

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.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenditure during the reporting period. Actual results could differ from those estimates. Estimates are used principally when accounting for income, provision for doubtful debts, payments to telecommunication operators, depreciation, employee pension schemes and taxes. Certain comparative figures have been restated to conform with revised presentation and reclassification of figures in the year ended 31 March 1998.

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 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.

The lives assigned to other significant tangible fixed assets are:

Freehold buildings –	40 years
Leasehold land and buildings –	Unexpired portion of lease or 40 years, whichever is the shorter
Transmission equipment:	
duct –	25 years
cable –	3 to 25 years
radio and repeater equipment –	2 to 25 years
Digital telephone exchange equipment –	2 to 13 years
Computers and office equipment –	2 to 7 years
Payphones, other network equipment, motor vehicles and cables	3 to 20 years

VIII 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.

IX 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.

X 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.

XI Pension scheme

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 X 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.

XII 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.

XIII Financial instruments**(a) Debt instruments**

Debt instruments are stated at the amount of net proceeds adjusted to amortise any discount evenly over the term of the debt.

(b) Derivative financial instruments

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

Criteria to qualify for hedge accounting

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

(b) Derivative financial instruments (continued)*Accounting for derivative financial instruments*

Principal amounts underlying currency swaps are revalued at exchange rates ruling at the date of the group balance sheet and are included in debtors or creditors.

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

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

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