

Corporate Governance

BT's policy is to achieve best practice in our standards of business integrity for all our activities around the world. This includes a commitment to the highest standards of corporate governance throughout the group. This section of the annual report describes how BT has applied the principles set out in Section 1 of the Combined Code on Corporate Governance (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 meets 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 are set out in a formal statement of the Board's role.

BT's aim is for approximately two-thirds of the Board to be non-executive directors. Of the current 12 directors, nine are independent, non-executive directors. Two directors are full-time executives. The Chairman is part-time. Between them, the non-executive directors bring experience and independent judgement at a senior level of international business operations and strategy, marketing, communications and international affairs.

The non-executive directors provide a strong independent element on the Board with Lord Marshall and Sir Anthony Greener, the Joint Deputy Chairmen, as the senior independent members. 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 considers, on the recommendation of the *Nominating Committee*, whether to continue the appointment. Appointments will be reviewed again by the Board before the end of the sixth year. After the third anniversary, appointments can be terminated by either the director or BT on 12 months' written notice. Normally, non-executive directors will remain in office for no more than ten years. Lord Marshall's contract was renewed for a second three-year term from 1 April 1998. It was extended in June 2000 to the end of this year's annual general meeting when Lord Marshall will retire. Sir Anthony Greener's contract is for a three-year term from 1 October 2000.

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. At least 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. To comply with the Code, BT's policy is that, in practice, no director stays in office for more than three years without re-election.

The Chairman and executive directors have service agreements, which are approved by the *Remuneration Committee*. Information about the periods of these contracts is in the *Report on directors' remuneration* on page 70.

The Board has 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 take part in an induction programme when they receive information about BT, the formal statement of the Board's role, the terms of reference and memberships of the principal Board and management committees, including the powers that have been delegated to the management committees, the company's corporate governance framework and executive reserved powers and latest financial information about the group. This is supplemented by visits to key BT locations and meetings with members of the *Executive Committee* and other key senior executives. Throughout their period in office, they are updated on BT's business, the competitive and regulatory environments in which it operates and other changes, by written briefings and 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 *Executive Committee*. The other members are the Group Finance Director, the Group Commercial Director and Secretary, the Group Personnel Director, the Chief Executive Officers of the following lines of business (BT Wireless, BT Ignite, BT Openworld, BT Wholesale and BT Retail), the Chief Executive of BT Business Services, the Group Strategy and Development Director, the Group Communications Director, the Group Engineering Director and Chief Technology Officer and the Restructuring

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Project Director. 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, the Joint Deputy Chairmen and three other non-executive directors, recommends to the Board appointments of all directors. To ensure an appropriate balance of expertise and ability, it has agreed, and regularly reviews, a profile of the skills and attributes required from the non-executive directors as a whole. 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 *Audit Committee*, comprising solely non-executive directors, is chaired by Sir Anthony Greener. It reviews BT's systems of internal control and risk management, considers the company's published financial reports for statutory compliance and against standards of best practice and recommends to the Board appropriate disclosure in these reports. The Board takes responsibility for disclosures on internal control in the annual report. The *Audit Committee* 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 Committee 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. Sir Anthony Greener will chair the Committee after Lord Marshall's retirement. Further details about the Committee are included in the *Report on directors' remuneration*.

Committee membership is identified in the table of directors on pages 49 and 50.

Internal control and risk management

The Board is responsible for the group's systems of internal control and risk management and for reviewing the effectiveness of those systems. Such systems are designed to manage, rather than eliminate, the risk of failure to achieve business objectives; any system can provide only reasonable and not absolute assurance against material misstatement or loss.

BT has processes for identifying, evaluating and managing the significant risks faced by the group. These processes have

been in place for the whole of the 2001 financial year and have continued up to the date on which this document was approved. The processes are in accordance with the guidance for directors published in the UK in September 1999.

Risk assessment and evaluation takes place as an integral part of the group's annual strategic planning cycle. The group has a detailed risk management process which identifies the key risks facing each business unit. This information is reviewed by senior management as part of the strategic review. The group's current key risks are summarised on pages 57 to 61 of this document.

The key features of the risk management process comprise the following procedures:

- the group's lines of business carry out risk assessments of their operations, have created registers relating to those risks, and ensure that the key risks are addressed. Lines of business audit committees monitor the standards of internal controls in the lines of business;
- senior management report regularly to the Group Finance Director on the operation of internal controls in their area of responsibility;
- the annual strategy review process includes consideration of major business risks;
- the Chief Executive receives annual reports from senior executives with responsibilities for major group operations with their opinion on the effectiveness of the operation of internal controls during the financial year;
- the group's internal auditors carry out continuing assessments of the quality of risk management and control; they also promote effective risk management in the lines of business' operations;
- the *Audit Committee*, on behalf of the Board, considers the effectiveness of the operation of internal control procedures in the group during the financial year. This follows the consideration of the matter by the *Executive Committee* at a preceding meeting. The *Audit Committee* reviews reports from the *Executive Committee*, from the internal auditors and from the external auditors and reports its conclusions to the Board. The *Audit Committee* has carried out these actions for the 2001 financial year.

Material joint ventures and associates, which BT does not control, outside the UK have not been dealt with as part of the group for the purposes of this internal control assessment.

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 that has not already been made available generally to the company's shareholders.

The company is continuing its policy that shareholders vote on the annual report at the AGM.

The Board has also decided that shareholders should this year be asked to vote on the directors' and senior executives' remuneration policy, as set out on pages 62 to 65 in the *Report on directors' remuneration*. Shareholders were asked to vote on the remuneration policy for the first time at the AGM in 1999, but were not asked to do so in 2000 as there had been no significant change.

It is 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.

The proxy votes for and against each resolution, as well as abstentions, will be counted before the 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 chairmen of the *Audit* and *Remuneration* committees are at the AGM and are available to answer questions.

BT's practice is to post the Annual Report and Notice of AGM in the most cost-effective manner, given the large number of shareholders. We aim to give as much notice as possible and at least 21 clear days, as required by our articles of association. In practice, the Annual 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

To reinforce our commitment to achieve best practice in our standards of business integrity, BT has a written Statement of Business Practice ("The Way We Work"). The Statement reflects BT's international operations and the increasing expectations in the areas of corporate governance and business practice standards. A copy of the Statement (which is available in eight languages) has been sent to every employee and is also available on the company's intranet site. There is a question and answer guide for managers to help them brief their teams.

An ongoing comprehensive communications exercise, using vehicles such as video and CD-ROM, continues to be rolled out across the group, helping to raise awareness of the Statement and embody our ethics and business principles across all the company's activities. BT has also developed, collaboratively with The Institute of Business Ethics, an internal business practice excellence award – an industry first.

These high-level principles are supported by online training, and a confidential helpline and e-mail facility are 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.

Political donations

It has always been the company's policy not to give cash contributions to any political party. However, given the nature of the group's businesses, BT and other group companies have a business need to contact politicians and political parties on a non-partisan basis to make them aware of key arguments and technology and industry trends. BT believes these activities form a legitimate part of normal relationships between companies and the political machinery. They are not designed to support or influence support for a particular party. Provisions of the Political Parties, Elections and Referendums Act 2000, which mainly came into operation on 16 February 2001, have changed significantly the controls over the funding of political parties in the EU and other forms of EU political expenditure. The new Act has also extended the definition of political donations to the extent that we anticipate some of our existing activities will be caught, even though they are not "donations" in the ordinary sense of the word. As we wish to continue these activities, we are, in accordance with the Act, seeking shareholders' approval at the AGM to continue to make political donations and incur other EU political expenditure, as these terms are defined by the Act. Expenditure will continue to be on an even-handed basis related broadly to the electoral strength of each party. The policy of not making any direct cash contributions to any party will continue.

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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.

On 1 April 2001, we introduced a defined contribution scheme for new employees after closing the BT Pension Scheme to new entrants. The defined contribution scheme has been established under a separate trust from the existing BT Pension Scheme, but also has company and union-nominated trustees and an independent chairman. Its assets are held separately from those of the company.

Reporting

A statement by the directors of their responsibilities for preparing the financial statements is included in the statement of directors' responsibilities set out on page 71.