

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 we have 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.

The Board is currently made up of the part-time Chairman, five executive directors and six non-executive directors. It is BT's stated policy to appoint a further non-executive director to retain a majority of independent non-executive directors. All the non-executives are independent. Between them, the non-executive directors bring experience and independent judgement at a senior level of international business operations and strategy, marketing, communications, and political and international affairs.

The non-executive directors provide a strong independent element on the Board. Sir Anthony Greener, the Deputy Chairman, is the senior independent member. However, the Board operates as a single team.

Non-executive directors are appointed initially for three years. At the end of that period, the appointment may be continued by mutual agreement.

All directors are required by the company's articles of association to be elected by shareholders at the first AGM after their appointment, if appointed by the Board. A director must also retire by rotation and may seek re-election at the AGM if he or she was last elected or re-elected at or before the AGM held in the third year before the year in question.

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 69.

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 *Operating 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, social and environmental matters 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, Ben Verwaayen, chairs the *Operating Committee*. The other members are the Group Finance Director and the Chief Executives of BT Ignite, BTopenworld, BT Wholesale and BT Retail. The Secretary attends its meetings. The Committee has collective responsibility for running the group's business end-to-end. To do that, it develops the group's strategy and budget for agreement by the Board, recommends to the Board the group's capital expenditure and inorganic investments budgets, monitors the financial, operational and customer quality of service performance of the whole group, allocates resources across the group within plans agreed by the Board, plans and delivers major cross-business programmes and reviews the senior talent base and succession plans of the group.

A sub-committee of the *Operating Committee*, the *Management Council*, meets monthly. It consists of the *Operating Committee* members plus a number of other senior executives. It is an advisory forum supporting the Chief Executive in policy formulation, on issues such as corporate social responsibility, technology, public policy and reputation, industrial relations and employment policies.

The *Nominating Committee*, consisting of the Chairman, the Deputy Chairman and two 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 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 Sir Anthony Greener. Further details about the Committee are included in the **Report on directors' remuneration**.

Committee membership is identified in the table of directors on pages 48 and 49.

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.

The Board also takes account of significant social, environmental and ethical matters that relate to BT's businesses. The company's workplace practices, specific environmental, social and ethical risks and opportunities and details of underlying governance processes are dealt with in the **Our people** and **Our commitment to society** sections of this report.

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 2002 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 the group and 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 55 and 56 of this document.

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

- senior executives, led by the group's Risk Manager, review the group's key risks and have created a group risk

register. This is reviewed by the *Management Council* before being presented to the Board and approved by the *Audit Committee*;

- the 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 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 consideration of the matter by the *Management Council*. The *Audit Committee* reviews reports from the *Operating 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 2002 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**, we also maintain 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.

We are continuing our policy that shareholders vote on the annual report at the AGM.

The Board has also decided that shareholders should again this year be asked to vote on the directors' and senior executives' remuneration policy, as set out on pages 57 to 61 in the **Report on directors' remuneration**.

It is part of our policy to involve our 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 chairman of the *Audit* and *Remuneration* committees is at the AGM and is available to answer questions.

Our 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.

Non audit services provided by the external auditors

As a result of regulatory or similar requirements, it is necessary to employ the group's auditors for certain non-audit work. In order to maintain the independence of the external auditors, the Board has determined that work of a consultancy nature will not be offered to the external auditors unless there are clear efficiencies and value added benefits to the company.

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 our 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.

These high-level principles are supported by a comprehensive communications programme and online training. A confidential helpline and e-mail facility are also 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 BT's policy not to make cash donations to any political party. This policy will continue. However, changes to the law introduced by the *Political Parties, Elections and Referendums Act 2000* have extended the

definitions of donations and EU political expenditure to the extent that they cover activities which form part of normal relationships between companies and the political machinery, but which would not be thought of as either political donations or expenditure in the ordinary sense of those words. This includes activities undertaken by BT, such as inviting politicians to the company's research facilities at Adastral Park and hosting briefings at parties' annual conferences. These activities are not designed to support or influence support for any particular party. As we wish to continue these activities, which we believe are in BT's best interests, we are seeking appropriate shareholders' authority at the AGM. Expenditure will continue to be made on an even-handed basis related broadly to each party's electoral strength.

Pension Funds

BT's two main pension funds – the BT Pension Scheme and the BT Retirement Plan – are not controlled by the Board, but by separate trustees who are company and union nominees, with independent chairmen. The trustees look after the assets of the funds, which are held separately from those of the company. The pension schemes' funds can only be used in accordance with their respective rules and for no other purpose.

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 70.