BT is one of Europe's leading communications companies, offering high quality innovative voice, broadband, data, internet and wireless services. We aim to help our customers make the most of the unprecedented opportunities that are arising as communications technologies advance and develop.

We have announced our intention of forming two strong and separately listed companies, BT Wireless and Future BT, with the objective of further increasing our ability to build shareholder value.

British Telecommunications plc is a public limited company registered in England, with listings on the London, New York and Tokyo stock exchanges.

This is the annual report for the year ended 31 March 2001. It complies with UK regulations and is the annual report on Form 20-F for the Securities and Exchange Commission to meet US regulations.

This annual report has been sent to shareholders who have elected to receive a copy. A separate annual review and summary financial statement for the year ended 31 March 2001 has been issued to all shareholders.

Contents

In this annual report, references to the ''financial year'' are to the year ended 31 March of each year, e.g. the ''2001 financial year'' refers to the year ended 31 March 2001. Unless otherwise stated, all non-financial statistics are at 31 March 2001.

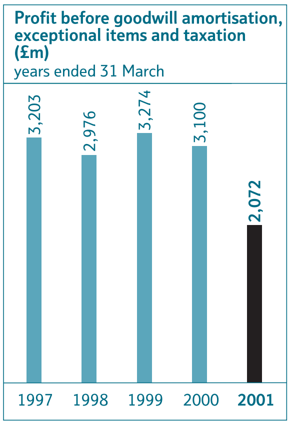
References to the ''company'' are to British Telecommunications public limited company, and references to ''BT'' or the ''group'' are to the company and its subsidiaries, or any of them as the context may require.

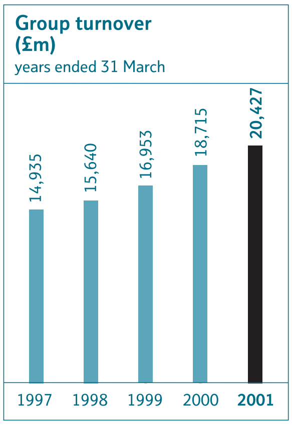
Please see cautionary statement regarding forward-looking statements on page 143

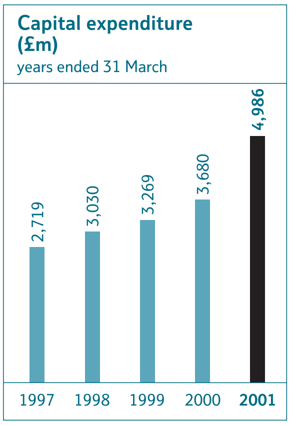
Financial headlines

Years ended 31 March	**2001**	2000	1999
Group turnover	**£20,427m**	£18,715m	£16,953m
Exceptional operating costs	**£2,857m**	£111m	£69m
Total operating profit (loss)	**£(336)m**	£3,198m	£3,474m
Profit on sale of fixed asset investments and group undertakings	**£619m**	£126m	£1,107m
Profit (loss) before taxation	**£(1,031)m**	£2,942m	£4,295m
Profit (loss) after taxation	**£(1,683)m**	£2,045m	£3,002m
Basic earnings (loss) per share	**(27.7)p**	31.7p	46.3p
Dividends per share	**8.7p**	21.9p	20.4p
Profit before goodwill amortisation, exceptional items and taxation	**£2,072m**	£3,100m	£3,274m
Basic earnings per share before goodwill amortisation and exceptional items	**20.5p**	34.2p	35.0p
Net cash flow from operating activities	**£5,887m**	£5,849m	£6,035m
Capital expenditure on property, plant and equipment	**£4,986m**	£3,680m	£3,269m
Investment in telecommunication licences, subsidiaries, associates and joint ventures	**£18,709m**	£7,165m	£1,998m

- Group turnover rose by 9.1 per cent to £20,427 million
- Disposal programme contributes £619 million to profit before tax
- Capital expenditure on property, plant and equipment rose by 35 per cent to £4,986 million
- Successful US$10 billion and Euro 9.7 billion bonds issued
- Goodwill impairment charges of £3.2 billion

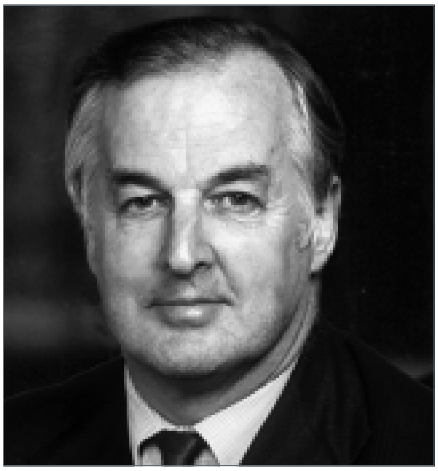






Chairman's message

The past year has been one that no-one with any involvement in the communications industry will ever forget.



We have seen the continuing rapid spread of communications technologies into every part of everyday life. But it has also been a year of great turbulence for the industry itself. At a time of such profound change, many players, including BT, have not found it easy to stay ahead of the game.

However, BT's operating performance during the year has been satisfactory, and in line with expectations. Group turnover rose by 9%, and earnings before interest, taxation, depreciation and amortisation have been maintained at similar levels to last year.

Net debt has risen to an unsustainable £27.9 billion at 31 March following the acquisitions made during the year. Our first priority is to repay a significant amount of this debt. We have made a good start with the agreed sales of investments in Japan, Spain, Switzerland and Malaysia, which should raise around £5.5 billion. Further disposals are planned.

A major part of our plans for the future is our intention to demerge BT Wireless. This will mean that, provided the necessary permissions are received, shareholders will own shares in two strong and separately quoted businesses, both in the FTSE 100 list: BT Wireless and Future BT, which will be a focused European network and retail group concentrating on voice and data services.

This amounts to nothing less than a structural and financial transformation of BT. I joined BT as Chairman on the basis that I was totally committed to this transformation and would be responsible for leading the Board in overseeing its delivery.

To provide greater financial stability and to help finance this restructuring, we have announced a £5.9 billion rights issue. Clearly it would not be appropriate to raise this amount of money from shareholders and then immediately recycle some of it back through dividends. We are, therefore, taking the unwelcome but necessary step of halting payments for the 2000/2001 final dividend and also the current year's interim dividend. Future dividend policy will be decided by the individual listed companies, taking into account their respective capital structures, their cash requirements and the markets in which they operate.

I would like to pay tribute to Sir Iain Vallance, my predecessor. As successively Director, Chief Executive and Chairman of BT, he played a major role in the development of BT from a nationalised utility into a leading player in the telecommunications industry.

In conclusion, I recognise that it will require determined and rapid action by BT management to achieve the transformation of the company. We have made a good start, the culture is changing, and I am confident that we can complete the process in the best interests of our shareholders, our customers and our employees.

Christopher Bland

Sir Christopher Bland *Chairman*
22 May 2001

> *"This amounts to nothing less than a structural and financial transformation of BT."*

Chief Executive's statement

BT has achieved much operationally over the past year. We have continued to introduce innovative products and services, such as Genie, our mobile internet portal; we have continued to develop our high-speed broadband network; and we have continued to compete vigorously.

Now, we are moving swiftly to take further action that will transform BT.

Action that:

- addresses the debt built up through pursuing our strategy;
- accepts the realities of the market;
- continues the process of separation by lines of business;
- creates two substantial listed companies; and
- keeps both companies focused on growth opportunities.

In April 2000, we began a radical restructuring of BT. We grouped some of our activities by market sector, rather than by geography, to create BT Wireless, BT Ignite, BTopenworld and Yell, four businesses with potential for high growth.

In October 2000, we split management of our UK communications services between BT Retail and BT Wholesale.

And, in November 2000, we announced our intention of seeking separate listings via initial public offerings for BT Wireless and Yell. We also stated our target of reducing our net debt by at least £10 billion by the end of 2001.

Since then, stock market volatility throughout the world, particularly in the telecommunications sector, has led us to reconsider whether selling off equity in parts of the business via the IPO route represents the best way ahead for the company.

As a result, we announced in May our intention to demerge BT Wireless and so create two substantial companies, **BT Wireless** and **Future BT**.

BT Wireless

We plan for BT Wireless to include all of our fully-owned wireless assets in the UK and Europe, and Genie, one of Europe's leading mobile internet portals. It should be a high-growth business, strongly positioned to develop third-generation services by taking advantage of its leadership in mobile data. It will be an independent wireless operator in a market which is consolidating.

Future BT

Future BT will combine four separately managed businesses, BT Retail, BT Wholesale, BTopenworld and BT Ignite to form a focused European network and retail group concentrating on voice and data services. Its aim is to create value based on service excellence, its brand leadership, its large scale networks and its existing customer base. It will also develop and market new, higher value broadband and internet products and services.

Your investment in BT will, therefore, provide ownership of two strong and separately quoted businesses, and the flexibility that gives shareholders. Although both companies are expected to be major components of the FTSE 100, they will have contrasting financial profiles: BT Wireless, high growth; and Future BT, well-established and cash generative.

The separation into distinct businesses gives our management teams greater focus and accountability. It enables them to focus hard on productivity and their own customer segments, and it gives each business more flexibility for forging partnerships and strategic alliances. We are already gaining distinct advantages from having our businesses up and running as separate units. The action we are planning now will enable us to build on this.

The greater transparency of the businesses should also help investors improve their understanding of each one. They can assess the dynamics, opportunities and contrasting financial profiles of each business – and this better enables them to attribute value to each.

This restructuring represents a major task for BT, but I'm confident that we can and will deliver. We're tackling the issues that need to be tackled and we're moving forward.

Sir Peter Bonfield CBE *Chief Executive*
22 May 2001

"This restructuring represents a major task for BT, but I'm confident that we can and will deliver. We're tackling the issues that need to be tackled and we're moving forward."

Message from Sir Iain Vallance

Nearly all BT shareholders are BT customers. And nearly all BT employees are BT shareholders. That exceptional association between owners, employees and customers has been a core strength of the organisation since it moved into the private sector some 17 years ago.

It has been a privilege for me to have been part of that association from the outset – for the most part as Chairman of the BT group.

The group has been a front-runner in the telecommunications world in countless ways. That can be put down to the talent and professionalism of its management and employees, and to the loyalty of its shareholders.

BT has won through some turbulent times in the past and I am confident it will do so again, with the support of its people and shareholders, under the guidance of Sir Christopher and the Board.

Iain Vallance

Sir Iain Vallance *President Emeritus*
22 May 2001

Business review

The review is divided into the following sections:

Please see cautionary statement regarding forward-looking statements on page 143.

All customer numbers are given as at 31 March 2001, unless stated otherwise.

EBITDA = Earnings before interest, taxation, depreciation and amortisation

Introduction

BT is one of Europe's leading providers of communications services, including:

- exchange lines and private circuits, and fixed local, national and international voice and data calls to homes and businesses in the United Kingdom (UK);
- wireless voice and data communication services and equipment for businesses and individuals in the UK and internationally;
- international new-wave products and services, including internet, multimedia, data transport and solutions;
- interconnection services for other UK operators; and
- classified advertising directories in the UK and United States (USA).

In the 12 months to 31 March 2001 (the 2001 financial year), 9% of BT's group revenues derived from activities outside the UK, compared with around 5% in the previous financial year. This excludes our proportionate share of the revenues of our joint ventures and associates.

The table on page 9 sets out a summary of our turnover for our products and services for the years ended 31 March 1999, 2000 and 2001.

Our new structure

During the 2001 financial year, we began a radical restructuring of our group. As a result, some of our activities have been grouped by market sector, rather than geography, to form four businesses with potential for high growth:

- **BT Wireless** – an international mobile business, with particular strengths in mobile voice, data and next generation services;
- **BT Ignite** – an international, data-centric solutions and broadband IP business focused on European corporate and wholesale markets;
- **BTopenworld** – a mass-market internet business focused increasingly on broadband services; and
- **Yell** – an international directories business.

These new lines of business have been operating since 1 July 2000.

In October 2000, management of the UK communications services businesses was split as follows:

- **BT Retail** – the UK's leading communications business and the prime UK channel to market for our other businesses; and
- **BT Wholesale** – the provider of network services and solutions to communications companies, network operators and service providers, including BT Retail, BT Wireless and BT Ignite.

These six businesses operate alongside Concert, our global joint venture with AT&T, launched in January 2000 which is a leading communications provider for multinational business customers, international carriers and ISPs worldwide.

In November 2000, we announced details of a restructuring plan which was drawn up following the identification of potential benefits which should follow from a separation of the group into a number of operating units with defined management accountability. We recognised the merits of separate flotations, following such restructuring, to improve our focus on value generation through the creation of distinct equity for each quoted entity. Our plan was to optimise the positioning of our individual businesses within their respective markets. We said we would focus on Western Europe and Japan and seek to float up to 25% of each of BT Wireless and Yell, and a possible separate flotation of BT Ignite would be reviewed by the end of 2001. In addition, we described proposals to create a new holding company to enhance corporate flexibility and provide scope for further subsidiary listings where advantageous to shareholders. We also detailed plans to create a new network company, NetCo, which would be both structurally and managerially separate. Following this corporate reorganisation, and subject to the satisfactory outcome of necessary discussions with the UK Government and Oftel, our intention was to seek a separate listing for up to 25% of NetCo.

During 2000, we had borrowed to finance acquisitions with the intention of reducing the level of indebtedness by asset sales and other means. We identified the need to introduce new equity capital into the business to support the reduction in the unsustainable level of group debt and we indicated our intention to raise new equity through the sale of minority stakes, notably of BT Wireless.

Our aim was to reduce the net debt of the group by December 2001 by at least £10 billion using the cash proceeds from the issue of equity in the various initial public offerings (IPOs), together with the proceeds of disposals of non-core businesses and assets. The weakness of the IPO market, particularly for telecommunications companies, has caused us to review whether the sale of equity in BT Wireless and Yell still constitutes the best option to strengthen the group's capital base.

The Board has concluded that shareholders' interests are best served by a rights issue to the company's existing shareholders. On 10 May 2001, the Board announced that BT is proposing to raise approximately £5.9 billion, after expenses, through a rights issue. The new equity introduced by the issue, together with cash from the disposals discussed below, should allow us to meet our debt reduction target of £10 billion by December 2001. Furthermore, the rights issue enables the implementation of structural change.

We now intend to demerge BT Wireless, which we expect will include all of BT's wireless assets in the UK (BT Cellnet), the Isle of Man (Manx Telecom), Germany (Viag Interkom), the Republic of Ireland (Esat Digifone) and The Netherlands (Telfort). BT Wireless will also include Genie, one of Europe's leading mobile internet portals.

We continue with our plans to create a new holding company to give us corporate flexibility and to facilitate other potential acquisitions, demergers, disposals or IPOs. We have determined that, in order to demerge BT Wireless efficiently, the new holding company structure should be put in place at the same time as the demerger. On demerger, the capital structure of BT Wireless is planned to include up to £2 billion of debt. We are reviewing our plans for Yell

Years ended 31 March	**2001 £m**	2000 £m*(a)*	1999 £m*(a)*
Turnover summary			
Fixed-network calls	**5,655**	5,908	6,026
Exchange lines	**3,674**	3,526	3,351
Receipts from other operators	**2,814**	1,974	1,417
Wireless products	**2,760**	2,170	1,400
Private services	**1,091**	1,135	1,140
Solutions	**1,074**	915	746
Yellow Pages and other directories	**754**	642	491
Customer premises equipment supply	**726**	847	870
Other sales and services	**1,879**	1,598	1,512
Group turnover	**20,427**	18,715	16,953
Share of associates' and joint ventures' turnover	**9,937**	3,364	1,270
Trading between group and principal joint venture	**(698)**	(176)	–
Total turnover	**29,666**	21,903	18,223

(a) Figures for the 1999 and 2000 financial years have been restated to conform with the method of classification used in the 2001 financial year.

Years ended 31 March	**2001 £m**	2000 £m	1999 £m
Group turnover on basis of origin			
UK	**18,642**	17,866	16,364
Europe, excluding the UK	**1,183**	285	240
Americas	**368**	383	237
Asia and Pacific	**234**	181	112
Total	**20,427**	18,715	16,953

and are currently considering proposals to sell or demerge this business, following a ruling from the UK Secretary of State for Trade and Industry on a report produced by the Office of Fair Trading that the prices charged for advertising in UK Yellow Pages directories should be subject to an RPI minus 6 price cap from January 2002.

Future BT strategy

Future BT will be a focused European network and retail business concentrating on voice and data services. It will also develop and market new higher value broadband and internet products and services to its large customer base. Future BT will comprise principally four separately managed lines of business, BT Retail, BTopenworld, BT Wholesale and BT Ignite, with Concert providing international connectivity. It will have a balanced portfolio of businesses with well-established, market-leading and cash generative UK retail and wholesale businesses and, in BT Ignite and BTopenworld, rapidly developing businesses in internet solutions and broadband in the UK and elsewhere in Europe. We are discussing a variety of strategic alternatives to the Concert joint venture, which could include all, or a substantial portion, of the business currently within BT Ignite. See "Discussions with AT&T regarding Concert and BT Ignite" on page 17.

Acquisitions

BT has made a number of significant acquisitions during the past three financial years, including taking stakes in Japan Telecom and J-Phone and control of Esat Telecom. We also transferred assets and businesses to Concert, our global joint venture with AT&T. During the 2001 financial year, we took sole control of Telfort and Viag Interkom, and, shortly after the end of the year, took sole control of Esat Digifone.

Telfort

In June 2000, we took full control of Telfort, our Dutch joint venture, when we acquired, for £1.21 billion (NLG 4.2 billion), the 50% of Telfort that we did not already own.

Viag Interkom

In January and February 2001, we took sole control of Viag Interkom by acquiring the remaining 45% which we did not already own from E.ON (formerly VIAG AG) for £4.6 billion, having already bought Telenor's 10% interest for £1.0 billion.

Esat Digifone

In April 2001, we acquired, for £0.85 billion, the remaining part of Esat Digifone, a mobile operator in the Republic of Ireland, which we did not already own. This follows our acquisition of control of Esat Telecom Group in March 2000, for approximately £1.5 billion.

Disposals

During the past three financial years, we disposed of an interest in sunrise communications and we have recently announced the prospective disposal of our interests in Airtel, Japan Telecom, J-Phone and Maxis Communications.

sunrise communications

On 30 November 2000, we sold our 34% stake in sunrise communications in Switzerland to Tele Danmark for the equivalent of £464 million in cash, realising a profit of over £400 million.

Japan Telecom and Airtel

On 2 May 2001, we announced that we had agreed to sell our interests in Japan Telecom, J-Phone and Airtel to Vodafone for £4.8 billion in cash. The sale comprises our 20% stake in Japan Telecom, our 20% stake in J-Phone Communications and shares to be converted from a call option, which represents 4.9% direct stakes in each of the J-Phone regional operating companies. The sale also includes our 17.8% stake in Airtel.

This deal values the Japanese investments at £3.7 billion and the investment in Airtel at £1.1 billion. As part of the deal, BT will exercise an option it holds in the J-Phone regional operating companies for a total of £380 million. In addition, Vodafone will take on £782 million of BT debt guarantees in favour of Japan Telecom.

Closure of the deal is conditional upon relevant regulatory and procedural approvals in Europe and Japan.

Maxis Communications

On 4 May 2001, we announced that we had agreed in principle to sell our 33.3% holding in Maxis Communications in Malaysia to our partner in Maxis, Usaha Tegas, for £350 million in cash. The sale is subject to final documentation, regulatory and other approvals.

Lines of business

The following table sets out the total turnover for each of our lines of business in the 2001 financial year. These lines of business were established earlier in the year. This turnover includes our proportionate share of the results of ventures.

Year ended 31 March 2001:	Total turnover[i] £m
BT Retail	11,813
BT Wholesale	11,493
BT Wireless	3,947
BT Ignite	3,861
Concert	2,576
Yell	778
BTopenworld	212
Eliminations and other[ii]	(5,014)
Total	29,666

(i) Includes turnover between businesses.
(ii) Includes intra-group revenues.

BT Retail

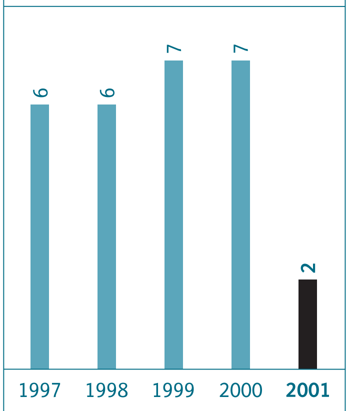
Year ended, or as at, 31 March 2001:	
Total turnover	£11,813m
EBITDA	£1,188m
Operating profit before goodwill amortisation	£1,004m
Capital expenditure on plant, equipment and property	£157m
Net operating assets	£1,114m
Employees	53,600

At 31 March 2001, BT had 28.9 million customer lines (exchange line connections). Around eight million of these were business lines and lines for other service providers. The remainder were lines for residential customers.

In a very competitive market, BT Retail's strategy is to maintain turnover and EBITDA margins, in the medium term, at 2001 levels by seeking ongoing productivity improvements from existing businesses and new business opportunities in higher value internet and broadband services.

In the 2001 financial year, BT's operating profit derived predominantly from fixed-network calls in the UK (fixed-network calls comprise calls within the UK and calls made from the UK to other countries). Calls on the UK fixed network accounted for about 28% of group turnover.

% annual fixed-network call volume growth
years ended 31 March

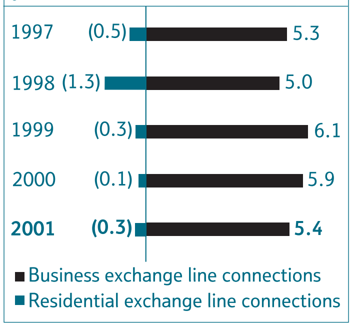


On average, about 90 million UK local and national calls are made every day. Call volumes continue to grow. The number of calls made from fixed to mobile phones and the level of internet usage both increased strongly. This largely offset the decline in traditional fixed-line local, national and international call volumes caused by mobile phone substitution and intense competition from other UK operators.

Exchange line turnover, comprising rental and connection charges, accounted for about 18% of group revenues in the 2001 financial year. Revenue from these activities continues to grow, mainly because of the increase in the number of business lines, particularly high-speed ISDN lines. Charges for business lines are higher than for residential lines.

The number of residential lines declined slightly over the year. Since the beginning of 1995, we have experienced a small net reduction in the number of our residential line connections as a result of increasing competition from cable operators, particularly in urban areas. Business connections have shown a steady increase over the same period.

Exchange line connections % growth (fall) over previous year
years ended 31 March



We provide many of our business customers with private circuits. These are lines between fixed points reserved for a customer's exclusive use and charged at a fixed rate irrespective of usage. Revenue from this activity accounted for approximately 5% of group turnover in the 2001 financial year.

Among the other services we offer are: the sale or rent of communications equipment; public payphones; advanced data and voice services; visual services, including distributing television material for broadcasting organisations and closed circuit television operators; and audio and videoconferencing.

Marketing and pricing

BT has continued to reduce prices and simplify its pricing structure, while at the same time introducing new options to give customers greater choice and control over how they are charged for using our products and services. All of our residential customers (except those on special schemes for low users) now get an inclusive call allowance included as part of the standard rental.

The new BT Together range of pricing plans provides residential and smaller business customers with competitive prices, inclusive call allowances and other features for a fixed monthly fee. From 1 September 2000, customers on BT Together and BT Working Together plans have also benefited from an evening and weekend calling rate of nine pence per minute to 13 of our most popular international destinations.

On 1 December 2000, we launched the new choices package from BT Together. This offers unlimited off-peak voice and/or internet calls for a fixed monthly fee. More than one million of the new packages were sold in the first seven weeks following their launch. Over eight million customers are now benefiting from one of the choices from BT Together. These customers, who account for more than half of our total call traffic, are showing more positive calling trends and lower churn levels than the remainder of our consumer customer base.

SurfTime, BT's low-cost internet access service, which offers unlimited internet calls for a fixed fee, was launched in June 2000 and has more than 446,000 customers.

An independently audited report, published in January 2001, compared the best prices offered at that time by major UK telecoms suppliers. Five typical residential customer bill profiles were analysed. In each case, BT was the cheapest operator providing nationwide coverage.

BT has also introduced the BT Commitment option to deliver competitive prices to corporate business customers.

Our website, **bt.com**, provides residential and business customers with an e-commerce channel for accessing information and services for all their communication needs. It has around 1.5 million registered users and, on average, every week some 100,000 users view a bill on the site. Orders for more than £100 million worth of products and services were made or initiated through **bt.com** during the 2001 financial year.

Customer satisfaction

BT's quality of service and our customers' satisfaction with that service is extremely important to us. To ensure that our customers are satisfied with our service and to understand ways in which we can improve it, we talk to thousands of our UK customers every month. We also run an extensive market research programme to focus on wider issues and to help us match our product and service offerings to customer requirements.

During the 2001 financial year, specialist market research agencies, acting on our behalf, talked to around 300,000 residential and business customers in the UK about all aspects of the services we provide. We also closely monitor our performance against a number of key business measures, including providing services in response to orders and remedying faults when they appear.

Results for the period October 2000 to March 2001 showed that, despite problems caused by the knock-on effects of the fuel strike in September 2000, the wettest autumn since records began and the outbreak of foot-and-mouth disease in farm animals, all of which made access to customers in many parts of the country difficult, over 97% of business and residential orders were completed by the date agreed with the customer. For provision of services, 82% of small and medium-sized business customers and 87% of residential customers stated that they were satisfied with BT's performance.

Repair services too came under pressure, particularly from the bad weather and flooding, which increased the number of faults and made it more difficult for us to deal with them. We aim to rectify faults within nine hours for residential customers and five hours for business customers, or by some other mutually agreed time. Despite all the difficulties, we cleared 82% of business faults and 65% of residential faults within these objective times, and customer satisfaction with the repair service was broadly maintained.

To achieve this, as many as 600 BT people were transferred to the most seriously affected areas, we employed over 200 outside contractors to support our efforts, and, for a number of weeks, we deployed over a thousand man days of extra resource per week by employing people beyond their scheduled hours.

BT Wholesale

Year ended, or as at, 31 March 2001:	
Total turnover	£11,493m
EBITDA	£4,278m
Operating profit before goodwill amortisation	£2,540m
Capital expenditure on plant, equipment and property	£2,273m
Net operating assets	£12,511m
Employees	30,000

BT Wholesale provides network services within the UK to communication companies, network operators and service providers. Together, BT Retail, BT Ignite and BT Wireless currently account for some 70% of its turnover, the majority of which is subject to regulatory price control.

BT Wholesale will build on its reputation for delivery of wholesale network solutions to BT Retail and other communications companies. BT Wholesale's strategy is to extract efficiencies from the scale and scope of its operations, broaden its customer base and expand next generation services by, among other things, satisfying demand for bandwidth and applying new technology to boost capacity, expand its product portfolio and reduce costs. We believe this should minimise erosion of market share and generate attractive returns on capital.

During the 2001 financial year, we continued to invest in our UK network to meet increasing demand for high-quality fixed-network products and services, both narrowband and broadband. During the year, network reliability remained good. On average, customers will experience a fault with our network only once in seven years.

Many other telecommunications operators use our network to help deliver their customers' calls. This interconnect activity has increased rapidly as competition in the fixed and mobile sectors has intensified. The receipts from other operators for this activity accounted for about 14% of group revenues in the 2001 financial year.

Growth in UK core network traffic was met in the year by replacing 46 trunk exchanges with Next Generation Switches (NGS), which have double the capacity of the replaced exchanges. This means that, in less than a year, nearly half of the trunk exchanges, which took five years to install in the 1980s, have been replaced. Plans are in place for introducing a further 13 NGSs, and the upgrade and expansion of 27 of the switches to include Asynchronous

Transfer Mode (ATM) switching, by March 2002, again potentially doubling the capacity of each switch.

We are upgrading our network to meet the growing demand for bandwidth. We believe that BT is ahead of similar European operators in large-scale deployment of high-capacity Synchronous Digital Hierarchy (SDH) and Wavelength Division Multiplexing (WDM) technology.

We are also upgrading our exchange-based switches to provide carrier pre-selection (CPS). This enables customers to pre-select an alternative carrier for their calls without having to dial additional access codes. CPS was introduced, on an interim basis, by means of auto-diallers installed on customers' premises. An exchange-based solution became available for national and international calls in December 2000, and should be available for all calls by December 2001.

Digital Subscriber Line (DSL) services turn a normal copper telephone line into a high-speed digital access line, providing residential and business customers with fast access to high-value, multimedia-rich content. BT launched its first DSL-based services in June 2000. At 31 March 2001, 839 UK exchanges were equipped to provide Asymmetric DSL (ADSL). This means that 50% of UK households are now in areas currently served by an ADSL-enabled exchange.

During the 2001 financial year, BT participated in implementing and accelerating the local loop unbundling (LLU) programme in the UK. LLU enables other telecommunications operators to use the existing local loop (the connections between customers' premises and the exchange) to connect directly with their customers to provide telecommunications services, including DSL-type broadband services. Operators install their own equipment either in exchanges or in nearby buildings to provide this service.

We have been offering LLU since December 2000. The roll out of LLU has been the subject of an amendment to the BT Licence, a specific EU regulation and, in the UK, agreements with Oftel. BT has met all of the requirements set out in the EU regulation and has also met the objectives concerning implementation, as set by Oftel.

In November 2000, BT and Crown Castle UK entered into an agreement to provide infrastructure to 3G mobile and wireless operators. This should enable us to receive significant rental income through the development of the roof-space and surroundings of, initially, 4,000 of our exchange buildings. The programme has the potential to be extended to cover all of our operational buildings. Agreements have been signed with three of the 3G licence holders, including BT Wireless, for use of the combined BT and Crown Castle portfolio.

BT Wireless

Year ended, or as at, 31 March 2001:	
Total turnover, including share of ventures	£3,947m
Group turnover	£3,408m
EBITDA before exceptional items	£220m
Operating loss before goodwill amortisation and exceptional items	£(225)m
Capital expenditure on plant, equipment and property	£1,105m
Net operating assets	£18,634m
Share of ventures' net assets, including goodwill	£27m
Employees	14,900

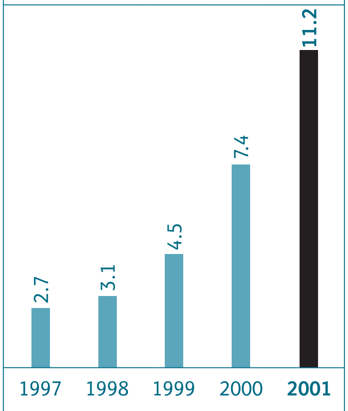
BT Wireless consists of our wholly-owned interests in European wireless operations, including BT Cellnet in the UK, Viag Interkom in Germany, Telfort in The Netherlands and Esat Digifone in the Republic of Ireland. BT Wireless has approximately 16.9 million customers. BT Wireless also includes Genie, our mobile internet business, one of Europe's leading mobile portals.

BT Wireless' strategy is to attract and retain high-value customers and increase revenues per customer by positioning itself as a leader in the European mobile data market. Being wholly owned, the wireless businesses will be managed on a unified basis, facilitating the development of common technology and the swift roll out of services, such as the Genie mobile internet portal and associated content and applications, across the BT Wireless networks. BT Wireless has developed relationships with a large number of applications and content developers through its application developer forum. It will seek productivity improvements through these cross business synergies and seek network sharing options with others to reduce build out costs where allowed.

The UK

BT Cellnet is our wholly-owned wireless business in the UK and is the second largest mobile network operator in the UK, with 11.2 million customers, an increase of more than 50% during the 2001 financial year. This represents an estimated market share of approximately 26%. BT Cellnet's total turnover for the 2001 financial year was £3,031 million, with EBITDA for the same period of £591 million. In the UK wireless markets, BT Cellnet has the second largest market share by customer base and a strong position in the business market.

BT Cellnet customers (millions)
at 31 March



The UK market grew rapidly during the 2001 financial year and remained extremely competitive, reflecting significant demand for competitively priced pre-pay products.

BT Cellnet launched General Packet Radio Service (GPRS) services in June 2000. In the UK Government's 3G licence auction, which concluded in April 2000, BT obtained a licence for £4.03 billion to operate 3G mobile services.

In April 2000, BT Cellnet purchased, for £45 million, the 60% of The Mobile Phone Store that it did not already own, as part of BT Wireless' initiative to obtain increased control over its distribution channels.

Germany

BT Wireless' German operations are conducted through Viag Interkom, which, since February 2001, has been our wholly-owned subsidiary. Viag Interkom launched mobile telephony services in October 1998 as the fourth entrant into the German market and, by 31 March 2001, had achieved an estimated 7% market share with over 3.7 million customers. Viag Interkom's turnover, including its fixed business, for the year ended 31 March 2001 was £1,078 million, with negative EBITDA for the same period of £407 million before exceptional items. The fixed business market formerly addressed by Viag Interkom is now served by BT Ignite Germany.

The German market is currently a highly competitive four-player market, and two further entrants are possible following the auction of six 3G licences carried out by the German Government in August 2000. Viag Interkom holds one of the 3G licences, which was purchased for £5.13 billion.

The construction of Viag Interkom's Global System for Mobile communications (GSM) network is ongoing. It currently covers an estimated 81% of the German population, but a national roaming agreement with T-Mobil allows Viag Interkom to offer service covering approximately 99% of the German population.

Viag Interkom launched GPRS services in January 2001.

Viag Interkom is developing other initiatives to achieve a greater share of the business market, such as cooperation arrangements with specialised service providers. It is also seeking to improve network costs per minute by increasing use of its network from selected wholesale opportunities and by other initiatives, such as outsourcing functions to achieve cost efficiencies.

Republic of Ireland

Our wireless operations in the Republic of Ireland are conducted through Esat Digifone, which became a wholly-owned subsidiary in April 2001. Esat Digifone entered the Irish market in March 1997 and, by 31 March 2001, it was serving over 1.1 million customers, representing an estimated market share of approximately 41%. Esat Digifone's turnover for the year ended 31 March 2001 was £312 million, with EBITDA for the same period of £69 million. Esat Digifone expects to apply for one of the four licences to be offered by the Irish Government to build and operate a 3G network in Ireland.

The Netherlands

Telfort launched its service in 1998 in the Dutch mobile market. It now has a network covering over 97% of the population and more than 918,000 customers representing an estimated market share of approximately 8%. Telfort's turnover, including its fixed business, for the year ended 31 March 2001 was £301 million, with negative EBITDA for the same period of £118 million before exceptional items. The fixed business market formerly addressed by Telfort is now served by BT Ignite Netherlands.

Telfort was awarded a 3G licence in July 2000 for £267 million.

Genie

Genie is BT's mobile internet portal, comprising web and WAP portals in the UK, France, Germany, Hong Kong, Italy, The Netherlands and Spain. With more than four million registered customers, according to Red Sheriff Services' data collection software, Genie is one of the major players in the mobile internet portal market, offering content including entertainment, m-commerce, games, and the latest sports, news and business information.

Genie also functions as an Application Service Provider (ASP) to network operators, offering hosted, secure access to enterprise applications through an integrated customised portal, and provides mobile internet communications and portal services on a hosted basis in the Asia-Pacific region.

In November 2000, Genie launched the UK's first exclusively online mobile service, offering mobile phones with mobile internet access through text messaging and WAP.

By offering high quality content and applications and developing personalised relationships with our customers, we believe Genie will assist in increasing average revenues per user and reducing churn.

BT Ignite

Year ended, or as at, 31 March 2001:	
Total turnover, including share of ventures	£3,861m
Group turnover	£3,470m
EBITDA before exceptionals	£47m
Operating loss before goodwill amortisation and exceptionals	£(380)m
Capital expenditure on plant, equipment and property	£936m
Net operating assets	£3,584m
Share of ventures' net assets, including goodwill	£178m
Employees	18,800

BT Ignite, our solutions and broadband IP business, delivers a range of services, including customer solutions, application service packages, web hosting and data transport to European business customers.

Building on its position as a leading business in the European services market, as measured by customer and revenue base, BT Ignite plans to continue to build its revenues from the high end of the value chain – value-added services and complex solutions – from current levels of 50% of revenue. It aims to use its large sales force to add more business customers and increase revenue per customer by selling more of these higher value products and migrating customers towards tailored services, such as moving customers through hosting and applications to solutions. Its strategy for moving into profitability also includes increasing the throughput in its existing network infrastructure of cables and data hosting to benefit from operational gearing. We also expect to generate synergies across BT Ignite by establishing functional responsibilities, including single network management and single product management across the business. We are discussing a variety of strategic alternatives to the Concert joint venture which could include all, or a substantial portion, of the business currently within BT Ignite. See "Discussions with AT&T regarding Concert and BT Ignite" on page 17.

Across Europe, BT Ignite is primarily a service business supported by its own infrastructure. BT Ignite has a sales force of 4,000 employees, including 2,000 solutions consultants. It sells directly to businesses in Europe and sells to businesses in the UK through BT Retail's sales force.

Value-added services

BT Ignite's international solutions businesses had turnover of £2,082 million, including work done for other parts of BT, in the 2001 financial year. External turnover from solutions accounted for 5% of group turnover in the same period.

Syntegra, our global consulting and systems integration business, is a market leader in creating new systems, which, through the use of the internet and associated technologies, are transforming business-to-business relationships around the world. Syntegra has customers in more than 60 countries.

BT Ignite Solutions (formerly Syncordia Solutions) is a leading provider of integrated information and communications solutions. Underpinned by the internet and associated technologies, these solutions are based on end-to-end managed IP networks and the provision of e-business and e-CRM (electronic Customer Relationship Management) applications on these networks.

BT Ignite offers a range of advanced web hosting application and network services, utilising its 21 internet data centres in Europe. BT Ignite's internet data centres provide the hardware, software and high-speed communications connections required by customers to run their websites and other online business applications, allowing these customers to focus on their core business and meet growing requirements for e-commerce.

BT Ignite Application Services provides software over IP networks to large and small companies, generally on a per user rental basis. Application Services has developed partnerships with key software providers, including Microsoft, Lotus, Commerce One and Verisign, to provide a range of e-mail, collaborative e-commerce and security applications.

European network

BT Ignite, with its European partners, has a pan-European fibre network which provides coverage to the top 100 commercial centres and serves over 400,000 business customers with 52,000 route kilometres of fibre cable connecting 250 towns and cities through Belgium, Denmark, France, Germany, the Republic of Ireland, Italy, The Netherlands, Norway, Spain, Sweden, Switzerland and the UK.

BT Ignite is responsible for broadband services based on DSL technology in the UK, selling wholesale DSL products to more than 150 service providers and corporate clients. These enable service providers to offer their own customers fast access to high-value content and applications. They also enable corporate customers to provide their teleworkers with fast, remote access to their private networks on the internet.

Yell

Year ended, or as at, 31 March 2001:	
Total turnover, including share of ventures	£778m
Group turnover	£774m
EBITDA	£223m
Operating profit before goodwill amortisation	£210m
Capital expenditure on plant, equipment and property	£21m
Net operating assets	£710m
Share of venture's net assets, including goodwill	£2m
Employees	5,300

Yell is a leading provider of classified advertising directories and associated products and services, principally to small and medium-sized enterprises and consumers in the UK and USA. Yell's products and services are designed to generate business leads by connecting buyers and sellers through an integrated portfolio of advertising solutions, including printed telephone, and internet-based, directories. In addition, Yell provides a growing range of business-to-consumer and business-to-business products and services through new media, primarily the internet.

In the UK, Yell distributes approximately 28.9 million copies of directories to households and businesses, and publishes 861,000 advertisements on behalf of 418,000 advertisers. In the 2000 financial year, Yellow Book USA, Yell's US business, distributed approximately 17.5 million copies of directories to households and businesses, and published 1,155,000 advertisements on behalf of 170,000 advertisers. The revenues from Yell products and services, including Yellow Book USA, represented about 4% of group turnover in the 2001 financial year.

Yell's principal activity is the sale of advertising in, and the preparation and publication of, classified directory products. Yell maintains, develops and regularly updates extensive databases of information on businesses, the core of which is small and medium-sized enterprises in the UK, and in the eastern, mid-western and southern USA.

Yell's principal products and services are:

- *UK Printed Directories,* comprising Yellow Pages and Business Pages;
- *US Printed Directories,* comprising Yellow Book;
- *On-line Services,* incorporating the Yell.com and Yellowbook.com internet sites, and website design and hosting services in the UK and USA; and
- *Other Products and Services,* including the following products and services in the UK:
  - *Talking Pages,* a telephone-based, operator-assisted, classified information service;
  - *The Business Database,* which provides customer-specific, direct marketing and database development services to businesses;
  - *Service Call,* a telephone answering service; and
  - sales agent services which Yell provides for the BT Phone Book white pages directories.

BTopenworld

Year ended, or as at, 31 March 2001:	
Total turnover, including share of ventures	£212m
Group turnover	£167m
EBITDA loss	£(253)m
Operating loss before goodwill amortisation	£(296)m
Capital expenditure on plant, equipment and property	£25m
Net operating liabilities	£(17)m
Share of ventures' net assets, including goodwill	£12m
Employees	700

BTopenworld brings together, in a single mass-market business, all of our UK ISPs and portals (both dial-up and broadband) serving the needs of both the consumer and the small and medium-sized business customer.

BTopenworld's strategy focuses on growing average revenue per customer through added-value services, such as narrowband internet, fast internet and video centric services.

Internet services earn us revenue directly, through subscriptions, e-commerce and advertising, and indirectly, through increased network usage.

BTopenworld has approximately 1.25 million active customers (i.e. customers accessing BTopenworld's internet products on a regular basis) on its dial-up narrowband internet (BTinternet, Connect2Business and BTAccess) and BTopenworld broadband services. BTopenworld remains one of the largest unmetered internet access providers in the UK, with almost 700,000 customers on its unmetered access packages (including 25,000 customers on its BTopenworld broadband service).

BTopenworld also manages our other internet ventures in the UK:

- our 50/50 joint venture with LookSmart, a leading US-based online navigation company, which creates and distributes internet portal services throughout Europe and Asia;
- ExciteUK, our joint venture with Excite, in which we have a 42% stake; and
- our virtual ISP services, which provide internet access service on a wholesale basis for companies such as Dell, WH Smith and ONdigital.

BTopenworld has launched a range of mass-market broadband services aimed at consumers, small businesses and teleworkers. We continue to develop a range of tools, including communications, navigation and personalisation, all of which will be linked and made available through a Personal openworld Portal accessible across a number of devices.

Concert

BT's share for the year ended, or as at, 31 March 2001:	
Turnover	£2,576m
EBITDA	£170m
Operating profit before goodwill amortisation	£19m
Share of venture's net assets, including goodwill	£1,430m

Concert is a major global communications joint venture owned equally by BT and AT&T. It combines what were the trans-border assets and operations of BT and AT&T, including the majority of their international networks, international traffic and international products for business customers.

Supporting Concert, BT, AT&T and their respective families of joint ventures is a common networking architecture planned to provide seamless service to customers. Concert's frame relay network reaches every major city in the UK and USA and extends to over 200 cities in 60 countries. Its global public network reaches 237 countries directly. Concert also has investments in 115 undersea cables totalling more than 480,000 kilometres globally.

In addition to using BT and AT&T's extensive networks in the UK and USA, Concert has built a high-speed IP backbone network, spanning 21 cities in 17 countries. This supports a wide range of internet access, internet backbone and IP virtual private network services. Concert's IP network is interconnected with BT and AT&T's domestic IP backbone networks, which distribute Concert services in the UK and USA.

Work is underway to converge Concert's network, infrastructure and managed services with those of AT&T Global Network Services, previously IBM Global Network. When this is complete, the Concert IP backbone network should extend to more than 60 cities worldwide and the combined portfolio of IP, data and virtual private network services will be offered through Concert, AT&T and BT Ignite distribution channels, particularly for delivery in Europe, Asia Pacific and Latin America. See "Discussions with AT&T regarding Concert and BT Ignite", below.

Discussions with AT&T regarding Concert and BT Ignite

We and AT&T are discussing ways to improve the performance of the business and strengthen the scope of the relationship between us and AT&T in business services. These discussions include a variety of strategic alternatives to the Concert joint venture, including the sale to, or other business combination of our business services operations with, AT&T's business services unit upon its planned separation from the remainder of AT&T. Such a transaction could include all or a substantial portion of our business services operations, including BT Ignite and our interest in Concert, in exchange for some mixture of cash, equity and/or other instruments in the combined business. These discussions may or may not lead to any sale or other business combination and may or may not lead to any change in the existing alliance arrangements. As possible alternatives to such a transaction, we have also been considering a narrowing of Concert's business scope, as well as its termination as a joint venture. There can be no assurances, however, that agreement could be reached with AT&T with regard to either of such alternatives.

The BT Board believes that the BT Ignite and Concert businesses will generate potentially significant value for the group in the future. The Board will keep under review whether this value is best achieved for shareholders by a combination of these businesses with AT&T's business services unit, a disposal of all or part of the businesses or their separation from BT by way of IPO or demerger from BT. Where necessary, we will seek the approval of our shareholders.

Other

We hold a 26% stake in Cegetel, a leading French telecommunications company providing a broad range of telecommunications services, including mobile and fixed telephony, internet access, data services and transmission. We currently intend to retain our shareholding in Cegetel. We also have fixed and wireless operations in Canada, Hong Kong, India, Italy, Singapore and South Korea.

Future BT will also include a number of other business units, including Information Systems Engineering, fleet operations, logistics and procurement services and BTexact Technologies, a world-renowned research and development capability.

Research and development

Our commitment to research and development is fundamental to ensuring that we can continue to provide our customers with advanced information and communication services.

In the 2001 financial year, we invested £364 million in research and development, compared with £345 million and £268 million in the 2000 and 1999 financial years, respectively.

Major areas of work included next-generation internet, broadband wireless and fixed access networks; advanced data services; information and network security; 3G mobile multimedia services; and software systems to support the management and integrity of our networks worldwide. We are also undertaking research on the impact of advanced communications on lifestyles, education and healthcare in the connected society of the twenty-first century.

On 1 April 2001, we launched BTexact Technologies, a wholly-owned business comprising our engineering and technology research and development activities. BTexact Technologies' principal customers are the BT lines of business and our alliance partners. However, we also intend to offer a select portfolio of professional and consultancy services to external customers. BTexact Technologies plans to exploit BT's extensive intellectual property rights where this is to our commercial and strategic advantage.

BTexact Technologies will include Brightstar, our in-house technology incubator. Brightstar aims to help BT people get the best hi-tech business ideas launched as start-up businesses. Three such businesses were launched in the 2001 financial year and a further 11 are currently in development.

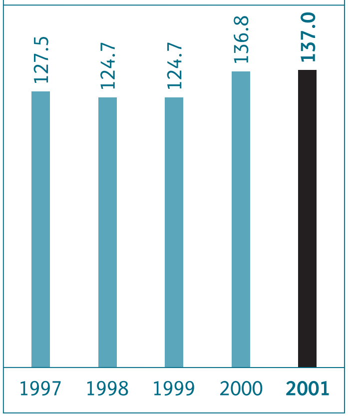
Our research and development centre at Adastral Park in the UK is complemented by a wide range of partnerships with leading technology suppliers and universities on a global scale. To provide advanced communications research, the BT MIT Disruptive Lab in Boston, USA, has been created in association with the Massachusetts Institute of Technology, and the Asian Research Centre has been opened in Malaysia.

Our people

Years ended 31 March	2001 '000	2000 '000	1999 '000
Number of employees in the group:			
UK	**117.9**	126.0	118.9
Non-UK	**19.1**	10.8	5.8
Total employees	**137.0**	136.8	124.7

At 31 March 2001, BT employed around 137,000 people throughout the world, with 117,900 in the UK, making us one of the UK's largest employers. Additionally, we employed, on average, around 13,000 temporary people during the 2001 financial year. A total of 7,500 people joined the group from Telfort and Viag Interkom. These additions were offset by people leaving the company through voluntary means, including redundancy, moving to Concert, and joining e-peopleserve, our human resources (HR) joint venture, and other outsourced activities.

Employees (thousands)
at 31 March



As part of the continuing programme of reshaping the group, during the 2001 financial year, we ran a voluntary redundancy programme under which some 3,500 managers and professionals left the company. In February 2001, we launched NewStart, a new approach to managing our people resource, based around retraining and reskilling, rather than company-wide voluntary redundancy programmes.

In a move designed to bring significant value to BT, we have formed a joint venture with Accenture (formerly Andersen Consulting) to deliver outsourced human resources services to large organisations. The venture, e-peopleserve, came into being on 1 August 2000 and offers end-to-end, e-enabled, integrated global HR solutions to large companies.

Following the setting up of the venture, e-peopleserve has a five-year contract to deliver transactional HR services to BT. This is one of the largest HR outsourcing contracts agreed to date anywhere in the world. e-peopleserve is a natural product extension for both BT and Accenture and should enable BT to create value from an existing cost base. Enshrined in the agreement is a commitment by e-peopleserve to reduce transactional HR costs to BT year on year. There is also an incentive programme linked to their overall service performance, which places a heavy emphasis on the customer experience. The joint venture should deliver to BT new services of a high quality, as well as customer-friendly e-solutions to existing services, at reduced cost.

Our people are critical to our success and we believe that a reputation as a good employer helps us win and retain customers. As part of this responsibility, we take the wellbeing of our people seriously. The 2001 financial year saw the launch of an innovative 'top down' health and safety strategy, which maintains our commitment to set and achieve high standards in this area.

To help our people balance work and home responsibilities, we have a range of flexible working arrangements, including alternative attendance patterns, homeworking, part-time working and job sharing.

During the year, BT further developed its eBT portfolio. We have an award-winning e-HR programme, which provides BT people with an online, self-service approach to a broad range of HR products and services.

We encourage our people to acquire shares in their company to enable them to share in its success. The BT Employee Share Ownership Scheme is operated annually and a percentage of the pre-tax profits is set aside to purchase shares for employees, which are held in trust for three years. £32 million has been set aside this year for the allocation of shares to employees under the Scheme. Participants in the Scheme will be able to benefit from the rights issue announced on 10 May 2001. Employees also have the opportunity, from time to time, to buy shares at a discount under the popular BT Employee Sharesave Scheme, a savings-related share option scheme. Share options are normally exercisable on completion of a three or five-year save-as-you-earn contract.

There is a similar savings-related scheme for employees based outside the UK, and an employee stock purchase plan for employees in the USA. Appropriate adjustments will be made to the allocation of shares under these plans to take account of the rights issue.

The BT New Ideas scheme, under which BT people are encouraged to put forward suggestions for improvements in the company's activities, generated more than 8,000 suggestions in the year, contributing to savings of around £85 million.

We run CARE, an annual employee attitude survey, and encourage managers and their teams to put in place action plans to address the issues that it highlights.

Most BT employees are members of the BT Pension Scheme, which is controlled by trustees who are company or union nominees. On 1 April 2001, we introduced a defined contribution scheme for new employees after closing the BT Pension Scheme to new entrants. The defined contribution scheme has been established under a separate trust from the existing BT Pension Scheme, but also has company and union-nominated trustees.

An estimated 75% of the company's UK employees belong to one of two main trade unions recognised by the company. We have a good record of industrial relations and continue to have constructive relations with both unions, built on partnership and mutual respect.

BT is an equal opportunities employer and is committed to developing a working culture that enables all employees to make their own distinctive contribution. BT seeks to realise the potential of disabled people to contribute to our business performance. During the year, BT supported the launch of AbilityNet's London Centre. AbilityNet is a charity that brings the benefits of computer technology to adults and children with disabilities, both in BT and in the communities in which it operates. New BT people should benefit from pre-recruitment assessments designed to ensure that they have the most productive and comfortable equipment available as soon as they join the company. Existing BT people should also benefit from easier access to expert assessment and advice, and earlier provision of appropriate reasonable adjustments to their working environment.

BT prides itself on being a learning organisation. We spend around £200 million a year on the training and development of our people. They have access to a comprehensive portfolio of development and training options, including technical and commercial training, personal skills and management development. Increasingly, we are using the internet to deliver training and development programmes. The BT Academy is a web-based corporate learning portal that delivers world-class e-learning to BT people via the company's intranet.

During the year, BT became the largest company to achieve re-accreditation as a Corporate Investor in People; a further demonstration of BT's commitment to the development and growth of all our people.

Property

At 31 March 2001, the group had a property portfolio of approximately 8,000 buildings, with a total floor space of six million square metres, located principally throughout the UK.

Specialised operational buildings account for the majority of properties, both in number and book value. They house mainly exchange equipment and are needed as part of the group's continuing activities. They do not readily adapt to other uses.

General purpose properties consist chiefly of offices, depots, computer centres and shops.

In January 2001, we announced that we were in negotiations to realise the value of our UK property portfolio. This, we believe, should enable us to take a more flexible approach to our office arrangements and building requirements. However, we intend to retain the freehold and right to occupy our operational buildings. In April 2001, Telereal Group, a 50/50 joint venture between Land Securities Trillium and William Pears Group, was selected as the preferred bidder for the proposed acquisition of the BT property portfolio and the subsequent provision of certain buildings and management services to BT.

On 1 May 2001, we announced that, in view of the reduced number of people requiring accommodation in the group centre at the end of the restructuring process, and consistent with a less centralised group, we have decided to vacate and sell our BT Centre headquarters building in London.

The principal categories of BT's plant and equipment are exchanges and transmission equipment. Transmission equipment comprises copper, fibre and radio access; underground ducts for copper and fibre access; equipment for the trunk network; and cellular and other transmission equipment.

Regulation, competition and prices

The commercial environment in the United Kingdom and in the countries in which BT operates or wishes to operate is increasingly competitive and dynamic. However, we remain subject to extensive regulation, particularly in the UK, which can materially affect the way in which the company carries out its business.

Regulation in the UK

The regulatory structure for UK telecommunications is set out principally in the *Telecommunications Act 1984*, which gives regulatory authority to the Secretary of State for Trade and Industry and the Director General of Telecommunications, who heads the Office of Telecommunications (Oftel). The Secretary of State and the Director General are required to ensure, as far as reasonably practical, that all reasonable demand for telecommunication services, including certain community services, is met and to secure the ability of licensed telecommunications operators to finance the provision of the services which they are licensed to provide. In addition, they are required, among other things, to promote the interests of consumers, purchasers and other users in the prices, variety and quality of telecommunication services and equipment, and to promote and maintain efficiency and effective competition among UK telecommunications operators.

With limited exceptions, a licence under the Telecommunications Act is required to operate a telecommunication system in the UK. The Secretary of State is responsible for issuing licences after consulting the Director General.

The BT Licence

BT operates in the UK under a number of licences, the most important of which is its licence to operate its fixed-line public telecommunications network (the "Licence"). The Licence remains in force indefinitely, but the Secretary of State may revoke the Licence on 10 years' notice. The Licence can also be revoked at any time on various grounds, including non-compliance with its terms.

The Licence contains terms and conditions designed principally to ensure the widespread provision of telecommunication services in the UK, to protect the interests of consumers and to encourage the development of effective competition in telecommunication services and network provision within the UK.

Under the Licence, BT has to fulfil reasonable requests for access to voice telephony, low-speed data and fax transmission services, and reasonable access to public call boxes throughout nearly all the UK, including rural areas (these being the principal elements of the Universal Service Obligation).

Under the Licence, the company must allow other licensed operators to interconnect with its telecommunications systems on cost-oriented, transparent and non-discriminatory terms.

The company must comply with a variety of fair trading obligations, such as:

- a prohibition on showing undue discrimination or unfairly favouring any part of its own business as against competitors on the basis of price terms or quality of service; and
- a prohibition on the unfair cross-subsidy of certain activities of the company.

BT must publish audited financial statements for the regulated "businesses" and "activities", in order to support the linkage of costs with interconnect prices and with a view to providing demonstrable evidence that BT is neither behaving in a discriminatory fashion nor unfairly subsidising its activities. If it appears to the Director General that an unfair cross-subsidy exists between specified parts of its own business, BT must take such steps as the Director General may direct to remedy the situation. The regulatory businesses for which separated accounts are currently produced are access, apparatus supply, network, retail systems, supplemental and residual services. In addition, for the first time, BT produced separated financial statements for its mobile business for the 2000 financial year. The Licence also contains provisions enabling the Director General to monitor the company's activities, including requirements for BT to supply him with information requested.

The Licence permits the imposition of price control formulae, the overall effect of which requires the company to reduce, or restricts the extent to which it can increase, the prices of many of its telephony services to the bulk of the residential market and also the prices for its interconnection services. In addition, the Licence contains certain specific restrictions on the terms on which BT can trade. In particular, the company is required to publish and adhere to standard prices and other terms for providing certain services.

The Director General may make modifications to a licence if the licensee does not object or if the amendment is deregulatory. Alternatively, he may refer proposed changes to the licence to the Competition Commission ("CC"). In either case, the Telecommunications Act requires public consultation before a licence can be modified.

Licences may also be modified by legislation, including legislation implementing European Commission directives into UK law.

Implementation of Licensing Directive

In September 1999, modifications to the Licence came into force to meet the harmonisation requirements of the European Community Licensing Directive (the "Directive"). The intention of the Directive was to prevent excessive or unjustified regulation through licensing of telecommunications. The modifications included the removal, from January 2001, of restrictions that prevented BT from competing in the conveyance and provision of broadcast visual services to homes in the whole of the UK.

Competition

Competition Act

In addition to telecommunications industry regulation, BT is subject to general competition law.

The *Competition Act 1998*, which came into effect in March 2000, brings the UK in line with European Community law by prohibiting anti-competitive agreements and concerted practices and the abuse of a dominant market position. In the case of telecommunications, the Director General of Telecommunications has concurrent investigatory and enforcement powers with the Director General of Fair Trading. They have significant new investigative powers. Breach of the relevant prohibitions could lead to fines of up to 10% of UK turnover for each year of infringement (up to a maximum of three years) and/or result in claims for damages in the civil courts. There are powers to order a company to cease an infringing activity.

There is a new statutory independent appeals mechanism for decisions under the Competition Act.

The competitive environment

The UK telecommunications market is fully open to entry and highly competitive. As a result, the UK Government (HM Government) and Oftel have indicated their expectation that it will be appropriate to move away from sector-specific (including licence-based) regulation to greater reliance on the Competition Act.

However, as described above, Oftel currently regulates BT mainly through the provisions in the Licence. BT has commenced discussions with Oftel on amendments that BT believes should be made to the Licence to take account of the introduction of the Competition Act.

Although it is some years since the Telecommunications Act abolished the company's monopoly in telecommunications, obligations placed on BT are generally more onerous than for other licensees. BT believes the separation of the wholesale and retail businesses should mean that the retail business will be regulated in a similar manner to other equivalent businesses.

Pricing regulation

Fixed network

BT is subject to price controls on its fixed-network services in the UK at two levels: retail and network. Competitors are generally not subject to price controls.

Retail price controls

BT is subject to two sets of UK retail price controls, one on certain public-switched telephony call charges and exchange line rentals, and one on certain private circuits. Each price control is based on a formula calculated by reference to the UK Retail Prices Index (RPI) and an efficiency factor, X.

For services covered by the controls, weighted average prices cannot increase in each year beginning 1 August by more than the annual change in RPI minus X. In times of low inflation, the overall effect of this control requires the company to reduce its prices.

The retail price control for public-switched telephony, applying from August 1997 to July 2001, is RPI minus 4.5. Although it is measured on services used by the lowest 80% of BT's residential customers classified by bill size, controlled prices must be offered to all customers. The price control formula and the company's performance against the formula are set out in the table below.

BT has also given an assurance that a "control" price package will be made available to business customers. The control package for small business customers provides that call charges will be no higher than the prices used for calculating adherence to the residential price control, and line rental increases will be no more than the change in RPI.

Under the price controls for private circuits, applying from August 1997 to July 2001, prices for domestic analogue and low-speed digital private circuits cannot be increased by more than the change in the RPI in any year. Each discrete international private circuit price is subject to a safeguard cap of RPI.

Network charge control

The company operates under interconnection agreements with most other licensed operators.

A network charge control regime, operating until 30 September 2001, gives BT the freedom to set reasonable charges based on long-run incremental costs for

Years commencing 1 August	1995	1996	1997	1998	1999	**2000**
Price control formula (RPI-X)						
% RPI movement for the relevant period *(a)*	3.52	2.14	2.94	3.75	1.35	**3.32**
X in price control formula *(b)*	7.50	7.50	4.50	4.50	4.50	**4.50**
% required reduction in prices *(c)*	(1.38)	(4.92)	(1.56)	(0.73)	(3.15)	**(1.09)**
% reduction in prices overall	(1.82)	(4.92)	(1.56)	(0.73)	(3.24)	**(1.20)***(d)*

(a) Annual increase in RPI to previous June

(b) From 1 August 1997, the RPI formula covers the main switched telephone services provided to the lowest 80% of BT's residential customers by bill size

(c) After permitted carry forward of any unused allowance or shortfall from previous years

(d) Price changes implemented up to 22 May 2001

its standard interconnection services. Depending on the degree of competition for these services, charges are cap controlled (presently at RPI minus 8), safeguard cap controlled (i.e. no increases above RPI during any relevant year), or no longer subject to direct charge controls. Those services which Oftel considers unlikely to become competitive in the near future are subject to charge cap controls; those which it considers likely to become competitive are subject to safeguard cap controls and those services considered fully competitive (or which have been introduced by BT since the start of the network charge control regime) are not subject to direct charge controls.

We must publish a notification to the Director General and other licensed operators if we intend to amend existing charges or to offer new services.

Review of retail price controls and network charges

In February 2001, Oftel published its Proposals for Network Charge and Retail Price Controls which included draft licence modifications. In this Statement, Oftel proposed to extend the current retail price cap of RPI minus 4.5 by one year until 31 July 2002, rather than remove controls or introduce the usual new four-year control, and to consult again to determine whether there is sufficient competition to remove retail price controls from 1 August 2002. Should Oftel decide that there is insufficient competition at that stage, then it would consider renewing price controls and/or introducing other regulatory measures.

Oftel's network proposals include retaining the broad structure of interconnect (network) services for another four years. It proposes varying levels of "X" within the RPI minus X price-cap formula of between 7.5% and 13% for each of the five services, compared to the current level of 8%.

BT has accepted Oftel's proposals.

Mobile networks

Licence modifications required by the CC led to a reduction of about 25% in the price of calls from a BT line to mobile telephones from 30 April 1999, followed by an annual RPI minus 7 reduction for a further two years. Specifically, the CC required a reduction in BT's average retention (the amount BT keeps to cover costs and an element of profit after paying a termination charge to the mobile operator completing the call) from 5.8 pence per minute (ppm) to 3.09 ppm for the 2001 financial year. Under their latest proposals for the Price Control Review, Oftel has extended the current controls by four months until 31 July 2002, and will review them as part of the broader retail price control review.

The CC also recommended that BT Cellnet and Vodafone made price reductions on their average termination charges, from 14.8 ppm to 10.9 ppm for the 2000 financial year; this price came under a price control of RPI minus 9 for three years. Oftel is currently consulting to determine whether controls on their termination charges should be extended beyond the present period, which runs out in March 2002. Oftel has broadened the consultation to also consider the termination rates for mobile to mobile calls, and whether the two other UK wireless network operators, One2One and Orange, should fall within any future controls. Oftel expects to complete the review by July 2001.

Non-UK regulation

In developing its business internationally, BT must take account of the regulatory regimes in the countries in which it operates or wishes to operate.

European Union

The European Commission is pursuing a policy of progressive liberalisation and harmonisation in telecommunications. Since January 1998, the provision of infrastructure and all telecommunication services has been liberalised in the European Union (EU). Specific directives imposed rules for, among other things, voice telephony, leased lines and interconnection, with particular emphasis on organisations with significant market power and with a common set of principles for licensing and enforcement. These have largely been implemented in national legislation. The European Commission reviewed progress during 1999 and 2000 and is proposing a simplified regulatory framework, which will include a more uniform regulatory treatment of different communications technologies and a revision of the concept of significant market power to be applied by national regulatory authorities.

United States

In the United States, the Federal Communications Commission has extensive authority to regulate interstate and foreign services and services provided by common carriers, as well as the authority to implement policies that promote competition for all telecommunication services.

Japan

Japan is taking a staged approach to deregulation. Full liberalisation, save a 20% ceiling on foreign ownership in Nippon Telegraph and Telephone Corporation, was implemented in 1998. A move to more effective regulation, especially in the areas of forward-looking costs for interconnection, carrier pre-selection and number portability, is planned.

In April 2000, the Japanese government invited applications for 3G mobile licences. In June 2000, J-Phone was granted a 3G licence, one of three awarded.

Rest of the world

The World Trade Organisation's Agreement on Basic Telecommunications, signed in February 1997, created a framework for the progressive opening of telecommunications markets in accordance with world trade standards. The agreement provides assurance that commitments made by the 73 participating nations can be legally enforced. However, the commitments themselves provide only limited opportunities in some markets. Detailed implementation schedules are required in many of those countries in which BT has an interest. A further round of World Trade Organisation negotiations on services is due to take place, although the timetable is unclear.

Other significant changes and issues

Local loop unbundling

In April 2000, following consultation, BT accepted an amendment to its Operating Licence which required it to provide unbundled local loops to other operators, to enable them to provide telecommunications services, including broadband DSL-type services, to end customers. The amendment came into force in August 2000, with local loop unbundling (LLU) to be available from July 2001.

The EU thereafter passed a regulation requiring LLU, line sharing and sub loop unbundling to be offered from December 2000, thereby bringing forward the implementation date. BT published a revised standard reference offer on 29 December 2000.

During 2001, BT will introduce line sharing as required by the EU regulation. Oftel will determine the prices for the broadband frequency band of a shared loop after consultation and input by BT of relevant cost calculations.

Carrier pre-selection

From 1 January 2000, the European Commission required the provision of carrier pre-selection (CPS) by Member State operators with significant market power. CPS allows customers to opt for certain classes of call to be carried by an alternative operator, selected in advance, without having to dial additional access codes.

Software changes to BT's local exchanges could not be introduced before January 2001 (for national and international calls) and January 2002 (for all other calls) and HM Government applied to the European Commission for a deferment of BT's obligation. The European Commission granted a limited deferment until 1 April 2000, but decided that CPS should be provided in the interim by means of auto-diallers on customers' premises.

BT introduced permanent CPS service (for national and international calls) ahead of schedule on 12 December 2000.

Leased lines

Oftel published a Direction in respect of partial private circuits (PPCs) on 29 March 2001. This resulted from a review of the competitiveness of the national leased lines market in the UK and the need for regulation in this sector. The Direction followed a consultation in August 2000 and an Oftel statement in December 2000. Oftel has concluded that more competition is needed in the provision of wholesale "terminating segments" and has proposed that BT offer PPCs to other operators at cost-based prices. Oftel has given time limits for the conclusion of negotiations. It is expected that the proposals will be implemented during the second half of 2001.

Mobile services

BT Cellnet operates under its own Mobile Public Telecommunications Operators licence that authorises provision of a range of mobile telecommunications services.

The Director General has previously determined, and is in the process of re-determining, that BT Cellnet and Vodafone have "market influence". A determination of market influence triggers, among other things, an obligation to supply independent service providers with wholesale airtime on their networks on fair and non-discriminatory terms for resale.

As a pre-condition to eligibility for bidding in the 3G licence auction, BT Cellnet and one other existing second generation (2G) mobile operator, Vodafone, were required to agree to amendments to their licences to incorporate a "roaming condition". This obliges BT Cellnet and Vodafone to allow the one new 3G entrant to roam onto their networks. The roaming condition will come into effect at the latest once this new entrant has rolled out its network to cover an area in which at least 20% of the UK population live.

BT Cellnet and Vodafone will be expected to negotiate roaming agreements with the new 3G entrant. If they are unable to agree, the matter may be referred to the Director General for resolution. The roaming condition will remain in force until 31 December 2009.

In addition to the consultation on termination charges for calls to mobiles, Oftel has issued a consultation document assessing the state of competition in the mobile market and the form of regulatory regime going forward. Oftel has indicated that its initial view is that the mobile market is not yet effectively competitive and that two or more of the mobile operators in the UK are likely to be subject to some regulation to promote competition.

Universal service

In September 2000, Oftel issued a further consultation on BT's Universal Service Obligation (USO). BT endorses Oftel's view that, at this point, BT's USO should not be extended to cover broadband services. Whilst BT welcomes Oftel's revision of costs and benefits set out in the previous consultation, BT is disappointed by Oftel's failure to acknowledge the strong case for industry funding of the significant net costs that fall on BT in providing universal service. BT still believes social telephony would be better funded through an industry-wide fund. BT awaits Oftel's final conclusions.

HM Government's review of telecommunications and broadcasting regulation

HM Government has initiated a review of telecommunications and broadcasting regulation. HM Government published a White Paper in December 2000 proposing regulatory reform concerning the convergence of the communications industries. A new regulatory body is proposed, to be called the Office of Communications (OFCOM), that will amalgamate the roles of five existing regulatory agencies: Office of Telecommunications; Independent Television Commission; Broadcasting Standards Commission; Radio Authority and Radiocommunications Authority. OFCOM will be headed by a chairman and chief executive supported by executive and non-executive board members.

The main change for telecoms would be the proposed introduction of fines for breach of regulatory obligations. BT supports HM Government's vision for the converging sector and welcomes the intention not to apply broadcasting rules to internet content. However, BT, along with many others, is seeking full rights of appeal against regulatory decisions and the incorporation within OFCOM of incentives to reduce the level of regulation when appropriate.

Oftel strategy statement

In January 2000, Oftel published a strategy statement based on the principle that regulation should go no further than the minimum necessary to protect consumers. The two key features of the strategy are increased use of industry self- and co-regulation, and reviews of the effectiveness of competition in major market sectors. BT supports the proposal for an extension of self- and co-regulation, which has the potential to result in regulation which is more flexible, more responsive and more pragmatic. BT is discussing with other stakeholders how this can best be put into practice, especially in consumer-related areas.

BT also supports the aim of the effective competition reviews, which are intended to ensure that the regulatory framework responds to changed competitive conditions. The reviews will be carried out over the next few years according to a schedule which Oftel has published: where it is found that competition is delivering benefits to consumers in the sectors reviewed, regulation will be reduced or withdrawn, as appropriate. Sectors for which reviews have already been initiated or completed include national leased lines and mobile telephony. BT supports Oftel's plans to review the duplication between licence conditions and the Competition Act during the current financial year.

Interconnection product

On 26 May 2000, Oftel issued a determination stating that BT should provide an interconnection product under its licence for flat rate internet access call origination (FRIACO). The determination requires BT to provide call origination for internet access, not on the standard pence per minute basis but with charging based upon network capacity purchased. The determination directed BT to offer FRIACO at the local exchange level from 1 June 2000. BT complied with this direction. BT had concerns at potential network congestion should FRIACO have to be made available at the next level up from the local exchange (DMSU). Oftel has acknowledged these concerns and, on 13 November 2000, began consulting on proposals that would make FRIACO available at the DMSU level, although with safeguards in place for one year to ensure the network does not become congested. A final determination on DMSU FRIACO was issued on 15 February 2001 requiring BT to offer such a product but with safeguards, including requirements on other operators to re-arrange traffic, to prevent network congestion. The charges for both FRIACO services are to be incorporated in the network charge control regime.

Office of Fair Trading review of Yellow Pages

On 11 May 2001, the Director General of Fair Trading issued a statement that, at the request of the Secretary of State for Trade and Industry, the OFT is to seek further undertakings from BT in respect of Yell's fees for advertising in its printed UK consumer classified directories (Yellow Pages). BT is being asked, amongst other things, to cap the fees at RPI minus 6 for four years from January 2002.

The decision follows a review by the OFT of undertakings entered into by BT in 1996. The existing undertakings were given following a 1996 Monopolies and Mergers Commission (now Competition Commission) report on the supply of classified directory advertising services. They cap Yell's advertising rates at RPI minus 2. They also require Yell to publish a rate card, ensure that directory areas do not overlap and to provide financial statements to the OFT.

Had the revised price cap been in effect during the 2001 financial year, it would have applied to around 65% of Yell's group turnover and we estimate that, assuming no change in advertising volume, Yell's revenues would have been reduced by approximately £20 million.

Domestic obligations in a global market
As a result of BT's international interests, a Licence condition prohibits BT from doing anything, by act or omission, that would detract materially from its ability to meet its Licence obligations to provide UK telecommunication services, and to do so to any specified standards. BT's directors are required to submit an annual compliance certificate to the Director General.

Relationship with HM Government

HM Government collectively is BT's largest customer, but the provision of services to any one department or agency of HM Government does not comprise a material proportion of BT's revenues. Except as described below, the commercial relationship between BT as supplier and HM Government as customer has been on a normal customer and supplier basis.

BT can be required by law to do certain things and to provide certain services for HM Government. In addition, the Secretary of State has statutory powers to require BT to take certain actions in the interests of national security or international relations.

Legal proceedings

The company does not believe there are any pending legal proceedings which would have a material adverse effect on the financial position or results of operations of the group.

Our commitment to society

Introduction

BT takes seriously the responsibility that comes with being a company that has the potential to improve people's lives through better communications.

We aim to discharge this responsibility:

- through our community programme;
- by minimising the environmental impact of our activities;
- through ethical sourcing policies and practices;
- by respecting different cultures and those who are disadvantaged or disabled; and
- by encouraging our people to act with integrity.

This is covered in more detail in our independently verified, environmental and social report.

BT in the community

We commit a minimum of 0.5% of our UK pre-tax profits to direct activities in support of society. This has grown from £10 million in 1987 to £16 million (including £1.2 million to charities) in the 2001 financial year.

The *Community Support Committee* oversees this social investment expenditure and establishes the strategy for maximising BT's contribution to society. The committee is made up of representatives from BT businesses and external non-executives who have a reputation for excellence in this field.

Our aim is to help create a better world by tackling big issues where better communication can make a real difference.

For example, BT has continued to make a commitment to education in the UK. More than 3,400 schools and 850,000 young people have had direct experience of the BT FutureTalk in Education programme, a drama-based campaign helping children to improve their communications skills.

The internet is now playing a much greater role in schools. A new BT teacher resource, **www.bt.com/futuretalk/education/** published in September 2000, offers information and communications technology teaching solutions and has attracted more than four million hits. It has been formally endorsed by the National Grid for Learning.

Our contribution to charitable causes is extensive and uses a range of communications tools, such as telethons for Comic Relief, Children in Need and GMTV's Get Up and Give, plus disaster appeals, including that for the Indian earthquake crisis. We also provide helplines and websites. In this way, every year, we help charities raise tens of millions of pounds for vital projects which can make a real difference to people's lives.

In addition, during the 2001 financial year, BT people gave £1.8 million directly to charities through Give-as-you-Earn, to which BT added a direct contribution of £1 million.

Environment

Sir Peter Bonfield has Board level responsibility for environmental matters. The Environmental Policy Steering Group has operational management responsibility and delivers an annual report to the Board and the *Executive Committee*.

This report advises the Board of the extent to which the company is meeting its obligations arising from its stated environmental policy. In particular, it reports on the manner in which BT:

- manages its operations in ways that meet relevant legal regulations;
- derives financial benefit from energy, road transport and waste minimisation programmes; and
- minimises its exposure to any potential environmental liabilities.

Our certification to ISO 14001, the international standard for environmental management systems, provides an additional level of risk management assurance and opportunities for enhancing marketing and sales propositions, as well as enhancing our wider corporate reputation by demonstrating sustainable and socially-responsible business practices.

As a result of these risk assessment processes, which are part of our approach to meeting the requirements of the Combined Code on Corporate Governance, the bulk storage of diesel fuel for use in back-up generators at telephone exchanges has been identified as BT's most significant environmental risk.

Although there are a small number of BT sites where ground remediation is taking place, the cost is not material and so the company declares no material contingent environmental liability in its financial statements. In order to minimise any future liability in this area, we have commenced an £18 million programme to cover tank testing, enhanced maintenance schedule and remedial works.

Some components from old exchange equipment contain polychlorinated napthalenes. When they require disposal, we exceed our legal obligations and ensure their safe destruction as hazardous waste.

During the 2001 financial year, we have made no purchase of any tangible fixed assets solely on the basis of environmental requirements. We often take environmental considerations into account when purchasing new equipment, but do not account for these considerations separately.

The main areas of environmental impact associated with BT's operations include energy consumption, waste disposal, transportation, and the use of ozone-depleting chemicals.

Since 1993, our energy efficiency programme has been accredited to the Energy Efficiency Accreditation Scheme run by the National Energy Foundation. Since 1991, we have reduced our energy consumption by over 22%, contributing to a 46% reduction in overall CO_2 emissions. This is equivalent to 850,000 tonnes of CO_2.

In the 2001 financial year, we recycled 18% of our total waste. We received £4 million income from our recycling activities, offset against the £7 million we spent on recycling and the £1.5 million spent sending 117,000 tonnes of waste to landfill.

During the 2001 financial year, we reduced the amount of copier paper we purchased by 290 tonnes, largely due to increased use of e-mail and the BT intranet. This year, by printing on both sides of the paper used for telephone bills, we should save a further 156 million sheets of paper.

We use CFCs in a small number of refrigeration systems and halons for fire extinguishing. We plan to adhere fully to the proposed new legislation on the use of CFCs and are part way through a programme to eliminate the use of halons for fire extinguishing, well in advance of any legal requirements. During the 2001 financial year, 15,750 kilograms of halon was recovered, from over 4,000 BT sites, and has been destroyed.

Our operational fleet of almost 38,000 vehicles, one of the largest in the UK, is now predominantly diesel fuelled. Over the past nine years, we have reduced our fleet size by 27% and achieved a 33% reduction in fuel consumption, with a corresponding 25% reduction in overall CO_2 emissions. This is equivalent to 57,800 tonnes of CO_2.

We are also continuing to reduce our transport-related environmental impacts in other ways. For example, a research study, undertaken in the 2001 financial year on behalf of BT, shows that the internal use of audio conference calls saved BT 59 million car miles during the period April 1999 to March 2000, and around 150 million journey miles across all modes of transport (car, rail, air, etc). This equates to a reduction in CO_2 emitted of some 34,000 tonnes, and a saving of seven million litres of fuel – worth almost £6 million.

Older or disabled customers

We are committed to supporting all our customers and, through our Age and Disability Unit, pay special attention to the additional requirements of our older or disabled customers. We fund Typetalk, a text-to-voice relay service that allows textphone users to communicate with hearing people. We provide:

- a free priority fault repair service for housebound people;
- telephones with additional features, such as large buttons and amplification, to give people greater freedom to communicate for themselves; and
- bills and other information in alternative formats, such as Braille and large print, for those who find it difficult to read standard text.

Details of these and other products and services can be found in our Guide for Older or Disabled People via **www.bt.com**

Future objectives

Our success in addressing issues of corporate responsibility has been widely recognised. In the past financial year, BT was presented with Business in the Community's Community Investment Award by HRH Prince of Wales, received an ACCA award for continued excellence in environmental reporting, and maintained its position as top of its industry sector in the Business in the Environment's annual index of environmental engagement.

The next phase of our strategic approach to corporate social responsibility will be built around the overall objective of helping bring about a better world through better communications. This will be particularly apparent through our employee involvement education programme, through our support for charities and through a high-profile campaign focusing on digital inclusion. We shall also be introducing an internal governance process into the restructured BT, based around our existing Statement of Business Practice.

For more information, you will find our latest environmental and social report at **www.groupbt.com/society**

Five-year financial summary

Profit and loss account

Years ended 31 March	1997 £m	1998 £m	1999 £m	2000 £m	**2001 £m**
Total turnover – ongoing activities	15,021	16,039	18,223	21,903	**29,666**
– discontinued activities	2,358	1,372	–	–	**–**
Total turnover, including discontinued activities	17,379	17,411	18,223	21,903	**29,666**
Group's share of associates' and joint ventures' turnover	(2,444)	(1,771)	(1,270)	(3,364)	**(9,937)**
Trading between group and principal joint venture	–	–	–	176	**698**
Group turnover – ongoing activities	14,935	15,640	16,953	18,715	**20,427**
Other operating income *(a)*	106	372	168	242	**393**
Operating costs *(b)(c)(d)(e)(f)(g)(h)*	(11,796)	(12,355)	(13,305)	(15,359)	**(20,759)**
Group operating profit	3,245	3,657	3,816	3,598	**61**
Group's share of operating profit (loss) of associates and joint ventures *(i)(j)*	184	(196)	(342)	(400)	**(397)**
Total operating profit (loss):					
Ongoing activities	3,209	3,436	3,474	3,198	**(336)**
Discontinued activities	220	25	–	–	**–**
	3,429	3,461	3,474	3,198	**(336)**
Profit on sale of fixed asset investments and group undertakings *(k)*	8	63	1,107	126	**619**
Net interest payable *(l)*	(174)	(310)	(286)	(382)	**(1,314)**
Premium on repurchase of bonds	(60)	–	–	–	**–**
Profit (loss) on ordinary activities before taxation	3,203	3,214	4,295	2,942	**(1,031)**
Tax on profit (loss) on ordinary activities:					
Corporation and similar taxes	(1,102)	(977)	(1,293)	(897)	**(652)**
Windfall tax	–	(510)	–	–	**–**
Profit (loss) on ordinary activities after taxation	2,101	1,727	3,002	2,045	**(1,683)**
Minority interests	(24)	(25)	(19)	10	**(127)**
Profit (loss) for the financial year	2,077	1,702	2,983	2,055	**(1,810)**
Average number of shares used in basic earnings per share (millions)	6,332	6,387	6,442	6,488	**6,525**
Basic earnings (loss) per share	32.8p	26.6p	46.3p	31.7p	**(27.7)p**
Diluted earnings (loss) per share	32.2p	26.2p	45.3p	30.9p	**(27.7)p**
Basic earnings (loss) per share from ongoing activities	30.8p	26.3p	46.3p	31.7p	**(27.7)p**
Diluted earnings (loss) per share from ongoing activities	30.2p	25.9p	45.3p	30.9p	**(27.7)p**
Dividends per share (including 1997 special dividend of 35p)	54.85p	19.0p	20.4p	21.9p	**8.7p**
Dividends per share, cents (including 1997 special dividend of 56c) *(m)*	87.8c	31.5c	33.0c	35.7c	**14.0c**
Profit before goodwill amortisation, exceptional items and taxation	3,203	2,976	3,274	3,100	**2,072**
Basic earnings per share before goodwill amortisation and exceptional items	32.8p	31.7p	35.0p	34.2p	**20.5p**
Diluted earnings per share before goodwill amortisation and exceptional items	32.2p	31.2p	34.2p	33.4p	**20.2p**
(a) Including MCI merger break-up fee net of expenses in 1998	–	238	–	–	**–**
(b) Including redundancy charges	367	106	124	59	**104**
(c) Including exceptional costs relating to the disengagement from MCI	–	–	69	64	**–**
(d) Including exceptional costs relating to the proposed closure of the BT Cellnet analogue network in 2000	–	–	–	47	**–**
(e) Including exceptional costs relating to impairment in goodwill	–	–	–	–	**3,000**
(f) Including exceptional credit for rates refunds, relating to prior years	–	–	–	–	**193**
(g) Including exceptional costs relating to the write off of Viag Interkom IT systems	–	–	–	–	**43**
(h) Including exceptional costs relating to the write off of subscriber acquisition costs	–	–	–	–	**7**
(i) Including exceptional costs relating to the write off of subscriber acquisition costs	–	–	–	–	**132**
(j) Including exceptional costs relating to impairment in goodwill	–	–	–	–	**200**
(k) Including gain on MCI shares sold in 1998	–	–	1,133	–	**–**
(l) Including exceptional credit for interest receivable on rates refunds, relating to prior years	–	–	–	–	**25**

(m) Dividends expressed in US currency have been converted at the actual exchange rate used in the payment of dividends to US shareholders.

Cash flow statement

Years ended 31 March	1997 £m	1998 £m	1999 £m	2000 £m	**2001 £m**
Cash flow from operating activities	6,185	6,071	6,035	5,849	**5,887**
Dividends from associates and joint ventures	7	5	2	5	**10**
Returns on investments and servicing of finance	(220)	(160)	(328)	(163)	**(727)**
Taxation paid	(1,045)	(1,886)	(630)	(1,311)	**(669)**
Capital expenditure and financial investment	(2,820)	(3,108)	1,046	(3,752)	**(8,442)**
Acquisitions and disposals	(252)	(1,501)	(1,967)	(6,405)	**(13,754)**
Equity dividends paid	(1,217)	(3,473)	(1,186)	(1,364)	**(1,432)**
Cash inflow (outflow) before management of liquid resources and financing	638	(4,052)	2,972	(7,141)	**(19,127)**
Management of liquid resources	(504)	2,247	(2,447)	1,236	**(480)**
Financing	(224)	1,794	(458)	5,959	**19,735**
Increase (decrease) in cash for the year	(90)	(11)	67	54	**128**
Decrease (increase) in net debt for the year	849	(3,860)	3,146	(6,582)	**(18,942)**

Balance sheet

At 31 March	1997 £m	1998 £m	1999 £m	2000 £m	**2001 £m**
Intangible fixed assets	–	–	742	5,777	**18,380**
Tangible fixed assets	16,802	17,252	17,854	18,163	**21,625**
Fixed asset investments	1,273	1,708	1,832	5,878	**5,204**
Net current liabilities	(2,667)	(2,637)	(495)	(7,115)	**(11,143)**
Total assets less current liabilities	15,408	16,323	19,933	22,703	**34,066**
Loans and other borrowings falling due after one year	(2,693)	(3,889)	(3,386)	(5,354)	**(18,775)**
Provisions for liabilities and charges	(1,391)	(1,426)	(1,391)	(1,056)	**(723)**
Minority interests	(208)	(223)	(216)	(498)	**(499)**
Total assets less liabilities	11,116	10,785	14,940	15,795	**14,069**
Called up share capital	1,589	1,603	1,617	1,627	**1,646**
Share premium account	675	892	1,206	1,580	**2,195**
Other reserves	777	776	774	933	**884**
Profit and loss account	8,075	7,514	11,343	11,655	**9,344**
Total equity shareholders' funds	11,116	10,785	14,940	15,795	**14,069**
Total assets	25,062	23,285	27,962	37,588	**54,799**

US GAAP

Years ended 31 March	1997 £m	1998 £m	1999 £m	2000 £m	**2001 £m**
Group operating profit (loss)	3,398	3,243	3,356	2,990	**(633)**
Income (loss) before taxes	3,326	2,791	3,745	2,096	**(1,959)**
Net income (loss):					
Ongoing activities	2,069	1,503	2,589	1,393	**(2,357)**
Discontinued activities	80	(56)	–	–	**–**
	2,149	1,447	2,589	1,393	**(2,357)**
Average number of ADSs used in basic earnings per ADS (millions)	633	639	644	649	**653**
Basic earnings (loss) per ordinary share	33.9p	22.7p	40.2p	21.5p	**(36.1)p**
Diluted earnings (loss) per ordinary share	33.6p	22.3p	39.3p	21.0p	**(36.1)p**
Basic earnings (loss) per share from ongoing activities	32.6p	23.5p	40.2p	21.5p	**(36.1)p**
Diluted earnings (loss) per share from ongoing activities	32.1p	23.2p	39.5p	21.0p	**(36.1)p**
Basic earnings (loss) per ADS	£3.39	£2.27	£4.02	£2.15	**£(3.61)**
Diluted earnings (loss) per ADS	£3.36	£2.23	£3.93	£2.10	**£(3.61)**
At 31 March					
Total assets	27,239	27,951	29,323	38,481	**55,361**
Ordinary shareholders' equity	11,588	12,615	13,674	13,634	**10,231**

Financial review

Please see cautionary statement regarding forward-looking statements on page 143.

Introduction

BT's loss of 27.7 pence per share for the year ended 31 March 2001 (the 2001 financial year) compares with earnings of 31.7 pence for the 2000 financial year and 46.3 pence for the 1999 financial year. Exceptional items and goodwill amortisation have affected earnings in each of these years. Earnings for the 2001 financial year were affected by net exceptional charges of 39.6 pence per share, primarily relating to goodwill impairment and mobile subscriber acquisition costs written off partially offset by the profit on disposals of investments and rates refunds. Of the earnings in the 2000 financial year, 0.1 pence per share represented net exceptional income. In the 1999 financial year, net exceptional income amounted to 11.6 pence per share mainly relating to the sale of the group's investment in MCI Communications Corporation in September 1998. Goodwill amortisation adversely affected earnings by 8.6 pence per share in the 2001 financial year before exceptional charges, by 2.6 pence per share in the 2000 financial year and by 0.3 pence per share in the 1999 financial year. Before goodwill amortisation and exceptional items, earnings of 20.5 pence per share for the 2001 financial year compare with an equivalent 34.2 pence and 35.0 pence for the 2000 and 1999 financial years, respectively.

The results for the 2001 financial year reflect the higher interest charges which have arisen from BT's recent investment in new businesses and new third-generation mobile licences, as well as losses incurred by our newly acquired businesses and the adverse effect which competitive pressures have had on our operating margins in the UK fixed-voice telephony and wireless markets. The results for the 2000 financial year also reflected the adverse effect which competitive pressures had on operating margins. The results for that year were additionally impacted by the costs of meeting increased customer demand, particularly for wireless communications, and of growing new areas of business. In both the 2001 and 2000 financial years, BT benefited from the strong growth in demand for the group's products and services. Internet and wireless phone usage expanded rapidly and this led to increased turnover. In the 2000 financial year, the buoyant UK economy had a beneficial effect on the results. Our ventures in North America, continental Europe and Asia Pacific which we have established, or in which we have acquired interests, in recent years, contributed significantly to our total turnover growth. However, the initial losses incurred by many in their development stages are, as anticipated, adversely affecting the group's results. We continue to be affected by the tight regulatory regime in the UK. Price reductions, including those imposed by the price control formulae, totalled approximately £200 million in the 2001 financial year, following reductions of approximately £550 million in the 2000 financial year and over £500 million in the 1999 financial year.

The 2001 financial year has been dominated by the restructuring of our previously centrally organised business into several decentralised lines of business, by our acquisitions of interests and mobile licences in Europe and by the consequent increase in net debt, which rose to £27.9 billion at

Summarised profit and loss account	2001 £m	2000 £m	1999 £m
Total turnover	**29,666**	21,903	18,223
Group's share of ventures' turnover	**(9,937)**	(3,364)	(1,270)
Trading between group and principal joint venture	**698**	176	–
Group turnover	**20,427**	18,715	16,953
Other operating income	**393**	242	168
Operating costs	**(20,759)**	(15,359)	(13,305)
Group operating profit (loss)	**61**	3,598	3,816
Group's share of ventures' losses	**(397)**	(400)	(342)
Total operating profit (loss)	**(336)**	3,198	3,474
Profit on sale of fixed asset investments and group undertakings	**619**	126	1,107
Net interest	**(1,314)**	(382)	(286)
Profit (loss) before taxation	**(1,031)**	2,942	4,295
Taxation	**(652)**	(897)	(1,293)
Profit (loss) after taxation	**(1,683)**	2,045	3,002
Minority interests	**(127)**	10	(19)
Profit (loss) for the financial year	**(1,810)**	2,055	2,983
Basic earnings (loss) per share	**(27.7)p**	31.7p	46.3p
Profit before goodwill amortisation, exceptional items and taxation	**2,072**	3,100	3,274
Basic earnings per share before goodwill amortisation and exceptional items	**20.5p**	34.2p	35.0p

31 March 2001. Towards the end of the 2001 financial year, in January and February 2001, we acquired the 55% interest in Viag Interkom of Germany we did not already own. Earlier on in the year, in June 2000, we acquired the 50% interest in Telfort of The Netherlands not already owned.

During the year, we acquired through auctions one of the five UK third-generation mobile licences, Viag Interkom gained one of six licences in Germany and Telfort acquired one in The Netherlands. We also acquired a significant economic interest in the J-Phone mobile businesses in Japan in May 2000 which we have now agreed to sell to Vodafone, our main competitor in the wireless market in the UK and elsewhere in Europe. In order to finance these investments, we issued two significant series of bonds totalling £13 billion, one primarily in the US and the other primarily in Europe. In November 2000, we sold our 34% interest in sunrise communications at a profit of £454 million.

In early January 2000, Concert, our global venture 50/50 owned with AT&T, was established. Concert took over a major part of our international communications activities and is currently managing the communication needs of a number of our multinational corporate customers. At the same time, it also acquired the Concert Communications Services group (Concert Communications) from BT. As a consequence, from the last quarter of the 2000 financial year, certain of the group's former turnover is reported as part of our proportionate share of our joint ventures' turnover. Also in the 2000 financial year, BT took a 30% interest, jointly with AT&T, in Japan Telecom, acquired the remaining 40% interest in BT Cellnet which it did not already own, and acquired control of Esat Telecom Group, a leading Irish communications group. The AT&T ownership interest in Japan Telecom has been acquired by Vodafone in April 2001 and in May 2001 we agreed to sell our interest in Japan Telecom also to that company.

In the 1999 financial year, the group's interest in MCI, held since 1994, was sold on the completion of the MCI/WorldCom merger. We recognised a pre-tax profit of £1,133 million on this sale; this followed the £273 million fee we received in November 1997 on the announcement of their agreed merger, as compensation for the break-off of the merger we had planned with MCI. We ceased equity accounting for MCI as an associate on 31 October 1997. At the same time as we disposed of our interest in MCI in September 1998, we acquired the minority interest owned by MCI in Concert Communications.

On 10 May 2001, we announced our intention to demerge BT Wireless later in 2001 to create two separately listed companies; the first, BT Wireless, will comprise our controlled wireless operations in Europe, and the other, Future BT, will be a focused European network and retail business concentrating on voice and data services. We are currently considering proposals to sell or demerge Yell, our classified advertising directories business. We also announced on 10 May 2001, a rights issue to raise approximately £5.9 billion from shareholders and that we were halting the payment of dividends for the time being. These steps combined with asset disposals, including the sale of the investments in Japan, are designed to reduce net debt in Future BT to between £15 billion and £20 billion by 31 March 2002.

Restructuring

We announced in April 2000 that we would restructure our operations, by separating the UK fixed-network business into two businesses and forming four new international businesses to operate and manage BT's broadband, internet, wireless and directories businesses. The four international businesses, BT Wireless, BT Ignite, BTopenworld and Yell began operations on 1 July 2000. The BT Wholesale and BT Retail businesses were formed in October 2000.

In November 2000, we announced an intention to sell public minority stakes in some of BT's international businesses and to dispose of non-core holdings. We also stated that we expected to reduce our net borrowings from a peak of approximately £30 billion by around £10 billion. Certain of the restructuring steps have been changed to reflect developments in the capital markets. As noted above, we intend to demerge BT Wireless towards the end of 2001 and to demerge or sell Yell.

The financial impact of these proposals are illustrated in the pro forma statements on pages 133 to 140 of this document.

BT Wireless comprises the group's controlled mobile activities in the UK, Germany, Ireland and The Netherlands, and the Genie mobile internet business. The group's minority interests in wireless companies are held centrally pending clarification of their future within the BT group. The financial information on BT Wireless and the other international businesses for the 2001 financial year reflects this composition.

On 2 May 2001, we announced that we had agreed to sell our interests in Japan Telecom and J-Phones to Vodafone at a value of £3.7 billion and our interest in Airtel in Spain also to Vodafone for £1.1 billion. The overall impact of the combined transaction will be a net reduction in total BT group debt of £4.4 billion. Completion of the transactions is conditional upon relevant regulatory and procedural approvals in Europe and Japan.

We also announced, on 4 May 2001, that we had agreed in principle to sell our interest in Maxis Communications in Malaysia for £350 million. This transaction is also subject to regulatory and other approvals.

Financial review

On 10 May 2001, we announced a rights issue, proposed to raise approximately £5.9 billion, net of expenses, of up to 1,976 million new BT shares at a price of 300 pence per share. The rights issue is due to close on 15 June 2001. Earnings (loss) and dividends per share figures in this document are stated before adjusting for the dilutionary effect of this rights issue, the exact impact of which will only be known on closing of the rights issue.

Regulation and prices

BT has been operating under the existing retail price control from 1 August 1997, under which a cap of RPI minus 4.5 applies to the services used by the lowest 80% of BT's residential customers by bill size. This retail price control is estimated to have covered services representing about 13% of the group's turnover for the 2001 financial year. In the current price control year to 31 July 2001, BT has already reduced its prices by 1.20%, which is more than the required reduction of 1.09%. The equivalent reduction in the previous control year was 3.24%.

Most of BT's interconnect (network) charges to other UK operators are based on long-run incremental costs. There are annual reductions in these charges based on a RPI minus 8 price cap. The current network charge control regime operates until 30 September 2001. After this time it has been proposed that the broad structure of the interconnect (network) services be retained for another four years but that the "X" within the RPI minus X price-cap formula be varied between 7.5 and 13.

The Competition Commission (CC) required BT to reduce charges from a BT line to mobile phones by around 25% in the 1999 financial year and an effective annual RPI minus 7 reduction for the 2000 and 2001 financial years.

On 11 May 2001, the Office of Fair Trading issued a statement outlining the decision of the Secretary of State for Trade and Industry on the Office of Fair Trading's review of Yell's Yellow Pages business. The statement requires Yell to cap the fees charged for advertising in its UK Yellow Pages directories at RPI minus 6 for four years from January 2002. The current price cap of RPI minus 2 has been in force since 1996.

The regulatory environment in the UK has had, and will continue to have, a significant adverse impact on the group's turnover and operating profit. As the group has extended its activities to other countries, BT is required to consider the regulatory regimes in those countries.

Competition and the UK economy

BT has a significant market share in its main UK markets for fixed-network calls and provision of exchange lines. Competition has eroded BT's market share significantly in key market sectors, in particular areas of the UK and for certain products and services. We estimate that BT had 57% of the market for national calls in the 2001 financial year, compared with 64% and 69% in the 2000 and 1999 financial years, respectively, and supplied 83% of the exchange lines in the UK at 31 March 2001, compared with 84% and 86% at 31 March 2000 and 1999, respectively. Additionally, we estimate that BT had 71% of the market for local calls in the 2000 financial year, compared with 74% and 78% in the 2000 and 1999 financial years, respectively.

The growth in cable operators' networks in the UK is having an adverse effect on BT's share of the residential market. In recent years, BT has experienced a small net annual reduction in residential exchange line connections as a result of increasing competition from these cable operators in certain geographic areas. This small rate of reduction is expected to continue.

In an environment of strong competition, BT Cellnet had 26% of the market based on the number of customer connections at 31 March 2001, compared with 27% at 31 March 2000 and 30% at 31 March 1999. There has also been a downward pressure on prices.

The group has seen some diversion of demand from its fixed network as a result of the growth of other licensed operators' activities. This diversion may intensify now that BT's fixed-line customers are able to pre-select their carrier.

Additionally, BT's Licence was amended in April 2000 to require BT to provide other operators with use of the lines connecting BT's local exchanges to its customers and allow operators to install equipment in BT's exchanges (local loop unbundling). This amendment took effect in December 2000. This could result in further intensification of competition and have an adverse effect on BT's results.

For its operations as a whole, BT expects the competitive pressure to persist and it will continue to defend its market share vigorously and fairly.

The strength of the UK economy is an important determinant of BT's business volumes and the gross domestic product grew by 2.5% in the 2001 financial year, compared with 2.9% and 1.5% in the 2000 and 1999 financial years, respectively.

Lines of business results

In the following commentary, we discuss the operations of the group for the 2001 financial year in terms of the new lines of business. However, as it is not practical for us to compile comparative figures for the 2000 and 1999 financial years for all the lines of business, these two earlier years are discussed in general terms in the context of the relevant line of business.

The lines of business' results for the 2001 financial year are as follows:

	Total turnover £m	Total operating profit (loss) before exceptional items and goodwill amortisation £m
BT Retail	11,813	1,004
BT Wholesale	11,493	2,540
BT Wireless	3,947	(225)
BT Ignite	3,861	(380)
Concert	2,576	19
Yell	778	210
BTopenworld	212	(296)
Other	7,151	539
Eliminations	(12,165)	–
Totals	29,666	3,411

The group's profits are derived predominantly from BT Retail and BT Wholesale's fixed network business in the UK. The profit from BT Wireless's mobile network in the UK is largely offset by losses being incurred in establishing its networks in Ireland, The Netherlands and Germany. Yell contributed a profit principally from its Yellow Pages directory activities in the UK. BT Ignite and BTopenworld are both in a development stage incurring losses.

Turnover

Group turnover, excluding BT's share of the ventures' turnover, grew by 9.1% to £20,427 million in the 2001 financial year after growing by 10.4% in the 2000 financial year compared with the 1999 financial year. The strong growth in demand for the group's products and services of approximately 9% in the 2001 financial year was partially offset by the effect of price reductions which averaged approximately 1% across the business. The principal areas of growth were through the acquisition of interests in Europe and from interconnect with other UK operators. Acquisitions made in the 2001 and 2000 financial years contributed approximately £940 million to the growth in turnover. The transfer of certain BT businesses to the Concert global venture in January 2000 has had the effect of reducing group turnover by approximately £610 million. In the 2000 financial year, acquisitions in the 2000 and 1999 financial years contributed about 25% of the growth in group turnover. Growth in demand of approximately 11% in the 2000 financial year was partially offset by the effect of price reductions which averaged approximately 3% across the business. Both mobile calls and interconnect receipts in the UK made strong contributions to the growth in group turnover in the 2000 financial year, as a result of the significant growth in BT Cellnet's mobile customer base and increased mobile usage.

The group's turnover by product is analysed as follows:

	2001 £m	2000*(a)* £m	1999*(a)* £m
Fixed-network calls	**5,655**	5,908	6,026
Exchange lines	**3,674**	3,526	3,351
Receipts from other operators	**2,814**	1,974	1,417
Wireless products	**2,760**	2,170	1,400
Private services	**1,091**	1,135	1,140
Solutions	**1,074**	915	746
Yellow Pages and other directories	**754**	642	491
Customer premises equipment supply	**726**	847	870
Other sales and services	**1,879**	1,598	1,512
Group turnover	**20,427**	18,715	16,953
Share of ventures' turnover	**9,937**	3,364	1,270
Trading between group and principal joint venture	**(698)**	(176)	–
Total turnover	**29,666**	21,903	18,223

(a) Figures for the 1999 and 2000 financial years have been restated to conform with the method of classification used in the 2001 financial year.

BT Retail

BT Retail's turnover is mainly derived from BT's UK fixed network customers through the provision of fixed-network call services, exchange lines and private services.

Turnover from fixed-network calls declined by 4.3% to £5,655 million in the 2001 financial year following a decline of 2.0% in the 2000 financial year compared with the 1999 financial year. Fixed-network calls comprise all calls by customers made from fixed lines in the UK, including outbound international calls. In both the 2001 and 2000 financial years, call volume growth was more than offset by the effect of significant price reductions.

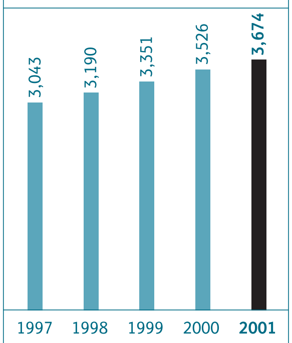
Price reductions had an impact on turnover from fixed-network calls for all the years under review. In the 2001 financial year, the principal reductions were in the prices for most types of geographic calls. In the 2000 financial year, the principal reduction was the 25% cut in fixed to mobile call prices from the end of April 1999 as required by the CC. Other reductions included enhanced discounts and lower Freefone and Lo-call prices charged to other service providers. The combined effect of the price changes to fixed-network calls totalled approximately £280 million in the 2001 financial year, which was equivalent to a 5% reduction in call prices following falls of 9% and 3% in the previous two years.

The main volume growth in fixed-network calls in the 2001 financial year was derived from a significant increase in calls to mobile phones and the increased use of the internet. In the 2000 financial year, similar factors were also behind the increase in calls over BT's fixed network. The call volume growth of 2% in the 2001 financial year compares with 7% in the 2000 financial year. While fixed to mobile and internet-related local calls continued to grow strongly, traditional geographic fixed-network calls declined in volume, which we attribute partly to mobile phone substitution and also to intense competition. The trend in fixed network call volumes, which we expect will continue, is illustrated in the table below:

Fixed network calls volume growth	12 months' volume growth (decline) 2001 %	2000 %
Non-geographic calls:		
Internet related and other	38	95
Fixed to mobile	30	48
Geographic calls:		
Local	(12)	(9)
National	(7)	(4)
International	(3)	(3)
Overall	2	7

Turnover from exchange lines grew by 4.2% in the 2001 financial year to £3,674 million after increasing by 5.2% in the 2000 financial year. The increased turnover was the combined result of the growth in business lines and rental price increases. The number of business lines grew by 5.4% in the 2001 financial year and by 5.9% in the 2000 financial year, with ISDN services being the main driver behind this growth. The numbers of residential lines declined slightly in both years due to the competition from other fixed line providers largely offset by the high number of BT customers installing second lines. Overall, BT's total fixed-network lines grew by 1.3% in the 2001 financial year to 28.95 million and by 1.9% in the 2000 financial year to 28.58 million.

Exchange lines turnover (£m)
years ended 31 March



Private services turnover decreased by 3.9% in the 2001 financial year to £1,091 million, following a decline of 0.4% in the previous financial year. The decline in both years was mainly attributable to the transfer of activities to the Concert global venture in January 2000.

BT Retail achieved an operating profit of £1,004 million, before exceptional items, in the 2001 financial year on turnover of £11,813 million. Margins for the year have been affected by the adverse mix effect of the increase in calls from fixed to mobile and the Internet, with declines in geographic calls, although the rate of decline in geographic calls reduced in the last quarter of the year. We believe that this is linked to the success of the new BT Together family of products which have now been taken up by eight million customers.

BT Wholesale

The majority of BT Wholesale's turnover is derived from supplying network services to BT Retail. Its external turnover is derived from receipts from other operators for interconnect services.

Turnover from receipts from other operators for interconnect charges increased by 39% in the 2000 financial year and by 43% to £2,814 million in the 2001 financial year. This turnover mainly comprises the income BT generates from other UK operators for passing calls from one operator to another and for terminating calls on BT's network. In the 1999 and 2000 financial years, it also included receipts from international operators for incoming international and transit calls which BT received before this activity was transferred to Concert in early January 2000. From that date, this turnover includes receipts from Concert for terminating incoming calls into the UK and handling Concert's UK multinational customer domestic traffic. The increases in turnover, in the 2001 and 2000 financial years, primarily reflect the growing market share of BT's UK competitors, particularly mobile phone operators, and the increasing level of traffic flowing through and into BT from their networks. There has been a large corresponding increase in the payments made by BT to these operators for traffic passing to their networks. Although growth has been rapid, with volumes growing at 39% for the 2001 financial year, and 38% for the 2000 financial year, BT's interconnect business does not provide the group with the same overall level of margin as its UK retail business.

In the 2001 financial year, BT Wholesale contributed an operating profit before exceptional items of £2,540 million on turnover of £11,493 million. Externally generated turnover amounted to slightly over £3 billion for the year. BT Wholesale has the responsibility for wholesale broadband products and the losses for this activity are included in the results. Return on capital employed was 20%.

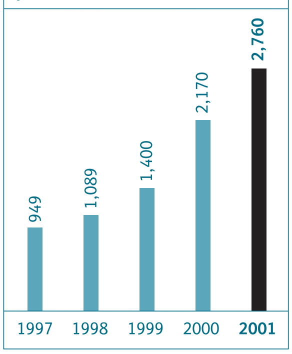
BT Wireless

The group's wireless turnover mainly comprises calls charged to and subscriptions from BT Cellnet customers in the UK. It also includes the turnover of the three major acquired companies, Esat Digifone in Ireland since its acquisition in March 2000, Telfort's mobile activities in The Netherlands since its acquisition in June 2000 and Viag Interkom's mobile activities in Germany since its acquisition in February 2001.

Wireless turnover increased by 27% in the 2001 financial year to £2,760 million, following growth of 55% in the previous financial year. Over three-quarters of the increase in turnover in the 2001 financial year was contributed by the three major acquisitions and nearly half of the increase in turnover in the 2000 financial year was contributed by the BT Cellnet Lumina and DX Communications businesses acquired in 1999. Otherwise, the turnover increases in the 2001 and 2000 financial years reflected the 51% and 64% growth in BT Cellnet's customer-base in the two years, respectively, offset by the effect of reductions in mobile call prices. Nearly 3.8 million new customers were connected to BT Cellnet's network in the 2001 financial year, following the 2.9 million connected in the 2000 financial year, substantially due to the success of the "pre-paid" mobile phone introduced in the second half of the 1999 financial year. BT Cellnet had 11.2 million customer connections at 31 March 2001, of which over two-thirds were on a pre-paid basis.

BT Wireless incurred a total operating loss of £225 million before goodwill amortisation and exceptional items on total turnover of £3,947 million in the 2001 financial year. The results reflect the start up losses of the Genie wireless portal business which amounted to £138 million on turnover of £13 million. The figures directly reflect the BT Wireless business proposed to be demerged later in 2001. BT Wireless' results overall were hit by acquisition costs associated with the record customer growth in BT Cellnet and other operations.

Wireless products turnover (£m)
years ended 31 March



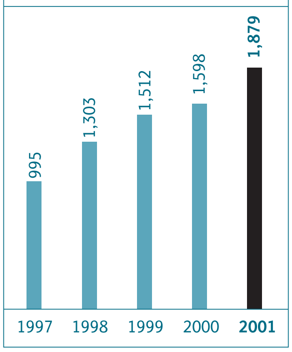
Viag Interkom incurred an operating loss of £41 million before goodwill amortisation and exceptional items, for BT Wireless, on turnover of £70 million from 20 February 2001, the date of acquisition. The exceptional items attributable to BT Wireless include £2,800 million of the Viag Interkom goodwill impairment charge.

BT Ignite, BTopenworld and other

Turnover from the external sales of BT Ignite Solutions and Syntegra, which provides outsourcing and systems integration services, both in the UK and worldwide has grown by 17.4% in the 2001 financial year to £1,074 million after growing by 23% in the 2000 financial year. The reduction in the growth in turnover in the 2001 financial year is attributable to the transfer of activities to the Concert global venture in January 2000.

Turnover from BT's other sales and services has grown by 17.6% in the 2001 financial year to £1,879 million after growing by 5.7% in the 2000 financial year. The turnover in the 2001 financial year included the fixed-network business of Telfort, Esat and Viag Interkom since acquisition. Videoconferencing, and broadcasting and other multimedia services, contributed strongly to the growth in turnover. This category also included sales by Concert Communications up to early January 2000 before its transfer to the new Concert joint venture.

Other sales and services turnover (£m)
years ended 31 March



BT Ignite's turnover in the 2001 financial year was £3,861 million with an operating loss of £380 million before goodwill amortisation and exceptional items. The main driver of operating losses for BT Ignite is from investments in BT's new value added business, amounting to £358 million in the year. These include £115 million in the year for content hosting and application service provision. The operating losses generated by fixed operations consolidated for first time in this financial year, including Esat, Telfort and Viag Interkom, amounted to a total of £135 million.

BTopenworld incurred an operating loss of £296 million on turnover of £212 million in the 2001 financial year. Its turnover is derived principally from its UK and continental European narrowband internet access products. Narrowband activities contributed approximately 50% of the operating loss whilst our broadband services make up around 40% reflecting the start-up nature of the businesses. It is our aim to achieve narrowband EBITDA break-even by the end of the 2003 financial year. The broadband business is expected to follow shortly afterwards. To do this, we have already put in place various cost cutting measures which include the reduction of headcount by 20% following a recent reorganisation. We are also exiting loss making legacy contracts and rationalising our numerous e-mail platforms.

Yell

BT's Yellow Pages and other directory businesses include the Yellow Book USA business acquired in August 1999. Turnover of £754 million has grown by 17.4% in the 2001 financial year, substantially due to this acquisition. Turnover grew by 31% in the 2000 financial year, of which two-thirds is due to the acquisition. Turnover in the UK business was broadly unchanged in the 2001 financial year in contrast to the 2000 financial year when the UK business grew by about 9%, partly reflecting the good growth in the economy.

Yell contributed an operating profit of £210 million before goodwill amortisation on turnover of £778 million. The results include its US operations in its first full year.

Financial review

Total turnover

Total turnover in the 2001 financial year of £29,666 million includes BT's proportionate share of its ventures' turnover of £9,937 million before adjusting for trading between the Concert joint venture and the BT group. This total turnover grew by 35% in the 2001 financial year after growing by 20% in the 2000 financial year compared with the total turnover in the 1999 financial year. BT's acquisitions of businesses and interests in new ventures in North America, Europe and Asia Pacific, including Concert from January 2000, accounted for around three-quarters of the increase in total turnover in the 2001 financial year and around a half of the increase in total turnover in the 2000 financial year.

Other operating income

As part of the arrangements for the establishment of Concert, BT has been seconding staff and providing administrative and other services from its launch in early January 2000. The income from these services totalled £168 million in the 2001 financial year and £79 million in the 2000 financial year.

Operating costs

Total operating costs increased by 35% in the 2001 financial year to £20,759 million after increasing by 15.4% in the 2000 financial year. As a percentage of group turnover, operating costs, excluding goodwill amortisation, increased from 79% in the 1999 financial year to 82% in the 2000 financial year and to 85% in the 2001 financial year. In all three financial years, net exceptional costs were incurred. These amounted to £2,857 million, £111 million and £69 million in the 2001, 2000 and 1999 financial years, respectively. These exceptional costs are considered separately in the table below and the discussion which follows.

	2001 £m	2000 £m	1999 £m
Staff costs	**4,625**	4,283	3,871
Own work capitalised	**(693)**	(498)	(428)
Depreciation	**3,045**	2,704	2,568
Goodwill and other intangibles amortisation	**386**	89	–
Payments to telecommunication operators	**3,802**	3,068	2,106
Other operating costs	**6,737**	5,602	5,119
Total operating costs before exceptional costs	**17,902**	15,248	13,236
Exceptional costs	**2,857**	111	69
Total operating costs	**20,759**	15,359	13,305

Staff costs increased by 8.0% in the 2001 financial year to £4,625 million, after rising by 10.6% in the 2000 financial year. In the 2001 financial year, the numbers employed in the group increased by 200 to 137,000 at 31 March 2001. Over 5,800 people left the group on voluntary release and other incentive terms and some 3,000 people transferred to joint ventures. Over 7,500 people joined through the acquisitions of Viag Interkom and Telfort. Higher pension costs and the annual pay awards were the main reasons for the increase in staff costs. In the 2000 financial year, the numbers employed in the group increased by 12,100. This net increase included 5,000 individuals employed outside the UK mainly through acquisitions, 2,500 former agency workers now working for BT, and around 4,500 people needed in the UK to meet increased demand and to roll out the ADSL broadband product. These increases and the impact of pay awards caused the increase in staff costs in the 2000 financial year.

The allocation for the employee share ownership scheme, included within staff costs, was £32 million in the 2001 financial year. This represents 2% of the pre-tax profit for the year, before the exceptional goodwill impairment charges and the gains made on certain disposals. The allocation for the 2000 financial year was £59 million and represented 2% of pre-tax profit for that year. The allocation for the 1999 financial year of £64 million represented 2% of pre-tax profit for that year, before the gain on the sale of MCI shares.

The depreciation charge increased by 12.6% in the 2001 financial year to £3,045 million after increasing by 5.3% in the 2000 financial year, reflecting BT's continuing high level of investment in its networks and, in the 2001 financial year, the acquisition of its new businesses.

Goodwill amortisation in respect of subsidiaries and businesses acquired since 1 April 1998, when BT adopted FRS 10, and amortisation of other intangibles amounted to £386 million in the 2001 financial year compared with £89 million in the 2000 financial year. Of the total in the 2001 financial year, £150 million relates to the BT Cellnet minority acquisition in November 1999 and £93 million relates to the Esat group acquisition in March 2000.

Payments to other telecommunication operators grew by 24% in the 2001 financial year to £3,802 million after increasing by 46% in the 2000 financial year. The growth in these payments was primarily as a result of the growing number of calls originating on or passing through BT's networks and terminating on UK competitors' fixed and mobile networks. This is due, in particular, to the increase in mobile phone usage and internet-related calls. The payments include those made to Concert for the delivery of BT's outgoing international calls from early January 2000 and those made by BT to international operators for outgoing and transit calls prior to that time. Also included are payments made to mobile phone operators on behalf of BT Cellnet Lumina and DX Communications' customers.

Other operating costs, which rose by 20% in the 2001 financial year to £6,737 million and by 9.4% in the 2000 financial year, include the maintenance and support of the networks, accommodation and marketing costs, the cost of sales of customer premises equipment and redundancy costs. The increase in costs in the 2001 financial year is mainly attributable to the other operating costs of acquired businesses. The costs incurred in supporting the high growth of BT Cellnet was the main factor behind the increase in costs in the 2000 financial year. Also, in the 1999 financial year, a currency gain of £87 million from investing the proceeds of the MCI shares was offset against these costs.

Redundancy costs of £104 million were incurred in the 2001 financial year, compared with £59 million in the 2000 financial year and £124 million in the 1999 financial year. The redundancy costs in the 2001 financial year and to a much lesser extent in the 2000 financial year include the costs of over 3,000 managers who took early voluntary release as part of BT's plans to improve efficiency. In view of a pension fund surplus, which for accounting purposes includes the provision for pension costs in the group's balance sheet, and in accordance with BT's accounting policies, redundancy charges for the three financial years 2001, 2000 and 1999 do not include the costs of the incremental pension benefits provided to early retirees, which totalled £429 million, £140 million and £279 million, respectively.

We are changing the arrangements under which people leave BT in advance of the normal retirement age. Under our NewStart programme launched during the fourth quarter of the 2001 financial year, BT employees will be expected to leave with a leaving payment in place of a redundancy payment, and incremental pension benefits are to be scaled down. This should reduce early leaver costs, which have been very significant in recent years.

The exceptional items within operating costs are summarised in the table in the adjacent column. The most significant item in the 2001 financial year is the impairment of goodwill in Viag Interkom. We completed the acquisition of the 55% interest in the company for £8,770 million in January and February 2001 including repayment of loans. Goodwill of £4,992 million arose on this transaction, the consideration for which was negotiated in August 2000. We have undertaken an impairment review under the requirements of the UK Accounting Standard FRS 11, incorporating reduced expectations for the rate of growth in profits in the medium term reflecting current market views.

Exceptional operating costs	**2001 £m**	2000 £m	1999 £m
Impairment of goodwill in Viag Interkom	**3,000**	–	–
Write off of Viag Interkom's IT systems	**43**	–	–
Infrastructure rates refunds	**(193)**	–	–
Write off of cellular subscriber acquisition costs	**7**	–	–
Costs relating to the disengagement from MCI	**–**	64	69
Costs relating to the closure of the BT Cellnet analogue network	**–**	47	–
Total exceptional costs	**2,857**	111	69

An impairment in goodwill of £3,000 million resulted from this review.

Other exceptional items within operating costs in the 2001 financial year mainly comprised:

- a write off of £43 million on Viag Interkom's IT systems following its division into fixed and wireless business on BT's acquisition;
- a credit of £193 million for the refund of rates on BT's infrastructure following a successful legal action taken by BT in 2000 to challenge the rateable valuations on which it was charged for its network assets.

The exceptional costs for the 2000 financial year included £47 million for the exit of BT Cellnet's analogue network in autumn 2000. Additionally, in the 2000 and 1999 financial years, costs of £64 million and £69 million, respectively, involved in the work to ensure that BT's business became fully independent of MCI have been shown as exceptional items in the group profit and loss account.

In the 2002 financial year productivity improvements and cost savings will be sought and initiatives to reduce costs totalling approximately £575 million have been identified.

Group operating profit

Group operating profit for the 2001 financial year of £61 million was £3,537 million lower than in the previous year, principally due to the £3,000 million goodwill impairment charge. The profit for the 2000 financial year was £218 million lower than in the 1999 financial year. Before goodwill amortisation and the exceptional items described above, group operating profit in the 2001 financial year was 13.3% lower than in the 2000 financial year. This, in turn, was 2.2% lower than that in the 1999 financial year. The reduction in profit in the 2001 financial year was caused by reduced call prices, increased lower margin wholesale business with other operators, the losses of

£298 million incurred by our newly-acquired businesses and higher redundancy costs. The reduction in profit in the 2000 financial year was also caused by reduced call prices and increased lower margin wholesale business with other operators, as well as the cost of developing new products and areas of business and increased expenditure on improving the quality of service to our customers. We expect the factors experienced in the 2001 financial year to continue.

Associates and joint ventures

The results of associates and joint ventures by line of business for the 2001 financial year are as follows:

	Share of turnover £m	Share of operating profit (loss) before exceptional items and goodwill amortisation £m
BT Wireless	539	(228)
BT Ignite	391	(119)
Concert	2,576	19
BTopenworld	45	(69)
Japanese and other investments	6,386	517
	9,937	120

BT Wireless's ventures comprised BT's mobile interests in Germany and The Netherlands until their full acquisition. BT Ignite's ventures comprise BT's fixed and data networks in those areas. Concert is the global joint venture with AT&T launched in January 2000. BTopenworld's ventures comprise new and developing internet operations in the UK, Spain and Italy. BT Retail, BT Wholesale and Yell do not have any significant associates or joint ventures.

BT's share of its ventures' turnover rose from £1,270 million in the 1999 financial year to £3,364 million in the 2000 financial year and to £9,937 million in the 2001 financial year, including sales by the principal venture to BT. This growth was due to our establishment and acquisition of interests in ventures in North America, Europe and Asia Pacific over the past three years. Acquisitions of interests contributed £6,133 million of the growth in the 2001 financial year and £1,229 million of the growth in the 2000 financial year. In the 2001 financial year, £9,677 million of the total arose from ventures located outside the UK, compared with £3,164 million in the 2000 financial year and £1,149 million in the 1999 financial year. The principal contributors in the 2001 financial year were Japan Telecom and J-Phone (£4,542 million), Concert (£2,576 million), Cegetel (£860 million), Viag Interkom (£449 million to February 2001), Airtel (£286 million) and LG Telecom (£281 million). The main contributors in the 2000 financial year were Cegetel (£727 million), Concert (£583 million from January 2000), Japan Telecom (£501 million from September 1999), Viag Interkom (£296 million), Airtel (£250 million) and a full year's contribution from LG Telecom (£200 million). In the 1999 financial year, the main contributors were Cegetel (£578 million), Airtel (£157 million), Viag Interkom (£82 million) and LG Telecom (£81 million from October 1998).

The group's share of its ventures' operating losses totalled £12 million in the 2001 financial year, before £385 million goodwill amortisation and impairment. The results included an exceptional write off of £132 million for subscriber acquisition costs. The comparable losses, before goodwill amortisation, amounted to £316 million in the 2000 financial year and £325 million in the 1999 financial year. The underlying improvement in the 2001 financial year was mainly due to the investment in the J-Phone companies in May 2000.

The principal loss in all three years arose in Viag Interkom, before it became a wholly-owned subsidiary in February 2001, in developing its networks to compete in the German market. BT's share of these losses was £277 million (for 11 months), £240 million and £193 million in the 2001, 2000 and 1999 financial years, respectively. Telfort also incurred losses in every year before it became a wholly-owned subsidiary in June 2000, as it had been developing its fixed and mobile networks in the Netherlands. In the 2001 financial year, other losses were mainly incurred by Blu and Albacom in Italy and British Interactive Broadcasting (BIB) in the UK until our interest was diluted in June 2000. BIB launched its new Open interactive digital TV service in the UK in autumn 1999 after a period of development. Ventures returning operating profits in the 2001 financial year mainly comprised Japan Telecom and J-Phone, together with Concert, Cegetel in France, Airtel in Spain, and Maxis Communications in Malaysia. We have agreed in principle to sell our interest in Maxis.

BT's share of the operating profits of Japan Telecom and J-Phone totalled £473 million before goodwill amortisation, interest, tax and minority interests deductions, in the 2001 financial year. This profit was mainly derived from BT's investment in the J-Phone companies which was made in May 2000. After goodwill amortisation, interest, tax and minority interest deductions, the profit attributable to BT shareholders amounted to £39 million for the 2001 financial year. Shortly before the 2001 financial year end, BT reduced its economic interest in the J-Phone companies and after the year-end reduced its direct interest in Japan Telecom. We have now agreed to sell these investments.

We have aligned the accounting of all the BT Wireless operating units during the 2001 financial year; this has resulted in an exceptional write off of previously capitalised costs in certain non-UK operations of which £132 million related to deferred subscriber acquisition costs in the ventures.

Concert's operating profit before goodwill amortisation and exceptional items attributable to BT was £19 million for the 2001 financial year on our share of turnover of £2,576 million. Concert's performance deteriorated as the year progressed and, in the final quarter, it moved into losses for the first time. The performance was impacted by bad debt provisions as its customers have weakened financially, along with depreciation from increased investment in cable systems. The competitive pressure on margins is continuing and management action is being taken to improve the performance of the business. The new management of Concert have already taken action, including the reduction of headcount. As currently structured, losses are likely to be significant in the 2002 financial year. BT and AT&T are discussing various options relating to Concert, including ways to improve the performance of the business and strengthen the scope of the relationship and various strategic alternatives to the Concert joint venture. See "Discussions with AT&T regarding Concert and BT Ignite" on page 17.

In the 2000 financial year, losses, other than those already noted, were mainly incurred by BIB and Albacom. Ventures returning operating profits in the 2000 financial year included Concert, Airtel, Cegetel, Japan Telecom and Maxis Communications. In the 1999 financial year, the other losses were incurred by Albacom, BIB and LG Telecom in the Republic of Korea, which has been a BT joint venture since October 1998.

Goodwill amortisation has been increasing as a result of new acquisitions in ventures. In the 2001 financial year, the charge totalled £185 million compared with £84 million in the 2000 financial year and £17 million in the 1999 financial year, which was the first year in which BT adopted FRS 10. This trend is not expected to continue since we have not made any major acquisitions of interests in ventures since May 2000. We consider that goodwill arising in Asian ventures became impaired during the 2001 financial year, and we have incurred an exceptional impairment charge of £200 million.

As a consequence of the termination of the BT/MCI merger agreement and the then-prospective MCI/WorldCom merger, BT ceased treating MCI as an associate on 31 October 1997, although we held the investment until its sale to WorldCom in September 1998.

Total operating profit (loss)

Total operating loss for the 2001 financial year was £336 million, including BT's share of the operating results of its ventures. This was a decrease of £3,534 million compared with the operating profit in the 2000 financial year and was principally due to the £3,200 million goodwill impairment charges. The profit for the 2000 financial year had decreased by £276 million over the 1999 financial year. Before goodwill amortisation and exceptional items, total operating profit for the 2001 financial year was 2.0% lower than that in the previous financial year, which was 2.2% lower than the result for the 1999 financial year. The decline in the underlying total operating profit in the 2001 and 2000 financial years were due to the factors explained above.

Profit on sale of group undertakings and fixed asset investments

We sold our 34% interest in sunrise communications of Switzerland to another joint venture partner in November 2000 for £464 million, realising a profit of £454 million. This is the main element in the total profit from disposals of group undertakings and fixed asset investments of £619 million in the 2001 financial year. Other profits during the year were principally derived from the disposal of certain of our aeronautical and maritime interests, the sale of an interest in I.Net by way of a public offering, the reduction of our equity interest in BIB to below 20% and the sale of minor equity investments.

Following the completion of the MCI/WorldCom merger in September 1998, BT sold its holding in MCI to WorldCom under the agreement made in November 1997. The proceeds totalled £4,159 million on which an exceptional profit of £1,133 million was realised in the 1999 financial year, after taking into account the goodwill written off on BT's interest in MCI, originally acquired in September 1994.

Interest charge

In the 2001 financial year, the total net interest charge, including BT's share of its ventures' charges, at £1,314 million was £932 million higher than in the preceding year, which in turn was £96 million higher than in the 1999 financial year. Of the total charge, £1,044 million arises in the BT group for the 2001 financial year, compared with £306 million and £261 million in the 2000 and 1999 financial years, respectively.

The substantially higher charge in the 2001 financial year is due to the cost of funding the third-generation mobile licences, principally in the UK and Germany, and the cost of acquisitions in the 2001 and 2000 financial years, including the BT Cellnet minority interests, the Esat group, Telfort and Viag Interkom. There has also been a £194 million increase in BT's share of its ventures' interest charges principally through the Japanese investments and Viag Interkom. The group's net interest charge has benefited in the year by an exceptional interest receipt of £25 million relating to the rates refund from the UK Government, noted above.

Financial review

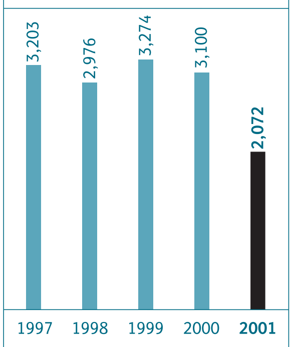
The higher total interest charge in the 2000 financial year over the previous year was due to an increase in BT's share of its ventures interest costs and the cost of funding the acquisitions made by BT during the 2000 financial year, including the BT Cellnet minority acquisition.

Interest cover for the 2001 financial year represented 2.6 times total operating profit before goodwill amortisation and impairment, and compares with interest cover of 8.8 in the 2000 financial year and 12.2 in the 1999 financial year. The decline in cover is due to the substantial increase in the interest charge compared with a relatively static operating profit before goodwill amortisation and impairment. We expect the net interest charge to further increase and interest cover to decline in the 2002 financial year following the significant increase in net debt during the 2001 financial year to be offset in part by the expected proceeds of the rights issue and the sales of investments already announced.

Profit (loss) and taxation

The group's loss before taxation for the 2001 financial year was £1,031 million, compared with profits of £2,942 million in the 2000 financial year and £4,295 million in the 1999 financial year. The loss in the 2001 financial year was principally due to the £3,200 million exceptional goodwill impairment charges discussed above. The substantially higher profit in the 1999 financial year was largely due to the gain on the MCI shares sold. Before exceptional items and goodwill amortisation, profit before taxation in the 2001 financial year of £2,072 million was 33% lower than the comparable profit in the 2000 financial year. This was 5.3% lower than in the 1999 financial year. The significantly lower underlying profit in the 2001 financial year was chiefly due to the higher interest charges, explained above. The lower profit in the 2000 financial year was due to the lower group operating profit and higher interest charges, also explained above.

Profit before goodwill amortisation, exceptional items and taxation (£m)
years ended 31 March



Tax relief is not available against the £3,200 million goodwill impairment charges, and the tax charge of £652 million for the 2001 financial year represents 30.1% of profit before taxation and goodwill impairment. This compares with a tax charge of 30.5% for the 2000 financial year and 30.1% for the 1999 financial year. The 2001 and 2000 effective tax rates compare with the standard 30% corporation tax rate for those years. The effective tax rate for the 2001 financial year has been adversely affected by the higher goodwill amortisation charges in the year which are not allowable expenses for tax purposes, partially offset by the gain on the sale of the investment in sunrise communications which is effectively subject to a lower tax charge. The group's tax charge for the 1999 financial year was an effective 31.0% of pre-tax profit. The MCI share sale gain was effectively subject to a lower tax charge under UK capital gains tax legislation. This effective tax charge reflects the higher 31% rate of corporation tax set for the 1999 financial year.

The minority interests in the results of the 2001 financial year of £127 million are primarily attributable to outside interests in the Japanese investments.

Earnings (loss) and dividends

Basic loss per share, based on the loss for the 2001 financial year of £1,810 million, were 27.7 pence. Earnings per share for the 2000 and 1999 financial years were 31.7 pence and 46.3 pence, respectively. Earnings before goodwill amortisation and exceptional items were 20.5 pence per share for the 2001 financial year, in comparison with 34.2 pence for the 2000 financial year and 35.0 pence for the 1999 financial year. Diluted earnings per share are not materially different.

The dividend for the 2001 financial year of 8.7 pence per share comprised the interim dividend paid in February 2001 which absorbed £571 million. As part of BT's debt reduction and restructuring plans, the Board has decided that there will be no final dividend in respect of the 2001 financial year and that there will be no interim dividend declared for the 2002 financial year. Future dividend policy will be decided by the individual listed companies, taking into account their respective capital structure, cash requirements and the markets in which they operate. The board expects that Future BT will recommence a final dividend in respect of the 2002 financial year.

BT paid or recommended dividends of 21.9 pence per share for the 2000 financial year and dividends of 20.4 pence per share in respect of the 1999 financial year.

Financing

Net cash inflow from operating activities of £5,887 million in the 2001 financial year compared with £5,849 million in the 2000 financial year and £6,035 million in the 1999 financial year. Special contributions to the main pension fund, described below, of £300 million in the 2001 financial year, £230 million in the 2000 financial year and £200 million in the 1999 financial year were paid, consequently reducing the cash inflow in those years.

Tax paid in the 2001 financial year totalled £669 million compared with £1,311 million paid in the 2000 financial year. The lower tax paid in the 2001 financial year was due to the lower profits earned in the 2001 and 2000 financial years compared with the 1999 financial year. The payments in the 2001 and 2000 financial years included the first quarterly instalments under the new corporation tax regime in the UK. Tax paid in the 1999 financial year, which totalled £630 million, included the second and final windfall tax instalment of £255 million which had been levied by the UK Government on privatised companies in the 1998 financial year. Less UK corporation tax was paid in the 1999 financial year than in the two succeeding years because the advance corporation tax (ACT) on a special dividend paid in September 1997 was able to be offset. The tax paid in the 1998 financial year had included £561 million ACT paid in respect of the special dividend.

HM Government changed the pattern of corporation tax payments from April 1999 by requiring companies to pay tax in quarterly instalments starting at the half-year stage in each financial year. The changes are being phased in over the 2000 to 2002 financial years, and replace the former main single corporation tax payment made nine months after the financial year end and ACT payments associated with dividends.

Net cash outflow of £8,442 million for capital expenditure and financial investment in the 2001 financial year was principally for capital expenditure on plant and equipment of £4,756 million and £4,208 million invested in third-generation mobile licences. The net cash outflow of £3,752 million in the 2000 financial year was principally for capital expenditure on plant and equipment. In the 1999 financial year, there was a net cash inflow of £1,046 million which mainly comprised the £4,159 million proceeds of the MCI shares sold in September 1998 offset by expenditure on plant, equipment and property totalling £3,220 million.

Net cash outflow on acquisitions totalled £13,754 million in the 2001 financial year. This included £11,438 million invested in Viag Interkom, including acquisition of its licences, £1,233 million in Telfort, £1,176 million in completing the Esat Telecom Group acquisitions, offset by £464 million received on the disposal of sunrise communications and from other divestments. The net cash outflow on acquisitions of £6,405 million in the 2000 financial year was principally £3,014 million on the acquisition of the minority interest in BT Cellnet, £1,254 million invested jointly with AT&T in Japan Telecom and £659 million in Canadian interests, jointly owned with AT&T. The net cash outflow on acquisitions of £1,967 million in the 1999 financial year was mainly the acquisition of MCI's minority interest in Concert Communications and the investments in LG Telecom and Maxis Communications, as well as additional funding of our European ventures. We paid the consideration of £856 million for the completion of the Esat Digifone minority acquisition in early April 2001.

Equity dividends paid in the 2001 financial year totalled £1,432 million, compared with £1,364 million in the 2000 financial year and £1,186 million in the 1999 financial year. As explained above, we do not intend to pay any equity dividends in the 2002 financial year.

The resulting cash outflow, before liquid resources and financing, of £19,127 million for the 2001 financial year was funded by our issuing substantial amounts of long-term debt instruments and drawing on our medium-term notes programmes. In December 2000, we raised £6,909 million through the issue of four series of US dollar notes totalling $10 billion, with maturities between three and thirty years. In February 2001, we received £6,038 million through the issue of six series of euro and sterling notes totalling €9.7 billion, with maturities between two and sixteen years. In April 2000, we issued a twenty five-year £250 million index-linked Eurobond.

Summarised cash flow statement	**2001 £m**	2000 £m	1999 £m
Net cash inflow from operating activities	**5,887**	5,849	6,035
Dividends from associates and joint ventures	**10**	5	2
Net cash outflow for returns on investments and servicing of finance	**(727)**	(163)	(328)
Taxation paid	**(669)**	(1,311)	(630)
Net cash inflow (outflow) for capital expenditure and financial investment	**(8,442)**	(3,752)	1,046
Net cash outflow for acquisitions and disposals	**(13,754)**	(6,405)	(1,967)
Equity dividends paid	**(1,432)**	(1,364)	(1,186)
Cash inflow (outflow) before management of liquid resources and financing	**(19,127)**	(7,141)	2,972
Management of liquid resources	**(480)**	1,236	(2,447)
Net cash inflow (outflow) from financing	**19,735**	5,959	(458)
Increase in cash in the year	**128**	54	67
Decrease (increase) in net debt in the year	**(18,942)**	(6,582)	3,146

Financial review

We issued £7,219 million of medium term notes in the year. Commercial paper outstanding decreased by £1,390 million over the year to 31 March 2001.

In the 2000 financial year, there was a net cash outflow of £7,141 million which was partly funded by the issue of new long-term financial instruments, principally two US dollar Eurobonds totalling US$1.2 billion and a £600 million Eurobond. In that year, we also drew on commercial paper programmes under which approximately £4.9 billion was outstanding at 31 March 2000 and used the group's existing short-term investments. In the 1999 financial year, a net cash inflow, before liquid resources and financing, of £2,972 million was mainly applied by investing in short-term investments.

The cash outflow for the 2001 financial year resulted in net debt increasing to £27,942 million at 31 March 2001. In the previous financial year, the cash outflow for the year resulted in net debt increasing to £8,700 million at 31 March 2000. This was in contrast to the cash inflow for the 1999 financial year, generated mainly by the MCI share sale proceeds, which resulted in net debt falling to £953 million at 31 March 1999.

Consequently, balance sheet gearing or the ratio of net debt (borrowings net of cash and short-term investments) to shareholders' equity and minority interests stood at 192% at 31 March 2001, compared with 53% a year earlier.

In the 2001 financial year, the group borrowed £14,552 million in long-term loans and repaid £225 million in long-term debt. This was in accordance with our intention, expressed at the end of the 2000 financial year, to refinance a significant part of our commercial paper borrowings with medium or longer-term debt when market conditions allowed and also to raise further significant finance in the 2001 financial year to meet the financing needs of the UK third-generation licence, won in April 2000, increased capital expenditure and acquisitions of interests in subsidiaries, joint ventures and associates and their additional funding requirements.

In April 2000, BT issued a £250 million 3.5% index-linked Eurobond repayable in 2025. In December 2000, we issued four series of notes comprising US$2.8 billion 8.625% thirty-year notes, US$3.0 billion 8.125% ten-year notes, US$3.1 billion 7.625% five-year notes and US$1.1 billion three-year floating rate notes. In February 2001, we issued six series of notes comprising £700 million 7.5% sixteen-year notes, €2.25 billion 6.875% ten-year notes, €3.0 billion 6.125% six-year notes, £400 million 7.125% six-year notes, €1.75 billion 5.625% three-year notes and €1.0 billion two-year floating rate notes. Loans repaid during the year totalling £225 million were mainly in respect of the Esat Telecom acquisition.

In the 2000 financial year, the group borrowed £1,473 million in long-term loans and repaid £587 million in long-term debt. In May 1999, BT issued a £600 million 5.75% Eurobond repayable in 2028 and, in October 1999, a US$1.0 billion five-year 6.75% Eurobond. In August 1999, BT repaid a US$200 million Eurobond on maturity which was refinanced by a further ten-year US$200 million Eurobond. On the acquisition of Esat, BT assumed approximately £550 million of debt, based on Esat's 31 December 1999 balance sheet. In the 1999 financial year, the group repaid long-term debt totalling £457 million; no significant new long-term debt needed to be raised.

In the 2002 financial year, £507 million of long-term debt falls due. The rights issue is proposed to raise approximately £5.9 billion, after expenses, which, together with the cash from disposals already announced, should allow us to meet our debt reduction target of £10 billion by December 2001. Any debt assumed by Yell or BT Wireless on demerger or proceeds received from the sale of Yell will further contribute to debt reduction. We expect net debt to increase as a result of net cash outflows from our planned capital expenditure and interest payments even after taking into account the restructuring plans. However, our target is now to reduce net debt in Future BT to between £15 billion and £20 billion by 31 March 2002.

Treasury policy

The group has a centralised treasury operation which will remain following the progressive devolution of the group's operations. Its primary role is to manage liquidity, funding, investment and the group's financial risk, including risk from volatility in currency and interest rates and counterparty credit risk. The treasury operation is not a profit centre and the objective is to manage risk at optimum cost.

The Board sets the treasury department's policy and its activities are subject to a set of controls commensurate with the magnitude of the borrowings and investments under its management. Counterparty credit risk is closely monitored and managed within controls set by the Board. Derivative instruments, including forward foreign exchange contracts, are entered into for hedging purposes only.

We have set out further details on this topic and on our capital resources and foreign currency exposure in note 35 to the financial statements in compliance with FRS 13.

Capital resources

During the 2001 financial year, the group has increased its level of borrowings so that its net debt was £28 billion at 31 March 2001 and £29 billion at the end of April 2001. We have stated our intention to reduce net debt in Future BT to between £15 billion and £20 billion by 31 March 2002. This debt reduction is dependent on our being successful in completing our rights issue and the sales of investments already announced. If we are unsuccessful in our plans either in part or in whole, there is a risk that our credit rating will be further downgraded and if this happens we may lose some financial flexibility in our ability to raise short-term finance for our operational needs.

The directors have a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future and therefore they continue to adopt the going-concern basis in preparing the financial statements.

There has been no significant change in the financial or trading position of the group since 31 March 2001, other than the announcement of the rights issue and the planned Japanese and other investment disposals described above, and the completion of the Esat Digifone minority interest purchase in April 2001.

At 31 March 2001, the group had cash and short-term investments of £2,969 million. At that date, £11,629 million of short-term debt was outstanding, comprising principally £3,494 million of borrowings under BT's commercial paper programmes and £7,094 million under its medium-term note programme. In addition, the group had unused committed short-term bank facilities, amounting to approximately £16,750 million at 31 March 2001, in support of a commercial paper programme or other borrowings. The group also has £460 million of uncommitted short-term bank facilities.

At 31 March 2000, the group had cash and short-term investments of £2,304 million. At that date, £5,121 million of short-term debt was outstanding. In addition, the group had unused committed short-term bank facilities, amounting to approximately £5,800 million at 31 March 2000.

The increase in short-term borrowings in the 2001 financial year was required to finance, in part, BT's acquisitions of third-generation mobile licences and investments during the year.

Foreign currency and interest rate exposure

Most of the group's current turnover is invoiced in pounds sterling, and most of its operations and costs arise within the UK. The group's foreign currency borrowings, which totalled £24.9 billion at 31 March 2001, are used to finance its operations. Of these borrowings, approximately £19.1 billion was swapped into sterling. Cross currency swaps and forward foreign exchange contracts have been entered into to reduce the foreign currency exposure on the group's operations and the group's net assets. The group also enters into forward foreign exchange contracts to hedge investment, interest expense, purchase and sale commitments. The commitments hedged are principally US dollars, the euro and the yen. As a result of these policies, the group's exposure to foreign currency arises mainly on the residual currency exposure on its non-UK investments in its subsidiaries and ventures and on any imbalances between the value of outgoing and incoming international calls with Concert. To date, these imbalances have not been material. As a result, the group's profit has not been materially affected by movements in exchange rates, with the exception of the second half of the 1999 financial year when we had a large US dollar position with the short-term investments resulting from the MCI proceeds. We progressively closed out this exposure in the period to 31 March 1999 as the US dollar strengthened against sterling and, as noted above, we recorded a gain of £87 million, which was included in the profit for the 1999 financial year.

The majority of the group's long-term borrowings has been, and is, subject to fixed interest rates. The group has entered into interest rate swap agreements with commercial banks and other institutions to vary the amounts and period for which interest rates are fixed. At 31 March 2001, the group had outstanding interest rate swap agreements with notional principal amounts totalling £9,574 million. At 31 March 2000, the group had outstanding interest rate swap agreements and gilt locks (based on forward sales of HM Government treasury stock) with notional principal amounts totalling £2,073 million.

The long-term debt instruments issued in December 2000 and February 2001 both contain covenants that if the BT group credit rating is downgraded below A3 in the case of Moody's or below A minus in the case of Standard & Poor's, additional interest accrues from the next interest coupon period at the rate of 0.25 percentage points for each ratings category adjustment by each ratings agency. Based upon the total amount of debt of £12,930 million outstanding on these instruments at 31 March 2001, BT's annual interest charge would increase by £65 million if BT's credit rating was to fall by one credit rating category by both agencies below a long-term debt rating of A3/A minus. In May 2001, Moody's downgraded BT's credit rating to Baa1, which will increase BT's annual interest charge by £32 million. Our credit rating from S&P's is A minus.

The greater use of floating rate debt in the 2001 and 2000 financial years has increased the group's sensitivity to changes in short-term sterling interest rates. Based upon the composition of net debt at 31 March 2001, a one percentage point increase in interest rates would increase the group's annual net interest expense by less than £90 million. Based upon the composition of net debt at 31 March 2000, a one percentage point increase in interest rates would have increased the group's annual net interest expense by less than £55 million. This compares with a decrease in the annual net interest expense of £35 million based on the composition of net debt at 31 March 1999 using the same variation in interest rates. The greater effect over the 2000 financial year is due to the increase in BT's floating rate borrowings. The change in effect during the 2000 financial year was due to the change from an excess of short-term investments over short-term borrowings at the beginning of the 2000 financial year to an excess of short-term borrowings over short-term investments at its end.

The group's exposure to changes in currency rates has increased following significant investment in Germany. A 10% strengthening in sterling against major currencies would cause the group's net assets at 31 March 2001 to fall by less than £1,200 million, with insignificant effect on the group's profit. This compares with a fall of less than £500 million in net assets based on the group's net assets at 31 March 2000 using the same variation in currency rates. The increase in effect of currency movements over the year was due to the greater proportion of the group's net assets deployed in non-UK countries following its significant investments in Germany and other European countries in the year. Because foreign exchange contracts are entered into as a hedge of sales and purchases, a change in the fair value of the hedge is offset by a corresponding change in the value of the underlying sale or purchase.

Capital expenditure

Capital expenditure on plant, equipment and property totalled £4,986 million in the 2001 financial year, compared with £3,680 million in the 2000 financial year and £3,269 million in the 1999 financial year. Of the total capital expenditure, £4,260 million, £3,287 million and £3,005 million was in the UK in the 2001, 2000 and 1999 financial years respectively. Work continues on enhancing the intelligence of the network to enable customers to benefit from advanced services and improving the network's capacity to carry high-speed data. We had installed ADSL equipment in 839 UK exchanges by the end of the 2001 financial year as the continuation of our plan to roll out this equipment to all our major local exchanges. We are progressively changing the fixed network from one based on switched technologies to a modern network based on the internet protocol (IP). In the 2001 financial year 46 trunk exchanges in the core network were cut-over to Next Generation Switches (NGS) which have double the capacity of the earlier exchanges. This brought the total of NGSs to 57 by 31 March 2001. Plans are in place for introducing a further 13 NGSs and for the upgrade and expansion of 27 of the switches to include core Asynchronous Transfer Mode (ATM) switching by March 2002, which potentially doubles the port capacity of each switch. Investment in the access network continued to be driven by demand for both new copper and fibre lines and by quality and resilience improvement programmes. BT Cellnet has continued improving the quality and capacity of its digital GSM network. Of the capital expenditure outside the UK, £632 million was concentrated in Europe in the 2001 financial year following our acquisition of Esat, Telfort and Viag Interkom in building out their networks. In the 2000 financial year, £233 million was incurred in North America mainly by Concert Communications before the establishment of the Concert global venture in January 2000. Assets in course of construction increased in the 2001 financial year by £733 million to £1,966 million at 31 March 2001. The increase reflected the acquisition of businesses in the year, BT Cellnet's continuing construction of its networks and further expenditure on ADSL.

As already discussed, in April 2000, we purchased one of the five 3G licences in the UK Government's auction for £4.03 billion, which we paid in May 2000. This 20-year licence should enable BT, coupled with our existing GSM spectrum, to deliver the next generation mobile multimedia service to its customers. A third generation mobile licence in The Netherlands was awarded to Telfort in July 2000 for £267 million.

The group expects capital expenditure in the 2002 financial year to be around £4.9 billion, of which £1.5 billion would be incurred by BT Wireless. We anticipate BT Wholesale's capital expenditure will be £2 billion per annum and BT Ignite's to be £1 billion per annum. Contracts placed for ongoing capital expenditure totalled £1.2 billion at 31 March 2001. We plan to continue to spend on our IP backbone network, in providing web hosting facilities and continuing the expansion of our networks to meet the projected broadband demand. We also intend building the new third generation wireless networks in the UK, Germany, The Netherlands and Ireland. We are focusing capital expenditure on projects with higher and more immediate financial returns. BT expects that future capital expenditure will be provided from net cash inflows from operating activities, our rights offering and, if required, by external financing.

Acquisitions

During the 2001 financial year, BT completed a number of acquisitions of businesses, mainly located outside the UK. The total amount invested, including further funding of existing ventures, was £14,501 million.

In April 2000, we took an equity interest, jointly with Japan Telecom, in a number of regional Japanese mobile phone companies (J-Phone Communications). Instead of investing directly in J-Phone Communications, we guaranteed bank loans to that group totalling £782 million at 31 March 2001. As noted above, we have now agreed to sell our interests to Vodafone for £3.7 billion. As part of this transaction, BT will exercise options to buy just under 5% of the shares in each of the three regional J-Phone operating companies from Japan Telecom for a total of £380 million.

In June 2000, we acquired for £1,207 million our partner's 50% interest in Telfort, the communications joint venture which we established in The Netherlands in 1997. Goodwill of £986 million arose on the transaction which is being amortised over a 20-year period.

In the final quarter of the 2001 financial year, we acquired the 55% interest in Viag Interkom that we did not already own under agreements made in August 2000. In January 2001, we acquired a 10% interest from Telenor for £1,611 million, including its share of the German third generation licence and in February 2001, we acquired the remaining 45% interest from E.ON for £7,148 million, including its share of the cost of licence. Goodwill of £4,992 million arose on the transactions. In the light of falling equity valuations for wireless companies in the 2001 financial year, we have carried out impairment reviews of the carrying values of Viag Interkom and our other major wireless interests. As discussed above, we have recognised a £3,000 million goodwill impairment in Viag Interkom. The remaining goodwill is being amortised over a 20-year period.

Shortly after the end of the 2001 financial year, in April 2001, we acquired the 49.5% interest in Esat Digifone that we did not already own, also from Telenor, for £856 million under an agreement made in early 2000.

During the 2000 financial year, BT also completed a number of acquisitions of businesses or interests in ventures. The total amount invested, including deferred considerations and further funding of existing ventures, was £8,755 million. The investment in the new Concert global venture, in the form of assets contributed, was additional to this.

In November 1999, we completed the acquisition of the 40% minority interest in BT Cellnet held by Securicor. The total cost of this acquisition was £3,173 million, including legal fees and other expenses. Goodwill of £2,997 million arose on the transaction which is being amortised over a 20-year period.

BT acquired jointly with AT&T a 30% interest in Japan Telecom for £1,254 million in August 1999, with BT having an economic interest of 20%. Concurrent with this transaction, BT sold its Japanese subsidiary to Japan Telecom. Goodwill arising on the interest of Japan Telecom of £432 million is being amortised over a 20-year period. As already mentioned, Vodafone has acquired AT&T's interest and, on completion, our interest in Japan Telecom will be through a simple 20% direct investment in the company pending the sale to Vodafone.

In Canada, BT acquired an effective 9% economic interest in AT&T Canada. In conjunction with AT&T, we jointly purchased 33% of Rogers Cantel Mobile Communications, a leading mobile operator, leaving BT with an effective interest of approximately 17%. The consideration paid by BT in August 1999 for these two investments totalled £659 million.

In January 2000, BT and AT&T announced the financial completion of Concert, the global communications joint venture. This venture was formed by BT transferring the majority of its cross-border international network assets, its international traffic, its business with selected multinational customers, together with Concert Communications, and AT&T transferring similar assets and businesses. The provisional unrealised profit on transferring these assets of £159 million was recognised in BT's statement of recognised gains and losses in the 2000 financial year. During the 2001 financial year, certain true-up calculations have been made causing a downward adjustment of £49 million to the unrealised profit which has been recognised in this year's statement of recognised gains and losses.

In August 1999, we completed the acquisition of the Yellow Book USA classified directory advertising business based in New York for a total consideration of £415 million. In the same month, we acquired Control Data Systems (renamed Syntegra (USA)), a US-based e-commerce and systems integration company, for £213 million. In May 1999, we acquired a 20% interest in SmarTone of Hong Kong, a leading provider of digital mobile communications services, for £241 million.

Under an agreed offer made in January 2000 and separate transactions with two of its major shareholders, we acquired control of Esat Telecom Group (Esat) at the end of March 2000, following regulatory clearance. We paid the majority of the consideration of £1,558 million in April 2000 after the 2000 financial year end. This Irish communications group held a 49.5% interest in Esat Digifone, Ireland's second largest mobile phone operator. We acquired a further 1% in this company in January 2000, so it also became part of the BT group at the end of March 2000. On completion of the fair value exercise goodwill of £1,878 million arose on the combined transactions which is being amortised over a 20-year period. As noted above, Telenor was the other shareholder in Esat Digifone, with a 49.5% interest which we acquired in April 2001.

In the 1999 financial year, BT acquired from MCI its 24.9% interest in Concert Communications for £607 million. Goodwill of £568 million arose on this transaction. As explained above, Concert Communications was transferred to the global venture with AT&T in early January 2000.

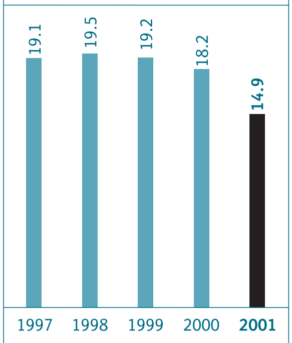
In March 1999, the group, through its then 60%-owned subsidiary BT Cellnet, completed the acquisition of Martin Dawes Telecommunications Holdings (MDT) (renamed BT Cellnet Lumina), then the largest independent mobile telecommunication services provider in the UK. The consideration totalled approximately £130 million, of which £90 million was deferred. In December 1999, an additional £27 million was paid in acquiring a minority interest in MDT's main operating subsidiary. Goodwill of £186 million arose on this combined acquisition and is being amortised over 10 years.

The group invested £1,326 million in the 1999 financial year on acquiring interests in associates and joint ventures and providing their further funding. The most significant investments were made in October 1998 in the Asia-Pacific region. A 33.3% stake in Maxis Communications of Malaysia was acquired for £279 million and a 23.5% interest in LG Telecom in the Republic of Korea was acquired for £234 million. BT continued to share in funding the development of its then ventures, Viag Interkom (£482 million) and Telfort (£103 million).

Return on Capital Employed

The group made a return before goodwill amortisation and impairment of 14.9% on the average capital employed in its business excluding goodwill, on a historical cost basis, in the 2001 financial year, compared with returns of 18.2% and 19.2% in the 2000 and 1999 financial years, respectively. The declining returns reflect the reduced margins earned in an increasingly capital intensive business.

% return on capital employed
years ended 31 March



Pensions

The most recently completed actuarial valuation of the BT Pension Scheme (BTPS), BT's main pension fund, performed for the trustees of the scheme, was carried out as at 31 December 1999. This valuation revealed the fund to be in deficit to an amount of approximately £982 million, after taking credit for a special contribution of £230 million paid by BT in March 2000. Assets of the fund of £29,692 million at that date covered 96% of the fund's liabilities. This actuarial valuation took into account the anticipated effect of the High Court judgement noted below.

The previous actuarial valuation of the BTPS was carried out as at 31 December 1996. This valuation revealed the fund to be in surplus to an amount of approximately £66 million. This actuarial valuation took into account the effect of HM Government's measures in July 1997 to end pension funds' ability to reclaim the tax credit associated with UK companies' dividends.

The move into deficit during the three years was mainly the result of the general trend towards longer life expectancy and the effect of redundancies.

The group's annual pension charge for the 2001 financial year of £326 million has been based on the December 1999 valuation, but using a slightly higher investment return assumption than was used for the trustees' funding valuation summarised above. The group's pension charges for the 2000 and 1999 financial years of £167 million and £176 million, respectively, were based on the December 1996 valuation. The charges for the three financial years take into account the amount of the pension provision which had been established over recent years in the group's accounts and which stood at £335 million at 31 March 2001. Additionally, under UK accounting standards, the cost of providing incremental pension benefits for early leavers in each of these three financial years has not been charged against the profit in the period in which people agree to leave, since the latest relevant actuarial valuation of the pension fund, together with the pension provision, indicated a surplus. The increase in the charge in the 2001 financial year was due, in part, to the general trend towards longer life expectancy. There was also a smaller amortisation of the combined pension fund position and pension provision held in the BT group balance sheet. The amortisation credit netted in pension costs amounted to £35 million in the 2001 financial year compared with £163 million in the 2000 financial year.

The group's ordinary contribution into the fund was raised to 11.6% of employees' pensionable pay for the 2001 financial year compared with 9.5% of pay during each of the two previous financial years under review. In addition, the company paid special contributions into the fund of £100 million in March 2001, £200 million in December 2000, £230 million in March 2000 and £200 million in March 1999 in part because of redundancies. The company is committed to pay special funding contributions of £200 million each year until such time as the deficit is made good. The company may also be required by the trustees of the fund to pay special contributions to cover any costs on the pension fund arising from redundancies.

The number of retired members and other current beneficiaries in the pension fund has been increasing in recent years and, at 31 December 2000, was approximately 55% higher than the number of active members. Consequently, BT's future pension costs and contributions will depend to a large extent on the investment returns of the pension fund and could fluctuate in the medium term.

Following a High Court judgement made in October 1999, the BTPS is liable to pay additional benefits to certain former employees of the group who left under voluntary redundancy terms. These were former employees, in managerial grades, who had joined the group's business prior to 1 December 1971. The value of the additional benefits at 31 March 2001 is estimated at

£200 million. On 26 April 2001, an application for permission to appeal against the judgement on behalf of certain former employees in non-managerial grades was lodged in an attempt to extend the additional benefits to those grades. BT will be strongly resisting this new claim if permission to appeal is given.

A further actuarial valuation of the BTPS at 31 December 2000 is under consideration. This is in advance of the normal three-yearly valuation and is being considered in light of the high level of redundancies since the December 1999 valuation, the fall in global equity markets in 2000 and the early part of 2001 and the current restructuring of the group.

The BTPS was closed to new entrants on 31 March 2001 and we have set up a new defined contribution pension scheme which will provide benefits to employees joining the scheme based on their and the employing company's contributions. This change is in line with the practice increasingly adopted by major UK groups and is designed to be more flexible for employees and enable the group to determine its pension costs more precisely than is the case for defined benefit schemes. The financial impact of this change is not expected to be significant in the next several years but it should reduce pension costs in the longer term.

Property

We are in negotiations with Land Securities Trillium and the William Pears Group, for their joint venture company to provide property services to BT. We are planning to grant long leases on much of our specialised properties to that company and to lease back these properties on a short-term basis. In the process, we expect to receive a significant cash sum which will go towards reducing our borrowings. We anticipate that the transaction will be completed during the first half of the 2002 financial year. The main continuing impact on our results from this transaction is expected to be an increase in operating lease rental expenses, partly offset by the beneficial impact on our interest costs and depreciation charges.

Impact of inflation

In accordance with a requirement of BT's main licence, the group's annual accounts for the 2000 financial year prepared on a current cost basis were published in September 2000. These accounts showed that the group's current cost profit before tax was £2,189 million, compared with £2,942 million under the historical cost convention. The group's current cost total assets at 31 March 2000 were £40,408 million, compared with £37,588 million in its historical cost accounts. These current cost accounts are no longer required to be published following a licence amendment.

Environment

When removing old analogue exchange equipment from buildings, BT recycles the metal content and takes special care to properly dispose of any hazardous materials. Although BT receives proceeds from the sale of recovered materials, this is more than offset by the cost of dealing with hazardous materials, contracting and planning their removal and preparing the released site for further development. BT believes that the total cost of dealing with these hazardous materials will not be significant.

Geographical information

In the 2001 financial year, approximately 91% of the group's turnover was generated by operations in the UK, compared with 95% in the 2000 and 96% in the 1999 financial years. Including BT's proportionate share of its ventures, which are mainly located outside the UK, 62% of total turnover was generated in the UK, compared with 82% in the 2000 financial year and 90% in the 1999 financial year. BT's operating profits have been derived from its UK operations with losses being incurred outside the UK in each of the last three financial years.

Regulatory financial information

BT is required under its main licence to publish disaggregated financial information for various activities of the group, which have been used as the basis of charges paid by other telecommunication operators in the UK for the use of BT's network. The activities presented separately in the regulatory financial statements do not necessarily correspond with any businesses separately managed, funded or operated within the group. The results set out in these statements for the 2000, 1999 and 1998 financial years showed that the group's operating profit is derived predominantly from fixed-network calls, after taking account of an operating deficit arising on the provision of exchange lines.

New UK accounting standards

Under a new UK accounting standard FRS 19 – Accounting for deferred tax, we are required to provide for deferred tax on a full liability basis from 1 April 2001, in place of the existing requirement to provide only for that deferred tax which we consider we shall be paying in the foreseeable future. The impact of this new standard will reduce our distributable reserves by approximately £2 billion. The adverse impact of the standard on our annual profit after tax is estimated at around £60 million and 0.9 pence reduction in our earnings per share. If this new standard had been adopted on 31 March 2001, our gearing would be standing at 220% in place of the 192% under current accounting policies. This new accounting standard has no effect on the actual corporation tax we shall pay or on our cash flows. The standard allows companies to discount their deferred tax liabilities. We do not intend to adopt this discounting approach since it is not in line with US GAAP and it might introduce unnecessary volatility into the profit and loss account.

Under a new UK accounting standard FRS 17 – Accounting for retirement benefits, the method of accounting for defined benefit pensions will be substantially changed. We are required to adopt fully this new standard by our 2004 financial year. We expect this standard will have the effect of increasing the pension costs to be included in operating costs, thus reducing our operating profit, but this will be offset in part by our stated financing costs being reduced. Pension fund actuarial gains and losses, including investment returns varying from the assumed returns, will be recorded in full in our statement of recognised gains and losses annually. Pension fund deficits, calculated in accordance with prescribed rules in the standard, will be shown in our balance sheet as will any surpluses to the extent we expect to obtain value from them in the foreseeable future.

Economic and Monetary Union (EMU)

On 1 January 1999, a new currency, the euro, was introduced into the European Union as part of EMU. Twelve member states have established fixed conversion rates between their existing currencies and the euro. The currencies of these participating member states now exist only as subdivisions of the euro. It is expected that these national currencies will be withdrawn on 31 December 2001 and that all notes and coins in these currencies will cease to be valid tender by 1 June 2002.

Most of the group's business in Europe is conducted in the UK, which is not one of the 12 participating member states. Government policy on UK membership of the single currency was set out by the Chancellor of the Exchequer in a statement to the House of Commons in October 1997, as restated by the Prime Minister in February 1999 on the launch of the first Outline National Changeover Plan. The determining factor underpinning any Government decision on membership of the single currency is whether the economic case for the UK joining is clear and unambiguous. Because of the magnitude of the decision, HM Government believes that, whenever the decision to enter is taken, it should be put to a referendum of the British people. The Government has said that it will produce an assessment of five relevant economic tests early in the next parliament, which commences in June 2001, and that both Government and business should make active preparations to give the UK the genuine option to decide to join.

BT has established a steering group, with representatives from across each of the lines of business and supporting group functions, to review the impact of the introduction of EMU. A project team acts as a co-ordination point to ensure consistency of approach across the group and that plans are in place to meet agreed business strategy on EMU.

The group carries on business in certain of the participating member states and is continuing to take appropriate steps to adapt its operations to use the euro.

BT is considering the impact of EMU on the UK business and the associated costs.

US GAAP

The group's net income (loss) and earnings (loss) per share for the three financial years ended 31 March 2001 and shareholders' equity at 31 March 2001 and 2000 under US Generally Accepted Accounting Principles (US GAAP) are shown further in the United States Generally Accepted Accounting Principles Section (see Consolidated financial statements). Differences between UK GAAP and US GAAP include results of the differing accounting treatment of pension costs, redundancy costs, intangible assets, goodwill, deferred taxation, capitalisation of interest, financial instruments, contributing assets to joint ventures, stock compensation, directories in progress and dividends. Cash flow information under the US GAAP presentation is also shown further in this document.

SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities as amended by SFAS No. 137 and SFAS No. 138, became effective for BT on 1 April 2001. SFAS No. 133, which requires the group to record all derivatives on the balance sheet at fair value, introduces new rules in respect of hedge accounting and the recognition of movements in fair value through the income statement. BT expects that it will not designate any of its derivative instruments as qualifying hedge instruments under SFAS No. 133 and, accordingly, the group expects to record changes in the fair value of its derivative instruments in current earnings each period. The group expects that the one-time pre-tax charge for the initial adoption of SFAS No. 133 to be recorded against US GAAP income will not be material. The group expects to record an unrealised pre-tax loss of approximately £143 million in shareholders' equity for the quarter ending 30 June 2001. These transition adjustments will be calculated using the assumption that none of the hedging relationships that existed prior to the adoption of SFAS No. 133 will qualify for hedge accounting after the adoption of SFAS No. 133. At this time, the group plans no significant change to its risk management strategies due to the adoption of SFAS No. 133.

Board of Directors and Executive Committee

Board of Directors

Chairman

Sir Christopher Bland *(d) (f)*
Sir Christopher Bland was appointed to the Board as Chairman on 1 May 2001. He chairs the *Nominating* and *Community Support* committees. Sir Christopher has been chairman of the BBC since 1 April 1996 and was deputy chairman of the Independent Broadcasting Authority and chairman of its Complaints Review Board from 1972 until 1979. In 1982, he became a non-executive director of LWT Holdings and was chairman from 1983 until 1994, when the company was acquired by Granada Group. From December 1994 to May 2000, he was chairman of NFC. Sir Christopher was chairman of the Hammersmith and Queen Charlotte's Hospitals Special Health Authority from 1982 to 1994 and of Hammersmith Hospitals NHS Trust from 1994 to February 1997. He was knighted for his work in the NHS in 1993. Aged 62.

Executive Directors

Sir Peter Bonfield CBE *Chief Executive (a)*
Sir Peter Bonfield was appointed to the Board on 1 January 1996 as Chief Executive. He chairs the *Executive Committee*. Sir Peter is a Fellow of the Royal Academy of Engineering and the Institution of Electrical Engineers. From 1981 to 1995, he worked for ICL, latterly as chairman and chief executive. He is a non-executive director of AstraZeneca Group, a member of the international advisory board of Salomon Smith Barney and vice president of the British Quality Foundation. Aged 56.

Philip R Hampton *Group Finance Director (a) (e)*
Philip Hampton was appointed to the Board on 1 November 2000 as Group Finance Director. He is an Associate of the Institute of Chartered Accountants. He was formerly, from July 1996, a board member of the BG Group with responsibility for finance, having previously been executive director for finance at British Steel. From 1975 to 1980, Philip Hampton worked for Coopers & Lybrand (now PricewaterhouseCoopers) and, between 1981 and 1990, he worked for Lazards. In 1986, he was seconded to Lazard Frères, New York and, in 1987, was appointed an executive director of Lazard Brothers. Aged 47.

Non-Executive Directors

Lord Marshall of Knightsbridge *Joint Deputy Chairman (b) (c) (d)*
Lord Marshall was appointed to the Board in 1995 and was Deputy Chairman between 1996 and 2000. On 1 January 2001, he became Joint Deputy Chairman. He currently chairs the *Remuneration Committee* and was chairman of the *Audit Committee* until 31 December 2000. Lord Marshall is chairman of British Airways and Invensys, and a non-executive director of HSBC Holdings. Aged 67.

Lord Marshall will retire from the Board at the end of the 2001 AGM.

Sir Anthony Greener *Joint Deputy Chairman (b) (c) (d)*
Sir Anthony Greener was appointed to the Board on 1 October 2000. He became Joint Deputy Chairman and chairman of the *Audit Committee* on 1 January 2001. Sir Anthony is vice president of The Marketing Council, chairman of University for Industry and a non-executive director of Robert Mondavi Corporation. He was formerly chairman of Diageo. Prior to the merger of Guinness and Grand Metropolitan, he was chairman and chief executive of Guinness, having been chief executive of Guinness since 1992. Aged 60.

Sir Anthony will become sole Deputy Chairman from the date of the 2001 AGM.

Helen Alexander *(b) (d)*
Helen Alexander joined the Board on 1 June 1998. She has been chief executive of The Economist Group since January 1997. Helen Alexander joined The Economist in 1984 and was managing director of The Economist Intelligence Unit from 1993 to the end of 1996. She is also a non-executive director of Northern Foods and a member of the ethics committee of the University College London Hospitals. Aged 44.

Dr Iain Anderson *(b) (c) (d) (e)*
Dr Anderson was appointed to the Board in 1995. He is chairman of the BT Scotland Board and chairs the *Pensions Committee*. Dr Anderson joined the board of Unilever in 1988 and was the strategy and technology director of Unilever until he retired in May 1998. He is chairman of Intense Photonics, a non-executive director of Scottish & Newcastle, a director of Scottish Science Trust and was special adviser to the Prime Minister on millennium compliance. Aged 62.

Louis R Hughes *(b)*
Louis Hughes joined the Board on 1 January 2000. He was formerly president and chief operating officer of Lockheed Martin Corporation and previously executive vice president of General Motors. He is a non-executive director of AB Electrolux, Maxager Technology Inc and Sulzer AG. He is a US national. Aged 52.

Neville Isdell *(b) (c) (d)*
Neville Isdell joined the Board on 1 July 1998. He is vice-chairman and chief executive of Coca-Cola HBC. Neville Isdell joined Coca-Cola in 1968 and has held a number of posts

Board of Directors and Executive Committee

managing Coca-Cola's businesses in various parts of the world. He has served on the boards of the publicly-quoted Coca-Cola Enterprises US and Coca-Cola Amatil Australia, and is a member of the council of the World Economic Forum. He is an Irish national. Aged 57.

June de Moller *(c) (e)*
June de Moller was appointed to the Board on 1 September 1999. A former director of Carlton Communications, she became Carlton's managing director in 1993, stepping down from that position in January 1999. June de Moller is also a non-executive director of Cookson Group, Lynx Group and J Sainsbury. Aged 53.

Maarten van den Bergh *(b) (c) (e)*
Maarten van den Bergh was appointed to the Board on 1 September 2000. Prior to his retirement in February 2000, he was president of Royal Dutch Petroleum Company and vice chairman of its Committee of Managing Directors from July 1998, having been appointed a managing director of the Royal Dutch Shell Group of companies in July 1992. Maarten van den Bergh is chairman of Lloyds TSB Group and a non-executive director of Shell Petroleum Company. He is a Dutch national. Aged 59.

Sir John Weston *(b) (e) (f)*
Sir John Weston joined the Board on 1 October 1998. He retired as Britain's Ambassador to the United Nations in New York in July 1998. Sir John was formerly British Ambassador to NATO. He is also a non-executive director of Hakluyt & Co and Rolls-Royce, and honorary president of the UK-wide Community Foundation Network. Aged 63.

Key to membership of principal Board committees:
(a) Executive
(b) Audit
(c) Remuneration
(d) Nominating
(e) Pensions
(f) Community Support
All of the non-executive directors are considered independent of the management of the company.

Executive Committee

Sir Peter Bonfield *Chief Executive*
Sir Peter Bonfield has been Chief Executive of BT, and chairman of the *Executive Committee*, since January 1996. See page 49 for biographical details.

Geoff Almeida, *Chief Executive, BT Business Services*
Geoff Almeida joined BT in 1991 and was appointed to the *Executive Committee* on 1 April 2001. He is Chief Executive Officer of BT Business Services, which was created in October 2000 to manage the delivery of infrastructure services to the group, achieving economies of scale and freeing up BT's businesses to concentrate on their core activities. Aged 49.

Pierre Danon *Chief Executive, BT Retail*
Pierre Danon joined BT and was appointed to the *Executive Committee* on 4 October 2000. As Chief Executive Officer of BT Retail, he has responsibility for developing and executing BT's retail strategy and maximising revenues, cash flow, profitability and customer satisfaction from the business' 21 million UK-based, residential and business customers. Aged 45.

Chris Earnshaw *Group Engineering Director and Chief Technology Officer*
Chris Earnshaw joined BT from the company's predecessor corporation, having joined the Post Office in 1972. He was appointed to the *Executive Committee* in March 1995. As Group Engineering Director and Chief Technology Officer, his role is to ensure BT capitalises on the revolution in communication and information technologies. He provides leadership across the BT group in all matters concerned with engineering and technology. Aged 47.

Peter Erskine *Chief Executive, BT Wireless*
Peter Erskine joined BT in 1993 and was appointed to the *Executive Committee* in January 1997. As Chief Executive Officer of BT Wireless, he has responsibility for the development of all BT's global mobile services and direct in-country operations, as well as for BT's move into broadband mobile networks through the introduction of GPRS and 3G services globally. Aged 49.

Pat Gallagher *Group Director, Strategy and Development*
Pat Gallagher joined BT in 1985 as Commercial Advisor to the UK business and later became Commercial Director. In 1996, he was appointed President of BT Europe, leading BT's expansion into Europe. He was appointed to the *Executive Committee* in July 2000 as Group Director of Strategy and Development. Aged 46.

Andy Green *Chief Executive, BTopenworld*
Andy Green joined BT in 1986 and was appointed to the *Executive Committee* in March 1995. As Chief Executive Officer of BTopenworld, he has responsibility for all BT's mass-market internet activities, including BTinternet, BTopenworld Broadband and BT's ISPs in other markets. Aged 45.

Colin R Green *Group Commercial Director and Secretary*
Colin Green, a solicitor, joined BT from the company's predecessor corporation, having joined the Post Office in 1977. Before joining the Post Office, he was a partner in a private practice. He was appointed to the *Executive Committee* in January 1996. Appointed Secretary and Chief Legal Adviser in 1994, he has been Group Commercial Director and Secretary since April 1999. Colin Green is a trustee of the BT Pension Scheme. Aged 52.

Philip R Hampton *Group Finance Director*
Philip Hampton has been Group Finance Director of BT, and a member of the *Executive Committee*, since 1 November 2000. See page 49 for biographical details.

Alfred T Mockett *Chief Executive, BT Ignite*
Alfred Mockett joined BT in 1991 and was appointed to the *Executive Committee* in April 1994. As Chief Executive Officer of BT Ignite, he has responsibility for BT's international, data-centric, broadband internet protocol (IP) and solutions business. Aged 52.

Robin Pauley *Director, Group Communications*
Robin Pauley joined BT and was appointed to the *Executive Committee* on 1 November 1999. As Director of Group Communications, he has responsibility for BT's global corporate communications, including public affairs, public and media relations, brand, sponsorship, and social policy. Aged 53.

Dr Paul Reynolds *Chief Executive, BT Wholesale*
Dr Reynolds joined BT from the company's predecessor corporation, which he joined in 1983. He was appointed to the *Executive Committee* in June 2000. As Chief Executive of BT Wholesale, he has responsibility for providing network services and solutions to telecoms operators and service providers, including BT Retail and BT Ignite. Aged 44.

Alison Ritchie *Restructuring Project Director*
Alison Ritchie joined BT from the company's predecessor corporation, which she joined in 1981. She was appointed a member of the *Executive Committee* in December 2000. As Restructuring Project Director, she has responsibility for co-ordinating and managing the totality of the restructuring programme, including the project teams working on the creation of a BT group holding company, the structural separation of BT's business and the potential stock exchange flotation of BT businesses. Aged 40.

John Steele *Group Personnel Director*
John Steele joined BT in 1989 and was appointed to the *Executive Committee* in March 1990. As Group Personnel Director, he has responsibility for fostering the human capability to deliver the company's strategic imperatives and ambitious business goals. John Steele is chairman of e-peopleserve, BT's HR joint venture. Aged 58.

Report of the Directors

The directors submit their report and the audited financial statements of the company, British Telecommunications plc, and the group, which includes its subsidiary undertakings, for the 2001 financial year.

Introduction

The business review on pages 8 to 25, our commitment to society on pages 26 and 27, the financial review on pages 30 to 48, the discussion on corporate governance on pages 53 to 56, risk factors on pages 57 to 61 and the report on directors' remuneration on pages 62 to 71 form part of this report. The audited financial statements are presented on pages 73 to 131.

Principal activity

The group's principal activity is the supply of communications services and equipment. In the 2001 financial year, 91% of group turnover arose from operations in the UK.

Directors

The names and biographical details of the directors of the company are given on pages 49 and 50. All served throughout the financial year, with the exception of Maarten van den Bergh, Sir Anthony Greener and Philip Hampton who joined the Board on 1 September, 1 October and 1 November 2000, respectively, and Sir Christopher Bland, who joined the Board as Chairman on 1 May 2001. In addition, Robert Brace and Keith Oates served as directors until their retirement on 31 December 2000, as did Bill Cockburn and Sir Iain Vallance until their retirement on 31 March and 1 May 2001, respectively. Following his retirement from the Board, the former Chairman, Sir Iain Vallance, remains with BT as President Emeritus.

In accordance with the articles of association, Sir Christopher Bland, Sir Anthony Greener, Philip Hampton and Maarten van den Bergh, having been appointed to the Board since the last annual general meeting, retire at the forthcoming annual general meeting and will be proposed for election. Lord Marshall, Dr Anderson and Sir John Weston retire by rotation. Dr Anderson and Sir John Weston will be proposed for re-election. Details of these directors' service contracts or contracts of appointment are included in the discussion on corporate governance on page 53 and the report on directors' remuneration on pages 70 and 71.

Substantial shareholdings

At 22 May 2001, the company had received no notification under Part VI of the Companies Act 1985 in respect of holdings of 3% or more of the company's issued ordinary share capital.

Interest of management in certain transactions

During and at the end of the 2001 financial year, none of the company's directors was materially interested in any material transaction in relation to the group's business and none is materially interested in any presently proposed material transactions.

Policy on the payment of suppliers

BT's policy is to use its purchasing power fairly and to pay promptly and as agreed.

BT has a variety of payment terms with its suppliers. The terms for payments for purchases under major contracts are settled when agreeing the other terms negotiated with the individual suppliers. It is BT's policy to make payments for other purchases within 30 working days of the invoice date, provided that the relevant invoice is presented to the company in a timely fashion and is complete. BT's payment terms are printed on the company's standard purchase order forms or, where appropriate, specified in individual contracts agreed with the supplier. The ratio, expressed in days, between the amounts invoiced to the company by its suppliers in the 2001 financial year and the amounts owed to its trade creditors at the end of the year was 21 days.

Auditors

A resolution to reappoint PricewaterhouseCoopers as auditors of the company and authorise the directors to settle their remuneration will be proposed at the annual general meeting.

Authority to purchase shares

The authority given at last year's annual general meeting for the company to purchase in the market 650 million of its shares, representing 10% of the share capital in issue at 24 May 2000, expires on 11 October 2001. This authority was not used during the year and shareholders will be asked to give a similar authority at the annual general meeting.

Annual general meeting resolutions

The resolutions to be proposed at the annual general meeting to be held on 18 July 2001, together with explanatory notes, appear in the separate Notice of Annual General Meeting sent to all shareholders.

By order of the Board

C R Green
Secretary
22 May 2001

Registered office: 81 Newgate Street, London EC1A 7AJ
Registered in England No. 1800000

Corporate Governance

BT's policy is to achieve best practice in our standards of business integrity for all our activities around the world. This includes a commitment to the highest standards of corporate governance throughout the group. This section of the annual report describes how BT has applied the principles set out in Section 1 of the Combined Code on Corporate Governance (the Code).

The directors consider that, throughout the year, BT has fully complied with the provisions set out in Section 1 of the Code.

The Board

The Board meets every month, except in August. Its principal focus is the overall strategic direction, development and control of the group. Key matters, such as approval of the group's strategic plans and annual operating plan and budget, and monitoring the company's operating and financial performance, are reserved for the Board. These are set out in a formal statement of the Board's role.

BT's aim is for approximately two-thirds of the Board to be non-executive directors. Of the current 12 directors, nine are independent, non-executive directors. Two directors are full-time executives. The Chairman is part-time. Between them, the non-executive directors bring experience and independent judgement at a senior level of international business operations and strategy, marketing, communications and international affairs.

The non-executive directors provide a strong independent element on the Board with Lord Marshall and Sir Anthony Greener, the Joint Deputy Chairmen, as the senior independent members. However, the Board operates as a single team.

Non-executive directors are appointed initially for three years. Towards the end of that period, the Board considers, on the recommendation of the *Nominating Committee*, whether to continue the appointment. Appointments will be reviewed again by the Board before the end of the sixth year. After the third anniversary, appointments can be terminated by either the director or BT on 12 months' written notice. Normally, non-executive directors will remain in office for no more than ten years. Lord Marshall's contract was renewed for a second three-year term from 1 April 1998. It was extended in June 2000 to the end of this year's annual general meeting when Lord Marshall will retire. Sir Anthony Greener's contract is for a three-year term from 1 October 2000.

All directors are required by the company's articles of association to be elected by shareholders at the first annual general meeting after their appointment. At least one-third of the other directors must seek re-election by the shareholders each year. This can mean that directors are not necessarily re-elected every three years. To comply with the Code, BT's policy is that, in practice, no director stays in office for more than three years without re-election.

The Chairman and executive directors have service agreements, which are approved by the *Remuneration Committee*. Information about the periods of these contracts is in the *Report on directors' remuneration* on page 70.

The Board has a procedure for directors, in furtherance of their duties, to take independent professional advice if necessary, at the company's expense. In addition, all directors have access to the advice and services of the Secretary, the removal of whom is a matter for the whole Board. He advises the Board on appropriate procedures for the management of its meetings and duties, as well as the implementation of corporate governance and compliance in the group.

On appointment, directors take part in an induction programme when they receive information about BT, the formal statement of the Board's role, the terms of reference and memberships of the principal Board and management committees, including the powers that have been delegated to the management committees, the company's corporate governance framework and executive reserved powers and latest financial information about the group. This is supplemented by visits to key BT locations and meetings with members of the *Executive Committee* and other key senior executives. Throughout their period in office, they are updated on BT's business, the competitive and regulatory environments in which it operates and other changes, by written briefings and meetings with senior BT executives. Directors are also advised on appointment of their legal and other obligations as a director of a listed company, both in writing and in face-to-face meetings with the Secretary. They are reminded of these obligations each year and are encouraged to attend training courses at the company's expense.

Guidelines are in place concerning the content, presentation and delivery of papers to directors for each Board meeting, so that the directors have enough information to be properly briefed.

Principal Board committees

The Chief Executive, Sir Peter Bonfield, chairs the *Executive Committee*. The other members are the Group Finance Director, the Group Commercial Director and Secretary, the Group Personnel Director, the Chief Executive Officers of the following lines of business (BT Wireless, BT Ignite, BTopenworld, BT Wholesale and BT Retail), the Chief Executive of BT Business Services, the Group Strategy and Development Director, the Group Communications Director, the Group Engineering Director and Chief Technology Officer and the Restructuring

Corporate Governance

Project Director. The Committee develops the group's strategy, for Board approval, and oversees its implementation. It also finalises, before Board approval, annual operating and capital expenditure plans and budgets, reviews operational activities and agrees and monitors group-wide policies, where these are not reserved to the Board.

The Nominating Committee, consisting of the Chairman, the Joint Deputy Chairmen and three other non-executive directors, recommends to the Board appointments of all directors. To ensure an appropriate balance of expertise and ability, it has agreed, and regularly reviews, a profile of the skills and attributes required from the non-executive directors as a whole. This profile is used to assess the suitability as non-executive directors of candidates put forward by the directors and outside consultants. Candidates short-listed for appointment are met by the Committee before it recommends an appointment to the Board.

The *Audit Committee*, comprising solely non-executive directors, is chaired by Sir Anthony Greener. It reviews BT's systems of internal control and risk management, considers the company's published financial reports for statutory compliance and against standards of best practice and recommends to the Board appropriate disclosure in these reports. The Board takes responsibility for disclosures on internal control in the annual report. The *Audit Committee* also reviews annually the performance of the company's auditors to ensure that an objective, professional and cost-effective relationship is maintained. It recommends to the Board the auditors' fees for their audit services. The Group Finance Director and the Group Commercial Director and Secretary attend Committee meetings. Each year, the Committee sets aside time to seek the views of the company's auditors in the absence of executives.

The *Remuneration Committee* comprises solely non-executive directors and is chaired by Lord Marshall. Sir Anthony Greener will chair the Committee after Lord Marshall's retirement. Further details about the Committee are included in the *Report on directors' remuneration*.

Committee membership is identified in the table of directors on pages 49 and 50.

Internal control and risk management

The Board is responsible for the group's systems of internal control and risk management and for reviewing the effectiveness of those systems. Such systems are designed to manage, rather than eliminate, the risk of failure to achieve business objectives; any system can provide only reasonable and not absolute assurance against material misstatement or loss.

BT has processes for identifying, evaluating and managing the significant risks faced by the group. These processes have been in place for the whole of the 2001 financial year and have continued up to the date on which this document was approved. The processes are in accordance with the guidance for directors published in the UK in September 1999.

Risk assessment and evaluation takes place as an integral part of the group's annual strategic planning cycle. The group has a detailed risk management process which identifies the key risks facing each business unit. This information is reviewed by senior management as part of the strategic review. The group's current key risks are summarised on pages 57 to 61 of this document.

The key features of the risk management process comprise the following procedures:

- the group's lines of business carry out risk assessments of their operations, have created registers relating to those risks, and ensure that the key risks are addressed. Lines of business audit committees monitor the standards of internal controls in the lines of business;
- senior management report regularly to the Group Finance Director on the operation of internal controls in their area of responsibility;
- the annual strategy review process includes consideration of major business risks;
- the Chief Executive receives annual reports from senior executives with responsibilities for major group operations with their opinion on the effectiveness of the operation of internal controls during the financial year;
- the group's internal auditors carry out continuing assessments of the quality of risk management and control; they also promote effective risk management in the lines of business' operations;
- the *Audit Committee*, on behalf of the Board, considers the effectiveness of the operation of internal control procedures in the group during the financial year. This follows the consideration of the matter by the *Executive Committee* at a preceding meeting. The *Audit Committee* reviews reports from the *Executive Committee*, from the internal auditors and from the external auditors and reports its conclusions to the Board. The *Audit Committee* has carried out these actions for the 2001 financial year.

Material joint ventures and associates, which BT does not control, outside the UK have not been dealt with as part of the group for the purposes of this internal control assessment.

Relations with shareholders

Senior executives, led by the Chief Executive and Group Finance Director, hold meetings with the company's principal institutional shareholders to discuss the company's strategy, financial performance and specific major investment activities. As explained in the *Report on directors' remuneration*, the company also maintains contact, when appropriate, through the chairman of the *Remuneration Committee* and appropriate senior executives to discuss overall remuneration policies and plans. Contact with institutional shareholders (and financial analysts, brokers and the press) is controlled by written guidelines to ensure the protection of share price sensitive information that has not already been made available generally to the company's shareholders.

The company is continuing its policy that shareholders vote on the annual report at the AGM.

The Board has also decided that shareholders should this year be asked to vote on the directors' and senior executives' remuneration policy, as set out on pages 62 to 65 in the *Report on directors' remuneration*. Shareholders were asked to vote on the remuneration policy for the first time at the AGM in 1999, but were not asked to do so in 2000 as there had been no significant change.

It is part of the company's policy to involve its shareholders fully in the affairs of the company and to give them the opportunity at the AGM to ask questions about the company's activities and prospects and to vote on every substantially different issue by proposing a separate resolution for each issue. The Board's opinion is that the re-election and fees of the auditors are inter-related issues and should therefore be dealt with by one resolution.

The proxy votes for and against each resolution, as well as abstentions, will be counted before the AGM and the results will be made available at the meeting after shareholders have voted on a show of hands.

It is our policy for all directors to attend the AGM if at all possible. Whilst, because of ill health or other pressing reasons, this may not always be achievable, in normal circumstances this means the chairmen of the *Audit* and *Remuneration* committees are at the AGM and are available to answer questions.

BT's practice is to post the Annual Report and Notice of AGM in the most cost-effective manner, given the large number of shareholders. We aim to give as much notice as possible and at least 21 clear days, as required by our articles of association. In practice, the Annual Report and the Notice of AGM are being sent to shareholders more than 20 working days before the AGM.

Established procedures ensure the timely release of share price sensitive information and the publication of financial results and regulatory financial statements.

Statement of Business Practice

To reinforce our commitment to achieve best practice in our standards of business integrity, BT has a written Statement of Business Practice ("The Way We Work"). The Statement reflects BT's international operations and the increasing expectations in the areas of corporate governance and business practice standards. A copy of the Statement (which is available in eight languages) has been sent to every employee and is also available on the company's intranet site. There is a question and answer guide for managers to help them brief their teams.

An ongoing comprehensive communications exercise, using vehicles such as video and CD-ROM, continues to be rolled out across the group, helping to raise awareness of the Statement and embody our ethics and business principles across all the company's activities. BT has also developed, collaboratively with The Institute of Business Ethics, an internal business practice excellence award – an industry first.

These high-level principles are supported by online training, and a confidential helpline and e-mail facility are available to employees who have questions regarding the application of these principles. We also continue to require our agents and contractors to apply these principles when representing BT.

Political donations

It has always been the company's policy not to give cash contributions to any political party. However, given the nature of the group's businesses, BT and other group companies have a business need to contact politicians and political parties on a non-partisan basis to make them aware of key arguments and technology and industry trends. BT believes these activities form a legitimate part of normal relationships between companies and the political machinery. They are not designed to support or influence support for a particular party. Provisions of the Political Parties, Elections and Referendums Act 2000, which mainly came into operation on 16 February 2001, have changed significantly the controls over the funding of political parties in the EU and other forms of EU political expenditure. The new Act has also extended the definition of political donations to the extent that we anticipate some of our existing activities will be caught, even though they are not "donations" in the ordinary sense of the word. As we wish to continue these activities, we are, in accordance with the Act, seeking shareholders' approval at the AGM to continue to make political donations and incur other EU political expenditure, as these terms are defined by the Act. Expenditure will continue to be on an even-handed basis related broadly to the electoral strength of each party. The policy of not making any direct cash contributions to any party will continue.

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Pension Fund

BT's main pension fund – the BT Pension Scheme – is not controlled by the Board, but by trustees who are company and union nominees, with an independent chairman. The trustees look after the assets of the pension fund, which are held separately from those of the company. The pension scheme funds can only be used in accordance with its rules and for no other purpose.

On 1 April 2001, we introduced a defined contribution scheme for new employees after closing the BT Pension Scheme to new entrants. The defined contribution scheme has been established under a separate trust from the existing BT Pension Scheme, but also has company and union-nominated trustees and an independent chairman. Its assets are held separately from those of the company.

Reporting

A statement by the directors of their responsibilities for preparing the financial statements is included in the statement of directors' responsibilities set out on page 71.

Risk Factors

The following describes some of the significant risks that could affect us. Additionally, some risks may be unknown to us and other risks, currently believed to be immaterial, could turn out to be material. All of these could materially adversely affect our business, turnover, profits, assets, liquidity and capital resources. They should also be considered in connection with the forward looking statements in this document and the warning regarding forward-looking statements on page 143 of this document. These risks include the risks relating to the BT Wireless business which is proposed to be demerged.

Financing

To finance several significant investments and acquisitions since November 1999, we have substantially increased our outstanding debt. In part because of this increase, our credit ratings were reduced during the second half of 2000 and during May 2001. Any further reduction in our ratings would increase our cost of borrowings. Subsequent downgrades may hinder our ability to expand and develop our business and may affect our ability to raise short-term finance.

During the 2001 financial year our borrowings, less short-term investments and cash, have risen from £8.7 billion as at 31 March 2000 to £27.9 billion as at 31 March 2001, primarily as a consequence of our cash investments in 3G mobile licences and from acquiring interests from our former partners in European joint ventures.

Credit rating downgrades

Due to this increase in borrowings, as well as decreased stability and predictability of revenue streams from our new business sectors such as mobile data services, the capital expenditure investment needed to enhance our competitive position in a fast changing technological environment and the increasingly competitive nature of the UK telecommunications market, our credit ratings on our long-term debt and senior debt ratings were downgraded in August and September of 2000 and in May 2001. This downgrade in credit ratings has caused an increase in our borrowing costs. Before goodwill amortisation the net interest charge was covered 2.6 times by total operating profit for the year ended 31 March 2001 down from 8.8 times in the year ended 31 March 2000. Our ratio of earnings to fixed charges (which consists mainly of gross interest expense) calculated in accordance with US GAAP has decreased from 5.9 in the year ended 31 March 2000 to 0.2 in the year ended 31 March 2001. Furthermore, our net debt has increased during April 2001.

In February 2001, Standard and Poor's placed us on "CreditWatch with negative implications". Approximately one-third of our debt (i.e. the debt that was issued after the ratings downgrades in August and September 2000) is subject to covenants which would increase the interest rate if we were subjected to further downgrades. In addition, further downgrades would increase the cost of future borrowings, and subsequent downgrades may hinder our ability to expand and develop our business and may affect our ability to raise short-term finance.

Debt reduction

We have indicated that we intend to reduce our debt by at least £10 billion by 31 December 2001. Our ability to achieve this will largely depend on the success of the rights issue and our ability to effect our restructuring programme including certain disposals. In November 2000, we announced details of our restructuring plans to focus resources on specific geographical areas and optimise the positioning of our individual businesses within their respective markets. We said we would focus on Western Europe and Japan and float up to 25% of BT Wireless and Yell and that a flotation of BT Ignite was possible, to be reviewed by the end of 2001. In addition, we described proposals to create a new holding company to enhance corporate flexibility, and provide scope for further subsidiary flotations where advantageous to shareholders. We also detailed plans to create a new network company, NetCo, which would be both structurally and managerially separate. Following this corporate reorganisation, and subject to the satisfactory outcome of necessary discussions with HM Government and Oftel, our intention was to float up to 25% of NetCo. Our aim was to reduce net debt of the group by December 2001 by at least £10 billion using the cash proceeds from the sale of equity in these various IPOs, together with the proceeds of disposals of non-core businesses and assets.

The weakness of the IPO market, particularly for telecommunications companies, has caused us to review whether the sale of equity in BT Wireless and Yell in an IPO still constitutes the best option to strengthen our capital base. In addition to the rights issue, we plan to demerge BT Wireless (creating a new holding company at the same time). On demerger the capital structure of BT Wireless is planned to include up to £2 billion of net debt. We are reviewing our plans for Yell and are currently considering proposals to sell or demerge Yell. We continue with our programme of non-core disposals which to date has included agreements to sell our Japanese investments and our investment in Airtel which, when completed, should reduce our net debt by £4.4 billion. Completion is conditional upon relevant regulatory and other approvals in Japan and Europe. We have also announced plans to realise the value of our UK property portfolio through a sale and lease back transaction as well as the sale of our London headquarters. We have also decided that there will not be a final dividend for the 2001 financial year and that there will be no interim dividend for the 2002 financial year. As a result, we believe we are on track to meet our target to reduce group debt by at least £10 billion by 31 December 2001 using the cash from disposals already announced and the anticipated proceeds from the rights issue. However, we cannot assure you that these disposals will occur as planned or that the rights issue will be fully taken up. The rights issue is not being underwritten and therefore we are not guaranteed any minimum proceeds from the rights issue which is due to close on 15 June 2001. We may not be able to achieve our intended debt reduction if our plans do not succeed on the proposed terms or take significantly longer to achieve than we anticipate. If we do not achieve this reduction there is a likelihood that our credit ratings will be further downgraded.

Notwithstanding our expectation that we should be able to meet our £10 billion debt reduction target, we anticipate that the ratings of the company are likely to be downgraded because of the view taken of the prospects for our fixed network business and for third generation services. We believe, however, that the group will be able to maintain an investment grade rating. We cannot assure you that the successful implementation of the restructuring will have this result.

In the course of the 2002 financial year, we expect net debt to increase as a result of net cash outflows from our planned capital expenditure and interest payments. However, our debt reduction and cash generation focus continues and our target is now to reduce net debt to between £15 billion and £20 billion in Future BT by 31 March 2002. Proceeds from our restructuring plan will be used to reduce net debt.

Our ability to pay dividends in the future depends on the success of the new companies created by our restructuring programme.

We have, since shortly after our incorporation in 1984, annually paid interim dividends in February and final dividends in September. The interim dividend we paid in February 2001 was 8.7 pence per ordinary share, unchanged from the previous year. However, as part of our debt reduction and restructuring plans, we have decided that there will be no final dividend in respect of the 2001 financial year and that there will be no interim dividend for the 2002 financial year. The total cost of the dividends for the 2000 financial year was approximately £1.4 billion. We expect that Future BT will recommend a final dividend in respect of the 2002 financial year.

Future dividends, if any, to be received by our shareholders will depend on the progress of the individual companies created by our restructuring programme. These companies will determine their own dividend policies in accordance with their respective capital structures, cash requirements and the markets in which they operate. As a result, we can give no assurance to our shareholders as to the level of dividends, if any, to be paid after February 2002 by us, or any of the new public companies created by our restructuring.

We are undertaking a substantial restructuring of our businesses to improve our position in a rapidly changing market place. Our plans for the implementation of the restructuring are incomplete in many respects, and the success of the restructuring will depend in part on factors that are beyond our control. As a result, we cannot assure our shareholders that the goals of our restructuring plan will be fully achieved. We also cannot assure shareholders that completion of the restructuring plan will result in the success of our strategy.

As discussed above, we are undergoing a major restructuring of our business from a centrally organised one to one based on several lines of business. Although the lines of business were mostly established by 1 July 2000 and BT Retail and BT Wholesale were split in October 2000, the detailed organisation continues to be developed and changed. In particular, we have not yet determined the exact form of the new UK network company, NetCo, which is to take over the majority of BT Wholesale's activities and provide network services to telecoms operators and service providers. Delay in implementation of the restructuring may lead to the new managements not being able to concentrate on developing their businesses with certainty, or to pursue opportunities in their respective marketplaces and may lead to staff retention problems. As we refine the plans for our restructuring, we may encounter significant obstacles that we have not yet anticipated and that prevent us from fully implementing the restructuring or fully achieving our strategic goals.

Certain aspects of our restructuring plans require prior consultation with our regulators, the Secretary of State for Trade and Industry and the Director General of Telecommunications who heads Oftel. We expect to conduct extensive discussions with Oftel regarding our restructuring plans. Depending on the outcome of these discussions, regulatory restrictions may impact our ability to complete the restructuring according to our existing plans.

We cannot assure our shareholders that we will be successful in completing the restructuring as currently planned or that we will achieve all of our strategic goals. Failure in this regard could adversely affect our strategic and competitive position.

We need to obtain a number of consents, approvals and/or clearances before we can demerge BT Wireless. At this stage, we cannot be certain that we will obtain these on acceptable terms or within our proposed timetable.

For the BT Wireless demerger to proceed as planned, we need first to obtain consents, approvals and/or clearances from: our shareholders; the High Court of Justice in England and Wales; the Department of Trade and Industry; the Inland Revenue; and certain regulators.

We expect to seek shareholder approval at an extraordinary general meeting to be held towards the end of 2001. Our current intention is that the demerger of BT Wireless will take place at the same time as the creation of a new holding company which would be undertaken through a court approved scheme of arrangement.

The trustee of certain of BT's notes and bonds has confirmed, having taken independent legal and financial advice, that, subject to certain conditions being met, it will not take any steps in relation to the demerger of BT Wireless. The principal condition is the successful completion of the rights issue; other conditions include the information provided by us to the trustee remains accurate and no new and materially adverse factor emerges. Further certification will be required by the trustee prior to implementation of the demerger. There can be no guarantee that this certification will be obtained.

We can give no assurance that the rights issue will be deemed successful by the trustee or that we will be able to obtain the necessary consents, approvals and/or clearances and consequently that we will be able to implement the demerger of BT Wireless.

We have asked the Department of Trade and Industry to confirm our expectation that our main telecommunications licence, the BT Cellnet licence, and our 3G licence will remain in effect after the demerger. There are also a number of non-UK licences, including those for Viag Interkom and Esat Digifone for which consent or notification will be required. We will require certain clearances from the UK Inland Revenue to confirm the tax treatment of the companies involved in the demerger and for our shareholders on demerger.

We are facing significant competition in the markets in which BT Wireless operates, which may reduce our revenues and profitability.

There is intense competition in all of the markets in which BT Wireless operates. BT Wireless is competing with leading global wireless operators as well as virtual network operators, traditional fixed line providers, resellers of wireless services and cable operators. In many countries new competitors may also enter into their markets as additional bands of spectrum and licences for wireless communications may be auctioned or otherwise offered or sold by the governmental authorities.

We expect that recent market trends in the telecommunications industry, such as accelerating technological convergence, will also intensify competition in all existing markets, both from existing competitors and new entrants. Continuing competition has and may lead to: price erosion on products and services; reduction in market share; loss of existing or prospective customers and increased difficulty in retaining customers; increases in handset subsidies; faster network expansion and upgrading; and more rapid development of wireless technologies.

BT Wireless's competitive position will depend also on the efficiency and success of marketing and branding initiatives and its ability to anticipate and respond to various competitive factors affecting it, its competitors and its industry. Such competitive factors include, amongst other things, new services and products, network coverage, pricing of wireless services and handsets, the quality of customer service and changes in consumer preferences.

Any failure by BT Wireless to compete effectively or successful competitive behaviour by its competitors would have a material adverse effect on our operating results and prospects for so long as BT Wireless remains within the group.

If our subsidiary Viag Interkom continues to incur losses, we may not realise a return on our investment.

We have invested approximately £12 billion, mainly in the 2001 financial year, in Viag Interkom, our newly acquired subsidiary business in Germany against which a goodwill impairment charge of £3 billion was made in the year to 31 March 2001. Viag Interkom, a startup established in 1997, has incurred losses in each of its completed financial years. Viag Interkom has an estimated 7% share in the highly competitive German mobile phone market as at 31 March 2001. Under a licence it acquired in 2000, Viag Interkom is required to develop a 3G mobile network in Germany. Although the development of a 3G mobile network will require substantial capital expenditure by Viag Interkom, we cannot be certain that the demand for 3G mobile products and services will justify the related costs or that Viag Interkom will develop a competitive 3G network. We have not managed a similar sized operation outside the United Kingdom in recent years. We can give our shareholders no assurance that Viag Interkom will cease incurring losses in the foreseeable future, nor that we will be able to make an economic return from our investment in the company.

Our investments in third generation mobile licences and networks may not generate an economic return.

We have invested approximately £10 billion in 3G licences in the 2001 financial year, principally in Germany and the United Kingdom. These licences are for the use of particular parts of the radio spectrum for 20 year periods and are required to enable us to provide advanced mobile data services to our customers. We have given undertakings to build a mobile network infrastructure to give a certain level of geographic coverage in Germany, the United Kingdom and The Netherlands. We expect that this will require a further investment of up to £10 billion over a five year period. Completion of this investment may be hindered by more stringent planning controls over the siting of masts, particularly in rural areas. In addition, we expect BT Wireless to apply for a 3G licence in the Republic of Ireland which will entail further licence and roll out costs.

The technology for the new services is not yet fully developed by the suppliers of the handsets and other equipment to be used by us and our competitors in providing the services. Developing 3G technology may take longer than we anticipate and prove not to be superior to the existing technologies. The size of the market for these services is as yet unknown and may fall short of the industry's expectations. We cannot be certain that the demand for such services will justify the related costs. In some locations, the investment, although required under the licences, may not be commercially desirable. In addition, we have a number of significant competitors in each geographic market.

We expect to roll out our 3G network at the same time that many of our competitors roll out their own 3G networks throughout Europe. This, combined with the limited number of suppliers of 3G network equipment, is likely to create high demand for, and may extend the delivery times of, such equipment, which may cause delays in the construction of our 3G networks.

The potential level of competition, together with these uncertainties, means that we cannot give our shareholders any assurance that we will make an economic return from our investments in 3G licences or networks. In the event that we fail to generate significant revenue from our planned 3G mobile service offerings, we may not be able to meet financial obligations incurred in relation to the 3G network or otherwise and our business, financial condition and results of operations may suffer.

We face strong competition in the UK fixed network services.

We continue to have a significant market share in some aspects of the UK fixed network services. In particular, approximately 82% of exchange lines in the United Kingdom were in our network as at 31 March 2001. Regulators are attempting to promote competition in this area by allowing other operators to site equipment in or adjacent to our exchanges (local loop unbundling) and to make it easier for our customers to route some or all of their calls over competitors' networks (carrier pre-selection). Reduction in our market share in the fixed network may lead to a fall in the group's turnover and an adverse effect on profitability. Unlike other operators, we continue to be obliged by the current regulatory regime to serve customers in the United Kingdom, whether or not such provision of service is economic, and the two competitive measures described above may have the effect of accelerating the diversion of our more profitable existing customers without us being able to reduce our costs commensurately. These changes in the regulatory environment and ensuing increased competition on our fixed network may cause adverse effects on our business, results of operations, financial condition and prospects.

If we are subject to significant price controls, we may lose market share, competitive advantage and our future profitability may be affected.

Most of our fixed network activities in the United Kingdom are subject to significant regulatory controls. The controls regulate, among other things, the prices we may charge for our services and the extent to which we have to provide services to our competitors. In recent years, the effect of these controls has been to cause us to reduce our prices. In addition, the regulators are considering bringing our UK wireless operations under wider price control which may have the effect of further reducing the prices we can charge for mobile services. We cannot assure our shareholders that the regulatory authorities will not increase the severity of the price controls, or extend the services to which controls apply, or extend the services which we have to provide our competitors. These controls may adversely affect our market share, the severity of competition and our future profitability.

Our business depends on our ability to exploit technological advances quickly and successfully.

We operate in an industry with a recent history of fast technological changes. We expect that new products and technologies will emerge and that existing products and technologies will develop further. We cannot predict the actual effect of these technological changes on our business or on our ability to provide competitive services. For example, presently there is evidence of some substitution by customers who use their mobile phones for day-to-day voice calls in place of making such calls over the fixed network. Additionally, some calls are now being routed over the internet in place of the traditional switched network. If these trends accelerate, our fixed network assets may be used uneconomically and our investment in these assets may not be recovered through profits on fixed network calls and line rentals. Impairment write-downs may be incurred and margins may decline if fixed costs cannot be reduced in line with falling turnover.

Health concerns from mobile phone handsets and masts may reduce customer demand and affect profitability.

There has been speculation that mobile phone handsets give off harmful radiation to their users and that transmitter masts emit such radiation, adversely affecting the health of people in their vicinity. Although research has failed to provide evidence of any links between such radiation and long-term harmful effects on people's health, HM Government has issued a guideline, suggesting that people below the age of 18 should limit the time spent using mobile phones and some schools have not allowed masts to be sited on their premises.

Increased speculation regarding health risks or any subsequent substantiation of such risks may result in an adverse effect on customer demand, may affect the future sitings of masts and/or may lead to legal compensation claims or other liabilities.

Report on directors' remuneration

The *Remuneration Committee* is made up wholly of independent non-executive Directors. Throughout the year, the company has applied the principles in Section 1 of the Combined Code on Corporate Governance (the Code) and complied with the Code.

The Committee's role is to set the remuneration policy for the Chairman, the executive directors and the members of the company's *Executive Committee* (EC). Specifically, the *Remuneration Committee* agrees their service contracts, salaries, other benefits, including bonuses and participation in the company's long-term incentive plans, and other terms and conditions of employment.

It also agrees terms for their cessation of employment and their appointments as non-executive directors of non-BT group companies and other organisations. It also approves the company's new long-term incentive plans, recommends to the Board those plans which require shareholder approval and oversees their operation.

Lord Marshall has chaired the Committee since 1 January 1996. Other members of the *Remuneration Committee* during the year were:

- Dr Iain Anderson
- Sir Anthony Greener (appointed 1 October 2000)
- Neville Isdell
- June de Moller
- Maarten van den Bergh (appointed 1 September 2000)
- Keith Oates (retired 31 December 2000)

Lord Marshall will retire from the BT Board and as chairman of the Committee at the end of the 2001 AGM. He will be succeeded as chairman of the Committee by Sir Anthony Greener.

The Committee met eight times during the 2001 financial year. The Chairman and Chief Executive are invited to attend meetings when appropriate. They are not present when matters affecting their own remuneration arrangements are considered.

Although the Board remains ultimately responsible for both the framework and the cost of executive remuneration, it has delegated prime responsibility for executive remuneration to the *Remuneration Committee*. Non-executive directors who are not members of the Committee are entitled to receive papers and minutes of the Committee.

The Committee has access to professional advisers, both within the company and externally. The Committee chairman and senior executives maintain contact when appropriate with BT's principal shareholders and the main representative groups of the institutional shareholders to consult on the company's overall remuneration policy and its development.

Remuneration Policy

BT's executive remuneration policy is in line with the company's overall practice on pay and benefits. This is to reward employees competitively, taking into account individual performance, company performance, market comparisons and the competitive pressures in the worldwide information technology and communications industry. Our external comparisons look at comparable roles in similar organisations, in terms of size, market sector, business complexity and international scope. To reflect BT's international presence, the company takes account of remuneration packages outside the UK where a particular market warrants this approach. The strategy for executive pay, in general terms, is for basic salaries to reflect the relevant market median, with total direct compensation (basic salary, annual bonus and the value of any long-term incentives) to be at the upper quartile for exceptional performance.

The *Remuneration Committee* considers that, in the interests of shareholders, it is important to link a significant proportion of the total executive remuneration package to individual and corporate performance. Remuneration policy and arrangements are kept under regular review to achieve this objective and to ensure that the company can attract and retain executives of the necessary quality in a complex business and a highly and increasingly competitive international marketplace.

Packages

The remuneration package for the executive directors, EC members and, in limited cases, the Chairman comprises some or all of the following elements:

Basic salary

Salaries are reviewed annually (although not necessarily increased). Salary increases are made where the Committee believes that adjustments are appropriate to reflect performance, contribution, increased responsibilities and/or market pressures.

Performance-related remuneration

Annual bonus

The annual bonus plan focuses on annual objectives, and is designed to reward appropriately the achievement of results against these set objectives. It is measured on a scorecard basis. Targets are set at the beginning of the financial year, and are reviewed throughout the year. Targets are based on key corporate objectives, such as revenue growth, profitability, business development, quality of service, customer satisfaction and people management. Specific weights are attached to each objective on the basis of the BT Corporate Scorecard. The Committee retains the flexibility to adjust bonus awards in exceptional circumstances. The on-target and maximum bonuses were reviewed for the 2001 financial year for all EC members and some were increased to reflect benchmarks in the external market.

Current long-term incentives

The BT Equity Incentive Portfolio (the Portfolio), approved at the 2000 AGM, supports the company's remuneration strategy for our most critically-skilled people. The three elements which constitute the Portfolio are:

- Incentive Shares
- Retention Shares, and
- Share Options.

The key drivers of the Portfolio are performance, flexibility and transparency. Following the introduction of the Portfolio, no new awards have been granted under the BT Executive Share Plan or the BT Performance Share Plan. No individual has been awarded all of Incentive Shares, Retention Shares and Share Options.

Incentive Shares

Incentive Shares are the main element of the Portfolio. Awards are granted annually to the executive directors of BT and members of the senior executive team. Awards have been granted to around 2,500 key managers and professionals.

Awards of Incentive Shares normally vest after a performance period of three years, if the participant is still employed by the BT group and a performance target has been met. The performance measure is Total Shareholder Return (TSR) compared with the FTSE 100 companies. At the end of the three-year period, BT's TSR must be in the top 25 performing companies for all the shares to vest. The proportion of shares which vests reduces on a straight-line basis to 50th position, at which point 25% of the shares under award vest. Below 50th position, none of the shares vest.

To encourage exceptional performance, the *Remuneration Committee* has discretion to reward performance in the upper quartile. At the end of the three-year period, if the company is in the top 25 performing companies, the *Remuneration Committee* may increase the award of shares vesting. If BT's TSR is in the top ten companies of the FTSE 100, the increase may double the number of the shares vesting. The discretion will only be exercised if the *Remuneration Committee* is also satisfied that there has been a significant improvement in the company's underlying financial performance. The *Remuneration Committee* will take account of BT's Corporate Scorecard targets and earnings per share growth.

The initial value of awards of Incentive Shares in the 2001 financial year was 10% to 200% of salary, with the vast majority being below 100%. The first vesting of awards of Incentive Shares is expected to be in 2003. Based on performance to date, none of the shares would vest.

Share Options

Under the Share Options element of the Portfolio, options to acquire BT shares are granted as an alternative to Incentive Shares, primarily for overseas employees and, in the UK, for employees of BT's internet business and/or new recruits. The price at which shares may be acquired is the market price at the date of grant. For options granted in the 2001 financial year, the exercise of the option is generally phased over three years. The grant or exercise of options may be linked to a performance target. Currently, the grant is based on corporate and individual performance. This is kept under review.

Options have been granted over shares with an initial value generally in the range of one times to three times salary with one option with a value of four times salary. Around 1,000 people currently participate in this element of the Portfolio.

Retention Shares

Retention Shares are granted to individuals with critical skills as a recruitment or retention tool. As a result, awards of shares are not generally linked to the satisfaction of a corporate performance target, but may be linked to performance, such as the completion of specific projects.

The length of the retention period before awards vest is flexible. Awards may vest in annual tranches. The shares are transferred at the end of the specified period only if the individual is still employed by the BT group.

The first awards of shares were granted in August 2000. Retention Shares are used only in exceptional circumstances and, to date, less than 20 awards have been made.

BT Deferred Bonus Plan (DBP)

The DBP was established in 1998. Awards in the form of BT shares, were granted to around 260 senior executives during the 2001 financial year in respect of their performance in the 2000 financial year. The awards were generally equivalent in value to 50% of the executive's gross annual bonus. It is intended that the value of deferred bonuses granted in respect of the 2001 financial year will, except in a very limited number of circumstances where higher levels of award are justified, be of a similar value.

Report on directors' remuneration

It is anticipated that around 300 senior executives will receive deferred bonuses. The shares are held in trust and transferred to the executive if still employed by the company in three years' time. There are no additional performance measures for the vesting of DBP awards. The first awards granted under the DBP in 1998 are due to vest in July or August 2001. The DBP uses existing shares only.

During the 2001 financial year, the rules of the DBP were amended to permit, in the event of BT terminating a participant's employment, a participant's award to vest at the end of the deferred period where the date of vesting would have fallen during a period of notice and the full notice period is not served. This would not apply where employment is terminated for gross misconduct, breach of contract or serious shortfall in performance.

The rules were also amended so that, on a scheme of arrangement to create a new holding company, awards will roll over into shares in the new company. Without the change, the awards would vest automatically. Awards outstanding at the date of the amendment that roll over would be preserved until the end of the deferred period if a participant leaves employment (other than for gross misconduct). The value of these awards would also be preserved.

Former long-term incentives

BT Share Option Scheme

This scheme expired in January 1995. The last options were granted in December 1994. Details of outstanding options held by the directors and former directors at the end of the 2001 financial year are shown on page 68.

BT Executive Share Plan/BT Performance Share Plan

The last awards under these plans were granted in 1999. Awards of BT shares under the BT Executive Share Plan (ESP) normally vest at the end of five years but only if BT's TSR meets a pre-determined target relative to the other companies in the FTSE 100. The second vesting of awards under the ESP was in the 2001 financial year. On the basis that the company's TSR was at 10th position compared with the other FTSE 100 companies at the end of the five-year performance period, 100% of the shares under award vested in 54 participants on 1 August 2000.

Like the ESP, the vesting of awards of BT shares under the BT Performance Share Plan (PSP) is subject to the company meeting a pre-determined TSR target measured against the FTSE 100 companies. Normally, if the performance target is met and the participant is still employed by the group, the awards will vest after the end of a cumulative three-year cycle. The final awards under the PSP are due to vest in August 2001. Based on BT's TSR measured over the three financial years to 31 March 2001, ranking it in 38th position, 80% of the shares under award will vest.

During the 2001 financial year, the change of control provisions of the ESP and PSP were amended to align them with those for the Incentive Shares. Vesting is based on performance to the date of change of control, with the Committee having discretion to vest higher amounts, taking other relevant factors into account (for example, length of service, anticipated future employment prospects and underlying company performance). Provision has also been made for the protection of any balance of a participant's award which did not vest on a change of control, if the participant is dismissed (other than for gross misconduct) or is demoted and leaves within twelve months. In addition, the cessation of employment provisions of the ESP and PSP were amended to align them with those for the Incentive Shares.

The rules of the ESP were also amended to permit the preservation of awards where the company terminates a participant's employment and the participant leaves within two years of their expected vesting date, or would have left after the date of preservation had a full notice period been served. This would not apply where employment is terminated by the company for gross misconduct, breach of contract or serious shortfall in performance.

Effect of the rights issue

Following the rights issue announced on 10 May 2001, certain adjustments will be made to the awards and options granted under the plans described above. In the case of the contingent awards granted under the ESP and PSP and the awards of Incentive and Retention Shares, the Board will recommend to the trustee of each relevant trust that sufficient rights are sold nil paid to enable the balance of the rights to be taken up with the proceeds of the sale, so that the new BT shares acquired can be allocated to the relevant awards and be released on the same basis as the awards to which they relate.

In the case of options granted under the BT Share Option Scheme and the Share Options element of the Portfolio, the Board proposes to adjust the number of shares in respect of which options may be exercised and the price at which the shares may be acquired to take account of the rights issue.

Executive share retention

A shareholding programme, which requires executive directors and EC members to build up a shareholding in the company was introduced during the 2001 financial year.

The programme, which is not mandatory, is designed to encourage executive directors and EC members to build up a shareholding with a value of 100% of their salary over a period of three years.

Pensions

For the executive directors and most other senior executives, the policy is to provide pension benefits of one-thirtieth of final salary for each year of service with two-thirds of the executive's pension for the surviving spouse. The executive directors and certain other senior executives have undertakings of pension benefits of two-thirds of final salary payable at normal retirement age with a pension of two-thirds of the director's or executive's pension for the surviving spouse. On death-in-service, a lump sum equal to four times annual salary is payable together with a pension of two-thirds of the director's or executive's prospective pension for the surviving spouse. Pensions are based on salary alone – bonuses, other benefits and long-term incentives are excluded.

Other benefits

Other benefits for the Chairman and executive directors include car and driver, personal telecommunications facilities, medical and dental cover for the director and immediate family and financial counselling. The company has a permanent health insurance policy to provide cover for the Chairman and full-time executive directors and members of the EC who may become permanently incapacitated.

Service agreements

The Chairman and executive directors have service agreements providing for one year's notice, except where it is necessary to offer longer periods to new directors from outside BT or circumstances make it appropriate to offer a longer fixed term. All the service agreements contain provisions dealing with the removal of a director through poor performance. They also deal with payments to which the director would be entitled in the event of early termination of the contract by BT.

Outside appointments

The Committee believes there are significant benefits to both the company and the individual from executive directors accepting non-executive directorships of companies outside BT. The Committee will consider up to two external appointments for which a director may retain the fees.

Non-executive directors' contracts of appointment

Non-executive directors have contracts of appointment. These cover, amongst other things, the initial terms for which they are appointed, a general statement of their role and duties, the fees they will receive as a director and supplementary fees for additional work such as being a member of a Board committee.

Non-executive directors are normally appointed for an initial period of three years and are then subject to 12 months' notice. Further details of their appointment arrangements are set out on page 53 in the section of the annual report dealing with corporate governance issues.

Non-executive directors' remuneration

Three-quarters of the BT Board are non-executive directors who, in accordance with BT's articles of association and as recommended by the Code, cannot individually vote on their own remuneration. Therefore, the Board does not consider it appropriate for the whole Board to determine non-executive remuneration. This is set by the Chairman and the Chief Executive after considering advice on appropriate levels of remuneration.

The basic fee for non-executive directors, which includes membership of one committee, is £30,000 per year. Additional fees for membership of Board committees range from £3,000 to £5,000 per year. Committee chairmen receive an additional fee of £2,000 per year for each committee they chair. Lord Marshall is paid an inclusive annual fee of £75,000 (2000 – £75,000), as Joint Deputy Chairman. Sir Anthony Greener, the other Joint Deputy Chairman, is paid an inclusive annual fee of £60,000. Sir Anthony's fee will be increased to £90,000 when he succeeds Lord Marshall as Deputy Chairman following the 2001 AGM.

To further align the interests of the non-executive directors with those of shareholders, the company's policy is to encourage these directors to purchase, on a voluntary basis, £5,000 of BT shares each year. The directors are asked to hold these shares until they retire from the Board. This policy is not mandatory.

Remuneration Review

Directors' remuneration

Sir Christopher Bland was appointed Chairman on 1 May 2001. His annual salary on appointment was £500,000 and he will not be entitled to receive an annual bonus.

From 1 April 2001, Sir Peter Bonfield's salary was increased from £780,000 to £820,000 a year.

Sir Peter Bonfield's annual bonus award in respect of the 2001 financial year is based predominantly on the achievement of group-wide objectives and results measured against the overall BT Corporate Scorecard. He is also bonused on achievement of personal objectives. His on-target bonus for the 2001 financial year was increased from 65% to 75% of salary, of which two-thirds remains targeted against the scorecard and one-third against the achievement of personal objectives. His maximum bonus has been retained at 100% of salary.

Report on directors' remuneration

Directors' remuneration (excluding pension arrangements and deferred bonuses) was as follows:

	Salary and fees		Annual and special bonus		Benefits excluding pension*(a)*		Total*(e)*	
	2001 £000	2000 £000	**2001 £000**	2000 £000	**2001 £000**	2000 £000	**2001 £000**	2000 £000
Sir Iain Vallance	**342**	308	**125**	400	**51**	38	**518**	746
Sir Peter Bonfield	**780**	725	**481**	500	**50**	53	**1,311**	1,278
P R Hampton*(b)*	**181**	–	**100**	–	**5**	–	**286**	–
R P Brace*(c)*	**380**	355	**130**	145	**31**	24	**541**	524
B Cockburn*(d)*	**516**	490	**200**	250	**45**	33	**761**	773
Lord Marshall	**75**	75	**–**	–	**–**	–	**75**	75
Sir Anthony Greener	**25**	–	**–**	–	**–**	–	**25**	–
H Alexander	**35**	35	**–**	–	**–**	–	**35**	35
J I W Anderson	**57**	54	**–**	–	**–**	–	**57**	54
L R Hughes	**32**	8	**–**	–	**–**	–	**32**	8
N Isdell	**39**	32	**–**	–	**–**	–	**39**	32
J F de Moller	**35**	20	**–**	–	**–**	–	**35**	20
J K Oates	**30**	40	**–**	–	**–**	–	**30**	40
M van den Bergh	**22**	–	**–**	–	**–**	–	**22**	–
Sir John Weston	**38**	38	**–**	–	**–**	–	**38**	38
	2,587	2,180	**1,036**	1,295	**182**	148	**3,805**	3,623

(a) Includes other benefits as described above. Sir Iain Vallance had use of a car in Scotland.

(b) Philip Hampton joined the company on 1 November 2000.

(c) On the terms of his leaving the company on 31 December 2000, Robert Brace continued to receive his salary and contractual benefits until the earlier of twelve months or until he obtained full-time employment. On 31 March 2001, these payments were discontinued when he was appointed to a new position. Between 31 December 2000 and 31 March 2001, salary of £95,000 was paid to Robert Brace, together with benefits to the value of £5,000. In addition, Robert Brace was paid a sum of £200,000, which was the estimated cost of providing the pension benefits that would have accrued over his notice period.

(d) On the terms of his leaving the company on 31 March 2001, Bill Cockburn will continue to receive his salary and value of his contractual benefits until the earlier of twelve months or until he obtains full-time employment.

(e) In addition deferred bonuses, payable in shares in three years' time, were awarded to Sir Peter Bonfield £481,000 (2000 – £500,000); Philip Hampton £50,000. When added to the amounts paid or currently payable for the 2001 financial year, in the table above, the total remuneration of Sir Peter Bonfield was £1,792,000 (2000 – £1,778,000) and Philip Hampton £336,000.

Bill Cockburn's salary was increased from £495,000 to £520,000 with effect from 1 June 2000 until his retirement on 31 March 2001. Philip Hampton joined the Board on 1 November 2000, on a salary of £435,000 per annum.

For Philip Hampton, Bill Cockburn and members of the EC, annual bonus awards are based on the achievement of a mix of group, divisional and personal objectives.

Philip Hampton's and Bill Cockburn's on-target bonuses for the 2001 financial year were 50% of salary, subject to a maximum of 75%, with Philip Hampton's being guaranteed at a minimum of £100,000 exceptionally in 2001 as part of the recruitment package.

Annual bonus awards to executive directors for the 2001 financial year ranged from 35% to 62% of salary.

Sir Iain Vallance's salary was increased from £325,000 to £350,000 from 1 August 2000. Sir Iain's bonus for the 2001 financial year was £125,000.

On 1 August 2000, awards of 41,552 shares and 48,480 shares under the ESP vested in former directors, Robert Brace and Sir Alan Rudge, respectively. The value of these awards of shares on the vesting date was £361,086 for Robert Brace and £421,291 for Sir Alan Rudge. Sir Alan Rudge retired as a director on 31 October 1997.

Board changes

Robert Brace and Keith Oates left the BT Board on 31 December 2000. Bill Cockburn left the Board on 31 March 2001. Maarten van den Bergh was appointed to the Board on 1 September 2000. Sir Anthony Greener was appointed a non-executive director on 1 October 2000. Philip Hampton was appointed to the Board as Group Finance Director and a member of the Board on 1 November 2000. Sir Iain Vallance retired as Chairman and left the Board on 1 May 2001. Following his retirement from the Board, Sir Iain has been appointed President Emeritus. Sir Christopher Bland joined the Board as Chairman on 1 May 2001. Yve Newbold, who retired in June 1997, remains on the *Community Support Committee*, for which she received fees of £5,000 in the 2001 financial year (2000 – £5,000).

Termination payments

Sir Peter Bonfield's contract entitles him to 12 months' compensation on termination by BT. His contract will terminate on 31 December 2002 and as part of his entitlement to 12 months' compensation for termination, he will receive £820,000 in lieu of salary and benefits. On termination by BT or expiry of the contract, Sir Peter's long-term awards will be preserved subject to satisfaction of the performance criteria, which, as in all executive directors' and EC members' contracts, is waived if termination is within 12 months after BT becomes a subsidiary of another company.

Philip Hampton's service contract entitles him to 12 months' compensation on termination by BT after 31 October 2001.

Pensions

Sir Peter Bonfield's pension arrangements provide for a pension of two-thirds of his final salary at age 60, inclusive of any retained benefits from his previous employment, and a widow's pension of two-thirds of his pension. He would have been entitled to a pension of 57% of salary if he had retired on 31 March 2001. If his retirement occurs before 2004, the percentage of salary used to calculate the pension will increase on a uniform basis to the target level at 60. His benefits are provided through a non-approved unfunded arrangement.

Philip Hampton's pension accrues at the rate of one thirtieth of his final salary for each year of service. In addition, a two-thirds widow's pension would be payable on his death. He is a member of the BT Pension Scheme, but as he is subject to the earnings cap, which is a restriction on the amount of pay which can be used to calculate pensions due from a tax approved pension scheme, the company has agreed to increase his benefits to the target level by means of a non-approved, unfunded arrangement.

Bill Cockburn left the company on 31 March 2001 and his deferred pension was increased to the level it would have been at had he remained in service until age 60. In addition, there would be no actuarial reduction if the deferred pension was to come into payment within 11 months before his 60th birthday.

Robert Brace left the company on 31 December 2000 at which time his pension ceased to accrue.

While Sir Iain Vallance was part-time Chairman and subsequently as President Emeritus, he is a deferred member of the BT Pension Scheme. He is currently receiving a pension, being paid by the company, which in the 2001 financial year amounted to £344,177 (2000 – £340,433). Sir Iain's pension arrangements entitle his surviving widow to his full pension until July 2003 and to two-thirds of his pension after that date.

The table below shows the increase in the accrued benefits to which each director has become entitled during the year and the transfer value of the increase in accrued benefit:

	Increase in accrued pension during year or to date of retirement in year*(a)*		Total accrued pension at year end or at date of retirement, if earlier*(b)*		Transfer value of increase in accrued benefit*(c)*	
	2001 £000	2000 £000	**2001 £000**	2000 £000	**2001 £000**	2000 £000
Sir Peter Bonfield	**37**	119	**235**	192	**683**	2,204
P R Hampton	**6**	–	**6**	–	**66**	–
R P Brace	**9**	17	**150**	137	**118**	246
B Cockburn	**52**	17	**94**	41	**963**	317

(a) The increase in accrued pension during the year excludes any increase for inflation.

(b) The pension entitlement is that which would be paid annually on retirement at normal retirement age based on service to the end of the year or date of retirement, if earlier.

(c) The transfer value has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11 and excludes directors' contributions. The transfer value represents a liability of the company rather than any remuneration due to the individual and cannot be meaningfully aggregated with annual remuneration, as it is not money the individual is entitled to receive.

Report on directors' remuneration

Directors' interests

The interests of directors and their families in the company's shares at 31 March 2001 and 1 April 2000, or date of appointment if later, are shown below:

	No. of shares	
Beneficial holdings	**2001**	2000
Sir Iain Vallance	**208,570**	208,504
Sir Peter Bonfield	**10,862***(a)*	10,583*(a)*
P R Hampton	**780**	780*(b)*
B Cockburn	**22,940**	22,865
Lord Marshall	**2,000**	2,000
Sir Anthony Greener	**8,936**	3,936*(b)*
H Alexander	**930**	930
J I W Anderson	**5,910**	5,910
L R Hughes	**6,800**	2,100
N Isdell	**7,500**	2,500
J F de Moller	**1,500**	1,500
M van den Bergh	**1,000**	–*(b)*
Sir John Weston	**1,046**	1,030
Total	**278,774**	262,638

(a) Includes 9,606 shares (2000 – 9,393 shares) purchased and held by Sir Peter Bonfield in the ESP (see note 33 to the financial statements).
(b) At date of appointment.

Details of share options held at 31 March 2001 are as follows:

	Number of shares under option **31 March 2001**	Option exercise price per share	Usual date from which exercisable	Usual expiry date
Sir Iain Vallance	**57,957**	**333p**	09/03/95	09/03/02
	20,770	**430p**	04/03/96	04/03/03
	3,760	**375p**	08/12/97	08/12/04
	82,487			
Sir Peter Bonfield	**6,460**	**267p**	14/08/01	14/02/02
R P Brace	**24,890**	**430p**	04/03/96	04/03/03*(a)*
	30,180	**460p**	15/11/96	15/11/03*(a)*
	23,470	**375p**	08/12/97	08/12/04*(a)*
	78,540			
B Cockburn	**3,330***(b)*	**518p**	14/08/03	14/02/04
Total	**170,817**			

(a) Robert Brace's options will lapse on 31 December 2001, twelve months after he ceased to be employed by the company.
(b) Option under BT Employee Sharesave Scheme exercisable over a maximum of 1,921 shares for six months from 31 March 2001, the date on which Bill Cockburn ceased employment with the company

All of the above options were granted for nil consideration. No options were granted to or exercised by the directors during the year. The above table also represents the position at 1 April 2000.

It is a term of Sir Christopher Bland's service agreement that (i) he purchases, as soon as permitted under BT's share dealing code, BT shares to the value of at least £1 million; and (ii) as soon as practical after the purchase of the shares (the Invested Shares), the company will grant an option under the Share Options element of the Portfolio over shares to the value of £1 million. So long as Sir Christopher is the legal and beneficial owner of the Invested Shares on 1 May 2004, the options will become exercisable on that date.

Unrealised gains on the above share options at 31 March 2001, based on the market price of the shares at that date, excluding the employee compensation for the special dividend which is discretionary in respect of directors' share options, were as shown below:

	Options exercisable			Options not exercisable		
		Unrealised gains			Unrealised gains	
	Number of shares	**2001 £000**	2000*(a)* £000	Number of shares	**2001 £000**	2000*(a)* £000
Sir Iain Vallance	82,487	**125**	673	–	**–**	–
Sir Peter Bonfield	–	**–**	–	6,460	**16**	59
B Cockburn	–	**–**	–	3,330	**–**	22
R P Brace	78,540	**67**	589	–	**–**	44

(a) Based on options outstanding at 31 March 2000 and the market price of the shares at that date.

The market price of the shares at 31 March 2001 was 510p (2000 – 1,175p) and the range during the 2001 financial year was 469p to 1,172p.

Details of the company's ordinary shares provisionally awarded to directors, as participants under the ESP and as awards of Incentive Shares and Retention Shares (note 33 to the financial statements), are as follows:

	Total number of award shares*(a)*						Range of value of award*(c)(d)*	
	1 April 2000	Awarded	Vested	Lapsed	Dividends reinvested	**31 March 2001**	Minimum £000	Maximum £000
Sir Peter Bonfield	390,207	179,516	–	–	16,172	**585,895**	304	2,988
P R Hampton*(d)*	–	59,361	–	–	828	**60,189**	307	307
B Cockburn	96,935	–	–	–	2,657	**99,592**	–	508
R P Brace*(b)*	269,954	43,728	41,552	77,449	6,592	**201,273**	192	1,026
Sir Alan Rudge*(b)*	48,480	–	48,480	–	–	**–**	–	–
Total	805,576	282,605	90,032	77,449	26,249	**946,949**	803	4,829

(a) Excluding shares purchased by each director and held under the ESP (see page 68).

(b) On 1 August 2000, total awards of 41,552 and 48,480 shares under the ESP vested in Robert Brace and Sir Alan Rudge, respectively. The five-year performance cycle for those awards ended on 31 July 2000 and, on the basis of BT's TSR position against the FTSE 100, 100% of the shares under award, including reinvested dividends, vested on 1 August 2000.

(c) Based on the market value of the company's shares at 31 March 2001. The minimum figure represents those shares held at 31 March 2001 which will transfer to each director under the ESP at the end of year five of the plan (2001 to 2004) and at the end of year three for Incentive Shares (2003). The maximum figure represents all shares held at 31 March 2001 which will transfer to each director at the end of year five of the ESP (2001 to 2004) and at the end of year three for Incentive Shares (2003) provided the corporate performance measure has been fully met. Normally, shares will transfer only if the individual is still employed by the group. However, the plans give discretion to preserve awards of shares on cessation.

(d) Philip Hampton was granted an award of Retention Shares over 59,361 shares, equivalent to 100% of salary. This award will vest, provided that he is still employed by the company, on 1 November 2003, the third anniversary of the date of the commencement of his employment with the company. The vesting of the shares is not subject to the satisfaction of a corporate performance target.

(e) At the next grant to participants of awards of Incentive Shares, Sir Christopher Bland will be granted an award equal to twice salary. After the grant of that award of Incentive Shares, he will not be eligible to receive further awards of Incentive Shares, Retention Shares or grants of Share Options until 1 May 2004.

Details of awards of shares under the ESP and awards of Incentive Shares which would vest based on BT's TSR compared with the other companies in the FTSE 100 for the relevant performance period up to 31 March 2001 are as follows:

			31 March 2001		31 March 2000	
	No. of shares under award	Expected vesting date	TSR position	Percentage of shares vesting	TSR position	Percentage of shares vesting
Sir Peter Bonfield	125,210	2001	28	100	3	100
	105,964	2002	34	90	3	100
	76,603	2003	38	80	5	100
	184,974	2003	91	–	–	–
	68,205	2004	86	–	–	–
B Cockburn	53,028	2003	38	80	5	100
	46,564	2004	86	–	28	100
R P Brace	77,625	2001	28	100	3	100
	57,637	2002	34	90	3	100
	38,887	2003	38	80	5	100

The following deferred bonuses have been awarded to the directors under the DBP. These shares will normally be transferred to participants at the end of the three-year deferred period if those participants are still employed by BT.

	1 April 2000	Awarded	Dividends reinvested	**31 March 2001**	Market value 2001 £000	Market value 2000 £000
Sir Peter Bonfield	123,938	57,537	4,857	**186,332**	950	1,456
B Cockburn	32,345	–	887	**33,232**	169	380
R P Brace	14,260	–	390	**14,650**	75	168

At 31 March 2001, Sir Iain Vallance, Sir Peter Bonfield, Philip Hampton and Bill Cockburn each had a non-beneficial interest in 97,578 shares (2000 – 78,454) purchased by BT Employee Shares Trustees Limited for allocation to employees under the BT Employee Share Ownership Scheme, and 19,144,802 shares (2000 – 19,292,068) held in trust by Ilford Trustees (Jersey) Limited for allocation to employees under the employee share schemes.

No director had any interest in the debentures of the company or in the share capital or debentures of its subsidiaries.

Subsequent to 31 March 2001, Sir Christopher Bland has notified the company of the acquisition of 220,000 shares on 15 May 2001. There have been no other changes in the directors' interests in the share capital, including options to subscribe for shares, or in the debentures of the company and its subsidiaries between 31 March 2001 and 22 May 2001.

Executive Committee

The aggregate remuneration of members of the EC, other than directors, for services in all capacities during the 2001 financial year was as follows:

	2001 £000
Salaries and benefits	**3,699**
Annual bonuses	**1,599**
Termination and retention payments	**97**
Provision for long-term incentive awards	**5,693**
Company pension contributions	**936**
Total	**12,024**

Options over 5,058 shares under the BT Employee Sharesave Scheme were granted to EC members during the 2001 financial year.

The members of the EC beneficially own less than 1% of the company's outstanding ordinary shares.

Directors' service agreements and contracts of appointment

The dates on which the Chairman's and each current executive director's initial service agreement commenced and the current expiry dates are as follows:

Chairman and executive directors	Commencement date of initial service agreement	Expiry date of current service contract
Sir Christopher Bland	1 May 2001	*(a)*
Sir Peter Bonfield	1 January 1996	*(b)*
P R Hampton	1 November 2000	*(c)*

(a) Sir Christopher Bland entered into a initial service agreement on 1 May 2001, terminable on 12 months' notice by either the company or the director.

(b) Sir Peter Bonfield entered into a new contract on 4 May 2001, which continues to 31 December 2002 terminable earlier by the company on payment of 12 months' compensation or by the director on six months' notice.

(c) Philip Hampton entered into a contract on 1 November 2000 for an initial period of two years. The contract is terminable on 12 months' notice ending at any time after the initial period by either the company or the director.

The dates on which current non-executive directors' contracts of appointment commenced and the current expiry dates are as follows:

Non-executive director	Commencement date of initial contract	Expiry date of current contract
Lord Marshall	1 April 1995	18 July 2001
Sir Anthony Greener	1 October 2000	*(a)*
H Alexander	1 June 1998	31 May 2002*(c)*
J I W Anderson	1 November 1995	*(b)*
L R Hughes	1 January 2000	31 December 2002
N Isdell	1 July 1998	30 June 2001
J F de Moller	1 September 1999	31 August 2002
M van den Bergh	1 September 2000	*(a)*
Sir John Weston	1 October 1998	30 September 2001

(a) Each director's contract of appointment is for an initial period of three years. After that period the contract is terminable on 12 months' notice by either the company or the director.

(b) Terminable on 12 months' notice by either the company or the director or on one month's notice effective on the sixth anniversary of the initial appointment.

(c) Renewable by mutual agreement.

There are no other service agreements or material contracts, existing or proposed, between the company and the directors. There are no arrangements or understandings between any director or executive officer and any other person pursuant to which any director or executive officer was selected to serve. There are no family relationships between the directors.

By order of the Board

Lord Marshall of Knightsbridge
Joint Deputy Chairman and Chairman of Remuneration Committee
22 May 2001

Statement of directors' responsibility for preparing the financial statements

The directors are required by law to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the group as at the end of the financial year and of the profit or loss and cash flows of the group for that period.

The directors consider that, in preparing the financial statements for the year ended 31 March 2001 on pages 73 to 131 the company has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates. The directors also consider that all applicable accounting standards have been followed and confirm that the financial statements have been prepared on the going concern basis.

The directors are responsible for ensuring that the company keeps accounting records which disclose with reasonable accuracy at any time the financial position of the company and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The directors are also responsible for taking such steps that are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

The auditors' responsibilities are stated in their report to the shareholders.

Report of the independent auditors to the shareholders of British Telecommunications plc

We have audited the financial statements which comprise the group profit and loss account, group and company balance sheets, group cash flow statement, group statement of total recognised gains and losses and the related notes which have been prepared under the historic cost convention and the accounting policies set out in the Accounting Policies section and the United States generally accepted accounting principles section.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, United Kingdom Auditing Standards issued by the Auditing Practices Board and the Listing Rules of the Financial Services Authority.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only those sections set out in the table of contents including Financial headlines, Chairman's message, Chief Executive's statement, Business and Financial reviews, Five-year financial summary, Report of the directors, Corporate governance and Risk factors.

We review whether the corporate governance statement reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the company's or group's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board and in accordance with auditing standards generally accepted in the United States. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements:

- give a true and fair view of the state of affairs of the company and the group at 31 March 2001 and of the loss and cash flows of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.
- present fairly, in all material respects, the consolidated financial position of the group as at 31 March 2001 and 31 March 2000, and the results of its operations and its cash flows for the years ended 31 March 2001, 31 March 2000 and 31 March 1999 in conformity with accounting principles generally accepted in the United Kingdom. These principles differ in certain respects from accounting principles generally accepted in the United States. The effect of the differences in the determination of net income, shareholders' equity and cash flows is shown in the United States generally accepted accounting principles section.

PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
London
22 May 2001

Notes:

(a) The maintenance and integrity of the British Telecommunications plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Accounting policies

I Basis of preparation of the financial statements

The financial statements are prepared under the historical cost convention and in accordance with applicable accounting standards and the provisions of the Companies Act 1985. The group financial statements consolidate those of the company and all of its subsidiary undertakings (with one minor exception – see note 20). Where the financial statements of subsidiary undertakings, associates and joint ventures do not conform with the group's accounting policies, appropriate adjustments are made on consolidation in order to present the group financial statements on a consistent basis. The principal subsidiary undertakings' financial years are all coterminous with those of the company, with the exception of one newly acquired group at 31 March 2001. References to the "company" are to British Telecommunications public limited company, and references to "BT" or the "group" are to the company and its subsidiaries, or any of them as the context may require.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenditure during the reporting period. Actual results could differ from those estimates. Estimates are used principally when accounting for income, provision for doubtful debts, payments to telecommunication operators, depreciation, employee pension schemes and taxes. Certain comparative figures have been restated to conform with revised presentation and reclassification of figures in the year ended 31 March 2001.

II Turnover

Group turnover, which excludes value added tax and other sales taxes, comprises the value of services provided and equipment sales by group undertakings, excluding those between them.

Total turnover is group turnover together with the group's share of its associates' and joint ventures' turnover, excluding the group's share of transactions between the group and its principal joint venture, Concert BV.

Turnover from calls is recognised in the group profit and loss account at the time the call is made over the group's networks. Turnover from rentals is recognised evenly over the period to which the charges relate. Turnover from sales is recognised at the point of sale. Prepaid call card sales are deferred until the customer uses the stored value in the card to pay for the relevant calls. Turnover from classified directories, mainly comprising advertising revenue, is recognised in the group profit and loss account upon completion of delivery. Turnover arising from the provision of other services, including maintenance contracts, is recognised evenly over the periods in which the service is provided to the customer.

III Research and development

Expenditure on research and development is written off as incurred.

IV Interest

Interest payable, including that related to financing the construction of tangible fixed assets, is written off as incurred. Discounts or premiums and expenses on the issue of debt securities are amortised over the term of the related security and included within interest payable. Premiums payable on early redemptions of debt securities, in lieu of future interest costs, are written off when paid.

V Foreign currencies

On consolidation, assets and liabilities of foreign undertakings are translated into sterling at year-end exchange rates. The results of foreign undertakings are translated into sterling at average rates of exchange for the year.

Exchange differences arising from the retranslation at year-end exchange rates of the net investment in foreign undertakings, less exchange differences on borrowings which finance or provide a hedge against those undertakings, are taken to reserves and are reported in the statement of total recognised gains and losses.

All other exchange gains or losses are dealt with through the profit and loss account.

VI Intangibles

(a) Goodwill

Goodwill, arising from the purchase of subsidiary undertakings and interests in associates and joint ventures, represents the excess of the fair value of the purchase consideration over the fair value of the net assets acquired.

For acquisitions completed on or after 1 April 1998, the goodwill arising is capitalised as an intangible asset or, if arising in respect of an associate or joint venture, recorded as part of the related investment. In most cases, the goodwill is amortised on a straight line basis from the time of acquisition over its useful economic life. Where special circumstances exist such that amortising goodwill over a finite period would not give a true and fair view, that goodwill is not amortised. The economic life is normally presumed to be a maximum of 20 years.

For acquisitions on or before 31 March 1998, the goodwill is written off on acquisition against group reserves.

If an undertaking is subsequently divested, the appropriate unamortised goodwill or goodwill written off to reserves is dealt with through the profit and loss account in the period of disposal as part of the gain or loss on divestment.

***(b)* Other intangibles**

Licence fees paid to governments, which permit telecommunication activities to be operated for defined periods, are amortised from the later of the start of the licence period or launch of service to the end of the licence period on a straight-line basis.

VII Tangible fixed assets

Tangible fixed assets are stated at historical cost less depreciation.

***(a)* Cost**

Cost in the case of network services includes contractors' charges and payments on account, materials, direct labour and directly attributable overheads.

***(b)* Depreciation**

Depreciation is provided on tangible fixed assets on a straight line basis from the time they are available for use, so as to write off their costs over their estimated useful lives taking into account any expected residual values. No depreciation is provided on freehold land.

The lives assigned to other significant tangible fixed assets are:

Freehold buildings –	40 years
Leasehold land and buildings –	Unexpired portion of lease or 40 years, whichever is the shorter
Transmission equipment:	
duct –	25 years
cable –	3 to 25 years
radio and repeater equipment –	2 to 25 years
Exchange equipment –	2 to 13 years
Computers and office equipment –	2 to 6 years
Payphones, other network equipment, motor vehicles and cableships –	2 to 20 years

VIII Fixed asset investments

Investments in subsidiary undertakings, associates and joint ventures are stated in the balance sheet of the company at cost less amounts written off. Amounts denominated in foreign currency are translated into sterling at year-end exchange rates.

Investments in associates and joint ventures are stated in the group balance sheet at the group's share of their net assets, together with any attributable unamortised goodwill on acquisitions arising on or after 1 April 1998.

The group's share of profits less losses of associates and joint ventures is included in the group profit and loss account.

Investments in other participating interests and other investments are stated at cost less amounts written off.

IX Asset impairment

Intangible and tangible fixed assets are tested for impairment when an event that might affect asset values has occurred. An impairment loss is recognised to the extent that the carrying amount cannot be recovered either by selling the asset or by the discounted future earnings from operating the assets.

X Stocks

Stocks mainly comprise items of equipment, held for sale or rental, consumable items and work in progress on long-term contracts.

Equipment held and consumable items are stated at the lower of cost and estimated net realisable value, after provisions for obsolescence.

Work in progress on long-term contracts is stated at cost, after deducting payments on account, less provisions for any foreseeable losses.

XI Debtors

Debtors are stated in the balance sheet at estimated net realisable value. Net realisable value is the invoiced amount less provisions for bad and doubtful debtors. Provisions are made specifically against debtors where there is evidence of a dispute or an inability to pay. An additional provision is made based on an analysis of balances by age, previous losses experienced and general economic conditions.

XII Redundancy costs

Redundancy costs arising from periodic reviews of staff levels are charged against profit in the year in which employees agree to leave the group.

If the most recent actuarial valuation of the group's pension scheme shows a deficit, which exceeds the amount of provision for pension liabilities in the balance sheet, the estimated cost of providing incremental pension benefits in respect of employees leaving the group is charged against profit in the year in which the employees agree to leave the group, within redundancy charges.

XIII Pension scheme

The group operates a funded defined benefit pension scheme, which is independent of the group's finances, for the substantial majority of its employees. Actuarial valuations of the scheme are carried out as determined by the trustees at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. In any intervening years, the actuaries review the continuing appropriateness of the contribution rates.

The cost of providing pensions is charged against profits over employees' working lives with the group using the projected unit method. Variations from this regular cost are allocated on a straight-line basis over the average remaining service lives of current employees to the extent that these variations do not relate to the estimated cost of providing incremental pension benefits in the circumstances described in XII above.

Interest is accounted for on the provision in the balance sheet which results from differences between amounts recognised as pension costs and amounts funded. The regular pension cost, variations from the regular pension cost, described above, and interest are all charged within staff costs.

XIV Taxation

The charge for taxation is based on the profit for the year and takes into account deferred taxation. Provision is made for deferred taxation only to the extent that timing differences are expected to reverse in the foreseeable future, with the exception of timing differences arising on pension costs where full provision is made irrespective of whether they are expected to reverse in the foreseeable future.

XV Financial instruments

(a) Debt instruments

Debt instruments are stated at the amount of net proceeds adjusted to amortise any discount evenly over the term of the debt, and further adjusted for the effect of currency swaps acting as hedges.

(b) Derivative financial instruments

The group uses derivative financial instruments to reduce exposure to foreign exchange risks and interest rate movements. The group does not hold or issue derivative financial instruments for financial trading purposes.

Criteria to qualify for hedge accounting

The group considers its derivative financial instruments to be hedges when certain criteria are met. For foreign currency derivatives, the instrument must be related to actual foreign currency assets or liabilities or a probable commitment and whose characteristics have been identified. It must involve the same currency or similar currencies as the hedged item and must also reduce the risk of foreign currency exchange movements on the group's operations. For interest rate derivatives, the instrument must be related to assets or liabilities or a probable commitment, such as a future bond issue, and must also change the interest rate or the nature of the interest rate by converting a fixed rate to a variable rate or vice versa.

Accounting for derivative financial instruments

Principal amounts underlying currency swaps are revalued at exchange rates ruling at the date of the group balance sheet and, to the extent that they are not related to debt instruments, are included in debtors or creditors.

Interest differentials, under interest rate swap agreements used to vary the amounts and periods for which interest rates on borrowings are fixed, are recognised by adjustment of interest payable.

The forward exchange contracts used to change the currency mix of net debt are revalued to balance sheet rates with net unrealised gains and losses being shown as part of debtors, creditors, or as part of net debt. The difference between spot and forward rate for these contracts is recognised as part of net interest payable over the term of the contract.

The forward exchange contracts hedging transaction exposures are revalued at the prevailing forward rate on the balance sheet date with net unrealised gains and losses being shown as debtors and creditors.

Instruments that form hedges against future fixed-rate bond issues are marked to market. Gains or losses are deferred until the bond is issued when they are recognised evenly over the term of the bond.

Group profit and loss account for the year ended 31 March 2001

	Notes	Business performance: Before goodwill amortisation, exceptional items and acquisitions £m	Business performance: Acquisitions £m	Business performance: **Total before goodwill amortisation and exceptional items £m**	Goodwill amortisation and exceptional items £m	**Total £m**
Total turnover	3	26,969	2,697	**29,666**	–	**29,666**
Group's share of joint ventures' turnover	3	(4,016)	(2)	**(4,018)**	–	**(4,018)**
Group's share of associates' turnover	3	(3,557)	(2,362)	**(5,919)**	–	**(5,919)**
Trading between group and principal joint venture	3	698	–	**698**	–	**698**
Group turnover	3	20,094	333	**20,427**	–	**20,427**
Other operating income	4	393	–	**393**	–	**393**
Operating costs	5	(16,996)	(533)	**(17,529)**	(3,230)	**(20,759)**
Group operating profit (loss)		3,491	(200)	**3,291**	(3,230)	**61**
Group's share of operating loss of joint ventures	6	(474)	(8)	**(482)**	(284)	**(766)**
Group's share of operating profit of associates	6	356	246	**602**	(233)	**369**
Total operating profit (loss)		3,373	38	**3,411**	(3,747)	**(336)**
Profit on sale of fixed asset investments	7	–	–	**–**	535	**535**
Profit on sale of group undertakings	7	–	–	**–**	84	**84**
Interest receivable	8	379	4	**383**	25	**408**
Interest payable	9	(1,622)	(100)	**(1,722)**	–	**(1,722)**
Profit (loss) on ordinary activities before taxation		2,130	(58)	**2,072**	(3,103)	**(1,031)**
Tax on profit (loss) on ordinary activities	10	(562)	(68)	**(630)**	(22)	**(652)**
Profit (loss) on ordinary activities after taxation		1,568	(126)	**1,442**	(3,125)	**(1,683)**
Minority interests	11	(27)	(79)	**(106)**	(21)	**(127)**
Profit (loss) for the financial year		1,541	(205)	**1,336**	(3,146)	**(1,810)**
Dividends	12					**(571)**
Transfer from reserves for the financial year	27					**(2,381)**
Basic earnings (loss) per share	13	23.6p	(3.1)p	**20.5p**	(48.2)p	**(27.7)p**
Diluted earnings (loss) per share	13	23.3p	(3.1)p	**20.2p**	(48.2)p	**(27.7)p**

Group profit and loss account for the year ended 31 March 2000

	Notes	Business performance: Before goodwill amortisation, exceptional items and acquisitions £m	Acquisitions £m	Total before goodwill amortisation and exceptional items £m	Goodwill amortisation and exceptional items £m	Total £m
Total turnover	3	20,972	931	21,903	–	21,903
Group's share of joint ventures' turnover	3	(1,784)	–	(1,784)	–	(1,784)
Group's share of associates' turnover	3	(936)	(644)	(1,580)	–	(1,580)
Trading between group and principal joint venture	3	176	–	176	–	176
Group turnover	3	18,428	287	18,715	–	18,715
Other operating income	4	243	(1)	242	–	242
Operating costs	5	(14,868)	(291)	(15,159)	(200)	(15,359)
Group operating profit (loss)		3,803	(5)	3,798	(200)	3,598
Group's share of operating loss of joint ventures	6	(399)	–	(399)	(28)	(427)
Group's share of operating profit of associates	6	57	26	83	(56)	27
Total operating profit		3,461	21	3,482	(284)	3,198
Profit on sale of fixed asset investments	7	–	–	–	–	–
Profit on sale of group undertakings	7	–	–	–	126	126
Interest receivable	8	188	5	193	–	193
Interest payable	9	(545)	(30)	(575)	–	(575)
Profit (loss) on ordinary activities before taxation		3,104	(4)	3,100	(158)	2,942
Tax on profit (loss) on ordinary activities	10	(869)	(23)	(892)	(5)	(897)
Profit (loss) on ordinary activities after taxation		2,235	(27)	2,208	(163)	2,045
Minority interests	11	11	(1)	10	–	10
Profit (loss) for the financial year		2,246	(28)	2,218	(163)	2,055
Dividends	12					(1,426)
Retained profit for the financial year	27					629
Basic earnings (loss) per share	13	34.6p	(0.4)p	34.2p	(2.5)p	31.7p
Diluted earnings (loss) per share	13	33.8p	(0.4)p	33.4p	(2.5)p	30.9p

Group profit and loss account for the year ended 31 March 1999

	Notes	Business performance Before goodwill amortisation, exceptional items and acquisitions £m	Goodwill amortisation and exceptional items £m	Total £m
Total turnover	3	18,223	–	18,223
Group's share of joint ventures' turnover	3	(561)	–	(561)
Group's share of associates' turnover	3	(709)	–	(709)
Trading between group and principal joint venture	3	–	–	–
Group turnover	3	16,953	–	16,953
Other operating income	4	168	–	168
Operating costs	5	(13,236)	(69)	(13,305)
Group operating profit		3,885	(69)	3,816
Group's share of operating loss of joint ventures	6	(330)	(12)	(342)
Group's share of operating profit of associates	6	5	(5)	–
Total operating profit		3,560	(86)	3,474
Profit on sale of fixed asset investments	7	–	1,107	1,107
Profit on sale of group undertakings	7	–	–	–
Interest receivable	8	165	–	165
Interest payable	9	(451)	–	(451)
Profit on ordinary activities before taxation		3,274	1,021	4,295
Tax on profit on ordinary activities	10	(1,002)	(291)	(1,293)
Profit on ordinary activities after taxation		2,272	730	3,002
Minority interests	11	(19)	–	(19)
Profit for the financial year		2,253	730	2,983
Dividends	12			(1,322)
Retained profit for the financial year	27			1,661
Basic earnings per share	13	35.0p	11.3p	46.3p
Diluted earnings per share	13	34.2p	11.1p	45.3p

Group statement of total recognised gains and losses **for the year ended 31 March 2001**

	2001 £m	2000 £m	1999 £m
Profit (loss) for the financial year:			
Group	**(915)**	2,576	3,362
Joint ventures	**(974)**	(480)	(362)
Associates	**79**	(41)	(17)
Total profit (loss) for the financial year	**(1,810)**	2,055	2,983
Currency movements arising on consolidation of non-UK:			
Subsidiaries	**215**	(27)	3
Joint ventures	**245**	(141)	27
Associates	**(31)**	102	15
Unrealised gain (loss) on transfer of assets and group undertakings to a joint venture	**(49)**	159	–
Total recognised gains and losses for the financial year	**(1,430)**	2,148	3,028

Group cash flow statement for the year ended 31 March 2001

	Notes	2001 £m	2000 £m	1999 £m
Net cash inflow from operating activities	14	**5,887**	5,849	6,035
Dividends from associates and joint ventures		**10**	5	2
Returns on investments and servicing of finance				
Interest received		**293**	286	111
Interest paid, including finance costs		**(1,020)**	(449)	(439)
Net cash outflow for returns on investments and servicing of finance		**(727)**	(163)	(328)
Taxation				
UK corporation tax paid		**(669)**	(1,308)	(359)
Windfall tax paid		**–**	–	(255)
Non-UK tax paid		**–**	(3)	(16)
Taxation paid		**(669)**	(1,311)	(630)
Capital expenditure and financial investment				
Purchase of intangible fixed assets		**(4,208)**	–	–
Purchase of tangible fixed assets		**(4,756)**	(3,568)	(3,220)
Sale of tangible fixed assets		**440**	143	143
Purchase of fixed asset investments		**(93)**	(373)	(103)
Disposal of fixed asset investments		**175**	46	4,226
Net cash inflow (outflow) for capital expenditure and financial investment		**(8,442)**	(3,752)	1,046
Acquisitions and disposals				
Purchase of subsidiary undertakings, net of £101m cash acquired (2000 – £69m cash acquired, 1999 – £5m overdraft)		**(11,215)**	(4,065)	(672)
Investments in joint ventures		**(3,214)**	(933)	(1,038)
Investments in associates		**(72)**	(2,167)	(288)
Repayment of loan to joint venture		**–**	550	–
Disposal of subsidiary undertakings		**245**	206	14
Sale of investments in joint ventures and associates		**502**	4	17
Net cash outflow for acquisitions and disposals		**(13,754)**	(6,405)	(1,967)
Equity dividends paid		**(1,432)**	(1,364)	(1,186)
Cash inflow (outflow) before management of liquid resources and financing		**(19,127)**	(7,141)	2,972
Management of liquid resources	15	**(480)**	1,236	(2,447)
Financing				
Issue of ordinary share capital		**149**	127	161
Issue of shares to minorities		**36**	432	13
New loans		**14,552**	1,473	10
Repayment of loans		**(225)**	(587)	(457)
Net increase (decrease) in short-term borrowings		**5,223**	4,514	(185)
Net cash inflow (outflow) from financing		**19,735**	5,959	(458)
Increase in cash in the year		**128**	54	67
Decrease (increase) in net debt in the year	17	**(18,942)**	(6,582)	3,146

Balance sheets at 31 March 2001

		Group		Company	
	Notes	**2001 £m**	2000 £m	**2001 £m**	2000 £m
Fixed assets					
Intangible assets	18	**18,380**	5,777	**–**	–
Tangible assets	19	**21,625**	18,163	**15,613**	14,976
Investments in joint ventures:	20				
Share of gross assets and goodwill		**5,439**	3,631		
Share of gross liabilities		**(3,512)**	(1,045)		
		1,927	2,586		
Investments in associates	20	**2,229**	2,639		
Other investments	20	**1,048**	653		
Total investments	20	**5,204**	5,878	**34,385**	20,038
Total fixed assets		**45,209**	29,818	**49,998**	35,014
Current assets					
Stocks		**361**	225	**102**	182
Debtors	21	**6,260**	5,241	**5,731**	4,678
Investments	22	**2,557**	2,051	**5,625**	1,748
Cash at bank and in hand		**412**	253	**22**	15
Total current assets		**9,590**	7,770	**11,480**	6,623
Creditors: amounts falling due within one year					
Loans and other borrowings	23	**12,136**	5,650	**21,201**	12,551
Other creditors	24	**8,597**	9,235	**7,479**	6,942
Total creditors: amounts falling due within one year		**20,733**	14,885	**28,680**	19,493
Net current liabilities		**(11,143)**	(7,115)	**(17,200)**	(12,870)
Total assets less current liabilities		**34,066**	22,703	**32,798**	22,144
Creditors: amounts falling due after more than one year					
Loans and other borrowings	23	**18,775**	5,354	**18,092**	4,836
Provisions for liabilities and charges	25	**723**	1,056	**385**	802
Minority interests		**499**	498	**–**	–
Capital and reserves					
Called up share capital	26	**1,646**	1,627	**1,646**	1,627
Share premium account	27	**2,195**	1,580	**2,195**	1,580
Other reserves	27	**884**	933	**747**	747
Profit and loss account	27	**9,344**	11,655	**9,733**	12,552
Total equity shareholders' funds	27	**14,069**	15,795	**14,321**	16,506
		34,066	22,703	**32,798**	22,144

The financial statements on pages 73 to 131 were approved by the board of directors on 22 May 2001 and were signed on its behalf by

Sir Christopher Bland *Chairman*
Sir Peter Bonfield CBE *Chief Executive*
P R Hampton *Group Finance Director*

Notes to the financial statements

1. Changes in accounting policies and presentation

With effect from 1 April 2000, the group changed its method of accounting for loans and other borrowings. Loans and other borrowings are now adjusted for the effect of currency swaps acting as hedges. There is no impact on the profit of the group as a result of this change; the adjustment is reflected in debtors or creditors. By adjusting for the effects of currency swaps acting as hedges the balances stated reflect the full economic exposure of the company arising from loans and other borrowings. The comparative figures have not been restated as the impact is not material.

During the year ended 31 March 2001, the group has made a number of changes in the presentation of its financial statements. Comparative figures have been restated accordingly. These are explained in the notes where material.

2. Segmental analysis

The group provides telecommunication services, principally in the UK and essentially operated as a unitary business prior to 1 July 2000. Its main services and products are fixed voice and data calls in the UK, the provision of fixed exchange lines to homes and businesses, the supply of mobile communication services and equipment to businesses and individuals, the provision of communication services in the UK to other operators, the provision of private services to businesses and the supply of telecommunication equipment for customers' premises.

In April 2000, the group announced a restructuring whereby the group and its associates and joint ventures would be managed in several separate lines of business comprising four international businesses and two UK operating businesses, together with the group's Concert global venture. The four international businesses, which were formed in July 2000, are: BT Wireless covering the group's interests in mobile communications; BT Ignite responsible for broadband and internet networks; BTopenworld covering the consumer market for internet products around the world; and Yell, responsible for the classified directories and associated e-commerce businesses. The two UK operating lines of business, which were formed in autumn 2000, are a wholesale line of business covering the UK fixed network and a retail line of business responsible for marketing UK fixed-network products. In November 2000, the group announced that it intended to set up a new company, provisionally named NetCo, to operate the group's UK fixed network. NetCo, which will be formed principally from the UK wholesale business and part of the UK retail business, is planned to be set up during the course of the year ending 31 March 2002.

The turnover of each line of business is derived as follows:

- BT Retail derives its turnover from the supply of exchange lines to the group's UK customers and from the calls they make over these lines, the leasing of private circuits and other private services, and the sale and rental of customer premises equipment.
- BT Wholesale derives its turnover from providing network services to BT Retail and other BT lines of business, and from interconnecting the group's UK network to other operators.
- BT Wireless mainly derives its turnover from the calls made and received by its customers using its mobile phones, from subscription fees charged to its contract customers and from handset equipment sales.
- BT Ignite mainly generates its turnover from outsourcing and systems integration work and from the fixed network operations of the group's European subsidiaries. The business also derives revenues from providing web hosting facilities.
- BTopenworld mainly derives its turnover from its narrowband internet access products, mainly by selling advertising.
- Yell derives its turnover from selling advertising in its classified directories in the UK and in the US.

Prior to the restructuring implemented during the year ended 31 March 2001, the group was managed as a unitary business providing an integrated range of services. For the purposes of exercising day-to-day managerial and budgetary control, however, the business was divided internally into divisions but these divisions were not self-standing businesses. Control was exercised by comparing performance against budgets agreed in advance. The group's chief operating decision maker (the CEO) reviewed the turnover and operating results for each main division. The group's capital expenditure programmes were largely centrally driven and were not necessarily linked to individual divisions. For this reason it had been group policy not to allocate certain assets to individual divisions, although depreciation charges were allocated.

2. Segmental analysis (continued)

Segmented information on the new lines of business is given below for the year ended 31 March 2001 as required by the UK accounting standard SSAP 25 and the US accounting standard SFAS No. 131 (SFAS 131).

Financial information in the group's new form was made available to the senior management of the group with respect to accounting periods from 1 July 2000.

For the years ended 31 March 1999 and 2000, information is provided as required by the US accounting standard, SFAS 131, on disclosures about segments of an enterprise. The information presented is required to be based on the segmental operating results regularly reviewed by the CEO.

Because of the fundamental restructuring and the previous progressive reorganisation explained below, it has not been practicable to restate the segment information for the years ended 31 March 1999 and 2000 onto the segment basis presented for the year ended 31 March 2001 with the limited exceptions of BT Wireless and Yell.

Between September 1997 and July 2000, the group was organised into two main divisions, BT UK and BT Worldwide, in order to reflect the group's two distinctive geographical operating regions and customer groups. Substantially all of the group's operations were within the UK and, of those, the majority were managed by BT UK. During the year ended 31 March 2000 and progressively from 1 October 1998, BT UK was sub-divided into ten separate business units, the principal five of which were Markets, Enterprises, Networks and Systems, Mobility, and Products and Solutions. Markets was the division providing the customer facing links for the group's fixed network services and Enterprises managed the Yellow Pages classified directory business and the group's wholesale interconnect business with other operators. Networks and Systems provided the UK fixed network as a platform for these services. Mobility provided the group's UK mobile communication services, principally via BT Cellnet. Products and Solutions managed the group's outsourcing services.

Prior to 30 September 1998, the Consumer Division within BT UK provided fixed network telecommunication services for residential customers, principally the provision of exchange lines to customers' homes and calls to and from those homes. The Business Division provided fixed network services to businesses and organisations other than multinational companies, principally the provision of exchange lines, private services and calls to and from their places of business and customer premises equipment. The Networks and Systems Division built, maintained and operated the company's fixed telecommunications network in the UK. Mobile Communications provided the group's UK mobile communications services. Other units within BT UK provided the group's classified advertising directories and outsourcing services.

BT Worldwide provided telecommunication service to multinational companies, including those based in the UK, and international incoming, outgoing and transit telecommunication services. It was responsible for managing Concert Communications and the group's other non-UK operations, and investments in non-UK joint ventures and associates.

The following information for the year ended 31 March 1999 set out below is based on the divisional organisation of the group at 1 April 1998, described above. As already noted, the BT UK organisation was changed progressively from 1 October 1998 into a substantially different form. Financial information in its then new form and set out for the year ended 31 March 2000 was made available to the senior management of the group with respect to accounting periods from 1 April 1999.

Year ended 31 March 2001	Turnover External £m	Turnover Internal £m	Turnover Business total £m	Depreciation and amortisation £m	Operating profit (loss) of associates and joint ventures £m	Total operating profit (loss) £m
BT Retail	10,657	1,154	11,811	185	–	1,003
BT Wholesale	3,005	8,488	11,493	1,738	–	2,540
BT Ignite	2,968	502	3,470	649	(124)	(672)
BT Wireless	2,873	535	3,408	3,416	(264)	(3,374)
Concert	–	–	–	–	(1)	(1)
Yell	768	6	774	35	2	188
BTopenworld	85	82	167	37	(69)	(296)
Other	71	302	373	371	59	276
Eliminations	–	(11,069)	(11,069)	–	–	–
Group totals	**20,427**	**–**	20,427	**6,431**	(397)	(336)

2. Segmental analysis (continued)

The following table shows the capital expenditure on plant, equipment and property for the year ended 31 March 2001 and the net operating assets of the new lines of business at 31 March 2001. Net operating assets comprise tangible and intangible fixed assets, stocks, debtors, less creditors, excluding loans and other borrowings, and provisions for liabilities and charges, excluding deferred tax.

	Capital expenditure £m	Net operating assets (liabilities) £m	Associates and joint ventures £m
BT Retail	157	1,114	–
BT Wholesale	2,273	12,511	–
BT Wireless	1,105	18,634	27
Ignite	936	3,584	178
Concert	–	–	1,430
Yell	21	710	2
BTopenworld	25	(17)	12
Other	469	1,040	2,507
Total	4,986	37,576	4,156

Year ended 31 March 2000	Turnover External £m	Turnover Internal £m	Turnover Business total £m	Depreciation and amortisation £m	Operating profit (loss) of associates and joint ventures £m	Total operating profit (loss) £m
Markets	11,636	8	11,644	67	(9)	2,564
Enterprises	3,114	328	3,442	100	(4)	835
Networks & Systems	3	–	3	1,812	–	4
Mobility	2,170	391	2,561	305	8	117
Products and Solutions	197	368	565	76	(103)	240
Other	10	2	12	132	–	(175)
Eliminations	–	(1,004)	(1,004)	–	–	–
Total BT UK	**17,130**	**93**	**17,223**	**2,492**	**(108)**	**3,585**
BT Worldwide	1,540	129	1,669	176	(335)	(520)
Other	45	10	55	173	43	133
Eliminations	–	(232)	(232)	–	–	–
Group totals	**18,715**	**–**	**18,715**	**2,841**	**(400)**	**3,198**

The above includes the following information presented on the new lines of business structure:

BT Wireless	2,245	391	2,636	313	(243)	(170)
Yell	617	5	622	18	1	191

Year ended 31 March 1999						
Business Division	5,624	294	5,918	106	–	1,535
Consumer Division	6,168	140	6,308	113	(7)	1,998
Networks & Systems	108	–	108	1,716	(3)	96
Mobile Communications	1,400	312	1,712	195	6	189
Other	1,282	1,877	3,159	126	(38)	(93)
Eliminations	–	(2,351)	(2,351)	–	–	–
Total BT UK	**14,582**	**272**	**14,854**	**2,256**	**(42)**	**3,725**
BT Worldwide	2,361	984	3,345	145	(292)	(327)
Other	10	847	857	180	(8)	76
Eliminations	–	(2,103)	(2,103)	–	–	–
Group totals	**16,953**	**–**	**16,953**	**2,581**	**(342)**	**3,474**

2. Segmental analysis (continued)

Year ended 31 March 1999	External £m	Internal £m	Turnover Business total £m	Depreciation and amortisation £m	Operating profit (loss) of associates and joint ventures £m	Total operating profit (loss) £m
The above includes the following information presented on the new lines of business structure:						
BT Wireless	1,510	312	1,822	195	(152)	45
Yell	466	3	469	6	–	177

Transactions between divisions are at prices set in accordance with those agreed with Oftel where the services provided are subject to regulation. Other transactions are at arms length. Internal supplies of services from Networks & Systems were accounted for by that division as negative costs in 1999 and 2000.

Information about geographic areas:

	2001 £m	2000 £m	1999 £m
Turnover with external customers			
Attributable to UK	**18,642**	17,161	15,612
Attributable to non-UK countries *(a)*	**1,785**	1,554	1,341
Group turnover	**20,427**	18,715	16,953

(a) Turnover attributable to non-UK countries comprises the external turnover of group companies and branches operating outside the UK, income from non-UK operators for calls terminating in or in transit through the UK and turnover with non-UK joint ventures and associates.

	2001 £m	2000 £m
Group fixed assets are located		
UK	**26,167**	20,940
Europe, excluding the UK	**13,893**	3,935
Americas	**2,990**	2,549
Asia and Pacific	**2,159**	2,394
Total	**45,209**	29,818

Geographical segment analysis in accordance with the requirements of SSAP 25 is as follows:

	2001 £m	2000 £m	1999 £m
Total turnover on basis of origin			
UK	**18,500**	17,975	16,485
Europe, excluding the UK	**3,084**	1,891	1,231
Americas	**2,771**	979	237
Asia and Pacific	**5,311**	1,058	270
Total	**29,666**	21,903	18,223

	2001 £m	2000 £m	1999 £m
Group turnover on basis of origin			
UK	**18,642**	17,866	16,364
Europe, excluding the UK	**1,183**	285	240
Americas	**368**	383	237
Asia and Pacific	**234**	181	112
Total	**20,427**	18,715	16,953

The analysis of turnover by geographical area is stated on the basis of origin. In an analysis of turnover by destination, incoming and transit international calls by country of origin and turnover with non-UK joint ventures and associates would be treated differently but would not lead to a materially different geographical analysis. See the "information about geographic areas" above.

2. Segmental analysis (continued)

	2001 £m	2000 £m	1999 £m
Group operating profit (loss)			
UK	**3,520**	3,621	3,858
Europe, excluding the UK	**(3,346)**	(42)	(31)
Americas	**(7)**	34	4
Asia and Pacific	**(106)**	(15)	(15)
Total	**61**	3,598	3,816

	2001 £m	2000 £m	1999 £m
Share of operating results of associates and joint ventures, including goodwill amortisation – profits (losses)			
UK	**(32)**	(118)	(13)
Europe, excluding the UK	**(471)**	(312)	(307)
Americas	**(66)**	43	–
Asia and Pacific	**172**	(13)	(22)
Total	**(397)**	(400)	(342)

	2001			2000		
Year ended 31 March	Net operating assets £m	Associates and joint ventures £m	Total £m	Net operating assets £m	Associates and joint ventures £m	Total £m
UK	**23,750**	**42**	**23,792**	16,428	17	16,445
Europe, excluding the UK	**12,878**	**468**	**13,346**	2,232	1,296	3,528
Americas	**783**	**1,716**	**2,499**	653	1,724	2,377
Asia and Pacific	**165**	**1,930**	**2,095**	156	2,188	2,344
Total	**37,576**	**4,156**	**41,732**	19,469	5,225	24,694

Net operating assets comprise tangible and intangible fixed assets, stocks, debtors less creditors, excluding loans and other borrowings, and provisions for liabilities and charges, excluding deferred tax.

3. Turnover

	2001 £m	2000*(a)* £m	1999*(a)* £m
Fixed network calls	**5,655**	5,908	6,026
Exchange lines	**3,674**	3,526	3,351
Receipts from other operators	**2,814**	1,974	1,417
Wireless products	**2,760**	2,170	1,400
Private services	**1,091**	1,135	1,140
Solutions	**1,074**	915	746
Yellow Pages and other directories	**754**	642	491
Customer premises equipment supply	**726**	847	870
Other sales and services	**1,879**	1,598	1,512
Group turnover	**20,427**	18,715	16,953
Group's share of associates' and joint ventures' turnover	**9,937**	3,364	1,270
Trading between group and principal joint venture	**(698)**	(176)	–
Total turnover	**29,666**	21,903	18,223

(a) Figures in the 1999 and 2000 financial years have been restated to conform with the method of classification used in the 2001 financial year.

3. Turnover (continued)

Group's share of associates' and joint ventures' turnover comprised:

	2001 £m	2000 £m	1999 £m
Joint ventures	**4,018**	1,784	561
Associates:			
Continuing activities	**2,362**	1,580	709
Acquisitions	**3,557**	–	–
	5,919	1,580	709
Group's share of associates' and joint ventures' turnover	**9,937**	3,364	1,270

Approximately 9% (2000 – 5%, 1999 – 4%) of group turnover arose from operations outside the UK and approximately 38% (2000 – 18%, 1999 – 10%) of total turnover arose from activities outside the UK (note 2). Unaudited information concerning the group's classified directory business in the UK is shown on page 142 of this annual report.

Concert, the joint venture with AT&T, was formed on 5 January 2000 (see note 16). From that date, international calls into, through and out of the UK and formerly handled by the company, have been handled by Concert. Additionally, certain of the company's multinational customers were transferred to Concert on the same date.

Fixed network calls comprise calls within the UK and calls made from the UK to other countries. Receipts from other operators include revenues from Concert for terminating incoming international calls from 5 January 2000 and revenues from non-UK operators for incoming and transit calls into and through the UK up to that date.

The group's share of trading with Concert, primarily in respect of international calls made to and from the UK and for services provided to Concert in the UK for the multinational customers transferred to Concert, is eliminated in arriving at total turnover, including the proportionate share of the group's associates and joint ventures, and is added back in arriving at group turnover.

4. Other operating income

	2001 £m	2000 £m	1999 £m
Seconded staff and administration and other services provided to Concert	**168**	79	–
Other	**225**	163	168
Total other operating income	**393**	242	168

Notes to the financial statements

5. Operating costs

	2001 £m	2000 £m	1999 £m
Staff costs:			
Wages and salaries	**3,954**	3,754	3,366
Social security costs	**313**	316	275
Pension costs (note 30)	**326**	167	176
Employee share ownership scheme *(a)*	**32**	59	64
Total staff costs	**4,625**	4,296	3,881
Own work capitalised	**(693)**	(498)	(428)
Depreciation (note 19)	**3,045**	2,752	2,581
Amortisation and impairment of goodwill and other intangibles (note 18)	**3,386**	89	–
Payments to telecommunications operators	**3,802**	3,086	2,120
Other operating costs *(b)*	**6,594**	5,634	5,151
Total operating costs	**20,759**	15,359	13,305
Operating costs included the following:			
Redundancy charges	**104**	59	124
Research and development	**364**	345	268
Rental costs relating to operating leases, including plant and equipment hire £15 million (2000 – £12 million, 1999 – £9 million)	**166**	189	185
Foreign currency gains	**(50)**	(26)	(88)
Amortisation of goodwill and exceptional items comprising:			
Exceptional costs relating to impairment of goodwill	**3,000**	–	–
Exceptional credit for rates refunds, relating to prior years	**(193)**	–	–
Exceptional costs relating to the write off of subscriber acquisition costs *(c)*	**7**	–	–
Exceptional costs relating to the write off of Viag Interkom IT systems	**43**	–	–
Exceptional costs relating to the proposed closure of the BT Cellnet analogue network:			
Depreciation	**–**	37	–
Other operating costs	**–**	10	–
	–	47	–
Exceptional costs relating to the disengagement from MCI:			
Staff costs	**–**	13	10
Depreciation	**–**	11	13
Payments to telecommunication operators	**–**	18	14
Other operating costs	**–**	22	32
	–	64	69
Total exceptional items	**2,857**	111	69
Goodwill amortisation	**373**	89	–
Total amortisation of goodwill and exceptional items	**3,230**	200	69

(a) Amount set aside for the year for allocation of ordinary shares in the company to eligible employees.

(b) No charge for the cost of providing incremental pension benefits for employees taking early retirement was made in the years ended 31 March 2001, 2000 and 1999 in view of the combined surplus in the BT Pension Scheme disclosed by the actuarial valuations as at 31 December 1999 and 1996, and the amount provided for pension costs within provisions for liabilities and charges.

(c) The accounting of all the BT Wireless operating units has been aligned; this has resulted in a write off of previously capitalised costs in certain non-UK operations.

The directors believe that the nature of the group's business is such that the analysis of operating costs required by the Companies Act 1985 is not appropriate. As required by the Act, the directors have therefore adapted the prescribed format so that operating costs are disclosed in a manner appropriate to the group's principal activity.

5. Operating costs (continued)

The operating costs for the year ended 31 March 2001 on page 88, include the following amounts relating to acquisitions made in the year.

	2001 £m
Total staff costs	65
Depreciation	76
Amortisation of intangibles	8
Payments to telecommunications operators	138
Other operating costs	246
Total operating costs	533

6. Group's share of operating profit (loss) of associates and joint ventures

The group's share of operating profit (loss) of associates and joint ventures comprised:

	2001 £m	2000(b) £m	1999(b) £m
Joint ventures:			
Continuing	**(377)**	(124)	(84)
Acquisitions	**(8)**	–	–
Discontinued or subsequently wholly acquired	**(381)**	(303)	(258)
	(766)	(427)	(342)
Associates:			
Continuing	**168**	41	–
Acquisitions	**201**	(14)	–
	369	27	–
Group's share of operating loss of associates and joint ventures *(a)*	**(397)**	(400)	(342)
(a) Includes:			
Exceptional item relating to impairment of goodwill	**200**	–	–
Exceptional item relating to write off of subscriber acquisition costs	**132**	–	–
Amortisation of goodwill arising in joint ventures and associates	**185**	84	17

(b) Prior years' figures have been restated to provide comparative information for joint ventures discontinued or subsequently wholly acquired in the year ended 31 March 2001.

7. Profit on sale of fixed asset investments and group undertakings

In November 2000, the group sold its 34% stake in sunrise communications, its joint venture in Switzerland, to a fellow shareholder for a consideration of £464 million, on which a realised profit of £454 million has been recognised. In December 2000, BT sold off part of its Aeronautical and Maritime division at a profit of £46 million. Reductions in BT's holdings in I.Net SpA and British Interactive Broadcasting Limited resulted in gains of £38 million and £25 million, respectively. Other gains during the year totalled £56 million. All these items have been classified as exceptional in the year ended 31 March 2001.

In August 1999, the group sold BT Communications Services KK to Japan Telecom for a consideration of £170 million, on which a realised profit of £80 million has been recognised. In February 2000, BT's photonics research facility was sold at a profit of £35 million. Other gains during the year totalled £11 million. All these items have been classified as exceptional in the year ended 31 March 2000.

In September 1998, the group completed the sale of its interest in MCI for £4,159 million at a pre-tax profit of £1,133 million, after taking into account goodwill of £2,214 million originally written off on the acquisition of the group's interest in MCI in September 1994. A provision for impairment of £26 million against another fixed asset investment has been offset against this profit giving a net gain of £1,107 million. These two items have been classified as exceptional in the year ended 31 March 1999.

With the exception of Concert Communications (see note 16), the subsidiary undertakings disposed of in the years ended 31 March 2001, 2000 and 1999 had a negligible effect on the group's operating profit and cash flows and their net assets were immaterial to the group's financial position.

Notes to the financial statements

8. Interest receivable

	2001 £m	2000 £m	1999 £m
Income from listed investments	**30**	13	9
Other interest receivable *(a)*	**352**	169	150
Group	**382**	182	159
Joint ventures	**19**	4	2
Associates	**7**	7	4
Total interest receivable	**408**	193	165
(a) Includes:			
Exceptional credit for interest on rates refunds received in 2000, relating to prior years	**25**	–	–

9. Interest payable

	2001 £m	2000 £m	1999 £m
Interest payable and similar charges in respect of:			
Bank loans and overdrafts	**181**	87	77
Other borrowings *(a)*	**1,245**	401	343
Group	**1,426**	488	420
Joint ventures	**176**	47	19
Associates	**120**	40	12
Total interest payable	**1,722**	575	451

(a) Includes £7 million premium charged in the year ended 31 March 1999 on the early redemption of US$200 million 9 5/8% Guaranteed Debentures 2019 on 16 February 1999.

10. Tax on profit (loss) on ordinary activities

	2001 £m	2000 £m	1999 £m
United Kingdom:			
Corporation tax at 30% (2000 – 30%, 1999 – 31%)	**690**	852	1,200
Deferred taxation charge (credit) at 30%	**27**	(3)	71
Taxation on the group's share of results of associates	**6**	3	1
Taxation on the group's share of results of joint ventures	**42**	–	–
Prior year adjustments	**(296)**	4	–
Total UK taxation	**469**	856	1,272
Non-UK taxation:			
Current	**24**	5	14
Taxation charge on the group's share of results of joint ventures	**33**	11	3
Taxation charge on the group's share of results of associates	**146**	25	4
Prior year adjustments	**(20)**	–	–
Total tax on profit (loss) on ordinary activities	**652**	897	1,293

In the year ended 31 March 2001, the loss on ordinary activities before taxation was £1,031 million, after charging £3,200 million goodwill impairment, which is not an allowable expense for taxation. In the following table, the effective corporation tax rate is reconciled to the profit of £2,169 million before this impairment charge.

10. Tax on profit on ordinary activities (continued)

Total tax on profit on ordinary activities, varied from the amount computed by applying the corporation tax rate to profit on ordinary activities before taxation. The differences were attributable to the following factors:

	2001 %	2000 %	1999 %
UK corporation tax rate	**30.0**	30.0	31.0
Non-deductible depreciation and amortisation	**9.0**	2.5	0.6
Non-deductible non-UK losses	**11.3**	2.7	1.5
Higher taxes on non-UK profits	**4.0**	–	–
Unprovided deferred taxes on excess capital allowances	**(2.8)**	(2.0)	(0.7)
Lower effective tax on net foreign exchange gains	**–**	(1.2)	–
Effect of reduction in UK corporation tax rate on deferred tax provision	**–**	–	(0.1)
Lower effective tax on gain in MCI shares	**–**	–	(2.4)
Lower effective tax on gain on disposal of fixed asset investments and group undertakings	**(8.3)**	(1.2)	–
Prior year adjustments	**(14.6)**	–	–
Other	**1.5**	(0.3)	0.2
Effective corporation tax rate	**30.1**	30.5	30.1

Deferred taxation of £60 million (2000 – £60 million, 1999 – £30 million) arising on excess capital allowances was not provided in the year ended 31 March 2001.

The deferred taxation charge (credit) was mainly the result of the tax effect of timing differences as follows:

	2001 £m	2000 £m	1999 £m
Excess capital allowances	**(74)**	(80)	1
Pension provisions	**87**	97	81
Other timing differences	**14**	(20)	(11)
	27	(3)	71
Prior year adjustments *(a)*	**(111)**	16	5
Total deferred taxation charge (credit)	**(84)**	13	76

(a) Reclassification between deferred and current taxation on the profit on ordinary activities for prior years.

11. Minority Interests

	2001 £m	2000 £m	1999 £m
Minority interests in profits (losses):			
Group	**6**	(15)	15
Associates	**121**	5	4
Total minority interests	**127**	(10)	19

12. Dividends

	2001 pence per share	2000 pence per share	1999 pence per share	2001 £m	2000 £m	1999 £m
Interim dividend paid	**8.70**	8.70	8.10	**571**	565	523
Proposed final dividend	**–**	13.20	12.30	**–**	861	799
Total dividends	**8.70**	21.90	20.40	**571**	1,426	1,322

Notes to the financial statements

13. Earnings (loss) per share

The basic earnings (loss) per share are calculated by dividing the profit for the financial year attributable to shareholders by the weighted average number of shares in issue after deducting the company's shares held by employee share ownership trusts.

In calculating the diluted earnings (loss) per share, share options outstanding and other potential ordinary shares have been taken into account.

The weighted average number of shares in the years were:

	2001 millions of shares	2000 millions of shares	1999 millions of shares
Basic	**6,525**	6,488	6,442
Dilutive ordinary shares from share options outstanding and shares held in trust	**96**	154	150
Total diluted	**6,621**	6,642	6,592

Options over 39 million shares were excluded from the calculation of the total diluted number of shares in the year ended 31 March 2001 because to do so would have been antidilutive.

The items in the calculation of earnings (loss) per share before goodwill amortisation and exceptional items in the years were:

	2001 pence per share	2000 pence per share	1999 pence per share	**2001 £m**	2000 £m	1999 £m
Profit on sale of group undertakings	**9.4**	1.9	–	**619**	126	–
Rates refunds relating to prior years	**3.0**	–	–	**193**	–	–
Goodwill impairment	**(49.0)**	–	–	**(3,200)**	–	–
Write off of subscriber acquisition costs	**(2.1)**	–	–	**(139)**	–	–
Viag Interkom write off of IT Systems	**(0.7)**	–	–	**(43)**	–	–
Interest receivable on rates refunds, relating to prior years	**0.4**	–	–	**25**	–	–
Costs relating to the closure of the BT Cellnet analogue network	**–**	(0.7)	–	**–**	(47)	–
Profit on sale of MCI shares	**–**	–	17.6	**–**	–	1,133
Provision against another fixed asset investment	**–**	–	(0.4)	**–**	–	(26)
Costs relating to the disengagement from MCI	**–**	(1.0)	(1.1)	**–**	(64)	(69)
Goodwill amortisation	**(8.6)**	(2.6)	(0.3)	**(558)**	(173)	(17)
Total credit (charge) before tax and minority interest	**(47.6)**	(2.4)	15.8	**(3,103)**	(158)	1,021
Tax charge attributable	**(0.3)**	(0.1)	(4.5)	**(22)**	(5)	(291)
Minority Interest	**(0.3)**	–	–	**(21)**	–	–
Net credit (charge)	**(48.2)**	(2.5)	11.3	**(3,146)**	(163)	730
Basic earnings (loss) per share/profit for the financial year after goodwill amortisation and exceptional items	**(27.7)**	31.7	46.3	**(1,810)**	2,055	2,983
Goodwill amortisation and exceptional charge (credit)	**48.2**	2.5	(11.3)	**3,146**	163	(730)
Basic earnings per share/profit for the financial year before goodwill amortisation and exceptional items	**20.5**	34.2	35.0	**1,336**	2,218	2,253

Earnings per share before goodwill amortisation and exceptional items are provided to help readers evaluate the performance of the group.

14. Reconciliation of operating profit to operating cash flows

	2001 £m	2000 £m	1999 £m
Group operating profit	**61**	3,598	3,816
Depreciation	**3,045**	2,752	2,581
Goodwill amortisation and impairment	**3,386**	89	–
Increase in stocks	**(67)**	(48)	(8)
Increase in debtors	**(432)**	(1,175)	(410)
Increase in creditors	**203**	982	388
Decrease in provisions	**(222)**	(295)	(259)
Other	**(87)**	(54)	(73)
Net cash inflow from operating activities	**5,887**	5,849	6,035

15. Management of liquid resources

	2001 £m	2000 £m	1999 £m
Purchase of short-term investments and payments into short-term deposits over 3 months	**(1,344)**	(3,178)	(2,973)
Sale of short-term investments and withdrawals from short-term deposits over 3 months	**1,765**	3,850	1,735
Net movement of short-term investments and short-term deposits under 3 months not repayable on demand	**(901)**	564	(1,209)
Net cash inflow (outflow) from management of liquid resources	**(480)**	1,236	(2,447)

Movements in all short-term investments and deposits not repayable on demand are reported under the heading of management of liquid resources.

16. Acquisitions and disposals

Acquisition of subsidiary companies

Year ended 31 March 2001	Viag Interkom (a) £m	Telfort (c) £m	Other £m	Total £m
Consideration:				
Cash	8,770	1,207	160	**10,137**
Carrying value of joint venture wholly acquired	479	235	–	**714**
Total	**9,249**	1,442	160	**10,851**

Year ended 31 March 2000	Cellnet Group(e) £m	Esat(f) £m	Yellow Book (USA) (g) £m	Syntegra (USA) (h) £m	Other £m	Total £m
Consideration:						
Cash	3,014	179	401	213	327	**4,134**
Deferred	–	1,167	–	–	45	**1,212**
Loan notes 2000/2009	159	–	–	–	–	**159**
Other loan notes	–	174	14	–	14	**202**
Carrying value of associate wholly acquired	–	–	–	–	23	**23**
Total	**3,173**	**1,520**	**415**	**213**	**409**	**5,730**

Year ended 31 March 1999	Concert (i) £m	MDT (i) £m	Other £m	Total £m
Consideration:				
Cash	607	41	19	**667**
Deferred	–	–	8	**8**
Loan notes 1999/2006	–	90	–	**90**
Total	**607**	**131**	**27**	**765**

16. Acquisitions and disposals (continued)

(a) On 20 February 2001, the group took full control of Viag Interkom GmbH & Co (Viag Interkom). Under an agreement announced in August 2000, the group purchased from E.ON its 45% interest in Viag Interkom by means of a put option priced at €7.25 billion (£4,562 million). In January 2001, the group acquired the 10% interest in the company previously owned by Telenor for €1.6 billion (£1,032 million). As part of the transactions, the group repaid loans due by Viag Interkom to E.ON and Telenor totalling £3,165 million. The total cash consideration amounted to £8,770 million, including £11 million expenses.

	Book and fair values £m
Fixed assets	6,728
Current assets	619
Current liabilities	(585)
Long-term liabilities	(2,505)
Group's share of original book value of net assets	4,257
Goodwill	4,992
Total cost	9,249
Consideration:	
Cash	8,770
Carrying value of joint venture wholly acquired	479
Total	9,249

Since the acquisition was made towards the end of the year ended 31 March 2001, the fair values of the identifiable assets and liabilities have been determined on a provisional basis. Goodwill arising on acquisition of Viag Interkom is being amortised over 20 years.

The consolidated results of Viag Interkom for the year ended 31 December 2000 and for the period from 1 January 2001 to 19 February 2001, on the basis of its accounting policies, are summarised as follows:

	Period 1 January to 19 February 2001 £m	Year ended 31 December 2000 £m
Group turnover	216	856
Total operating loss	(108)	(686)
Loss before taxation	(160)	(784)
Taxation	–	–
Minority interests	–	–
Loss for the financial period	(160)	(784)

16. Acquisitions and disposals (continued)

(b) Other subsidiary companies

During the year ended 31 March 2001, the acquisition of interests in other subsidiary companies and the consideration given comprised:

Year ended 31 March 2001	Telfort*(c)* £m	Other £m	**Total £m**
Minority Interest	–	31	**31**
Fixed assets	496	–	**496**
Current assets	221	16	**237**
Current liabilities	(261)	–	**(261)**
Group share of original book value of net assets (liabilities) and fair value to group	456	47	**503**
Goodwill	986	113	**1,099**
Total cost	1,442	160	**1,602**
Consideration:			
Cash	1,207	160	**1,367**
Carrying value of joint venture wholly acquired	235	–	**235**
Total	1,442	160	**1,602**

(c) On 22 June 2000, BT received regulatory approval to acquire the remaining 50% interest of Telfort BV, its provider of fixed and mobile services to businesses and consumers in The Netherlands, that it did not already own for £1,207 million. Goodwill arising on the acquisition of Telfort BV is being amortised over 20 years. Telfort BV's loss after tax for the year ended 31 December 1999 was £141 million and its loss for the six months ended 30 June 2000 was £86 million.

(d) During the year ended 31 March 2000, the acquisition of the interests in subsidiary companies and the consideration given comprised:

	Cellnet Group*(e)* £m	Esat*(f)* £m	Yellow Book USA*(g)* £m	Syntegra (USA)*(h)* £m	Other £m	**Total £m**
Minority interest	176	(2)	–	1	40	**215**
Fixed assets		428	6	12	157	**603**
Current assets		137	49	48	68	**302**
Current liabilities		(137)	(21)	(88)	(108)	**(354)**
Long-term liabilities		(487)	–	–	(62)	**(549)**
Provisions for liabilities and charges		–	–	–	(2)	**(2)**
Group share of original book value of net assets (liabilities)	176	(61)	34	(27)	93	**215**
Fair value adjustment to achieve consistency of accounting policies	–	(115)	–	–	–	**(115)**
Other fair value adjustments	–	(69)	–	–	–	**(69)**
Fair value to the group	176	(245)	34	(27)	93	**31**
Goodwill	2,997	1,765	381	240	316	**5,699**
Total cost	3,173	1,520	415	213	409	**5,730**
Consideration:						
Cash	3,014	179	401	213	327	**4,134**
Deferred	–	1,167	–	–	45	**1,212**
Loan notes 2000/2009	159	–	–	–	–	**159**
Other loan notes	–	174	14	–	14	**202**
Carrying value of associate wholly acquired	–	–	–	–	23	**23**
Total	3,173	1,520	415	213	409	**5,730**

16. Acquisitions and disposals (continued)

(e) On 10 November 1999, BT acquired the 40% interest in Cellnet Group Limited, its mobile cellular phone operator, that it did not already own for £3,150 million, excluding £23 million expenses. Goodwill arising on acquisition of Cellnet Group Limited is being amortised over 20 years.

The consolidated results of Cellnet Group Limited for the years ended 31 March 1999 and 2000 are summarised as follows:

	2000 £m	1999 £m
Group turnover	**2,435**	1,410
Total operating profit	**97**	165
Exceptional items included in total operating profit:		
Impairment of analogue equipment and network closure costs (note 5)	**(47)**	–
Profit before taxation	**49**	117
Taxation	**(23)**	(39)
Minority interests	**(2)**	–
Profit for the financial year	**24**	78

(f) At the end of March 2000, BT acquired control of Esat Telecom Group plc (Esat), a leading telecommunications operator in Ireland. An interest comprising 70% of the company was acquired under a public offer, the consideration for which passed in April 2000. In January 2000, BT acquired 13% of the company from its then chairman and chief executive for US$287 million (£174 million) and a further 12% interest from a major shareholder for US$271 million (£179 million). Of the total consideration, £179 million was settled in cash in January 2000, £1,029 million in cash in April 2000 and £187 million was satisfied by loan notes repayable at the option of the holder not later than 30 April 2005. The balance of the consideration covered the remaining interest which was compulsorily acquired and compensation to employee share option holders. Goodwill arising on acquisition of Esat is being amortised over 20 years.

Esat holds a 49.5% interest in Esat Digifone. In January 2000, BT acquired a further 1% interest in this company for £15 million. At 31 March 2000 and 2001, Telenor owned the remaining 49.5% interest. In the table above, the assets acquired and the liabilities assumed comprise those of both Esat and Esat Digifone. Since BT acquired control just before the 2000 financial year end, only a preliminary assessment of the fair values of Esat's assets and liabilities, which were based on 31 December 1999 balance sheets, had been undertaken. The fair value adjustment relates to an uplift of £69 million to the carrying value of Esat's debt to its market value on 30 March 2000. During the year ended 31 March 2001, in the final assessment of fair values, the fair values of the net liabilities were increased by £75 million, the fair value of the consideration was increased by £38 million and goodwill increased by £113 million to £1,878 million.

Esat incurred a loss after tax of IR£120 million (£95 million) for the year ended 31 December 1999.

Under an agreement with Telenor made in 2000, Telenor had the right to exchange its 49.5% interest in Esat Digifone for a 33% interest in Esat and a right to purchase from BT such additional shares as would result in Telenor having an almost 50% interest in Esat at a total price of US$624 million plus interest. If Telenor did not exercise this right, Telenor agreed to sell its interest in Esat Digifone to the group for US$1,238 million. In February 2001, Telenor decided to sell its interest in Esat Digifone to the group and this transaction was completed in April 2001 for £856 million.

(g) On 31 August 1999, BT acquired Yellow Book USA, an independent classified directory publisher in the USA, for £415 million. Yellow Book's loss after tax for the year ended 31 October 1998 was £5 million.

(h) On 31 August 1999, BT acquired Syntegra (USA) (previously named Control Data Systems), an international systems integration company based in the USA, for £213 million. Goodwill arising on acquisition of Syntegra (USA) is being amortised over 20 years. Syntegra (USA)'s loss after tax for the year ended 31 December 1998 was £37 million.

16. Acquisitions and disposals (continued)

(i) During the year ended 31 March 1999, the acquisition of the interests in Concert Communications on 15 September 1998, Martin Dawes Telecommunications (MDT) (renamed Lumina Limited) on 8 March 1999 and other subsidiary companies and the consideration given comprised:

	Concert £m	MDT £m	Other £m	**Total £m**
Minority interest	39	–	14	**53**
Fixed assets		34	1	**35**
Current assets		101	1	**102**
Current liabilities		(152)	(3)	**(155)**
Long-term liabilities		(3)	–	**(3)**
Group share of original book value of net assets (liabilities)	39	(20)	13	**32**
Fair value adjustment to achieve consistency of accounting policies	–	(9)	–	**(9)**
Fair value to the group	39	(29)	13	**23**
Goodwill	568	160	14	**742**
Total cost	607	131	27	**765**
Consideration:				
Cash	607	41	19	**667**
Deferred	–	–	8	**8**
Loan notes 1999/2006	–	90	–	**90**
Total	607	131	27	**765**

In September 1998, the group acquired MCI's 24.9% interest in Concert Communications Company (Concert Communications) for £607 million. Goodwill of £568 million arose on this transaction (refer below). This goodwill was transferred into the Concert global venture with AT&T Corp on 5 January 2000.

MDT's profit after tax for the year to 31 December 1998 was £2 million. Goodwill arising on acquisition of MDT is being written off over 10 years.

Formation of principal joint venture

On 5 January 2000, the company and AT&T formed their global venture named Concert for the two companies' trans-border communications activities. The venture is jointly owned and controlled. The group contributed the majority of its cross-border international networks, its international traffic, its business with selected multinational customers and its international products for business customers, as well as Concert Communications. AT&T contributed a similar set of assets and businesses.

The book value of the assets contributed by the group to the joint venture comprised:

	£m
Intangible assets	568
Tangible fixed assets	870
Total fixed assets	1,438
Current assets	123
Current liabilities	(183)
Net current assets (liabilities)	(60)
Provisions for liabilities and charges	(13)
Long-term debt owed to the BT group	(1,169)
Net assets contributed	196

Notes to the financial statements

16. Acquisitions and disposals (continued)

The acquisition of the group's 50% interest in Concert comprised:

	£m
Group's share of Concert's opening net assets (US GAAP)	631
Group's share of US to UK GAAP adjustments	(180)
Group's share of Concert's opening net assets (UK GAAP)	451
Net assets contributed by the group to the joint venture	(196)
Transition costs	(96)
Unrealised gain on the contribution	159

The gain on the transfer of the assets is unrealised since the group continues to maintain a 50% interest in the assets contributed. This gain has been taken to a non-distributable reserve and is shown in the statement of total recognised gains and losses for the year ended 31 March 2000. There is no tax charge on the gain.

During the year ended 31 March 2001, the group's share of Concert's opening net assets was amended, due to certain true up contributions, reducing the unrealised gain by £49 million. This is shown in the statement of total recognised gains and losses for the year ended 31 March 2001.

Acquisition of associates and joint ventures

Year ended 31 March 2001	Telenordia (j) £m	J-Phone (k) £m
Group share of original book value of net assets (net liabilities)	10	5
Fair value adjustment to achieve consistency of accounting policies	–	–
Fair value to the group	10	5
Goodwill	84	–
Total cost	**94**	**5**

Year ended 31 March 2000	Japan Telecom (l) £m	AT&T Canada (m) £m	Rogers Cantel Mobile Communi-cations (m) £m	Smartone Mobile Communi-cations (m) £m	Other (m) £m
Group share of original book value of net assets	871	101	11	96	34
Fair value adjustment to achieve consistency of accounting policies	(49)	–	–	–	–
Fair value to the group	822	101	11	96	34
Goodwill	432	259	288	145	51
Total cost	**1,254**	**360**	**299**	**241**	**85**

Year ended 31 March 1999	Maxis Communi-cations (n) £m	LG Telecom (n) £m	Airtel Movil (o) £m
Group share of original book value of net assets	60	98	62
Fair value adjustment to achieve consistency of accounting policies	(9)	(58)	(19)
Fair value to the group	51	40	43
Goodwill	228	194	158
Total cost	**279**	**234**	**201**

***(j)* Telenordia**

On 8 September 2000, BT increased its existing 33% interest in Telenordia, based in Sweden, to 50% for £94 million. Goodwill is being amortised over 20 years.

16. Acquisitions and disposals (continued)

***(k)* J-Phone**

On 8 May 2000, the group acquired a 40% interest in a company, with Japan Telecom owning the other 60% interest, which holds a 74% interest in J-Phone Communications Co Limited (JPC). JPC in turn acquired controlling interests, averaging 51%, in nine regional Japanese mobile phone J-Phone companies. These J-Phone companies merged into three larger regional companies during the year ended 31 March 2001. Japan Telecom also held a direct 18% interest, in the J-Phone companies.

During the year ended 31 March 2001, the group held an effective 23% interest in J-Phone. The impact of the combined J-Phone/Japan Telecom ownership structure, however, led the group to reflect 63% of the J-Phone results at the turnover and operating profit levels and all items below including interest and taxation, in accordance with the requirements of FRS 9. In May 2001, the group agreed to sell this interest (see note 29).

***(l)* Japan Telecom**

On 31 August 1999, the group completed its acquisition of a 30% interest, jointly with AT&T Corp, in Japan Telecom, a leading Japanese telecommunications company. Japan Telecom is held through a BT subsidiary company, 66.7% BT owned and 33.3% AT&T owned. The group has a 20% economic interest. AT&T's economic interest is shown within the group's minority interests. Goodwill on this acquisition is being amortised over 20 years.

On 31 March 2001, the 30% interest in Japan Telecom had a market value equivalent to £1,607 million (2000 – £3,398 million), compared with a carrying value of £1,282 million (2000 – £1,345 million). In April 2001, the group's direct interest in Japan Telecom was reduced to its 20% economic interest and in May 2001, the group agreed to sell this interest (see note 29).

***(m)* AT&T Canada, Rogers Cantel Mobile Communications, SmarTone Mobile Communications and other investments**

On 16 August 1999, the group acquired a 30% interest in an AT&T subsidiary undertaking which holds a 31% interest in AT&T Canada Corporation, a fixed network telecommunications company operating in Canada. The resulting economic interest of 9.3% cost £360 million. On 31 March 2001, the 9.3% interest in AT&T Canada had a market value equivalent to £267 million (2000 – £477 million), compared with a carrying value of £352 million (2000 – £345 million). From 1 April 2000, the group decided it no longer exercised significant influence over this company and the investment was reclassified as an other investment.

On 16 August 1999, the group acquired jointly with AT&T an approximate 33% interest in Rogers Cantel Mobile Communications Inc, a cellular mobile phone company operating in Canada. The resulting economic interest of approximately 17% cost £299 million. On 31 March 2001, the 17% interest in Rogers Cantel Mobile Communications Inc had a market value of £191 million (2000 – £520 million), compared with a carrying value of £285 million (2000 – £298 million).

On 10 May 1999, the group acquired a 20% interest in SmarTone Mobile Communications Limited, a cellular mobile phone company operating in Hong Kong. On 31 March 2001, the 20% interest in SmarTone Mobile Communications Limited had a market value of £107 million (2000 – £277 million) compared with a carrying value of £243 million (2000 – £230 million). Goodwill arising on the acquisition of Rogers Cantel and SmarTone is being amortised over 20 years.

***(n)* Maxis Communications and LG Telecom**

On 9 October 1998, the group completed its acquisition of a 33.3% interest in Maxis Communications, a leading Malaysian telecommunications company. On 14 October 1998, the group completed its acquisition of a 23.5% interest in LG Telecom, a major Korean mobile telecommunications company. As stated in note 29, the group agreed in principle in May 2001 to sell its interest in Maxis Communications.

***(o)* Airtel Movil**

Following the clearance in 1998 by the European Commission of the alliance between the company, AirTouch and other investors in Airtel Movil SA, a leading Spanish mobile telecommunications company, the group's 15.8% investment in Airtel was reclassified as a joint venture on 1 April 1998. Airtel is jointly controlled by the company as a consequence of the alliance agreement. During the year ended 31 March 1999, the group acquired an additional 2% interest in Airtel for £55 million. Goodwill on this acquisition is being amortised over 20 years. In May 2001, the group agreed to sell this interest (see note 29).

16. Acquisitions and disposals (continued)

(p) MCI Communications Corporation

In September 1994, the company completed the acquisition of a 20% equity interest in MCI (a major carrier of long-distance telecommunications services in the United States) represented by a holding of 136 million unlisted Class A common shares, whereupon MCI became the group's most significant associate. On 3 November 1996, the company entered into a merger agreement with MCI whereby the group would acquire the entire share capital of MCI, not already owned. On 21 August 1997, the terms of the merger agreement were modified. On 1 October 1997, WorldCom announced its intention to offer shares in its company to MCI shareholders as an alternative to the proposed merger and, following an improved offer from WorldCom on 9 November 1997, the company agreed with WorldCom and MCI that it would support the proposed merger of MCI with WorldCom. On 15 September 1998, MCI and WorldCom merged to form MCI WorldCom.

On completion of the merger, the company sold the group's holding of 136 million unlisted Class A common shares in MCI to WorldCom for US$51 per share in cash. The consideration of US$6,936 million was equivalent to £4,133 million at the exchange rate ruling on 15 September 1998. The group also held 0.7 million listed common shares in MCI, most of which were purchased in November 1995. These shares were exchanged for MCI WorldCom common shares on completion of the merger and subsequently sold in the market for £26 million.

As a consequence of the termination of the company's merger agreement with MCI and the company's agreement with WorldCom and MCI, the group ceased treating MCI as an associate on 31 October 1997.

At 31 March 1998, the group's investment in MCI was stated at £813 million. Goodwill, amounting to £2,214 million written off to group reserves in prior years in respect of this investment, was accounted for at the completion of the MCI/WorldCom merger in determining the profit on the sale of the shares which the group recognised (see note 7).

17. Net debt

	At 1 April 2000 £m	Cash flow £m	Acquisition or disposal of subsidiary undertakings £m	Other non-cash changes £m	Currency movement £m	**At 31 March 2001 £m**
Analysis of net debt						
Cash in hand and at bank	253	159	–	–	–	**412**
Overnight deposits	41	(21)	–	–	–	**20**
Bank overdrafts	(138)	(10)	–	–	–	**(148)**
	156	128	–	–	–	**284**
Other current assets investments	2,010	480	48	16	(17)	**2,537**
Short-term investments and cash, less bank overdrafts	2,166	608	48	16	(17)	**2,821**
Debt due within one year, excluding bank overdrafts	(5,512)	(5,544)	(62)	(804)	(66)	**(11,988)**
Debt due after one year	(5,354)	(14,006)	(34)	562	57	**(18,775)**
Total debt, excluding bank overdrafts	(10,866)	(19,550)	(96)	(242)	(9)	**(30,763)**
Net debt	(8,700)	(18,942)	(48)	(226)	(26)	**(27,942)**

	2001 £m	2000 £m	1999 £m
Reconciliation of net cash flow to movement in net debt			
Increase in cash in the year	**128**	54	67
Cash (inflow) outflow from (increase) decrease in debt	**(19,550)**	(5,400)	632
Cash (inflow) outflow from (decrease) increase in liquid resources	**480**	(1,236)	2,447
Decrease (increase) in net debt resulting from cash flows	**(18,942)**	(6,582)	3,146
Currency and translation movements	**(26)**	(124)	(2)
Debt assumed on acquisitions	**(48)**	(971)	(94)
Other non-cash movements	**(226)**	(70)	(26)
Decrease (increase) in net debt in the year	**(19,242)**	(7,747)	3,024
Net debt at 1 April	**(8,700)**	(953)	(3,977)
Net debt at 31 March	**(27,942)**	(8,700)	(953)

18. Intangible assets

	Goodwill*(a)* *£m*	Telecommunication licences*(b)* *£m*	Total £m
Cost			
At 1 April 2000	5,864	3	5,867
Additions	–	4,315	4,315
Acquisitions of subsidiary undertakings	6,116	5,488	11,604
Adjustments	99	3	102
Disposals and transfers	(4)	–	(4)
Currency movements	35	(63)	(28)
Total cost at 31 March 2001	**12,110**	**9,746**	**21,856**
Amortisation			
At 1 April 2000	89	1	90
Charge for the year – amortisation	373	13	386
– impairment *(c)*	3,000	–	3,000
Total amortisation at 31 March 2001	**3,462**	**14**	**3,476**
Net book value at 31 March 2001	**8,648**	**9,732**	**18,380**
Net book value at 31 March 2000	5,775	2	5,777

(a) The goodwill arising on acquisitions of subsidiary undertakings in the year ended 31 March 2001 mainly arose from the acquisition in June 2000 of the 50% interest in Telfort which the group did not already own (£986 million) and the acquisition in January and February 2001 of the 55% interest in Viag Interkom which the group did not already own (£4,992 million). The consideration for the acquisition of the 55% interest in Viag Interkom was negotiated in August 2000. (See note 16.)

(b) The telecommunication licences mainly comprise third generation mobile licences in the UK and Germany. In April 2000, the group won a third generation mobile licence in the UK government's auction. The licence, which cost £4,030 million, will be amortised over its remaining 20-year term from the date of launch of services using the licensed radio spectrum. In August 2000, Viag Interkom won a third generation mobile licence in the German government's auction. This licence, which cost £5,164 million, will be similarly amortised over its remaining 20-year term from the date of launch of service.

(c) In accordance with FRS 11 (Impairment of fixed assets and goodwill), the carrying values of the group's subsidiary undertakings in Germany, Ireland, The Netherlands and the UK at 31 March 2001 have been compared to their recoverable amounts, represented by their value in use to the group.

The value in use has been derived from discounted cash flow projections which cover the ten years from 1 April 2001. The projections cover a ten year period as the directors consider that the growth in these businesses will exceed the average growth rate of the countries concerned over ten years. Also, the development of the technology and assets required for such growth means ten year projections would more fairly reflect their long-term values. After the ten year period, the projections use a long-term growth rate compatible with projections for the countries concerned. The discount rate used to arrive at this calculation was 10% on a pre-tax basis.

The review has resulted in an exceptional charge to operating costs of £3,000 million in respect of Viag Interkom. The charge has been allocated to the goodwill arising on the acquisition of the remaining 55% interest in the company that was purchased during the year. The remaining goodwill of £1,921 million will be amortised over 20 years in accordance with the group's accounting policies.

19. Tangible fixed assets

	Land and buildings(a) £m	Plant and equipment £m	Assets in course of construction £m	Total £m
Group				
Cost				
Balances at 1 April 2000	3,135	31,295	1,233	35,663
Acquisitions of subsidiary undertakings	87	1,924	188	2,199
Additions	40	998	3,951	4,989
Transfers	178	3,195	(3,373)	–
Other disposals and adjustments	40	(1,956)	(33)	(1,949)
Total cost at 31 March 2001	**3,480**	**35,456**	**1,966**	**40,902**
Depreciation				
Balances at 1 April 2000	1,424	16,142	–	17,566
Acquisitions of subsidiary undertakings	22	438	–	460
Charge for the year	136	2,909	–	3,045
Other disposals and adjustments	(16)	(1,714)	–	(1,730)
Total depreciation at 31 March 2001	**1,566**	**17,775**	**–**	**19,341**
Net book value at 31 March 2001	**1,914**	**17,681**	**1,966**	**21,561**
Engineering stores	**–**	**–**	**64**	**64**
Total tangible fixed assets at 31 March 2001	**1,914**	**17,681**	**2,030**	**21,625**
Net book value at 31 March 2000	1,711	15,153	1,233	18,097
Engineering stores	–	–	66	66
Total tangible fixed assets at 31 March 2000	1,711	15,153	1,299	18,163

	Land and buildings(a) £m	Plant and equipment £m	Assets in course of construction £m	Total £m
Company				
Cost				
Balances at 1 April 2000	1,093	27,899	1,027	30,019
Additions	–	448	3,032	3,480
Transfers	106	2,693	(2,799)	–
Disposals and adjustments	(210)	(1,314)	(61)	(1,585)
Total cost at 31 March 2001	**989**	**29,726**	**1,199**	**31,914**
Depreciation				
Balances at 1 April 2000	451	14,658	–	15,109
Charge for the year	42	2,430	–	2,472
Disposals and adjustments	(107)	(1,111)	–	(1,218)
Total depreciation at 31 March 2001	**386**	**15,977**	**–**	**16,363**
Net book value at 31 March 2001	**603**	**13,749**	**1,199**	**15,551**
Engineering stores	–	–	62	62
Total tangible fixed assets at 31 March 2001	**603**	**13,749**	**1,261**	**15,613**
Net book value at 31 March 2000	642	13,241	1,027	14,910
Engineering stores	–	–	66	66
Total tangible fixed assets at 31 March 2000	642	13,241	1,093	14,976

19. Tangible fixed assets (continued)

	Group		Company	
	2001	2000	**2001**	2000
	£m	£m	**£m**	£m
(a) The net book value of land and buildings comprised:				
Freehold	**1,514**	1,327	**319**	365
Long leases (over 50 years unexpired)	**170**	182	**119**	120
Short leases	**230**	202	**165**	157
Total net book value of land and buildings	**1,914**	1,711	**603**	642

	Group	
	2001	2000
	£m	£m
(b) Expenditure on tangible fixed assets comprised:		
Plant and equipment		
Transmission equipment	**2,295**	1,563
Exchange equipment	**479**	413
Other network equipment	**1,180**	703
Computers and office equipment	**574**	502
Motor vehicles and other	**251**	257
Land and buildings	**210**	229
Increase (decrease) in engineering stores	**(3)**	13
Total expenditure on tangible fixed assets	**4,986**	3,680

20. Fixed asset investments

	Interests in associates and joint ventures(b) Shares £m	Loans £m	Share of post acquisition profits (losses) £m	Other participating interests £m	Other investments (c) £m	Total £m
Group						
Cost						
Balances at 1 April 2000	6,247	1,073	(1,049)	122	619	7,012
Additions	1,882	3,955	–	66	199	6,102
Joint ventures becoming subsidiary companies	(2,718)	(3,321)	1,348	–	–	(4,691)
Disposals	(67)	–	12	–	(118)	(173)
Share of losses less retained profits for the year	–	–	(569)	–	–	(569)
Repayments and other transfers	(463)	(956)	–	(31)	367	(1,083)
Currency movements	195	(7)	(14)	–	26	200
Balances at 31 March 2001	**5,076**	**744**	**(272)**	**157**	**1,093**	**6,798**
Provisions and amounts written off						
Balances at 1 April 2000	(1,046)	–	–	–	(88)	(1,134)
Goodwill amortisation for the year	(185)	–	–	–	–	(185)
Exceptional item relating to impairment in goodwill	(200)	–	–	–	–	(200)
Disposals	21	–	–	–	3	24
Transfers	24	–	–	–	(8)	16
Increase in the year	(6)	–	–	–	(109)	(115)
Balances at 31 March 2001	**(1,392)**	**–**	**–**	**–**	**(202)**	**(1,594)**
Net book value at 31 March 2001	**3,684**	**744**	**(272)**	**157**	**891**	**5,204**
Net book value at 31 March 2000	5,201	1,073	(1,049)	122	531	5,878

	Subsidiary undertakings(a) Shares £m	Loans £m	Associates and joint ventures(a) £m	Other participating interests £m	Other investments £m	Total £m
Company						
Cost						
Balances at 1 April 2000	19,258	9	741	122	397	20,527
Additions	24,272	219	885	66	5	25,447
Disposals	(5,775)	–	(62)	–	(5)	(5,842)
Repayments and other transfers	–	(219)	(913)	(31)	–	(1,163)
Currency movements	–	–	5	–	–	5
Balances at 31 March 2001	**37,755**	**9**	**656**	**157**	**397**	**38,974**
Provisions and amounts written off						
Balances at 1 April 2000	(253)	–	(15)	–	(221)	(489)
Increase in the year	(4,263)	–	–	–	(22)	(4,285)
Disposals and transfers	182	–	–	–	3	185
Balances at 31 March 2001	**(4,334)**	**–**	**(15)**	**–**	**(240)**	**(4,589)**
Net book value at 31 March 2001	**33,421**	**9**	**641**	**157**	**157**	**34,385**
Net book value at 31 March 2000	19,005	9	726	122	176	20,038

***(a)* Subsidiary undertakings, associates and joint ventures**

Details of the principal operating subsidiary undertakings, joint ventures and associates are set out on pages 130 and 131.

20. Fixed asset investments (continued)

(b) Associates and joint ventures

	2001 £m	2000 £m
Associates:		
Goodwill	**2,439**	1,578
Loans	**7**	–
Share of other net assets (liabilities)	**(217)**	1,061
Total – associates	**2,229**	2,639
Joint ventures:		
Goodwill	**526**	728
Loans	**737**	1,073
Share of other net assets	**664**	785
Total – joint ventures	**1,927**	2,586
Net book value at 31 March	**4,156**	5,225

The group's proportionate share of its associates and joint ventures' assets and liabilities, in aggregate, at 31 March was as follows:

	2001 £m	2000 £m
Fixed assets	**8,257**	4,446
Current assets	**5,726**	1,833
Current liabilities	**(7,398)**	(1,656)
Net current assets (liabilities)	**(1,672)**	177
Non-current liabilities	**(3,771)**	(1,161)
Minority interests	**(714)**	(45)
Share of net assets	**2,100**	3,417

The group's proportionate share of its associates and joint ventures' losses less profits before taxation totalled £667 million (2000 – £476 million, 1999 – £367 million) and its share of their losses less profits attributable to shareholders totalled £895 million for the year ended 31 March 2001 (2000 – £521 million, 1999 – £379 million).

At 31 March 2001, the group had a 74.5% interest in e-escape Limited, a UK telecommunications service provider, having acquired an additional 25.5% on 19 December 2000. This additional interest was acquired with the intention of selling it to another investor and not for holding as a long-term investment. For this reason, the investment in this company has continued to be accounted for on the equity basis. For the year ended 31 March 2001, e-escape's turnover was £3 million and it incurred a loss after taxation of £9 million. Purchases from the group amounted to £3 million, and the balances due to the group at 31 March 2001 was £12 million. The net book value of the investment in e-escape is £nil at 31 March 2001.

(c) Other investments

Other investments include ordinary shares of the company, with a net book value of £97 million (2000 – £117 million) and a market value of £97 million (2000 – £227 million), held in trust for the BT Incentive Share Scheme, the BT Retention Share Scheme, the BT Executive Share Plan, the BT Performance Share Plan and the BT Deferred Bonus Plan (note 33). They also include ordinary shares of the company, with a net book value of £64 million and a market value of £122 million, held in trust for employee sharesave schemes. In the group balance sheet at 31 March 2001, listed investments were held with a book value of £588 million (2000 – £297 million) and a market value of £489 million (2000 – £775 million).

21. Debtors

	Group		Company	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Trade debtors *(a)*	**3,379**	2,487	**2,196**	2,056
Amounts owed by subsidiary undertakings	**–**	–	**1,333**	368
Amounts owed by joint ventures (trading)	**532**	602	**464**	322
Amounts owed by associates (trading)	**5**	6	**–**	–
Other debtors	**506**	596	**352**	589
Accrued income	**1,420**	1,298	**1,218**	1,208
Prepayments	**418**	252	**168**	135
Total debtors	**6,260**	5,241	**5,731**	4,678

(a) The group's trade debtors are stated after deducting £487 million (2000 – £421 million) for doubtful debts. The amount charged to the group profit and loss account for doubtful debts for the year ended 31 March 2001 was £227 million (2000 – £264 million, 1999 – £231 million).

22. Current asset investments

	Group		Company	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Listed investments	**85**	419	**5**	5
Short-term loans to subsidiary undertakings	**–**	–	**3,965**	1,466
Other short-term deposits and investments	**2,472**	1,632	**1,655**	277
Total current asset investments	**2,557**	2,051	**5,625**	1,748
Market value of listed investments	**85**	420	**5**	5

23. Loans and other borrowings

	Group		Company	
	2001 £m	2000 £m	**2001 £m**	2000 £m
US dollar 8.625% notes 2030*(a)*	**1,928**	–	**1,928**	–
5.75% bonds 2028 (less unamortised discount £4 million (2000 – £5 million))	**596**	595	**596**	595
3.5% indexed linked notes 2025 (less unamortised discount of £5 million)	**252**	–	**252**	–
8.625% bonds 2020 (less unamortised discount £4 million (2000 – £4 million))	**296**	296	**296**	296
7.5% notes 2016*(a)* (less unamortised discount of £10 million)	**690**	–	**690**	–
Euro 6.875% notes 2011*(a)* (less unamortised discount of £14 million)	**1,385**	–	**1,385**	–
US dollar 8.125% notes 2010*(a)*	**2,073**	–	**2,073**	–
US dollar 8.765% bonds 2009	**141**	125	**–**	–
Euro 11.875% senior notes 2009 (including unamortised premium £26 million (2000 – £28 million)	**134**	133	**–**	–
US dollar 11.875% senior notes 2008 (including unamortised premium £13 million (2000 – £17 million))	**126**	112	**–**	–
US dollar 12.5% senior deferred coupon notes 2007 (less unamortised discount £3 million (2000 – £13 million))	**138**	116	**–**	–
US dollar 7% notes 2007 (less unamortised discount £3 million (2000 – £3 million))	**605**	624	**605**	624
12.25% bonds 2006	**229**	229	**229**	229
7.125% notes 2006*(a)* (less unamortised discount of £4 million)	**396**	–	**396**	–
Euro 6.125% notes 2006*(a)* (less unamortised discount of £10 million)	**1,855**	–	**1,855**	–
US dollar 7.625% notes 2005*(a)*	**2,140**	–	**2,140**	–
US dollar 6.75% bonds 2004	**604**	627	**604**	627
Euro 5.625% notes 2004*(a)* (less unamortised discount of £5 million)	**1,083**	–	**1,083**	
US dollar floating rate notes 2003*(a)*	**761**	–	**761**	–
12.25% bonds 2003	**180**	180	**180**	180
7.125% bonds 2003 (less unamortised discount £1 million (2000 – £2 million))	**499**	498	**499**	498
Euro floating rate notes 2003*(a)* (less unamortised discount of £3 million)	**619**	–	**619**	–
US dollar 6.75% notes 2002 (less unamortised discount £3 million (2000 – £5 million))	**907**	936	**907**	936
Total listed bonds, debentures and notes	**17,637**	4,471	**17,098**	3,985
Lease finance	**270**	9	**–**	1
Bank loans due 2000-2009 (average effective interest rate 9.6%)	**637**	827	**–**	–
Euro floating rate note 2000-2005	**204**	172	**–**	–
Floating rate note 2000-2009 (average effective interest rate 5.4%)	**141**	159	**141**	159
Other loans	**268**	245	**115**	112
Bank overdrafts and other short-term borrowings	**1,041**	237	**2,522**	1,078
Euro Medium Term Notes	**7,219**	–	**7,219**	–
Commercial paper	**3,494**	4,884	**3,494**	4,884
Loans from subsidiary undertakings	**–**	–	**8,704**	7,168
Total loans and other borrowings	**30,911**	11,004	**39,293**	17,387

(a) The interest rate payable on these notes will be subject to adjustment from time to time if either Moody's or Standard and Poor's (S&P) reduces the rating ascribed to the group's senior unsecured debt below A3 in the case of Moody's or below A minus in the case of S&P. In this event, the interest rate payable on the notes and the spread applicable to the floating notes will be increased by 0.25% for each ratings category adjustment by each ratings agency. In addition, if Moody's or S&P subsequently increase the rating ascribed to the group's senior unsecured debt, then the interest rate then payable on notes and the spread applicable to the floating notes will be decreased by 0.25% for each rating category upgrade by each rating agency, but in no event will the interest rate be reduced below the initial interest rate reflected in the table above.

23. Loans and other borrowings (continued)

Apart from the lease finance all borrowings at 31 March 2001 are unsecured. Lease finance is repayable by instalments.

	Group		Company	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Repayments fall due as follows:				
Within one year, or on demand	**12,136**	5,650	**21,201**	12,551
Between one and two years	**1,933**	12	**1,906**	–
Between two and three years	**2,430**	1,225	**2,403**	1,190
Between three and four years	**869**	589	**844**	558
Between four and five years	**4,245**	895	**4,225**	867
After five years	**9,298**	2,633	**8,714**	2,221
Total due for repayment after more than one year	**18,775**	5,354	**18,092**	4,836
Total loans and other borrowings	**30,911**	11,004	**39,293**	17,387

The effect of the change in the group's accounting policy relating to the group's loans and borrowings as disclosed in note 1, is that the total loans and other borrowings disclosed at 31 March 2001 are £170 million lower than they would be prior to this change. Prior to the change in policy the total loans and other borrowings would be £31,081 million.

24. Other creditors

	Group		Company	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Trade creditors	**3,287**	2,416	**2,139**	1,801
Amounts owed to subsidiary undertakings	**–**	–	**1,968**	762
Amounts owed to joint ventures (trading)	**504**	747	**469**	504
Corporation taxes	**625**	757	**122**	499
Other taxation and social security	**379**	377	**307**	349
Other creditors *(a)*	**1,603**	2,556	**675**	823
Accrued expenses	**948**	558	**820**	490
Deferred income	**1,251**	963	**979**	853
Dividends	**–**	861	**–**	861
Total other creditors	**8,597**	9,235	**7,479**	6,942

(a) Group includes Esat purchase consideration of £1,167 million at 31 March 2000.

25. Provisions for liabilities and charges

	Deferred taxation*(a)* £m	Pension provisions £m	Other provisions*(b)* £m	Total £m
Group				
Balances at 1 April 2000	354	629	73	1,056
Charged (credited) against profit for the year	(84)	326	52	294
Utilised in the year	–	(620)	(7)	(627)
Total provisions at 31 March 2001	**270**	**335**	**118**	**723**
Company				
Balances at 1 April 2000	152	629	21	802
Charged (credited) against profit for the year	(120)	326	(2)	204
Utilised in the year	–	(620)	(1)	(621)
Total provisions at 31 March 2001	**32**	**335**	**18**	**385**

25. Provisions for liabilities and charges (continued)

(a) Deferred taxation

The elements of deferred taxation provided in the accounts at 31 March were as follows:

	Group		Company	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Tax effect of timing differences due to:				
Excess capital allowances	**439**	613	**214**	434
Pension provisions	**(102)**	(189)	**(102)**	(189)
Other	**(67)**	(70)	**(80)**	(93)
Total provision for deferred taxation	**270**	354	**32**	152

The total potential liability to deferred taxation at 31 March was as follows:

	Group		Company	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Tax effect of timing differences due to:				
Excess capital allowances	**2,454**	2,568	**2,229**	2,389
Pension provisions	**(102)**	(189)	**(102)**	(189)
Other	**(67)**	(70)	**(80)**	(93)
Total potential liability for deferred taxation	**2,285**	2,309	**2,047**	2,107

(b) Other provisions comprise amounts provided for legal or constructive obligations arising from insurance claims and litigation.

26. Called up share capital

The authorised share capital of the company throughout the year ended 31 March 2001 was £2,625,000,001 divided into 10,500,000,004 ordinary shares of 25p each.

The allotted, called up and fully paid share capital of the company was £1,646 million at 31 March 2001 (2000 – £1,627 million), representing 6,585,228,408 ordinary shares (2000 – 6,507,104,882 ordinary shares).

Of the authorised but unissued share capital at 31 March 2001, 192 million ordinary shares were reserved to meet options granted under the employee share option schemes described in note 33.

Ordinary shares allotted during the year were as follows:

	Number	Nominal value £m	Consideration*(a)* £m
Savings related schemes *(b)*	69,999,933	17	145
BT Employee Share Ownership Scheme	7,117,008	2	59
Other share option schemes	881,470	–	3
Stock purchase plan	125,115	–	1
Totals for the year ended 31 March 2001	**78,123,526**	**19**	**208**

(a) Consideration excludes contributions from group undertakings as described in *note 27(c)*.
(b) Includes shares held in trust in anticipation of a vesting under BT's share schemes *(note 33)*.

27. Reconciliation of movement in shareholders' funds

	Share capital £m	Share premium account*(a)* £m	Capital redemption reserve*(a)* £m	Other reserves*(a)* £m	Profit and loss account £m	Total £m
Group						
Balances at 31 March 1998	1,603	892	749	27	7,514	10,785
Goodwill, previously written off to reserves, taken back to the profit and loss account *(note 7)*	–	–	–	–	2,214	2,214
Employee share option schemes – 50 million shares issued *(c)* *(note 33)*	12	314	–	–	–	326
Movement relating to BT's employee share ownership trust *(c)*	–	–	–	–	(165)	(165)
Currency movements (including £22 million net losses in respect of foreign currency borrowings) *(d)*	–	–	–	–	45	45
Profit for the financial year	–	–	–	–	2,983	2,983
Dividends (20.4p per ordinary share)	–	–	–	–	(1,322)	(1,322)
Scrip dividend – 8 million shares issued	2	–	(2)	–	74	74
Balances at 31 March 1999	1,617	1,206	747	27	11,343	14,940
Goodwill, previously written off to reserves, taken back to the profit and loss account *(b)*	–	–	–	–	6	6
Employee share option schemes – 38 million shares issued *(c)* *(note 33)*	10	374	–	–	–	384
Movement relating to BT's employee share ownership trust *(c)*	–	–	–	–	(257)	(257)
Currency movements (including £10 million net losses in respect of foreign currency borrowings) *(d)*	–	–	–	–	(66)	(66)
Profit for the financial year	–	–	–	–	2,055	2,055
Dividends (21.9p per ordinary share)	–	–	–	–	(1,426)	(1,426)
Unrealised gain on transfer of assets and group undertakings to a joint venture	–	–	–	159	–	159
Balances at 31 March 2000	1,627	1,580	747	186	11,655	15,795
Employee share option schemes – 78 million shares issued *(c)* *(note 33)*	19	615	–	–	–	634
Movement relating to BT's employee share ownership trust *(c)*	–	–	–	–	(359)	(359)
Currency movements (including £65 million net gain in respect of foreign currency borrowings) *(d)*	–	–	–	–	429	429
Loss for the financial year	–	–	–	–	(1,810)	(1,810)
Dividend (8.7p per ordinary share)	–	–	–	–	(571)	(571)
Adjustment to unrealised gain on transfer of assets and group undertakings to a joint venture	–	–	–	(49)	–	(49)
Balances at 31 March 2001	**1,646**	**2,195**	**747**	**137**	**9,344**	**14,069**

27. Reconciliation of movement in shareholders' funds (continued)

	Share capital £m	Share premium account*(a)* £m	Capital redemption reserve*(a)* £m	Profit and loss account £m	Total £m
Company					
Balances at 31 March 1998	1,603	892	749	9,801	13,045
Employee share option schemes – 50 million shares issued *(c)* *(note 33)*	12	314	–	–	326
Movement relating to BT's employee share ownership trust *(c)*	–	–	–	(165)	(165)
Profit for the financial year *(e)*	–	–	–	3,785	3,785
Dividends (20.4p per ordinary share)	–	–	–	(1,322)	(1,322)
Scrip dividend – 8 million shares issued	2	–	(2)	74	74
Currency movements	–	–	–	1	1
Balances at 31 March 1999	1,617	1,206	747	12,174	15,744
Employee share option schemes – 38 million shares issued *(c)* *(note 33)*	10	374	–	–	384
Movement relating to BT's employee share ownership trust *(c)*	–	–	–	(252)	(252)
Profit for the financial year *(e)*	–	–	–	2,064	2,064
Dividends (21.9p per ordinary share)	–	–	–	(1,426)	(1,426)
Currency movements	–	–	–	(8)	(8)
Balances at 31 March 2000	1,627	1,580	747	12,552	16,506
Employee share option schemes – 78 million shares issued *(c)* *(note 33)*	19	615	–	–	634
Movement relating to BT's employee share ownership trust *(c)*	–	–	–	(263)	(263)
Loss for the financial year *(e)*	–	–	–	(2,056)	(2,056)
Dividend (8.7p per ordinary share)	–	–	–	(571)	(571)
Currency movements	–	–	–	71	71
Balances at 31 March 2001	**1,646**	**2,195**	**747**	**9,733**	14,321

(a) The share premium account, representing the premium on allotment of shares, the capital redemption reserve and £110 million of the other reserves are not available for distribution.

(b) Aggregate goodwill at 31 March 2001 in respect of acquisitions completed prior to 1 April 1998 of £1,383 million (2000 – £1,383 million, 1999 – £1,389 million) has been written off against retained earnings in accordance with the group's accounting policy. The goodwill written off against retained earnings will be charged in the profit and loss account on the subsequent disposal of the business to which it related.

(c) During the year ended 31 March 2001 the company issued shares at a market value of £400 million (2000 – £375 million) in respect of the exercise of options awarded under its principal savings-relating share option scheme. Employees paid £145 million (2000 – £118 million) to the group for the issue of these shares and the balance of £255 million (2000 – £257 million) comprised contributions to the qualifying employee share ownership trust from group undertakings. In addition the company issued shares at a market value of £171 million to the qualifying employee share ownership trust in anticipation of the exercise of share options in August 2001 paid for by contributions to the trust from group undertakings, these shares were written down by £96 million to the option exercise price as part of the movement relating to the employee share ownership trust.

(d) The cumulative foreign currency translation adjustment, which increased retained earnings at 31 March 2001, was £278 million (2000 – £151 million decrease, 1999 – £85 million decrease).

(e) The loss for the financial year, dealt with in the profit and loss account of the company and after taking into account dividends from subsidiary undertakings, was £2,056 million (2000 – £2,064 million profit, 1999 – £3,785 million profit). As permitted by Section 230 of the Companies Act 1985, no profit and loss account of the company is presented.

28. Related party transactions with associates and joint ventures

In the year ended 31 March 2001, the group's turnover with Concert amounted to £804 million (2000 – £181 million) and it purchased £612 million (2000 – £170 million) in services and products from Concert. In addition, the group provided certain support services to Concert, including the secondment of staff, which totalled £168 million (2000 – £79 million) and is shown as other operating income. Interest for the year of £41 million (2000 – £12 million) was receivable on long-term debt due from Concert at a rate of 6.5%. The amount of debt outstanding at 31 March 2001 was £651 million (2000 – £665 million). The maximum debt outstanding during the year was £674 million (2000 – £665 million). As at the latest practicable date, 30 April 2001, the balance of the loan was £636 million. During the year ended 31 March 2000, Concert Communications' net outflow from operations was £18 million and its purchase of tangible fixed assets was £106 million. Comparative figures for 2000 are for the period from the formation of the joint venture on 5 January 2000 to 31 March 2000.

28. Related party transactions with associates and joint ventures (continued)

In the year ended 31 March 2001, the group's turnover with its other associates and joint ventures amounted to £21 million (2000 – £64 million, 1999 – £129 million) and the group purchased £63 million (2000 – £nil million, 1999 – £1 million) in services and products from these undertakings. Interest for the year of £81 million (2000 – £8 million) was receivable on debt due from these undertakings. Interest was charged on debt at a rate of 6%. The amount of debt outstanding with these joint ventures, at 31 March 2001, was £73 million (2000 – £408 million). The maximum debt outstanding during the year was £3,332 million (2000 – £442 million). As at the latest practicable date, 30 April 2001, the amount of debt outstanding was £46 million.

29. Financial commitments, contingent liabilities and subsequent events

	Group		Company	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Contracts placed for capital expenditure not provided in the accounts	**1,231**	1,000	**948**	940
Operating lease payments payable within one year of the balance sheet date were in respect of leases expiring:				
Within one year	**7**	9	**3**	1
Between one and five years	**32**	37	**23**	26
After five years	**110**	140	**82**	85
Total payable within one year	**149**	186	**108**	112

Future minimum operating lease payments for the group at 31 March 2001 were as follows:

	2001 £m
Payable in the year ending 31 March:	
2002	**149**
2003	**139**
2004	**131**
2005	**121**
2006	**113**
Thereafter	**816**
Total future minimum operating lease payments	**1,469**

Operating lease commitments were mainly in respect of leases of land and buildings.

At 31 March 2001, there were no contingent liabilities or guarantees other than those arising in the ordinary course of the group's business and on these no material losses are anticipated. The group has insurance cover to certain limits for major risks on property and major claims in connection with legal liabilities arising in the course of its operations. Otherwise, the group generally carries its own risks.

The company has guaranteed certain borrowings of subsidiary undertakings amounting to £974 million (2000 – £926 million). The company has provided guarantees amounting to £1,160 million at 31 March 2001, in respect of bank loans and guarantees provided to associates and joint ventures, including £782 million relating to J-Phone Communications.

Satellite consortia, in which the company has participating interests, are organisations without limited liability. At 31 March 2001, the company's share of the aggregate borrowings of these consortia amounted to £100 million (2000 – £130 million).

The company does not believe there are any pending legal proceedings which would have a material adverse effect on the financial position or results of operations of the group.

Subsequent events

In April 2001, the group acquired the 49.5% of Esat Digifone that was not already owned, from Telenor, for £856 million under an agreement made in early 2000.

29. Financial commitments, contingent liabilities and subsequent events (continued)

On 2 May 2001, BT announced that it had agreed to sell its interests in Japan Telecom and J-Phones for £3.7 billion, and its interest in Airtel in Spain for £1.1 billion, both to Vodafone. The impact of the combined transaction will be a net reduction in total group debt of £4.4 billion. Completion of the transactions is conditional upon relevant regulatory and procedural approvals in Europe and Japan.

On 4 May 2001, BT also announced that it had agreed in principle to sell its interest in Maxis Communications in Malaysia for £350 million. This transaction is also subject to regulatory and other approvals.

On 10 May 2001, BT announced that it proposed to raise approximately £5.9 billion, net of expenses, by the issue of up to 1,975,580,052 new ordinary shares at a price of 300 pence per share. The issue is being made by way of a rights issue on the basis of 3 new ordinary shares for every 10 existing ordinary shares held on 9 May 2001. The rights issue is due to close on 15 June 2001.

30. Pension costs

The total pensions cost of the group expensed within staff costs was £326 million (2000 – £167 million, 1999 – £176 million), of which £315 million (2000 – £159 million, 1999 – £167 million) related to the group's main pension scheme, the BT Pension Scheme (BTPS). The increase in cost in the year ended 31 March 2001 was mainly attributable to the general trend towards longer life expectancy and a smaller amortisation of the combined pension fund position and pension provision held in the group balance sheet.

The pension cost for the year ended 31 March 2001 was based on the valuation of the BTPS at 31 December 1999. The pension costs for the years ended 31 March 2000 and 1999 were based on the valuation of the BTPS at 31 December 1996. The valuations, carried out by professionally qualified independent actuaries, used the projected unit method. The valuations were determined using the following long-term assumptions:

	Rates (per annum) 1999 valuation %	1996 valuation %
Return on existing assets, relative to market values	**5.45**	7.95
(after allowing for a real increase in dividends of)	**1.00**	0.75
Return on future investments	**7.12**	8.42
Average increase in retail price index	**3.00**	4.00
Average future increases in wages and salaries	**4.80**	5.82
Average increase in pensions	**3.00**	3.75-4.00

At 31 December 1999, the assets of the BTPS had a market value of £29,692 million and, taking account of the special contribution by the company in March 2000, were sufficient to cover 96.8% of the benefits that had accrued to members by that date, after allowing for expected future increases in wages and salaries but not taking into account the costs of providing incremental pension benefits for employees taking early retirement under release schemes since that date. This cost, which amounted to £429 million in the year ended 31 March 2001, will be taken into account in the next actuarial valuation being undertaken at 31 December 2000. The costs for the previous financial years (2000 – £140 million, 1999 – £279 million) were taken into account in the 31 December 1999 valuation.

For the purpose of determining the group's pension expenses in the year ended 31 March 2001, the same assumptions were used as set out above for the December 1999 valuation, with the exception that, over the long term, it has been assumed that the return on the existing assets of the scheme, relative to market values, would be 5.6% per annum (allowing for real equity dividend growth of 1.25% per annum).

In the year ended 31 March 2001, the group made regular contributions of £308 million (2000 – £253 million, 1999 – £239 million) and special contributions of £300 million (2000 – £230 million, 1999 – £200 million).

30. Pension costs (continued)

Certain activities of the BTPS are carried out at the company's pension centre, all costs of which are borne by the company. These costs have not been apportioned for accounting purposes between those attributable to the BTPS and those attributable to the company because functions maintained for both entities cannot be meaningfully divided between them. The company occupies nine properties owned by the scheme on which an annual rental of £3 million is payable. The BTPS assets are invested in UK and overseas equities, UK and overseas properties, fixed interest and index linked securities, deposits and short-term investments. At 31 March 2001, the UK equities included 51 million (2000 – 51 million) ordinary shares of the company with a market value of £258 million (2000 – £597 million).

Following a High Court judgement made in October 1999, the BTPS is liable to pay additional benefits to certain former employees of the group who left on voluntary redundancy terms. These were former employees, in managerial grades, who had joined the group's business prior to 1 December 1971. The value of the additional benefits at 31 March 2001 is estimated at £200 million. The actuarial valuation at 31 December 1999 took into account the cost of these additional benefits.

On 26 April 2001, an application for permission to appeal against the judgement was lodged on behalf of certain former employees in non-managerial grades in an attempt to extend the additional benefits to those grades. The company will be strongly resisting this new claim if permission to appeal is given.

31. Directors

Directors' emoluments

The emoluments of the directors for the year ended 31 March 2001 and the benefits received under the long-term incentive plans were, in summary, as follows:

	2001 £000	2000 £000	1999 £000
Salaries	**2,199**	1,878	1,695
Performance-related bonus	**1,036**	1,295	1,515
Deferred bonus in shares	**531**	573	1,513
Other benefits	**182**	148	123
	3,948	3,894	4,846
Payments to non-executive directors *(a)*	**388**	302	283
Total emoluments	**4,336**	4,196	5,129
Gain on the exercise of share options *(b)*	**–**	–	932
Value of shares vested under the Executive Share Plan and the Performance Share Plan *(c) (d)*	**782**	1,845	–

(a) Payments to non-executive directors include fees paid to their principal employer of £nil (2000 – £nil, 1999 – £9,500).

(b) The amount for the year ended 31 March 1999 includes £41,000 attributable to a former director.

(c) The amount for the year ended 31 March 2000 includes £834,000 attributable to a former director.

(d) The amount for the year ended 31 March 2001 is entirely attributable to former directors.

More detailed information concerning directors' remuneration, shareholdings, pension entitlements, share options and other long-term incentive plans is shown in the report on directors' remuneration from pages 66 to 71.

32. People employed

	2001		2000		1999	
	Year end '000	**Average '000**	Year end '000	Average '000	Year end '000	Average '000
Number of employees in the group:						
UK	**117.9**	**120.3**	126.0	123.8	118.9	119.8
Non-UK	**19.1**	**13.1**	10.8	8.3	5.8	5.1
Total employees	**137.0**	**133.4**	136.8	132.1	124.7	124.9

33. Employee share schemes

The company has a share ownership scheme used for employee share allocations (profit sharing), savings-related share option schemes for its employees and those of participating subsidiaries, further share option schemes for selected group employees and an employee stock purchase plan for employees in the United States. It also has several share plans for executives.

Share option schemes

The major share option scheme, the BT Employee Sharesave Scheme, is savings related and the share options are normally exercisable on completion of a three- or five-year Save As You Earn contract. A similar savings related scheme exists for group employees based outside the UK. Under the other share option schemes, share options are normally exercisable between the third and tenth anniversaries of the date of grant. Under a new option scheme introduced in 2000, scheme participants are awarded options which may vest after three years and which may be linked to a performance target. Options outstanding under these share option schemes at 31 March 2000 and 2001, together with their exercise prices and dates, were as follows:

		Number of ordinary shares	
Normal dates of exercise	Option price per share	**2001 millions**	2000 millions
Savings-related schemes			
2000	404p	**–**	4
2000	306p	**–**	37
2001	267p	**58**	62
2001	583p	**3**	4
2002	359p	**44**	48
2002	949p	**3**	4
2003	518p	**35**	38
2003	818p	**5**	–
2004	844p	**23**	29
2005	727p	**32**	–
Total		**203**	226
Global share options			
2001-2010	885p	**2**	–
2002-2011	885p	**3**	–
2003-2012	885p	**3**	–
Total		**211**	–
Other share option schemes			
1993-2011	289p to 1206p	**5**	6
Total options outstanding		**216**	232

In the period 1 April 2001 to 22 May 2001, no share options were granted, and options over eleven million shares lapsed.

During the year ended 31 March 2001, BT granted options over 49 million shares (2000 – 34 million, 1999 – 46 million) of which 41 million were under employee sharesave schemes and eight million were under the BT Global Share Option Plan. The weighted average fair value of share options granted during the year ended 31 March 2001 has been estimated on the date of grant using the Black-Scholes option pricing model. The following weighted average assumptions were used in that model: an expected life extending one month later than the first exercise date; estimated annualised dividend yield of approximately 2% (2000 – 2%, 1999 – 3%); risk free interest rates of approximately 7% (2000 – 6%, 1999 – 7%) on options exercisable three years after the date of grant and 7% (2000 – 6%, 1999 – 7%) on options exercisable five years after the date of grant; and expected volatility of approximately 41% (2000 – 40%, 1999 – 30%).

The weighted average fair value of the share options granted in the year ended 31 March 2001 was 329p (2000 – 413p, 1999 – 313p) for options exercisable three years after the date of grant and 424p (2000 – 524p, 1999 – 309p) for options exercisable five years after the date of grant. The total value of share options granted by BT in the year ended 31 March 2001 was £168 million (2000 – £170 million, 1999 – £139 million). In accordance with UK accounting practices, no compensation expense is recognised for the fair value of options granted. See *United States Generally Accepted Accounting Principles – IV Accounting for share options* for the treatment under US GAAP.

33. Employee share schemes (continued)

Options granted, exercised and lapsed under these share option schemes during the years ended 31 March 1999, 2000 and 2001 and options exercisable at 31 March 1999, 2000 and 2001 were as follows:

	Savings related schemes millions	Other share option schemes millions	Total millions	Exercise price range	Weighted average exercise price
Outstanding, 31 March 1998	253	8	261	262p–596p	316p
Granted	45	1	46	518p–1053p	536p
Exercised	(46)	(3)	(49)	262p–583p	321p
Lapsed	(15)	–	(15)	265p–773p	328p
Outstanding, 31 March 1999	237	6	243	267p–1053p	356p
Granted	33	1	34	844p–1206p	862p
Exercised	(36)	(1)	(37)	267p–949p	333p
Lapsed	(8)	–	(8)	267p–1043p	366p
Outstanding, 31 March 2000	226	6	232	267p–1206p	432p
Granted	41	8	49	534p–885p	751p
Exercised	(46)	(1)	(47)	168p–1351p	319p
Lapsed	(17)	(1)	(18)	168p–1351p	619p
Outstanding, 31 March 2001	**204**	**12**	**216**	**168p–1351p**	**564p**
Exercisable, 31 March 1999	–	4	4	289p–460p	369p
Exercisable, 31 March 2000	–	3	3	289p–460p	368p
Exercisable, 31 March 2001	–	3	3	289p–460p	368p

BT Incentive Share Plan and BT Retention Share Plan

The BT Incentive Share Plan (ISP) and the BT Retention Share Plan (RSP) were introduced for employees of the group in 2001. Under the plans, company shares are acquired by an employee share ownership trust and are conditionally awarded to participants. Under the ISP participants are normally only entitled to these shares in full at the end of a three-year period if the company has met the relevant pre-determined corporate performance measure and if the participants are still employed by the group. If the company has exceeded the pre-determined corporate performance measure the participants may be awarded up to double the shares conditionally awarded. Under the RSP the length of retention period before awards vest is flexible. Awards may vest in annual tranches. The shares are transferred at the end of a specified period, only if the individual is still employed by the group. The corporate performance measure assesses the company's overall performance against those top 100 companies listed on the London Stock Exchange, as rated by the *Financial Times* (the FT-SE 100 index), at the beginning of the relevant performance period.

BT Executive Share Plan, BT Performance Share Plan and BT Deferred Bonus Plan

The BT Executive Share Plan (ESP) and the BT Performance Share Plan (PSP) were introduced for employees of the group in 1994 and 1995 respectively. Under the plans, company shares are acquired by an employee share ownership trust and are conditionally awarded to participants. Participants are only entitled to these shares in full at the end of a five-year period under the ESP and the end of a three-year period, under the PSP if, at the end of the applicable period, the company has met the relevant pre-determined corporate performance measure. Awards of shares were granted in each of the years from 1994 to 1999 under the ESP and from 1995 to 1997 under the first performance cycle of the PSP.

In 1994, 1995 and 1996 ESP participants could invest 50% of their annual bonus in the ESP for the purchase of shares. These invested shares were matched by the company.

Further awards of shares were granted in 1998 and 1999 under the second three-year performance cycle of the PSP. The corporate performance measure assesses the company's overall performance against those top 100 companies listed on the London Stock Exchange, as rated by the *Financial Times* (the FT-SE 100 index), at the beginning of the relevant performance period.

The second five-year performance cycle of the ESP ended on 31 July 2000 (first: 31 July 1999) and on the basis of the corporate measure, the company's Total Shareholder Return target relative to the other companies in the FT-SE 100, 100% (1999: 100%) of the shares vested on 1 August 2000 in 54 participants (1999: 25 participants) and 0.7 million shares (1999: 0.6 million shares) were transferred to those participants.

33. Employee share schemes (continued)

The first three-year performance cycle of the PSP ended on 31 July 1998 and on the basis of the corporate measure, the company's Total Shareholder Return target relative to the other companies in the FT-SE 100, 90% of the shares vested on 19 August 1998 in 745 participants and 5.0 million shares were transferred to those participants.

The second and final three-year performance cycle of the PSP ended on 31 March 2001 and on the basis of the corporate measure, the company's Total Shareholder Return target relative to other companies in the FT-SE 100, 80% of the shares will vest on 1 August 2001 in 1,560 participants and 2.0 million shares will transfer to those participants.

The BT Deferred Bonus Plan (DBP) was established in 1998 and awards were granted to employees of the group in July 1998 and 1999. Under this plan, shares in the company are acquired by an employee share ownership trust and transferred to participants at the end of three years if he or she has continued to be employed by the group throughout that period.

At 31 March 2001, 19.1 million shares (2000 – 19.3 million) in the company were held in trust for employee share schemes, of which 9.7 million shares were held for the ISP, 0.4 million shares were held for the RSP, 5.4 million shares (2000 – 5.9 million) were held for the ESP, 2.0 million shares (2000 – 2.2 million) were held for the PSP and 1.6 million shares (2000 – 0.9 million) were held for the DBP. Dividends or dividend equivalents earned on the shares during the conditional periods are reinvested in company shares for the potential benefit of the participants. Additional information relating to the plans is as follows:

	Year ended 31 March 2001					
	ISP £m	RSP £m	ESP £m	PSP £m	DBP £m	Total £m
Value of range of possible future transfers: nil to	25.2	2.2	24.7	10.2	6.7	**69.0**
Provision for the costs of the plans charged to the profit and loss account in year	–	1.5	5.8	(1.7)	2.5	**8.1**
Nominal value of shares held in trust	2.4	0.1	1.4	0.5	0.4	**4.8**
Market value of shares held in trust	49.7	2.2	27.3	10.2	8.3	**97.7**

	Year ended 31 March 2000					
	ISP £m	RSP £m	ESP £m	PSP £m	DBP £m	Total £m
Value of range of possible future transfers: nil to	–	–	66.9	25.3	10.4	**102.6**
Provision for the costs of the plans charged to the profit and loss account in year	–	–	6.4	14.4	7.7	**28.5**
Nominal value of shares held in trust	–	–	1.5	0.6	0.2	**2.3**
Market value of shares held in trust	–	–	69.4	25.4	10.4	**105.2**

In addition, 10.3 million shares were held at 31 March 2000 in trust for future awards under employee share schemes. These shares had a nominal value of £2.6 million and a market value of £122 million at 31 March 2000.

The values of possible future transfers of shares under the plans were based on the company's share price at 31 March 2001 of 510p (2000 – 1,175p). The provisions for the costs of the ISP, RSP, ESP and PSP were based on best estimates of the company's performance over the plans' conditional periods, relating to those portions of the plan conditional periods from commencement up to the financial year end.

BT Employee Stock Purchase Plan

An employee stock purchase plan was established in 1998 for employees in the United States. Under this plan, employees may purchase American Depositary Shares (ADSs) on a monthly basis at a price equal to the lower of (i) 85% of the average trading price of the ADSs on the New York Stock Exchange on the date on which the purchase rights are granted and, (ii) 85% of the average trading price of the ADSs on the date of purchase. During the year ended 31 March 2001, the discounted price was between US$65.98 and US$154.88 (2000 – US$92.20 and US$170.21) per ADS and 0.1 million shares (2000 – 0.8 million) were issued under this plan.

34. Auditors

The auditors' remuneration for the year ended 31 March 2001 for the group was £3,639,000 (2000 – £2,650,000, 1999 – £2,491,000), including £1,261,000 (2000 – £1,229,000, 1999 – £1,216,000) for the company.

The following fees were paid or are payable to the company's auditors, PricewaterhouseCoopers, in the UK for the years ended 31 March 2001, 31 March 2000 and 31 March 1999:

	2001 £000	2000 £000	1999 £000
Audit of the company's statutory accounts	**1,261**	1,229	1,216
Audits of the UK subsidiary undertakings' statutory accounts	**839**	834	605
Other services *(a)*:			
Accountants' reports on restructuring/demerger projects	**9,756**	–	–
Regulatory, tax, accounting and other audit	**2,717**	2,617	3,030
Concert global venture related work	**1,196**	5,117	1,023
Systems advice	**1,360**	1,461	2,808
Corporate finance advice	**730**	1,810	596
Other consultancy	**464**	1,740	1,398
Total	**18,323**	14,808	10,676

(a) Fees for the year ended 31 March 1999 comprise work carried out by Coopers & Lybrand and Price Waterhouse in the three months to 30 June 1998 and work carried out by PricewaterhouseCoopers on or subsequent to 1 July 1998, the date of the firms' merger.

In addition, fees of £3,025,000 were paid or are payable to PricewaterhouseCoopers for the year ended 31 March 2001 (2000 – £6,382,000) in respect of audit and other services to the company's subsidiary undertakings outside the UK. Fees of £6,418,000 were paid to other international members of Coopers & Lybrand, Price Waterhouse or PricewaterhouseCoopers for the year ended 31 March 1999 in respect of audit and other services to the company's subsidiary undertakings outside the UK. Fees of £1,283,000 and £865,000 were paid for work carried out by Price Waterhouse inside and outside the UK, respectively, between 1 April and 1 July 1998.

35. Financial instruments and risk management

The group holds or issues financial instruments mainly to finance its operations; for the temporary investment of short-term funds; and to manage the currency and interest rate risks arising from its operations and from its sources of finance. In addition, various financial instruments – for example trade debtors and trade creditors – arise directly from the group's operations.

The group finances its operations primarily by a mixture of issued share capital, retained profits, long-term loans and, increasingly over the years ended 31 March 2000 and 2001, short-term loans, principally by issuing commercial paper and medium-term notes. The group borrows in the major long-term debt markets in major currencies and significant new long-term debt was taken on in the year ended 31 March 2001. Typically, but not exclusively, the bond markets provide the most cost-effective means of long-term borrowing. The group uses derivative financial instruments primarily to manage its exposure to market risks from changes in interest and foreign exchange rates. The derivatives used for this purpose are principally interest rate swaps, gilt locks, currency swaps and forward currency contracts.

The types of financial instrument used for investment of short-term funds are prescribed in group treasury policies with limits on the exposure to any one organisation. Short-term investing in financial instruments is undertaken on behalf of the group by external substantial fund managers who are limited to dealing in debt instruments and certain defined derivative instruments and are given strict guidelines on credit, diversification and maturity profiles.

During the year ended 31 March 2001, net debt increased from £8.7 billion to £27.9 billion mainly as a result of the group making acquisitions of businesses and third-generation mobile licences. This increase in debt has been funded primarily by the issuance of long-term debt together with use of the group's medium-term note programme. As a result of this, together with the group's interest rate swap activity, the borrowing profile has changed during the year from one mainly at floating rates to one with a fixed: floating rate ratio of approximately 70:30. This change is in line with the group's intention to limit the group's exposure to interest rate increases given the substantial size of the group's debt portfolio. During the second quarter of the year

35. Financial instruments and risk management (continued)

ended 31 March 2001, it was not practical for the group to issue longer-term debt in the global capital markets. The group therefore pre-hedged its desired fixed rate profile by transacting £9.3 billion of interest rate swaps with maturities ranging from five to 30 years at a weighted average fixed interest payable rate of 6.2%.

During the year ended 31 March 2000, net debt increased from £953 million to £8,700 million primarily as a result of the group making acquisitions of businesses and interests in joint ventures and associates. This increase in debt was primarily funded under the group's commercial paper programmes. As a result, the group's borrowing profile changed during that year from one at fixed rates to one mainly at floating rates.

The group uses financial instruments to hedge some of its currency exposures arising from its non-UK assets, liabilities and forward purchase commitments. The group also hedges some of its interest liabilities. The financial instruments used comprise borrowings in foreign currencies, forward foreign currency exchange contracts, gilt locks and interest and currency swaps.

There has been no change in the nature of the group's risk profile between 31 March 2001 and the date of these financial statements.

The risk profile of the group is likely to change following the completion of the rights issued announced on 10 May 2001, and the proceeds due to be received on the planned disposals of the investments in Japan and elsewhere which have been announced to date (see note 29). In May 2001, Moody's downgraded BT's credit rating to Baa1, which will increase BT's annual interest charge by £32 million.

The notional amounts of derivatives summarised below do not necessarily represent amounts exchanged by the parties and, thus, are not necessarily a measure of the exposure of the group through its use of derivatives. The amounts exchanged are calculated on the notional amounts and other terms of the derivatives which relate to interest and exchange rates.

(a) Interest rate risk management

The group has entered into interest rate swap agreements with banks and other institutions to vary the amounts and periods for which interest rates on borrowings are fixed. Under interest rate swaps, the group agrees with other parties to exchange, at specified intervals, the differences between fixed rate and floating rate interest amounts calculated by reference to an agreed notional principal amount. Under gilt locks, forward sales of UK government long-dated treasury stock were entered into for periods of up to one year. This hedge effectively fixed in the interest on part of the group's then future borrowings, all of which have now been taken on.

At 31 March 2001, the group had outstanding interest rate swap agreements having a total notional principal amount of £9,574 million (2000 – £2,073 million, including gilt locks).

(b) Foreign exchange risk management

Cross currency swaps and forward foreign exchange contracts have been entered into to reduce the foreign currency exposure on the group's operations and the group's net assets. The group also enters into forward foreign exchange contracts to hedge investments, interest expense and purchase and sale commitments denominated in foreign currencies (principally US dollars, the euro and the yen). The remaining terms of the currency swaps are up to 30 years and the terms of currency forward exchange contracts are typically less than one year. The purpose of the group's foreign currency hedging activities is to protect the group from the risk that the eventual net inflows and net outflows will be adversely affected by changes in exchange rates.

At 31 March 2001, the group had outstanding foreign currency swap agreements and forward exchange contracts having a total notional principal amount of £25,325 million (2000 – £11,948 million).

The fair values of forward foreign currency contracts at 31 March 2001 were £4,388 million (2000 – £7,088 million) for purchases of currency and £601 million (2000 – £1,852 million) for sales of currency. These fair values have been estimated by calculating their present values using the market discount rates, appropriate to the terms of the contracts, in effect at the balance sheet dates.

At 31 March 2001, the group had deferred unrealised gains of £13 million (2000 – £18 million) and losses of £34 million (2000 – £43 million), based on dealer-quoted prices, from hedging purchase and sale commitments, and in addition had deferred realised net gains of £25 million (2000 – £11 million). These are included in the profit and loss account as part of the hedged purchase or sale transaction when it is recognised, or as gains or losses when a hedged transaction is no longer expected to occur.

35. Financial instruments and risk management (continued)

(c) Concentrations of credit risk and credit exposures of financial instruments

The group considers that it is not exposed to major concentrations of credit risk. The group, however, is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not expect any counterparties to fail to meet their obligations. The group limits the amount of credit exposure to any one counterparty. The group does not normally see the need to seek collateral or other security.

The long-term debt instruments issued in December 2000 and February 2001 both contain covenants that if the group credit rating is downgraded below A3 in the case of Moody's or below A minus in the case of S&P, additional interest accrues from the next interest coupon period at the rate of 0.25 percentage points for each ratings category adjustment by each ratings agency. Based upon the total amount of debt of £12,930 million outstanding on these instruments at 31 March 2001, the group's annual interest charge would increase by £65 million if the group's credit rating was to fall by one credit rating category below a long-term debt rating of A3/A minus.

(d) Fair value of financial instruments

The following table shows the carrying amounts and fair values of the group's financial instruments at 31 March 2001 and 2000. The carrying amounts are included in the group balance sheet under the indicated headings, with the exception of derivative amounts, which are included in debtors or other creditors or as part of net debt as appropriate. The fair values of the financial instruments are the amount at which the instruments could be exchanged in a current transaction between willing parties, other than in forced or liquidation sale.

	Carrying amount		Fair value	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Non-derivatives:				
Assets				
Cash at bank and in hand	**412**	253	**412**	253
Short-term investments *(a)*	**2,557**	2,051	**2,562**	2,052
Fixed asset investments – loans to joint ventures *(b)*	**737**	1,073	**737**	1,073
Liabilities				
Short-term borrowings *(c)*	**10,220**	5,121	**10,219**	5,121
Long-term borrowings, excluding finance leases *(d)*	**20,592**	5,874	**20,852**	6,085
Derivatives relating to investments and borrowings (net) *(e)*:				
Assets	**259**	44	**–**	–
Liabilities	**–**	–	**350**	100
Derivative financial instruments held or issued to hedge the current exposure on expected future transactions (net):				
Assets	**–**	–	**–**	–
Liabilities	**–**	–	**21**	25

(a) The fair value of listed short-term investments were estimated based on quoted market prices for those investments. The carrying amount of the other short-term deposits and investments approximated to their fair values due to the short maturity of the instruments held.

(b) The fair value of loans to joint ventures approximated to carrying value due to loans bearing commercial rates of interest.

(c) The fair value of short-term borrowings approximated to carrying value due to the short maturity of the instruments.

(d) The fair value of the group's bonds, debentures, notes and other long-term borrowings has been estimated on the basis of quoted market prices for the same or similar issues with the same maturities where they existed, and on calculations of the present value of future cash flows using the appropriate discount rates in effect at the balance sheet dates, where market prices of similar issues did not exist.

(e) The fair value of the group's outstanding foreign currency and interest rate swap agreements was estimated by calculating the present value, using appropriate discount rates in effect at the balance sheet dates, of affected future cash flows translated, where appropriate, into pounds sterling at the market rates in effect at the balance sheet dates.

The following information is provided in accordance with the requirements of FRS 13 – "Derivatives and other financial instruments: disclosures". Except for disclosures under *currency exposures* below, the financial information excludes all of the group's short-term debtors and creditors.

35. Financial instruments and risk management (continued)

Financial liabilities

After taking into account the various interest rate swaps and forward foreign currency contracts entered into by the group, the interest rate profile of the group's financial liabilities at 31 March was:

	2001				2000			
	Fixed rate financial liabilities £m	**Floating rate financial liabilities £m**	**Financial liabilities on which no interest is paid £m**	**Total £m**	Fixed rate financial liabilities £m	Floating rate financial liabilities £m	Financial liabilities on which no interest is paid £m	Total £m
Currency:								
Sterling	**13,501**	**10,528**	**357**	**24,386**	2,429	6,686	376	9,491
US dollar	**806**	**145**	**293**	**1,244**	353	83	7	443
Euro	**4,759**	**664**	**72**	**5,495**	424	389	30	843
Yen	**508**	**–**	**–**	**508**	508	–	1	509
Other	**–**	**–**	**–**	**–**	–	111	4	115
Total	**19,574**	**11,337**	**722**	**31,633**	3,714	7,269	418	11,401

For the fixed rate financial liabilities, the average interest rates and the average periods for which the rates are fixed are:

	2001		2000	
	Weighted average interest rate %	**Weighted average period for which rate is fixed Years**	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Currency:				
Sterling	**7.5**	**16**	9.1	15
US dollar	**8.5**	**7**	8.7	8
Euro	**6.3**	**6**	5.8	8
Yen	**1.2**	**4**	1.2	4
Total	**7.1**	**13**	7.6	12

The floating rate financial liabilities bear interest at rates fixed in advance for periods ranging from one day to one year by reference to LIBOR. The financial liabilities on which no interest is paid are due to mature within one year of the balance sheet date.

The maturity profile of financial liabilities is as given in note 23.

Financial assets

After taking into account the various interest rate swaps and forward foreign currency contracts entered into by the group, the interest rate profile of the group's financial assets at 31 March was:

	2001				2000			
	Fixed rate financial assets £m	**Floating rate financial assets £m**	**Financial assets on which no interest is paid £m**	**Total £m**	Fixed rate financial assets £m	Floating rate financial assets £m	Financial assets on which no interest is paid £m	Total £m
Currency:								
Sterling	**56**	**2,935**	**306**	**3,297**	395	2,869	265	3,529
US dollar	**–**	**293**	**–**	**293**	–	31	–	31
Euro	**19**	**315**	**–**	**334**	–	53	–	53
Other	**–**	**27**	**–**	**27**	–	29	–	29
Total	**75**	**3,570**	**306**	**3,951**	395	2,982	265	3,642

35. Financial instruments and risk management (continued)

The sterling fixed rate financial assets yield interest at a weighted average of 6.3% (2000 – 6.6%) for a weighted average period of 30 months (2000 – 18 months).

The floating rate financial assets bear interest at rates fixed in advance for periods up to one year by reference to LIBOR.

Currency exposures

The table below shows the currency exposures of the group's net monetary assets (liabilities), in terms of those transactional exposures that give rise to net currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and monetary liabilities of the group that are not denominated in the operating (or "functional") currency of the operating unit involved, other than certain non-sterling borrowings treated as hedges of net investments in non-UK operations. At 31 March, these exposures were as follows:

	2001					2000				
	Sterling £m	**US dollar £m**	**Euro £m**	**Other £m**	**Total £m**	Sterling £m	US dollar £m	Euro £m	Other £m	Total £m
Functional currency of group operation:										
Sterling	**–**	**3**	**3**	**2**	**8**	–	13	117	29	159
Euro	**1**	**(21)**	**–**	**(5)**	**(25)**	6	(1)	–	–	5
Other	**–**	**2**	**–**	**–**	**2**	(10)	–	–	–	(10)
Total	**1**	**(16)**	**3**	**(3)**	**(15)**	(4)	12	117	29	154

The amounts shown in the table above take into account the effect of any currency swaps, forward contracts and other derivatives entered into to manage those currency exposures.

At 31 March 2001, the group also held various forward currency contracts that the group had taken out to hedge expected future foreign currency purchases and sales.

Fair values of financial assets held for trading

	2001 £m	2000 £m
Net gain included in profit and loss account	**62**	51
Fair value of financial assets held for trading at 31 March	**530**	980

The net gain was derived from government bonds, commercial paper and similar debt instruments. The average fair value of financial assets held during the year ended 31 March 2001 did not differ materially from the year end position.

Hedges

Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. Unrecognised and deferred gains and losses on instruments used for hedging and those recognised in the years ended 31 March 2001 and 31 March 2000 are as follows:

	2001		2000*(b)*	
	Gains £m	**Losses £m**	Gains £m	Losses £m
Gains and losses:				
recognised in the year but arising in previous years *(a)*	**35**	**31**	51	23
unrecognised at the balance sheet date	**323**	**952**	23	193
carried forward in the year end balance sheet, pending recognition in the profit and loss account *(a)*	**106**	**36**	99	15
expected to be recognised in the following year:				
unrecognised at balance sheet date	**73**	**96**	11	19
carried forward in the year end balance sheet pending, recognition in the profit and loss account *(a)*	**27**	**7**	24	12

(a) Excluding gains and losses on hedges accounted for by adjusting the carrying amount of a fixed asset.

35. Financial instruments and risk management (continued)

Average effective interest rates

The interest basis of interest rate swap agreements used, the notional amounts, their average maturities and weighted average interest rates are shown below:

	Average maturity	Notional amount £m	Average interest receivable rate %	Average interest payable rate %
Pay fixed interest and receive variable interest	Over 5 years	8,674	5.3	6.5
Pay variable interest and receive fixed interest	Under 5 years	900	6.5	5.5

The rates of the variable rate portion of the swaps are based on quoted rates. In calculating the average variable rates, the latest rates agreed with the counterparty on each swap have been used. Changes in interest rates will affect the variable rate information disclosed above.

Unused committed lines of credit

Unused committed lines of credit for short-term financing available at 31 March 2001 totalled approximately £16,750 million (2000 – £5,800 million), which was in support of a commercial paper programme or other borrowings. These lines of credit are available for up to one year.

36. Unaudited pro forma information relating to businesses acquired in the year ended 31 March 2001

The following unaudited pro forma information summarises the results of operations for the years indicated as if the Viag Interkom and Telfort acquisitions had been completed as of the beginning of the years presented. The pro forma data gives effect to actual operating results prior to the acquisition, adjusted to include the pro forma effect of interest expense, amortisation of intangibles and income taxes. These pro forma amounts do not purport to be indicative of the results that would have actually been obtained if the acquisitions occurred as of the beginning of the years presented or that may be obtained in the future.

	2001 £m	2000 £m
Turnover	**21,265**	19,612
Profit (loss) for the financial year	**(2,598)**	1,060
Earnings (loss) per share	**(39.8)p**	16.3p

United States Generally Accepted Accounting Principles

The group's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the UK (UK GAAP), which differ in certain respects from those applicable in the US (US GAAP).

I Differences between United Kingdom and United States generally accepted accounting principles

The following are the main differences between UK and US GAAP which are relevant to the group's financial statements.

(a) Pension costs

Under UK GAAP, pension costs are accounted for in accordance with UK Statement of Standard Accounting Practice No. 24, costs being charged against profits over employees' working lives. Under US GAAP, pension costs are determined in accordance with the requirements of US Statements of Financial Accounting Standards (SFAS) Nos. 87 and 88. Differences between the UK and US GAAP figures arise from the requirement to use different actuarial methods and assumptions and a different method of amortising surpluses or deficits.

(b) Accounting for redundancies

Under UK GAAP, the cost of providing incremental pension benefits in respect of workforce reductions is taken into account when determining current and future pension costs, unless the most recent actuarial valuation, combined with the provision for pension costs in the group balance sheet, under UK actuarial conventions shows a deficit. In this case, the cost of providing incremental pension benefits is included in redundancy charges in the year in which the employees agree to leave the group.

Under US GAAP, the associated costs of providing incremental pension benefits are charged against profits in the period in which the termination terms are agreed with the employees.

(c) Capitalisation of interest

Under UK GAAP, the group does not capitalise interest in its financial statements. To comply with US GAAP, the estimated amount of interest incurred whilst constructing major capital projects is included in fixed assets, and depreciated over the lives of the related assets. This includes capitalisation of interest incurred on funding the 3G licences for the period up to the launch of the related services. The amount of interest capitalised is determined by reference to the average interest rates on outstanding borrowings. At 31 March 2001 under US GAAP, gross capitalised interest of £692 million (2000 – £349 million) with regard to the company and its subsidiary companies was subject to depreciation generally over periods of three to 25 years.

(d) Goodwill

Under UK GAAP, in respect of acquisitions completed prior to 1 April 1998, the group wrote off goodwill arising from the purchase of subsidiary undertakings, associates and joint ventures on acquisition against retained earnings. The goodwill is reflected in the net income of the period of disposal, as part of the calculation of the gain or loss on divestment. Under US GAAP, such goodwill is held as an intangible asset in the balance sheet and amortised over its useful life and only the unamortised portion is included in the gain or loss recognised at the time of divestment. Gross goodwill under US GAAP at 31 March 2001 of £10,309 million (2000 – £7,978 million) was subject to amortisation over periods of three to 20 years. The value of goodwill is reviewed annually and the net asset value is written down if a permanent diminution in value has occurred. When impairment indicators exist, goodwill impairment is measured by discounting future projected cashflows or using quoted market prices if available.

(e) Mobile cellular telephone licences, software and other intangible assets

Certain intangible fixed assets recognised under US GAAP purchase accounting requirements are subsumed within goodwill under UK GAAP. Under US GAAP these separately identified intangible assets are valued and amortised over their useful lives.

(f) Financial instruments

Under UK GAAP, investments are held on the balance sheet at historical cost, and own shares held in trust for share schemes are recorded in fixed asset investments. Gains and losses on instruments used for hedges are not recognised until the exposure being hedged is recognised. Under US GAAP, trading securities and available-for-sale securities are carried at market value with appropriate valuation adjustments recorded in profit and loss and shareholders' equity, respectively. Certain derivative financial instruments which qualify as hedge accounting under UK GAAP do not qualify for hedge accounting under US GAAP.

These financial instruments, under US GAAP, are carried at market value with valuation adjustments recorded in profit and loss. Own shares held in trust are treated as a reduction to shareholders' equity until they are reissued to employees. The reassessment and purchase of derivatives in the year ended 31 March 2001 gave rise to an adjustment reducing net income by £93 million (2000 – £95 million). The net unrealised holding gain on available-for-sale securities for the year ended 31 March 2001 was £8 million (2000 – £311 million, 1999 – £76 million).

(g) Deferred gain

Under UK GAAP, assets contributed to a joint venture by the group's partners are measured at their net replacement cost. Any difference between the group's share of the joint venture's resulting net assets and the net book value of assets contributed by the group to the joint venture, including certain accrued start up costs, is immediately reflected by adjusting the group's investment in the joint venture and recording a deferred difference in shareholders' equity. Under US GAAP, the assets contributed by all joint venture partners are carried at their historical net book value and any difference between the group's share of the joint venture's resulting net assets and the net book value of assets contributed by the group to the joint venture is amortised over the life of the items giving rise to the difference.

(h) Employee share plans

Certain share options have been granted under BT save-as-you-earn plans at a 20% discount. Under UK GAAP, the share issues are recorded at their discounted price when the options are exercised. Under US GAAP, a plan is considered compensatory when the discount to market price is in excess of 15%. Compensation cost is recognised for the difference between the exercise price of the share options granted and the quoted market price of the shares at the date of grant or measurement date and accrued over the vesting period of the options.

(i) Directories in progress

Under UK GAAP, the cost of classified advertising directories in progress deferred in stock represents direct fixed and variable costs as well as directly attributable overhead costs. Under US GAAP, the deferred costs associated with directories in progress comprise only the incremental direct costs associated with selling and creating the directories. Directories in progress acquired in a business purchase are valued at replacement value under UK GAAP and at retail value under US GAAP. Under UK GAAP, this difference is included in goodwill.

(j) Revenue recognition

During the year ended 31 March 2001 the group adopted Securities and Exchange Commission Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements". The adoption did not have a material impact on the results of operations or financial condition.

(k) Investments in associates

Under UK GAAP, the group records the share of operating profit and loss of ventures based upon the total interest in the venture based upon the consolidation structure. The group records the equity in the operations of the venture on the basis of its consolidated results excluding the holdings of any of the group's other ventures for the purpose of determining the economic interest. The share of the operations of the ventures is reduced to the economic interest through an increase to minority interests at the group level. Under US GAAP, the share of the operating results of the venture is recorded at the amount of the group's economic interest.

(l) Deferred taxation

Under UK GAAP, provision for deferred taxation is generally only made for timing differences which are expected to reverse. Under US GAAP, deferred taxation is provided on a full liability basis on all temporary differences as defined in SFAS No. 109.

At 31 March 2001, the adjustment of £1,296 million (2000 – £1,377 million) reconciling ordinary shareholders' equity under UK GAAP to the amount under US GAAP included the tax effect of other US GAAP adjustments. This comprised an adjustment increasing non-current assets by £26 million (2000 – £25 million increase); an adjustment increasing current assets by £92 million (2000 – £63 million increase); an adjustment decreasing minority interests by £14 million (2000 – £35 million decrease) and an adjustment increasing long-term liabilities by £1,428 million (2000 – £1,500 million increase).

United States Generally Accepted Accounting Principles

(m) Dividends

Under UK GAAP, dividends are recorded in the year in respect of which they are declared (in the case of interim or any special dividends) or proposed by the board of directors to the shareholders (in the case of final dividends). Under US GAAP, dividends are recorded in the period in which dividends are declared.

II Net income and shareholders' equity reconciliation statements

The following statements summarise the material estimated adjustments, gross of their tax effect, which reconcile net income and shareholders' equity from that reported under UK GAAP to that which would have been reported had US GAAP been applied.

Net income

Years ended 31 March	**2001 £m**	2000 £m	1999 £m
Net income (loss) applicable to shareholders under UK GAAP	**(1,810)**	2,055	2,983
Adjustment for:			
Pension costs	**(42)**	(209)	(104)
Redundancy charges	**(453)**	(300)	(284)
Capitalisation of interest, net of related depreciation *(a)*	**348**	(14)	(19)
Goodwill amortisation *(a)*	**(55)**	(64)	85
Mobile licences, software and other intangible asset capitalisation and amortisation, net *(a)*	**(32)**	(33)	(226)
Financial instruments	**(133)**	(129)	(6)
Deferred gain	**(71)**	(19)	–
Employee share plans	**(38)**	–	–
Deferred taxation *(a)*	**11**	106	220
Directories in progress	**(82)**	–	–
Other items *(a)*	**–**	–	(60)
Net income (loss) as adjusted for US GAAP	**(2,357)**	1,393	2,589
Basic earnings (loss) per American Depositary Share as adjusted for US GAAP *(b)*	**£(3.61)**	£2.15	£4.02
Diluted earnings (loss) per American Depositary Share as adjusted for US GAAP *(b)*	**£(3.61)**	£2.10	£3.93

(a) The disposal of the group's interest in MCI shares during the year ended 31 March 1999 gave rise to adjustments; increasing net income by £163 million relating to goodwill and £95 million relating to deferred taxation and decreasing net income by £197 million relating to software and other intangible assets, £60 million relating to foreign exchange translation differences and £5 million relating to the capitalisation of interest.

(b) Each American Depositary Share is equivalent to 10 ordinary shares of 25p each.

Shareholders' equity

At 31 March	**2001 £m**	2000 £m
Shareholders' equity under UK GAAP	**14,069**	15,795
Adjustment for:		
Pension costs	**(2,755)**	(2,202)
Redundancy costs	**(25)**	(83)
Capitalisation of interest, net of related depreciation	**620**	261
Goodwill, net of accumulated amortisation	**122**	175
Mobile licences, software and other intangible asset capitalisation and amortisation	**521**	533
Financial instruments	**(620)**	(99)
Deferred gain	**(323)**	(230)
Deferred taxation	**(1,296)**	(1,377)
Directories in progress	**(82)**	–
Dividend declared after the financial year end	**–**	861
Shareholders' equity as adjusted for US GAAP	**10,231**	13,634

III Minority interests

Under US GAAP, the loss to minority interests would have been reduced by £122 million (2000 – loss increased by £10 million, 1999 – income reduced by £12 million) after adjusting for goodwill amortisation and accounting for associates and joint ventures. Net assets attributable to minority interests would have been £32 million higher (2000 – £82 million higher) after adjusting for financial instruments.

IV Accounting for share options

Under UK GAAP, the company does not recognise compensation expense for the fair value, at the date of grant, of share options granted under the employee share option schemes. Under US GAAP, the company adopted the disclosure-only option in SFAS No. 123 "Accounting for Stock-Based Compensation". Accordingly, the company accounts for share options in accordance with APB Opinion No. 25 "Accounting for Stock Issued to Employees", under which no compensation expense is recognised. Had the group expensed compensation cost for options granted in accordance with SFAS No. 123, the group's pro forma net income (loss), basic earnings (loss) per share and diluted earnings (loss) per share under US GAAP would have been £(2,419) million loss (2000 – £1,347 million profit, 1999 – £2,560 million profit), (37.1)p loss (2000 – 20.8p, 1999 – 39.7p) and (37.1)p loss (2000 – 20.3p, 1999 – 38.8p), respectively. The SFAS No. 123 method of accounting does not apply to share options granted before 1 January 1995, and accordingly, the resulting pro forma compensation costs may not be representative of that to be expected in future years. See note 33 for the SFAS No. 123 disclosures of the fair value of options granted under employee schemes at date of grant.

V Consolidated statements of cash flows

Under UK GAAP, the Consolidated Statements of Cash Flows are presented in accordance with UK Financial Reporting Standard No. 1 (FRS 1). The statements prepared under FRS 1 present substantially the same information as that required under SFAS No. 95.

Under SFAS No. 95 cash and cash equivalents include cash and short-term investments with original maturities of three months or less. Under FRS 1 cash comprises cash in hand and at bank and overnight deposits, net of bank overdrafts.

Under FRS 1, cash flows are presented for operating activities; returns on investments and servicing of finance; taxation; capital expenditure and financial investments; acquisitions and disposals; dividends paid to the company's shareholders; management of liquid resources and financing. SFAS No. 95 requires a classification of cash flows as resulting from operating, investing and financing activities.

Cash flows under FRS 1 in respect of interest received, interest paid (net of that capitalised under US GAAP) and taxation would be included within operating activities under SFAS No. 95. Cash flows from purchases, sales and maturities of trading securities, while not separately identified under UK GAAP, would be included within operating activities under US GAAP. Capitalised interest, while not recognised under UK GAAP, would be included in investing activities under US GAAP. Dividends paid would be included within financing activities under US GAAP.

The following statements summarise the statements of cash flows as if they had been presented in accordance with US GAAP, and include the adjustments which reconcile cash and cash equivalents under US GAAP to cash at bank and in hand reported under UK GAAP.

	2001 £m	2000 £m	1999 £m
Net cash provided by operating activities	**5,515**	4,003	3,876
Net cash used in investing activities	**(22,785)**	(9,104)	(950)
Net cash provided by (used in) financing activities	**18,311**	4,697	(1,665)
Net increase (decrease) in cash and cash equivalents	**1,041**	(404)	1,261
Effect of exchange rate changes on cash	**(15)**	(1)	33
Cash and cash equivalents under US GAAP at beginning of year	**1,255**	1,660	366
Cash and cash equivalents under US GAAP at end of year	**2,281**	1,255	1,660
Short-term investments with original maturities of less than three months	**(1,869)**	(1,002)	(1,558)
Cash at bank and in hand under UK GAAP at end of year	**412**	253	102

United States Generally Accepted Accounting Principles

VI Current asset investments

Under US GAAP, investments in debt securities would be classified as either trading, available-for-sale or held-to-maturity. Trading investments would be stated at fair values and the unrealised gains and losses would be included in income. Securities classified as available-for-sale would be stated at fair values, with unrealised gains and losses, net of deferred taxes, reported in shareholders' equity. Debt securities classified as held-to-maturity would be stated at amortised cost. The following analyses do not include securities with original maturities of less than three months.

At 31 March 2001, the group held trading investments (as defined by US GAAP) at a carrying amount of £390 million (2000 – £866 million) with fair values totalling £394 million (2000 – £873 million). Held-to-maturity securities at 31 March 2000 and 2001 consisted of the following:

	Amortised cost £m	Estimated fair value £m
UK Government securities and other UK listed investments	8	8
Commercial paper, medium-term notes and other investments	30	30
Total at 31 March 2001	**38**	**38**
UK Government securities and other UK listed investments	15	15
Commercial paper, medium-term notes and other investments	168	168
Total at 31 March 2000	183	183

The contractual maturities of the held-to-maturity debt securities at 31 March 2001 were as follows:

	Cost £m	Fair value £m
Maturing on or before 31 March 2002	38	38
Maturing after 31 March 2002	–	–
Total at 31 March 2001	**38**	**38**

VII Pension costs

The following position for the main pension scheme is computed in accordance with US GAAP pension accounting rules under SFAS No. 87 and SFAS No. 88, the effect of which is shown in the above reconciliation statements.

The pension cost determined under SFAS No. 87 was calculated by reference to an expected long-term rate of return on scheme assets of 6.25% (2000 – 6.5%, 1999 – 7.7%). The components of the pension cost for the main pension scheme comprised:

	2001 £m	2000 £m	1999 £m
Service cost	**580**	498	387
Interest cost	**1,673**	1,459	1,653
Expected return on scheme assets	**(1,850)**	(1,600)	(1,712)
Amortisation of prior service costs	**24**	24	24
Amortisation of net obligation at date of limited application of SFAS No. 87	**52**	52	52
Recognised gains	**(133)**	(65)	(137)
Additional cost of termination benefits	**349**	263	279
Pension cost for the year under US GAAP	**695**	631	546

VII Pension costs (continued)

The information required to be disclosed in accordance with SFAS No. 132 concerning the funded status of the main scheme at 31 March 2000 and 31 March 2001, based on the valuations at 1 January 2000 and 1 January 2001, respectively, is given below.

	2001 £m	2000 £m
Changes in benefit obligation		
Benefit obligation at the beginning of the year	**31,024**	27,158
Service cost	**580**	498
Interest cost	**1,673**	1,459
Employees' contributions	**183**	171
Additional cost of termination benefits	**349**	263
Actuarial movement *(a)*	**(1,342)**	2,992
Other changes	**31**	21
Benefits paid or payable	**(1,314)**	(1,538)
Benefit obligation at the end of the year	**31,184**	31,024

	2001 £m	2000 £m
Changes in scheme assets		
Fair value of scheme assets at the beginning of the year	**29,876**	25,120
Actual return on scheme assets	**(350)**	5,619
Employers' contributions *(b)*	**605**	483
Employees' contributions	**183**	171
Other changes	**31**	21
Benefits paid or payable	**(1,314)**	(1,538)
Fair value of scheme assets at the end of the year	**29,031**	29,876

	2001 £m	2000 £m
Funded status under US GAAP		
Projected benefit obligation in excess of scheme assets	**(2,153)**	(1,148)
Unrecognised net obligation at date of initial application of SFAS No. 87 *(c)*	**106**	158
Unrecognised prior service costs *(d)*	**151**	175
Other unrecognised net actuarial gains	**(1,181)**	(2,001)
Accrued pension costs under US GAAP	**(3,077)**	(2,816)

(a) In the year ended 31 March 2000, the actuarial movement is significant mainly due to revised mortality assumptions being employed in the year.

(b) The employers' contributions for the year ended 31 March 2001 includes special contributions of £200 million paid on 21 December 2000 and £100 million paid on 30 March 2001 (2000 – £230 million, paid 31 March 2000).

(c) The unrecognised net obligation at the date of initial application is being amortised over 15 years from 1 April 1988.

(d) Unrecognised prior service costs on scheme benefit improvements, are being amortised over periods of 15 or 16 years commencing in the years of the introduction of the improvements.

The benefit obligation for the main pension scheme was determined using the following assumptions at 1 January 2000 and 1 January 2001:

	2001 per annum %	2000 per annum %
Discount rate	**5.7**	5.5
Rate of future pay increases	**4.8**	4.8

The determination also took into account requirements in the scheme as to future pension increases.

Subsidiary undertakings, joint ventures and associates

British Telecommunications plc is the parent company of the group. Brief details of its principal operating subsidiary undertakings, joint ventures and associates at 31 March 2001, all of which were unlisted unless otherwise stated, were as follows:

	Activity	Group interest in allotted capital*(b)*	Country of operations*(c)*
Subsidiary undertakings			
BT Australasia Pty Limited *(d)*	Communication related services and products provider	100% ordinary 100% preference	Australia
BT Cableships Limited *(d)*	Cableship owner	100% ordinary	International
BT Cellnet Limited *(d)(e)*	Mobile cellular telephone system provider and operator	100% ordinary	UK
BT Communications Management Limited *(d)*	Telecommunication services provider	100% ordinary	UK
BT (Hong Kong) Limited *(d)*	Communication related services and products provider	100% ordinary 100% preference	Hong Kong
BT Ignite GmbH *(d)*	Data services provider	100% ordinary	Germany
BT Ignite GmbH & Co *(d)*	Communication related services and products provider	100% ordinary	Germany
BT Ignite Nederland BV *(d)*	Communication related services and products provider	100% ordinary	Netherlands
BT North America Inc *(d)*	Communication related services and products provider	100% common	USA
BT Property Limited *(d)*	Property holding company	100% ordinary	UK
BT Subsea Cables Limited	Cable maintenance and repair	100% ordinary	UK
BT Telecomunicaciones SA *(d)*	Communication related services and products provider	100% ordinary	Spain
BT (Worldwide) Limited *(d)*	International telecommunication network systems provider	100% ordinary	International
BT Wireless Limited *(f)*	Holding company for the BT Cellnet group	100% ordinary	UK
Clear Communications Limited *(d)*	Communication related services and products provider	100% ordinary	New Zealand
Esat Digifone Limited *(d)(g)*	Mobile cellular telephone system provider and operator	50.5% ordinary	Ireland
Esat Group Limited *(d)*	Telecommunication services provider	100% ordinary	Ireland
Farland BV *(c)(d)*	Provider of trans-border fibre network across BT's partners in Europe	100% ordinary	International
Manx Telecom Limited *(d)*	Telecommunication services supplier	100% ordinary	Isle of Man
Syntegra Groep BV *(d)*	Systems integration and application development	100% common	Netherlands
Syntegra SA *(d)*	Systems integration and application development	100% ordinary	France
Syntegra (USA) Inc *(c)(d)(h)*	Systems integration and electronic business outsourcing services	100% common	International
Telfort Mobiel BV *(d)*	Mobile cellular telephone system provider and operator	100% ordinary	Netherlands
Viag Interkom GmbH & Co *(d)*	Mobile cellular telephone system provider and operator	100% ordinary	Germany
Yell Limited	Classified directory advertising services provider	100% ordinary	UK
Yellow Book USA Inc *(d)*	Classified directory publisher	100% common	USA
Yellow Pages Sales Limited *(d)*	Yellow Pages sales contractor	100% ordinary	UK

(a) The group comprises a large number of companies and it is not practical to include all of them in this list. The list, therefore, only includes those companies that have a more significant impact on the profit or assets of the group.

(b) The proportion of voting rights held corresponds to the aggregate interest percentage held by the holding company and subsidiary undertakings.

(c) All overseas undertakings are incorporated in their country of operations. Subsidiary undertakings operating internationally are all incorporated in England and Wales, except Farland BV and Syntegra (USA) Inc, which are incorporated in The Netherlands and USA, respectively.

(d) Held through intermediate holding company.

(e) In November 2000, Telecom Securicor Cellular Radio Limited changed its name to BT Cellnet Limited.

(f) In March 2001, Cellnet Group Limited changed its name to BT Wireless Limited.

(g) On 17 April 2001, Telenor exercised a put option for BT to acquire its shareholding – Esat Digifone is now 100% owned.

(h) Formerly Control Data Systems Inc.

b = billions m = millions	Activity	Share capital Issued*(a)*	 Percentage owned	Country of operations*(b)*
Joint Ventures				
Airtel Movil SA *(c)(d)*	Mobile cellular telephone system provider and operator	Ptas 78b	17.8%	Spain
Albacom SpA	Communication related services and products provider	ITL 543b	45.5%	Italy
Bharti Cellular Limited	Mobile cellular telephone system provider and operator	Rs1.05b	44%	India
Concert BV	Global communication related services and products provider	NLG 50m	100%*(e)*	International
e-peopleserve (Jersey) Limited	Human resource training and administration provider	£8.6m	50%	International
LG Telecom	Mobile cellular telephone system provider and operator	Won 953b	24.12%	Republic of Korea
Springboard Internet Services Limited *(f)*	Internet service provider	£8.3m	50%	UK
Telenordia AB	Communication related services and products provider	SKr106m	50%	Sweden

(a) Issued share capital comprises ordinary or common shares, unless otherwise stated. All investments are held through intermediate holding companies.
(b) All overseas companies are incorporated in their country of operations, with the exception of Concert BV which is incorporated in The Netherlands.
(c) Airtel Movil SA is being accounted for as a joint venture because of the relationship with other shareholders.
(d) On 2 May 2001, BT announced that subject to regulatory and procedural approvals Vodafone has agreed to purchase its interest in Airtel Movil SA.
(e) 100% of ordinary 'B' shares held giving an effective economic interest of 50%.
(f) BT sold its interest in Springboard Internet Services Limited on 25 April 2001.

b = billions m = millions	Activity	Share Capital Issued*(a)*	 Percentage owned	Country of operations*(b)*
Associates				
Cegetel SA	Communications related services and products provider	FFr 9.55b	26%	France
Japan Telecom Company Limited *(c)*	Communications related services and products provider	¥32b	30% *(d)*	Japan
J-Phone Communications Co Limited*(c)*	Mobile cellular telephone system provider and operator	¥3.2b	20%	Japan
Maxis Communications Berhad *(e)(f)(g)*	Communications related services and products provider	Myr 158m	33.3%	Malaysia
Rogers Wireless Communications Inc	Mobile cellular telephone system provider and operator	–	16.8% *(h)*	Canada
SmarTone Telecommunications Holdings Limited	Mobile cellular telephone system provider and operator	HK$60m	20.05%	Hong Kong
The Link Stores Limited	Telecommunications equipment retailer	£80	40%	UK

(a) Issued share capital comprises ordinary or common shares, unless otherwise stated. All investments are held through intermediate holding companies.
(b) All overseas undertakings are incorporated in their country of operations.
(c) On 2 May 2001, BT announced that subject to regulatory and procedural approvals Vodafone has agreed to purchase its interests in Japan Telecom Company Limited and J-Phone Communications Co Limited.
(d) Held through a BT subsidiary company – 66.7% BT owned, 33.3% AT&T owned. Economic holding is 20%.
(e) Certain exchange control constraints operate in Malaysia.
(f) Formerly Binariang Berhad.
(g) On 4 May 2001, BT announced that it had agreed in principle to sell its interest in Maxis Communications, subject to regulatory and other approvals.
(h) Held through a 50% interest in an intermediary company, which holds 33.6% of Rogers Wireless Communications Inc.

Quarterly analysis of turnover and profit

(Unaudited) Year ended 31 March 2001 Quarters	1st £m	2nd £m	3rd £m	4th £m	**Total £m**
Total turnover	6,791	7,603	7,525	7,747	**29,666**
Group's share of associates' and joint ventures' turnover	(2,222)	(2,761)	(2,442)	(2,512)	**(9,937)**
Trading between group and principal joint venture	163	178	170	187	**698**
Group turnover	4,732	5,020	5,253	5,422	**20,427**
Other operating income	88	65	101	139	**393**
Group operating profit (loss)	755	753	936	(2,383)	**61**
Group's share of operating profit (loss) of associates and joint ventures	4	8	(337)	(72)	**(397)**
Total operating profit (loss)	759	761	599	(2,455)	**(336)**
Profit on sale of fixed asset investments and group undertakings	41	24	500	54	**619**
Net interest payable	(239)	(314)	(339)	(422)	**(1,314)**
Profit (loss) on ordinary activities before taxation	561	471	760	(2,823)	**(1,031)**
Tax on profit (loss) on ordinary activities	(193)	(176)	(187)	(96)	**(652)**
Profit (loss) on ordinary activities after taxation	368	295	573	(2,919)	**(1,683)**
Minority interests	(47)	(24)	(41)	(15)	**(127)**
Profit (loss) for the financial period	321	271	532	(2,934)	**(1,810)**
Basic earnings (loss) per share	4.9p	4.2p	8.1p	(44.9)p	**(27.7)p**
Diluted earnings (loss) per share	4.8p	4.1p	8.0p	(44.9)p	**(27.7)p**
Profit before goodwill amortisation, exceptional items and taxation	637	644	472	319	**2,072**
Basic earnings per share before goodwill amortisation and exceptional items	6.6p	5.9p	4.3p	3.0p	**20.5p**
Diluted earnings per share before goodwill amortisation and exceptional items	6.5p	5.9p	4.3p	3.0p	**20.2p**

(Unaudited) Year ended 31 March 2000 Quarters	1st £m	2nd £m	3rd £m	4th £m	**Total £m**
Total turnover	4,987	5,329	5,585	6,002	**21,903**
Group's share of associates' and joint ventures' turnover	(457)	(627)	(845)	(1,435)	**(3,364)**
Trading between group and principal joint venture	–	–	–	176	**176**
Group turnover	4,530	4,702	4,740	4,743	**18,715**
Other operating income	33	46	31	132	**242**
Group operating profit	930	998	869	801	**3,598**
Group's share of operating loss of associates and joint ventures	(95)	(129)	(108)	(68)	**(400)**
Total operating profit	835	869	761	733	**3,198**
Profit on sale of fixed asset investments and group undertakings	–	90	–	36	**126**
Net interest payable	(63)	(69)	(110)	(140)	**(382)**
Profit on ordinary activities before taxation	772	890	651	629	**2,942**
Tax on profit on ordinary activities	(235)	(272)	(198)	(192)	**(897)**
Profit on ordinary activities after taxation	537	618	453	437	**2,045**
Minority interests	(3)	7	–	6	**10**
Profit for the financial period	534	625	453	443	**2,055**
Basic earnings per share	8.3p	9.6p	7.0p	6.8p	**31.7p**
Diluted earnings per share	8.1p	9.4p	6.8p	6.7p	**30.9p**
Profit before goodwill amortisation, exceptional items and taxation	804	832	722	742	**3,100**
Basic earnings per share before goodwill amortisation and exceptional items	8.7p	9.1p	8.0p	8.4p	**34.2p**
Diluted earnings per share before goodwill amortisation and exceptional items	8.5p	8.9p	7.8p	8.2p	**33.4p**

Unaudited pro forma condensed combined financial statements

Pro forma financial information
British Telecommunications plc and subsidiaries

Introduction

The following unaudited pro forma condensed combined statements of operations for the years ended 31 March 2001, 2000 and 1999 give pro forma effect to (a) the acquisition of Viag Interkom GmbH & Co. ("Viag Interkom") and (b) the related financings, as if each of these transactions had occurred on 1 April 2000, and (c) the probable demerger of BT Wireless, and (d) the probable demerger or sale of Yell, as if each of these transactions had occurred on 1 April 1998. The unaudited pro forma condensed combined balance sheet as of 31 March 2001 gives effect to (a) the probable demerger of BT Wireless and (b) the probable demerger or sale of Yell as if each such transaction had occurred on that date.

The unaudited pro forma condensed combined statements of operations and balance sheet have been prepared based upon BT's audited annual consolidated financial statements for the years ended 31 March 2000 and 31 March 1999, BT's audited annual consolidated financial statements as of and for the year ended 31 March 2001, and the audited consolidated financial statements of Viag Interkom for the year ended 31 December 2000, each included elsewhere or incorporated by reference in this Annual Report on Form 20-F, and based upon other available information and assumptions which management believes are reasonable.

BT has a year-end of 31 March, Viag Interkom had a year end 31 December. As a result, the period for which a consolidated result of operations of Viag Interkom has been obtained and reflected in the unaudited pro forma condensed consolidated statement of operations does not exactly conform to the reporting period presented therein.

The acquisition of Viag Interkom has been accounted for using the purchase method of accounting under UK and US GAAP. Assets and liabilities have been recorded at their estimated fair values at the date of purchase. The fair value adjustments included in the unaudited condensed statement of operations for the year ended 31 March 2001 represent BT's preliminary determination of these adjustments based upon available information and assumptions which management believes are reasonable.

Upon receipt of the necessary approvals required to effect the probable sale or demergers, BT will report BT Wireless and Yell as discontinued operations under US GAAP, in accordance with APB Opinion No. 30 "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions".

No account has been taken within the unaudited pro forma condensed combined statements of operations of any costs associated with the demerger or any future changes in administrative costs incurred or charged from BT which may or are expected to occur as a result of the demerger of BT Wireless or the demerger or sale of Yell.

There can be no assurance that the actual results of Future BT, BT Wireless or Yell will not differ significantly from the pro forma figures reflected in the unaudited financial information presented herein.

The pro forma condensed combined statements of operations and balance sheet are for information only. The pro forma condensed combined statements of operations do not purport to represent our consolidated results of operations had the demerger of BT Wireless and the demerger or sale of Yell actually occurred on 1 April 1998, and had the acquisition of Viag Interkom actually occurred on 1 April 2000, nor are they intended to represent results which may occur in the future.

The pro forma financial information has been prepared in accordance with UK GAAP, which differs in certain significant respects from US GAAP as described in note 9 of the unaudited pro forma condensed combined financial statements.

In preparing the unaudited pro forma condensed combined financial statements, certain adjustments were identified and made to reflect the differences between UK GAAP, as applied by BT and German GAAP, as applied by Viag Interkom. For the purpose of presenting the unaudited pro forma condensed consolidated financial information, the Viag Interkom statement of operations has been conformed to UK GAAP.

These unaudited pro forma condensed combined financial statements should be read in conjunction with the financial review, BT's audited consolidated financial statements, including the notes to those statements appearing elsewhere in this Annual Report on Form 20-F for the financial year ended 31 March 2001 and the audited consolidated financial statements of Viag Interkom and the related notes thereto, furnished to the US Securities and Exchange Commission on Form 6-K dated 10 May 2001.

Unaudited pro forma condensed combined financial statements

Unaudited pro forma condensed combined balance sheet as at 31 March 2001

		Discontinued operations		
	Historical BT (note 1) £m	BT Wireless (note 5) £m	Yell (note 6) £m	Pro forma BT £m
Fixed assets				
Intangible assets	18,380	15,601	429	2,350
Tangible assets	21,625	3,734	43	17,848
Investments	5,204	68	2	5,134
Total fixed assets	45,209	19,403	474	25,332
Current assets				
Stocks	361	149	88	124
Debtors	6,260	946	304	5,010
Investments	2,557	–	–	2,557
Cash at bank and in hand	412	–	–	412
Total current assets	9,590	1,095	392	8,103
Creditors: amounts falling due within one year				
Loans	(12,136)	–	–	(12,136)
Other creditors	(8,597)	(1,436)	(154)	(7,007)
Total creditors: amounts falling due within one year	(20,733)	(1,436)	(154)	(19,143)
Net current assets (liabilities)	(11,143)	(341)	238	(11,040)
Total assets less current liabilities	34,066	19,062	712	14,292
Creditors: amounts falling due after more than one year				
Loans and other borrowings	(18,775)	–	–	(18,775)
Provisions for liabilities and charges	(723)	(226)	–	(497)
Total net assets (liabilities)	14,568	18,836	712	(4,980)
Minority interests	499	–	–	499
Capital and reserves (deficit)	14,069	18,836	712	(5,479)
	14,568	18,836	712	(4,980)
US GAAP information				
Total assets				33,435
Total shareholders' equity (deficit)				(9,579)

See notes to unaudited pro forma condensed combined financial statements.

Unaudited pro forma statement of income for the year ended 31 March 2001

	Historical BT (note 1) £m	Viag Interkom results (note 2) £m	Viag Interkom Pro forma adjustment (note 3) £m	Combined Pro forma Group (note 4) £m	BT Wireless (note 5) £m	Yell (note 6) £m	Eliminations and other (note 7) £m	Pro forma BT £m
Group turnover	20,427	870	(100)	21,197	3,935	775	(831)	17,318
Other operating income	393	–	–	393	–	–		393
Operating costs	(20,759)	(1,508)	(36)	(22,303)	(7,663)	(589)	831	(14,882)
Group operating profit (loss)	61	(638)	(136)	(713)	(3,728)	186	–	2,829
Group's share of operating loss of associates and joint ventures	(397)	–	277	(120)	7	2		(129)
Total operating profit (loss)	(336)	(638)	141	(833)	(3,721)	188	–	2,700
Profit on sale of group undertakings and fixed asset investments	619	–	(12)	607	1	–		606
Net interest payable	(1,314)	(99)	(498)	(1,911)	(170)	(25)		(1,716)
Profit (loss) on ordinary activities before taxation	(1,031)	(737)	(369)	(2,137)	(3,890)	163	–	1,590
Tax on profit (loss) on ordinary activities	(652)	–	263	(389)	189	(58)		(520)
Profit (loss) on ordinary activities after taxation	(1,683)	(737)	(106)	(2,526)	(3,701)	105	–	1,070
Minority interest	(127)	–	–	(127)	–	–		(127)
Profit (loss) for the financial year	(1,810)	(737)	(106)	(2,653)	(3,701)	105	–	943
Other financial information								
Pro forma basic earnings per share								14.5p
Pro forma diluted earnings per share								14.2p
Shares used in computing basic earnings per share								6,525m
Shares used in computing diluted earnings per share								6,621m
US GAAP information								
Net income								£242m
Pro forma basic earnings per ADS								£0.37
Pro forma diluted earnings per ADS								£0.37

See notes to unaudited pro forma condensed combined financial statements.

Unaudited pro forma condensed combined financial statements

Unaudited pro forma statements of income

Year ended 31 March 2000	Historical BT (note 1) £m	BT Wireless (note 5) £m	Yell (note 6) £m	Eliminations and other (note 7) £m	Pro forma BT £m
Group turnover	18,715	2,636	622	(764)	16,221
Other operating income	242	–	–		242
Operating costs	(15,359)	(2,563)	(432)	764	(13,128)
Group operating profit	3,598	73	190	–	3,335
Group's share of operating profit (loss) of associates and joint ventures	(400)	(243)	1	–	(158)
Total operating profit (loss)	3,198	(170)	191	–	3,177
Profit on sale of group undertakings	126	–	–	–	126
Net interest payable	(382)	(48)	(11)	–	(323)
Profit (loss) on ordinary activities before taxation	2,942	(218)	180	–	2,980
Tax on profit (loss) on ordinary activities	(897)	(2)	(58)	–	(837)
Profit (loss) on ordinary activities after taxation	2,045	(220)	122	–	2,143
Minority interest	10	(2)	–	–	12
Profit (loss) for the financial year	2,055	(222)	122	–	2,155
Other financial information					
Pro forma basic earnings per share					33.2p
Pro forma diluted earnings per share					32.4p
Shares used in computing basic earnings per share					6,488m
Shares used in computing diluted earnings per share					6,642m
US GAAP information					
Net income					£1,512m
Pro forma basic earnings per ADS					£2.33
Pro forma diluted earnings per ADS					£2.28
Year ended 31 March 1999					
Group turnover	16,953	1,822	469	(537)	15,199
Other operating income	168	–	–	–	168
Operating costs	(13,305)	(1,625)	(292)	537	(11,925)
Group operating profit	3,816	197	177	–	3,442
Group's share of operating loss of associates and joint ventures	(342)	(152)	–	–	(190)
Total operating profit	3,474	45	177	–	3,252
Profit on sale of fixed asset investments	1,107	–	–	–	1,107
Net interest payable	(286)	(40)	–	–	(246)
Profit on ordinary activities before taxation	4,295	5	177	–	4,113
Tax on profit on ordinary activities	(1,293)	(15)	(60)	–	(1,218)
Profit (loss) on ordinary activities after taxation	3,002	(10)	117	–	2,895
Minority interests	(19)	(34)	–	–	15
Profit (loss) for the financial year	2,983	(44)	117	–	2,910
Other financial information					
Pro forma basic earnings per share					45.2p
Pro forma diluted earnings per share					44.1p
Shares used in computing basic earnings per share					6,442m
Shares used in computing diluted earnings per share					6,592m
US GAAP information					
Net income					£2,532m
Pro forma basic earnings per ADS					£3.93
Pro forma diluted earnings per ADS					£3,84

See notes to unaudited pro forma condensed combined financial statements.

Notes to the pro forma consolidated financial information

The unaudited pro forma condensed combined statements of operations for the years ended 31 March 2001, 2000 and 1999 give pro forma effect to (a) the acquisition of Viag Interkom and (b) the related financings, as if each of these transactions had occurred on 1 April 2000, and (c) the probable demerger of BT Wireless, and (d) the probable demerger or sale of Yell, as if each of these transactions had occurred on 1 April 1998. The unaudited pro forma condensed combined balance sheet as of 31 March 2001 gives effect to (a) the probable demerger of BT Wireless and (b) the probable demerger or sale of Yell as if each transaction had occurred on that date.

1. BT historical information

The historical information included in the unaudited pro forma condensed combined balance sheet and statement of operations as of and for the years ended 31 March 2001 and for the years ended 31 March 2000 and 1999 has been extracted from our audited consolidated financial statements as of 31 March 2001 and for the three years then ended, included in this Annual Report on Form 20-F.

2. Historical Viag Interkom

The historical Viag Interkom financial information incorporated by reference in the unaudited pro forma condensed combined statement of operations for the year ended 31 March 2001 has been derived from the profit and loss account included in the audited consolidated financial statements of Viag Interkom as of and for the year ended 31 December 2000 incorporated by reference in this document.

The historical consolidated financial statements of Viag Interkom are presented in Deutsche Marks. The historical profit and loss account of Viag Interkom for the year ended 31 December 2000 has been translated into Sterling at the average exchange rate for the year of 3.2108 Deutsche Marks to one pound Sterling. It should be noted that such translation should not be construed as representations that the Deutsche Mark amounts actually represent such Sterling amounts, or could have been or will be converted at the rate indicated or at all.

Historical Viag Interkom financial information has been included in the pro forma financial statements on a UK GAAP basis. The historical consolidated financial statements of Viag Interkom were prepared in accordance with accounting principles generally accepted in Germany ("German GAAP"), which differs in certain material respects from UK GAAP.

For the purposes of preparing the unaudited pro forma condensed combined financial information, the translated historical profit and loss account of Viag Interkom for the year ended 31 December 2000 has been restated as if UK GAAP had applied by giving effect to the following adjustment:

Depreciation

Under German GAAP, the depreciable life of fixed assets is determined in accordance with lives specified by German tax regulations. Under UK GAAP, the depreciable life of fixed assets is based on the estimated useful life of the underlying asset regardless of the tax regulations. The historical depreciation expense reported by Viag Interkom for the year ended 31 December 2000 has been decreased by £46 million to be restated in accordance with UK GAAP.

3. Viag Interkom purchase accounting, financing and elimination adjustments

The Group's interest in Viag Interkom was accounted for as a joint venture investment under the equity method of accounting in the period 1 April 2000 to 19 February 2001 and as a subsidiary in the period 20 February 2001 to 31 March, 2001. For the purposes of the pro forma statement of operations for the year ended 31 March 2001, adjustments have been made to account for Viag Interkom as though it had been acquired on 1 April 2000.

Notes to the pro forma consolidated financial information

3. Viag Interkom purchase accounting, financing and elimination adjustments (continued)

	(a) £m	*(b)* £m	*(c)* £m	*(d)* £m	*(e)* £m	Total £m
Group turnover	(100)	–	–	–	–	(100)
Operating costs	193	–	–	(229)	–	(36)
Group operating profit (loss)	93	–	–	(229)	–	(136)
Group's share of operating loss of associates and joint ventures	–	277	–	–	–	277
Total operating profit	93	277	–	(229)	–	141
Profit on sale of group undertakings and fixed asset investments	(12)	–	–	–	–	(12)
Net interest payable	28	70	(596)	–	–	(498)
Tax on profit (loss) on ordinary activities	(33)	(104)	179	–	221	263

(a) This adjustment eliminates the profit and loss items included in the post acquisition consolidated results of BT in the period from 20 February 2001 to 31 March 2001.

(b) This adjustment eliminates BT's historical equity share of the losses of Viag Interkom included within group's share of operating loss of associates and joint ventures relating to the period from 1 April 2000 to 19 February 2001.

(c) This adjustment records the additional interest expense arising from the financing arrangements incurred to effect the acquisition of Viag Interkom. BT primarily financed the acquisition of Viag Interkom, and associated investments, of £10.8 billion by the issuance of long-term fixed-rate debt. BT estimates that the debt used to finance the acquisition of Viag Interkom and its 3G mobile licence carries a weighted average interest rate of 7.1% after taking into account interest rate swaps and forward foreign currency contracts.

Accordingly, the adjustment comprises the estimated full year interest expense of £767 million, less £171 million already included in the consolidated results of BT for the year ended 31 March 2001 in respect of interest already expensed relating to this debt.

BT has estimated that the effect on the pro forma net income of a 0.125% change in the interest rates, assuming the interest on £11.3 billion of debt is based on variable rates, would be approximately £14 million in the year ended 31 March 2001.

The tax effect on the pro forma interest adjustments of £179 million has been calculated at an assumed rate of 30%.

(d) This adjustment records the additional amortisation of goodwill as a result of the preliminary fair value adjustments made upon acquisition. Provisional goodwill arising on acquisition has been estimated at £4,992 million. This amount was being amortised on a straight-line basis over 20 years. Accordingly, the adjustment comprises the full year amortisation charge of £250 million, less an amount of £21 million already included in the consolidated results of BT for the year ended 31 March 2001 in respect of amortisation expenses in the period from 20 February 2001 to 31 March 2001. There is presumed to be no tax effect in respect of the goodwill adjustment on the basis that goodwill is not tax deductible. As discussed in the Financial Review, a goodwill impairment charge of £3,000 million has been made at 31 March 2001 and thus the full year amortisation charge is expected to the £100 million from 1 April 2001, based on the revised book value of goodwill.

(e) Adjustment to the group tax charge to reflect group relief for Viag Interkom's losses at 30%.

4. Combined group

This gives pro forma effect to acquisition of Viag Interkom by combining the historic results of operations of BT for the year ended 31 March 2001 with the historic results of Viag Interkom for the year ended 31 December 2000, after taking into account financing adjustments, preliminary purchase accounting adjustments and the elimination of intercompany transactions.

5. BT Wireless discontinued operations

As described in the Business Review, the group has announced that it plans to seek a demerger and listing of BT Wireless. These adjustments present management's best assessment of the historical results of operations and the historical financial position of BT Wireless to reflect the demerger of BT Wireless from BT as though that transaction had occurred on (i) 1 April 1998 in respect of the unaudited pro forma condensed statements of operations; and (ii) 31 March 2001 in respect of the unaudited pro forma condensed combined balance sheet. These historical results are not necessarily indicative of the stand-alone results of BT Wireless had the group operated as a stand-alone entity during that period. BT Wireless is assumed to have been demerged free of all cash and outstanding intercompany balances. Accordingly, the historical balance sheet of BT Wireless as of 31 March 2001 excludes all such balances, which have been reclassified as invested equity on the BT Wireless balance sheet. An assumption has been made that BT Wireless will not assume any third party debt from BT, nor retain any third party debt that exists on its own balance sheet. The historical results of operations of BT Wireless for the year ended 31 March 2001 have been further adjusted to give pro forma effect to the acquisition of the wireless business of Viag Interkom as though that acquisition had occurred on 1 April 2000.

Notes to the pro forma consolidated financial information

6. Yell discontinued operations

As described in the Business Review, the group has announced that it plans to seek a demerger and listing or sale of Yell. These adjustments present management's best assessment of the historical results of operations and the historical financial position of Yell to reflect the demerger or sale of Yell as though that demerger or sale had occurred on (i) 1 April 1998 in respect of the unaudited pro forma condensed statements of operations; and (ii) 31 March 2001 in respect of the unaudited pro forma condensed combined balance sheet. These historical results are not necessarily indicative of the stand-alone results of Yell had that group operated as a stand-alone entity. Yell is assumed to have been demerged or sold free of all cash and outstanding intercompany balances. Accordingly, the historical balance sheet of Yell as of 31 March 2001 excludes all such balances, which have been reclassified as invested equity on the Yell balance sheet. An assumption has been made that Yell will not assume any third-party debt from BT, nor retain any third-party debt that exists on its own balance sheet.

7. Other adjustments

To record the historical amount of intercompany revenue and expense transactions between (i) pro forma BT and (ii) BT Wireless and Yell. These amounts were eliminated in the BT consolidated financial statements and are not therefore reflected in BT's historical consolidated results of operations.

8. Pro forma basic and diluted earnings per share

The calculations of pro forma basic earnings per share are based on the net profit attributable to shareholders divided by the average number of shares in issue during the period, after deducting the shares held by employee share ownership trusts.

In calculating pro forma diluted earnings per share, the average number of shares in issue during the period presented have been adjusted for share options outstanding and other potential ordinary shares.

Details of the basic and total diluted weighted average number of shares in each year are set out in note 13 on page 92 of this Annual Report on Form 20-F.

9. Reconciliation to US GAAP

BT prepares its consolidated financial statements in accordance with accounting principles that conform in all material respect with UK GAAP, which differs in certain material respects from US GAAP.

A summary of the significant differences between UK and US GAAP that are relevant to the BT pro forma financial information is set out on pages 124 to 126 of this Annual Report on Form 20-F.

The calculation of pro forma combined net income under US GAAP for each of the three years ended 31 March 2001 is as follows:

	Years ended 31 March, 2001 £m	2000 £m	1999 £m
Pro forma profit on ordinary activities after taxation and minority interests under UK GAAP	943	2,155	2,910
Adjustment for:			
Pension costs	(42)	(209)	(104)
Redundancy charges	(453)	(300)	(284)
Capitalisation of interest, net of related depreciation	(13)	(14)	(19)
Goodwill amortisation	(27)	(45)	101
Mobile licences, software and other intangible asset capitalisation and amortisation, net	(32)	(33)	(226)
Financial instruments	(133)	(129)	(6)
Deferred gain	(71)	(19)	–
Deferred taxation	108	106	220
Other	(38)	–	(60)
Pro forma net income as adjusted for US GAAP	242	1,512	2,532

Notes to the pro forma consolidated financial information

9. Reconciliation to US GAAP (continued)

The calculation of pro forma BT shareholders' equity (deficit) under US GAAP as of 31 March 2001 is as follows:

	As at 31 March 2001 £m
Pro forma capital and reserves (deficit) under UK GAAP	(5,479)
Adjustment for:	
Pension costs	(2,755)
Redundancy costs	(25)
Capitalisation of interest, net of related depreciation	259
Goodwill, net of accumulated amortisation	139
Mobile licences, software and other intangible asset capitalisation and amortisation, net	521
Financial instruments	(620)
Deferred gain	(323)
Deferred taxation	(1,296)
Shareholders' equity (deficit) as adjusted for US GAAP	(9,579)

10. Pro forma basic and diluted earnings per ADS

Each ADS is equal to 10 ordinary shares of 25p each.

Financial statistics years ended 31 March

	1997	1998	1999	2000	**2001**
Financial ratios					
Basic earnings (loss) per share – pence	32.8	26.6	46.3	31.7	**(27.7)**
Return on capital employed % *(a)*	19.1	19.5	19.2	18.2	**14.9**
Gearing – net debt to equity % *(b)*	1.6	36.1	6.3	53.4	**191.8**
Interest cover *(c)*	19.7	11.2	12.2	8.8	**2.6**

(a) The ratio is based on profit before tax, goodwill amortisation and interest on long-term borrowings, to average capital employed. Capital employed is represented by total assets, excluding goodwill, less current liabilities, excluding corporate taxes and dividends payable, and provisions other than those for deferred taxation. Year-end figures are used in the computation of the average, except in the case of short-term investments and borrowings where average daily balances are used in their place.

(b) The ratio is based on borrowings net of cash and short-term investments to capital and reserves and minority interests.

(c) The number of times net interest payable is covered by total operating profit before goodwill amortisation. In 1997, net interest excludes the premium paid on the repurchase of bonds.

	1997 £m	1998 £m	1999 £m	2000 £m	**2001 £m**
Expenditure on research and development					
Total expenditure	291	307	268	345	**364**

	1997 £m	1998 £m	1999 £m	2000 £m	**2001 £m**
Expenditure on tangible fixed assets					
Plant and equipment					
Transmission equipment	1,131	1,219	1,416	1,563	**2,295**
Exchange equipment	445	512	411	413	**479**
Other network equipment	503	502	558	703	**1,180**
Computers and office equipment	350	372	464	502	**574**
Motor vehicles and other	175	230	230	257	**251**
Land and buildings	143	211	205	229	**210**
Increase (decrease) in engineering stores	(28)	(16)	(15)	13	**(3)**
Total expenditure on tangible fixed assets	2,719	3,030	3,269	3,680	**4,986**
Decrease (increase) in creditors	104	(10)	(49)	(112)	**(230)**
Cash outflow on purchase of tangible fixed assets	2,823	3,020	3,220	3,568	**4,756**

Financial statistics have been restated where necessary to provide consistency with the presentation of the 2001 financial year figures.

Operational statistics and regulatory information years ended 31 March

	1997	1998	1999	2000	**2001**
Call growth					
% growth in UK fixed-network call volumes over the previous year:	6	6	7	7	**2**

Growth is estimated by reference to turnover growth attributable to calls, adjusted to eliminate the effect of price changes.

	1997	1998	1999	2000	**2001**
UK exchange line connections					
Business ('000)	7,160	7,521	7,982	8,450	**8,910**
% growth over previous year	5.3	5.0	6.1	5.9	**5.4**
Residential ('000)	20,393	20,130	20,067	20,040	**19,970**
% growth over previous year	(0.5)	(1.3)	(0.3)	(0.1)	**(0.3)**
Service providers	–	–	–	90.0	**70.0**
% growth over previous year	–	–	–	–	**(22.2)**
Total exchange line connections ('000)	27,553	27,651	28,049	28,580	**28,950**
% growth over previous year	0.9	0.4	1.4	1.9	**1.3**

	1997	1998	1999	2000	**2001**
Cellular telephones					
BT Cellnet (Cellular telephones in the UK)					
Prepaid ('000)	–	–	909	3,591	**7,707**
Contract ('000)	1,125	2,303	3,254	3,658	**3,455**
Total digital GSM ('000)	1,125	2,303	4,163	7,249	**11,162**
Analogue ('000)	1,573	774	359	155	**–**
Total ('000)	2,698	3,077	4,522	7,404	**11,162**
% growth over previous year	12.9	14.0	47.0	63.7	**50.8**
Viag Interkom – Germany ('000)	–	–	81	1,332	**3,720**
% growth over previous year	–	–	n/m	n/m	**179.3**
Telfort – Netherlands ('000)	–	–	37*(a)*	492	**918**
% growth over previous year	–	–	n/m	n/m	**86.6**
Esat Digifone – Ireland ('000)	–	134	302	630	**1,059**
% growth over previous year	–	n/m	125.4	108.6	**68.1**

(a) December 1998
n/m = not meaningful

	1997	1998	1999	2000	**2001**
UK optical fibre					
Fibre – kilometres in the network ('000)	3,302	3,591	4,058	4,555	**5,100**

	1997	1998	1999	2000	**2001**
People employed					
Total employees ('000)	127.5	124.7	124.7	136.8	**137.0**

Classified directory business in the UK

The company is providing the following information with respect to its classified directory business in the UK in accordance with undertakings made with the Office of Fair Trading in 1996. For the year ended 31 March 2001, the classified directory business of BT made an operating profit of £216 million (2000 – £205 million) on turnover of £502 million (2000 – £478 million) and, at 31 March 2001, it employed net assets of £178 million (2000 – £161 million). Since the classified directory business is integrated with the company's wider operations, this financial information incorporates the effects of certain apportionments and allocations of expenditures and assets. The figures for the year ended 31 March 2000 have been restated.

BT is required to submit annual audited accounts in respect of the classified directory business to the Director of the Office of Fair Trading within nine months of the company's financial year end. Copies of these accounts, when available, may be obtained free of charge from *Yellow Pages* at *Queens Walk, Reading RG1 7PT*.

Additional information for shareholders

Cautionary statement regarding forward-looking statements

Certain statements in this annual report are forward-looking and are made in reliance on the safe harbour provisions of the US Private Securities Litigation Reform Act of 1995. These statements include, without limitation, those concerning: BT's strategy and its ability to achieve it; the benefits and advantages of the restructuring; BT's debt reduction plans; BT's credit ratings; the plans to demerge BT Wireless, the structure of the demerger and the composition of the demerged group; BT's plans regarding Yell; BT's plans regarding Concert; growth of, and opportunities available in, the communications industry and BT's positioning to take advantage of those opportunities; expectations regarding competition, prices and growth; expectations regarding the convergence of technologies; expectations regarding the future of the mobile data market; BT's network development and expansion plans; plans for the launch of new products and services; expectations regarding participation in bids for third-generation (3G) licences outside the United Kingdom; the impact of regulatory initiatives on operations, including the regulation of the UK fixed wholesale and retail businesses; BT's possible or assumed future results of operations and/or those of its associates and joint ventures; capital expenditure and investment plans; adequacy of capital; financing plans; and those preceded by, followed by, or that include the words ''believes'', ''expects'', ''anticipates'', ''intends'' or similar expressions.

Although BT believes that the expectations reflected in these forward-looking statements are reasonable, it can give no assurance that these expectations will prove to have been correct. Because these statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by these forward-looking statements.

Factors that could cause differences between actual results and those implied by the forward-looking statements include, but are not limited to: material adverse changes in economic conditions in the markets served by BT and its lines of business; future regulatory actions and conditions in its operating areas, including competition from others in the United Kingdom and other international communications markets; selection by BT and its lines of business of the appropriate trading and marketing models for its products and services; the costs associated with deploying GPRS technology and building 3G networks and the speculative nature of future revenues and earnings streams from these investments; technological innovations, including the cost of developing new products and the need to increase expenditures for improving the quality of service; the anticipated benefits and advantages of new technologies not being realised; developments in the convergence of technologies; prolonged adverse weather conditions resulting in a material increase in overtime, staff or other costs; the timing of entry and profitability of BT and its lines of business in certain communication markets; significant changes in market shares for BT and its principal products and services; fluctuations in foreign currency exchange rates and interest rates; to the extent that BT chooses to sell assets or minority interests in its subsidiaries, prevailing market levels for such sales; and general financial market conditions affecting BT's ability to succeed with its restructuring. Certain of these factors are discussed in more detail elsewhere in this annual report including, without limitation, in ''Risk Factors''.

Background

Telephone services in almost all of the UK were, until 1981, provided by the Post Office, which was a government department until 1969 when it was established as a state public corporation. In 1981, the postal and telecommunications services of the Post Office became the responsibility of two separate corporations, with British Telecommunications – under the trading name of British Telecom – taking over the telecommunications business.

As a result of the Telecommunications Act, which received Royal Assent in 1984, the company was incorporated in the United Kingdom under the Companies Acts 1948 to 1981 on 1 April 1984 as a public limited company wholly owned by HM Government of the United Kingdom. The transfer of property, rights and liabilities of the corporation to British Telecommunications plc was made on 6 August 1984.

In November 1984, HM Government offered 3,012 million ordinary shares (50.2% of the total issued ordinary shares) to the public. The share sale was fully subscribed. British Telecom shares made their debut on the London Stock Exchange on 3 December 1984.

British Telecommunications plc has been trading as BT since April 1991.

Additional information for shareholders

In December 1991, HM Government sold over half its remaining shares in BT, retaining a holding of about 22%. It sold this residual holding in July 1993. Subsequently, in September 1997, HM Government redeemed at par a special rights redeemable preference share to which certain special rights attached.

In 1985, Cellnet was launched as a joint venture between British Telecom and Securicor which held 40% of the company. BT acquired full control of Cellnet (now BT Cellnet) by acquiring Securicor's minority holding in July 1999.

In July 1998, BT and AT&T launched Concert, a 50/50 joint venture serving customers around the world. BT and AT&T transferred their trans-border assets and operations to Concert in January 2000.

BT's registered number is 1800000 and its registered office address is 81 Newgate Street, London EC1A 7AJ. The company's agent in the USA is Jan Vinokour, 350 Madison Avenue, New York, NY 10017.

Listings

The principal listing of BT's ordinary shares is on the London Stock Exchange. The shares are also listed on the Tokyo Stock Exchange. American Depositary Shares (ADSs), each representing 10 ordinary shares, have been issued by Morgan Guaranty Trust Company of New York, as Depositary for the American Depositary Receipts (ADRs) evidencing the ADSs, and are listed on the New York Stock Exchange. ADSs also trade, but are not listed, on the London Stock Exchange. Trading on the New York Stock Exchange is under the symbol "BTY". BT shares are traded on the Tokyo Stock Exchange under the Code "9484".

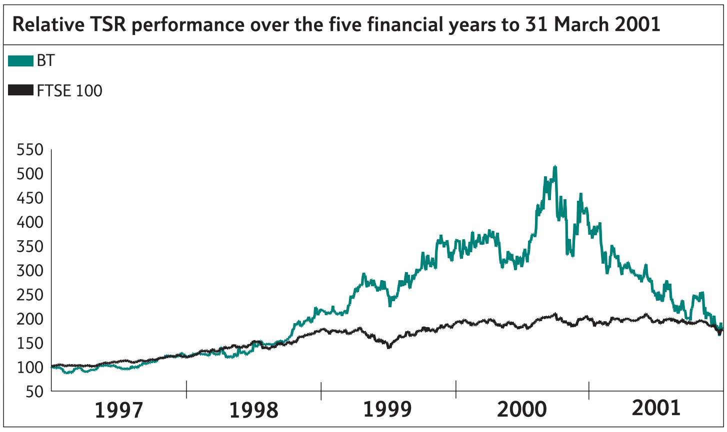
Share and ADS prices

	Pence per ordinary share		US$ per ADS	
	High pence	Low pence	High $	Low $
Year ended 31 March				
1997	461½	326½	73½	50¼
1998	685	379½	113⅞	60⅞
1999	1,118½	630	179 15/16	102¼
2000	1,513	889	244½	147⅝
2001	1,172	469	186	68¾
Year ended 31 March 2000				
1 April – 30 June 1999	1,137	970	181 15/16	159
1 July – 30 September 1999	1,151	889	184⅝	147⅝
1 October – 31 December 1999	1,513	906½	244½	153
1 January – 31 March 2000	1,423	964	241 1/16	152½
Year ended 31 March 2001				
1 April – 30 June 2000	1,172	854	186	127
1 July – 30 September 2000	932	711	141	107 1/16
1 October – 31 December 2000	808	570	119	84⅞
1 January – 31 March 2001	729	469	109½	68¾
Month				
November 2000	790	609	114¾	86⅛
December 2000	688½	570	101 11/16	84⅞
January 2001	726	560	109½	87 1/16
February 2001	729	567½	109¼	84¾
March 2001	588	469	86 1/20	68¾
April 2001	595	479	89¾	68 9/16

The prices are the highest and lowest closing middle market prices for BT ordinary shares, as derived from the Daily Official List of the London Stock Exchange and the highest and lowest sales prices of ADSs, as reported on the New York Stock Exchange composite tape.

Fluctuations in the exchange rate between the pound sterling and the US dollar affect the dollar equivalent of the pound sterling price of the company's ordinary shares on the London Stock Exchange and, as a result, are likely to affect the market price of the ADSs on the New York Stock Exchange.

Total shareholder return



1 April 1996 = 100
Source: Primark Datastream

Total Shareholder Return (TSR) is the measure of the returns that a company has provided for its shareholders and is, therefore, a good indicator of a company's overall performance. The TSR indices on the above graph are the product of share price movement, plus gross dividends reinvested in the shares to July 1997 and net dividends after that date.

Analysis of shareholdings

Size of shareholding at 31 March 2001	Number of shareholders	Percentage of total	Ordinary shares of 25p each: Number of shares held (millions)	Ordinary shares of 25p each: Percentage of total
1 – 399	800,412	44.7	167	2.6
400 – 799	518,649	29.0	280	4.3
800 – 1,599	315,693	17.6	344	5.2
1,600 – 9,999	150,005	8.4	404	6.2
10,000 – 99,999	4,022	0.2	97	1.5
100,000 – 999,999	1,296	0.1	459	6.9
1,000,000 – 4,999,999	380	–	837	12.7
5,000,000 and above *(a),(b),(c)*	187	–	3,991	60.6
Total	**1,790,644**	**100.0**	**6,579**	**100.0***(d)*

(a) 19 million shares were held in trust by Ilford Trustees (Jersey) Limited for allocation to employees under the employee share schemes.

(b) Under the BT Employee Share Ownership Scheme, 21 million shares were held in trust on behalf of 121,210 participants who were beneficially entitled to the shares. 60 million shares were held in the BT EasyShare corporate nominee service on behalf of 106,049 beneficial owners.

(c) Approximately 109 million shares were represented by ADSs and a further 9 million shares were held by a nominee of the Tokyo Stock Exchange on behalf of investors. Analysis by size of holding is not available for these holdings.

(d) 17.5% of the shares were in 1,730,672 individual holdings, of which 153,056 were joint holdings, and 82.5% of the shares were in 59,972 institutional holdings.

So far as the company is aware, no person is the beneficial owner of more than 5% of the company's ordinary shares, nor is the company directly or indirectly owned or controlled by another corporation or by HM Government or any other foreign government or by any other natural or legal person severally or jointly. There are no arrangements known to the company the operation of which may at a subsequent date result in a change in control of the company.

At 17 May 2001, there were 6,585,266,841 ordinary shares outstanding. At the same date, approximately 11 million ADSs (equivalent to 110 million ordinary shares, or approximately 1.7% of the total number of ordinary shares outstanding on that date) were outstanding and were held by 3,012 record holders of ADRs.

Additional information for shareholders

CREST: London Stock Exchange settlement system

The company's ordinary shares are settled in CREST, the computerised system for settling sales and purchases of shares. CREST is a voluntary system which enables shareholders, if they wish, to hold and transfer their shareholdings electronically rather than by paper. Shareholders who wish to retain their certificates are able to do so.

Individual savings accounts (ISAs)

Information about investing in BT shares through an ISA may be obtained from Halifax Share Dealing Limited, Westbank, Water Lane, Leeds LS11 5TL (telephone 0870 242 5588). ISAs are also offered by other organisations.

Dividends

The company has, since shortly after its incorporation in 1984, paid interim dividends annually in February and final dividends in September. The interim dividend we paid in February 2001 was at the same rate as in the previous year. However, as part of BT's debt reduction and restructuring plans, the Board is not recommending the payment of a final dividend to shareholders for the year ended 31 March 2001. In addition, the company has announced that there will be no interim dividend for the year ending 31 March 2002.

Future dividends, if any, will depend on the progress of the new companies created by our restructuring programme. These companies will determine their own dividend policies in accordance with their respective capital structures, cash requirements and the markets in which they operate.

The dividends paid or payable on BT shares and ADSs for the last five years are shown in the following table. The dividends on the ordinary shares exclude the associated tax credit. The dividends on the ADSs paid before 5 April 1999 include the associated UK tax credit available to certain beneficial owners who are resident in the United States or Canada for tax purposes, but before deduction of UK withholding taxes. The amounts shown are not those that were actually paid to holders of ADSs. For the tax treatment of dividends, which changed for dividends paid on or after 6 April 1999, see *Taxation of dividends* below. Dividends have been translated from pounds sterling into US dollars using exchange rates prevailing on the date the ordinary dividends were paid.

	Per ordinary share			Per ADS			Per ADS		
Years ended 31 March	Interim pence	Final pence	Total pence	Interim £	Final £	Total £	Interim US$	Final US$	Total US$
1997*(a)*	7.90	11.95	19.85	0.987	1.494	2.481	1.582	2.391	3.973
1998*(b)*	7.55	11.45	19.00	0.944	1.431	2.375	1.540	2.400	3.940
1999*(b)*	8.10	12.30	20.40	1.012	1.366	2.378	1.644	2.202	3.846
2000*(b)*	8.70	13.20	21.90	0.870	1.320	2.190	1.529	2.039	3.568
2001*(b)*	8.70	–	8.70	0.870	–	0.870	1.397	–	1.397

(a) In addition, a special dividend of 35p per share, excluding the associated tax credit, or £4.375 (US$7.002) per ADS, including the UK associated tax credit, was paid at the same time as the final dividend for the 1997 financial year.

(b) The dividends for the 1998, 1999, 2000 and 2001 financial years include an adjustment to take account of the effect of the 1997 special dividend.

As dividends paid by the company are in pounds sterling, exchange rate fluctuations will affect the US dollar amounts received by holders of ADSs on conversion by the Depositary of such cash dividends.

Dividend mandate

Any shareholder wishing dividends to be paid directly into a bank or building society account should contact the Registrar for a dividend mandate form. Dividends paid in this way will be paid through the Bankers Automated Clearing System (BACS). Alternatively, a form may be downloaded from the internet at **www.groupbt.com/investorcentre**

Dividend investment plan

The dividend investment plan replaced the share dividend plan for shareholders following the 1999 interim dividend. Under the dividend investment plan, cash from participants' dividends is used to buy further BT shares in the market.

Shareholders could elect to receive additional shares in lieu of a cash dividend for the following dividends:

	Date paid	Price per share pence
1999 final	20 September 1999	970.1
2000 interim	14 February 2000	991.5
2000 final	18 September 2000	809.6
2001 interim	12 February 2001	621.8

Global Invest Direct

Details of the Morgan Guaranty Trust Company's direct purchase plan, Global Invest Direct, including reinvestment of dividends, are available from Morgan Guaranty Trust Company of New York on 1 800 749 1687 (toll free in the United States) or +1 781 575 4328 (from outside the United States), or on written request to the Depositary.

Results announcements

Expected announcements of results:

1st quarter	26 July 2001
2nd quarter and half year	8 November 2001
3rd quarter and nine months	February 2002
4th quarter and full year	May 2002
2002 annual report and accounts published	June 2002

ShareGift

The Orr Mackintosh Foundation operates a charity share donation scheme for shareholders with small parcels of shares whose value makes it uneconomic to sell them. Details of the scheme are available on the ShareGift internet site **www.sharegift.org**, or can be obtained from the BT Shareholder Helpline.

Exchange rates

BT publishes its consolidated financial statements expressed in pounds sterling. The following tables detail certain information concerning the exchange rates between pounds sterling and US dollars based on the noon buying rate in New York City for cable transfers in pounds sterling as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate).

	Years ended 31 March				
	1997	1998	1999	2000	**2001**
Period end	1.64	1.68	1.61	1.59	**1.42**
Average *(a)*	1.60	1.65	1.65	1.61	**1.47**
High	1.71	1.70	1.72	1.68	**1.60**
Low	1.49	1.58	1.60	1.55	**1.40**

	Month					
	November 2000	December 2000	January 2001	February 2001	March 2001	April 2001
High	1.45	1.50	1.50	1.48	1.47	1.45
Low	1.40	1.44	1.46	1.44	1.42	1.42

(a) The average of the Noon Buying Rates in effect on the last day of each month during the relevant period.

On 17 May 2001, the most recent practicable date for this annual report, the Noon Buying Rate was US$1.43 to £1.00.

Additional information for shareholders

Memorandum and Articles of Association

The following is a summary of the principal provisions of BT's memorandum and articles of association ("Memorandum" and "Articles"), a copy of which has been filed with the Registrar of Companies.

Memorandum

The Memorandum states that its principal objects are, among other things, to carry on any business of running, operating, managing and supplying telecommunication systems and systems of any kind for conveying, receiving, storing, processing or transmitting sounds, visual images, signals, messages and communications of any kind.

Articles

(a) Voting rights

In the following description of the rights attaching to the shares in the company, a "holder of shares" and a "shareholder" is, in either case, the person registered in the company's register of members as the holder of the relevant shares. Shareholders can choose whether their shares are to be evidenced by share certificates (i.e. in certificated form) or held in electronic (i.e. uncertificated) form in CREST (the electronic settlement system in the UK).

Subject to the restrictions described below, on a show of hands, every shareholder present at any general meeting has one vote and, on a poll, every shareholder present in person or by proxy has one vote for each share which they hold or represent.

Voting at any meeting of shareholders is by a show of hands unless a poll is demanded by the chairman of the meeting or by at least five shareholders at the meeting who are entitled to vote (or their proxies), or by one or more shareholders at the meeting entitled to vote (or their proxies) and who have, between them, at least 10% of the total votes of all shareholders who have the right to vote at the meeting.

No person is, unless the Board decides otherwise, entitled to attend or vote at any general meeting or to exercise any other right conferred by being a shareholder at or in relation to meetings of the company in respect of any shares held by them if they or any person appearing to be interested in those shares have been sent a notice under section 212 of the Companies Act 1985 (which confers upon public companies the power to require information with respect to interests in their voting shares) and they or any interested person has failed to supply to the company the information requested within 14 days after delivery of that notice. These restrictions end (unless the Board decides otherwise):

(i) seven days after the earlier of the date the shareholder complies with the request satisfactorily or the company receives notice that there has been an approved transfer of the shares; or

(ii) when circumstances described under "Limitation on size of shareholdings" below apply.

(b) Limitation on size of shareholdings

For the purpose of these provisions, the expression "interest" is widely defined. It generally follows but is more extensive than the definition used in deciding whether a notification to the company would be required under Part VI of the Companies Act, 1985 (which contains requirements for the notification of interests in shares in public limited companies). Any person who has an interest in voting shares in the company of 3% or more is required to notify the company of that interest and is otherwise required to give notices in relation to interests in voting shares as currently provided in Part VI of the Companies Act.

If the Board knows that a person has an interest in the company's shares which carry 15% or more of the total votes attaching to relevant share capital (as that expression is defined in the Act), the Board must send a written notice to all persons (other than certain persons referred to below) who appear to it to have such interests and, if different, to the registered holder(s) of the shares concerned. That notice will set out the restrictions referred to below and will call for the interest concerned to be reduced to less than 15% by sale or other disposal of shares within 21 days of the giving of the notice to the registered holder(s) (or such longer period as the Board considers reasonable). No transfer of the shares comprised in the interest may be made except for the purpose of reducing the interest to less than 15% or if the notice sent by the Board is withdrawn.

If that notice is not complied with to the satisfaction of the Board and has not been withdrawn, the Board must effect the disposal on the terms as it decides, based upon advice obtained by it for the purpose.

A registered holder on whom a notice referred to above has been served is not entitled in respect of the share or shares comprised in the interest, until that notice has been withdrawn or complied with to the satisfaction of the Board, to attend or vote at any general meeting of the company or meeting of the holders of a class of shares and those rights will vest in the chairman of the meeting who may act entirely at his discretion.

The Board is not required to send a notice to any person if it does not know that person's identity or address. Not delivering a notice in such case and any accidental error in or failure to give notice to a person to whom notice is required to be sent will not prevent the implementation of or invalidate any procedure under the relevant Article. Any resolution or determination of, or decision or exercise of any discretion or power by, the Board is conclusive.

Certain specified shareholders, including the ADS Depositary and The Depositary Trust Company, are not subject to these restrictions.

(c) Variation of rights

Whenever the share capital of the company is split into different classes of shares, the special rights attached to any of those classes can be varied or withdrawn either:

(i) with the sanction of any extraordinary resolution passed at a separate meeting of the holders of the shares of that class; or

(ii) with the consent in writing of the holders of at least 75% in nominal value of the issued shares of that class.

At any separate meeting, the necessary quorum is two persons holding or representing by proxy not less than one-third in nominal amount of the issued shares of the class in question (but at any adjourned meeting, any person holding shares of the class or his proxy is a quorum).

The company can issue new shares and attach any rights and restrictions to them, as long as this is not restricted by special rights previously given to holders of any existing shares. Subject to this, the rights of new shares can take priority over the rights of existing shares, or existing shares can take priority over them, or the new shares and the existing shares can rank equally.

(d) Changes in capital

The company may by ordinary resolution:

(i) consolidate and divide all or any of its share capital into shares of a larger amount;

(ii) divide all or part of its share capital into shares of a smaller amount;

(iii) cancel any shares which have not, at the date of the ordinary resolution, been taken or agreed to be taken by any person and reduce the amount of its share capital by the amount of the shares cancelled; and

(iv) increase its share capital.

The company may also:

(i) buy back its own shares; and

(ii) by special resolution reduce its share capital, any capital redemption reserve and any share premium account.

(e) Dividends

The company's shareholders can declare dividends by passing an ordinary resolution. No dividend can exceed the amount recommended by the directors. Dividends must be paid out of profits available for distribution. If the directors consider that the profits of the company justify such payments, they can pay interim dividends on any class of shares of the amounts and on the dates and for the periods they decide. Fixed dividends will be paid on any class of share on the dates stated for the payments of those dividends.

The directors can offer ordinary shareholders the right to choose to receive new ordinary shares, which are credited as fully paid, instead of some or all of their cash dividend. Before they can do this, the company's shareholders must have passed an ordinary resolution authorising the directors to make this offer.

Any dividend which has not been claimed for 12 years after it was declared or became due for payment may be forfeited and will belong to the Company unless the Directors decide otherwise.

BT can stop paying dividends if payments for two dividends in a row are sent back or not cashed or have not been able to be made. BT must start paying dividends again if the shareholder or a person entitled to the shares by transmission claims them.

Additional information for shareholders

(f) Distribution of assets on winding up

If the company is wound up (whether the liquidation is voluntary, under supervision of a court or by a court) the liquidator can, with the authority of an extraordinary resolution passed by the shareholders, divide among the shareholders all or any part of the assets of the company. This applies whether the assets consist of property of one kind or different kinds. For this purpose, the liquidator can place whatever value the liquidator considers fair on any property and decide how the division is carried out between shareholders or different group of shareholders. Under general law the holders of BT shares will be entitled to participate in any surplus assets in a winding up in proportion to their shareholdings, as BT has only one class of shares.

(g) Transfer of shares

Certificated shares of the company may be transferred in writing either by an instrument of transfer in the usual standard form or another form approved by the Board. The transfer form must be signed or made effective by or on behalf of the person making the transfer. The person making the transfer will be treated as continuing to be the holder of the shares transferred until the name of the person to whom the shares are being transferred is entered in the register of members of the company.

The Board may refuse to register any transfer of any share held in certificated form:

- which is in favour of more than four joint holders; or
- unless the transfer form to be registered is properly stamped to show payment of any applicable stamp duty and delivered to the company's registered office or any other place the Board decides. The transfer must have with it the share certificate for the shares to be transferred; any other evidence which the Board asks for to prove that the person wanting to make the transfer is entitled to do this; and if the transfer form is executed by another person on behalf of the person making the transfer, evidence of the authority of that person to do so.

Transfers of uncertificated shares must be carried out using a relevant system (as defined in the Uncertificated Securities Regulations 1995 (the Regulations)). The Board can refuse to register a transfer of an uncertificated share in the circumstances stated in the Regulations.

If the Board decides not to register a transfer of a share, they must notify the person to whom that share was to be transferred no later than two months after the company receives the transfer form or instruction from the operator of the relevant system.

The Board can decide to suspend the registration of transfers, for up to 30 days a year, by closing the register of shareholders. This register must not be closed without the consent of the operator of a relevant system (as defined in the Regulations), in the case of uncertificated shares.

(h) Untraced shareholders

BT may sell any shares after advertising its intention and waiting for three months if the shares have been in issue for at least 12 years, during that period at least three dividends have become payable on them and have not been claimed and BT has not heard from the shareholder or any person entitled to the dividends by transmission. The net sale proceeds belong to BT, but it must pay those proceeds to the former shareholder or the person entitled to them by transmission if that shareholder, or that other person, asks for them.

(i) General meetings of shareholders

Every year BT must hold an annual general meeting. The Board can call an extraordinary general meeting at any time and, under general law, it must call one on a shareholders' requisition.

(j) Limitations on rights of non-resident or foreign shareholders

The only limitation imposed by the Articles on the rights of non-resident or foreign shareholders is that a shareholder whose registered address is outside the UK and who wishes to receive notices of meetings of shareholders must give the company an address within the UK to which they may be sent.

(k) Directors

Directors' remuneration

Excluding remuneration referred to below, each director will be paid such fees for his services as the Board decides, not exceeding £50,000 a year and increasing by the percentage increase of the retail prices index (as defined by Section 833(2) Income and Corporation Taxes Act 1988) for any 12 month period beginning 1 April 1999 or an anniversary of that date. The company may by ordinary resolution decide on a higher sum. This resolution can increase the fee paid to all or any directors either permanently or for a particular period. The directors may be paid their expenses properly incurred in connection with the business of the company.

The Board can award extra fees to a director who holds an executive position; acts as chairman or deputy chairman; serves on a Board committee or board at the request of the Board; or performs any other services which the Board considers extends beyond the ordinary duties of a director.

The Board may grant pensions or other benefits to, among others, any director or former director or persons connected with them. However, BT can only provide these benefits to any director or former director who has not been an employee or held any other office or executive position in the company or any of its subsidiary undertakings or to relations or dependants of, or people connected to, those directors or former directors, if the shareholders approve this by passing an ordinary resolution.

Directors' votes

A director need not be a shareholder, but a director who is not a shareholder can still attend and speak at shareholders' meetings.

Unless the Articles say otherwise, a director cannot vote on a resolution about a contract in which the director has a material interest (this will also apply to interests of a person connected with the director). The director can vote if the interest is only an interest in BT shares, debentures or other securities. A director can, however, vote and be counted in a quorum in respect of certain matters in which he is interested as set out in the Articles.

Subject to the legislation, the shareholders can by passing an ordinary resolution suspend or relax, among other things, the provisions relating to the declaration of the interest of a director in any contract or arrangement or relating to a director's right to vote and be counted in a quorum on resolutions in which he is interested to any extent or ratify any particular contract or arrangement carried out in breach of those provisions.

Directors' interests

If the legislation allows and the director has disclosed the nature and extent of the interest to the Board, the director can:

(i) have any kind of interest in a contract with or involving BT (or in which BT has an interest or with or involving another company in which BT has an interest);

(ii) have any kind of interest in a company in which BT has an interest (including holding a position in that company or being a shareholder of that company);

(iii) hold a position (other than auditor) in BT or another company in which BT has an interest on terms and conditions decided by the Board; and

(iv) alone (or through some firm with which the director is associated) do paid professional work (other than as auditor) for BT or another company in which BT has an interest on terms and conditions decided by the Board.

A director does not have to hand over to BT any benefit received or profit made as a result of anything permitted to be done under the Articles.

When a director knows that they are interested in a contract with BT they must tell the other directors.

Retirement of directors

Provisions of the legislation which, read with the Articles, would restrict the appointment of a director or require him to stop being a director because he has reached a particular age do not apply to the company.

At every annual general meeting one third of the directors (or if their number is not a multiple of three, the number nearest to but greater than one third) must retire by rotation as directors. The directors to retire are selected on the basis of time in office since their last election. Any director appointed by the directors automatically retires at the next following annual general meeting, and is then eligible for election, but is not taken into account in determining which and how many directors are to retire by rotation at such meeting. A retiring director is eligible for re-election.

Additional information for shareholders

Directors' borrowing powers

To the extent that the legislation and the Articles allow, the Board may exercise all the powers of the company to borrow money, to mortgage or charge its business, property and assets (present and future) and to issue debentures and other securities, and give security either outright or as collateral security for any debt, liability or obligation of the company or another person. The Board must limit the borrowings of the company and exercise all voting and other rights or powers of control exercisable by the company in relation to its subsidiary undertakings so as to ensure that the aggregate amount of all borrowings by the group outstanding at any time is not more than three times the adjusted capital and reserves (as defined in the Articles). This affects subsidiary undertakings only to the extent that the Board can do this by exercising these rights or powers of control. This limit can be exceeded if the consent of the shareholders has been given in advance by passing an ordinary resolution.

Material contracts

The following contracts (not being contracts entered into in the ordinary course of business) have been entered into in the two years preceding the date of this document by BT or another member of the group and are, or may be, material to the group or have been entered into by BT or another member of the group and contain a provision under which a member of the group has an obligation or entitlement which is, or may be, material to BT or such other member of the group.

(i) Viag Interkom

On 16 August 2000, the company, through its wholly-owned subsidiary BT Interkom Verwaltungs GmbH, entered into option agreements with each of its partners in the Viag Interkom joint venture, E.ON AG and Telenor A.S., giving BT the option to purchase, and the other partners the right to sell, their interests in Viag Interkom which holds a third-generation mobile telecommunications licence in Germany.

On 19 February 2001, BT and BT Interkom Verwaltungs GmbH exercised their options and entered into share transfer agreements with each of the joint venture partners for the transfer of their interest to BT.

The purchase prices for E.ON's 45% share and Telenor's 10% share of the venture were Euro 7.25 billion and Euro 1.61 billion, respectively.

The agreement with E.ON includes the right for BT to continue to use the name "VIAG" or "Viag Interkom" for three years, following which they may enter into good faith negotiations for its continued use. It also contains covenants restricting E.ON's rights to compete with Viag Interkom for 12 months.

The agreement with Telenor contains certain indemnities granted by BT to Telenor.

(ii) Japan Telecom

A sale and purchase agreement dated 2 May 2001 among BT, a subsidiary of BT, Vodafone Group plc ("Vodafone") and a subsidiary of Vodafone, under which the subsidiary of BT agreed to sell three subsidiaries which hold BT's interests in Japan Telecom Co., Ltd. ("JT"), J-Phone Communications Co., Ltd. ("JPC"), J-Phone Central Co., Ltd ("JC"), J-Phone East Co., Ltd. ("JEC") and J-Phone West Co., Ltd. ("JWC"). JT is one of Japan's leading telecommunications companies and parent of JPC, which in turn has controlling interests in the three regional J-Phone wireless operating companies, JC, JEC and JWC.

The consideration for the transaction comprises a cash payment of £3.7 billion, and the assumption by Vodafone of £782 million of BT debt guarantees in favour of JT.

The closing of the transaction remains conditional upon relevant procedural approvals in Japan. Closing of the transfer of the subsidiaries holding BT's interests in JT and JPC (for £3.05 billion) may occur prior to (and is not conditional upon) closing of the transfer of its interests in JEC and JWC for the Euro equivalent of £650 million (which will follow upon completion of the exercise of certain options over shares in JC, JEC and JWC, with the option price of some £380 million to be paid by BT).

The agreement contains certain warranties and indemnities in favour of Vodafone. These largely expire on 30 June 2002, however certain limited tax and title warranties survive indefinitely. The agreement is conditional on certain matters, including the need for consent from the Bank of Japan, and the parties have certain termination rights.

(iii) Airtel

A sale and purchase agreement dated 2 May 2001 between BT, a subsidiary of BT and Vodafone, under which the BT subsidiary has agreed to sell its entire interest in Airtel Móbil, S.A. ("Airtel") to Vodafone. The consideration for the transaction is £1.1 billion (payable in cash in euros). The closing of the transaction is conditional on EC Merger Regulation approval.

Taxation (US Holders)

This is a summary only of the principal US federal income tax and UK tax consequences to beneficial owners of ADSs who either are resident in the United States or hold ordinary shares or ADSs as assets effectively connected with a US trade or business (US Holders). It is not a complete analysis or listing of all potential tax consequences of the purchase, ownership and disposal of ordinary shares or ADSs.

Investors are advised to consult their tax advisers with respect to the tax consequences of their holdings, including the consequences under applicable state and local laws. The statements of UK and US tax laws and practices set out below are based on the laws in force and as interpreted by the relevant taxation authorities as of the date of this annual report. The statements are subject to changes occurring after that date in UK or US law or practice, in the interpretation thereof by the relevant taxation authorities, or in any double taxation convention between the United States and the UK.

In particular, this summary is based on the current convention between the United States and the UK for the avoidance of double taxation with respect to taxes on income and capital gains (the Treaty) and the US Internal Revenue Code of 1986, as amended. The US and the UK have entered into negotiations with respect to a new US-UK tax treaty, the provisions of which ultimately may modify certain aspects of the following discussion.

Taxation of dividends

For dividends paid on or before 5 April 1999, US Holders were generally entitled to receive the cash dividend plus a Treaty payment from the Inland Revenue of one quarter of the dividend, subject to a UK withholding tax of 15% of the aggregate amount paid. As an example for illustration purposes only, a US Holder who was entitled to a dividend of £80 was also entitled to a Treaty payment of £20, reduced by the withholding tax of 15% on the gross amount of £100, i.e. £15, leaving a net cash payment of £85. The full dividend plus the full Treaty payment including the UK tax withheld was taxable income for US purposes, and the US tax withheld generally was available as a US credit or deduction.

For dividends paid on or after 6 April 1999, the Treaty payment reduces to one ninth of the dividend (i.e. one tenth of the gross payment). As a result of the UK withholding tax (which cannot exceed the amount of the hypothetical Treaty payment), US Holders will no longer receive any Treaty payment. In the above example, the cash dividend would be £80, and the hypothetical Treaty payment would be £8.89 (one ninth of £80). However, since the UK withholding tax (15% of £88.89), would exceed the amount of the hypothetical Treaty payment, no Treaty payment will be made and the US Holder will receive only the cash dividend (here, £80). A US holder will be taxable in the US on the full dividend and full hypothetical Treaty payment (£88.89), and will be treated as having paid a foreign tax equal to the hypothetical Treaty payment (here, £8.89). The foreign tax deemed paid generally will be available as a US credit or deduction.

For US federal income tax purposes, a distribution will be treated as ordinary dividend income to the extent paid out of our current or accumulated earnings and profits, as determined for US tax purposes, based on the US dollar value of the distribution on the date it is actually or constructively received (calculated by reference to the spot rate on the relevant date). Distributions by us in excess of our current and accumulated earnings and profits will be treated first as a return of capital to the extent of the US Holder's basis in the ordinary shares and thereafter as capital gain. For foreign tax credit limitation purposes, dividends paid by us will be income from sources outside the United States. Dividends paid by us will not be eligible for the US dividends received deduction.

US Holders are urged to consult their own tax advisers concerning whether they are eligible for benefits under the Treaty, whether, and to what extent, a foreign tax credit will be available with respect to dividends received from us and the treatment of any foreign currency gain or loss on any pounds sterling received with respect to ordinary shares that are not converted into US dollars on the date the pounds sterling are actually or constructively received.

Additional information for shareholders

Taxation of capital gains

Unless a US resident carries on a trade through a branch or agency in the UK, and the disposal of ordinary shares and/or ADSs is related to the activities of that trade, UK capital gains tax is not charged on US residents who dispose of ordinary shares and/or ADSs.

For US federal income tax purposes, a US Holder will recognise a capital gain or loss on the sale or other disposition of ordinary shares or ADSs (if the ordinary shares or ADSs disposed of are held as capital assets) in an amount equal to the difference between the US Holder's adjusted tax basis in the ordinary shares and the amount realised on the disposition. Such gain or loss will be US source gain or loss, and will be treated as long-term capital gain or loss if the ordinary shares have been held for more than one year. The deductibility of capital losses is subject to significant limitations. Capital gains of an individual US Holder are subject to US federal income tax at preferential rates if specified holdings periods are met.

US information reporting and back up withholding

Dividends paid on and proceeds received from the sale or disposition of ordinary shares or ADSs may be subject to information reporting to the IRS and back up withholding at a 31% rate. Certain exempt recipients (such as corporations) are not subject to these information reporting requirements. Back up withholding will not apply, however, to a holder who provides a correct taxpayer identification number or certificate of foreign status and makes any other required certification or who is otherwise exempt. US persons who are required to establish their exempt status generally must file IRS Form W-9 (Request for Taxpayer Identification Number and Certification). Non-US holders generally will not be subject to US information reporting or back up withholding. However, such holders may be required to provide certification of non-US status in connection with payments received in the United States or through certain US-related financial intermediaries. Finalised Treasury regulations have generally expanded the circumstances under which US information reporting and back up withholding may apply.

Amounts withheld as back up withholding may be credited against a holder's US federal income tax liability. A holder may obtain a refund of any excess amounts withheld under the back up withholding rules by filing the appropriate claim for refund with the IRS and furnishing any required information.

UK stamp duty

A transfer for value of an ordinary share will generally be subject to UK stamp duty or to UK stamp duty reserve tax. No UK stamp duty will be payable on the transfer of an ADS, provided that the separate instrument of transfer is not executed in, and always remains outside, the UK.

Inheritance and gift taxes

US-domiciled holders of ordinary shares and ADSs generally will not be subject to UK inheritance tax on a gift of ordinary shares and/or ADSs if the gift would be subject to US federal gift tax. Similarly, ordinary shares and/or ADSs passing on the death of a US-domiciled shareholder generally will not be subject to UK inheritance tax if the estate would be subject to US estate tax.

Exchange controls and other limitations affecting security holders

There are currently no government laws, decrees or regulations in the United Kingdom that restrict the export or import of capital, including, but not limited to, UK foreign exchange control restrictions, or that affect the remittances of dividends or other payments to non-resident holders of the company's ordinary shares, except as otherwise described in *Taxation (US Holders)* above and except in respect of the government of, or any resident of, Iraq or any person treated as so resident. There are no limitations under the laws of the United Kingdom restricting the right of non-residents to hold or to vote shares in the company.

Publications

BT produces a series of reports on the company's financial, economic, social and environmental performance. Most of these reports, which are available to shareholders on request, can be accessed on the internet at **www.groupbt.com/investorcentre**

Document	Publication date
Annual Review including summary financial statement	June
Annual Report and Form 20-F	June
Report for Shareholders	February and September
Quarterly results releases	February, May, July and November
Current Cost Financial Statements for the Businesses and Activities and Statement of Standard Services (as required by Oftel)	September
Social and Environment Report	June
Statement of Business Practice	*(a)*
Quality of Service Report	May and November

(a) First issued in June 1999.

For printed copies, when available, contact the BT Shareholder Helpline on ***Free**fone 0808* ***100 4141*** or, alternatively, contact **The Registrar** in the UK, **BT North America Inc.** in the USA or **The Toyo Trust & Banking Co. Limited** in Japan at the addresses on page 156.

Additional information for shareholders

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Shareholder enquiries
Lloyds TSB Registrars maintain BT's share register and the separate BT EasyShare Service and BT Employee Share Ownership Scheme registers. They also provide a BT Shareholder Helpline service.

Shareholders should contact the Registrar (details above) if they have any enquiries about their shareholding.

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A full list of BT contacts, and an electronic feedback facility, is available at **www.bt.com/talk**

Glossary of terms and US equivalents

Term used in UK annual report	US equivalent or definition
Accounts	Financial statements
Advance corporation tax (ACT)	No direct US equivalent. Tax payable on cash dividends treated as advance payments on the company's UK income tax due
Associates	Equity investees
Capital allowances	Tax depreciation
Capital redemption reserve	Other additional capital
Creditors	Accounts payable and accrued liabilities
Creditors: amounts falling due within one year	Current liabilities
Creditors: amounts falling due after more than one year	Long-term liabilities
Debtors: amounts falling due after more than one year	Other non-current assets
Employee share schemes	Employee stock benefit plans
Employment costs	Payroll costs
Finance lease	Capital lease
Financial year	Fiscal year
Fixed asset investments	Non-current investments
Freehold	Ownership with absolute rights in perpetuity
Inland calls	Local and long-distance calls
Interests in associates and joint ventures	Securities of equity investees
Loans to associates and joint ventures	Indebtedness of equity investees not current
Net asset value	Book value
Operating profit	Net operating income
Other debtors	Other current assets
Own work capitalised	Costs of group's employees engaged in the construction of plant and equipment for internal use
Profit	Income
Profit and loss account (statement)	Income statement
Profit and loss account (under "capital and reserves" in balance sheet)	Retained earnings
Profit for the financial year	Net income
Profit on sale of fixed assets	Gain on disposal of non-current assets
Provision for doubtful debts	Allowance for bad and doubtful accounts receivable
Provisions	Long-term liabilities other than debt and specific accounts payable
Recognised gains and losses (statement)	Comprehensive income
Redundancy charges	Early release scheme expenses
Reserves	Shareholders' equity other than paid-up capital
Share premium account	Additional paid-in capital or paid-in surplus (not distributable)
Shareholders' funds	Shareholders' equity
Stocks	Inventories
Tangible fixed assets	Property, plant and equipment
Trade debtors	Accounts receivable (net)
Turnover	Revenues

Cross reference to Form 20-F

The information in this document that is referred to in the following table shall be deemed to be filed with the Securities and Exchange Commission for all purposes:

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