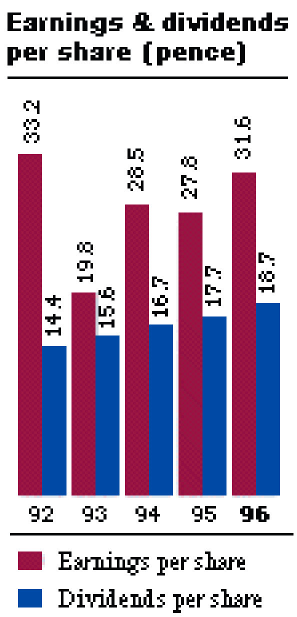
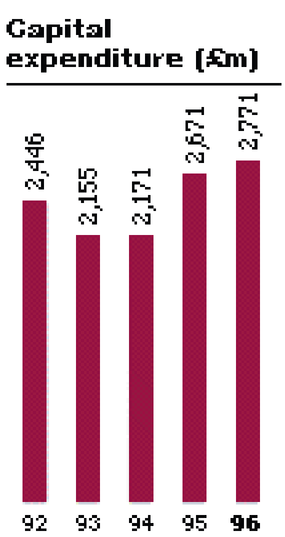
BT Annual Report and Accounts 1996





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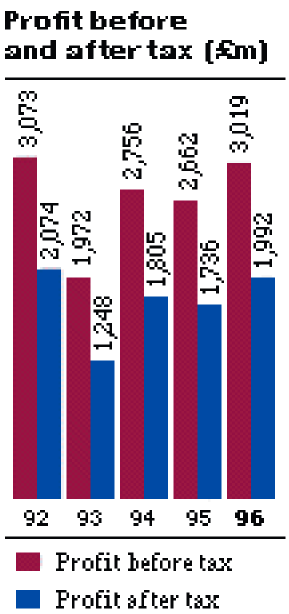

- First national operator in the world to provide per second pricing
- Call prices reduced by over £470 million in the year
- 30 per cent growth in mobile communications turnover with Cellnet customers now reaching 2.4 million
- Over £2 billion spent on modernisation and expansion of BT's networks
- The high and improving level of BT's quality of service compares favourably with its UK competitors
- 5.6 per cent increase in dividends per share

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BT's mission

BT’s mission, our central purpose, is to provide world-class telecommunications and information products and services, and to develop and exploit our networks, at home and overseas, so that we can:

- meet the requirements of our customers,

- sustain growth in the earnings of the group on behalf of our shareholders, and

- make a fitting contribution to the community in which we conduct our business.

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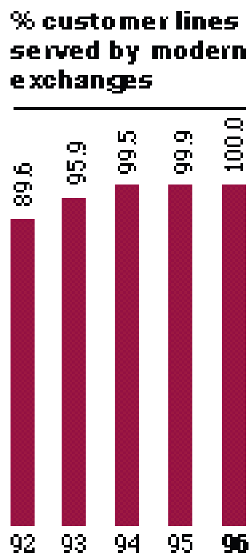
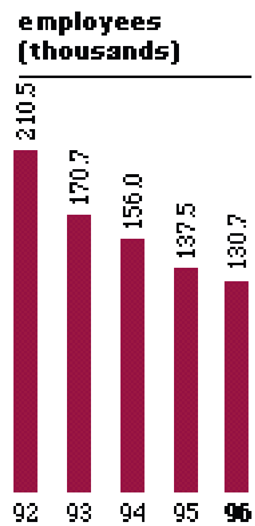
Financial highlights

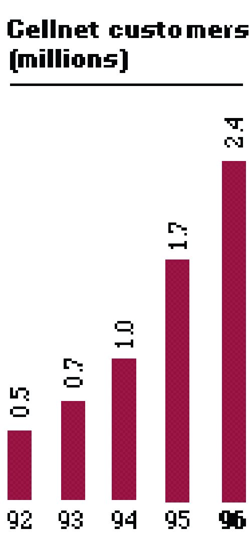
FOR THE YEAR ENDED 31 MARCH 1996

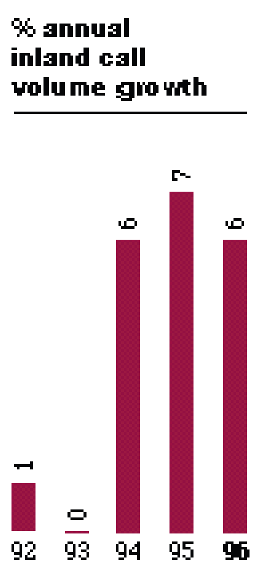
	1996	1995
Turnover	**£14,446m**	£13,893m
Profit before taxation	**£3,019m**	£2,662m
Profit after taxation	**£1,992m**	£1,736m
Earnings per share	**31.6p**	27.8p
Dividends per share	**18.7p**	17.7p
Capital expenditure	**£2,771m**	£2,671m

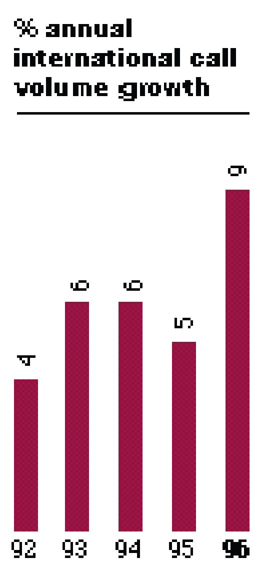
return on capital employed graph











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Chairman’s statement

BT has had a satisfactory year, rather than an outstanding one. The tough regulatory regime and the unexciting growth in the UK economy both took their toll. We have kept our eye on the long run, through focusing on customers, developing high-quality products and services and putting in place the various pieces of our overseas strategic jigsaw.

Turnover grew by 4 per cent, helped by innovative marketing campaigns and continued rapid growth in the mobile telephony market. Although the rate of growth of inland call volumes was down slightly on the previous year, this was offset by significant growth in the number of international calls.The news is good on costs; most of the downsizing exercise is now behind us and efficiency savings are coming through.

The year also saw the first full year’s contribution from MCI, our partner in the United States. Our joint venture company, Concert, has just completed its first trading year and has won $1 billion dollars in committed revenue, with as much again in the pipeline.

In mainland Europe - with the liberalisation in telecommunications just over 18 months away - we have a significant presence in most of the major markets. In the Asia-Pacific region we continue to form special relationships with leading telecommunications companies at a sub-regional level. The termination of merger discussions with Cable and Wireless leaves our strategy unchanged.

Earnings per share increased to 31.6 pence. The recommended final dividend of 11.25 pence per share brings the total dividends for the year to 18.7 pence, an increase of 5.6 per cent on last year.

Competition is now a major factor and we relish it. The UK has 150 licensed operators, including the cable TV companies, and we are competing vigorously and fairly.

The regulatory environment is much the same as when I wrote to all shareholders about it in February. Our view is that Oftel’s proposals will not promote sustainable competition in the telecommunications market but will simply deter investment. They also concentrate too much power in the hands of one individual. I still hope continuing discussions will bring a better result for BT, for our customers, for you, our shareholders, and for the industry.

BT’s long-run trading prospects are very good, but susceptible to short-run turbulence in the regulatory environment, overseas as well as in the UK. We have a talented management team and a committed workforce - under our new Chief Executive, Sir Peter Bonfield. We have a growing focus on our customers’ requirements; we are strong financially and technologically; and we have the right relationships and partners outside the UK. All the main pieces are in place to build a sound future for the group.

Sir Iain Vallance
Chairman
21 MAY 1996

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An interview with Chief Executive, Sir Peter Bonfield

Sir Peter Bonfield joined BT as Chief Executive in January 1996. Sir Peter was chairman and chief executive of ICL from 1985, and remains ICL's non-executive chairman. He is a member of the President's Committee of the CBI and in 1994 he participated in the high-level working group established by the European Union to consider the creation of the Information Society. Welcoming him to BT, Chairman Sir Iain Vallance commended his wide international experience and in-depth knowledge of the computing industry as key to the next phase of BT's future.

What are your first impressions of BT?

I knew BT from the outside before I came here, both in the UK and from an overseas perspective. And I think it's worth repeating that, internationally, BT is very well regarded. It is perceived as the company that has made a success of privatisation, and is making a success of globalisation.

From the inside, my first and overriding impression is of a company facing enormous opportunities in an exciting and dynamic industry.

These opportunities are of three kinds. In the UK, we need to work to grow the market by encouraging greater use of basic telephony services. The advanced services market is also very important for us. New technology is making possible new ways of accessing and interacting with information. Finally, as telecoms markets around the world liberalise, major opportunities will be created for those companies that are fast enough on their feet.

What is your vision of the kind of company BT might become?

BT's vision says it all really: to become the most successful worldwide telecommunications group.

Few other companies could even aspire to such a goal, so how are we going to do it? Well, for a start, we need to be even more focused on customer requirements; more committed, innovative and flexible and quicker to market. But, we also have to do new things in new ways. BT is a company in transition - from telecommunications company to communications company.

What issues are at the top of your list of priorities?

First and foremost, is continuing to deliver world-class services to all our customers at a cost that compares well with the best in the world.

To do this, I have to focus on the people, resources, skills and systems we will need to become more flexible, more decisive and more accountable. At the moment, I am introducing trading units, with individual managers having much greater responsibility and accountability for their profit and loss performance. And we need to be better at judging our performance by the measures that really matter to our customers. Then there is the share price, which has hadits upsand downs in the last few years. My entire team is committed to making long-term shareholder value a priority.

It is also vital that we continue to develop as a global player in a global market, either through direct entry or joint ventures and partnerships of all kinds. The termination of merger discussions with Cable and Wireless in no way changes our basic strategy; the credibility of the BT/MCI alliance in global markets is uniquely high and many other players want to join our 'family'.

And finally, but not least, there is developing revenues - and I mean profitable revenues - in advanced services: Internet services, multimedia, systems integration and so on.

How are you finding working in an industry that is as highly regulated as BT?

Regulation is a fact of life. It is one of the issues that we have to deal with, but then all companies have issues that they have to deal with. Nor is it special to the UK; all the overseas markets that we operate in are regulated to some degree.

As we go to print we are awaiting the outcome of Oftel’s consultation on the price cap that will apply to many of our main prices from the middle of next year. The media have tended to present this as a confrontation between BT and Oftel. This is wrong. It is a debate about the industry as a whole, about whether or not the regulator is genuinely promoting competition or risking stifling investment.

Also at stake are the powers that the regulator wishes to adopt to deal with what he regards as anti-competitive behaviour. We have been arguing for some time that too much power should not be invested in one person and that the regulated companies should have a right of appeal against decisions that they feel are misguided.

BT has welcomed the DTI’s Information Society initiative; will BT be playing a part in the development of the Information Society?

The answer is, of course, yes. But, inevitably, it again raises the issue of regulation. My view is that the Information Society will only be built with private capital, but that will only happen if there is incentive to encourage the necessary investment.

BT is already involved in a number of products and services relating to education, healthcare, entertainment, public information and so on. We are well into a major marketing trial of interactive services, including video on demand, home-banking and home-shopping. Just in the last few months we have introduced a BT Internet service and Wireplay, a multiplayer games service.

These new services show that commercial and social benefit can be two sides of the same coin. There are still major issues to be resolved, issues like the usability, cost and availability of the new services, but I do believe that our industry can be seen, and will continue to be seen, to be making a genuine contribution to the communities in which we operate.

Sir Peter Bonfield CBE
Chief Executive
21 MAY 1996

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This is BT

BT is one of the world's leading providers of telecommunications services. Its main products and services are local, long-distance and international calls (with direct dial connection to more than 230 countries); telephone lines, equipment and private circuits for homes and businesses; providing and managing private networks; and supplying mobile communications services.

The telecommunications market is one of the most rapidly changing in the world today. It is an industry which affects all our lives. Telecommunications networks are society's nervous system, critical to industrial competitiveness and social cohesion.

Our customers range from the single line domestic user to some of the world's largest multinationals. In the UK, BT has 20.5 million domestic and 6.8 million business exchange lines. BT handles about 100 million local, national and international calls every day.

BT employs around 130,000 people.

BT was incorporated as a public limited company in the UK in 1984. It has more than 2.3 million shareholders and is listed on the stock exchanges in London, New York and Tokyo.

In 1994, BT's UK operation became the largest single organisation in the world to receive company-wide registration under the international quality standard ISO 9001.

In the UK, BT operates under a licence, the terms of which require it to provide telecommunications services throughout the UK (with the exception of Kingston-upon-Hull, which runs its own service), publish standard terms for providing services and, year on year, reduce its prices overall in real terms for a "basket" of its main services. BT and its competitors in the UK telecommunications industry are regulated by the Office of Telecommunications (Oftel).

BT's corporate strategy is to:

- **develop and grow new business in the UK market - now the most open and competitive in the world, with more than 150 licensed operators;**
- **expand into new services such as interactive TV and multimedia; and**
- **expand overseas in chosen markets, both alone and through partnerships.**

BT’s 20 per cent stake in MCI Communications Corp, the USA’s second largest long-distance operator, gives it a significantly enhanced position in North America. The strategic alliance between BT and MCI has resulted in the setting up of a joint venture company - Concert - which offers a 'one-stop shopping' facility for customers with global communications needs.

In mainland Europe, BT is involved in joint ventures with Banco Santander, one of Spain’s largest banks; the German industrial group, VIAG; and with Banca Nazionale del Lavoro in Italy.An arrangement is also in place with Danish and Norwegian telecommunications operators to offer telecommunications services in the Swedish market.

In the Asia-Pacific region, BT has partners or distributorship arrangements in a number of countries, including Hong Kong, India, Indonesia, Japan, Korea, Malaysia, New Zealand, Singapore, Taiwan and Thailand.

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Business review

Highlights of the year

- **Following the introduction of per second pricing in June last year - BT is the first national operator in the world to provide this facility on all direct dialled calls - there was an immediate price reduction. This and other price cuts have encouraged customers to make more and longer calls.**

- Over 90 per cent of our customers can now take advantage of advanced network services such as Caller Display, Call Return and a whole range of billing options. A new service, Call Minder, was launched in May last year.

- **At the end of March 1996, Cellnet - the company jointly owned by BT and Securicor - had almost 2.4 million customers (up 655,000 in the year) and the number grew by about three per cent a month.**

  Mobile customers are also benefiting from substantial price cuts of up to 30 per cent which became effective in March. Prices of digital calls were reduced, off peak time was increased and per second billing was launched.

- An initiative that has generated a good deal of public interest is the consumer test marketing of interactive services, which began in East Anglia last year. In the trial, customers use a special set-top box linked to the telephone line to watch films and TV programmes on demand, buy goods and services, shop, download games and carry out banking transactions - all from the comfort of their armchairs.

- **Concert - the joint venture between BT and MCI - is growing rapidly, with more than $1 billion of committed revenue and a further billion in the pipeline. Concert covers 60 countries and now has around 2,500 customers.**

- Another new service launched during the year was CampusWorld - one of the world's largest on-line networks providing a dedicated service for education. By accessing the Internet through CampusWorld, educationalists can find what they need quickly and easily. About 2,000 primary and secondary schools had subscribed by March 1996.

- **BT and VIAG, who have already formed a joint venture company known as Viag Interkom, moved towards forming a triple alliance with German industrial group RWE to offer telecommunications services in Germany, the largest telecommunications market in Europe.**

- BT Internet went live in February. A mass market, dial-up service aimed at residential customers, it offers worldwide electronic mail and access to vast quantities of information through the World Wide Web.

- **Overall customer satisfaction with BT remains high. Latest figures show that 86 per**

cent of residential customers and 79 per cent of business customers are satisfied with the company's services.

- In the year, we significantly increased our marketing efforts. The "*It's good to talk*" campaign was complemented by the "*Work smarter, not just harder*" campaign aimed at businesses, and a series of pricing campaigns aimed at dispelling some of the myths about BT prices.

- **BT won some notable contracts, including a £70 million deal over five years with theLloydsTSB Group for new data links and a £40 million link-up over seven years with the Inland Revenue for a new data network.**

The network

At the core of all BT's operations is its network - one of the most advanced and sophisticated in the world.

Keeping pace with technology is a continual challenge, and BT spent more than £2 billion in the year on modernising and expanding its networks and supporting systems. This investment enables BT to reduce operating costs, while atthe same time offering new and innovative services to our customers.

Digital technology and optical fibres enable the network to carry a range of services simultaneously, including high-speed data, images and text, and the growing volume of Internet traffic. 100,000 business customers across the UK are already within reach of direct fibre links. These "broadband" networks are the foundation of the Information Society of the future.

BT's investment in the integrated services digital network (ISDN) is enabling customers to change the way they work. Examples include an insurance company using ISDN to add video images to accident claims, and a hospital that has started taking remote, freeze-frame shots during the filming of operations. Other services such as videoconferencing bring the concept of the "virtual office" a step nearer.

New technology has also improved the quality and reliability of our traditional phone services and a landmark was achieved in June 1995 when we completed the process of connecting all our customers to digital or modern electronic exchanges. We have modernised our computer systems to provide our sales and support people with all the information they need to serve customers.

Working with our partners worldwide, we have also invested in technology to deliver innovative business solutions to customers with global operations.

Pricing

The downward trend in BT's prices has been maintained.

Since privatisation in 1984, BT's main call prices have fallen on average by nearly 53 per cent in real terms. And, since November 1993, average call bills have fallen in real terms by around 24 per cent for BT's business customers and 27 per cent for residential customers. This has represented total annual savings for BT customers of around £1 billion.

An independent report from the OECD shows that the UK's telephone prices are now among the lowest in the world.

Nevertheless, the impression remains that BT is expensive.When asked to estimate the costs of certain types of calls, customers tend to overestimate the charge, sometimes by as much as 600 per cent. BT regards the closing of this gap between perception and reality as an urgent priority and has commissioned pricing advertising aimed at both residential and business customers.

The number of customers taking advantage of BT's residential discount packages - now offering savings of up to 25 per cent on calls - continues to rise. Membership of *PremierLine* doubled in the year, and the number of customers who have opted for *Friends & Family* trebled.

Mobile communications

One of the major success stories of the year for BT was the continuing rise in demand for mobile telephony services - not only in the business sector but among residential customers, too.

Cellnet's current project to create the world's most advanced mobile phone network brings its total investment in cellular telephony to more than £1 billion. Cellnet's introduction of digital technology, which conforms to the Global System for Mobile Communications (GSM) standard, began at the end of 1993 and is now complete across the UK.

Customers can also use their digital phones internationally in more than 35 different countries and across more than 50 networks, including most of Europe and Australia as well as parts of Africa and the Far East, without needing to contact the local operator.

Outside the UK

It is several years since BT made its first moves into the global marketplace and the group is now well established as one of the leading global operators.

Its highly-focused strategy remains the provision of network-based services to multinational customers and their extended enterprises in Europe, North America and the Asia-Pacific region.

BT has had a 20 per cent stake in MCI, North America's second-largest long-distance carrier, since 1994. The two companies established a joint venture company - Concert - to address the global telecommunications needs of large multinationals.

The rapid roll-out of the Concert network continues: last year, capacity for voice and data services grew several fold. Concert now has the most extensive packet switching and international frame relay networks anywhere in the world, and the largest non-correspondent, intelligent voice network.

At the end of 1995, we were able to launch the second generation of Concert voice and data products, before our competitors had brought a first generation to market.

In Europe, BT now has partners in most of the major markets: Germany, Italy, Spain and Scandinavia.

In the Asia-Pacific region, BT has an agreement with Nippon Information and Communication to distribute Concert products to its customers in Japan, where BT also has a joint investment with Marubeni Corporation in the value-added services company, NIS. A joint venture has also been established with Wipro - a market leader in information technology in India - to provide telecommunications services for business customers and, in March 1996, BT took a 25 per cent stake in Clear Communications, New Zealand's second largest telecommunications company.

Quality of service

One of the cornerstones of BT's continuing success is its fierce determination to improve constantly the quality of all its services for customers.

In the past 12 months we have put in place a number of initiatives aimed at boosting the effectiveness of the company's field engineering force. There has been particular emphasis on achieving quality workmanship in repair operations, while other measures have focused on improving productivity and reducing costs.

To ensure that our customers are receiving the service they require, we have a comprehensive programme of customer opinion research. Our customer satisfaction measures are based on about 30,000 interviews every month with our residential customers and 13,000 a month with our business customers.

For the six months to March 1996, more than 98 per cent of business and residential orders were completed by a date confirmed with the customer. Nearly 90 per cent of faults experienced by business customers were cleared within five working hours or by successful appointment. More than 82 per cent of repairs to faults experienced by residential customers were cleared within the target time.

Operator Services, including Directory Assistance, and the public payphone service also worked to high standards of performance and produced good customer satisfaction levels.

Reports comparing the performance of major telecommunications operators in the UK against key quality measures are now issued regularly by Oftel. These show that BT compares very favourably with its competitors in almost every area and validate the data BT has gathered and published in the past few years, showing the high and improving level of BT's quality of service.

Competition

Competition, of course, remains a constant spur to BT. The UK telecommunications market is now the most open in the world, with more than 150 licensed operators. BT is determined to defend its position and help to grow the market overall by continuing to provide top quality innovative products and services.

BT has continued to make its presence felt through its Local Partnership campaigns. Following the success of earlier events in Bristol, Birmingham, Leeds and Bradford, attention was turned last year to Cardiff and the Solent area. Once more, valuable extra revenue was generated as teams of BT volunteers took to the streets with members of the permanent sales force to spread the BT message among the community. Even so, the overall number of residential lines declined slightly for the first time.

BT has also been successful in regaining the business of customers who had moved to the competition.

BT people

For BT people, it was another eventful 12 months. The company-wide voluntary redundancy programme was operated for the last time during the year. By the end of March 1996, around 130,000 people were employed by BT, compared with 227,000 five years ago.

For those who have stayed with the company, there were major development and training opportunities - averaging over three days per person at formal events and a similar amount of time spent on "in job training" and other activities to help equip our people for the BT of the future.

BT continues to promote the health, safety and welfare of all its employees.

The company remains committed to providing equal opportunities for all its people and actively encourages the employment, training and career development of disabled people. BT has emphasised its commitment to equal opportunities by registering under the Government's Two Ticks disability scheme for organisations which can demonstrate a positive approach towards people with disabilities.

Employees' opinions are actively sought and an annual company-wide attitude survey gives people full scope to air their views.

As well as providing a range of publications and briefings, BT operates a formal team meeting system, broadcast news services and a business TV channel.

BT continues to consult and negotiate with recognised trade unions. Building on our platform of good employee relations in the UK, we have established, with the support of the UK unions, the BT European Consultative Council. The inaugural meeting is planned for the end of June 1996.

Corporate citizenship

BT's programme of community involvement is one of the largest of its kind in the UK.

During the year, BT made contributions to the community in cash and kind worth £15 million, with total donations to charity exceeding £2.7 million. No contributions were made to any political party.

The company is focusing its community involvement increasingly on areas which relate to its business and the particular contribution its technology can make.

BT's work with community organisations often provides the leverage to obtain funds from other sources. For example, the Gatehouse Centre, an enterprise, training and community development complex in Bristol, received £100,000 from BT. This, in turn, released a total of £1 million from the Department of the Environment and Bristol City Council.

Participative fund-raising projects, such as the BT Swimathon, demonstrate that BT money helps generate further funding for good causes. The main beneficiary of this year's BT Swimathon was ChildLine, which received £1.2 million.

In education, the company's major commitment is to promote telecommunications and information technology to equip young people for modern industrial society.

BT offers a Light User discount scheme for those who need the phone as a lifeline but who make few calls. Approximately one in five of BT's customers is eligible for this discount.

In the past year, BT's commitment to meeting the needs of customers with disabilities has been recognised by two prestigious awards - the 1995 Communicator of the Year award from the Royal National Institute for Deaf People, and the See it Right award from the Royal National Institute for the Blind.

Customer consultation

Liaison panels, established throughout the UK, are at the heart of the company's consumer consultation programme and ensure that the needs of individual customers are reflected in BT's policy making and product and service developments.

The environment

BT sets new targets for environmental improvement each year and progress is documented in an annual *Environmental Performance Report*. For a copy, call (0171) 356 5636.

Total energy consumption over the last four years has been reduced by over 13 per cent.

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Financial review

Introduction

BT's earnings of 31.6 pence per share for the year ended 31 March 1996 were 13.7% above the previous year's, principally because of lower redundancy and interest costs. The results have benefited from the strong growth in demand for BT's products and services and the improved efficiencies brought about by the redundancies of recent years, but the continuing impact of price reductions has offset much of these benefits. The group's results are summarised in the following table:

	1996 £m	1995 £m	Increase (decrease) %
Turnover	**14,446**	13,893	4.0
Operating costs before redundancy costs	**10,925**	10,410	4.9
Redundancy costs	**421**	820	(48.7)
Operating profit	**3,100**	2,663	16.4
Group's share of profits of associated undertakings	**82**	92	
Profit on sale of group undertakings	**7**	241	
Net interest payable and premium	**(170)**	(334)	
Profit before taxation	**3,019**	2,662	13.4
Taxation	**1,027**	926	
Profit after taxation	**1,992**	1,736	14.7
Minority interests	**6**	5	
Profit for the financial year	**1,986**	1,731	14.7
Earnings per share	**31.6p**	27.8p	13.7

Regulation and prices

BT's main UK services, principally inland and outgoing international call services and exchange line rentals, are subject to price regulation. BT reduced its overall prices for its main UK services by over 7% in the price control year ended 31 July 1995 in accordance with the regulatory arrangements in force from August 1993 to July 1997, under the RPI minus 7.5 formula. These price reductions included those made at the end of June 1995 to coincide with the change to the per second method of pricing calls and those introduced in September 1994.

The RPI minus 7.5 price control is estimated to have affected about 52% of the group's total turnover for the year ended 31 March 1996. And, if the RPI at June 1996 shows an annual increase at the same rate as the 2.4% increase experienced for the twelve months to April 1996, the price control will require the group to reduce prices of its main services during the year commencing 1 August 1996, by about 5.1%. A further reduction of about 1.4% must also be made before the current price control year ends on 31 July 1996.

Oftel is currently consulting with BT and other interested parties, including competitors, consumers and others outside the industry, on the structure of the successor price control to the current RPI minus 7.5 formula, which expires on 31 July 1997.

Competition and the UK economy

BT has a significant market share in its main UK markets for telephone calls and provision of exchange lines. However, competition has eroded BT's market share signficantly in key market sectors and in particular areas of the UK and for certain products and services. Cellnet faces strong competition from its direct competitor and the two personal communications operators in the UK.

BT expects a continuing increase in competitive pressure as a result of the growth in market share of recent entrants to the UK telecommunications industry. BT will defend its markets vigorously but nevertheless the company expects that the overall impact of these competitors will become increasingly material.

The strength of the UK economy is an important determinant of BT's business volumes and the gross domestic product grew by 2.0% in the year ended 31 March 1996, compared with 3.9% in the previous year.

Turnover

Total turnover grew by 4.0% to £14,446 million in the year. The strong growth in demand for the group's products and services of approximately 8% was partially offset by the effect of price reductions which averaged nearly 4% across the business.

The group's turnover is analysed as follows:

	1996 £m	1995 £m	Change %
Inland telephone calls	**4,882**	4,941	(1.2)
International telephone calls	**1,980**	1,935	2.3
Telephone exchange line rentals	**2,685**	2,534	6.0
Private circuits	**1,056**	1,024	3.1
Customer premises equipment supply	**946**	1,041	(9.1)
Mobile communications	**856**	657	30.3
Yellow Pages directories	**408**	371	10.0
Other sales and services	**1,633**	1,390	17.5
Total turnover	**14,446**	13,893	4.0

Price reductions had a major impact on inland telephone call turnover for the second year in succession. The combined effect of the price changes described above totalled over £330 million, which was equivalent to a 7% reduction in call prices following a 12% fall in the previous year. Call volume growth of 6% largely mitigated the price reduction effect, resulting in total inland call turnover declining by 1.2% in the year.

International call turnover rose by 2.3% as a result of strong call volume growth of 9% offset by price reductions averaging about 7%.

Turnover from exchange line rentals grew by 6.0%. The increased turnover was the combined result of a 5% price increase in February 1995 and the growth in business line connections. The number of these connections grew by 5.2% in the year with high speed digital ISDN services contributing significantly to the growth. For the first time, the numbers of residential lines declined due mainly to the new competition from the cable operators. Although the decline was slight, being limited to 113,000 lines, it partially offset the growth in business lines and BT's total exchange line connections grew by 0.8% to 27.3 million.

Cellnet added 655,000 telephone users to its network in the year to bring its total to just under 2.4 million, almost matching that of its major UK competitor. Mobile communications turnover consequently grew by 30% in the year to £856 million. The continuing high costs of this expansion have been included in the results.

BT's expansion worldwide with Concert services was a primary reason for the 17.5% increase in other sales and services. Concert, BT's joint venture company with its US partner, MCI Communications Corporation, specialises in products and services for multinational businesses and provides services in 60 countries.

Operating costs

Total operating costs increased by 1.0% in the year. Significant decreases in redundancy and employment costs were more than offset by higher sales related costs and payments to other operators for terminating calls on their networks.

	1996 £m	1995 £m	Change %
Staff costs	**3,680**	3,912	(5.9)
Own work capitalised	**(417)**	(460)	(9.3)
Depreciation	**2,189**	2,137	2.4
Payments to telecommunication operators	**1,383**	1,192	16.0
Other operating costs	**4,193**	3,758	11.6
Other operating income	**(103)**	(129)	(20.2)
Total operating costs, before redundancy charges	**10,925**	10,410	4.9
Redundancy charges	**421**	820	(48.7)
Total operating costs	**11,346**	11,230	1.0

Total operating costs as a percentage of total turnover decreased from 80.8% in the previous financial year to 78.5%. Excluding redundancy charges, operating costs as a percentage of turnover increased by nearly one percentage point over the previous year.

The group's operating efficiency continued to improve with a reduction of 6,800 people employed in the year, compared with a reduction of 18,500 in the previous year. Staff costs were reduced by 5.9% as a result of savings from these reductions more than offsetting pay increases.

Payments to other telecommunication operators increased by 16.0% as the result of the growing number of calls terminating on UK competitors' networks, the increased volume of outgoing international calls and BT's expanding operations overseas.

Other operating costs, which rose by 11.6% in the year, include the maintenance and support of the networks, occupancy costs and the cost of sales of customer premises equipment. The rapid expansion of Cellnet’s services has resulted in additional costs being incurred in winning new business and supporting additional customers. Higher expenditure on these cellular and other marketing activities were the main factors behind the increase in costs. A further contributor to the increase was the cost of Concert’s expanding operations.

The redundancy costs incurred as a result of the workforce reductions discussed above totalled £421 million in the year, compared with £820 million in the previous year. The lower costs reflect the fewer number of people leaving the group during the year. BT will be continuing to reduce the number of employees, but at a slower pace than in recent years.

Operating profit

Operating profit for the year of £3,100 million was £437 million higher than in the previous year. Of this increase, £399 million was attributable to the lower redundancy costs and, after adjusting for this, the group’s underlying operating profit was 1.1% higher than in the previous year.

Associates, disposals and interest charge

The group’s £82 million share of profits of associated undertakings consists primarily of the company’s share of MCI’s profits less BT’s share of start up losses in its joint ventures in Germany and Sweden. The amount is stated after taking into account BT’s £73 million share of a restructuring charge incurred by MCI in the year. MCI, in which BT has held a 20% interest since September 1994, is growing rapidly with turnover up by 14% in its last financial year.

The profit on disposal of group undertakings in the previous year arose primarily from the sale of AT&T Corporation shares which had been converted in 1994 from BT’s interest in McCaw Cellular Communications, Inc., a former associate.

The net interest charge of £170 million was £89 million or 34.4% lower than the interest charge in the previous year, after excluding the premium of £75 million incurred on repurchasing Government held bonds in that year. The lower charge was due to strong positive cash flow and the repayment of significant amounts of high coupon debt in the previous year. The net interest charge was covered 18.2 times by operating profit.

Profit and taxation

The group’s profit before taxation for the year was £3,019 million, an increase of 13.4% on the previous year. The tax charge of £1,027 million as a percentage of profit before taxation was 34.0%, compared with 34.8% for the previous year.

Earnings and dividends per share

Earnings per share, based on a profit for the financial year of £1,986 million, were 31.6 pence.

The dividends paid and recommended of 18.7 pence per share represent a 5.6% increase on the previous year and are covered 1.7 times by earnings. The dividends comprise the interim dividend of 7.45 pence per share, which was paid in February 1996, and the proposed final dividend of 11.25 pence per share which, if approved at the annual general meeting, will be paid on 16 September 1996 to shareholders on the register on 13 August 1996. The dividends absorb £1,184 million.

Financing

	1996 £m	1995 £m
Net cash inflow from operating activities	**5,829**	5,113
Net cash outflow from returns on investments and servicing of finance	**(1,283)**	(1,407)
Tax paid	**(784)**	(1,175)
Net cash outflow from investing activities	**(3,156)**	(2,861)
Net cash inflow (outflow) before financing	**606**	(330)
Net cash inflow (outflow) from financing	**215**	(160)
Net increase (decrease) in cash and cash equivalents	**821**	(490)
Decrease (increase) in net debt	**1,319**	(2,146)

Net cash inflow from operating activities of £5,829 million in the year was 14.0% higher than in the previous year. This improvement in part reflects the lower redundancy costs in the year and the absence of an additional contribution to the pension fund, compared with a £250 million payment in the prior year.

Tax paid in the year, principally on the prior year's profit, amounted to £784 million. The decrease of £391 million on the previous year is mainly due to the timing of tax payments made.

Net cash outflow from investing activities of £3,156 million mainly comprises expenditure on plant, equipment and property of £2,547 million.

In the year, the group drew down £175 million in long-term loans and long-term debt repaid totalled £133 million. During the year, the group also received £130 million for new shares subscribed by employees under share option schemes.

Treasury policy and capital resources

The group has a centralised treasury operation. Its primary role is to manage liquidity, funding, investment and the group's financial risk, including risk from volatility in exchange 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 department's policy and its activities are subject to a set of controls commensurate with the magnitude of investments and borrowings 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.

At 31 March 1996, the group had cash and short-term investments of £2,689 million. At that date, £13 million of short-term debt was outstanding.

The ratio of net debt (borrowings net of cash and short-term investments) to shareholders' equity and minority interests was 7.4% at 31 March 1996, compared with 17.8% at 31 March 1995. The group had £948 million net debt at 31 March 1996, a decrease of £1,319 million in the year through cash flow.

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.

Capital expenditure

Capital expenditure on plant, equipment and property totalled £2,771 million in the year, £100 million higher than the amount spent in the previous year. Continued modernisation of the local access network, telephone exchanges and construction of Cellnet's digital GSM network constituted the main areas of spend. Nearly 88% of customer lines are now served by digital exchanges and Cellnet has over 350,000 connections on the GSM network.

The group expects capital expenditure in the year ending 31 March 1997 to be at a slightly higher level than that in the year under review. BT expects that future capital expenditure will be provided from net cash inflows from operating activities supplemented, if appropriate, by external financing.

Goodwill

MCI completed a significant acquisition of an information technology business in November 1995 for approximately $1,100 million. BT's share of goodwill arising on this acquisition is the main element of the £302 million written off to group reserves in the year, in line with BT's accounting policies.

Return on capital employed

The group made a return of 18.3% on the average capital employed, on an historical cost basis, in its business in the year ended 31 March 1996, compared with a return of 15.6% in the previous year. The higher return is due to the lower level of redundancy costs in the year under review.

Foreign currency exposure

Most of the group's 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 £1,032 million at 31 March 1996, are used to finance its UK operations and to finance the group's overseas investments, including MCI, in order to reduce the currency exposure on the underlying assets. Cross currency swaps have been entered into to minimise the foreign currency exposure on the borrowings used to finance the group's operations. The group also enters into forward foreign exchange contracts to hedge interest expense, purchase and sale commitments. The commitments hedged are principally US dollars. As a result of these policies, the group's exposure to foreign currency arises mainly on the residual currency exposure on overseas investments and on any imbalances between the value of outgoing, transit and incoming international calls with overseas telecommunication operators. 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.

BT's expanding overseas operations are likely to lead to a gradual increase in its foreign currency exposure in the future.

Monopolies and Mergers Commission

The Monopolies and Mergers Commission (MMC) reported during the year on the matter referred to it by Oftel relating to the responsibility for bearing the costs of number portability.

The MMC decided that BT should bear a significant part, but not all, of these costs and, indeed, less of the costs than proposed by Oftel. Number portability, which has yet to be introduced on a wide scale, will make it easier for BT's customers to switch to an alternative operator and may lead to a loss of turnover.

The MMC also reported on BT's Yellow Pages directories business referred to it by the Office of Fair Trading, in view of its large market share in the specialised classified directory advertising industry. As a result of the report, BT's directory advertising prices are to be controlled under an RPI minus 2 formula, similar to that on BT's main services discussed above, and BT will be limited to publishing one directory in any one area. BT will be required to publish financial information relating to this business.

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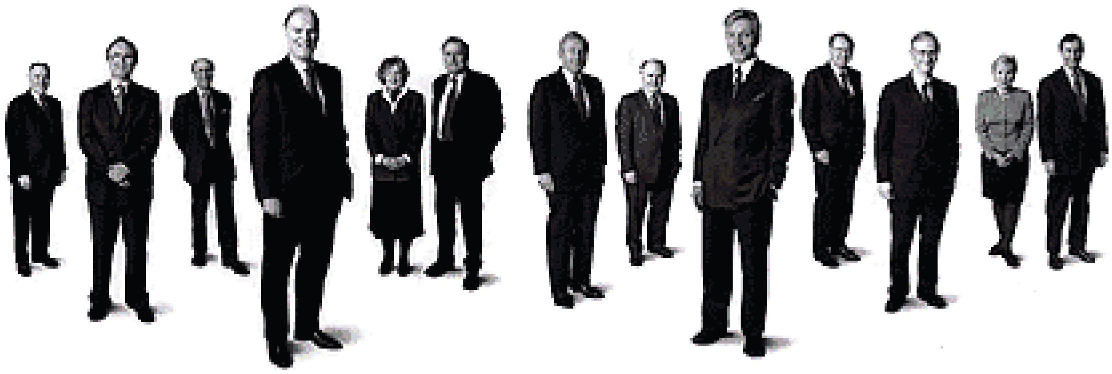
Board of directors

EXECUTIVE DIRECTORS



LEFT TO RIGHT: Bert C Roberts Jnr, Robert Brace, The Rt Hon Lord Tebbit, Sir Iain Vallance, Birgit Breuel, Sir Ewen Fergusson, Sir Colin Marshall, Dr Iain Anderson, Sir Peter Bonfield, Malcolm Argent, Dr Alan Rudge, Yve Newbold, Keith Oates.

Sir Iain Vallance *Chairman (a) (i) (j)*
Sir Iain joined the Post Office in 1966. Appointed a director of the company in 1984, he served as Chief Executive from 1986 until December 1995 and has been Chairman since 1987. Sir Iain is non-executive vice chairman of the Royal Bank of Scotland and also chairman of the Princess Royal Trust for Carers. Aged 53.

Sir Peter Bonfield CBE *Chief Executive (a) (b) (c) (i)*
Sir Peter was appointed to the Board on 1 January 1996 as Chief Executive. He is a director of BT's associated company, MCI Communications Corporation. 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, most recently as chairman and chief executive. Sir Peter is currently non-executive chairman of ICL and a non-executive director of Zeneca. Aged 51.

Dr Alan W Rudge CBE *Deputy Chief Executive (a) (b) (c)*
Dr Rudge FRS FEng FIEE joined BT in 1987 and was appointed to the Board in 1989. He became Deputy Chief Executive in January 1996. Dr Rudge is also a director of MCI Communications Corporation. He is chairman of the Engineering Council and the Engineering and Physical Sciences Research Council, and a past president of the Institution of Electrical Engineers. Aged 58.

Robert P Brace FCA *Group Finance Director (a) (b) (c) (e) (g)*
Mr Brace joined the company in 1989 and was appointed to the Board in 1993 as Group Finance Director. A career-long finance professional, he started with Peat Marwick Mitchell (KPMG) in 1971 and subsequently held senior finance roles with Unipart and Black & Decker.

Mr Brace chairs BT's Welsh Advisory Forum. Aged 46.

NON-EXECUTIVE DIRECTORS

Sir Colin Marshall *Deputy Chairman (a) (d) (h) (j)*
Sir Colin was appointed a director on 1 April 1995 and became Deputy Chairman in January 1996. He ceased to be chairman and chief executive of British Airways at the end of 1995, but remains non-executive chairman. Sir Colin is also non-executive chairman of Inchcape, a non-executive director of HSBC Holdings, the New York Stock Exchange and Qantas Airways and president of the Confederation of British Industry. Aged 62.

Dr Iain Anderson *(d) (e) (h)*
Dr Anderson was appointed to the Board on 1 November 1995. He is chairman of the chemicals sector of Unilever, for whom he has worked since 1965. Dr Anderson joined the Unilever board in 1988. He has post-doctorate qualifications in microbiology from both Glasgow and Massachusetts Universities. Aged 57.

Malcolm Argent CBE *(c) (d) (e) (f) (g) (j)*
After a career in the Post Office, Mr Argent was appointed Secretary of the company in 1984 and a director in 1989. Since retiring in August 1994, he has served on the Board as a non-executive director. Mr Argent is deputy chairman of the Civil Aviation Authority and a non-executive director of Clerical Medical and General Life Assurance Society and Westminster Health Care Holdings. Aged 60.

Birgit Breuel *Germany*
Appointed to the Board as a non-executive director on 1 April 1995, Mrs Breuel is general commissioner of EXPO 2000 and was previously president of Treuhandanstalt, the agency responsible for the privatisation of industry in the former East Germany. Mrs Breuel is also a non-executive director of Daimler-Benz and Novartis. Aged 58.

Sir Ewen Fergusson GCMG, GCVO *(h)*
Sir Ewen was appointed a director in 1993, having retired as HM Ambassador to France after a 36 year career in the Diplomatic Service. He is non-executive chairman of Coutts & Co and the Savoy Hotel and a non-executive director of the Sun Alliance Group. Sir Ewen chairs BT's Scottish Advisory Forum. Aged 63.

Yve Newbold *(d) (f) (h)*
Appointed to the Board in 1991, Mrs Newbold is a solicitor and chief executive of PRO NED. She was company secretary of Hanson from 1986 to 1995. Mrs Newbold is also a non-executive director of Coutts & Co and a governor of the London Business School. Aged 55.

Keith Oates *(d) (h) (j)*

Mr Oates was appointed a director in June 1994. He is deputy chairman and managing director of Marks and Spencer. Mr Oates' international experience includes working for IBM, and Black & Decker. He is also a non-executive director of Guinness and a member of the Sports Council of Great Britain. Aged 53.

Bert C Roberts Jnr USA
Mr Roberts joined the Board as a non-executive director in October 1994. He is chairman and chief executive officer of BT's associated company, MCI Communications Corporation, based in Washington DC. Aged 53.

The Rt Hon Lord Tebbit CH *(d) (h) (j)*
A former MP, Lord Tebbit became Secretary of State for Employment in 1981, Secretary of State for Trade and Industry in 1983, and Chancellor of the Duchy of Lancaster and chairman of the Conservative Party in 1985. Having left the Government, he joined the Board as a non-executive director in 1987. Lord Tebbit is also a non-executive director of Sears and The Spectator. Aged 65.

(a) Member of *Chairman's Committee*
(b) Member of *Executive Committee*
(c) Member of *Investment Committee*
(d) Member of *Board Audit Committee*
(e) Member of *Board Committee on Pensions*
(f) Member of *Board Community and Charities Committee*
(g) Member of *Board Committee on Incentive Schemes*
(h) Member of *Board Committee on Executive Remuneration*
(i) Member of *Board Committee on Non-Executive Remuneration*
(j) Member of *Nominating Committee*

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Corporate governance

The directors consider that during the year BT has fully complied with the *Code of Best Practice* published by the *Committee on the Financial Aspects of Corporate Governance* (the "Cadbury Committee") and complies with Section A of the best practice provisions of the Stock Exchange Listing Rules introduced following the publication of *Directors' Remuneration - Report of a Study Group chaired by Sir Richard Greenbury* (the "Greenbury Report").

The Board

The Board meets regularly to consider matters specifically reserved for its attention. It sets the strategic direction of the group and monitors overall performance.

The majority of the directors are non-executive and, between them, have a wide range of experience at a senior level in international, legal, marketing, government and diplomatic affairs. Seven of the nine non-executive directors are independent of the management of BT, either being free from any business or other relationships which could materially interfere with the exercise of their judgement or not previously involved in the management of BT.

Non-executive directors have normally been appointed for periods of three years. Towards the end of that period, the Board has considered whether to continue the appointment for a further period. The Board has now agreed that non-executive directors will normally be appointed initially for three years. At the end of that period it will consider whether to continue the appointment, which will then become terminable on twelve months' notice from either BT or the director. Appointments will be reviewed again by the Board at the end of the sixth year. Normally, appointments will be for a maximum of ten years.

The non-executive directors provide a strong independent element on the Board, with Sir Colin Marshall, Deputy Chairman, as senior member. However, the Board operates as a single team.

The executive directors have service agreements which are reviewed by the *Board Committee on Executive Remuneration*. Information about the periods of these contracts is in the report of the *Board Committee on Executive Remuneration*.

The Board has agreed and established 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 company secretary, the removal of whom would be a matter for the whole Board.

Board committees

Following Sir Peter Bonfield's appointment as Chief Executive, the Board set up an *Executive Committee* which he chairs. In addition to Sir Peter, the members of the Committee are the Deputy Chief Executive, the Group Finance Director and other senior executives responsible for

BT's operations and central functions. These executives include the heads of BT's three customer-facing divisions and the network and systems division, together with the Secretary and Chief Legal Adviser, the Group Personnel Director and two executives responsible for developing the group's strategy and plans. The Committee develops the group's stategy, for Board approval, and oversees implementation. It also finalises (before Board approval) annual quality plans and budgets and reviews operational activities.

The *Nominating Committee* of the Chairman, Deputy Chairman and three other non-executive directors ensures the Board has an appropriate balance of expertise and ability among the non-executive directors. For this purpose it has agreed, and regularly reviews, a profile of the required skills and attributes. 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 Committee also assesses candidates for executive directorships before it recommends an appointment.

The *Board Audit Committee*, consisting solely of non-executive directors, is chaired by Sir Colin Marshall. Its terms of reference include reviewing BT's internal controls and published financial reports for statutory compliance and against standards of best practice, and recommending appropriate disclosure to the Board. It also reviews annually the services and fees of the company's auditors, to ensure that an objective and professional relationship is maintained.

There are also two Board remuneration committees. The *Board Committee on Executive Remuneration* consists solely of non-executive directors and is chaired by Sir Colin Marshall. It reviews the service agreements of the Chairman and the members of the *Executive Committee* and reviews their remuneration, including performance-related bonuses. There is a separate report from the Committee (Part 1 and Part 2).

Non-executive directors' remuneration

In line with the recommendations contained in the Greenbury Report, the remuneration of the non-executive directors is set by the Board, on the recommendation of the *Board Committee on Non-Executive Remuneration*. The non-executive directors' remuneration is discussed in the report of the *Board Committee on Executive Remuneration*.

Internal financial control

The directors are responsible for the group's systems of internal financial control. Such systems can provide only reasonable and not absolute assurance against material financial misstatement or loss. Key elements are:

- Formal policies and procedures are in place, including the documentation of key systems and rules relating to the delegation of authorities, which allow the monitoring of controls and restrict the unauthorised use of the group's assets.

- Experienced and suitably qualified staff take responsibility for important business functions. Annual appraisal procedures have been established to maintain standards of performance.

- Forecasts and budgets are prepared which allow management to monitor the key business and financial activities and risks and the progress towards financial objectives set for the year and the medium term; monthly management accounts are prepared promptly providing relevant, reliable and up-to-date financial and other information; significant variances from budget are investigated as appropriate.

- All investment projects are subject to formal authorisation procedures, with an investment committee, comprising members of the Board, considering major investment projects.

- The *Board Audit Committee* reviews reports from management, from the internal auditors and from the external auditors, to provide reasonable assurance that control procedures are in place and are being followed.

- Formal procedures have been established for instituting appropriate action to correct weaknesses identified from the above reports.

On behalf of the Board, the *Board Audit Committee* has reviewed the effectiveness of the systems of internal financial control in existence in the group for the year ended 31 March 1996 and for the period up to the date of approval of the financial statements.

Statement of BT Business Practice

BT will comply with the laws and regulations of the territories in which it operates. However, we aim to go further and maintain high international standards of business integrity and professional competence in all our activities worldwide, in our drive to become the most successful worldwide telecommunications group.

The Board has adopted a *Statement of Business Practice* which sets out the principles that the group will observe. BT requires its employees, agents and contractors to apply these.

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.

Reporting
A statement by the directors of their responsibilities for preparing the financial statements is included.

The auditors, Coopers & Lybrand, have reported to the company that, in their opinion, the directors' comments on internal financial control above and on going concern, provide the disclosures required by paragraphs 4.5 and 4.6 of the *Code of Best Practice* (as supplemented by the related guidance) and are not inconsistent with the information of which they are aware from their audit work on the financial statements, and the statements above appropriately reflect the company's compliance with the other paragraphs of the Code specified by the London Stock Exchange for their review. The auditors were not required to carry out the additional work necessary to, and do not, express any opinion on the effectiveness of either the group's systems of internal financial control or its corporate governance procedures, nor the ability of the group or the company to continue in operational existence.

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Report of the Board Committee on Executive Remuneration

Directors' remuneration

The *Board Committee on Executive Remuneration* comprises non-executive directors of the company. It has been chaired since 1 January 1996 by Sir Colin Marshall, non-executive Deputy Chairman, and its members are shown elsewhere. The Committee was previously chaired by Paul Bosonnet until his retirement as non-executive Deputy Chairman on 31 December 1995. Sir Colin Marshall joined the Committee on 20 September 1995 and Dr Iain Anderson on 1 November 1995. Sir Michael Bett was a member until his retirement as a director on 31 January 1996. The Committee determines the remuneration, benefits and terms and conditions of employment of the executive directors and the members of the company's *Executive Committee*. The Committee met six times during the year ended 31 March 1996.

The Committee considers that the company complies with Section A of the best practice provisions of the Stock Exchange Listing Rules. The Committee has also given full consideration to Section B of the best practice provisions in framing its remuneration policy.

BT's executive remuneration policy is to reward senior executives competitively. The Committee does not seek to maintain any strict market position but rather to ensure that pay is set appropriately and in the knowledge of pay practice amongst appropriate comparators. The Committee focuses on the largest companies by market capitalisation, i.e. the FT-SE 100 and in particular on those organisations where the complexity of roles, of the business and the extent of international scope are comparable. The Committee obtains advice and information from external experts.

The main components of the remuneration package for executive directors are:

- **Basic salary**
  Salaries are reviewed annually. However, in times of low inflation/market movement the Committee does not seek automatically to increase salaries each year.This year the total salaries of executive directors will increase from 1 July 1996 by 3.4%; individual increases range from zero to 14.6%. During the year ended 31 March 1996, the Committee made some significant adjustments to the salaries of selected senior executives, to align them more closely with the external market, taking into account their responsibilities and contribution to the business.

- **Annual bonus**
  The Committee believes that annual bonus awards are an appropriate mechanism for rewarding senior executives who have achieved results against stretching targets. The annual bonus plan is currently capped at 50% of salary for directors and the norm for bonuses, averaged over five years, is around 35%. Targets are set at the beginning of the financial year in accordance with the Quality Plan and Budget and the BT Corporate Score Card. The measures are those which the Committee and the Board believe are key

to delivering shareholder return and long-term growth of the group - for example, profitability, earnings per share, quality of service, productivity and expansion of international business. After the end of the financial year, the Committee meets to consider the performance of the executive directors and members of the *Executive Committee* on the basis of group and divisional results, personal contribution and the advice of the Chairman and the Chief Executive. The determination of reward for performance is made rigorously but not mechanistically. The Committee will decide the extent to which performance has been "on target", below target or above. The Chairman and the Chief Executive were eligible for bonuses for part only of the year. Bonus awards for executive directors for the year under review, on an annualised basis, ranged from 34% to 45%.

- **Long Term Remuneration Plan**
  The Long Term Remuneration Plan (LTRP) was operated for the second time in 1995. The grant of awards under the LTRP was approved by shareholders at the 1995 AGM. Seventy senior executives now participate. The plan was designed to ensure that BT's remuneration package remains competitive; to encourage personal investment in BT shares; to foster community of interest with shareholders; to encourage key executives to stay with BT and to link reward and long-term corporate performance more effectively. Under the plan, which runs on a five-year rolling basis, participants receive a contingent award of BT shares. Participants are encouraged to invest up to half their annual bonus, net of tax, in BT shares, which are held in trust under the plan for five years, in order to obtain the full benefits.
  If participants invest up to half their annual bonus, net of tax, that investment is matched by the company on a gross basis once, twice or three times (depending on the responsibilities of the individual) with an award of performance-linked shares. Participants also receive an award of service-linked shares equivalent in value to half their annual bonus. Again, this award is matched once, twice or three times by an award of performance-linked shares. To date the maximum matching multiple for both performance and service-linked shares has been two. For the 1995 operation of the plan, the initial value of awards as a percentage of salary ranged from 12% to 60%.
  All shares are held in trust and dividends reinvested in further BT shares for the potential benefit of participants. At the end of five years the service-linked shares will be transferred to participants if they are still employed by BT. The remaining performance-linked shares will be transferred only if, in addition, BT has met a pre-determined performance measure. The measure is Total Shareholder Return (TSR) which is defined as share price growth plus reinvested dividends compared to the FT-SE 100.
  When considering whether to operate the plan each year, the Committee reviews both the size of awards and the performance measure to ensure they are appropriate and challenging. During the year, the views of a number of institutional shareholders and bodies representing institutional and other investors were sought about the plan.
  As a result of this consultation, the Committee has decided to modify the plan including revising the target range for TSR. Currently, only if BT's TSR ranks in the top 40

companies at the end of five years will all the performance-linked shares be transferred to the participant. If BT's TSR is below 80th position, none of the performance-linked shares will be transferred. Between 40th and 80th position, a proportion of the shares, which increases from 25% to 100% as the ranking improves, will be transferred.
For future operations of the plan, BT's TSR will have to rank in the top 30 companies for all the performance-linked shares to be transferred to the participant. The proportion of shares transferred will decrease on a straight line basis from 30th to 70th position, at which point, no shares will be transferred.
Initial awards will in future be subject to a maximum value of 100% of salary.

- **BT Share Option Scheme**
  The share option scheme for senior executives was not renewed after its expiry in January 1995. The last options were granted in December 1994. During the year under review there were no exercises of options by directors under this scheme. In 1995, Sir Iain Vallance and Dr Rudge each exercised options over 1,714 shares under the BT Employee Sharesave Scheme in which all employees of the company are eligible to participate.

- **Other benefits**
  These include car and driver, fuel, personal telephone facilities and personal call allowance, medical cover for the director and immediate family and financial counselling.

- **Pensions**
  Funding through the BT Pension Scheme (BTPS) is the primary means of securing pensions for the executive directors and their dependants. Company pensions are based on salary alone - bonus, other benefits and long-term incentives are excluded. For members of the BTPS, the company contributed 9.5% of salary to the scheme and the individual contributed 6% of salary in the year ended 31 March 1996.
  The policy for the executive directors is to provide pension benefits of 2/3rds final salary. The way in which this is provided will depend on when the individual joined the company and can be either through the BTPS or through non-approved, unfunded arrangements or a combination of both.
  Sir Iain Vallance is a member of the BTPS. Following his decision to step down as Chief Executive, the Committee reviewed Sir Iain's pension arrangements and modified his benefits so as to provide him with the flexibility to retire at any time after age 55 with a pension equivalent to 2/3rds of his final salary. His spouse's contingent pension is 2/3rds of his pension.
  The excess of the entitlement above that provided by the BTPS is unfunded. The pension arrangements for Sir Iain Vallance are set out in further detail below.
  Unfunded arrangements were agreed for Sir Peter Bonfield as part of his recruitment package, to provide for a pension of 2/3rds of his final salary at age 60, inclusive of any retained benefits from his previous employment, and a spouse's contingent pension of 2/3rds of his pension.

When recruiting, if an individual's pension expectation has been disrupted by changes in employment and/or a lower "transferred in" service credit in the BTPS, the company may purchase additional service in the BTPS. This is the case for Dr Rudge and Mr Brace.

All employees in the company have death in service cover to the value of three times salary. For senior employees, including the executive directors, there is additional cover equal to annual salary which is funded through a separate insurance policy.

Service agreements

All the executive directors have service agreements. It is the policy of the Committee for these to be one-year rolling contracts. All service agreements contain provision for the removal of a director through poor performance.

Sir Iain Vallance's contract is subject to twelve months' notice either side which can expire at any time after 5 August 1997. Dr Rudge's existing contract expires on 5 August 1997 and it is intended to extend it to 31 October 1997, the last day of the month in which he reaches the age of 60. The company intends to offer Mr Brace a one-year rolling contract in August 1996 to replace his existing contract which expires on 5 August 1997. Sir Peter Bonfield, who joined the company as Chief Executive on 1 January 1996, has an initial three-year contract which may be terminated at any time after 31 December 1998 by either party giving 12 months' notice.

Sir Ewen Fergusson and Dr Anderson have contracts of appointment as non-executive directors which expire on 23 May 1996 and 31 October 1998, respectively. The Board has agreed to continue Sir Ewen Fergusson's appointment from 24 May 1996 subject to a one-year period of notice on either side.

With the appointment of the new Chief Executive and the subsequent Board restructuring, it was mutually agreed that Mr Hepher, the former Group Managing Director, would leave on 31 December 1995 before the expiry of his contract. In these circumstances, the company is abiding by the terms of his contract and Mr Hepher continues to receive his salary and contractual benefits until his service contract expires on 5 August 1997. He may also exercise options held under the BT Share Option Scheme until 31 December 1996.

Non-executive directorships

The Committee believes the company benefits from executive directors accepting appointments to non-associated companies as non-executive directors. All appointments require the approval of the Committee. The Committee will normally allow one appointment although, where it is appropriate and in the company's interest, more than one may be allowed. The practice has been for directors to retain fees from non-executive appointments.

Non-executive directors' remuneration

In line with the recommendations in the Greenbury Report, remuneration for non-executive directors is determined by the Board based on the recommendations of the *Board Committee on Non-Executive Remuneration* whose members are the Chairman and the Chief Executive. The basic fee for non-executive directors is £19,500 per year. Additional fees (ranging for each committee from £3,000 to £5,000 per year) are paid for additional duties on Board committees. They also receive the use of telecommunications equipment while they are directors. Sir Colin Marshall receives an inclusive fee of £65,000 per year as Deputy Chairman.

It is intended to review these fees during 1996 with any changes to be effective from 1 January 1997.

Directors' remuneration

The remuneration (excluding pension arrangements) of the directors, including the Chairman who was the highest paid director, was as follows:

	Salary and fees		Bonus		Benefits excluding pension *(a)*		Total	
	1996 £000	1995 £000	**1996 £000**	1995 £000	**1996 £000**	1995 £000	**1996 £000**	1995 £000
Sir Iain Vallance	**476.3**	465.0	**162.0**	115.0	**19.2**	19.3	**657.5**	599.3
Sir Peter Bonfield	**118.8**	-	**42.5**	-	**4.5**	-	**165.8**	-
A W Rudge	**268.8**	245.0	**100.0**	63.0	**13.4**	15.0	**382.2**	323.0
R P Brace	**233.8**	215.0	**85.0**	54.0	**14.2**	82.5*(b)*	**333.0**	351.5
A J Booth	**-**	65.0	**-**	-	**-**	9.2	**-**	74.2
M L Hepher	**373.1***(c)*	415.0	**154.0**	100.0	**16.2***(c)*	21.6	**543.3**	536.6
Sir Colin Marshall	**34.1**	-	**-**	-	**0.4**	-	**34.5**	-
J I W Anderson	**11.4***(d)*	-	**-**	-	**-**	-	**11.4**	-
M Argent	**82.1**	140.0*(e)*	**-**	19.0	**32.7***(f)*	18.0	**114.8**	177.0
B Breuel	**19.5**	-	**-**	-	**-**	-	**19.5**	-
Sir Ewen Fergusson	**30.0**	30.0	**-**	-	**0.2**	0.2	**30.2**	30.2
Y M Newbold	**27.1***(d)*	25.5	**-**	-	**0.2**	0.2	**27.3**	25.7
J K Oates	**26.8**	21.0	**-**	-	**0.2**	-	**27.0**	21.0
B C Roberts	**-**	-	**-**	-	**-**	-	**-**	-
Rt Hon Lord Tebbit	**27.7**	25.5	**-**	-	**-**	-	**27.7**	25.5

Sir Michael Bett	**31.3**	27.5	**-**	-	**1.4**	13.0	**32.7**	40.5
P G Bosonnet	**56.3**	75.0	**-**	-	**-**	-	**56.3**	75.0
Sir Geoffrey Mulcahy	**-**	5.6	**-**	-	**-**	-	**-**	5.6
Sir David Scholey	**-**	13.6	**-**	-	**-**	-	**-**	13.6
Total remuneration	**1,817.1**	1,768.7	**543.5**	351.0	**102.6**	179.0	**2,463.2**	2,298.7

(a) Includes such benefits as company car, petrol, driver, personal telephone facilities, medical cover, financial counselling and share schemes.

(b) Includes £66,888 reimbursement of relocation expenses.

(c) For the period ended 31 December 1995. Under the terms for his leaving the company, Mr Hepher continues to receive his salary and contractual benefits until his service contract expires on 5 August 1997. The total salary payable for the period 1 January 1996 to 5 August 1997 is £686,600 and benefits are estimated at £57,700. For the year ended 31 March 1996, he received a bonus of £154,000.

(d) Payments to non-executive directors include fees paid to their principal employer of £11,375 for Dr Anderson and £12,750 for Mrs Newbold.

(e) Includes salary as an executive director for the period to 31 July 1994.

(f) Benefits include a company car, valued at £19,500, transferred to Mr Argent.

The directors' long-term remuneration benefits, through the exercise of share options, were as follows:

	1996 £000	1995 £000
Sir Iain Vallance	**3.0**	640.8
A W Rudge	**3.3**	-
M Argent	**-**	7.0

The figures in the above table are based on the amount by which the market value of the shares on the date of exercise exceeded the option price.

Sir Peter Bonfield joined the Board on 1 January 1996, Sir Colin Marshall and Mrs B Breuel on 1 April 1995 and Dr J I W Anderson on 1 November 1995. In the previous financial year, Mr J K Oates joined the Board on 1 June 1994 and Mr B C Roberts on 14 October 1994. Mr Roberts receives no remuneration as a non-executive director of the company.

Mr M L Hepher and Mr P G Bosonnet retired on 31 December 1995. Sir Michael Bett retired on 31 January 1996; he remains chairman of Cellnet Group Limited, a subsidiary company. Mr M Argent had special responsibilities from the date of his retirement as an executive director on 31 July 1994 until 31 December 1995. In the previous financial year, Mr A J Booth and Sir Geoffrey Mulcahy retired on 30 June 1994 and Sir David Scholey on 14 October 1994.

The detailed pension arrangements for the Chairman are as follows. Sir Iain Vallance is a member of the BT Pension Scheme and during the year he contributed 6% of his salary to the scheme and the company made payments of £46,039 (1995 - £44,952). This consisted of £45,244 (9.5% of salary) which the company contributed to the scheme and £795 top-up life insurance cover. As referred to above, the Chairman’s pension arrangements have been modified during the year, and the main part of the provision for the year of £838,000 (1995 - £51,150) for his unfunded pension benefits is to cover the possibility of his retiring after his 55th birthday on a full pension.

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Report of the Board Committee on Executive Remuneration (continued)

Directors' interests
The interests of directors and their families in the company's shares at 31 March 1996 and 1 April 1995, or date of appointment if later, are shown below:

Beneficial holdings	**1996**	1995
Sir Iain Vallance	**182,616**	180,844
Sir Peter Bonfield	**-**	- *(b)*
A W Rudge	**41,693** *(a)*	39,591 *(a)*
R P Brace	**13,110** *(a)*	8,485 *(a)*
Sir Colin Marshall	**2,000**	-
J I W Anderson	**-**	- *(b)*
M Argent	**17,988**	17,988
B Breuel	**-**	-
Sir Ewen Fergusson	**92**	74
Y M Newbold	**1,150**	1,150
J K Oates	**3,660**	3,660
B C Roberts	**5,000**	-
Rt Hon Lord Tebbit	**7,815**	4,215

(a) Includes 12,498 shares (1995 - 7,473 shares) purchased and held by Dr Rudge and 10,495 shares (1995 - 6,228 shares) by Mr Brace in the Long Term Remuneration Plan (see note 27 to the financial statements).

(b) Date of appointment.

In common with other eligible individual shareholders, the directors and members of their families may be entitled to a share bonus from HM Government under its public offer of the company's shares in 1993, up to a maximum bonus of 100 shares.

Details of share options held at 1 April 1995, granted and exercised under the share option schemes during the year, and the balance held at 31 March 1996 are as follows:

	Number of share options				Option exercise price per share	Market price at date of exercise	Usual date from which exercisable	Usual expiry date
	1 April 1995	Granted	Exercised	**31 March 1996**				
Sir Iain Vallance	55,189	-	-	**55,189**	**264p**		07/09/92	07/09/99
	100,207	-	-	**100,207**	**289p**		07/12/93	07/12/00
	57,957	-	-	**57,957**	**333p**		09/03/95	09/03/02
	1,714	-	1,714 *(a)*	**-**	210p	387p	14/04/95	14/10/95
	20,770	-	-	**20,770**	**430p**		04/03/96	04/03/03
	3,073	-	-	**3,073**	**244p**		14/06/96	14/12/96
	3,760	-	-	**3,760**	**375p**		08/12/97	08/12/04
	242,670	-	1,714	**240,956**				
		-	-					
A W Rudge	60,000	-	-	**60,000**	**264p**		07/09/92	07/09/99
	65,622	-	-	**65,622**	**289p**		07/12/93	07/12/00
	34,534	-	-	**34,534**	**333p**		09/03/95	09/03/02
	1,714	-	1,714 *(a)*	**-**	210p	401p	14/04/95	14/10/95
	10,940	-	-	**10,940**	**430p**		04/03/96	04/03/03
	2,745	-	-	**2,745**	**265p**		14/06/97	14/12/97
	2,460	-	-	**2,460**	**375p**		08/12/97	08/12/04
	2,254	-	-	**2,254**	**306p**		14/06/00	14/12/00
	180,269	-	1,714	**178,555**				
R P Brace	136,890	-	-	**136,890**	**263p**		06/09/92	06/09/99
	18,680	-	-	**18,680**	**289p**		07/12/93	07/12/00
	18,020	-	-	**18,020**	**333p**		09/03/95	09/03/02
	24,890	-	-	**24,890**	**430p**		04/03/96	04/03/03
	4,610	-	-	**4,610**	**244p**		14/06/96	14/12/96
	30,180	-	-	**30,180**	**460p**		15/11/96	15/11/03
	23,470	-	-	**23,470**	**375p**		08/12/97	08/12/04
	2,265	-	-	**2,265**	**320p**		14/06/98	14/12/98

	259,005	-	-	**259,005**				
M Argent *(b)*	82,975	-	-	**82,975**	**289p**		07/12/93	07/12/00
	33,873	-	-	**33,873**	**333p**		09/03/95	09/03/02
	10,940	-	-	**10,940**	**430p**		04/03/96	04/03/03
	127,788	-	-	**127,788**				
Sir Michael Bett *(b)*	64,705	-	-	**64,705**	**289p**		07/12/93	07/12/00
	36,156	-	-	**36,156**	**333p**		09/03/95	09/03/02
	5,820	-	-	**5,820**	**430p**		04/03/96	04/03/03
	106,681	-	-	**106,681**				
M L Hepher *(b)*	400,000	-	-	**400,000**	**400p**		03/09/94	03/09/01
	10,350	-	-	**10,350**	**430p**		04/03/96	04/03/03
	4,000	-	-	**4,000**	**375p**		08/12/97	08/12/04
	5,664	-	-	**5,664**	**320p**		14/06/98	14/12/98
	420,014	-	-	**420,014**				

(a) Sir Iain Vallance and Dr Rudge each exercised options under the BT Employee Sharesave Scheme in which all employees of the company are eligible to participate.

(b) Options exercisable at 31 March 1996 by Mr Argent and Sir Michael Bett lapse on or before 3 September 1996 and by Mr Hepher on or before 31 December 1996.

Unrealised gains on the above share options at 31 March 1996, based on the market price of the shares at that date, were as follows:

	Options exercisable			Options not exercisable		
		Unrealised gains			Unrealised gains	
	Number of shares	**1996 £000**	1995 *(a)* £000	Number of shares	**1996 £000**	1995 *(a)* £000
Sir Iain Vallance	**234,123**	**159**	206	**6,833**	**4**	8

A W Rudge	**171,096**	**128**	163	**7,459**	**4**	9
R P Brace	**198,480**	**166**	205	**60,525**	**7**	12
M Argent	**127,788**	**79**	104	**-**	**-**	-
Sir Michael Bett	**106,681**	**65**	87	**-**	**-**	-
M L Hepher	**420,014**	**3**	-	**-**	**-**	5
	1,258,182	**600**	765	**74,817**	**15**	34

(a) Based on options outstanding at 31 March 1995 and the market price of the shares at that date.

The market price of the shares at 31 March 1996 was 369p (1995 - 391p) and the range during the year ended 31 March 1996 was 332p to 415p.

Details of the company's ordinary shares provisionally awarded to each director, as a participant under the Long Term Remuneration Plan (note 27 to the financial statements), were as follows:

	Total number of award shares *(a)*				Range of value of award *(b)*	
	1 April 1995	Awarded	Dividends reinvested	**31 March 1996**	Minimum £000	Maximum £000
A W Rudge	62,507	38,817	3,682	**105,006**	77	387
R P Brace	52,089	33,272	3,087	**88,448**	65	326

(a) Excluding shares purchased by each director under the plan (see above).

(b) Based on the market value of the company's shares at 31 March 1996. The minimum figure represents those shares held at 31 March 1996 which will transfer to each director at the end of year five of the plan (1999 and 2000) provided the individual is still employed by the group. The maximum figure represents all shares held at 31 March 1996 which will transfer to each director at the end of year five (1999 and 2000) provided the individual is still employed by the group and that the corporate performance measure has been fully met.

At 31 March 1996, Sir Iain Vallance, Sir Peter Bonfield, Dr Rudge and Mr Brace each had a non-beneficial interest in 95,841 shares (1995 - 110,951) purchased by BT Employee Shares

Trustees Limited for allocation to employees under the BT Employee Share Ownership Scheme, and 3,292,627 shares (1995 - 699,127) held in trust by Ilford Trustees (Jersey) Limited for allocation to participating employees under the Long Term Remuneration Plan and the Performance Share Plan.

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 1996, Mr Brace has notified the company of an acquisition of a beneficial holding of 49 ordinary shares under a personal equity plan. There have been no other changes in the directors' interests in the share capital or in the debentures of the company and its subsidiaries between 31 March 1996 and 21 May 1996.

By order of the Board

Sir Colin Marshall

Chairman of the Board Committee on Executive Remuneration

21 MAY 1996

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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 year ended 31 March 1996.

Introduction

The business review, the financial review, the discussion on corporate governance and the report of the *Board Committee on Executive Remuneration* (Part 1 and Part 2) form part of this report. The audited financial statements are also presented.

The group's principal activity is the supply of telecommunication services and equipment. In the year, 98% of group turnover arose from operations in the United Kingdom.

Directors

The current directors of the company are also shown. All served throughout the financial year with the exception of Dr Iain Anderson who was appointed to the Board as from 1 November 1995 and Sir Peter Bonfield who was appointed as from 1 January 1996.

In addition, Mr Michael Hepher and Mr Paul Bosonnet served on the Board until their retirement as directors on 31 December 1995, and Sir Michael Bett served until his retirement on 31 January 1996.

In accordance with the articles of association, Sir Peter Bonfield and Dr Iain Anderson, having been appointed to the Board since the last annual general meeting, retire at the annual general meeting and will be proposed for election. Sir Iain Vallance, Sir Ewen Fergusson and Mr Robert Brace retire by rotation and will be proposed for re-election. Details of these directors' service contracts or contracts of appointment are shown in the report of the *Board Committee on Executive Remuneration*.

During and at the end of the financial year, no director was materially interested in any contract of significance in relation to the group's business.

Substantial shareholdings

At 21 May 1996, the company had received a notification from the Prudential Corporation group of companies under Part VI of the Companies Act 1985 in respect of a holding of 189 million shares representing 3.0% of the company's issued ordinary share capital.

HM Government's present beneficial shareholding is 30 million shares (0.5% of the issued ordinary shares). Under the share bonus arrangements made under the UK Government's offer for sale in 1993, shares will be transferred from HM Government to eligible individuals who purchased shares in the offer and continue to hold them until 31 July 1996.

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 thirty 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 suppliers.

Close company provisions
The close company provisions of the Income and Corporation Taxes Act 1988 do not apply to the company. There has been no change in this respect since the end of the financial year.

Auditors
A resolution to reappoint Coopers & Lybrand as the company's auditors will be proposed 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 1996, together with explanatory notes, appear in the separate *Notice of 1996 Annual General Meeting* sent to all shareholders.

By order of the Board

C R Green
Secretary and Chief Legal Adviser
21 MAY 1996

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

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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, total recognised gains or losses and cash flows of the group for that period.

The directors consider that, in preparing the financial statements for the year ended 31 March 1996 on pages 30 to 55 [of the printed report], the company has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates. The directors also consider that all accounting standards which they consider to be applicable 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 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.

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Report of the auditors

TO THE SHAREHOLDERS OF BRITISH TELECOMMUNICATIONS plc

We have audited the financial statements on pages 30 to 55 including the information on directors' remuneration and directors' interests on pages 23 to 26 [of the printed report].

Respective responsibilities of directors and auditors
As described in the statement of directors' responsibility, the company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion to you.

Basis of opinion
We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. 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 1996 and of the profit, total recognised gains and cash flows of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Coopers & Lybrand
Chartered Accountants and Registered Auditors
London
21 MAY 1996

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Five year financial summary

YEARS ENDED 31 MARCH

	1992 £m	1993 £m	1994 £m	1995 £m	**1996 £m**
Profit and loss account					
Turnover	13,337	13,242	13,675	13,893	**14,446**
Operating profit *(a)*	3,370	2,403	2,982	2,663	**3,100**
Group's share of profits of associated undertakings	7	13	18	92	**82**
Profit (loss) on sale of group undertakings	-	(132)	(14)	241	**7**
Net interest payable	304	256	230	259	**170**
Premium on repurchase of bonds	-	56	-	75	**-**
Profit on ordinary activities before taxation	3,073	1,972	2,756	2,662	**3,019**
Tax on profit on ordinary activities	999	724	951	926	**1,027**
Profit on ordinary activities after taxation	2,074	1,248	1,805	1,736	**1,992**
Minority interests	30	28	38	5	**6**
Profit for the financial year	2,044	1,220	1,767	1,731	**1,986**
Earnings per share	33.2p	19.8p	28.5p	27.8p	**31.6p**
Dividends per share	14.4p	15.6p	16.7p	17.7p	**18.7p**
Cash flow statement					
Net cash inflow from operating activities	5,710	5,127	4,914	5,113	**5,829**
Interest paid less returns on investments	(351)	(314)	(184)	(324)	**(125)**
Dividends paid	(859)	(931)	(1,014)	(1,083)	**(1,158)**
Net cash outflow from returns on investments and servicing of finance	(1,210)	(1,245)	(1,198)	(1,407)	**(1,283)**
Tax paid	(897)	(975)	(605)	(1,175)	**(784)**

Purchase of tangible fixed assets	(2,565)	(2,148)	(2,161)	(2,638)	**(2,547)**
Purchase of subsidiary undertakings and investments	(52)	(27)	(612)	(2,395)	**(233)**
Net (purchase) disposal of short-term investments	(416)	327	(463)	1,934	**(524)**
Other investing activities	95	92	168	238	**148**
Net cash outflow from investing activities	(2,938)	(1,756)	(3,068)	(2,861)	**(3,156)**
Net cash inflow (outflow) before financing	665	1,151	43	(330)	**606**
Balance sheet					
Tangible fixed assets	15,785	15,736	15,584	16,012	**16,496**
Fixed asset investments	660	735	1,312	1,082	**1,057**
Net current assets (liabilities)	(150)	322	125	(725)	**(106)**
Total assets less current liabilities	16,295	16,793	17,021	16,369	**17,447**
Loans and other borrowings falling due after one year	(3,768)	(3,386)	(3,199)	(3,361)	**(3,322)**
Provisions for liabilities and charges	(665)	(1,117)	(701)	(879)	**(1,267)**
Minority interests	(108)	(72)	(95)	(132)	**(180)**
Total assets less liabilities	11,754	12,218	13,026	11,997	**12,678**

(a) Operating profit for the years ended 31 March 1992 to 1995 has been restated for a reclassification of the annual charge for the employee share ownership scheme.

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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. The group financial statements consolidate those of the company and all of its subsidiary undertakings. Where the financial statements of subsidiary and associated undertakings 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.

II Turnover

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

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 Goodwill

Goodwill, arising from the purchase of subsidiary and associated undertakings, representing the excess of the fair value of the purchase consideration over the fair value of the net assets acquired, is written off on acquisition against group reserves. If an undertaking is subsequently divested, or if there has been a permanent diminution in value, the appropriate goodwill is dealt with through the profit and loss account in the period of disposal as part of the calculation of gain or loss on divestment or in the period of permanent diminution.

VII Intangible assets
Mobile cellular telephone and broadcasting licences, which were held in an associated undertaking until divestment in the year ended 31 March 1995, were stated at historical cost. No amortisation was provided on these assets, but their value was reviewed annually by the directors and the cost would have been written down if permanent diminution in value had occurred.

VIII Tangible fixed assets
Tangible fixed assets are stated at historical cost less depreciation.

(a) Cost
Cost in the case of network services comprises expenditure up to and including the last distribution point and includes contractors' charges and payments on account, materials, direct labour and related 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.

Semi-electronic telephone exchange equipment is in the course of being replaced by digital equipment and will be substantially written off by 2000.

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 -	10 to 37 years
radio and repeater equipment -	4 to 25 years
Digital telephone exchange equipment -	11 to 13 years
Computers and office equipment -	2 to 7 years
Payphones, other network equipment, motor vehicles and cableships -	3 to 20 years

(c) Engineering stores
Most engineering stores items are used in the construction of new plant and the remainder for maintenance. When issued, these stores are charged to the cost of specific plant or to the profit and loss account, as appropriate. They are stated at cost, less a provision for excess and obsolete items.

IX Fixed asset investments Investments in subsidiary and associated undertakings 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 associated undertakings are stated in the group balance sheet at the group’s share of their net assets.

The group’s share of profits less losses of associated undertakings 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.

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

If the most recent actuarial valuation of the group’s pension scheme shows a deficit, 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 leave the group, within redundancy charges.

XII Pension schemes

The group operates a 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 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 XI 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.

XIII 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.

XIV Financial instruments

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

Currency swap agreements and forward exchange contracts, used to reduce the impact of changes in currency rates on certain of the group's long-term borrowings denominated in foreign currency, are valued at year-end exchange rates. The resulting gains or losses are offset against foreign exchange gains or losses on the related borrowings.

Premiums or discounts on financial instruments designated as hedges are reflected as adjustments to interest payable.

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Group profit and loss account

FOR THE YEAR ENDED 31 MARCH 1996

	Notes	**1996 £m**	1995 £m
Turnover	1	**14,446**	13,893
Operating costs *(a)*	2	**11,346**	11,230
Operating profit		**3,100**	2,663
Group's share of profits of associated undertakings		**82**	92
Profit on sale of group undertakings	3	**7**	241
Interest receivable	4	**(201)**	(155)
Interest payable	4	**371**	414
Premium on repurchase of bonds	4	**-**	75
Profit on ordinary activities before taxation		**3,019**	2,662
Tax on profit on ordinary activities	5	**1,027**	926
Profit on ordinary activities after taxation		**1,992**	1,736
Minority interests		**6**	5
Profit for the financial year		**1,986**	1,731
Dividends	6	**1,184**	1,108
Retained profit for the financial year	20	**802**	623
Earnings per share	7	**31.6p**	27.8p
(a) including redundancy charges		**421**	820

Group statement of total recognised gains and losses

FOR THE YEAR ENDED 31 MARCH 1996

	1996 £m	1995 £m
Profit for the financial year	**1,986**	1,731
Currency movements arising on consolidation of foreign subsidiary and associated undertakings	**42**	(56)
Total recognised gains and losses	**2,028**	1,675

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Group cash flow statement

FOR THE YEAR ENDED 31 MARCH 1996

	Notes	**1996 £m**	1995 £m
Net cash inflow from operating activities	8	**5,829**	5,113
Returns on investments and servicing of finance			
Interest and dividends received		**207**	147
Interest paid		**(332)**	(396)
Premium paid on repurchase of bonds		**-**	(75)
Dividends paid to the company's shareholders		**(1,138)**	(1,065)
Dividends paid to minorities		**(20)**	(18)
Net cash outflow from returns on investments and servicing of finance		**(1,283)**	(1,407)
Taxation			
UK corporation tax paid		**(738)**	(1,170)
Overseas tax paid		**(46)**	(5)
Tax paid		**(784)**	(1,175)
Investing activities			
Purchase of tangible fixed assets		**(2,547)**	(2,638)
Purchase of subsidiary undertakings		**(26)**	(6)
Purchase of fixed asset investments		**(207)**	(2,389)
Purchase of short-term investments		**(2,520)**	(2,430)
Sale of fixed assets		**148**	238
Sale of short-term investments		**1,996**	4,364
Net cash outflow from investing activities		**(3,156)**	(2,861)
Net cash inflow (outflow) before financing		**606**	(330)
Financing	9		

Issue of ordinary share capital		**130**	57
Issue of shares to minorities		**59**	61
New loans		**177**	2,178
Repayment of loans		**(151)**	(2,456)
Net cash inflow (outflow) from financing		**215**	(160)
Increase (decrease) in cash and cash equivalents	*10*	**821**	(490)
Decrease (increase) in net debt	*11*	**1,319**	(2,146)

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Group balance sheet

AT 31 MARCH 1996

	Notes	**1996 £m**	1995 £m
Fixed assets			
Tangible assets	*12*	**16,496**	16,012
Investments	*13*	**1,057**	1,082
Total fixed assets		**17,553**	17,094
Current assets			
Stocks		**212**	247
Debtors	*14*	**3,082**	2,720
Investments	*15*	**2,568**	1,260
Cash at bank and in hand		**121**	138
Total current assets		**5,983**	4,365
Creditors: amounts falling due within one year			
Loans and other borrowings	*16*	**315**	190
Other creditors	*17*	**5,774**	4,900
Total creditors: amounts falling due within one year		**6,089**	5,090
Net current liabilities		**(106)**	(725)
Total assets less current liabilities		**17,447**	16,369
Creditors: amounts falling due after more than one year			
Loans and other borrowings	*16*	**3,322**	3,361
Provisions for liabilities and charges	*18*	**1,267**	879

	Notes	1996	1995
Minority interests		**180**	132
Capital and reserves			
Called up share capital	19	**1,573**	1,559
Share premium account	20	**531**	415
Other reserves	20	**777**	768
Profit and loss account	20	**9,797**	9,255
Total shareholders' funds	21	**12,678**	11,997
		17,447	16,369

Debtors include amounts receivable after more than one year of £87m (1995 - £85m).

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Balance sheet of the company

AT 31 MARCH 1996

	Notes	**1996 £m**	1995 £m
Fixed assets			
Tangible assets	12	**14,313**	13,918
Investments	13	**5,825**	5,495
Total fixed assets		**20,138**	19,413
Current assets			
Stocks		**180**	225
Debtors	14	**3,098**	3,031
Investments	15	**1,983**	520
Cash at bank and in hand		**-**	1
Total current assets		**5,261**	3,777
Creditors: amounts falling due within one year			
Loans and other borrowings	16	**607**	710
Other creditors	17	**5,818**	5,773
Total creditors: amounts falling due within one year		**6,425**	6,483
Net current liabilities		**(1,164)**	(2,706)
Total assets less current liabilities		**18,974**	16,707
Creditors: amounts falling due after more than one year			
Loans and other borrowings	16	**3,876**	3,376
Provisions for liabilities and charges	18	**1,050**	717

Capital and reserves

Called up share capital	*19*	**1,573**	1,559
Share premium account	*20*	**531**	415
Capital redemption reserve	*20*	**750**	750
Profit and loss account	*20*	**11,194**	9,890
Total shareholders' funds	*21*	**14,048**	12,614
		18,974	16,707

Debtors include amounts receivable after more than one year of £119m (1995 - £287m).

The financial statements on pages 30 to 55 [of the printed report] were approved by the board of directors on 21 May 1996 and were signed on its behalf by

Sir Iain Vallance *Chairman*
Sir Peter Bonfield CBE *Chief Executive*
R P Brace *Group Finance Director*

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Notes to the financial statements

1. Turnover	**1996 £m**	1995 £m
Inland telephone calls	**4,882**	4,941
International telephone calls	**1,980**	1,935
Telephone exchange line rentals	**2,685**	2,534
Private circuits	**1,056**	1,024
Customer premises equipment supply	**946**	1,041
Mobile communications	**856**	657
Yellow Pages directories	**408**	371
Other sales and services	**1,633**	1,390
Total turnover	**14,446**	13,893

Turnover included income from telecommunication operators of £1,166m (1995 - £1,155m). In the year 2% (1995 - 2%) of turnover arose from operations outside the United Kingdom. There are no discontinued operations or acquisitions which require disclosure under Financial Reporting Standard 3. In the year ended 31 March 1995 turnover of £59m was attributable to subsidiary undertakings sold in that year.

2. Operating costs	**1996 £m**	1995 £m
Staff costs:		
Wages and salaries	**3,105**	3,352
Social security costs	**261**	282
Pension costs (note 23)	**284**	248
Employee share ownership scheme *(a)*	**30**	30
Total staff costs	**3,680**	3,912
Own work capitalised	**(417)**	(460)
Depreciation (note 12)	**2,189**	2,137
Payments to telecommunication operators	**1,383**	1,192
Redundancy charges *(b)*	**421**	820

Other operating costs	**4,193**	3,758
Other operating income	**(103)**	(129)
Total operating costs	**11,346**	11,230
Operating costs included the following:		
Research and development	**282**	271
Rental costs relating to operating leases, including plant and equipment hire £23m (1995 - £16m)	**250**	234

(a) Amount set aside for the year for allocation of ordinary shares in the company to eligible employees. In previous years this charge was shown as a separate item on the face of the profit and loss account; comparative figures have been restated.

(b) Redundancy charges for the year ended 31 March 1996 included £266m (1995 - £483m) being the cost of providing incremental pension benefits for employees taking early retirement.

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.

3. Profit on sale of group undertakings

The profit in the year ended 31 March 1995 of £241m arose primarily from the disposal of the group's interest in AT&T Corporation shares, which had been exchanged for shares in McCaw Cellular Communications, Inc previously an associated undertaking, and the disposal of BT Marine Limited, a wholly-owned subsidiary company, and a 24.9% interest in the previously wholly-owned Concert Communications Company. The profit was net of goodwill of £321m written off to reserves in prior years. In the years ended 31 March 1995 and 31 March 1996 the subsidiary undertakings disposed 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.

4. Interest	**1996 £m**	1995 £m
Total interest payable	**371**	414
Premium on repurchase of bonds (note 16)	**-**	75

Income from listed investments	**(29)**	(27)
Other interest receivable	**(172)**	(128)
Total interest receivable	**(201)**	(155)
Net interest payable (including premium on repurchase of bonds in 1995)	**170**	334

5. Tax on profit on ordinary activities	**1996 £m**	1995 £m
United Kingdom:		
Corporation tax at 33%	**1,000**	839
Deferred taxation charge (credit) at 33%	**(20)**	44
Taxation on the group's share of results of associated undertakings	**1**	4
Prior year adjustments	**(1)**	(18)
Total UK taxation	**980**	869
Overseas taxation:		
Current	**8**	45
Taxation on the group's share of results of associated undertakings	**39**	12
Total tax on profit on ordinary activities	**1,027**	926

The total tax charge for the year was £31m (1995 - £48m) higher than the result of applying the UK corporation tax rate of 33% to the group's profit on ordinary activities. This was primarily due to depreciation on certain tangible fixed assets which is not deductible for tax purposes. The higher tax charge in 1995 occurred mainly due to depreciation on tangible fixed assets and because tax relief was unavailable against the premium paid on the repurchase of bonds from HM Government. Deferred taxation of £30m (1995 - £30m) arising on excess capital allowances and £11m (1995 – £18m) on associated undertakings' profits was not provided in the year ended 31 March 1996.

6. Dividends	**1996 pence per share**	1995 pence per share	**1996 £m**	1995 £m
Interim dividend paid	**7.45**	7.05	**469**	439
Proposed final dividend	**11.25**	10.65	**715**	669
Total dividends	**18.70**	17.70	**1,184**	1,108

7. Earnings per share

Earnings per share are calculated by dividing the profit for the financial year ended 31 March 1996, amounting to £1,986m (1995 - £1,731m), by 6,283 million shares, the average number of shares in issue during the financial year (1995 - 6,228 million). A fully diluted earnings per share figure based on share options outstanding is not provided as the effect on the earnings per share is not significant.

8. Net cash inflow from operating activities	**1996 £m**	1995 £m
Operating profit	**3,100**	2,663
Depreciation	**2,189**	2,137
Reduction (increase) in stocks	**36**	(40)
Increase in debtors	**(335)**	(109)
Increase in creditors	**493**	265
Increase in pension provisions	**309**	230
Decrease in other provisions	**-**	(2)
Other	**37**	(31)
Net cash inflow from operating activities	**5,829**	5,113

9. Financing	Share capital (including premium) £m	Minority interests £m	Loans and other borrowings £m

Balances at 1 April 1994	1,917	95	3,999
Net cash inflows (outflow) from financing	57	61	(278)
Reduction in bank overdrafts and other short-term borrowings (note 10)	-	-	(57)
Currency movements	-	-	(132)
Other, including minority share of losses less retained profits	-	(24)	19
Balances at 31 March 1995	1,974	132	3,551
Net cash inflows from financing	130	59	26
Reduction in bank overdrafts and other short-term borrowings (note 10)	-	-	(29)
Currency movements	-	1	65
Other, including minority share of losses less retained profits	-	(12)	24
Balances at 31 March 1996	**2,104**	**180**	**3,637**

10. Cash and cash equivalents	**31 March 1996 £m**	31 March 1995 £m	**1996 Change in year £m**	1995 Change in year £m
Short-term investments *(a)*	**1,276**	461	**815**	(629)
Cash at bank and in hand	**121**	138	**(17)**	78
Bank overdrafts and other short-term borrowings *(a)*	**(13)**	(42)	**29**	57
Total	**1,384**	557	**827**	(494)
Currency movements			**(6)**	4
Increase (decrease) in cash and cash equivalents in year			**821**	(490)

(a) Investments or borrowings with original maturities of less than three months. Changes in other investments or borrowings are dealt with in the cash flow statement under investing activities or financing, respectively.

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NOTES TO THE FINANCIAL STATEMENTS

11. Analysis of net debt	1996 £m	1995 £m
Long-term loans and other borrowings falling due after more than one year	**3,322**	3,361
Short-term borrowings and long-term loans and other borrowings falling due within one year	**315**	190
Total debt	**3,637**	3,551
Short-term investments	**(2,568)**	(1,260)
Cash at bank and in hand	**(121)**	(138)
Net debt at 31 March	**948**	2,153

Movement in net debt:

At 1 April	**2,153**	1,226
Increase (decrease) in net debt through cash flow	**(1,319)**	2,146
Proceeds from sale of AT&T shares *(a)*	**-**	(1,141)
Currency and other movements	**114**	(78)
At 31 March	**948**	2,153

(a) The sale of short-term investments in the year ended 31 March 1995 of £4,364m included £1,141m gross proceeds from the sale of AT&T Corporation shares which had been exchanged for shares in McCaw Cellular Communications Corporation, Inc., previously an associated undertaking, in September 1994.

12. 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 1995	2,734	26,381	778	29,893
Additions	8	702	2,076	2,786
Transfers	76	1,752	(1,828)	-
Disposals and adjustments	(55)	(1,249)	(25)	(1,329)
Total cost at 31 March 1996	**2,763**	**27,586**	**1,001**	**31,350**
Depreciation				
Balances at 1 April 1995	1,151	12,857	-	14,008
Charge for the year	151	2,038	-	2,189
Disposals and adjustments	(44)	(1,187)	-	(1,231)
Total depreciation at 31 March 1996	**1,258**	**13,708**	**-**	**14,966**
Net book value at 31 March 1996	1,505	13,878	1,001	16,384
Engineering stores	-	-	112	112
Total tangible fixed assets at 31 March 1996	**1,505**	**13,878**	**1,113**	**16,496**
Net book value at 31 March 1995	1,583	13,524	778	15,885
Engineering stores	-	-	127	127
Total tangible fixed assets at 31 March 1995	1,583	13,524	905	16,012

Company				
Cost				
Balances at 1 April 1995	775	25,081	651	26,507
Additions	-	509	1,941	2,450
Transfers	30	1,694	(1,724)	-
Transfers to subsidiary undertakings	(3)	-	(44)	(47)
Other disposals and adjustments	(26)	(1,238)	(18)	(1,282)
Total cost at 31 March 1996	**776**	**26,046**	**806**	**27,628**

Depreciation				
Balances at 1 April 1995	333	12,377	-	12,710
Charge for the year	60	1,858	-	1,918
Other disposals and adjustments	(24)	(1,179)	-	(1,203)
Total depreciation at 31 March 1996	**369**	**13,056**	**-**	**13,425**
Net book value at 31 March 1996	**407**	**12,990**	**806**	**14,203**
Engineering stores	-	-	110	110
Total tangible fixed assets at 31 March 1996	**407**	**12,990**	**916**	**14,313**
Net book value at 31 March 1995	442	12,704	651	13,797
Engineering stores	-	-	121	121
Total tangible fixed assets at 31 March 1995	442	12,704	772	13,918

	Group		Company	
	1996 £m	1995 £m	**1996 £m**	1995 £m
(a) The net book value of land and buildings comprised:				
Freehold	**1,255**	1,313	**218**	225
Long leases (over 50 years unexpired)	**101**	80	**60**	46
Short leases	**149**	190	**129**	171
Total net book value of land and buildings	**1,505**	1,583	**407**	442

Interests in associated undertakings*(a) (b)*

13. Fixed asset investments	Shares £m	Loans £m	Share of post acquisition profits £m	Other participating interests £m	Other investments *(c)* £m	Total £m
Group						
Cost						
Balances at 1 April 1995	2,844	9	73	104	39	3,069
Additions	113	9	-	57	28	207
Share of retained profits for the year	-	-	37	-	-	37
Repayments, disposals and other transfers	(3)	-	-	(44)	-	(47)
Currency movements	57	-	4	-	-	61
Balances at 31 March 1996	**3,011**	**18**	**114**	**117**	**67**	**3,327**
Provisions and amounts written off						
Balances at 1 April 1995	(1,984)	-	-	-	(3)	(1,987)
Goodwill	(276)	-	-	-	-	(276)
Increase in the year	(3)	-	-	-	(4)	(7)
Balances at 31 March 1996	**(2,263)**	**-**	**-**	**-**	**(7)**	**(2,270)**
Net book value at 31 March 1996	**748**	**18**	**114**	**117**	**60**	**1,057**
Net book value at 31 March 1995	860	9	73	104	36	1,082

	Subsidiary undertakings *(a)*

	Shares £m	Loans £m	Associated undertakings *(a)(b)* £m	Other participating interests £m	Other investments *(c)* £m	Total £m
Company						
Cost						
Balances at 1 April 1995	2,701	19	2,711	104	156	5,691
Additions	329	-	12	57	10	408
Repayments, disposals and other transfers	7	(7)	-	(44)	(3)	(47)
Currency movements	-	-	178	-	-	178
Balances at 31 March 1996	**3,037**	**12**	**2,901**	**117**	**163**	**6,230**
Provisions and amounts written off						
Balances at 1 April 1995	(10)	(7)	(27)	-	(152)	(196)
Increase in the year	(209)	-	-	-	(2)	(211)
Disposals and transfers	(7)	7	-	-	2	2
Balances at 31 March 1996	**(226)**	**-**	**(27)**	**-**	**(152)**	**(405)**
Net book value at 31 March 1996	**2,811**	**12**	**2,874**	**117**	**11**	**5,825**
Net book value at 31 March 1995	2,691	12	2,684	104	4	5,495

(a) Subsidiary and associated undertakings
Details of the principal operating subsidiary and associated undertakings are set out elsewhere.

(b) MCI Communications Corporation
The group's most significant associated undertaking is MCI Communications Corporation (MCI), the second largest carrier of long-distance telecommunication services in the USA. The group's acquisition of a 20% interest in MCI was completed on 30 September 1994.

During the year ended 31 March 1996, MCI made certain acquisitions of subsidiary and associated undertakings and the group's share of goodwill arising from these, amounting to £232m, has been written off to reserves under the group's accounting policies.

At 31 March 1996, the group's 20% share of the net assets of MCI, calculated in accordance with group accounting policies, amounted to £804m (1995 - £907m). This value comprised tangible fixed assets of £1,179m (1995 - £994m), short-term investments of £82m (1995 - £346m) and other assets of £741m (1995 - £394m), from which are deducted borrowings of £524m (1995 - £377m) and other liabilities of £674m (1995 - £450m).

In the year ended 31 March 1996, the group's turnover with MCI amounted to £92m and the group purchased £77m in services and products from MCI. In the prior year, in the period from the acquisition of the interest, 30 September 1994, to 31 March 1995, the group's turnover with MCI amounted to £48m and the group purchased £38m in services and products from MCI. The group sold a 24.9% interest in Concert Communications Company, a previously wholly-owned subsidiary undertaking, to MCI for £54m on 30 September 1994.

The company's holding in MCI at 31 March 1996 comprised 136 million (1995 - 136 million) unlisted common shares and 0.7 million (1995 - nil) listed common shares. The listed common shares were purchased in the market in November 1995 at a cost of £12m.

(c) Other investments
Includes ordinary shares of the company, with a net book value of £9m (1995 - £2m), held in trust for the Long Term Remuneration Plan and the Performance Share Plan (note 27).
Following the introduction of UITF Abstract 13 there has been a reclassification of this investment from current assets to fixed asset investments and the comparative figures have been restated.

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NOTES TO THE FINANCIAL STATEMENTS

14. Debtors	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Trade debtors	**1,548**	1,171	**1,349**	1,045
Amounts owed by subsidiary undertakings	**-**	-	**414**	536
Amounts owed by associated undertakings	**29**	17	**-**	4
Other debtors	**217**	236	**118**	147
Advance corporation tax recoverable *(a)*	**-**	-	**-**	55
Accrued income	**1,135**	1,141	**1,095**	1,109
Prepayments	**153**	155	**122**	135
Total debtors	**3,082**	2,720	**3,098**	3,031
Total debtors included amounts receivable after more than one year:				
Amounts owed by subsidiary undertakings	**-**	-	**32**	147
Advance corporation tax recoverable *(a)*	**-**	-	**-**	55
Accrued income	**65**	51	**65**	51
Prepayments	**22**	34	**22**	34
Total	**87**	85	**119**	287
(a) Advance corporation tax recoverable				
Advance corporation tax on proposed final dividend	**179**	168	**179**	168
Amount offset against deferred tax provision (note 18)	**(179)**	(168)	**(179)**	(113)
Balance included within debtors	**-**	-	**-**	55

	Group	Company

15. Current asset investments	1996 £m	1995 £m	1996 £m	1995 £m
Listed investments	**179**	360	**65**	98
Other short-term deposits and investments	**2,389**	900	**1,918**	422
Total current asset investments	**2,568**	1,260	**1,983**	520
Market value of listed investments	**179**	372	**65**	106

16. Loans and other borrowings	Average effective interest rates *(a)* %	Group		Company	
		1996 £m	1995 £m	**1996 £m**	1995 £m
US dollar 7 5/8 % guaranteed bonds 1996	6.4	**164**	154	**-**	-
US dollar 6 1/2 % guaranteed notes 1997	7.7	**246**	230	**-**	-
US dollar 9 3/8 % guaranteed bonds 1998	6.5	**164**	154	**-**	-
US dollar 8 3/4 % guaranteed bonds 1999	8.8	**131**	123	**-**	-
US dollar 9 3/8 % guaranteed notes 1999	9.6	**196**	184	**-**	-
Zero coupon bonds 2000 (less unamortised discount £71m (1995 - £85m))	6.5	**129**	115	**129**	115
12 1/4 % bonds 2003	12.3	**180**	180	**180**	180
7 1/8 % bonds 2003 (less unamortised discount £5m (1995 - £5m))	7.3	**495**	495	**495**	495
12 1/4 % bonds 2006	12.3	**229**	229	**229**	229
US dollar 9 5/8 % guaranteed debentures 2019	9.8	**130**	122	**-**	-
8 5/8 % bonds 2020 (less unamortised discount £5m (1995 - £5m))	8.8	**295**	295	**295**	295
Total listed bonds, debentures and notes		**2,359**	2,281	**1,328**	1,314
Bonds held by HM Government (less unamortised increase in face value £42m (1995 - £52m)) *(b)*	11.9	**496**	616	**496**	616
Lease finance		**4**	7	**3**	6

Bank loans due 1999-2009	9.2	**765**	590	**-**	-
Bank overdrafts and other short-term borrowings	6.4	**13**	42	**144**	176
Commercial paper	6.0	**-**	15	**-**	15
Loans from subsidiary undertakings		**-**	-	**2,512**	1,959
Total loans and other borrowings		**3,637**	3,551	**4,483**	4,086

Apart from the lease finance, all borrowings are unsecured. Lease finance is repayable by instalments.

	Group		Company	
	1996 £m	1995 £m	**1996 £m**	1995 £m
Repayments fall due as follows:				
Within one year, or on demand	**315**	190	**607**	710
Between one and two years	**248**	288	**241**	301
Between two and three years	**359**	231	**342**	241
Between three and four years	**410**	338	**410**	330
Between four and five years	**165**	388	**742**	388
After five years	**2,140**	2,116	**2,141**	2,116
Total due for repayment after more than one year	**3,322**	3,361	**3,876**	3,376
Total loans and other borrowings	**3,637**	3,551	**4,483**	4,086

(a) The average effective interest rates in the table above take into account the effect of interest rate swaps.

(b) The bonds held by HM Government were formerly a series of unsecured loan stock which was issued to the Secretary of State in 1984, each series of which was modified in 1992 to form a corresponding series of bonds, repayable at par. In July 1994, the six series maturing on or after 31 March 1997 then outstanding, with original face values of £960m, were converted into series of bonds with new face values of £1,078m and lower interest rates attaching to them. In August 1994, three bonds in the series with a total new face value of £540m were repurchased by the company from HM Government and cancelled. The premium of £75m to the original face values paid on the repurchase was charged against the profit for the year ended 31 March 1995 (note 4). The increase in the face value of £58m on the three series of bonds that were converted but not repurchased is being amortised over the lives of those bonds; at 31 March 1996, £42m (1995 – £52m) remained to be amortised.

The repayment dates, unamortised increase in face value, and the current and former interest rates attaching to the bonds held by HM Government at 31 March 1996 are as follows:

Current interest rate %	Former interest rate %	Repayment date 31 March	Unamortised increase in face value £m	Balance sheet carrying value £m
8 1/4	12 1/2	1997	4	136
9 1/8	12 1/4	2001	14	165
9 1/8	12 1/4	2004	24	195
Total bonds held by HM Government				**496**

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17. Other creditors	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Trade creditors	**1,732**	1,177	**1,455**	1,005
Amounts owed to subsidiary undertakings	**-**	-	**726**	1,475
Amounts owed to associated undertakings	**37**	23	**2**	1
Corporation taxes	**1,091**	1,009	**1,007**	776
Other taxation and social security	**354**	344	**359**	336
Other creditors	**853**	752	**701**	697
Accrued expenses	**282**	221	**168**	119
Deferred income	**710**	705	**685**	695
Dividends	**715**	669	**715**	669
Total other creditors	**5,774**	4,900	**5,818**	5,773
Total other creditors included amounts due after more than one year:				
Deferred income	**28**	43	**28**	43

18. Provisions for liabilities and charges	Deferred taxation *(a)* £m	Pension provisions £m	Other provisions £m	Total £m
Group				
Balances at 1 April 1995	279	671	97	1,047
Charged against profit for the year:				
Regular pension cost	-	284	-	284
Redundancy charges	-	266	-	266
Other charges	96	-	10	106
Utilised in the year	-	(241)	(16)	(257)

	375	980	91	1,446
Advance corporation tax recoverable	(179)	-	-	(179)
Total provisions at 31 March 1996	**196**	**980**	**91**	**1,267**
Company				
Balances at 1 April 1995	113	671	46	830
Charged against profit for the year:				
Regular pension cost	-	275	-	275
Redundancy charges	-	266	-	266
Other charges	87	-	7	94
Utilised in the year	-	(232)	(4)	(236)
	200	980	49	1,229
Advance corporation tax recoverable	(179)	-	-	(179)
Total provisions at 31 March 1996	**21**	**980**	**49**	**1,050**

	Group		Company	
(a) Deferred taxation The elements of deferred taxation provided in the accounts at 31 March were as follows:	**1996 £m**	1995 £m	**1996 £m**	1995 £m
Tax effect of timing differences due to:				
Excess capital allowances	**712**	554	**654**	532
Pension provisions	**(323)**	(352)	**(323)**	(352)
Other	**(14)**	77	**(131)**	(67)
Total deferred taxation provided	**375**	279	**200**	113
Advance corporation tax recoverable	**(179)**	(168)	**(179)**	(113)
Total provision for deferred taxation	**196**	111	**21**	-

The total potential liability to deferred taxation at 31 March was as follows:

Tax effect of timing differences due to:				
Excess capital allowances	**2,700**	2,512	**2,642**	2,490
Pension provisions	**(323)**	(352)	**(323)**	(352)
Other	**(14)**	77	**(131)**	(67)
Total	**2,363**	2,237	**2,188**	2,071
Advance corporation tax recoverable	**(179)**	(168)	**(179)**	(168)
Total potential liability for deferred taxation	**2,184**	2,069	**2,009**	1,903

19. Called up share capital

The authorised share capital of the company throughout the year ended 31 March 1996 was £2,625,000,001 divided into one special rights redeemable preference share of £1 and 10,500,000,000 ordinary shares of 25p each.

The allotted, called up and fully paid share capital of the company was £1,573m at 31 March 1996 (1995 - £1,559m), representing 6,291,457,275 ordinary shares (1995 - 6,234,917,704) and one special rights redeemable preference share (1995 - 1).

Certain special rights, set out in the company's articles of association, attach to the special rights redeemable preference share issued to HM Government. This share, which carries no right to capital or profits beyond its nominal value, is redeemable at par at the option of the shareholder.

Of the authorised but unissued share capital at 31 March 1996, 257 million ordinary shares were reserved to meet options granted under the employee share option schemes described in note 27.

Ordinary shares allotted during the year were as follows:

	Number	Nominal value £	Consideration £
Savings related schemes	49,409,345	12,352,336	108,620,517
Other share option schemes	7,130,226	1,782,557	21,584,280

Totals for the year ended 31 March 1996	**56,539,571**	**14,134,893**	**130,204,797**

20. Reserves	Share premium account £m	Capital redemption reserve £m	Other reserves £m	Profit and loss account £m	Total £m
		Other reserves			
Group					
Balances at 1 April 1995	415	750	18	9,255	10,438
Premium on allotment of ordinary shares	116	-	-	-	116
Retained profit for the financial year	-	-	-	802	802
Goodwill, on acquisition of subsidiary and associated undertakings, written off *(a)*	-	-	-	(302)	(302)
Goodwill, previously written off to reserves, taken back to profit and loss account *(a)*	-	-	-	12	12
Currency movements arising on consolidation of foreign subsidiary and associated undertakings *(b)*	-	-	-	42	42
Other movements	-	-	9	(12)	(3)
Balances at 31 March 1996	**531**	**750**	**27**	**9,797**	**11,105**
Company					
Balances at 1 April 1995	415	750	-	9,890	11,055
Premium on allotment of ordinary shares	116	-	-	-	116
Retained profit for the financial year *(c)*	-	-	-	1,155	1,155
Currency movements arising on investments in subsidiary and associated undertakings *(b)*	-	-	-	149	149

Balances at 31 March 1996	**531**	**750**	**-**	**11,194**	**12,475**

(a) Aggregate goodwill in respect of acquisitions in the current and earlier years of £2,477m (1995 - £2,187m) has been written off against the group's reserves.

(b) The currency movements for the group and the company included net losses, in respect of currency borrowings, of £29m and £28m, respectively.

(c) The profit for the financial year, dealt with in the profit and loss account of the company, was £2,339m (1995 - £1,800m). As permitted by Section 230 of the Companies Act 1985, no profit and loss account of the company is presented.

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21. Shareholders' funds	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
The movement in the year was as follows:				
Profit for the financial year	**1,986**	1,731	**2,339**	1,800
Dividends	**(1,184)**	(1,108)	**(1,184)**	(1,108)
Retained profit for the financial year	**802**	623	**1,155**	692
Goodwill, on acquisition of subsidiary and associated undertakings, written off	**(302)**	(1,970)	**-**	-
Goodwill, previously written off to reserves, taken back to profit and loss account	**12**	321	**-**	-
Net currency movements arising on consolidation of foreign subsidiary and associated undertakings	**42**	(56)	**149**	(175)
Issue of ordinary share capital	**130**	57	**130**	57
Other movements	**(3)**	(4)	**-**	-
Net addition (reduction) in year	**681**	(1,029)	**1,434**	574
Balances at 1 April	**11,997**	13,026	**12,614**	12,040
Balances at 31 March	**12,678**	11,997	**14,048**	12,614

22. Financial commitments and contingent liabilities	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Contracts placed for capital expenditure not provided for in the accounts	**1,180**	1,166	**1,133**	1,077

Operating lease payments payable within one year of the balance sheet date were in respect of leases expiring:				
Within one year	**7**	13	**3**	8
Between one and five years	**26**	33	**21**	26
After five years	**111**	123	**95**	99
Total payable within one year	**144**	169	**119**	133

Future minimum operating lease payments for the group at 31 March 1996 were as follows:

Payable in the year ending 31 March:	**£m**
1997	**144**
1998	**133**
1999	**126**
2000	**120**
2001	**114**
Thereafter	**1,452**
Total future minimum operating lease payments	**2,089**

Operating lease commitments were mainly in respect of leases of land and buildings.

At 31 March 1996, 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 £1,796m (1995 - £1,557m).

Satellite consortia, in which the company has participating interests, are organisations without limited liability. At 31 March 1996, the company's share of the aggregate borrowings of these consortia amounted to £153m (1995 - £151m).

Outstanding at 31 March 1996 were warrants entitling the holders to subscribe in 1999 for US dollar 8.765% guaranteed bonds at par, repayable in 2009, to be issued by the group with a total principal value equivalent to £131m.

23. Pension costs

The total pension cost of the group charged within staff costs was £284m (1995 - £248m), of which £275m (1995 - £241m) related to the group's main pension scheme, the BT Pension Scheme. The increase in the charge for the year was due to the interest accounted for on the pension provisions in the balance sheet which have risen by £309m to £980m in the year.

The pension cost for the year was based on the valuation of the BT Pension Scheme at 31 December 1993. The valuation, carried out by professionally qualified independent actuaries, used the projected unit method. The major assumptions used by the actuaries were that, over the long term, the return on the existing assets of the scheme, relative to market values, would be 8.6% per annum and on future investments the return would be 9.7% per annum (allowing for real equity dividend growth of 0.5% per annum), the retail price index would increase at an average of 5.0%, and wages and salary rates would increase at an average of 6.8%. The assets of the scheme, which had a market value of £17,196m at the valuation date, were sufficient to cover 97% of the benefits that had accrued to members by 31 December 1993, after allowing for expected future increases in wages and salaries but not taking into account the cost of providing incremental pension benefits for employees taking early retirement under release schemes since that date. This cost, charged within redundancy costs, amounted to £266m in the year ended 31 March 1996 (1995 - £483m).

In the year ended 31 March 1996, the group made regular contributions of £234m to the scheme; in the prior year the group made a special contribution of £250m, in addition to regular contributions of £251m.

24. Financial instruments and risk management

The group uses derivative financial instruments primarily to manage its exposure to market risks from changes in interest and foreign exchange rates. The group does not enter into or issue derivative financial instruments for trading purposes.

The notional amounts of derivatives summarised below do not necessarily represent amounts exchanged by the parties and, thus, are not 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 commercial banks and other institutions to vary the amounts and periods for which interest rates on borrowings are fixed. By swapping fixed rates on long-term borrowings into floating rates, the group has obtained lower floating-rate borrowings than those available if borrowing directly at a floating rate. Under interest rate swaps, the group agrees with other parties to exchange, at specified intervals, the difference between fixed rate and floating rate interest amounts

calculated by reference to an agreed notional principal amount.

At 31 March 1996, the group had outstanding interest rate swap agreements having a total notional principal amount of £1,253m (1995 - £1,056m).

(b) Foreign exchange risk management The group has foreign currency swap agreements in place which reduce the impact of changes in currency rates on certain of its long-term borrowings denominated in US dollars. The group also enters into forward exchange contracts to hedge interest expense, purchase and sale commitments denominated in foreign currencies (principally US dollars). The terms of the currency swaps are up to 20 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 1996, the group had outstanding foreign currency swap agreements and forward exchange contracts having a total notional principal amount of £2,377m (1995 - £1,814m).

The fair values of foreign currency contracts at 31 March 1996 were £396m (1995 - £502m) for purchases of currency and £1,027m (1995 - £358m) 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 1996, BT had deferred unrealised gains of £2m (1995 - £3m) and losses of £15m (1995 - £14m), based on dealer-quoted prices, from hedging purchase and sale commitments. At 31 March 1996, the group also had deferred realised net gains of £4m (1995 - £10m). These are included in the profit and loss account as part of the purchase or sale transaction when it is recognised, or as gains or losses when a hedged transaction is no longer expected to occur.

(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. Based on interest and exchange rates in effect at 31 March 1996, the group had a maximum credit exposure of £116m (1995 - £87m) to one counterparty under foreign currency and interest rate swap agreements. 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.

(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 1996 and 1995. The carrying amounts are included in the group balance sheet under the indicated headings, with the exception of derivative amounts related to borrowings, which are included in debtors or other creditors 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 a forced or liquidation sale.

	Carrying amount		Fair value	
	1996 £m	1995 £m	**1996 £m**	1995 £m
Non-derivatives:				
Assets				
Cash at bank and in hand	**121**	138	**121**	138
Short-term investments *(i)*	**2,568**	1,260	**2,568**	1,272
Liabilities				
Short-term borrowings *(ii)*	**13**	57	**13**	57
Long-term borrowings, excluding finance leases *(iii)*	**3,620**	3,487	**3,874**	3,693
Derivatives relating to borrowings (net) *(iv)*:				
Assets	**16**	-	**61**	-
Liabilities	**-**	31	**-**	14

(i) The fair values 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.

(ii) The fair value of short-term borrowings approximated to carrying value due to the short maturity of the instruments.

(iii) 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.

(iv) 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.

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25. Directors

Directors' emoluments

The emoluments of the directors for the year ended 31 March 1996 were, in summary, as follows:

	1996 **£000**	1995 £000
Salaries	**1,471**	1,482
Performance-related bonus	**543**	351
Other benefits	**68**	153
	2,082	1,986
Payments to non-executive directors *(a)*	**381**	313
	2,463	2,299
Payments to pension scheme	**235**	216
Provision for unfunded pensions	**789**	380
Total emoluments	**3,487**	2,895

(a) Payments to non-executive directors include fees paid to their principal employer of £24,000 (1995 - £39,000).

Pensions in respect of the management services of past and present directors paid by the company for the year ended 31 March 1996 were £84,000 (1995 - £82,000). The cumulative provision for present and past directors' unfunded pension benefits at 31 March 1996 was £4,171,000 (1995 - £3,150,000), including the interest accounted for on the provision, and is based on actuarial advice.

More detailed information concerning directors' remuneration, shareholdings, options and long-term incentive plans is shown in the report of the *Board Committee on Executive Remuneration* (Part 1 and Part 2).

	1996	1995

26. People employed	**Year end '000**	**Average '000**	Year end '000	Average '000
Number of employees in the group:				
UK	**127.8**	**132.6**	134.9	146.6
Overseas	**2.9**	**2.6**	2.6	2.3
Total employees	**130.7**	**135.2**	137.5	148.9

27. 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 and further share option schemes for selected group employees. It also has a performance share plan which was introduced during the year and a long-term remuneration plan.

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 five-year Save As You Earn contract; there is a similar savings-related scheme for group employees overseas. Under the other share option schemes, share options are normally exercisable between the third and tenth anniversaries of the date of grant.

Options outstanding under these share option schemes at 31 March, together with their exercise prices and dates, were as follows:

Normal dates of exercise	Option price per share	Number of ordinary shares **1996 millions**	Number of ordinary shares 1995 millions	Normal dates of exercise	Option price per share	Number of ordinary shares **1996 millions**	Number of ordinary shares 1995 millions
Savings-related schemes:				Other share option schemes:			
1995	210p	**-**	42	1991-1998	243p	**1**	1
1996	244p	**58**	64	1992-1999	281p	**1**	2
1997	265p	**50**	55	1993-2000	289p	**4**	7
1998	320p	**50**	55	1994-2001	380p	**1**	1
1999	341p	**30**	35	1995-2002	333p	**5**	8

2000	306p	**50**	52

1996-2003	430p	**3**	3
1997-2004	375p	**4**	4
Total options outstanding		**257**	329

In the year ended 31 March 1996, options for 57 million shares were exercised under the share option schemes and options for 15 million shares lapsed. No significant options were granted in the year.

Long-term remuneration and performance share plans

A long-term remuneration plan (LTRP) and a 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, although participants will only be entitled to these shares in full at the end of a five-year period under the LTRP and the end of a three-year period, which may be extended to four or five years, under the PSP if, at the end of the applicable period, the company has met the relevant pre-determined corporate performance measure and the participants are still employed by the group. Awards of shares were granted in 1994 and 1995 under the LTRP and in 1995 under 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.

27. Employee share schemes (continued)

At 31 March 1996, 1.8 million shares were held in trust for the PSP and 1.5 million (1995 – 0.7 million) were held in trust for the LTRP. Dividends 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:

	PSP	LTRP	
	1996 £m	**1996 £m**	1995 £m
Value of range of possible future transfers: nil to	**6.5**	**4.7**	2.7
Provision for the costs of the plans charged to the profit and loss account in year	**2.0**	**0.7**	0.2
Nominal value of shares held in trust	**0.4**	**0.4**	0.2
Market value of shares held in trust	**6.6**	**5.5**	2.7

The values of possible future transfers of shares under the plans were based on the company's share price at 31 March 1996 of 369p (1995 - 391p). The provisions for the costs of the plans were based on best estimates of the company's performance over the plans' performance periods, relating to those portions of the plan performance periods from commencement up to the financial year end.

28. Auditors

The auditors' remuneration for the year ended 31 March 1996 for the group was £2,138,000 (1995 - £1,879,000), including £1,170,000 (1995 - £1,164,000) for the company.

The following fees were paid or are payable to the company's auditors, Coopers & Lybrand, in the UK for the year ended 31 March 1996:

	1996	1995
	£000	£000
Audit of the company's statutory accounts	**1,170**	1,164
Audits of the UK subsidiary undertakings' statutory accounts	**380**	432
Other services, including regulatory audits and tax compliance work	**4,004**	3,049
Total	**5,554**	4,645

In addition, fees of £1,364,000 (1995 - £637,000) were paid or are payable to other members of Coopers & Lybrand International for the year ended 31 March 1996 in respect of audit and other services to the company's overseas subsidiary undertakings and in respect of other services to the group.

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Subsidiary and associated undertakings

Brief details of principal operating subsidiary and associated undertakings at 31 March 1996, all of which were unlisted unless otherwise stated, were as follows:

Subsidiary undertakings	Activity	Group interest in allotted capital *(b)*	Country of operations *(c)*
Albacom SpA *(a)*	Communication related services and products provider	50% ordinary	Italy
BT Australasia Pty Limited *(a)*	Communication related services and products provider	100% ordinary 100% preference	Australia
BT (CBP) Limited *(a)*	Financial market telecommunication equipment provider	100% ordinary	International
BT Cableships Limited *(a)*	Cableship owner	100% ordinary	International
BT Communications Management Limited *(a)*	Telecommunication services provider	100% ordinary	International
BT France SNC *(a)*	Communication related services and products provider	100% equity	France
BT Limited *(a)*	Communication related services and products provider	100% ordinary	International
BT (Hong Kong) Limited *(a)*	Communication related services and products provider	100% ordinary 100% preference	Hong Kong

BT North America Inc *(a)*	Communication related services and products provider	100% common	USA
BT Property Limited *(a)*	Property holding company	100% ordinary	United Kingdom
BT Subsea Cables Limited	Cable maintenance and repair	100% ordinary	United Kingdom
BT Telecomunicaciones SA *(a)*	Communication related services and products provider	50% ordinary	Spain
BT Visual Images LLC *(a)*	Video conferencing products and services provider	50% equity	USA
BT (Worldwide) Limited *(a)*	International telecommunication network systems provider	100% ordinary	International
Call Connections Limited *(a)*	Cellular services provider	60% ordinary 60% preference	United Kingdom
Cellnet Solutions Limited *(a)*	Messaging service provider for cellular telephone systems	60% ordinary	United Kingdom
Concert Communications Company *(a)*	Telecommunication services and network systems provider	75% ordinary	International
First State Computing Unit Trust *(a)*	Systems integration and application development	100% equity	Australia
Manx Telecom Limited *(a)*	Telecommunication services supplier	100% ordinary	Isle of Man

Telecom Securicor Cellular Radio Limited *(a)*	Mobile cellular telephone system provider and operator	60% ordinary	United Kingdom
Westminster Cable Company Limited	Cable television service provider	100% ordinary	United Kingdom
Yellow Pages Sales Limited *(a)*	Yellow Pages sales contractor	100% ordinary	United Kingdom

(a) Held through intermediate holding company.

(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.

		Share capital or debt securities		
Associated undertakings	Activity	Issued *(c)*	Percentage owned	Country of operations *(d)*
Clear Communications Limited *(a)*	Telecommunications services supplier	Equity NZ $101m	25%	New Zealand
Jetphone Limited *(a)* (incorporated in Republic of Ireland)	Communication related services and products provider	Equity IR£2m	50%	International
MCI Communications Corporation *(b)*	Telecommunication services supplier	Equity US $74m Notes US $2,377m	20% -	USA
Telenordia AB *(a)*	Communication related services and products provider	Equity SKR102m	33%	Sweden

Viag Interkom GmbH & Co *(a)*	Communication related services and products provider	Equity DM101m	50%	Germany

(a) Held through intermediate holding company.

(b) Listed company.

(c) Equity comprises ordinary or common shares.

(d) All overseas undertakings are incorporated in their country of operations, unless otherwise stated.

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Quarterly analysis of turnover and profit

(UNAUDITED) YEAR ENDED 31 MARCH 1996

Quarters	1st £m	2nd £m	3rd £m	4th £m	**Total £m**
Turnover	3,499	3,549	3,620	3,778	**14,446**
Operating profit *(a)*	886	798	835	581	**3,100**
Group's share of profits (losses) of associated undertakings	31	(26)	30	47	**82**
Profit on sale of group undertakings	5	-	2	-	**7**
Interest receivable	(42)	(51)	(53)	(55)	**(201)**
Interest payable	90	91	91	99	**371**
Profit on ordinary activities before taxation	874	732	829	584	**3,019**
Tax on profit on ordinary activities	297	249	282	199	**1,027**
Profit on ordinary activities after taxation	577	483	547	385	**1,992**
Minority interests	2	4	-	-	**6**
Profit for the financial period	575	479	547	385	**1,986**
Earnings per share	9.2p	7.6p	8.7p	6.1p	**31.6p**
(a) including redundancy charges	22	101	60	238	**421**

(UNAUDITED) YEAR ENDED 31 MARCH 1995

Quarters	1st £m	2nd £m	3rd £m	4th £m	**Total £m**
Turnover	3,382	3,469	3,466	3,576	**13,893**
Operating profit *(a) (b)*	841	831	669	322	**2,663**
Group's share of profits of associated undertakings	3	15	31	43	**92**

Profit on sale of group undertakings	-	-	33	208	**241**
Interest receivable	(37)	(42)	(38)	(38)	**(155)**
Interest payable	100	101	111	102	**414**
Premium on repurchase of bonds	-	75	-	-	**75**
Profit on ordinary activities before taxation	781	712	660	509	**2,662**
Tax on profit on ordinary activities	270	271	228	157	**926**
Profit on ordinary activities after taxation	511	441	432	352	**1,736**
Minority interests	7	9	(9)	(2)	**5**
Profit for the financial period	504	432	441	354	**1,731**
Earnings per share	8.1p	6.9p	7.1p	5.7p	**27.8p**
(a) including redundancy charges	54	97	217	452	**820**

(b) Operating profit for the fourth quarter and year ended 31 March 1995 has been restated for a reclassification of the annual charge for the employee share ownership scheme.

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Financial statistics

Financial ratios YEAR ENDED 31 MARCH

	1992	1993	1994	1995	**1996**
Earnings per share - pence	33.2	19.8	28.5	27.8	**31.6**
Growth in net dividends per share %	8.3	8.3	7.1	6.0	**5.6**
Return on capital employed % *(a)*	19.3	13.6	17.1	15.6	**18.3**
Gearing - net debt to equity % *(b)*	21.1	14.3	9.3	17.8	**7.4**
Interest cover *(c)*	11.1	9.4	13.0	10.3	**18.2**
Dividend cover *(d)*	2.3	1.3	1.7	1.6	**1.7**

(a) The ratio is based on profit before tax and interest on long-term borrowings, adjusted to reflect the utilisation of any restructuring provision, to average capital employed. Capital employed is represented by total assets less current liabilities, excluding corporate taxes and dividends payable, and provisions other than those for deferred taxation and restructuring. 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 operating profit. In 1993 and 1995, net interest excludes the premiums paid on the repurchase of bonds.

(d) The number of times dividends are covered by earnings.

Expenditure on research and development
YEAR ENDED 31 MARCH

	1992 £m	1993 £m	1994 £m	1995 £m	**1996 £m**
Total expenditure	240	233	265	271	**282**

Expenditure on tangible fixed assets
YEAR ENDED 31 MARCH

Plant and equipment

Transmission	1,173	835	896	1,060	**1,114**
Telephone exchanges	722	545	493	605	**566**
Other network equipment	281	296	335	378	**491**
Computers and office equipment	170	152	219	343	**333**
Motor vehicles and other	131	272	153	214	**195**
Land and buildings	54	66	51	75	**87**
Increase (decrease) in engineering stores	(85)	(11)	24	(4)	**(15)**
Total expenditure on tangible fixed assets	2,446	2,155	2,171	2,671	**2,771**
Decrease (increase) in creditors	119	(7)	(10)	(33)	**(224)**
Cash outflow on purchase of tangible fixed assets	2,565	2,148	2,161	2,638	**2,547**

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Operational statistics

Call growth YEAR ENDED 31 MARCH

	1992	1993	1994	1995	**1996**
% growth in telephone call volumes over the previous year:					
Inland	1	-	6	7	**6**
International *(a)*	4	6	6	5	**9**

(a) Outgoing, incoming and transit.

Exchange line connections AT 31 MARCH					
Business ('000)	5,859	5,947	6,129	6,459	**6,798**
% growth over previous year	1.2	1.5	3.1	5.4	**5.2**
Residential ('000)	19,729	20,114	20,471	20,613	**20,500**
% growth (reduction) over previous year	0.8	2.0	1.8	0.7	**(0.5)**
Total exchange line connections ('000)	25,588	26,061	26,600	27,072	**27,298**
% growth over previous year	0.9	1.8	2.1	1.8	**0.8**
Network modernisation AT 31 MARCH					
% customer lines served by type of telephone exchange:					
Digital	54.6	64.0	74.9	82.7	**87.7**
Semi-electronic	35.0	31.9	24.6	17.2	**12.3**
Electro-mechanical	10.4	4.1	0.5	0.1	**-**
Total	100.0	100.0	100.0	100.0	**100.0**
% itemised billing availability	80.7	88.6	96.5	99.2	**100.0**
Optical fibre AT 31 MARCH					
Fibre - kilometres in the network ('000)	2,045	2,337	2,577	2,782	**3,043**

Cellnet (Cellular telephones in the UK) AT 31 MARCH					
Analogue - low usage tariffs ('000)	-	107	331	935	**1,463**
Analogue - high usage tariffs ('000)	547	551	688	765	**573**
Digital GSM ('000)	-	-	-	34	**353**
Total	547	658	1,019	1,734	**2,389**

Payphones AT 31 MARCH					
Total public payphones in the UK ('000)	106	113	124	129	**133**

People employed AT 31 MARCH					
Total employees ('000)	210.5	170.7	156.0	137.5	**130.7**

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Regulatory statistics

Price control

Under the company's licence, there are restrictions on the prices it may charge for its main switched telephone services. The company's performance against this price constraint, which is linked to the annual movement in the retail price index (RPI), is shown below.

YEAR COMMENCING 1 AUGUST

	1991	1992		1993	1994	**1995**	
% RPI movement for the relevant period *(a)*	5.84	3.88		1.22	2.62	**3.52**	
RPI formula in effect	(6.25)	(6.25)		(7.50)	(7.50)	**(7.50)**	
% required reduction in prices *(b)*	(0.23)	(0.95)	*(c)*	(6.94)	(4.86)	**(1.38)**	
% reduction in prices overall	(0.73)	(0.47)		(6.95)	(7.35)	**(0.02)**	*(d)*

(a) Annual increase in RPI to previous June.

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

(c) After adjustment for a shortfall in directory enquiry revenue in the years commencing 1 August 1990 and 1991.

(d) Reductions implemented to 21 May 1996; a further reduction of 1.36% is required to be implemented before 31 July 1996.

Exchange line disconnections for non-payment of bills YEAR ENDED 31 MARCH 1996

	April	May	June	July	Aug	Sep
Business ('000)	14	18	17	18	17	19
Residential ('000)	52	75	73	68	74	71
Total disconnections ('000)	66	93	90	86	91	90

	Oct	Nov	Dec	Jan	Feb	Mar
Business ('000)	19	19	13	25	25	20
Residential ('000)	79	69	46	96	70	62

Total disconnections ('000)	98	88	59	121	95	82

BT's policy is not to disconnect customers for non-payment of bills unless 28 days have elapsed from the despatch of the relevant bill, except in cases of suspected fraud. Customers who are late in paying receive at least two reminders from BT, one of which is normally given by telephone, before the company considers disconnection. BT takes this action only as a last resort after giving customers an opportunity to agree revised payment plans.

Financial, operational and regulatory statistics have been restated where necessary to provide consistency with the presentation of the 1996 figures.

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United States Generally Accepted Accounting Principles reconciliations

The group's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the UK (UK GAAP), which differ in certain significant respects from those applicable in the US (US GAAP).

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 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) Early release schemes
Under UK GAAP, the group generally charges to profit and loss direct severance costs, primarily severance payments and payments in lieu of notice, in the period in which employees leave the group. The cost of providing incremental pension benefits in respect of workforce reductions are taken into account in determining current and future pension costs, unless the most recent actuarial valuation under UK actuarial conventions shows a deficit. In this case, the costs of providing incremental pension benefits are included in early release scheme expenses in the year in which the employees leave the group.

Under US GAAP, if employees are encouraged to leave voluntarily by the use of special termination benefits, then the termination benefits, primarily severance payments, payments in lieu of notice and the associated cost of providing incremental pension benefits, are charged against profits in the period in which the termination terms are agreed with the employees. If staff terminations are likely to be enforced, then the termination benefits are charged against profits at the time when the group is committed to the staff terminations and the associated costs can be reasonably estimated.

(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. The

amount of interest capitalised is determined by reference to the average interest rates on outstanding borrowings.

(d) Goodwill

Under UK GAAP, the group writes off goodwill arising from the purchase of subsidiary and associated undertakings 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, or when recognising a permanent diminution in value. 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.

(e) Mobile cellular telephone and broadcasting licences

Under UK GAAP, the group adopted the policy of stating mobile cellular telephone and broadcasting licences, held in a former associated undertaking, at historical cost. No amortisation was provided on these assets. To comply with US GAAP, such intangible assets were amortised over a period of 40 years.

(f) Software capitalisation

Under UK GAAP software development expenditure is written off as incurred. Under US GAAP, development expenditure, subsequent to proving technical feasibility, and purchases are capitalised and amortised over their useful lives.

(g) Acquisition provisions

Under UK GAAP, in assessing the fair value of the net assets of subsidiary and associated undertakings, provisions were made on acquisition for commitments and developments in progress. To comply with US GAAP, the provisions established on acquisition were eliminated, the relevant costs being charged to income in the year in which they arose.

(h) 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 US Statement of Financial Accounting Standards No. 109.

(i) Dividends

Under UK GAAP, dividends are recorded in the year in respect of which they are declared (in the case of interim 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.

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 YEAR ENDED 31 MARCH

	1994 £m	1995 £m	**1996 £m**	**1996 $m** *(a)*
Net income applicable to shareholders under UK GAAP	1,767	1,731	**1,986**	**3,039**
Adjustments for:				
Pension costs	(232)	(392)	**18**	**28**
Early release schemes	(119)	125	**(152)**	**(233)**
Capitalisation of interest, net of related depreciation	(16)	(18)	**(22)**	**(34)**
Goodwill	(10)	85 *(b)*	**(74)**	**(113)**
Mobile cellular telephone and broadcasting licences amortisation	(28)	130 *(b)*	**-**	**-**
Software and other intangible asset capitalisation and amortisation, net	(1)	21	**38**	**58**
Acquisition provisions	(19)	-	**-**	**-**
Deferred taxation	132	56	**14**	**21**
Other items	2	6	**(2)**	**(3)**
Net income as adjusted for US GAAP	1,476	1,744	**1,806**	**2,763**
Earnings per American Depositary Share as adjusted for US GAAP *(c)*	£2.38	£2.80	**£2.87**	**$4.40**

Shareholders' equity AT 31 MARCH

	1995 £m	**1996 £m**	**1996 $m** *(a)*
Shareholders' equity under UK GAAP	11,997	**12,678**	**19,397**
Adjustments for:			

Pension costs	(1,158)	**(1,140)**	**(1,744)**
Early release schemes	(16)	**(168)**	**(257)**
Capitalisation of interest, net of related depreciation	387	**366**	**560**
Goodwill, net of accumulated amortisation	1,992	**2,174**	**3,326**
Software and other intangible asset capitalisation and amortisation	144	**196**	**300**
Deferred taxation	(1,833)	**(1,802)**	**(2,757)**
Dividend declared after the financial year end	669	**715**	**1,094**
Other items	3	**(9)**	**(14)**
Shareholders' equity as adjusted for US GAAP	12,185	**13,010**	**19,905**

(a) Translated at US$1.53 to £1.00, the rate ruling on 31 March 1996.

(b) The disposal of the group's interest in AT&T Corporation shares which had been exchanged for shares in McCaw Cellular Communications, Inc, during the year ended 31 March 1995 gave rise to adjustments, increasing net income, of £125m to goodwill and £137m to mobile cellular telephone and broadcasting licence amortisation.

(c) Each American Depositary Share is equivalent to 10 ordinary shares of 25p each.

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Additional information for shareholders

Analysis of shareholdings

Size of shareholding AT 31 MARCH 1996	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	1,056,995	44.4	231	3.7
400 - 799	715,891	30.0	382	6.1
800 - 1,599	428,028	17.9	463	7.4
1,600 - 9,999	178,797	7.5	454	7.2
10,000 - 99,999	3,552	0.1	94	1.5
100,000 - 999,999	1,504	0.1	531	8.4
1,000,000 - 4,999,999 *(a)*	468		1,007	16.0
5,000,000 and above *(b)(c)*	161		3,129	49.7
Total	2,385,396 *(d)*	100.0	6,291	100.0 *(d)*

(a) Under the BT Long Term Remuneration Plan and the BT Performance Share Plan 3.3 million shares were held in trust in respect of contingent awards of shares which have been granted to 675 participants in the two plans.

(b) Under the BT Employee Share Ownership Scheme 39 million shares were held in trust on behalf of 196,449 participants who were beneficially entitled to the shares.

(c) Approximately 124 million shares were represented by American Depositary Receipts and a further 15 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) 23.4% of the shares were in 2,302,881 individual holdings, of which 206,660 were joint holdings, and 76.1% of the shares were in 82,514 institutional holdings. HM Government retains a residual holding of 0.5% of the shares, to meet the requirements of the share bonus arrangements made under the offer for sale of July 1993.

Listings

BT has a listing on the Stock Exchanges in London, New York and Tokyo.

It is expected that transactions will be settled in CREST, the new system for the electronic settlement of shares in the UK, when BT shares are bought or sold on the London Stock Exchange from 9 December 1996.

BT shares are traded on the New York Stock Exchange in the form of American Depositary Shares (ADSs). Each ADS represents ten ordinary shares. Trading on the New York Stock Exchange is under the symbol ‘‘BTY’’.

In Japan, BT shares are traded on the Tokyo Stock Exchange under the code ‘‘9484’’.

Dividends

The proposed 1996 final dividend will be paid on 16 September to shareholders on the register on 13 August 1996. The expected dividend payment dates in 1997 are:

1997 interim dividend payable	February 1997
1997 final dividend payable	September 1997

Personal equity plans

Halifax Investment Services, regulated by IMRO, offers both a BT single company and a corporate PEP. For information, please contact Halifax Investment Services Limited, Trinity Road, Halifax HX1 2RG, or call **Free***fone 0800 371 769*.

Results announcements

Expected announcements of results:

1st quarter	25 July 1996
2nd quarter and half year	14 November 1996
3rd quarter and nine months	February 1997
4th quarter and full year	May 1997
1997 annual report and accounts published	June 1997

Form 20-F

The company will file an annual report on Form 20-F with the Securities and Exchange Commission in the USA, by 30 September 1996.

Regulatory financial statements

The company will publish historical cost Financial Statements for the Businesses and Activities and Current Cost Financial Statements for the year ended 31 March 1996, as required by Oftel, by 31 July 1996 and 30 September 1996, respectively.

Copies of the Form 20-F, the Financial Statements for the Business and Activities, the Current Cost Financial Statements and details of quarterly results announcements, when available, may be obtained on request from the BT Shareholder Helpline provided by the company's Registrar.

The Registrar
Lloyds Bank Registrars (450)
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Chuo-Ku, Osaka 541
(Corporate Agency Department)

Tel (06) 222 3111

Shareholder enquiries
Lloyds Bank Registrars maintain BT's share register and the separate BT Employee Share Ownership Scheme register. 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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