

Corporate governance

It is BT's policy in all our activities around the world to achieve best practice in our standards of business integrity. This includes a commitment to follow the highest standards of corporate governance throughout the BT group. This section of the annual report describes how BT has applied the principles set out by the London Stock Exchange, for all UK listed companies, in Section 1 of the Combined Code (the Code).

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

The Board

The Board continues to meet every month, except in August. Its principal focus is the overall strategic direction, development and control of the group. Key matters, such as approval of the group's strategic plans and annual operating plan and budget, and monitoring the company's operating and financial performance, are reserved for the Board. These reserved matters are set out in a formal statement of the Board's role. It is sent to all directors, key senior executives and managers involved in the management of the company's principal operations, together with information on the authorities delegated by the Board and the terms of reference and membership of the principal Board and management committees.

BT's aim is for the Board to comprise approximately two-thirds non-executive directors. Six of the ten current directors are non-executive, all of whom are independent of the management of BT. Between them, the non-executive directors bring experience and independent judgement at a senior level of international business operations and strategy, marketing, doing business in the key markets in which the group now operates and international affairs.

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

Non-executive directors are appointed initially for three years. Towards the end of that period, the Board will consider whether to continue the appointment, which will then become terminable on twelve months' notice from either BT or the director. Appointments will be reviewed again by the Board before the end of the sixth year. Normally, appointments will be for a maximum of ten years. The Deputy Chairman's contract was renewed for a second three-year term from 1 April 1998. It may be terminated on twelve months' notice.

All directors are required by the company's articles of association to be elected by shareholders at the first annual general meeting after their appointment. One third of the other directors must seek re-election by the shareholders each year. This can mean that directors are not necessarily re-elected every three years. Shareholders will be asked at this year's annual general meeting (AGM) to approve a change to the articles of association to clarify the position. To comply this year with the Code, four directors will retire by rotation and seek re-election rather than three as required by the articles of association.

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

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

On appointment, directors participate in an induction programme when they receive information about BT, the formal statement of the Board's role, the powers which have been delegated to the company's senior managers and management committees and latest financial information about the group. This is supplemented by visits to key BT locations and meetings with members of the *Group Executive Committee* and other key senior executives. Throughout their period in office this information is updated as BT's business, management structure and the competitive and regulatory environments in which it operates change. This can include further meetings with senior BT executives. Directors are also advised on appointment of their legal and other obligations as a director of a listed company, both in writing and in face-to-face meetings with the Secretary. They are reminded of these obligations each year and are encouraged to attend training courses at the company's expense.

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

Principal Board committees

The Chief Executive, Sir Peter Bonfield, chairs the *Group Executive Committee*. The other members are the Group Finance Director, the Group Managing Director BT UK, the President and Chief Executive BT Worldwide, the Group Commercial Director and Secretary, the Group Personnel Director, the Group Director Strategy and Development, the Director of Corporate Communications, the Group Engineering and Technology Director, and the Managing Director, BT Cellnet and UK Mobility. The Committee develops the group's strategy, for Board approval, and oversees its implementation. It also finalises, before Board approval, annual operating and capital expenditure plans and budgets, reviews operational activities and agrees and monitors group-wide policies, where these are not reserved to the Board.

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

The *Nominating Committee* also assesses candidates for executive directorships before it recommends an appointment.

The *Audit Committee*, comprising solely non-executive directors, is chaired by Lord Marshall. Its terms of reference, which are in writing, include reviewing BT's internal controls and published financial reports for statutory compliance and against standards of best practice, and recommending appropriate disclosure in these reports to the Board. It also reviews annually the performance of the company's auditors to ensure that an objective, professional and cost-effective relationship is maintained. It recommends to the Board the auditors' fees for their audit services. The Group Finance Director and the Group Commercial Director and Secretary attend these meetings. Each year, the Committee sets aside time to seek the views of the company's auditors in the absence of executives.

The *Remuneration Committee* comprises solely non-executive directors and is chaired by Lord Marshall. Further details about the Committee are included in the *Report on directors' remuneration*.

Committee membership is identified in the table of directors on pages 40 and 41.

Internal financial control

The Board is responsible for the group's systems of internal financial control.

Any system can provide only reasonable and not absolute assurance against material financial misstatement or loss. Key elements are:

- Formal policies and procedures are in place, including the documentation of key systems and rules relating to the delegation of authorities, which allow the monitoring of controls and restrict the unauthorised use of the group's assets.
- Experienced and suitably qualified staff take responsibility for important business functions. There are rigorous recruitment policies and annual appraisal procedures which assess performance against agreed objectives and identify necessary training to maintain and enhance standards of performance.
- Forecasts and budgets are prepared which allow management to monitor the key business and financial activities and risks and the progress towards financial objectives set for the year and the medium term; monthly management accounts are prepared promptly providing relevant, reliable and up-to-date financial and other information; significant variances from budget are investigated as appropriate.
- All investment projects are subject to formal authorisation procedures. The Board considers major investment projects, with other projects being approved by the *Group Investment Committee* (a sub-committee of the *Group Executive Committee*) or senior management within delegated authorities approved and reviewed by the Board.
- The *Audit Committee* reviews reports from management, from the internal auditors and from the external auditors, to provide reasonable assurance that control procedures are in place and are being followed.
- Formal procedures have been established for instituting appropriate action to correct weaknesses identified from the above reports.

The *Audit Committee* has conducted its annual review of the effectiveness of the systems of internal financial control in existence in the group for the year ended 31 March 1999 and for the period up to the date of approval of the financial statements.

The Board recognises the importance of non-financial controls. However, specific guidance on the scope, extent, nature and review of internal non-financial controls is not

expected to be finalised until summer 1999. When the guidelines are finalised, the Board intends to use them to report on the whole system of internal control.

Relations with shareholders

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

The company's policy has always been to allow shareholders to vote at the AGM on the annual report and it is continuing that policy this year. The Board has also decided that shareholders should this year be asked to vote on the company's directors' and senior executives' remuneration policy, as set out on pages 47 to 49 in the *Report on directors' remuneration*.

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

Shareholders are being asked this year to approve updated articles of association. These also include some changes to the current provisions. An explanation is given in the notes accompanying the Notice of the AGM. These are being dealt with in a single resolution as the Board considers changes to the company's constitution to be a single issue. The proxy votes for and against each resolution, as well as abstentions, will be counted before the 1999 AGM and the results will be made available at the meeting after shareholders have voted on a show of hands.

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

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

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

Statement of Business Practice

BT's policy is to achieve best practice in our standards of business integrity for all of our activities around the world. To reinforce our determination to live up to these standards BT has, over the year, reviewed its existing Statement of Business Practice, which sets out the principles the group will observe. This review included consultation with individuals and groups, inside and outside the company. The Statement now better reflects BT's growing worldwide operations and the increasing expectations in the areas of corporate governance and business practice standards. It also recognises the importance of our joint venture partnerships and outlines how we work with our partners in the creation of added value whilst working within high standards of business practice. This new Statement is being sent to every employee and it is on the company intranet site. These high level principles are then linked into everyday policies and principles by the operating units. A confidential help line is available to employees who have questions regarding the application of these principles. We also continue to require our agents and contractors to apply these principles when representing BT.

Pension fund

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

Reporting

A statement by the directors of their responsibilities for preparing the financial statements is included on page 57.