

Notes to the financial statements

1. Turnover	1998 £m	1997 £m	1996 £m
Inland calls	4,924	4,874	4,882
International calls	1,553	1,809	1,980
Exchange line rentals	2,957	2,811	2,685
Private circuits	1,149	1,124	1,056
Mobile communications	1,089	949	856
Customer premises equipment supply	896	914	946
Yellow Pages and other directories	466	438	408
Other sales and services	2,606	2,016	1,633
Total turnover	15,640	14,935	14,446

The group provides telecommunication services, principally in the United Kingdom, essentially operating as a unitary business. Its main services and products are local and national telephone calls in the United Kingdom, the provision of telephone exchange lines to homes and businesses, international telephone calls made to and from the United Kingdom, the provision of private circuits to businesses, the supply of mobile communication services and equipment to businesses and individuals and the supply of telecommunication equipment for customers' premises.

Turnover included income from UK and overseas telecommunications operators of £1,269m (1997 – £1,165m, 1996 – £1,166m). Approximately 4% (1997 – 3%, 1996 – 2%) of total operating revenues arose from operations outside the United Kingdom. There were no discontinued operations or acquisitions in the years ended 31 March 1996, 1997 and 1998 that require disclosure under Financial Reporting Standard 3.

Unaudited information concerning the group's classified directory business in the UK is shown on page 83 of this annual report.

2. Other operating income	1998 £m	1997 £m	1996 £m
Merger agreement break up fee (a)	273	–	–
Merger expenses written off	(35)	–	–
Other	134	106	103
Total other operating income	372	106	103

(a) The company received US\$465 million on 12 November 1997 from WorldCom, Inc as a break up fee and partial reimbursement of expenses ("the MCI merger break up fee") following the termination of the BT/MCI merger agreement on 9 November 1997 (note 15 (b)).

	1998	1997	1996
	£m	£m	£m
3. Operating costs			
Staff costs:			
Wages and salaries	3,290	3,161	3,105
Social security costs	266	262	261
Pension costs (<i>note 25</i>)	177	291	284
Employee share ownership scheme (<i>a</i>)	64	64	30
Employee share option scheme compensation for special dividend (<i>b</i>)	120	–	–
Total staff costs	3,917	3,778	3,680
Own work capitalised	(424)	(399)	(417)
Depreciation (<i>note 14</i>)	2,395	2,265	2,189
Payments to telecommunication operators	1,600	1,476	1,383
Redundancy charges (<i>c</i>)	106	367	421
Other operating costs	4,761	4,309	4,193
Total operating costs	12,355	11,796	11,449
Operating costs included the following:			
Research and development	307	291	282
Rental costs relating to operating leases, including plant and equipment hire £19m (1997 – £10m, 1996 – £23m)	192	215	250

(a) Amount set aside for the year for allocation of ordinary shares in the company to eligible employees.

(b) Compensation for employees holding share options on 15 August 1997 in respect of the September 1997 special dividend.

(c) Redundancy charges for the year ended 31 March 1997 included £258m (1996 – £266m) being the cost of providing incremental pension benefits for employees taking early retirement. No charge for these pension benefits was made in the year ended 31 March 1998 in view of the surplus in the BT pension scheme disclosed by the most recent actuarial valuation as at 31 December 1996; the previous valuation had shown a deficit.

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. Other operating income, previously presented within operating costs, is now shown separately on the face of the group profit and loss account because of its greater materiality in the year ended 31 March 1998.

4. Profit on sale of group undertakings

In the years ended 31 March 1998, 31 March 1997 and 31 March 1996 the subsidiary undertakings disposed of 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.

	1998	1997	1996
	£m	£m	£m
5. Interest receivable			
Income from listed investments	11	12	29
Other interest receivable	154	194	172
Total interest receivable	165	206	201

6. Interest payable	1998	1997	1996
	£m	£m	£m
Interest payable and similar charges in respect of:			
Bank loans and overdrafts	80	76	74
Other borrowings	334	259	297
Total interest payable	414	335	371

7. Premium on repurchase of bonds

In August 1996, the company repurchased two of the three series of HM Government held bonds then outstanding for £422m at an effective premium of £60m. The final bond series with a face value of £140m was repaid on maturity on 31 March 1997.

8. Tax on profit on ordinary activities	1998	1997	1996
	£m	£m	£m
United Kingdom:			
Corporation tax at 31% (1997 – 33%, 1996 – 33%)	985	1,135	1,000
Deferred taxation charge (credit) at 30% (1997 – 33%, 1996 – 33%)	17	(100)	(20)
Taxation on the group's share of results of associated undertakings	1	–	1
Deferred taxation provision released due to reduction in corporation tax rate	(25)	–	–
Prior year adjustments	(2)	1	(1)
Total UK taxation, excluding windfall tax	976	1,036	980
Overseas taxation:			
Current	6	17	8
Taxation charge (credit) on the group's share of results of associated undertakings	(4)	49	39
Total corporation and similar taxes	978	1,102	1,027
Windfall tax	510	–	–
Total tax on profit on ordinary activities	1,488	1,102	1,027

The company's charge to the UK windfall tax, imposed on certain privatised companies on 2 July 1997, is payable in two equal instalments, the first of which was paid on 2 December 1997. The second instalment is payable on 1 December 1998. The charge is based on the group's profit for the financial years ended 31 March 1986 to 31 March 1989.

Total tax on profit on ordinary activities, excluding the windfall tax, varied from the amount computed by applying the corporation tax rate to profit on ordinary activities before taxation. The differences were attributable to the following factors:

	1998	1997	1996
	%	%	%
UK corporation tax rate	31.0	33.0	33.0
Non-deductible depreciation	0.6	0.8	1.3
Non-deductible overseas losses	1.1	1.0	0.9
Unprovided deferred taxes on excess capital allowances	(0.9)	(0.9)	(1.0)
Effect of reduction in UK corporation tax rate on deferred tax provision	(0.8)	–	–
Lower effective tax on MCI merger break up fee	(0.7)	–	–
Non-deductible premium on bonds repurchased from HM Government	–	0.4	–
Other	0.1	0.1	(0.2)
Effective corporation tax rate	30.4	34.4	34.0

Deferred taxation of £30m (1997 – £28m, 1996 – £30m) arising on excess capital allowances and £nil (1997 – £19m, 1996 – £11m) on profits of associated undertakings was not provided in the year ended 31 March 1998.

8. Tax on profit on ordinary activities (continued)

The deferred taxation charge (credit) was mainly the result of the tax effect of timing differences as follows:

	1998 £m	1997 £m	1996 £m
Excess capital allowances	24	62	76
Pension provisions	20	(103)	(29)
Other timing differences	(27)	(59)	(67)
	17	(100)	(20)
Release due to reduction in corporation tax rate	(25)	–	–
Prior year adjustments (a)	(14)	21	116
Total deferred taxation charge (credit)	(22)	(79)	96

(a) Reclassification between deferred and current taxation on the profit on ordinary activities for prior years.

9. Dividends	1998 pence per share	1997 pence per share	1996 pence per share	1998 £m	1997 £m	1996 £m
	Interim dividend paid	7.55	7.90	7.45	483	502
Proposed final dividend	11.45	11.95	11.25	737	764	715
Total ordinary dividends	19.00	19.85	18.70	1,220	1,266	1,184
Special dividend	–	35.00	–	–	2,244	–
Total dividends	19.00	54.85	18.70	1,220	3,510	1,184

10. Earnings per share

Earnings per share are calculated by dividing the profit for the financial year ended 31 March 1998, amounting to £1,706m (1997 – £2,077m, 1996 – £1,986m), by 6,394 million shares, the weighted average number of shares in issue during the financial year (1997 – 6,336 million, 1996 – 6,283 million). The fully diluted earnings per share are based on share options outstanding.

The exceptional items in the calculation of the earnings per share before exceptional items in the year ended 31 March 1998 and the individual earnings per share effects are:

	Pence per share	£m
MCI merger break up fee received less expenses		238
Less tax charge attributable to the MCI merger break up fee		(50)
Net merger break up fee after tax	3.0	188
Windfall tax charge	(8.0)	(510)
Net charge	(5.0)	(322)

11. Reconciliation of operating profit to operating cash flows

	1998 £m	1997 £m	1996 £m
Operating profit, including share of results of associated undertakings	3,405	3,384	3,182
Depreciation	2,395	2,265	2,189
Share of losses (profits) of associated undertakings net of dividends received £5m (1997 – £7m, 1996 – £5m)	257	(132)	(77)
Decrease in stocks	36	31	36
Increase in debtors	(29)	(168)	(335)
Increase in creditors	44	478	493
Increase (decrease) in provisions	(47)	321	309
Other	15	13	37
Net cash inflow from operating activities	6,076	6,192	5,834

12. Management of liquid resources	1998 £m	1997 £m	1996 £m
Purchase of short-term investments and payments into short-term deposits over 3 months	(1,103)	(2,242)	(2,520)
Sale of short-term investments and withdrawals from short-term deposits over 3 months	1,334	2,790	1,996
Net movement of short-term investments and short-term deposits under 3 months not repayable on demand	2,016	(1,052)	(793)
Net cash inflow (outflow) from management of liquid resources	2,247	(504)	(1,317)

Movements in all short-term investments and deposits not repayable on demand are reported under the heading of management of liquid resources.

	At 1 April 1997 £m	Cash flow £m	Other non-cash changes £m	Currency movement £m	At 31 March 1998 £m
13. Net debt					
Analysis of net debt					
Cash in hand and at bank	26	36	-	-	62
Overnight deposits	30	(16)	-	-	14
Bank overdrafts	(11)	(31)	-	-	(42)
	45	(11)	-	-	34
Other current asset investments	2,944	(2,247)	(1)	21	717
Short-term investments and cash, less bank overdrafts	2,989	(2,258)	(1)	21	751
Debt due within one year, excluding bank overdrafts	(472)	(35)	(334)	2	(839)
Debt due after one year	(2,693)	(1,567)	315	56	(3,889)
Total debt, excluding bank overdrafts	(3,165)	(1,602)	(19)	58	(4,728)
Net debt	(176)	(3,860)	(20)	79	(3,977)

Reconciliation of net cash flow to movement in net debt	1998 £m	1997 £m	1996 £m
Increase (decrease) in cash in the year	(11)	(90)	28
Cash (inflow) outflow from (increase) decrease in debt	(1,602)	435	(26)
Cash (inflow) outflow from (decrease) increase in liquid resources	(2,247)	504	1,317
Decrease (increase) in net debt resulting from cash flows	(3,860)	849	1,319
Currency and translation movements	79	(47)	(60)
Other non-cash movements	(20)	(30)	(54)
Decrease (increase) in net debt in the year	(3,801)	772	1,205
Net debt at 1 April	(176)	(948)	(2,153)
Net debt at 31 March	(3,977)	(176)	(948)

	Land and buildings (a) £m	Plant and equipment £m	Assets in course of con- struction £m	Total £m
14. Tangible fixed assets				
Group				
Cost				
Balances at 1 April 1997	2,801	29,206	979	32,986
Acquisitions of subsidiary undertakings	–	5	–	5
Additions	24	1,058	1,964	3,046
Transfers	148	1,786	(1,934)	–
Disposals and adjustments	(111)	(3,376)	(35)	(3,522)
Total cost at 31 March 1998	2,862	28,679	974	32,515
Depreciation				
Balances at 1 April 1997	1,316	14,952	–	16,268
Acquisitions of subsidiary undertakings	–	1	–	1
Charge for the year	95	2,300	–	2,395
Disposals and adjustments	(82)	(3,251)	–	(3,333)
Total depreciation at 31 March 1998	1,329	14,002	–	15,331
Net book value at 31 March 1998	1,533	14,677	974	17,184
Engineering stores	–	–	68	68
Total tangible fixed assets at 31 March 1998	1,533	14,677	1,042	17,252
Net book value at 31 March 1997	1,485	14,254	979	16,718
Engineering stores	–	–	84	84
Total tangible fixed assets at 31 March 1997	1,485	14,254	1,063	16,802
Company				
Cost				
Balances at 1 April 1997	796	27,354	773	28,923
Additions	17	647	1,978	2,642
Transfers	102	1,782	(1,884)	–
Disposals and adjustments	(14)	(3,257)	(46)	(3,317)
Total cost at 31 March 1998	901	26,526	821	28,248
Depreciation				
Balances at 1 April 1997	391	14,122	–	14,513
Charge for the year	23	2,087	–	2,110
Disposals and adjustments	(18)	(3,188)	–	(3,206)
Total depreciation at 31 March 1998	396	13,021	–	13,417
Net book value at 31 March 1998	505	13,505	821	14,831
Engineering stores	–	–	68	68
Total tangible fixed assets at 31 March 1998	505	13,505	889	14,899
Net book value at 31 March 1997	405	13,232	773	14,410
Engineering stores	–	–	83	83
Total tangible fixed assets at 31 March 1997	405	13,232	856	14,493

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
14. Tangible fixed assets (continued)				
(a) The net book value of land and buildings comprised:				
Freehold	1,281	1,317	312	239
Long leases (over 50 years unexpired)	92	53	73	53
Short leases	160	115	120	113
Total net book value of land and buildings	1,533	1,485	505	405
(b) Expenditure on tangible fixed assets comprised:				
				Group
			1998 £m	1997 £m
Plant and equipment:				
Transmission equipment			1,219	1,131
Exchange equipment			512	445
Other network equipment			502	503
Computers and office equipment			372	350
Motor vehicles and other			230	175
Land and buildings			211	143
Decrease in engineering stores			(16)	(28)
Total expenditure on tangible fixed assets			3,030	2,719

	Interests in associated undertakings (a) (c)					
	Shares £m	Loans £m	Share of post acquisition profits (losses) £m	Other participating interests £m	Other investments (d) £m	Total £m
15. Fixed asset investments						
Group						
Cost						
Balances at 1 April 1997	3,100	20	197	140	155	3,612
Additions	1,281	135	–	70	196	1,682
Transfer of investment in MCI Communications Corporation (b)	(2,808)	–	(218)	–	3,026	–
Share of losses less retained profits for the year	–	–	(254)	–	–	(254)
Repayments, disposals and other transfers	22	1	(23)	(46)	24	(22)
Currency movements	(62)	(5)	12	–	(20)	(75)
Balances at 31 March 1998	1,533	151	(286)	164	3,381	4,943
Provisions and amounts written off						
Balances at 1 April 1997	(2,333)	–	–	–	(6)	(2,339)
Goodwill	(928)	–	–	–	–	(928)
Transfer of investment in MCI Communications Corporation (b)	2,214	–	–	–	(2,214)	–
Decrease (increase) in the year	42	–	–	–	(10)	32
Balances at 31 March 1998	(1,005)	–	–	–	(2,230)	(3,235)
Net book value at 31 March 1998	528	151	(286)	164	1,151	1,708
Net book value at 31 March 1997	767	20	197	140	149	1,273
	Subsidiary undertakings (a)					
	Shares £m	Loans £m	Associated undertakings (a) £m	Other participating interests £m	Other investments (d) £m	Total £m
Company						
Cost						
Balances at 1 April 1997	4,140	11	2,723	140	176	7,190
Additions	2,586	–	18	70	31	2,705
Transfer of investment in MCI Communications Corporation (b)	–	–	(2,613)	–	2,613	–
Repayments, disposals and other transfers	(68)	–	(16)	(46)	(1,212)	(1,342)
Currency movements	–	(1)	(80)	–	–	(81)
Balances at 31 March 1998	6,658	10	32	164	1,608	8,472
Provisions and amounts written off						
Balances at 1 April 1997	(411)	–	(27)	–	(153)	(591)
Increase in the year	(64)	–	–	–	(10)	(74)
Disposals and transfers	–	–	12	–	(11)	1
Balances at 31 March 1998	(475)	–	(15)	–	(174)	(664)
Net book value at 31 March 1998	6,183	10	17	164	1,434	7,808
Net book value at 31 March 1997	3,729	11	2,696	140	23	6,599

15. Fixed asset investments (continued)*(a) Subsidiary and associated undertakings*

Details of the principal operating subsidiary and associated undertakings are set out on pages 78 and 79.

(b) MCI Communications Corporation

In September 1994, the company completed the acquisition of a 20% equity interest in MCI (the second largest carrier of long-distance telecommunications services in the USA) represented by a holding of 136 million Class A common shares, whereupon MCI became the group's most significant associated undertaking. On 3 November 1996, the company entered into a merger agreement with MCI whereby the group would acquire the entire share capital of MCI, not already owned. On 21 August 1997, the terms of the merger agreement were modified. On 1 October 1997, WorldCom announced its intention to offer shares in its company to MCI shareholders as an alternative to the proposed merger and, following an improved offer from WorldCom on 9 November 1997, the company agreed that it would support the proposed merger with WorldCom to which the MCI board had agreed on the same day. On 11 March 1998, both MCI's and WorldCom's shareholders approved their merger.

The company has agreed with WorldCom and MCI to sell the group's holding of 136 million unlisted Class A common shares in MCI to WorldCom for US\$51 per share in cash at the time the MCI/WorldCom merger is completed. The potential consideration of US\$6,936m was equivalent to £4,137m at the exchange rate ruling on 31 March 1998. The completion of the merger is subject to regulatory clearance. The group also holds 0.7 million listed common shares in MCI, most of which were purchased in November 1995. These shares will be exchanged for WorldCom common shares on completion of the merger. If fully listed, the market value of the MCI shares held by the group at 31 March 1998 would have been £4,048m.

As a consequence of the termination of the company's merger agreement with MCI and the company's agreement with WorldCom and MCI, the group ceased treating MCI as an associate from 1 November 1997. The group's share of its associates' results includes a loss before tax of £27m for its share of MCI's results up to that date (1997 – £175m profit, 1996 – £101m profit).

At 31 March 1998, the group's investment in MCI is stated at £813m (1997 – £834m). Goodwill amounting to £2,214m has been written off to group reserves in prior years in respect of this investment and this goodwill will be accounted for at the completion of the MCI/WorldCom merger in determining the profit on the sale of the shares which the group will recognise.

In the period 1 April 1997 to 31 October 1997, the group's turnover with MCI amounted to £108m (1997 – £134m, 1996 – £92m) and the group purchased £56m in the same period (1997 – £87m, 1996 – £77m) in services and products from MCI.

(c) Cegetel

On 24 September 1997, the group completed its acquisition of a 26% interest in Cegetel, a leading French telecommunications company. Of the cost of the investment in the associated undertaking of £1,029m, goodwill arising of £862m has been written off against reserves.

The acquisition of the interest in Cegetel comprised:

	£m
Group share of original book value of net assets	483
Fair value adjustment to achieve consistency of accounting policies	(316)
Fair value to the group	167
Goodwill	862
Total cost	1,029

(d) Other investments

Other investments include ordinary shares of the company, with a net book value of £29m (1997 – £20m) and a market value of £68m (1997 – £28m), held in trust for the Long Term Remuneration Plan and the Performance Share Plan (note 28). Also, in the group balance sheet at 31 March 1998, listed investments were held with a book value of £117m (1997 – £72m) and a market value of £154m (1997 – £61m).

(e) Subsidiary company acquisition

In February 1997, the group entered into an agreement to purchase from Banco Santander SA its 50% holding in the share capital of BT Telecomunicaciones SA, a joint venture between a wholly-owned subsidiary of the company and Banco Santander SA, for the equivalent of £76m. The transaction was completed in July 1997.

(f) Other related party transactions with associates

In the year ended 31 March 1998, the group's turnover with its other associated undertakings amounted to £74m (1997 – £23m) and the group purchased £9m (1997 – £30m) in services and products from these undertakings.

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
16. Debtors				
Trade debtors (a)	1,801	1,757	1,679	1,552
Amounts owed by subsidiary undertakings	-	-	1,649	438
Amounts owed by associated undertakings	118	72	57	29
Other debtors	249	304	201	190
Advance corporation tax recoverable (b)	-	456	116	651
Accrued income	1,046	1,084	1,014	1,055
Prepayments	173	134	202	98
Total debtors	3,387	3,807	4,918	4,013

Total debtors included amounts receivable after more than one year:

Advance corporation tax recoverable (b)	-	456	116	651
Accrued income	97	80	97	80
Prepayments	-	10	-	10
Total	97	546	213	741

(a) The group's trade debtors are stated after deducting £227m (1997 – £163m) for doubtful debts. The amount charged to the group profit and loss account for doubtful debts for the year ended 31 March 1998 was £218m (1997 – £188m, 1996 – £179m).

(b) Advance corporation tax recoverable

Advance corporation tax on proposed final dividend and, in 1997,
on special dividend

	184	752	184	752
Amount offset against deferred tax provision (note 21)	(184)	(296)	(68)	(101)
Balance included within debtors	-	456	116	651

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
17. Current asset investments				
Listed investments	150	115	5	16
Other short-term deposits and investments	581	2,859	10	2,893
Total current asset investments	731	2,974	15	2,909
Market value of listed investments	150	115	5	16

	Average effective interest rates (a) %	Group		Company	
		1998 £m	1997 £m	1998 £m	1997 £m
18. Loans and other borrowings					
US dollar 6½% guaranteed notes 1997	7.7	–	230	–	–
US dollar 9¾% guaranteed bonds 1998	6.7	149	153	–	–
US dollar 9¾% guaranteed notes 1999	9.6	179	184	–	–
US dollar 8¾% guaranteed bonds 1999	8.8	119	123	–	–
Zero coupon bonds 2000 (less unamortised discount £38m (1997 – £55m))	6.6	162	145	162	145
US dollar 6¾% notes 2002 (less unamortised discount £9m)	7.1	886	–	886	–
12¼% bonds 2003	12.3	180	180	180	180
7½% bonds 2003 (less unamortised discount £3m (1997 – £4m))	7.3	497	496	497	496
12¼% bonds 2006	12.3	229	229	229	229
US dollar 7% notes 2007 (less unamortised discount £3m)	7.1	593	–	593	–
US dollar 9½% guaranteed debentures 2019	9.8	119	122	–	–
8½% bonds 2020 (less unamortised discount £5m (1997 – £5m))	8.8	295	295	295	295
Total listed bonds, debentures and notes		3,408	2,157	2,842	1,345
Lease finance		10	2	2	2
Bank loans due 1999-2009	9.0	792	796	–	–
Other loans	11.0	10	–	–	–
Bank overdrafts and other short-term borrowings	7.1	74	11	1,237	1,597
Commercial paper	7.1	476	210	476	210
Loans from subsidiary undertakings		–	–	2,851	2,655
Total loans and other borrowings		4,770	3,176	7,408	5,809

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

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Repayments fall due as follows:				
Within one year, or on demand	881	483	3,282	2,316
Between one and two years	459	338	432	331
Between two and three years	12	418	280	450
Between three and four years	2	–	1	774
Between four and five years	1,143	–	1,141	1
After five years	2,273	1,937	2,272	1,937
Total due for repayment after more than one year	3,889	2,693	4,126	3,493
Total loans and other borrowings	4,770	3,176	7,408	5,809

The group has an option to redeem the US dollar 9½% guaranteed debentures 2019 exercisable from February 1999 at a maximum premium of 105%.

18. Loans and other borrowings (continued)

(a) Average effective interest rates

The average interest rates on page 61 take into account the effect of interest rate swaps. The interest basis of interest rate swap agreements used, the notional amounts, their average maturities and weighted average interest rates are shown below:

	Average maturity	Notional amount £m	Average interest receivable rate %	Average interest payable rate %
Pay fixed interest and receive variable interest	Over 5 years	1,124	6.2	8.5
Pay variable interest and receive fixed interest	Under 5 years	365	9.5	7.4

The rates of the variable rate portion of the swaps are based on quoted rates. In calculating the average variable rates, the latest rates agreed with the counterparty on each swap have been used. Changes in interest rates will affect the variable-rate information disclosed above.

(b) Unused committed lines of credit for short-term financing available at 31 March 1998 totalled approximately £786m, which was in support of a commercial paper programme or other borrowings. These lines of credit are normally available for up to one year.

19. 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. There has been no change in the risk profile between the year end and the date of these financial statements.

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 1998, the group had outstanding interest rate swap agreements having a total notional principal amount of £1,489m (1997 – £1,247m).

(b) Foreign exchange risk management

Cross currency swaps and forward foreign exchange contracts have been entered into to reduce the foreign currency exposure on the group's operations and the group's net assets. The group also enters into forward foreign exchange contracts to hedge investments, interest expense and purchase and sale commitments denominated in foreign currencies (principally US dollars). The 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 1998, the group had outstanding foreign currency swap agreements and forward exchange contracts having a total notional principal amount of £4,476m (1997 – £2,541m).

The fair values of foreign currency contracts at 31 March 1998 were £3,037m (1997 – £1,071m) for purchases of currency and £892m (1997 – £683m) 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 1998, the group had deferred unrealised gains of £nil (1997 – £21m) and losses of £36m (1997 – £7m), based on dealer-quoted prices, from hedging purchase and sale commitments. At 31 March 1998, the group also had deferred realised net losses of £12m (1997 – £36m net losses). 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.

19. Financial instruments and risk management (continued)*(c) Concentrations of credit risk and credit exposures of financial instruments*

The group considers that it is not exposed to major concentrations of credit risk. The group, however, is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not expect any counterparties to fail to meet their obligations. Based on interest and exchange rates in effect at 31 March 1998, the group had a maximum credit exposure of £118m (1997 – £113m) 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 1998 and 1997. 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	
	1998 £m	1997 £m	1998 £m	1997 £m
Non-derivatives:				
Assets				
Cash at bank and in hand	62	26	62	26
Short-term investments (i)	731	2,974	731	2,974
Liabilities				
Short-term borrowings (ii)	550	221	550	221
Long-term borrowings, excluding finance leases (iii)	4,210	2,953	4,665	3,168
Derivatives relating to investments and borrowings (net) (iv):				
Assets	48	79	–	11
Liabilities	–	–	114	–

(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.

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
20. Other creditors				
Trade creditors	1,971	1,858	1,550	1,483
Amounts owed to subsidiary undertakings	–	–	870	898
Amounts owed to associated undertakings	39	46	–	–
Corporation and windfall taxes	833	1,774	589	1,503
Other taxation and social security	309	332	308	321
Other creditors	1,055	1,134	952	931
Accrued expenses	392	313	302	203
Deferred income	745	706	735	658
Dividends (a)	737	3,008	737	3,008
Total other creditors	6,081	9,171	6,043	9,005
Total other creditors included amounts due after more than one year:				
Deferred income	–	13	–	13

(a) The 1997 figures include the special dividend of £2,244m, paid in September 1997.

	Deferred taxation (a) £m	Pension provisions £m	Other provisions £m	Total £m
21. Provisions for liabilities and charges				
Group				
Balances at 1 April 1997	296	1,291	100	1,687
Charged (credited) against profit for the year	(22)	177	25	180
Utilised in the year	–	(244)	(13)	(257)
	274	1,224	112	1,610
Advance corporation tax recoverable	(184)	–	–	(184)
Total provisions at 31 March 1998	90	1,224	112	1,426
Company				
Balances at 1 April 1997	101	1,291	50	1,442
Charged (credited) against profit for the year	(33)	171	(5)	133
Utilised in the year	–	(238)	–	(238)
	68	1,224	45	1,337
Advance corporation tax recoverable	(68)	–	–	(68)
Total provisions at 31 March 1998	–	1,224	45	1,269

21. Provisions for liabilities and charges (continued)

(a) Deferred taxation

The elements of deferred taxation provided in the accounts at 31 March were as follows:

	Group		Company	
	1998	1997	1998	1997
	£m	£m	£m	£m
Tax effect of timing differences due to:				
Excess capital allowances	712	763	598	669
Pension provisions	(367)	(426)	(367)	(426)
Other	(71)	(41)	(163)	(142)
Total deferred taxation provided	274	296	68	101
Advance corporation tax recoverable	(184)	(296)	(68)	(101)
Total provision for deferred taxation	90	-	-	-

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

Tax effect of timing differences due to:

Excess capital allowances	2,576	2,781	2,463	2,687
Pension provisions	(367)	(426)	(367)	(426)
Other	(71)	(41)	(163)	(142)
Total	2,138	2,314	1,933	2,119
Advance corporation tax recoverable	(184)	(752)	(184)	(752)
Total potential liability for deferred taxation	1,954	1,562	1,749	1,367

22. Called up share capital

The authorised share capital of the company throughout the year ended 31 March 1998 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 £1,603m at 31 March 1998 (1997 – £1,589m), representing 6,411,214,670 ordinary shares (1997 – 6,355,115,816 ordinary shares and one special rights redeemable preference share).

Certain special rights, set out in the company's articles of association, were attached to the special rights redeemable preference share issued to HM Government. The share, which carried no right to capital or profits beyond its nominal value, was redeemed at par by HM Government on 10 September 1997.

Of the authorised but unissued share capital at 31 March 1998, 261 million ordinary shares were reserved to meet options granted under the employee share option schemes described in note 28.

Ordinary shares allotted during the year were as follows:

	Number	Nominal value £	Consideration(a) £
Savings related schemes	45,762,406	11,440,602	122,602,122
Other share option schemes	6,554,498	1,638,625	21,454,362
Scrip dividend	3,781,950	945,487	-
Totals for the year ended 31 March 1998	56,098,854	14,024,714	144,056,484

(a) Consideration excludes contributions from group undertakings as described in note 23(d).

During the year ended 31 March 1998 a number of shareholders elected to take all or part of their interim dividend in shares at a value of £18m. The nominal value of the shares issued has been funded out of the capital redemption reserve and the amount of the dividend has been added back to the profit and loss reserve.

23. Reconciliation of movement in shareholders' funds	Share capital £m	Share premium account(a) £m	Capital redemption reserve £m	Other reserves £m	Profit and loss account £m	Total £m
Group						
Balances at 31 March 1995	1,559	415	750	18	9,255	11,997
Goodwill, arising on acquisition of subsidiary and associated undertakings (b)	–	–	–	–	(302)	(302)
Goodwill, previously written off to reserves, taken back to the profit and loss account	–	–	–	–	12	12
Employee share option schemes – 57 million shares issued (note 28)	14	116	–	–	–	130
Currency movements (including £29 million net losses in respect of foreign currency borrowings) (c)	–	–	–	–	42	42
Transfer to other reserves	–	–	–	9	(9)	–
Profit for the financial year	–	–	–	–	1,986	1,986
Dividends (18.7p net per ordinary share)	–	–	–	–	(1,184)	(1,184)
Other movements	–	–	–	–	(3)	(3)
Balances at 31 March 1996	1,573	531	750	27	9,797	12,678
Goodwill, arising on acquisition of subsidiary and associated undertakings (b)	–	–	–	–	(199)	(199)
Goodwill, previously written off to reserves, taken back to the profit and loss account	–	–	–	–	5	5
Employee share option schemes – 64 million shares issued (note 28)	16	144	–	–	–	160
Currency movements (including £29 million net gains in respect of foreign currency borrowings) (c)	–	–	–	–	(76)	(76)
Profit for the financial year	–	–	–	–	2,077	2,077
Dividends (54.85p net per ordinary share)	–	–	–	–	(3,510)	(3,510)
Other movements	–	–	–	–	(19)	(19)
Balances at 31 March 1997	1,589	675	750	27	8,075	11,116
Goodwill, arising on acquisition of subsidiary and associated undertakings (b)	–	–	–	–	(937)	(937)
Goodwill, previously written off to reserves, taken back to the profit and loss account	–	–	–	–	5	5
Employee share option schemes – 52 million shares issued (d) (note 28)	13	217	–	–	–	230
Movement relating to BT's employee share ownership trust (d)	–	–	–	–	(85)	(85)
Currency movements (including £31 million net gains in respect of foreign currency borrowings) (c)	–	–	–	–	(74)	(74)
Profit for the financial year	–	–	–	–	1,706	1,706
Dividends (19.0p net per ordinary share)	–	–	–	–	(1,220)	(1,220)
Scrip dividend – 4 million shares issued (note 22)	1	–	(1)	–	18	18
Other movements	–	–	–	–	26	26
Balances at 31 March 1998	1,603	892	749	27	7,514	10,785

23. Reconciliation of movement in shareholders' funds (continued)

	Share capital £m	Share premium account (a) £m	Capital redemption reserve £m	Profit and loss account £m	Total £m
Company					
Balances at 31 March 1995	1,559	415	750	9,890	12,614
Employee share option schemes – 57 million shares issued (note 28)	14	116	–	–	130
Profit for the financial year (e)	–	–	–	2,339	2,339
Dividends (18.7p net per ordinary share)	–	–	–	(1,184)	(1,184)
Currency movements (including £28m net losses in respect of foreign currency borrowings)	–	–	–	149	149
Balances at 31 March 1996	1,573	531	750	11,194	14,048
Employee share option schemes – 64 million shares issued (note 28)	16	144	–	–	160
Profit for the financial year (e)	–	–	–	1,475	1,475
Dividends (54.85p net per ordinary share)	–	–	–	(3,510)	(3,510)
Currency movements (including £29m net gain in respect of foreign currency borrowings)	–	–	–	(155)	(155)
Balances at 31 March 1997	1,589	675	750	9,004	12,018
Employee share option schemes – 52 million shares issued (d) (note 28)	13	217	–	–	230
Movement relating to BT's employee share ownership trust (d)	–	–	–	(85)	(85)
Profit for the financial year (e)	–	–	–	2,150	2,150
Dividends (19.0p net per ordinary share)	–	–	–	(1,220)	(1,220)
Scrip dividend – 4 million shares issued (note 22)	1	–	(1)	18	18
Currency movements (including £31m net gain in respect of foreign currency borrowings)	–	–	–	(66)	(66)
Balances at 31 March 1998	1,603	892	749	9,801	13,045

(a) The share premium account, representing the premium on allotment of shares and the capital redemption reserve are not available for distribution.

(b) Aggregate goodwill at 31 March 1998 in respect of acquisitions in the current and earlier years of £3,603m (1997 – £2,671m, 1996 – £2,477m) has been written off against retained earnings. The goodwill written off in the year ended 31 March 1998 mainly arose in connection with the acquisition of the interest in Cegetel; that written off in the year ended 31 March 1997 mainly arose in connection with the acquisition of shares not already owned in BT Telecomunicaciones SA and the acquisition of Syntegra Groep BV; that written off in the year ended 31 March 1996 mainly arose in connection with an acquisition made by MCI.

(c) The cumulative foreign currency translation adjustment, which decreased retained earnings at 31 March 1998, was £130 million (1997 – £56m decrease, 1996 – £20m increase).

(d) During the year ended 31 March 1998 the company issued shares at a market value of £203m in respect of the exercise of options awarded under its principal savings-related share option scheme. Employees paid £118m to the group for the issue of these shares and the balance of £85m comprised contributions to the qualifying employee share ownership trust from group undertakings.

(e) The profit for the financial year, dealt with in the profit and loss account of the company and after taking into account dividends from subsidiary undertakings, was £2,150m (1997 – £1,475m, 1996 – £2,339m). As permitted by Section 230 of the Companies Act 1985, no profit and loss account of the company is presented.

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
24. Financial commitments and contingent liabilities				
Contracts placed for capital expenditure not provided for in the accounts	1,047	1,125	965	1,008
Operating lease payments payable within one year of the balance sheet date were in respect of leases expiring:				
Within one year	9	10	3	6
Between one and five years	39	32	21	19
After five years	135	131	94	92
Total payable within one year	183	173	118	117

Future minimum operating lease payments for the group at 31 March 1998 were as follows:

Payable in the year ending 31 March:

	1998 £m
1999	183
2000	167
2001	127
2002	122
2003	118
Thereafter	1,265
Total future minimum operating lease payments	1,982

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

At 31 March 1998, 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 £1,330m (1997 – £1,577m).

Satellite consortia, in which the company has participating interests, are organisations without limited liability. At 31 March 1998, the company's share of the aggregate borrowings of these consortia amounted to £188m (1997 – £179m).

Outstanding at 31 March 1998 and 1997 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 £119m (1997 – £123m).

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

As explained in note 15(b), the company's merger agreement with MCI (the BT/MCI merger) was terminated on 9 November 1997. Individuals purporting to represent classes of MCI shareholders have now filed seventeen complaints in the Court of Chancery in the State of Delaware (the "Delaware Shareholder Class Actions"), asserting claims in connection with the original and renegotiated terms of the then-proposed BT/MCI merger. MCI and certain of its officers and directors, including officers of the company who served as MCI directors, are named as defendants in all seventeen Delaware Shareholder Class Actions. The company is named as a defendant in fifteen of these cases. The original and amended complaints filed in these fifteen cases collectively allege that the company breached and aided and abetted breaches of fiduciary duties owed to MCI shareholders in connection with the then-proposed BT/MCI merger. In addition, amended complaints in five of the Delaware Shareholder Class Actions assert claims in connection with the pending WorldCom/MCI merger, including challenges to the merger termination fee paid to the company and the company's right to receive cash in exchange for its Class A common shares in MCI. Four of these amended complaints name the company as a defendant. The court, having issued an order consolidating fifteen of the Delaware

24. Financial commitments and contingent liabilities (continued)

Shareholder Class Actions, subsequently directed the plaintiffs to submit a proposed order vacating that consolidation order and to submit a new proposed order of consolidation. The parties have agreed that the defendants are not obligated to respond to the complaints filed in these fifteen cases until the consolidation issue has been resolved and the plaintiffs serve the defendants with a consolidated and amended complaint. In the two Delaware Shareholder Class Actions that were not included in the court's initial consolidation order, neither the company nor its officers who served as MCI directors have been served, and have therefore not responded to the complaints.

In addition, after the renegotiation of the terms of the BT/MCI merger, an MCI shareholder filed a derivative action on behalf of MCI in the Court of Chancery in the State of Delaware. The complaint names the company and certain officers and directors of MCI, including officers of the company who served as MCI directors, as defendants. Among the claims asserted in the complaint is the allegation that the company aided and abetted breaches of fiduciary duty in connection with the proposed BT/MCI merger. The complaint does not take into account the subsequent WorldCom/MCI merger agreement. The parties have agreed that defendants need not respond to the complaint until the plaintiffs serve an amended complaint. No such complaint has yet been served.

In addition, individuals purporting to represent a class of persons who purchased MCI shares during the period 11 July 1997 to 21 August 1997 have filed a consolidated amended class action complaint (the "Complaint") under the caption In Re MCI Communications Corp Securities Litigation, now pending in the federal district court for the District of the District of Columbia. The Complaint supersedes certain earlier federal securities class action complaints. The Complaint alleges that MCI, the company and certain MCI officers and directors, including officers of the company who served as MCI directors, violated the federal securities laws by failing timely to disclose that MCI was renegotiating the terms of the merger with the company.

The company believes that it will prevail in the foregoing actions.

25. Pension costs

The total pension cost of the group expensed within staff costs was £177m (1997 – £291m, 1996 – £284m), of which £169m (1997 – £281m, 1996 – £275m) related to the group's main pension scheme, the BT Pension Scheme (BTPS). The reduction in the cost in the year ended 31 March 1998 was mainly attributable to the greater than assumed return on the BTPS assets in the three year period to 31 December 1996, i.e. between the last two actuarial valuations. The increase in the charge in the year ended 31 March 1997 was mainly attributable to the increase in interest on the pension provisions in the balance sheet which had risen by £311m to £1,291m in the year ended 31 March 1997.

The pension cost for the year ended 31 March 1998 was based on the valuation of the BTPS at 31 December 1996. The pension cost for the years ended 31 March 1996 and 1997 were based on the valuation of the BTPS at 31 December 1993. The valuations, carried out by professionally qualified independent actuaries, used the projected unit method. The valuations were determined using the following long-term assumptions:

	Rates (per annum)	
	1996 %	1993 %
Return on existing assets, relative to market values	8.0	8.6
Return on future investments	8.4	9.7
Real equity dividend growth	0.75	0.5
Average increase in retail price index	4.0	5.0
Average future increases in wages and salaries	5.8	6.8

At 31 December 1996, the assets of the BTPS had a market value of £19,879m and were sufficient to cover 100.3% of the benefits that had accrued to members by that date, after allowing for expected future increases in wages and salaries but not taking into account the costs of providing incremental pension benefits for employees taking early retirement under release schemes since that date. This cost, which amounted to £224m in the year ended 31 March 1998, will be taken into account at the next planned actuarial valuation at 31 December 1999. The incremental pension costs of employees taking early retirement in the years ended 31 March 1997 and 1996, £258m and £266m, respectively were included in redundancy costs charged to the profit and loss account in those years.

In the year ended 31 March 1998, the group made regular contributions of £238m (1997 – £232m, 1996 – £234m).

25. Pension costs (continued)

Certain activities of the BTPS are carried out at the company's pension centre, all costs of which are borne by the company. These costs have not been apportioned for accounting purposes between those attributable to the BTPS and those attributable to the company because functions maintained for both entities cannot be meaningfully divided between them. The company occupies eight properties owned by the scheme on which an annual rental of £3m is payable.

The BTPS assets are invested in UK and overseas equities, UK and overseas properties, fixed interest and index linked securities, deposits and short-term investments. At 31 March 1998, the UK equities included 42 million (1997 – 56 million) ordinary shares of the company with a market value of £270m (1997 – £250m).

26. Directors

Directors' emoluments

The emoluments of the directors for the year ended 31 March 1998 and the gains made by them on the exercise of share options were, in summary, as follows:

	1998 £000	1997 £000(a)	1996 £000(a)
Salaries	1,578	1,543	1,471
Performance-related bonus	882	636	543
Deferred bonus	222	–	–
Other benefits	114	94	71
	2,796	2,273	2,085
Payments to non-executive directors (b)	259	273	381
Total emoluments	3,055	2,546	2,466
Gain on the exercise of share options	857	93	6

(a) Comparative figures have been restated.

(b) Payments to non-executive directors include fees paid to their principal employer of £38,000 (1997 – £31,000, 1996 – £24,000).

More detailed information concerning directors' remuneration, shareholdings, options and long-term incentive plans is shown in the report on directors' remuneration on pages 33 to 40.

	1998		1997		1996	
	Year end '000	Average '000	Year end '000	Average '000	Year end '000	Average '000
27. People employed						
Number of employees in the group:						
UK	120.2	124.9	123.3	125.8	127.8	132.6
International	4.5	4.3	4.2	3.8	2.9	2.6
Total employees	124.7	129.2	127.5	129.6	130.7	135.2

28. Employee share schemes (continued)

Options granted, exercised and lapsed under these share option schemes during the years ended 31 March 1996, 1997 and 1998 and options exercisable at 31 March 1996, 1997 and 1998 were as follows:

	Savings related schemes millions	Other share option schemes millions	Total millions	Exercise price range	Weighted average exercise price
Outstanding, 31 March 1995	303	26	329	210p–460p	283p
Exercised	(50)	(7)	(57)	210p–380p	230p
Lapsed	(15)	–	(15)	210p–430p	305p
Outstanding, 31 March 1996	238	19	257	211p–460p	294p
Granted	79	–	79	267p–300p	271p
Exercised	(61)	(3)	(64)	211p–430p	251p
Lapsed	(7)	(2)	(9)	244p–430p	299p
Outstanding, 31 March 1997	249	14	263	243p–460p	297p
Granted	60	–	60	359p–596p	363p
Exercised	(46)	(6)	(52)	243p–430p	275p
Lapsed	(10)	–	(10)	243p–430p	313p
Outstanding, 31 March 1998	253	8	261	262p–596p	316p
Exercisable, 31 March 1996	–	13	13	211p–430p	333p
Exercisable, 31 March 1997	–	11	11	243p–460p	337p
Exercisable, 31 March 1998	–	7	7	262p–460p	362p

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 normally, if the participants are still employed by the group. Awards of shares were granted in each of the years from 1994 to 1997 under the LTRP and from 1995 to 1997 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.

At 31 March 1998, 5.8 million shares in the company (1997 – 3.5 million) were held in trust for the PSP and 4.6 million shares (1997 – 2.7 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		Total	
	1998 £m	1997 £m	1998 £m	1997 £m	1998 £m	1997 £m
Value of range of possible future transfers: nil to	37.9	15.6	29.5	11.6	67.4	27.2
Provision for the costs of the plans charged to the profit and loss account in year	6.8	0.1	2.5	0.9	9.3	1.0
Nominal value of shares held in trust	1.5	0.9	1.1	0.7	2.6	1.6
Market value of shares held in trust	38.0	15.6	30.0	12.0	68.0	27.6

The values of possible future transfers of shares under the plans were based on the company's share price at 31 March 1998 of 650.0p (1997 – 445.5p). 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.

29. Auditors

The auditors' remuneration for the year ended 31 March 1998 for the group was £2,396,000 (1997 – £2,135,000, 1996 – £2,138,000), including £1,216,000 (1997 – £1,167,000, 1996 – £1,170,000) 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 1998:

	1998	1997	1996
	£000	£000	£000
Audit of the company's statutory accounts	1,216	1,167	1,170
Audits of the UK subsidiary undertakings' statutory accounts	510	396	349
Other services, including regulatory audits and tax compliance work	4,724	4,620	4,004
Total	6,450	6,183	5,523

In addition, fees of £1,295,000 (1997 – £1,888,000, 1996 – £1,395,000) were paid or are payable to other members of Coopers & Lybrand International for the year ended 31 March 1998 in respect of audit and other services to the company's overseas subsidiary undertakings and in respect of other services to the group.

30. United States Generally Accepted Accounting Principles

The group's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the UK (UK GAAP), which differ in certain 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 (SFAS) Nos. 87 and 88. Differences between the UK and US GAAP figures arise from the requirement to use different actuarial methods and assumptions and a different method of amortising surpluses or deficits.

(b) Accounting for redundancies

Under UK GAAP, the 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 redundancy charges 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. At 31 March 1998 under US GAAP, gross capitalised interest of £525m (1997 – £722m) with regard to the company and its subsidiary companies was subject to depreciation generally over periods of 3 to 25 years.

(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

30. United States Generally Accepted Accounting Principles (continued)**(d) Goodwill** (continued)

or loss recognised at the time of divestment. Gross goodwill under US GAAP at 31 March 1998 of £925m (1997 – £1,986m) was subject to amortisation over periods of 3 to 40 years. Goodwill relating to MCI has been unchanged since 31 October 1997 when the investment ceased to have associated company status. The value of goodwill is reviewed annually and the net asset value is written down if a permanent diminution in value has occurred.

(e) Mobile cellular telephone licences, software and other intangible assets

Certain intangible fixed assets recognised under US GAAP purchase accounting requirements are subsumed within goodwill under UK GAAP. Under US GAAP these separately identified intangible assets are valued and amortised over their useful lives.

(f) Investments

Under UK GAAP, investments are held on the balance sheet at historical cost. Under US GAAP, trading securities and available-for-sale securities are carried at market value with appropriate valuation adjustments recorded in profit and loss and shareholder's equity, respectively. The net unrealised holding gain on available-for-sale securities for the year ended 31 March 1998 which related primarily to the investment in MCI was £1,315m (1997 – £nil, 1996 – £nil).

(g) Deferred taxation

Under UK GAAP, provision for deferred taxation is generally only made for timing differences which are expected to reverse. Under US GAAP, deferred taxation is provided on a full liability basis on all temporary differences, as defined in SFAS No. 109.

At 31 March 1998, the adjustment of £2,095m (1997 – £1,942m) reconciling ordinary shareholders' equity under UK GAAP to the approximate amount under US GAAP included the tax effect of other USGAAP adjustments. This comprised an adjustment decreasing non-current assets by £76m (1997 – £138m decrease); an adjustment increasing current assets by £68m (1997 – £408m decrease); an adjustment decreasing current liabilities by £184m (1997 – £191m decrease); an adjustment decreasing minority interests by £3m (1997 – £nil) and an adjustment increasing non-current deferred tax liabilities by £2,274m (1997 – £1,587m increase).

(h) Dividends

Under UK GAAP, dividends are recorded in the year in respect of which they are declared (in the case of interim or any special dividends) or proposed by the board of directors to the shareholders (in the case of final dividends). Under US GAAP, dividends are recorded in the period in which dividends are declared.

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	1998 £m	1997 £m	1996 £m
Net income applicable to shareholders under UK GAAP	1,706	2,077	1,986
Adjustments for:			
Pension costs	(66)	83	18
Redundancy charges	(253)	156	(152)
Capitalisation of interest, net of related depreciation	(38)	(23)	(22)
Goodwill amortisation	(71)	(73)	(74)
Mobile licences, software and other intangible asset capitalisation and amortisation, net	42	77	38
Investments	5	–	(2)
Deferred taxation	163	(148)	14
Other items	(37)	–	–
Net income as adjusted for US GAAP	1,451	2,149	1,806
Basic earnings per American Depositary Share as adjusted for US GAAP (a)	£2.27	£3.39	£2.88
Diluted earnings per American Depositary Share as adjusted for US GAAP (a)	£2.24	£3.36	£2.84

30. United States Generally Accepted Accounting Principles (continued)**Shareholders' equity**

AT 31 MARCH

	1998 £m	1997 £m
Shareholders' equity under UK GAAP	10,785	11,116
Adjustments for:		
Pension costs	(1,347)	(1,057)
Redundancy costs	(41)	(12)
Capitalisation of interest, net of related depreciation	299	337
Goodwill, net of accumulated amortisation	2,118	2,146
Mobile licences, software and other intangible asset capitalisation and amortisation	930	260
Investments	1,266	(24)
Deferred taxation	(2,095)	(1,942)
Dividend declared after the financial year end	737	764
Other items	(37)	–
Shareholders' equity as adjusted for US GAAP	12,615	11,588

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

Minority Interests

Under USGAAP, the minority interest charge would have been reduced by £5m (1997 – £nil, 1996 – £nil) after adjusting for goodwill amortisation. Net assets attributable to minority interests would have been £81m higher (1997 – £nil) after adjusting for goodwill, investments and other items.

Accounting for share options

Under UKGAAP, the company does not recognise compensation expense for the fair value, at the date of grant, of share options granted under the employee share option schemes. Under US GAAP, the company adopted the disclosure-only option in SFAS No. 123 "Accounting for Stock-Based Compensation" in the year ended 31 March 1997. Accordingly, the company accounts for share options in accordance with APB Opinion No. 25 "Accounting for Stock Issued to Employees", under which no compensation expense is recognised. Had the group expensed compensation cost for options granted in accordance with SFAS No. 123, the group's pro forma net income, basic earnings per share and diluted earnings per share under US GAAP would have been £1,436m (1997 – £2,126m, 1996 – £1,800m), 22.5p (1997 – 33.6p, 1996 – 28.7p) and 22.1p (1997 – 33.2p, 1996 – 28.4p), respectively. The SFAS No. 123 method of accounting does not apply to share options granted before 1 January 1995, and accordingly, the resulting pro forma compensation costs may not be representative of that to be expected in future years. See note 28 for the SFAS No. 123 disclosures of the fair value of options granted under employee sharesave schemes at date of grant.

Consolidated statements of cash flows

Under UK GAAP, the Consolidated Statements of Cash Flows are presented in accordance with UK Financial Reporting Standard No. 1 (FRS 1). The statements prepared under FRS 1 present substantially the same information as that required under SFAS No. 95.

Under SFAS No. 95 cash and cash equivalents include cash and short-term investments with original maturities of three months or less. Under FRS 1 cash comprises cash in hand and at bank and overnight deposits, net of bank overdrafts.

Under FRS 1, cash flows are presented for operating activities; returns on investments and servicing of finance; taxation; capital expenditure and financial investments; acquisitions and disposals; dividends paid to the company's shareholders; management of liquid resources and financing. SFAS No. 95 requires a classification of cash flows as resulting from operating, investing and financing activities.

30. United States Generally Accepted Accounting Principles (continued)

Cash flows under FRS 1 in respect of interest received, interest paid (net of that capitalised under US GAAP) and taxation would be included within operating activities under SFAS No. 95. Cash flows from purchases, sales and maturities of trading securities, while not separately identified under UK GAAP, would be included within operating activities under US GAAP. Capitalised interest, while not recognised under UK GAAP, would be included in investing activities under US GAAP. Dividends paid would be included within financing activities under US GAAP.

The following statements summarise the statements of cash flows as if they had been presented in accordance with US GAAP, and include the adjustments which reconcile cash and cash equivalents under US GAAP to cash at bank and in hand reported under UK GAAP.

	1998 £m	1997 £m	1996 £m
Net cash provided by operating activities	3,847	5,066	5,026
Net cash used in investing activities	(4,198)	(2,589)	(3,257)
Net cash used in financing activities	(1,647)	(1,517)	(975)
Net increase (decrease) in cash and cash equivalents	(1,998)	960	794
Effect of exchange rate changes on cash	21	(14)	4
Cash and cash equivalents under US GAAP at beginning of year	2,343	1,397	599
Cash and cash equivalents under US GAAP at end of year	366	2,343	1,397
Short-term investments with original maturities of less than 3 months	(304)	(2,317)	(1,276)
Cash at bank and in hand under UK GAAP at end of year	62	26	121

Current asset investments

Under US GAAP, investments in debt securities would be classified as either trading, available for sale or held-to-maturity. Trading investments would be stated at fair values and the unrealised gains and losses would be included in income. Securities classified as available-for-sale would be stated at fair values, with unrealised gains and losses, net of deferred taxes, reported in shareholders' equity. Debt securities classified as held-to-maturity would be stated at amortised cost. The following analyses do not include securities with original maturities of less than three months.

At 31 March 1998, the group held trading investments at a carrying amount of £384m (1997 – £173m) with fair values totalling £389m (1997 – £173m). Held-to-maturity securities at 31 March 1997 and 1998 consisted of the following:

	Amortised cost £m	Estimated fair value £m
UK Government securities and other UK listed investments	25	25
Commercial paper, medium term notes and other investments	18	18
Total at 31 March 1998	43	43
UK Government securities and other UK listed investments	44	44
Commercial paper, medium term notes and other investments	439	439
Total at 31 March 1997	483	483
The contractual maturities of the held-to-maturity debt securities at 31 March 1998 were as follows:	Cost £m	Fair value £m
Maturing on or before 31 March 1999	18	18
Maturing after 31 March 1999	25	25
Total at 31 March 1998	43	43

30. United States Generally Accepted Accounting Principles (continued)**Pension costs**

The following position for the main pension scheme is computed in accordance with US GAAP pension accounting rules under SFAS No. 87 and SFAS No. 88, the effect of which is shown in the above reconciliation statements.

The pension cost determined under SFAS No. 87 requirements for the year ended 31 March 1998 was calculated by reference to an expected long-term rate of return on scheme assets of 8.2% (1997 – 9.2%, 1996 – 9.6%). The components of the pension cost for the main pension scheme comprised:

	1998 £m	1997 £m	1996 £m
Cost of benefits earned during the year	327	268	266
Interest cost on projected benefit obligation	1,554	1,645	1,543
Actual return on scheme assets	(3,494)	(2,038)	(2,799)
Net amortisation and deferral	1,846	323	1,244
Additional cost of termination benefits	224	258	266
Pension cost for the year under US GAAP	457	456	520

The projected benefit obligation for the main pension scheme was determined using the following assumptions at 1 January 1997 and 1 January 1998:

	1998 per annum %	1997 per annum %
Discount rate	7.2	7.7
Rate of future pay increases	5.8	5.8

The determination also took into account requirements in the scheme as to future pension increases.

The information required to be disclosed in accordance with SFAS No. 87 concerning the funded status of the main scheme at 31 March 1997 and 31 March 1998, based on the valuations at 1 January 1997 and 1 January 1998, respectively, is given below.

	1998 £m	1997 £m
Actuarial present value of accumulated benefit obligation due to past and present employees (all benefits vested)	21,299	18,823
Projected benefit obligation	23,513	20,733
Scheme assets at fair value	22,666	19,879
Projected benefit obligation in excess of scheme assets	(847)	(854)
Unrecognised net obligation at date of initial application of SFAS No. 87 (a)	262	314
Unrecognised prior service costs (b)	223	247
Other unrecognised net gains	(2,199)	(2,062)
Accrued pension cost under US GAAP	(2,561)	(2,355)

(a) The unrecognised net obligation at the date of initial application is being amortised over 15 years from 1 April 1988.

(b) Unrecognised prior service costs on scheme benefit improvements, are being amortised over periods of 15 or 16 years commencing in the years of the introduction of the improvements.