the total number of issued shares;

2. Therefore, taking into account the amount corresponding to the advance over 2011 profits deliberated in December 2011 and paid on January 2012, the total amount to be distributed to the shareholders shall amount to Euro 582,733,125, corresponding to a dividend of Euro 0.65 per share;

3. Taking into account the proposal as set out in item 7 on the agenda of the Shareholder s Meeting, it will not be possible to accurately determine the number of own shares that will be in treasury on the date of the abovementioned payment without limiting the Company s intervention ability, we propose that, in the distribution of the overall sum of Euro 389,982,937.50, as provided for in the foregoing paragraphs, calculated on the basis of an unit amount per issued share (in this case, Euro 0.435 per share), the following be observed:

a) Each issued share shall be paid the unit amount of Euro 0.435;

b) The amount corresponding to the shares that, on the payment day of the abovementioned amount, belong to the Company itself (calculated on the said unit amount of Euro 0.435 per issued share) shall not be paid and shall be transferred to retained earnings;

4. That, considering the right to the abovementioned payment pertaining to the shares resulting from the exercise of the right to conversion of convertible bonds issued:

a) Each share entitled to dividend resulting from the conversion of convertible bonds shall be paid the said unit amount of Euro 0.435;

b) The payment to each share resulting from the conversion of convertible bonds shall be made by using retained earnings.

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2011 events and recent developments

The events of the year ended 31 December 2011 and recent developments are described in the 2011 Consolidated Annual Report of Portugal Telecom.

Lisbon, 22 March 2012

Henrique Granadeiro, Chairman of the Board of Directors

Zeinal Bava, Chief Executive Officer

Luís Pacheco de Melo, Executive Director

Alfredo José Silva de Oliveira Baptista, Executive Director

Carlos Alves Duarte, Executive Director

Pedro Humberto Monteiro Durão Leitão, Executive Director

Manuel Rosa da Silva, Executive Director

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Shakhaf Wine, Executive Director

Otávio Marques de Azevedo, Non-Executive Director

Francisco Manuel Marques Bandeira, Non-Executive Director

José Guilherme Xavier de Basto, Non-Executive Director

João Manuel de Mello Franco, Non-Executive Director

Joaquim Aníbal Brito Freixial de Goes, Non-Executive Director

Mário João de Matos Gomes, Non-Executive Director

Pedro Jereissati, Non-Executive Director

Gerald Stephen McGowan, Non-Executive Director

Rafael Luís Mora Funes, Non-Executive Director

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Maria Helena Nazaré, Non-Executive Director

Amílcar Carlos Ferreira de Morais Pires, Non-Executive Director

Francisco Teixeira Pereira Soares, Non-Executive Director

Paulo José Lopes Varela, Non-Executive Director

Milton Almicar Silva Vargas, Non-Executive Director

Nuno Rocha dos Santos de Almeida e Vasconcellos, Non-Executive Director

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PORTUGAL TELECOM, SGPS, S.A.

BALANCE SHEET

31 DECEMBER 2011 AND 2010

Euro

	Notes	2011	2010
ASSETS			
Non-current assets			
Tangible fixed assets	6	1,448,664	1,491,857
Financial investments - equity method of accounting	7	7,611,950,981	10,027,794,939
Financial investments - other methods		1,572,085	1,553,402
Balances with Group companies	8	906,273,575	928,190,728
Other financial assets	9	500	643,242
Deferred tax assets	10	121,242,478	5,871,483
Total non-current assets		**8,642,488,283**	**10,965,545,651**
Current assets			
Advances to suppliers		86,990	90,709
State and other public entities	11	57,005,512	5,667,463
Balances with Group companies	8	748,499,781	789,318,955
Other accounts receivable	12	71,084,090	35,111,329
Deferrals	13	7,197,630	2,127,133
Financial assets held for trading	4.(e)	60,000,000	
Non-current assets held for sale	7		131,839,636
Cash and bank deposits	4	467,617,335	825,831,437
Total current assets		**1,411,491,338**	**1,789,986,662**
Total assets		**10,053,979,621**	**12,755,532,313**
SHAREHOLDERS EQUITY			
Share capital	14	26,895,375	26,895,375
Treasury shares	14	(326,382,863)	(178,071,826)
Legal reserve	14	6,773,139	6,773,139
Other reserves	14	156,180,056	158,456,357
Adjustments to financial assets	14	(30,932,527)	428,480,272
Retained earnings		2,738,716,229	(413,661,880)
Advances on account of profits	14	(184,799,868)	(875,872,500)
Net income		342,259,821	5,124,694,888
Total shareholders equity		**2,728,709,362**	**4,277,693,825**
LIABILITIES			
Non-current liabilities			
Provisions	15	354,841	410,136
Loans obtained	16	1,377,456,176	2,940,777,587
Deferrals	13	4,860,716,873	4,860,716,873
Deferred tax liabilities	10	14,286,361	15,143,542
Other financial liabilities	9	8,532,123	3,805,052
Total non-current liabilities		**6,261,346,374**	**7,820,853,190**
Current liabilities			
Provisions	15	32,044,768	31,636,115

Loans obtained	16	749,748,092	553,908,306
Deferrals		227,490	227,490
Balances with Group companies	8	241,436,660	18,165,319
Suppliers	17	1,115,114	1,455,763
Accrued expenses	18	38,605,584	50,117,899
State and other public entities	11	89,921	1,471,344
Other accounts payable		656,256	3,062
Total current liabilities		**1,063,923,885**	**656,985,298**
Total liabilities		**7,325,270,259**	**8,477,838,488**
Total liabilities and shareholders equity		**10,053,979,621**	**12,755,532,313**

The accompanying notes form an integral part of these financial statements.

Accountant

The Board of Directors

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PORTUGAL TELECOM, SGPS, S.A.

INCOME STATEMENT

FOR THE YEARS ENDED 31 DECEMBER 2011 AND 2010

Euro

	Notes	2011	2010
Equity in earnings/(losses) of affiliated companies	19	206,660,270	5,271,597,728
Supplies and external services	20	(5,182,328)	(11,381,155)
Wages and salaries	21	(14,818,932)	(7,944,618)
Indirect taxes		(1,375,031)	(1,701,313)
Impairment of accounts receivable ((losses)/reversals)			(4,063,283)
Provisions ((increases)/reductions)	15	(463,653)	(6,208,060)
Increases/(reductions) in fair value	22	190,656	1,180,676
Other income and gains	23	5,514,730	3,484,646
Other expenses and losses	24	(8,364,928)	(33,990,721)
INCOME BEFORE DEPRECIATION AND AMORTISATION, FINANCING EXPENSES AND TAXES		**182,160,784**	**5,210,973,900**
Depreciaton and amortisation ((expenses)/reversals)	6	(259,939)	(271,044)
OPERATING INCOME (BEFORE FINANCING EXPENSES AND TAXES)		**181,900,845**	**5,210,702,856**
Interest and related income	25	148,416,665	99,979,131
Interest and related expenses	25	(117,977,194)	(214,030,095)
INCOME BEFORE TAXES		**212,340,316**	**5,096,651,892**
Income taxes	10	129,919,505	28,042,996
NET INCOME		**342,259,821**	**5,124,694,888**
Basic earnings per share	26	0.40	5.72
Diluted earnings per share	26	0.40	5.36

The accompanying notes form an integral part of these financial statements.

Accountant The Board of Directors

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PORTUGAL TELECOM, SGPS, S.A.

STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

FOR THE YEARS ENDED 31 DECEMBER 2010 AND 2011

Euro

		Share capital	Treasury shares	Legal reserve	Other reserves	Adjustments to financial assets	Retained earnings	Advances on account of profits	Net income	T shar e
Balance as at 31 December 2009	A	**26,895,375**	**(178,071,826)**	**6,773,139**	**158,560,276**	**(179,603,228)**	**579,166,608**		**644,363,246**	**1,058**
Changes in the period:										
Foreign currency translation adjustments						316,556,078				**316**
Unpaid dividends						1,458,649	(1,458,649)			
Transfer from adjustments to shareholders equityof subsidiaries						1,222,181,595	(1,222,181,595)			
Disposal of Vivo						(572,602,757)	101,303,598			**(47**
Other changes recognized in shareholders equity					(103,919)	(359,510,065)	2,249			**(359**
	B				**(103,919)**	**608,083,500**	**(1,122,334,397)**			**(514**
Net income	C								5,124,694,888	**5,124**
Comprehensive income	B+C									**4,610**
Operations with shareholders:										
Application of the previous year s earnings							140,736,558		(644,363,246)	**(502**
Advances on account of 2010 profits								(875,872,500)		**(875**
Taxes on income of equity swaps							(11,230,649)			**(11**
	D						**129,505,909**	**(875,872,500)**	**(644,363,246)**	**(1,390**
Balance as at 31 December 2010	E=A+B+C+D	**26,895,375**	**(178,071,826)**	**6,773,139**	**158,456,357**	**428,480,272**	**(413,661,880)**	**(875,872,500)**	**5,124,694,888**	**4,277**
Changes in the period:										

Foreign currency translation adjustments						(238,054,786)				**(23**
Unpaid dividends						1,276,199	(1,276,199)			
Transfer from adjustments to shareholders equityof subsidiaries						(41,573,309)	41,573,309			
Other changes recognized in shareholders equity					(2,276,301)	(181,060,903)	(398,882)			**(18**
	F				**(2,276,301)**	**(459,412,799)**	**39,898,228**			**(42**
Net income	G								342,259,821	**34**
Comprehensive income	F+G									**(79**
Operations with shareholders:										
Acquisition of Portugal Telecom s shares by Oi (Notes 1and 14.2)			(148,311,037)							**(14**
Application of the previous year s earnings							3,130,835,067	875,872,500	(5,124,694,888)	**(1,11**
Advances on account of 2011 profits								(184,799,868)		**(18**
Taxes on income of equity swaps							(18,355,186)			**(1**
	H		**(148,311,037)**				**3,112,479,881**	**691,072,632**	**(5,124,694,888)**	**(1,46**
Balance as at 31 December 2011	E+F+G+H	**26,895,375**	**(326,382,863)**	**6,773,139**	**156,180,056**	**(30,932,527)**	**2,738,716,229**	**(184,799,868)**	**342,259,821**	**2,72**

The accompanying notes form an integral part of these financial statements.

Accountant The Board of Directors

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PORTUGAL TELECOM, SGPS, S.A.

STATEMENT OF CASH FLOWS

FOR THE YEARS ENDED 31 DECEMBER 2011 AND 2010

Euro

	Notes	2011	2010
OPERATING ACTIVITIES			
Payments to suppliers		(7,129,129)	(21,547,750)
Payments to employees		(6,376,517)	(7,375,673)
		(13,505,646)	**(28,923,423)**
Cash receipts relating to income taxes	4.(a)	126,216,058	142,975,180
Other cash receipts		(9,876,815)	(18,607,219)
Cash flows from operating activities (1)		**102,833,597**	**95,444,538**
INVESTING ACTIVITIES			
Cash receipts resulting from:			
Financial investments	4.(b)	2,176,771,556	666,533,418
Loans granted	4.(c)	123,286,044	1,214,396,244
Interest and related income		112,205,889	74,111,637
Dividends	4.(d)	39,101,301	1,755,844,768
Tangible fixed assets		16,068	44,798
Other investing activities		1,776,022	
		2,453,156,880	**3,710,930,865**
Payments resulting from:			
Short-term financial applications	4.(e)	(60,000,000)	
Financial investments	4.(f)	(114,460,039)	(60,918,963)
Loans granted	4.(c)		(968,966,389)
Tangible fixed assets		(18,450)	(64,947)
		(174,478,489)	**(1,029,950,299)**
Cash flows from investing activities (2)		**2,278,678,391**	**2,680,980,566**
FINANCING ACTIVITIES			
Cash receipts resulting from:			
Loans obtained	4.(g)	5,006,000,000	18,121,461,846
Payments resulting from:			
Loans repaid	4.(g)	(6,485,439,187)	(18,522,531,136)
Dividends	14.6	(1,138,634,250)	(1,379,499,188)
Interest and related expenses		(120,884,372)	(199,453,054)
Other financing activities			(4,876,200)
		(7,744,957,809)	**(20,106,359,578)**
Cash flows from financing activities (3)		**(2,738,957,809)**	**(1,984,897,732)**
Change in cash and cash equivalents (4)=(1)+(2)+(3)		**(357,445,821)**	**791,527,372**
Effect of exchange differences		(768,281)	(287,013)
Cash and cash equivalents at the beginning of the period		825,831,437	34,591,078
Cash and cash equivalents at the end of the period	4.(h)	**467,617,335**	**825,831,437**

The accompanying notes form an integral part of these financial statements.

Accountant	The Board of Directors

PORTUGAL TELECOM, SGPS, S.A.

Notes to the Standalone Financial Statements

As at 31 December 2011

(Amounts in Euro)

1. Introduction

Portugal Telecom, SGPS, S.A. (Portugal Telecom or Company) and its subsidiaries, jointly controlled entities and associated companies (Note 8), which represent its corporate Group (Portugal Telecom Group or Group), operate primarily in the telecommunications sector, in Portugal, Brasil and several other countries in Africa and Asia. The corporate purpose of the Company is the management of investments.

As a result of the five privatization processes between 1 June 1995 and 4 December 2000, Portugal Telecom s share capital is held mainly by private shareholders. The shares of Portugal Telecom are listed on the Euronext and on the *NYSE - New York Stock Exchange*.

On 26 July 2011, Portugal Telecom s General Meeting of Shareholders approved an amendment to the Company s Bylaws, eliminating the special rights granted to the 500 Class A shares (the so-called golden share).

In September 2010, the Group disposed of its 50% interest in Brasilcel, the joint venture that controlled Vivo.

On 27 January 2011, Portugal telecom concluded the disposal to a third party of the 28.78% stake previously held by the Group in UOL, including the 21.95% (Note 7) and 6.83% stakes held respectively by Portugal Telecom and by another Group company as at 31 December 2010. This transaction was concluded for a total cash consideration of 356 million Brazilian Reais, equivalent to 10.3 Brazilian Reais per share.

On 28 March 2011, Portugal Telecom concluded the acquisition process of the investments in Oi and Contax and the agreements with the controlling shareholders of these companies, for a total cash consideration of R$8,437 million. As a result of this operation, Portugal Telecom acquired an economic interest of 25.3% in Oi and 14.1% in Contax. Under the terms of this acquisition, Portugal Telecom shares the power to govern the strategic financial and operating policies of these companies, and as such these investments are classified as jointly controlled entities, under the terms of IAS 31 Interest in Joint Ventures. Consequently, as permitted by this standard, the entities acquired are proportionally consolidated in the consolidated financial statements of Portugal Telecom, while in these standalone financial statements they are recognized by the equity method of accounting. Oi Group is the leading provider of telecommunication services in the Brazilian market and the largest fixed telecommunications

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operator in South America in terms of active clients. Contax is one of the leading corporate services company and the leader in contact centre services in Brazil.

The transaction mentioned above was completed following the Memorandum of Understanding entered into, on 28 July 2010, by Portugal Telecom with Andrade Gutierrez Participações, S.A. (AG) and LF Tel, S.A. (LF), two of the main shareholders of Telemar Participações, which sets the principles for the development of a strategic partnership between Portugal Telecom and Oi Group. The purpose of the strategic partnership between Portugal Telecom and Oi is to develop a global telecommunications platform that will allow for cooperation in diverse areas, with a view to, among other things, sharing best practices, achieving economies of scale, implementing research and development initiatives, developing new technologies, expanding internationally, particularly in Latin America and Africa, diversifying the services provided to customers, maximizing synergies and reducing costs, and seeking to offer constant high quality services to our corporate and individual customers, while creating and adding value for our shareholders.

Under the strategic partnership between Portugal Telecom and Oi, it is envisaged that, amongst other purposes, Oi would acquire up to 10% of the outstanding shares of Portugal Telecom. Up to 31 December 2011, Oi acquired 64,557,566 shares of Portugal Telecom, representing 7.2% of share capital. Portugal Telecom s share in this investment was classified as treasury shares in its Balance Sheet and amounted to Euro 148 million as at 31 December 2011 (Note 14.2) .

These financial statements, which relate to the Company on a standalone basis, were prepared in accordance with accounting principles generally accepted in Portugal (Note 2), and, as such, the financial investments were accounted for under the equity method, as explained in Note 3.4. 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 2011 and the net income for the year then ended include the effect of the consolidation of the shareholders equity and net income of Portugal Telecom s affiliated companies, based on their respective financial statements, but do not include the effect of the fully or proportionally consolidation of their assets, liabilities, costs and revenues.

2. Basis of presentation

These financial statements were prepared based on Decree-law nº. 158/2009, dated 13 July, and in accordance with the conceptual structure, Accounting and Reporting Standards (NCRF) and Interpretative Standards, as approved by Notices nº 15652/2009, 15655/2009 and 15653/2009 of the General-Secretary of the Ministry of Finance, dated 27 August 2009, which make up the New Portuguese accounting system, named Sistema de Normalização Contabilística (SNC).

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The Company adopted NCRF for the first time in 2010 and applied for this purpose the *NCRF 3 Adoption For The First Time of NCRF* (NCRF 3), with the transition date being 1 January 2009 for the purposes of the presentation of these financial statements. As permitted by Decree-Law nº. 158/2009, the Company also applies the International Financial Reporting Standards (IAS/IFRS) and related interpretations (SIC/IFRIC) issued by the International Accounting Standards Board (IASB), in order to fill in the gaps or omissions in SNC regarding specific situations of certain transactions.

The consolidated financial statements of Portugal Telecom are prepared, since 1 January 2005, in accordance with IFRS as adopted by the European Union, which are applicable to the listed companies in the European Union. Therefore, the shareholders equity as at 31 December 2011 and 2010 and the net income for the years then ended that are included in the consolidated financial statements of Portugal Telecom differ from the amounts presented in these standalone financial statements. The reconciliation of the shareholders equity as at 31 December 2011 and net income for the year then ended, attributable to the Company s shareholders, between the standalone (under NCRF) and the consolidated financial statements (under IFRS), is as follows:

Reconciliation between NCRF and IFRS **(Euro million)**

	Net income	Shareholders equity
In accordance with NCRF	**342**	**2,729**
Direct costs with business combinations (IFRS 3)	(12)	(36)
Amortization of goodwill and licences (IAS 36 and 38)	(7)	143
Subsidies for investments (IAS 20)		(8)
Disposal of UOL	16	
In accordance with IFRS	**339**	**2,828**

3. Main accounting policies, judgments and estimates

These standalone financial statements were prepared on a going concern basis of accounting. The main accounting policies used in the preparation of these standalone financial statements are described below and were applied consistently.

3.1. Tangible fixed assets

Tangible fixed assets are stated at acquisition cost, which includes the amount paid to acquire the asset and any expenses directly attributable to bring the asset to the location and condition necessary for their operation.

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Tangible fixed assets are depreciated on a straight-line basis from the month they are available for use, during its expected use life. The depreciation rates reflect the useful life of each class of assets, as follows:

Asset class	Years of useful life
Transportation equipment	4
Administrative equipment	3 - 8
Other tangible fixed assets	4 - 8

The gains and losses resulting from any write-off or disposal are determined by the difference between the amount received and the carrying value of the asset, and are recognized in the income statement.

3.2. Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. The remaining lease contracts are considered operating leases. The classification of leases depends on the substance of the transaction and not on the form of the contract.

Assets acquired under finance leases and the corresponding liabilities are accounted for at the beginning of the contract as the lower amount between the fair value of the assets and the present value of minimum lease payments. Rents include the reimbursement of the liability and interest expense, with interest being recognized in the income statement based on a periodic interest rate over the remaining liability.

Under operating leases, rents are recognized on a straight-line basis during the period of the lease.

3.3. Business combinations and goodwill

Acquisitions of subsidiaries are accounted for based on the purchase method. On the acquisition date, the purchase price includes the following components: (a) the fair value of assets acquired; (b) the fair value of liabilities incurred; (c) the fair value of equity instruments issued by the Company in exchange for the control of the subsidiary; and (d) expenses directly attributable to the acquisition. When applicable, the purchase price includes the effect of contingent payments agreed upon under the terms of the transaction, with subsequent changes in those payments being recorded as an adjustment to goodwill.

Any excess of the acquisition cost over the fair value of net assets acquired and contingent liabilities of the acquired company, at the date of acquisition, is recorded as goodwill, in accordance with *NCRF 14 Business Combinations* (NCRF 14). If the acquisition cost is lower

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than the fair value of identifiable net assets, the difference is recorded as a gain in the net income. As provided for in NCRF 3, the Company applies NCRF 14 only to acquisitions occurred after 1 January 2009.

Goodwill resulting from the acquisition of subsidiaries is included in the balance sheet under the caption Goodwill , while goodwill resulting from the acquisition of associated companies is included under the caption Financial investments - equity method of accounting , together with the financial investments in those entities, as part of the value assigned to the financial investment.

Goodwill is not amortized, but tested for impairment losses on an annual basis or whenever there is evidence of a potential loss of value. For impairment test purposes, goodwill is allocated to cash generating units. Any impairment loss is recognised in the income statement of the period, and cannot be reversed in a subsequent period.

3.4. Financial investments

Subsidiaries are those entities over which the Company has the power to govern the financial and operating policies of the entity, generally represented by the majority of the voting rights. Associated companies are entities over which the Company has a significant influence but not control, generally represented by stakes between 20% and 50% of voting rights.

Financial investments in subsidiaries and associated companies are recorded under the equity method of accounting. Under this method, financial investments are initially recorded at acquisition cost and subsequently adjusted for the changes, after the acquisition date, in the Company s share in the net assets of those entities. Portugal Telecom s earnings include its share in the earnings of its subsidiaries and associated companies.

Financial investments in foreign entities are translated to Euros using the exchange rates prevailing at the balance sheet date, while the Company s share in the earnings of those entities is computed based on the average exchange rates for the reported period. The effect of translation differences is recognised in shareholders equity under the caption Adjustments to financial assets , and is transferred to net income upon the disposal of a foreign entity or the realization of the investment through another way. The exchange rates used in the translation of the main foreign entities (held directly or indirectly by Portugal Telecom) are as follows:

	2011		2010	
Currency	**Closing balance**	**Average**	**Closing balance**	**Average**
American dollar	1.2939	1.392	1.3362	1.3259
Brazilian Real	2.4159	2.3265	2.2177	2.3315

Financial investments are evaluated whenever there is evidence they may be impaired and the related impairment losses are recorded in the income statement.

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Gains obtained in transactions with subsidiaries and associated companies are eliminated proportionally to the Company s share in those entities, against a reduction in the financial investment.

Capital 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, their recognition in earnings is made under the caption Equity in earnings/(losses) of affiliated companies , on the same proportion that goodwill recorded by the acquirer is recognized in earnings.

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

3.5. Accruals and deferrals

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

3.6. Income taxes

Income tax expense corresponds to the sum of current and deferred taxes. Deferred taxes are recognized in earnings except when they relate to items recorded directly in shareholders equity, in which case they are also recorded in shareholders equity.

Portugal Telecom adopted the special taxation regime for Groups of companies, as defined in Section 69 of the Corporate Income Tax Code (IRC), which applies to all companies in which it holds, directly or indirectly, at least 90% of the share capital and that, simultaneously, are located in Portugal and are subject to corporate income tax. Any gain generated by the Group as a result of the adoption of this regime, resulting from tax losses of the companies included in the tax consolidation, is recorded in earnings under the caption Equity in earnings/(losses) of affiliated companies (Note 19). 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 current income tax is computed based on the estimated taxable income for corporate income tax purposes, based on the statutory tax rate in Portugal, which is increased through a municipal tax and/or through an additional state surcharge depending on the collectible profit of the year (Note 10). The Company applies the municipal tax to consolidated taxable income, in accordance with Portuguese tax legislation, and applies the state surcharge to the standalone taxable income of each of the companies included in the Portugal Telecom s tax consolidation.

The income tax expense recorded in the financial statements was determined in accordance with *NCRF 25 Income Taxes* . In determining income tax expense for the year, besides the

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current tax based on profit before-tax adjusted in accordance with the tax legislation, it is also considered the effects of temporary differences between income before tax and taxable income originated in the year or in preceding years.

Deferred taxes correspond to the temporary differences between assets and liabilities for accounting purposes and the related amounts for taxable purposes. Deferred tax assets and liabilities are computed and evaluated annually, using the tax rates which are expected to be in force at the date of reversal of these temporary differences.

Deferred tax assets are recorded only when there is a reasonable expectation of sufficient future tax profits which allow for their use. As at the balance sheet date the Company conducts a reassessment of the temporary differences originating deferred tax assets, in order to record deferred tax assets not recognized previously and/or to reduce the amount of deferred tax assets that are recognized, based on the current estimate of its recoverable amount.

3.7. Accounts receivable

Accounts receivable are initially recognized at fair value, and subsequently measured at amortized cost, based on the effective interest rate method, deducted from impairment losses.

Impairment losses for doubtful accounts receivable are computed based on the evaluation of the estimated risks resulting from the non-collection of receivables. Impairment losses are recorded in the income statement.

3.8. Non-current assets held for sale

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered primarily through a sale transaction rather than through continuing use. This condition is regarded as met, only when the subject transaction is highly probable and the asset or group of assets is available for immediate sale in its present condition. The sale should be completed within one year as from the date the asset was classified as held for sale.

Non-current assets classified as held for sale are measured at the lower of the assets previous carrying amount or the fair value less costs to sell.

3.9. Provisions and contingent liabilities

The Company recognizes provisions when there is a present obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where any of the above mentioned criteria is not accomplished, the Company discloses the event as a contingent liability, unless the cash outflow is remote.

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Provisions are recognized for an amount corresponding to the present value of the best estimate, at the reporting date, of the resources needed to settle the obligation. That estimate is determined considering the risks and uncertainties associated with the obligation. Provisions are reviewed at the end of each year and adjusted for in order to reflect the best estimate as of that date.

3.10. Loans obtained

Loans obtained are initially recognized at fair value, net of transaction costs incurred, and subsequently presented at amortized cost, based on the effective interest method.

Exchangeable bonds issued by Portugal Telecom are recognized as compound instruments, comprising the following two components: (i) the present value of the debt, estimated through the prevailing market interest rate for similar non-convertible debt, which is recorded as a financial liability; and (ii) the fair value of the embedded option for the holder to convert the bond into equity, which is recorded directly in shareholders equity. As of the balance sheet date, the debt component is recognized at amortized cost and the shareholders equity component is recognized at the initial value.

3.11. Treasury shares

Equity swap contracts on own shares that include an option exercisable by Portugal Telecom for physical settlement are recognised as a financial liability and a corresponding reduction of shareholders equity, and are accounted for as an acquisition of treasury shares on the inception date of the contract.

Portugal Telecom s shares acquired by its subsidiaries are recognized in the Balance Sheet as treasury shares at the acquisition cost, based on the Portugal Telecom s effective interest in those entities.

3.12. Balance sheet 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, at present value.

3.13. Foreign currency transactions and balances

Transactions denominated in foreign currencies (different from the Company´s domestic currency) are translated to Euros at the exchange rates prevailing at the time the transactions

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are made. Assets and liabilities in foreign currency for which there is no agreement for fixing an exchange rate are translated to Euros using the exchange rates prevailing at the balance sheet date. Favourable or 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 or payment or at the balance sheet date are recorded as gains and losses in the income statement.

Assets and liabilities as at 31 December 2011 and 2010 were translated into Euros using the following exchange rates to the Euro reported by the Portuguese Central Bank:

Currency	**2011**	**2010**
American dollar	1.2939	1.3362
Brazilian Real	2.4159	2.2177

3.14. Financial assets and liabilities

Financial assets and liabilities are recognized in the balance sheet when the Company becomes part of the corresponding contractual terms, and are classified in the following categories: (a) at cost or amortized cost; and (b) at fair value, with the respective changes being recorded in the income statement.

(a) Financial assets and liabilities at cost or amortized cost

Assets and liabilities are classified at cost or amortized cost if they: (a) have a defined maturity; (b) have a fixed or determined income; and (c) don t represent or include a derivative financial instrument.

Assets and liabilities classified in this category are measured at amortized cost reduced by accumulated impairment losses (for financial assets) and correspond primarily to the following asset and liability captions included in the Company s balance sheet:

- Loans included under the caption Financial investments - equity method of accounting

- Loans obtained

- Balances with Group companies

- Suppliers
- Accrued expenses
- Advances to suppliers
- State and other public entities
- Other accounts receivable and payable
- Other financial assets and liabilities
- Cash and bank deposits

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Amortized cost is determined through the effective interest method. The effective interest rate is the one that discounts the estimated future payments and receipts, during the term of the financial instrument, to the carrying value of the financial asset or liability.

(b) Financial assets and liabilities at fair value

All the remaining financial assets and liabilities not included in the category cost or amortized cost are recognized at fair value. These financial assets and liabilities correspond primarily to interest and exchange rate derivative financial instruments.

The changes in the fair value of these derivatives are recognized through shareholders equity or profit and loss, depending on whether those derivatives meet or not the criteria for hedge accounting, respectively. These changes in fair value are recorded under the caption Increases/(reductions) in fair value (Note 22).

(c) Impairments on financial assets

Financial assets included under the caption cost or amortized cost are subject to impairment tests by the end of each year. Such assets are impaired when there is clear evidence that, as a result of one or more events occurred after its initial recognition, their future estimated cash flows will be affected.

For assets measured at amortized cost, the impairment loss corresponds to the difference between the carrying amount of the asset and the present value of the revised future estimated cash flows discounted using the initial effective interest rate. For financial assets measured at cost, the impairment loss corresponds to the difference between the carrying amount of the asset and the best estimated of the asset s fair value.

Subsequently, if there is a reduction in the impairment loss as a result of an event occurred after the initial recognition of the loss, the impairment should be reversed through earnings. The reversal is recognized up to the limit of the amount that would be recorded (at amortized cost) if the loss had not been initially recognized.

Impairment losses and related reversals are recorded in earnings primarily under the caption Impairment of accounts receivable ((losses)/reversals) .

(d) Derecognition of financial assets and liabilities

The Company derecognizes financial assets when its contractual rights to obtain the asset s cash flows expire, or when it transfers to another entity all the significant risks and rewards associated with the ownership of those assets. The Company derecognizes financial liabilities only when the corresponding obligation is settled, cancelled or expires.

3.15. Main accounting estimates and judgements

To prepare the standalone financial statements under NCRF, the Company s management uses estimates and assumptions that have an effect in the application of accounting policies and in

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the amounts reported. Estimates and judgments are continually evaluated and are based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances on which the estimate was based, or as a result of new information or more experience. The main accounting estimates reflected in the financial statements relate to the impairment tests of financial instruments and the evaluation of the fair value of financial instruments.

The Company tests annually its financial investments for impairment, whenever they present evidence of impairment, including severe decline in the operations activity of the affiliated company. Under this analysis, the Company determines the recoverable amounts of the financial investments. The recoverable amounts of investment are determined based on value-in-use calculations. The use of this method requires the estimate of future cash flows expected to arise from the continuing operation for each of the subsidiaries, the choice of a growth rate to extrapolate cash flow projections and the estimate of a suitable discount rate for each cash generating unit.

Estimates used are based on the best information available during the preparation of financial statements, although future events, neither controlled nor foreseeable by the Company, could occur and have an impact on those estimates. In accordance with *NCRF 4 Accounting Policies, Changes in Estimates and Errors* (*NCRF 4*), changes to these estimates that occur after the date of the financial statements are recognized in net income, using a prospective methodology.

3.16. Events occurred after the balance sheet date

Events occurred after the balance sheet date that provide additional information about conditions existing at the balance sheet date are reflected in the financial statements. Events occurred after the balance sheet date that provide information about conditions that occur after the balance sheet date are not reflected in the financial statements, but are disclosed in the notes to the financial statements, if material.

4. Cash flows

The caption Cash and cash equivalents of the statement of cash flows includes cash on hand and bank deposits readily convertible to a known amount of cash.

The Company is exposed to a liquidity risk if its sources of funding, including cash balances, operating cash inflows, divestments, credit lines and cash flows obtained from financing operations, do not match its financing needs, such as operating and financing outflows, investments, shareholder remuneration and debt repayments. Based on the cash flows generated by investing activities, mainly from dividends and interest received from affiliated companies, and on the available cash and cash equivalents plus undrawn committed standby

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facilities and underwritten commercial paper agreements, as detailed below, the Company believes that it will be able to meet its obligations.

Considering the centralized cash management system implemented by the Company in 2006 for its operations in Portugal, under which the companies that are included in this system can finance its cash requirements through Portugal Telecom, the Company manages the liquidity risk of its Group operations in Portugal. In order to reduce this risk, Portugal Telecom seeks to maintain a liquidity position and an average maturity of debt that allows the repayment of short-term loans obtained and, simultaneously, the payment of all contractual obligations, as mentioned above. As at 31 December 2011, the amount of available cash, from Group operations in Portugal, plus the undrawn amount of underwritten commercial paper lines (cash immediately available upon a 2 or 3-day notice) and committed standby facilities amounted to Euro 5,095 million, while average maturity of net debt was 3.5 years.

The capital structure of Portugal Telecom is managed in order to ensure that its businesses will be able to continue as a going concern and the maximizing of the return to shareholders. The capital structure of the Group includes loans obtained, cash and cash equivalents and equity attributable to equity holders of the parent, comprising issued capital, treasury shares, reserves and accumulated earnings. Portugal Telecom reviews periodically its capital structure considering the risks associated with each of the above mentioned classes of its capital structure.

The cash flow statement was prepared in accordance with NCRF 2 Statement of Cash Flows , with the following aspects being worth mentioning:

(a) Cash receipts relating to income taxes

In the years ended 31 December 2011 and 2010, this caption has the following composition:

Euro

	2011	**2010**
Collections from subsdiaries within RETGS (a)	153,696,404	125,779,793
Payments on account made by the Company	(17,108,412)	(47,535,649)
Income tax reimbursment related to the previous year	12,021,917	65,805,262
Income tax paid in Brazil related to the disposal of UOL (Note 10.3)	(7,114,332)	
Other (b)	(15,279,519)	(1,074,226)
	126,216,058	**142,975,180**

(a) In 2011 and 2010, this caption includes collections from subsidiaries related to (1) payments on account of income tax to be paid in the following year amounting to Euro 127,749,302 and Euro 115,729,188 (Note 8), respectively, and (2) the settlement of the fourth and last instalment regarding the previous year income tax, amounting to Euro 25,947,102 and Euro 10,050,605, respectively.

(b) In 2011, this caption includes mainly (1) Euro 8.9 million related to withholding taxes on capital income, primarily related to interest on short-term financial applications, (2) Euro 4.0 million related to withholding tax on income from equity swaps on own shares, and (3) Euro 2.1 million related to an additional tax assessment regarding prior years.

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(b) Cash receipts resulting from financial investments

In the years ended 31 December 2011 and 2010, this caption has the following composition:

Euro

	2011	2010
Reimbursement of additional paid in capital contributions (Note 7):		
PT Portugal	1,992,950,000	635,000,000
PT Investimentos Internacionais (PT II)	9,100,000	
PT Participações		6,674,110
PT Compras		2,620,000
	2,002,050,000	**644,294,110**
Disposals of financial investments:		
UOL (Note 7) (a)	119,327,361	
Bratel Brasil (Note 7)	36,644,195	
Brasilcel (Note 19)		150,000
	155,971,556	**150,000**
Share capital reductions (Note 7):		
Africatel Holdings B.V. (Africatel)	18,750,000	22,089,308
	18,750,000	**22,089,308**
	2,176,771,556	**666,533,418**

(a) This caption relates to the amount obtained from the disposal of the investment in UOL, which was classified as a non-current asset held for sale at 31 December 2010 (Note 7.e).

(c) **Cash receipts (payments) resulting from loans granted**

In the years ended 31 December 2011 and 2010, cash receipts from loans granted, net of cash payments, amounted to Euro 123,286,044 and Euro 245,429,855, respectively, and are as follows:

Euro

	2011	2010
Reimbursement of loans granted:		
Africatel (Note 8)	27,600,000	
Yunit (Note 7)	2,228,328	
Sportinveste Multimédia SGPS, S.A. (Sportinveste) (Note 7)	1,000,000	1,700,000

INESC (Note 7)	101,595	85,965
PT Comunicações		744,000,000
	30,929,923	**745,785,965**
Loans granted in the period (Note 8):		
PT Portugal		(572,200,000)
Telecomunicações Móveis de Moçambique (TMM)		(12,116)
		(572,212,116)
Intercompany loans within centralized cash management:		
TMN	52,799,489	321,371,860
PT Inovação	17,339,930	(23,766,128)
PT Sales	11,749,662	(5,502,399)
PT Contact	3,897,522	(8,570,230)
PT Centro Corporativo	3,301,499	(4,697,824)
PT Sistemas de Informação (PT SI)	2,489,876	(2,678,784)
PT Compras	333,190	(508,469)
PT Pro, Serviços Administrativos e de Gestão Partilhados, S.A. (PT Pro)	161,239	
PT Portugal		146,350,630
PT Comunicações		(337,114,865)
PT Prime		(13,410,666)
Other companies	283,714	382,881
	92,356,121	**71,856,006**
	123,286,044	**245,429,855**

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(d) Dividends received

In the years ended 31 December 2011 and 2010, this caption has the following composition:

Euro

	2011	**2010**
PT Participações (Note 7)	25,000,000	
Portugal Telecom Internacional Finance BV (PT Finance) (Note 7)	12,160,033	2,254,047
PT Centro Corporativo (Note 7)	1,798,593	2,014,150
Vortal (Note 25)	142,675	97,642
PT Portugal (Note 7)		1,751,350,311
UOL (Note 7)		128,618
	39,101,301	**1,755,844,768**

(e) Payments resulting from short-term financial applications

In the year ended 31 December 2011, the Company entered into short-term financial applications amounting to Euro 60,000,000, with maturity as at 16 April 2012 and a coupon of 6.5% .

(f) Payments resulting from financial investments

In the years ended 31 December 2011 and 2010, this caption has the following composition:

Euro

	2011	**2010**
Share capital increases (Note 7):		
PT Brasil	75,534,487	60,854,909
Bratel Brasil	36,678,542	
	112,213,029	**60,854,909**
Other operations:		
Additional paid in capital contributions granted to Yunit (Note 7)	2,228,328	
Advances for a share capital increase at Apor	13,940	
Incorporation of Vortal SGPS	4,742	

Advances for a share capital increase at PT Ásia (Note 7)		60,000
Incorporation of TMM (Note 7)		4,054
	2,247,010	**64,054**
	114,460,039	**60,918,963**

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(g) Cash receipts (payments) resulting from loans obtained

In the years ended 31 December 2011 and 2010, loans repaid, net of cash receipts from loans obtained, amounted to Euro 1,479,439,187 and Euro 401,069,290, respectively, and are as follows:

Euro

	2011	**2010**
External loans obtained (repaid), net:		
Short-term commercial paper	(1,327,050,000)	(445,650,000)
Bank loans	26,484,965	89,948,449
	(1,300,565,035)	**(355,701,551)**
Intercompany loans within centralized cash management:		
PT Portugal	(86,532,551)	
PT Comunicações	(4,761,996)	
PT II	(2,497,403)	
PT Imobiliária	(358,156)	(947,788)
PT Ventures	(94,981)	
PT Móveis		(41,226,418)
PT Pro		(1,502,388)
PT Prime		(993,688)
Other companies	(11,422)	(397,025)
	(94,256,509)	**(45,067,307)**
Partial reimbursement of liabilities on equity swaps on own shares (Note 16.5)	(84,304,307)	
Leases and other loans obtained	(313,336)	(300,432)
	(1,479,439,187)	**(401,069,290)**

(h) Cash and cash equivalents

As at 31 December 2011 and 2010, this caption has the following composition:

Euro

	2011	**2010**
Cash	2,000	2,000
Bank deposits immediately available	467,615,335	825,829,437
	467,617,335	**825,831,437**

5. Changes in accounting policies and estimates and errors

The Company did not adopt any new or revised standard or interpretation during the year ended 31 December 2011, and did not voluntarily changed other accounting policies or accounting estimates.

During the year ended 31 December 2011, the Company did not adjust its financial statements for any material errors from previous years.

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6. Tangible fixed assets

During the years ended 31 December 2011 and 2010, movements occurred in tangible fixed assets were as follows:

Euro

2011

	Buildings and other constructions	Transportation equipment	Administrative equipment	Other tangible fixed assets	Total
Gross amount					
Opening balance	111,715	1,244,377	903,600	1,046,328	3,306,020
Acquisitions		218,299		18,450	236,749
Disposals		(160,016)			(160,016)
Closing balance	**111,715**	**1,302,660**	**903,600**	**1,064,778**	**3,382,753**
Accumulated depreciation					
Opening balance	111,715	726,203	884,791	91,454	1,814,163
Depreciation		238,876	4,955	16,108	259,939
Disposals		(140,013)			(140,013)
Closing balance	**111,715**	**825,066**	**889,746**	**107,562**	**1,934,089**
Carrying amount		**477,594**	**13,854**	**957,216**	**1,448,664**

Euro

2010

	Buildings and other constructions	Transportation equipment	Administrative equipment	Other tangible fixed assets	Total
Gross amount					
Opening balance	111,715	1,427,126	903,600	1,046,328	3,488,769
Acquisitions		312,396			312,396
Disposals		(494,920)			(494,920)
Transfers and write-offs		(225)			(225)
Closing balance	**111,715**	**1,244,377**	**903,600**	**1,046,328**	**3,306,020**
Accumulated depreciation					
Opening balance	111,715	909,266	875,843	70,574	1,967,398
Depreciation		241,216	8,948	20,880	271,044
Disposals		(424,054)			(424,054)
Transfers and write-offs		(225)			(225)
Closing balance	**111,715**	**726,203**	**884,791**	**91,454**	**1,814,163**
Carrying amount		**518,174**	**18,809**	**954,874**	**1,491,857**

7. Financial investments - equity method of accounting

During the years ended 31 December 2011 and 2010, the movements occurred in this caption were as follows:

Euro

2011

	Investments in subsidiary companies	Additional paid in capital contributions in subsidiary companies	Investments in associated companies	Goodwill in associated companies	Loans to associated companies	Advances for financial investments	Total
Gross amount							
Opening balance	2,594,005,201	7,358,387,500	(18,162,984)	61,419,919	36,637,234	92,000	10,032,378,870
Increases	112,213,029				2,228,328		114,441,357
Reductions	(55,388,568)	(2,002,050,000)			(1,101,596)		(2,058,540,164)
Equity method	(302,717,114)		1,161,934				(301,555,180)
Dividends	(38,958,626)						(38,958,626)
Other	(131,171,345)					(60,000)	(131,231,345)
Closing balance	**2,177,982,577**	**5,356,337,500**	**(17,001,050)**	**61,419,919**	**37,763,966**	**32,000**	**7,616,534,912**
Impairment losses							
Opening balance			1,995,191		2,588,740		4,583,931
Closing balance			**1,995,191**		**2,588,740**		**4,583,931**
Carrying amount	**2,177,982,577**	**5,356,337,500**	**(18,996,241)**	**61,419,919**	**35,175,226**	**32,000**	**7,611,950,981**

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Euro

2010

	Investments in subsidiary companies	Additional paid in capital contributions in subsidiary companies	Investments in associated companies	Goodwill in associated companies	Loans to associated companies	Advances for financial investments	Total
Gross amount							
Opening balance	1,623,606,017	8,002,681,610	60,965,284	98,569,274	38,423,199	32,000	9,824,277,384
Increases	60,858,963					60,000	60,918,963
Reductions	(22,102,331)	(644,294,110)			(1,785,965)		(668,182,406)
Equitymethod	2,687,270,878		12,956,455				2,700,227,333
Dividends	(1,755,618,507)		(128,619)				(1,755,747,126)
Other	(9,819)		12,178	4,918,181			4,920,540
Non-current assets held for sale			(91,968,282)	(42,067,536)			(134,035,818)
Closing balance	**2,594,005,201**	**7,358,387,500**	**(18,162,984)**	**61,419,919**	**36,637,234**	**92,000**	**10,032,378,870**
Impairment losses							
Opening balance			1,995,191		2,588,740		4,583,931
Increases				2,196,182			2,196,182
Non-current assets held for sale				(2,196,182)			(2,196,182)
Closing balance			**1,995,191**		**2,588,740**		**4,583,931**
Carrying amount	**2,594,005,201**	**7,358,387,500**	**(20,158,175)**	**61,419,919**	**34,048,494**	**92,000**	**10,027,794,939**

a) Increases

In the years ended 31 December 2011 and 2010, increases in financial investments recorded by the equity method of accounting, including goodwill and loans granted to associated companies, were as follows (Note 4):

Euro

	2011	**2010**
Share capital increases at PT Brasil	75,534,487	60,854,909
Share capital increase at Bratel Brasil (a)	36,678,542	
Additional paid in capital contributions granted to Yunit	2,228,328	
Advances for a share capital increase at PT Ásia		60,000
Incorporation of TMM		4,054
	114,441,357	**60,918,963**

(a) On 27 January 2011, the Company subscribed 83,964,486 ordinary shares of Bratel Brasil for an amount of 83,964,518 Brazilian Real, as the remaining shareholders of this company relinquished its right of preference in this capital increase. As a result of this operation, Portugal Telecom obtained a direct stake of approximately 1.01% of Bratel Brasil. This subsidiary was used by the Group to realize the investment in Oi, being, indirectly, fully controlled by Portugal Telecom.

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b) Reductions

In the years ended 31 December 2011 and 2010, reductions in financial investments recorded by the equity method of accounting were as follows:

Euro

	2011	**2010**
Reimbursement of additional paid in capital contributions (Note 4):		
PT Portugal	1,992,950,000	635,000,000
PT II	9,100,000	
PT Participações		6,674,110
PT Compras		2,620,000
	2,002,050,000	**644,294,110**
Reductions in investments in subsidiarycompanies:		
Disposal of Bratel Brasil (a)	36,638,569	
Share capital reduction at Africatel (Note 4)	18,750,000	22,089,308
Disposal of PT Prime Tradecom		13,023
	55,388,569	**22,102,331**
Reimbursement of loans granted (Note 4):		
Sportinveste	1,000,000	1,700,000
INESC	101,595	85,965
	1,101,595	**1,785,965**
	2,058,540,164	**668,182,406**

(a) On 9 September 2011, the Company disposed of the 1.01% stake held in this subsidiary as a result of the share capital increase subscribed in January 2011, as mentioned above. Portugal Telecom disposed of this investment to Bratel BV, an entity, indirectly, fully controlled by the Company, for a total cash consideration of Euro 36,644,195 (Note 4), and recorded a capital gain of Euro 5,626 (Note 19).

c) Equity method of accounting

In the years ended 31 December 2011 and 2010, the movements occurred in investments in subsidiaries and associated companies resulting from the application of the equity method of accounting were recorded as follows:

Euro

	2011	**2010**
Gains in affiliated companies (Note 19)	90,759,112	3,219,380,548

Adjustments to financial assets (Note 14)	(392,314,292)	(519,153,215)
	(301,555,180)	**2,700,227,333**

d) Dividends attributed

The detail of dividends attributed by subsidiaries and associated companies in the years ended 31 December 2011 and 2010 is as follows (Note 4):

Euro

	2011	**2010**
PT Participações	25,000,000	
PT Finance BV	12,160,033	2,254,047
PT Centro Corporativo	1,798,593	2,014,150
PT Portugal (a)		1,751,350,311
UOL		128,618
	38,958,626	**1,755,747,126**

(a) In 2010, this caption includes dividends amounting to Euro 471,350,311 related to the year ended 31 December 2009 and an advance on account of profits related to the year ended 31 December 2010 amounting to Euro 1,280,000,000.

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e) Other movements

In the year ended 31 December 2011, other movements occurred in the caption Investments in subsidiary companies , totalling Euro 131,171,345, include the following net effects:

- An amount of Euro 148,311,037 corresponding to the Company s share in the investment made by Oi for the acquisition of 64,557,566 Portugal Telecom s shares, which was deducted from the financial investment in Oi, which is reflected in the Company´s Balance Sheet indirectly through the investment in PT Portugal, and recognized as treasury shares (Note 14.2);

- An amount of Euro 20,646,929 (Note 14.6), corresponding to the portion of dividends paid by Portugal Telecom related to the shares held by Oi that are classified in the Company´s Balance Sheet as treasury shares, since the payment of those dividends resulted in a reduction of the caption Cash and bank deposits and an increase in the financial investment in Oi as a result of the dividends received by this entity;

- An amount of Euro 3,512,719 (Note 14.6) corresponding to the portion of dividends attributed by Portugal Telecom in December 2011 related to the shares held by Oi; and

- An amount of Euro 7,019,956 corresponding to the income tax paid by Oi on dividends received from Portugal Telecom, which was recognized directly in shareholders equity.

In the year ended 31 December 2010, other movements in investments in subsidiaries and associated companies relate to the disposal of a 35.65% stake in PT Prime Tradecom, following which Portugal Telecom s interest decreased to 33,33% and, accordingly, this entity became an associate company instead of a subsidiary. In 2010, other movements occurred in goodwill related to associated companies, in the amount of Euro 4,918,181 (Note 14.5), correspond to the impact of foreign currency translation adjustments on goodwill related to the acquisition of the investment in UOL, which was disposed of in January 2011, as mentioned above.

f) Non-current assets held for sale

Non-current assets held for sale in the year ended 31 December 2010, amounting to a net value of Euro 131,839,636, relate to the total investment in UOL, and were reclassified to an independent caption in current assets following an offer received in December 2010 for the disposal of the 28.78% stake held by the Group in UOL, for a total amount of 356 million Brazilian Real. Consequently, the investment in UOL as at 31 December 2010 was adjusted to its recoverable amount, corresponding to the amount to be obtained with this sale, and was classified as a non-current asset held for sale.

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The disposal of the 28.78% stake in UOL, including the 21.95% and 6.83% stakes held as at 31 December 2010 by Portugal Telecom and PT Brasil, respectively, was completed in January 2011. As a result of these operations:

- The Group received a total amount of Euro 155,549,986, having Portugal Telecom received Euro 119,327,361 (Note 4);

- Portugal Telecom recognized a total gain of Euro 11,892,743 (Note 19), which includes a gain of Euro 21,384,507 (Note 14.5) corresponding to cumulative foreign currency translation adjustments relating to this investment, which were transferred from the caption Currency translation adjustments to profit and loss on the date that the Group completed this disposal (27 January 2011).

g) Goodwill

As at 31 December 2011 and 2010, goodwill amounting to Euro 61,419,919 was initially recorded in 2002 as a result of the acquisition of the investment in associated company Páginas Amarelas.

8. Related parties

8.1. Balances with Group companies

As at 31 December 2011 and 2010, the captions Balances with Group companies included in current and non-current assets and in current liabilities have the following composition:

Euro

	2011	2010
DEBIT BALANCES		
Non-Current		
Loans granted (a)	906,273,575	928,190,728
Total non-current	**906,273,575**	**928,190,728**
Current		
Intercompany loans granted within centralized cash management (b)	720,800,192	709,733,815
Accounts receivable within tax consolidation (c)	16,546,759	42,194,843
Other	11,152,830	37,390,297
Total current	**748,499,781**	**789,318,955**
Total	**1,654,773,356**	**1,717,509,683**
CREDIT BALANCES		
Current		

Accounts payable within tax consolidation (c)	50,211,430	2,940,076
Dividends attributed (d)	189,123,747	756,268
Other	2,101,483	14,468,975
Total current	**241,436,660**	**18,165,319**

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(a) As at 31 December 2011 and 2010, non-current loans granted have the following composition:

Euro

	2011	2010
PT Portugal (Note 4)	572,200,000	572,200,000
Africatel (i)	334,061,209	353,750,426
TMM (ii)	12,366	11,974
Yunit		2,228,328
	906,273,575	**928,190,728**

(i) The original currency of this loan granted to Africatel is the U.S. Dollar. During the year ended 31 December 2011, the change in the outstanding balance includes a reimbursement of Euros 27,600,000 (Note 4) and foreign currency translation gain of Euro 7,910,783 (Note 25). During the year ended 31 December 2010, there was no reimbursement and foreign currency translation adjustments amounted to a gain of Euro 24,080,096 (Note 25).

(ii) During the year ended 31 December 2010, the company granted a loan to this subsidiary for an amount of U.S. Dollar 16,000, equivalent to Euro 12,116 (Note 4) on the transation date.

(b) As at 31 December 2011 and 2010, the detail of loans granted under the centralized cash management system in order to meet short-term needs, is as follows:

Euro

	2011	2010
PT Comunicações	590,122,803	571,950,141
PT Portugal	93,310,445	7,577,894
PT Contact	18,512,710	22,410,232
PT Inovação	7,155,320	24,495,250
PT Centro Corporativo	5,763,119	9,064,617
PT II	2,551,425	
PT Sales	1,416,591	13,166,254
PT SI	188,908	2,678,784
PT Compras	175,279	508,469
PT Participações	85,537	304,450
PT Móveis	78,359	
PT PRO	63,525	
TMN		43,577,541
PT Prime		13,410,666
Other	1,376,171	589,517
	720,800,192	**709,733,815**

(c) As at 31 December 2011 and 2010, the net balance of these captions include mainly: (1) income taxes payable by the companies included in the tax consolidation regime, amounting to Euro 112,105,540 and Euro 156,507,985, respectively, (2) payments on account made by these companies, amounting to Euro 127,749,302 and Euro 115,729,188 (Note 4), respectively, (3) income taxes payable to subsidiaries related to withholding tax credits, in the amounts of Euro 12,532,333 and Euro 1,524,030, respectively; and (4) an amount of Euro 5,488,576 payable to subsidiaries as at 31 December 2011 related to the tax benefits for the year 2010 associated with the investment program SIFIDE.

(d) This caption includes mainly an amount of Euro 188,312,588 (Note 14.6) related to the dividends attributed by Portugal Telecom to its shareholders, as approved by the Board of Directors on 15 December 2011. This amount was paid to the shareholders on 4 January 2012.

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8.2. Financial investments in subsidiaries and associated companies

As mentioned in Note 1, Portugal Telecom is the parent company of the Group. Consequently, all companies included in the Group were considered as related parties.

As at 31 December 2011 and 2010, the detail of Portugal Telecom s financial investments in its subsidiaries and associated companies is as follows (Notes 7, 15 and 19):

Euro

	2011				2010				
Company name	**% held**	**Financial investments**	**Addicional paid-in capital**	**Share on net income**	**% held**	**Financial investments**	**Addicional paid-in capital**	**Provision for financial investments**	**Share on net income**
SUBSIDIARIES:									
PT Portugal	100.00%	1,120,296,314	5,306,050,000	(61,466,362)	100.00%	1,691,887,990	7,299,000,000		3,072,275,871
PT Brasil	99.99%	231,944,793		14,484,623	99.99%	155,277,905			631,938
PT Ásia (a)					99.84%			(55,295)	
Portugal Telecom Europa (b)	98.67%	169,373			98.67%	169,373			
PT Participações	100.00%	48,589,561		23,701,064	100.00%	50,115,307			20,831,157
Africatel (c)	75.00%	530,963,906	1,687,500	84,713,457	75.00%	464,382,930	1,687,500		101,595,323
PT Imobiliária	100.00%	12,191,413		(410,840)	100.00%	12,602,254			(1,415,397)
Previsão Sociedade Gestora de Fundos de Pensões, S.A.	82.05%	2,271,718		(369,998)	82.05%	2,641,507			(829,754)
PT Finance	100.00%	275,550,300		21,774,620	100.00%	265,935,713			15,205,381
PT Compras	100.00%	(34,326,055)	35,500,000	993,060	100.00%	(35,319,115)	35,500,000		(45,342)
PT II	100.00%	(11,440,979)	13,100,000	4,139,362	100.00%	(15,580,341)	22,200,000		6,123,755
PT Centro Corporativo	100.00%	1,768,178		1,679,147	100.00%	1,887,624			1,798,594
Bratel Brasil (d)				669,437					
TMM (b)	100.00%	4,055			100.00%	4,054			
		2,177,982,577	**5,356,337,500**	**89,907,570**		**2,594,005,201**	**7,358,387,500**	**(55,295)**	**3,216,171,526**
ASSOCIATED COMPANIES:									
Páginas Amarelas	24.88%	6,321,405		943,301	24.88%	5,378,105			846,336
SGPICE (e)					22.22%				1,055,024
UOL (f)					21.95%				10,431,091
Sportinveste (g)	50.00%	(25,668,975)	30,023,168	(108,645)	50.00%	(25,560,330)	30,023,168		(8,181,581)
INESC (h)	26.36%	1,995,192			26.36%	1,995,192			
Yunit	33.33%	351,318	2,228,328	16,886	33.33%	24,039			113,176
Multicert (b)		10				10			
		(17,001,050)	**32,251,496**	**851,542**		**(18,162,984)**	**30,023,168**		**4,264,046**
		2,160,981,527	**5,388,588,996**	**90,759,112**		**2,575,842,217**	**7,388,410,668**	**(55,295)**	**3,220,435,572**

(a) This company was liquidated during the year ended in 31 December 2011.

(b) These companies are not engaged in any activity.

(c) 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.

(d) As explained in Note 7, the Company acquired, on 27 January 2011, a 1.01% stake in this subsidiary, trough the subscription of a capital increase, and sold this same investment to a Group company on 9 September 2011.

(e) This company was disposed of in 2010.

(f) As mentioned in Note 7, the investment in UOL was classified as at 31 December 2010 under the caption Non- current assets held for sale and was disposed of in January 2011.

(g) The shareholders equity of this company includes additional paid-in capital contributions amounting to Euro 46,165,181, of which Euro 30,023,168 were granted by Portugal Telecom.

(h) This investment is fully adjusted for.

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The main financial information regarding the above entities, except for those which have no activity or are fully adjusted for, is as follows:

Euro

[redacted]

SUBSIDIARIES:											
PT Portugal	Av. Fontes Pereira de Melo, nº 40 - Lisbon	11,923,612,320	5,497,266,006		(61,466,362)	6,426,346,314	11,564,076,966	2,573,188,976		3,072,275,87
PT Brasil	R.Sampaio Viana, 277-5º Paraíso - S.Paulo, Brazil	259,544,085	27,576,095		14,486,072	231,967,990	195,669,112	40,375,678		632,00
PT Participações	Av. Fontes Pereira de Melo, nº 40 - Lisbon	237,866,340	189,276,779		23,701,064	48,589,561	236,530,489	186,415,182		20,831,15
Africatel	Naritaweg 165, Telestone 8, 1043 BW Amsterdam, Netherlands	1,072,352,683	362,150,808	490,593	112,951,275	710,201,875	1,013,928,290	392,501,049	429,192	135,460,43
PT Imobiliária	R. Tenente Espanca, nº 35 - Lisbon	13,251,451	1,060,038	497,812	(410,840)	12,191,413	13,731,500	1,129,247		(1,415,39
Previsão Sociedade Gestora de Fundos de Pensões, S.A.	R. Entrecampos, nº 28 - Lisbon	3,810,297	1,041,564	250,000	(450,948)	2,768,733	4,850,517	1,631,091	1,990,814	(1,011,29
PT Finance	Strawinkylaan 3105, 7º floor - Amsterdam, Netherlands	7,168,875,729	6,893,325,429		21,774,620	275,550,300	5,845,035,220	5,579,099,507		15,205,38
PT Compras	R. Entrecampos, nº 28 - Lisbon	3,928,576	2,754,631	1,748,877	993,060	1,173,945	2,990,495	2,809,610		(45,34
PT II	Av. Fontes Pereira de Melo, nº 40 - Lisbon	10,073,237	8,414,216	12,348,326	4,139,362	1,659,021	13,173,092	6,553,433	12,348,326	6,123,75
PT Centro Corporativo	Av. Fontes Pereira de Melo, nº 40 - Lisbon	31,857,143	30,088,965	62,363,365	1,679,147	1,768,178	32,673,187	30,785,563	62,363,365	1,798,59
ASSOCIATED COMPANIES:										
Páginas Amarelas	Av.Republica, 50, 6º - Lisbon	58,026,016	32,613,333	36,573,773	3,792,163	25,412,683	71,893,983	50,273,461	48,762,622	3,402,35
SGPICE	Rua Mouzinho da Silveira, 32, 7º - Lisbon									

UOL	São Paulo - Brazil						575,136,817	156,143,886	248,604,332	47,522,62
Sportinveste Multimédia,SGPS,SA	Lg. Lagoa, nº15 A Linda-a-Velha	36,166,719	25,385,022		(217,290)	10,781,697	41,152,940	30,153,952		(408,69
Yunit	Rua de Entrecampos nº 28, Lisbon	19,299,787	16,017,399	12,377,146	50,662	3,282,388	5,806,615	5,734,490	1,364,524	182,45

8.3. Balances and transactions with related parties

Besides the receivables and payables included under the captions Balances with Group companies , as detailed above, the Company has other receivables and payables with related parties included in other captions. The nature and detail of the main balances with related parties as at 31 December 2011 and 2010 are as follows:

Euro

2011

	Loans granted to associated companies	Shareholders and Group companies (debit balance) (a)	Other accounts receivable (b)	Total accounts receivable	Shareholders and Group companies (credit balance)	Loans obtained	Accounts payable and investment suppliers	Total accounts payable
SUBSIDIARIES:								
PT Portugal		665,510,445	22,109,887	**687,620,332**				
PT Comunicações		591,236,464	20,270,018	**611,506,482**	(39,247,567)		(86,902)	**(39,334,469)**
Africatel		334,061,209	14,769,532	**348,830,741**				
PT Contact		19,589,435	567,289	**20,156,724**				
TMN		9,282,847	24,501	**9,307,348**			(12,672)	**(12,672)**
PT Brasil		8,870,039	27,610	**8,897,649**			(959,370)	**(959,370)**
PT Inovação		7,513,979	537,487	**8,051,466**				
PT Centro Corporativo		6,490,055	546,699	**7,036,754**			(317,504)	**(317,504)**
PT Participações		3,425,574	57,664	**3,483,238**			(274)	**(274)**
PT II		3,240,535	42,527	**3,283,062**				
PT Sales		1,647,153	190,776	**1,837,929**				
PT Pro		1,380,215	37,432	**1,417,647**				
PT Compras		704,832	18,233	**723,065**				
PT SI		269,947	38,827	**308,774**	(1,507,911)		(1,112)	**(1,509,023)**
PT Móveis		78,359	35,134	**113,493**	(7,823,079)			**(7,823,079)**
Other companies		1,424,622	17,922	**1,442,544**	(1,632,873)		165,146	**(1,467,727)**
ASSOCIATED COMPANIES:								
Sportinveste	2,595,500		23,079	**2,618,579**				
INESC	2,916,971			**2,916,971**				
Páginas Amarelas (Note 24)							(4,487,449)	**(4,487,449)**
Other companies		47,646	148,864	**196,510**		(52,618)	(56,457)	**(109,075)**
	5,512,471	**1,654,773,356**	**59,463,481**	**1,719,749,308**	**(50,211,430)**	**(52,618)**	**(5,756,594)**	**(56,020,642)**

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Euro

2010

	Loans granted to associated companies	Shareholders and Group companies (debit balance) (a)	Other accounts receivable (b)	Total accounts receivable	Shareholders and Group companies (credit balance)	Loans obtained	Accounts payable and investment suppliers	Total accounts payable
SUBSIDIARIES:								
PT Comunicações		586,344,181	1,226,907	**587,571,088**	(9,558,279)		(14,145)	**(9,572,424)**
PT Portugal		579,777,894	4,044,032	**583,821,926**				
Africatel		362,986,357	16,394,374	**379,380,731**				
TMN		58,791,478	577,378	**59,368,856**	(1,363,200)			**(1,363,200)**
PT Prime		32,912,516	89,032	**33,001,548**	(598,800)			**(598,800)**
PT Inovação		24,495,250	56,596	**24,551,846**	(743,543)			**(743,543)**
PT Contact		23,829,845	41,517	**23,871,362**	(423,000)			**(423,000)**
PT Sales		13,385,329	15,597	**13,400,926**	(88,800)			**(88,800)**
PT Centro Corporativo		9,324,779	309,136	**9,633,915**	(86,400)		126,688	**40,288**
PT Brasil		8,771,440	27,610	**8,799,050**	(102,022)		(1,032,569)	**(1,134,591)**
PT Móveis		7,579,895	101,235	**7,681,130**			(18,643)	**(18,643)**
PT SI		2,878,716	7,041	**2,885,757**	(1,043,476)			**(1,043,476)**
PT II		2,207,929	28,122	**2,236,051**	(20,598)		(381)	**(20,979)**
PT Participações		304,450	205	**304,655**	(2,435,972)		(1,006)	**(2,436,978)**
Other companies		1,539,666	21,326	**1,560,992**	(776,961)	(137,101)	(8,640)	**(922,702)**
ASSOCIATED COMPANIES:								
Sportinveste	3,595,500		21,978	**3,617,478**				
INESC	3,018,566			**3,018,566**				
Páginas Amarelas (Note 24)							(8,518,621)	**(8,518,621)**
Other companies		2,379,958	302,643	**2,682,601**	(168,000)		(46,304)	**(214,304)**
	6,614,066	**1,717,509,683**	**23,264,729**	**1,747,388,478**	**(17,409,051)**	**(137,101)**	**(9,513,621)**	**(27,059,773)**

(a) As mentioned above, debit balances with shareholders and group companies are mainly related to loans granted and accounts receivable from the tax consolidation regime.

(b) This caption includes, primarily, financial expenses from subsidiaries, namely, interest expenses from loans granted.

In the years ended 31 December 2011 and 2010, the nature and detail of the main transactions with related parties are as follows:

Euro

	2011				**2010**			
	Net interest and related income	Supplies and external services	Recorevy of costs of wages and salaries	Other operacional income (expenses)	Net interest and related income	Supplies and external services	Recorevy of costs of wages and salaries	Other operacional income (expenses)
SUBSIDIARIES:								
Africatel	45,816,928			(524,916)	65,754,134			1,982,717
PT Comunicações	27,687,861	(332,038)	(153,713)		7,193,140	(6,398)	253,124	

PT Portugal	26,790,302				4,564,976			
PT Contact	751,461		(1,800)		111,103		89,887	
PT Centro Corporativo	444,884	(1,423,331)	1,517,536		104,376	(2,304,508)	1,825,942	
PT Sales	261,485				119,899			
TMN	21,829				2,540,874			
PT Prime					291,238			
Other companies	954,259	(3,007)	299,558	171,798	163,339		369,581	114,257
ASSOCIATED COMPANIES:								
Sportinveste	87,242				93,676		(4,354)	
Paginas Amarelas (Note 24)				(4,203,213)				(8,518,621)
Fundação PT			94,736				96,223	1,369,500
Other companies	150,386		(43,510)	381	140,276			(220)
	102,966,637	**(1,758,376)**	**1,712,807**	**(4,555,950)**	**81,077,031**	**(2,310,906)**	**2,630,403**	**(5,052,367)**

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Some of the major shareholders of Portugal Telecom are financial institutions and, in the ordinary course of business, Portugal Telecom and its subsidiaries entered into various transactions with those entities. In addition, Visabeira (a service provider of Portugal Telecom s wireline business) and Controlinveste (a media content provider) are also major shareholders of Portugal Telecom. Transactions occurred during the year ended 31 December 2011 and balances on that date between Group companies and its major shareholders are as follows (including VAT):

Euro

Company	**Revenues and gains (a)**	**Costs and losses (a)**	**Accounts receivable**	**Accounts payable**
Caixa Geral de Depósitos	54,171,401	11,185,302	5,610,759	506,281
BES	107,846,541	31,849,608	3,348,902	
Visabeira	6,251,177	97,957,253	2,497,519	12,643,673
Controlinveste	2,696,760	50,994,482	236,228	8,212,821
Ongoing	1,114,823	3,337,710	379,247	366,677
Barclays	407,638	10,368,511	177,504	
	172,488,340	**205,692,866**	**12,250,159**	**21,729,452**

(a) Revenues and gains include sales and services rendered by Portugal Telecom and interest received on bank deposits, while costs and losses include supplies and external services provided to Portugal Telecom and interest paid on financing agreements and equity swaps.

The terms and contractual conditions in agreements entered into by Portugal Telecom and shareholders are similar to those applicable to other independent entities in similar transactions.

8.4. Other information

During the years ended 31 December 2011 and 2010, fixed remunerations board members, which were established by the Remunerations Committee, amounted to Euro 5.32 million and Euro 6.68 million, respectively.

Under the terms of the remuneration policy established by the Remunerations Committee, executive board members are entitled to receive: (i) annual variable remuneration (AVR) related to the performance achieved in the year and payable in the following year, except for the amount in excess of 50% of the total variable remuneration attributed in the year, which payment is deferred for a period of 3 years, and (ii) variable remuneration related to the medium term performance (VRMT), which payment is deferred for a period of 3 years. In 2011, the annual variable remuneration of 2010 paid to the five executive board members amounted to Euro 2.34 million, and in 2010, the annual variable remuneration of 2009 paid to the seven executive board members amounted to Euro 3.52 million. In 2011 and 2010, there were no payments related to the VRMT and, under the terms of the approved remuneration policy of executive board members, the deferred payment of AVR and VRMT amounted to Euro 4.28 million as at 31 December 2011, which is conditional on the positive performance of the Company under the terms of the remuneration policy in place. On an annual basis, Portugal Telecom recognizes an accrual for the variable remunerations.

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Following the recommendation of some shareholders at the 2011 annual general meeting and based on a proposal of the Evaluation Committee, the Remunerations Committee approved an extraordinary variable remuneration payable to the Chairman and five executive board members regarding their performance under the Vivo transaction (Note 1) and the acquisition of a strategic investment in Oi and Contax (Note 1). Under the terms of the remuneration policy of board members, in 2011, the chairman and five executive board members were paid 50% of the above mentioned extraordinary variable remuneration amounting to Euro 2.55 million, and the payment of the remaining 50% was deferred for a period of 3 years, which is conditional on the positive performance of the Company under the terms of the remuneration policy in place. Following the Vivo transaction and based on a board of directors recommendation, the executive committee approved in December 2010 the payment to the majority of Portugal Telecom s employees of an extraordinary variable remuneration totaling Euro 14 million.

Additionally, in connection with the strategic partnership entered into with Oi and Contax, six of Portugal Telecom s board members perform executive duties in these companies (entities jointly controlled by Portugal Telecom), having received in 2011 a total fixed compensation of Euro 1.21 million, which was established by the competent corporate bodies in accordance with local legislation.

In addition to the above mentioned remunerations, executive board members are also entitled to fringe benefits that are primarily utilized in their daily functions, in accordance with a policy defined for the Group. As at 31 December 2011, there were no board members entitled to post retirement benefits under the plans of PT Comunicações and there was not in place any share based payment program or termination benefit.

For additional information regarding the remunerations of board members and key employees, please read the Corporate Governance Report included in the Consolidated Annual Report 2011.

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9. Other financial assets and liabilities

As at 31 December 2011 and 2010, these captions include the fair value of derivative financial instruments entered into by the Company and have the following composition:

Euro

	2011	2010
OTHER FINANCIAL ASSETS		
Non-Current		
Currency swap with exchange and interest rate components		639,422
Other	500	3,820
Total non-current	**500**	**643,242**
OTHER FINANCIAL LIABILITIES		
Non-Current		
Interest rate swaps:		
Cash flow hedges	6,269,645	2,134,355
Held for trading	465,805	1,262,004
Currency swap with exchange and interest rate components	1,796,673	408,693
Total non-current	**8,532,123**	**3,805,052**

The Company 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 signed 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 a preliminary approval by 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 2011, 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 of loans obtained.

As detailed in the table above, these instruments are classified in the following categories:

- **Cash flow hedges**

Changes in fair value of cash flow hedges are recorded directly in shareholders equity under the caption Other reserves , and amounted to losses of Euro 4,135,290 in 2011 and Euro 141,386 in 2010 (Note 14). As at 31 December 2011 and 2010, the nominal value of these instruments amounted to Euro 163.6 million and Euro 205.8 million, respectively, with maturities between 0.2 and 2.0 years and between 0.7 and 2.5 years, respectively;

- **Held for trading**

Changes in fair value of swaps held for trading are recorded in earnings under the caption Increases/(reductions) in fair value and amounted to gains of Euro 769,199 in 2011 and

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Euro 949,947 in 2010 (Note 22). As at 31 December 2011 and 2010, the nominal value of these instruments amounted to Euro 14.5 million and Euro 24.4 million, respectively, with an average maturity of 0.7 and 1.2 years, respectively.

Interest rate and foreign currency exchange risk

As at 31 December 2010, 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 11 million American Dollars. The fair value of this instrument was included in the Balance Sheet under the same caption as the related loan obtained, while the change in its fair value was recognized on a net basis together with the interest and the foreign currency exchange rate fluctuation of the related loan. The loan and the currency swap were paid in December 2011, in the maturity of both instruments.

In 2010, Portugal Telecom and PT Finance (subsidiary company) entered into two currency swap contracts with exchange and interest rate components, in order to eliminate the exposure of PT Finance to the risk of exchange rate fluctuations in loans denominated in U.S. Dollars. Considering that the purpose of these derivatives is to hedge risk in PT Finance, they were classified by the Company as held for trading and their fair value was recognized under the captions of other financial assets and liabilities, as detailed in the table above. Changes in the fair value of these instruments were recognized in earnings under the caption Increases/(reductions) in fair value , and amounted to a loss of Euro 605,543 in 2011 and a gain of Euro 230,729 in 2010 (Note 22). In 2011, the Company settled one of these instruments for an amount of Euro 1,421,859, and subsequently entered into a new instrument with the same features, which is outstanding as at 31 December 2011. Both transactions were performed as the financing associated with the first derivative financial instrument was repaid and a new financing has been subsequently contracted with the same features.

10. Income taxes

10.1. Introduction

As from 1 January 2010, following a change in tax legislation, the Company is subject to Corporate Income Tax at a rate of 25%, which is increased up to a maximum of 1.5% of taxable income through a municipal tax and by a 2.5% state surcharge applicable to taxable income in excess of Euro 2 million, leading to a maximum aggregate tax rate of approximately 29.0% . For the years 2012 and 2013, the Company will be subject to corporate income tax at a rate of 25%, which is increased (1) up to a maximum of 1.5% of taxable income through a municipal tax, and

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(2) by a 3.0% and 5.0% state tax applicable on taxable income between Euro 1.5 million and Euro 10.0 million and on taxable income in excess of Euro 10.0 million, respectively.

Portugal Telecom s taxable income in 2011 did not exceed Euro 2 million, and accordingly the Company applied the aggregate tax rate of 26.5% to compute its current income tax estimate. In addition, based on its expectations regarding the standalone taxable income in future years, the Company changed the tax rate used to recognize deferred taxes from 26.5% to 25.0% .

Income taxes are computed based on the tax rate mentioned above and are determined on the basis of profit before-tax adjusted in accordance with tax legislation.

In the year ended 31 December 2011, the Company s taxable income was estimated in accordance with the special taxation regime for groups of companies (tax consolidation), including the following companies: PT Comunicações, S.A.; TMN Telecomunicações Móveis Nacionais, S.A.; PT Contact Telemarketing e Serviços de Informação, S.A.; PT Imobiliária, S.A.; PT Inovação, S.A.; PT Móveis, SGPS, S.A.; PT Pro - Serviços Administrativos e de Gestão Partilhados, S.A.; PT-Sistemas de Informação, S.A.; PT Compras - Serviços de Consultoria e Negociação, S.A.; PT Participações SGPS, S.A.; PT Investimentos Internacionais Consultoria Internacional, S.A.; PT Prestações Mandatária de Aquisições e Gestão de Bens, S.A.; PT Portugal, SGPS, S.A.; PT Sales, S.A.; PT Centro Corporativo, S.A.; Infonet Portugal Serviços de Valor Acrescentado, Lda; and Openidea, Tecnologias de Telecomunicações e Sistemas de Informação, S.A.

In accordance with the prevailing legislation, tax returns are subject to review and correction by the tax authorities during a period of four years (five years for Social Security), except where there have been tax losses, tax 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 tax 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 2011, considering the provisions recorded and the current expectations of settlement of the tax contingencies described in Note 15.

10.2. Deferred taxes

In determining income tax expense for the year, besides the current tax based on profit before-tax adjusted in accordance with tax legislation, it is also considered the effects of temporary differences between the tax and accounting bases of assets and liabilities, arising in the year or in previous years.

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Movements occurred in deferred tax assets during the years ended 31 December 2011 and 2010 were as follows:

Euro

2011

	Financial instruments	**Tax losses carryforward**	**Other temporary differences**	**Total**
Opening balance	4,439,337		1,432,146	**5,871,483**
Increases (reductions)				
Net income	(1,095,823)	115,703,314		**114,607,491**
Shareholders equity (Note 14.4)	1,095,853			**1,095,853**
Utilizations				
Change in the statutory tax rate				
Net income	(157,239)		(81,065)	**(238,304)**
Shareholders equity (Note 14.4)	(94,045)			**(94,045)**
Closing balance	**4,188,083**	**115,703,314**	**1,351,081**	**121,242,478**

Euro

2010

	Financial instruments	**Tax losses carryforward**	**Other temporary differences**	**Total**
Opening balance	5,538,435		3,715,392	**9,253,827**
Increases (reductions)				
Net income	(1,136,565)		(2,283,246)	**(3,419,811)**
Shareholders equity (Note 14.4)	37,467			**37,467**
Closing balance	**4,439,337**		**1,432,146**	**5,871,483**

Changes in deferred tax assets recorded in shareholders equity under the caption Other reserves (Note 14.4) correspond to the tax effect associated with the change in the fair value of interest rate derivatives classified as cash flow hedges.

Deferred tax assets related to tax losses recorded in 2011 resulted from the tax loss recognized in the year by Portugal Telecom s tax consolidation. In accordance with current tax legislation, tax losses can be used during the five years following the year in which they were generated, with a limit of 75% of taxable income in each year. Given the estimated tax results of Group companies for the next five years, the Company believes that these deferred tax losses are recoverable.

Deferred tax liabilities amounting to Euro 14,286,361 and Euro 15,143,542 Euros as at 31 December 2011 and 2010, respectively, correspond to the tax effect associated with the equity component of the exchangeable bonds issued by Portugal Telecom in 2007 (Note 14.4). The change in the period, amounting to Euro 857,181, relates to the impact of the change in the tax rate applied for the calculation of deferred taxes and was recorded directly in shareholders equity.

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10.3. Tax rate reconciliation

In the years ended 31 December 2011 and 2010, the reconciliation between the expected tax computed by applying the nominal tax rate to income before taxes and the total income tax is as follows:

Euro

	2011	2010
Income before taxes	**212,340,316**	**5,096,651,892**
Nominal tax rate	26.5%	26.5%
Expected tax	**56,270,184**	**1,350,612,751**
Tax loss used in connection with RETGS	(115,703,314)	
Permanent differences (a)	(50,768,276)	(1,381,342,137)
Current income tax from previous years	(11,868,507)	(2,288,180)
Disposal of UOL (b)	3,962,755	
Municipal tax (c)	(6,096,623)	
Reversal of deferred taxes from previous years		3,243,600
Other	(5,715,724)	1,730,970
	(129,919,505)	**(28,042,996)**
Income tax		
Income tax-current (d)	(15,550,318)	(31,462,807)
Deferred tax	(114,369,187)	3,419,811
	(129,919,505)	**(28,042,996)**

(a) Permanent differences are as follows:

Euro

	2011	2010
Equity method of accounting (Note 19)	(90,759,112)	(3,220,435,572)
Gain related to the tax consolidation regime (Note 19)	(101,610,391)	(84,844,358)
Financial costs non deductible for tax purposes (i)	653,679	40,393,426
Provisions and adjustments not deductible for tax purposes	503,653	10,278,625
Recognition of deferred capital gains (Note 19)		(1,968,377,000)
Non-deductible operating expenses		5,360,000
Non deductible losses on investments in associated companies (Note 19)		2,196,182
Other	(366,228)	2,816,860
	(191,578,399)	**(5,212,611,837)**
Nominal tax rate	26.50%	26.50%
	(50,768,276)	**(1,381,342,137)**

(i) In 2011, the reduction in this caption is explained mainly by decreased in Company s debt and, consequently, the respective costs of financing.

(b) This caption corresponds to the difference between (1) the tax paid by the Company in Brazil under the disposal of the investment in UOL, amounting to Euro 7,114,332 (Note 4), and (2) the tax effect of Euro 3,151,577 related to the gain recorded under this transaction, amounting to Euro 11,892,743 (Note 19), determined based on the nominal tax rate in Portugal (26.5%).

(c) This caption corresponds to the effect of municipal tax on losses recorded by subsidiaries included in the tax consolidation of Portugal Telecom, to the extent that such losses were recorded on a standalone bases at a rate of 25.0%, in accordance with the tax legislation, but are recovered at a rate of 26.5% in the tax consolidation.

(d) This caption includes: (1) income tax of the current year corresponding to gains of Euro 3,681,881 in 2011 and Euro 29,174,626 in 2010; (2) adjustments to income taxes from previous years amounting to gains of Euro 11,868,507 in 2011 and Euro 2,288,180 in 2010; and (3) income tax paid in Brazil in 2011 in relation to the disposal of UOL shares, amounting to Euro 7,114,332, as mentioned above.

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11. State and other public entities

As at 31 December 2011 and 2010, the balances with these entities were as follows:

Euro

	2011		2010	
	Debit balances	**Credit balances**	**Debit balances**	**Credit balances**
Corporate income taxes	56,556,902	37,039	5,035,070	1,307,801
Personnel income taxes		33,616		155,940
Value added tax	448,610		632,393	
Social security taxes		8,310		4,876
Other taxes		10,956		2,727
	57,005,512	**89,921**	**5,667,463**	**1,471,344**

12. Other accounts receivable

As at 31 December 2011 and 2010, the detail of this caption is as follows:

Euro

	2011	2010
OTHER ACCOUNTS RECEIVABLE		
Current		
Unbilled financial charges	59,264,575	24,631,565
Unbilled revenues (a)	10,166,620	10,166,620
Other accounts receivable	5,753,427	4,413,676
	75,184,622	**39,211,861**
Accumulated impairment losses	(4,100,532)	(4,100,532)
Total other accounts receivable	**71,084,090**	**35,111,329**

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

13. Deferrals

As at 31 December 2011 and 2010, the detail of this caption is as follows:

Euro

	2011	**2010**
PREPAID EXPENSES		
Current		
Interest and other financial expenses	6,959,663	1,840,028
Other	237,967	287,105
Total current prepaid expenses	**7,197,630**	**2,127,133**
DEFERRED INCOME		
Non-Current		
Capital gains in intra-Group transactions	4,859,760,864	4,859,760,864
Other	956,009	956,009
Total non-current deferred income	**4,860,716,873**	**4,860,716,873**

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The detail and movement of deferred capital gains recorded as a result of the disposal of financial investments to other Group companies are as follows:

Euro

	Balance 31 Dec 2009	Recognition in 2010 (Note 19)	Balance 31 Dec 2010 and 31 Dec 2011
TMN	3,925,688,137	(1,968,377,000)	1,957,311,137
PT Comunicações	2,363,130,109		2,363,130,109
PT Ventures	306,943,829		306,943,829
PT Inovação	120,592,746		120,592,746
PT Pro	67,321,604		67,321,604
PT SI	44,458,071		44,458,071
PT Sales	3,368		3,368
	6,828,137,864	**(1,968,377,000)**	**4,859,760,864**

Capital gains recorded as a result of the disposal of financial investments to other Group companies are recognized in earnings on the same proportion that goodwill or assets and liabilities identified under the purchase price allocation are recognized in net income by the acquirers or by the disposal of the investment. Both the recognition of capital gains and the effect of the recognition of goodwill, indirectly through the equity method of accounting, are included under the caption Equity in earnings (losses) of affiliated companies (Note 19). Following the disposal of Vivo, completed in September 2010, the Company recognized part of the capital gain related to the disposal of TMN amounting to Euro 1,968,377,000, on the same proportion that goodwill was recognized in the income statement by PT Portugal.

14. Shareholders equity

14.1. Share capital

As at 31 December 2011, the Company s share capital was fully paid and amounted to Euro 26,895,375, and was represented by 896,512,000 ordinary shares and 500 Class A shares, with a nominal value of 3 cents of Euro each.

Following the General Shareholders Meeting of Portugal Telecom held on 26 July 2011, an amendment to the by-laws of the Company was approved, which resulted in the elimination of the special rights granted to the 500 Class A shares.

14.2. Treasury shares

As at 31 December 2011 and 2010, this caption includes equity swaps entered into by Portugal Telecom over 20,640,000 treasury shares, which were recognized as an effective acquisition of treasury shares, thus implying the recognition of a corresponding financial liability for the respective acquisition cost, amounting to Euro 178,071,826 (Note 16.5) .

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Additionally, as at 31 December 2011, this caption includes treasury shares that were acquired by Oi under the strategic partnership entered into with Portugal Telecom, under which it was envisaged the acquisition by Oi of up to 10% of the outstanding shares of Portugal Telecom. Up to 31 December 2011, Oi acquired 64,557,566 shares of Portugal Telecom, representing 7.2% of the share capital. The Company s hare in this investment, held indirectly through Bratel Brasil, was classified in the Balance Sheet as treasury shares and amounted to Euro 148,311,037 (Notes 1 and 7).

14.3. Legal reserve

Portuguese law provides that at least 5% of each annual profits must be appropriated to a legal reserve until this reserve equals the minimum requirement of 20% of share capital. This reserve is not available for distribution to shareholders but may be capitalized or used to absorb losses, once all other reserves and retained earnings have been exhausted.

As at 31 December 2011, the legal reserve was already fully incorporated in accordance with Portuguese law, and amounted to Euro 6,773,139.

14.4. Other reserves

As at 31 December 2011 and 2010, the detail of this caption is as follows:

Euro

	2011	**2010**
Free reserves	105,209,244	105,209,244
Conversion option of exchangeable bonds (a)	42,859,082	42,001,900
Reserves for treasury shares cancelled (b)	6,970,320	6,970,320
Reserve for concession	5,843,644	5,843,644
Interest rate swaps(c)	(4,702,234)	(1,568,751)
	156,180,056	**158,456,357**

(a) This caption corresponds to the fair value of the conversion option included in the exchangeable bonds issued by the Company (Note 16), amounting to Euro 57,145,442, net of the related tax effect amounting to Euro 14,286,361 and Euro 15,143,542 as at 31 December 2011 and 2010 (Note 10), respectively.

(b) This caption corresponds to a non-distributable reserve equivalent to the nominal value of the shares cancelled and has the same legal regime as the legal reserve. As at 31 December 2011 and 2010, this reserve related to shares cancelled on 20 December 2007, 24 March 2008 and 10 December 2008.

(c) This caption includes the effect of changes in fair value of interest rate swaps entered into by the Company that are classified as cash flow hedges, net of the related tax effect. During the years ended 31 December 2011 and 2010, changes in fair value that occurred in these financial instruments amounted to losses of Euro 4,135,290 and Euro 141,386 (Note 9), respectively, and its related tax effect amounted to Euro 1,095,852 and Euro 37,467 (Note 10), respectively. Additionally, a loss of Euro 94,045 was recognized under this caption related to the impact of the change in tax rate (Note 10).

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14.5. Adjustments to financial assets

During the years ended 31 December 2011 and 2010, the movements in this caption were as follows:

Euro

	Currency	**Other changes in**
&nbs		