

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).

I Differences between United Kingdom and United States generally accepted accounting principles

The following are the main differences between UK and US GAAP which are relevant to the group's financial statements.

(a) Pension costs

Under UK GAAP, pension costs are accounted for in accordance with UK Statement of Standard Accounting Practice No. 24, costs being charged against profits over employees' working lives. Under US GAAP, pension costs are determined in accordance with the requirements of US Statements of Financial Accounting Standards (SFAS) Nos. 87 and 88. Differences between the UK and US GAAP figures arise from the requirement to use different actuarial methods and assumptions and a different method of amortising surpluses or deficits.

(b) Accounting for redundancies

Under UK GAAP, the cost of providing incremental pension benefits in respect of workforce reductions is taken into account when determining current and future pension costs, unless the most recent actuarial valuation under UK actuarial conventions shows a deficit. In this case, the cost of providing incremental pension benefits is included in redundancy charges in the year in which the employees agree to leave the group.

Under US GAAP, the associated costs of providing incremental pension benefits are charged against profits in the period in which the termination terms are agreed with the employees.

(c) Capitalisation of interest

Under UK GAAP, the group does not capitalise interest in its financial statements. To comply with US GAAP, the estimated amount of interest incurred whilst constructing major capital projects is included in fixed assets, and depreciated over the lives of the related assets. The amount of interest capitalised is determined by reference to the average interest rates on outstanding borrowings. At 31 March 1999 under US GAAP, gross capitalised interest of £499m (1998 – £525m) with regard to the company and its subsidiary companies was subject to depreciation generally over periods of 2 to 25 years.

(d) Goodwill

Under UK GAAP, in respect of acquisitions completed prior to 1 April 1998, the group wrote off goodwill arising from the purchase of subsidiary undertakings, associates and joint ventures on acquisition against retained earnings. The goodwill is reflected in the net income of the period of disposal, as part of the calculation of the gain or loss on divestment. Under US GAAP, such goodwill is held as an intangible asset in the balance sheet and amortised over its useful life and only the unamortised portion is included in the gain or loss recognised at the time of divestment. Gross goodwill under US GAAP at 31 March 1999 of £1,957m (1998 – £925m) was subject to amortisation over periods of 3 to 20 years. Goodwill relating to MCI was unchanged for the period from 31 October 1997 when the investment ceased to have associated company status until disposal on 15 September 1998. The value of goodwill is reviewed annually and the net asset value is written down if a permanent diminution in value has occurred. Under UK GAAP, goodwill arising on acquisitions completed on or after 1 April 1998 is generally accounted for in line with US GAAP.

(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 1999 was £76m (1998 – £1,315m relating primarily to the investment in MCI, 1997 – £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 1999, the adjustment of £1,424m (1998 – £2,095m) reconciling ordinary shareholders' equity under UK GAAP to the approximate amount under US GAAP included the tax effect of other US GAAP adjustments. This comprised an adjustment increasing non-current assets by £59m (1998 – £76m decrease); an adjustment increasing current assets by £50m (1998 – £68m increase); £nil adjustment (1998 – £184m decrease) to current liabilities; an adjustment decreasing minority interests by £11m (1998 – £3m decrease) and an adjustment increasing long-term liabilities by £1,544m (1998 – £2,274m 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.

II Net income and shareholders' equity reconciliation statements

The following statements summarise the material estimated adjustments, gross of their tax effect, which reconcile net income and shareholders' equity from that reported under UK GAAP to that which would have been reported had US GAAP been applied.

Net income

YEAR ENDED 31 MARCH	1999 £m	1998 £m	1997 £m
Net income applicable to shareholders under UK GAAP	2,983	1,702	2,077
Adjustments for:			
Pension costs	(104)	(66)	83
Redundancy charges	(284)	(253)	156
Capitalisation of interest, net of related depreciation (a)	(19)	(38)	(23)
Goodwill amortisation (a)	85	(71)	(73)
Mobile licences, software and other intangible asset capitalisation and amortisation, net (a)	(226)	42	77
Investments	(6)	5	–
Deferred taxation (a)	220	163	(148)
Other items (a)	(60)	(37)	–
Net income as adjusted for US GAAP	2,589	1,447	2,149
Basic earnings per American Depositary Share as adjusted for US GAAP (b)	£4.02	£2.27	£3.39
Diluted earnings per American Depositary Share as adjusted for US GAAP (b)	£3.93	£2.23	£3.36

Shareholders' equity

AT 31 MARCH

	1999 £m	1998 £m
Shareholders' equity under UK GAAP	14,940	10,785
Adjustments for:		
Pension costs	(1,730)	(1,347)
Redundancy costs	(46)	(41)
Capitalisation of interest, net of related depreciation	245	299
Goodwill, net of accumulated amortisation	293	2,118
Mobile licences, software and other intangible asset capitalisation and amortisation	628	930
Investments	5	1,266
Deferred taxation	(1,424)	(2,095)
Dividend declared after the financial year end	799	736
Other items	(36)	(36)
Shareholders' equity as adjusted for US GAAP	13,674	12,615

(a) The disposal of the group's interest in MCI shares during the year ended 31 March 1999 gave rise to adjustments; increasing net income by £163m relating to goodwill and £95m relating to deferred taxation and decreasing net income by £197m relating to software and other intangible assets, £60m relating to foreign exchange translation differences and £5m relating to the capitalisation of interest.

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

III Minority Interests

Under US GAAP, the minority interest charge would have been reduced by £12m (1998 – £5m, 1997 – £nil) after adjusting for goodwill amortisation and accounting for associates and joint ventures. Net assets attributable to minority interests would have been £88m higher (1998 – £81m higher) after adjusting for goodwill, investments and other items.

IV Accounting for share options

Under UK GAAP, the company does not recognise compensation expense for the fair value, at the date of grant, of share options granted under the employee share option schemes. Under US GAAP, the company adopted the disclosure-only option in SFAS No. 123 “Accounting for Stock-Based Compensation” 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 £2,560m (1998 – £1,432m, 1997 – £2,126m), 39.7p (1998 – 22.4p, 1997 – 33.6p) and 38.8p (1998 – 22.1p, 1997 – 33.2p), 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 31 for the SFAS No. 123 disclosures of the fair value of options granted under employee schemes at date of grant.

V Consolidated statements of cash flows

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

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

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

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

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

	1999 £m	1998 £m	1997 £m
Net cash provided by operating activities	3,876	3,847	5,066
Net cash used in investing activities	(950)	(4,198)	(2,589)
Net cash used in financing activities	(1,665)	(1,647)	(1,517)
Net increase (decrease) in cash and cash equivalents	1,261	(1,998)	960
Effect of exchange rate changes on cash	33	21	(14)
Cash and cash equivalents under US GAAP at beginning of year	366	2,343	1,397
Cash and cash equivalents under US GAAP at end of year	1,660	366	2,343
Short-term investments with original maturities of less than 3 months	(1,558)	(304)	(2,317)
Cash at bank and in hand under UK GAAP at end of year	102	62	26

VI Current asset investments

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

At 31 March 1999, the group held trading investments (as defined by US GAAP) at a carrying amount of £1,678m (1998 – £384m) with fair values totalling £1,678m (1998 – £389m). Held-to-maturity securities at 31 March 1998 and 1999 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 1999	43	43
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
The contractual maturities of the held-to-maturity debt securities at 31 March 1999 were as follows:	Cost £m	Fair value £m
Maturing on or before 31 March 2000	30	30
Maturing after 31 March 2000	13	13
Total at 31 March 1999	43	43

VII Pension costs

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

The pension cost determined under SFAS No. 87 was calculated by reference to an expected long-term rate of return on scheme assets of 7.7% (1998 – 8.2%, 1997 – 9.2%). The components of the pension cost for the main pension scheme comprised:

	1999 £m	1998 £m	1997 £m
Service cost	387	327	268
Interest cost	1,653	1,554	1,645
Expected return on scheme assets	(1,712)	(1,595)	(1,668)
Amortisation of prior service costs	24	24	24
Amortisation of net obligation at date of limited application of SFAS No. 87	52	52	52
Recognised gains	(137)	(129)	(123)
Additional cost of termination benefits	279	224	258
Pension cost for the year under US GAAP	546	457	456

VII Pension costs (continued)

The information required to be disclosed in accordance with SFAS No. 132 concerning the funded status of the main scheme at 31 March 1998 and 31 March 1999, based on the valuations at 1 January 1998 and 1 January 1999, respectively, is given below.

	1999 £m	1998 £m
Changes in benefit obligation		
Benefit obligation at the beginning of the year	23,513	20,733
Service cost	387	327
Interest cost	1,653	1,554
Employees' contributions	163	157
Additional cost of termination benefits	279	224
Actuarial movement (a)	2,361	1,618
Other changes	25	7
Benefits paid	(1,223)	(1,107)
Benefit obligation at the end of the year	27,158	23,513
Changes in scheme assets		
Fair value of scheme assets at the beginning of the year	22,666	19,879
Actual return on scheme assets	3,050	3,494
Employers' contributions (b)	439	236
Employees' contributions	163	157
Other changes	25	7
Benefits paid	(1,223)	(1,107)
Fair value of scheme assets at the end of the year	25,120	22,666
Funded status under US GAAP		
Projected benefit obligation in excess of scheme assets	(2,038)	(847)
Unrecognised net obligation at date of initial application of SFAS No. 87 (c)	210	262
Unrecognised prior service costs (d)	199	223
Other unrecognised net actuarial gains	(1,039)	(2,199)
Accrued pension cost under US GAAP	(2,668)	(2,561)

(a) The actuarial movements in the years ended 31 March 1998 and 1999 are significant due to the decline in the discount rates used to calculate the benefit obligation as a result of the fall in long-term interest rates in 1997 and 1998.

(b) The employers' contributions for the year ended 31 March 1999 include a special contribution of £200m paid on 31 March 1999.

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

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

The benefit obligation for the main pension scheme was determined using the following assumptions at 1 January 1998 and 1 January 1999:

	1999 per annum %	1998 per annum %
Discount rate	5.5	7.2
Rate of future pay increases	4.8	5.8

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