

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 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) Sale and leaseback of properties

Under UK GAAP, the sale of BT's property portfolio is treated as a fixed asset disposal and the subsequent leaseback is an operating lease. Under US GAAP, the transaction is regarded as "financing" and the land and buildings are recorded on the balance sheet at their net book value, an obligation equivalent to the cash proceeds is recognised and the gain on disposal is deferred until the properties are vacated by BT. Rental payments made by BT are reversed and replaced by a finance lease interest charge and a depreciation charge.

(b) 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.

(c) 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, combined with the provision for pension costs in the group balance sheet, 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.

(d) 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. This included capitalisation of interest incurred on funding the 3G licences up to the date of the demerger. The amount of interest capitalised is determined by reference to the average interest rates on outstanding borrowings. At 31 March 2002 under US GAAP, gross capitalised interest of £330 million (2001 – £692 million) with regard to the company and its subsidiary companies was subject to depreciation generally over periods of three to 25 years.

(e) 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 2002 of £675 million (2001 – £10,309 million) was subject to amortisation over periods of three to 20 years. The value of goodwill is reviewed annually and the net asset value is written down if a permanent diminution in value has occurred. When impairment indicators exist, goodwill impairment is measured by discounting future projected cashflows or using quoted market prices if available.

(f) 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.

(g) Financial instruments

Under UK GAAP, investments are held on the balance sheet at historical cost, and own shares held in trust for share schemes are recorded in fixed asset investments. Gains and losses on instruments used for hedges are not recognised until the exposure being hedged is recognised. Under US GAAP, trading securities and available-for-sale securities are

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

carried at market value with appropriate valuation adjustments recorded in profit and loss and shareholders' equity, respectively. Certain derivative financial instruments which qualify as hedge accounting under UK GAAP do not qualify for hedge accounting under US GAAP.

These financial instruments, under US GAAP, are carried at market value with valuation adjustments recorded in profit and loss. Own shares held in trust are treated as a reduction to shareholders' equity until they are reissued to employees. The reassessment and purchase of derivatives in the year ended 31 March 2002 gave rise to an adjustment reducing net income by £20 million (2001 – £93 million). The net unrealised holding gain on available-for-sale securities for the year ended 31 March 2002 was £271 million (2001 – £8 million, 2000 – £311 million). SFAS 133 became effective for BT on 1 April 2001 and a transitional adjustment on adoption of £46 million net of tax has been recorded in shareholders' equity.

(h) Deferred gain

Under UK GAAP, assets contributed to a joint venture by the group's partners are measured at their net replacement cost. Any difference between the group's share of the joint venture's resulting net assets and the net book value of assets contributed by the group to the joint venture, including certain accrued start up costs, is immediately reflected by adjusting the group's investment in the joint venture and recording a deferred difference in shareholders' equity. Under US GAAP, the assets contributed by all joint venture partners are carried at their historical net book value and any difference between the group's share of the joint venture's resulting net assets and the net book value of assets contributed by the group to the joint venture is amortised over the life of the items giving rise to the difference.

(i) Employee share plans

Certain share options have been granted under BT save-as-you-earn plans at a 20% discount. Under UK GAAP, the share issues are recorded at their discounted price when the options are exercised. Under US GAAP, a plan is considered compensatory when the discount to market price is in excess of 15%. Compensation cost is recognised for the difference between the exercise price of the share options granted and the quoted market price of the shares at the date of grant or measurement date and accrued over the vesting period of the options.

Under UK GAAP, shares held by employee share ownership trusts are recorded as fixed asset investments at cost less amounts written off. Under US GAAP, those shares not fully vested are regarded as treasury stock and recorded at cost as a deduction from shareholders' equity.

(j) Investments in associates

Under UK GAAP, the group records the share of operating profit and loss of ventures based upon the total interest in the venture based upon the consolidation structure. The group records the equity in the operations of the venture on the basis of its consolidated results excluding the holdings of any of the group's other ventures for the purpose of determining the economic interest. The share of the operations of the ventures is reduced to the economic interest through an increase to minority interests at the group level. Under US GAAP, the share of the operating results of the venture is recorded at the amount of the group's economic interest.

(k) Deferred taxation

Following the introduction of FRS 19, under UK GAAP, provision is made for deferred tax in so far as a liability or asset arose as a result of transactions that had occurred by the balance sheet date and give rise to an obligation to pay more tax in the future, or a right to pay less tax in the future. Under US GAAP, deferred taxation is provided for on a full liability basis.

(l) 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.

(m) Impairment

Under UK GAAP, if there is an indication of impairment the assets should be tested for impairment and, if necessary written down to the value in use, calculated based on discounted future pre-tax cash flows related to the asset or the income generating unit to which the asset belongs.

US GAAP requires that an entity assess whether impairment has occurred based on the undiscounted future cash flows. An impairment loss exists if the sum of these cash flows is less than the carrying amount of the asset. The impairment loss recognised in the income statement is based on the asset's fair value, being either market value or the sum of discounted future cash flows.

I Differences between United Kingdom and United States generally accepted accounting principles continued**(n) Discontinued operations**

Under UK GAAP, the disposal of certain lines of business and joint ventures and associates are shown as discontinued activities. Under US GAAP, only the disposals of lines of business under Accounting Principles Board (APB) Opinion No. 30 would be reported as discontinued operations.

(o) Directories in progress

Under UK GAAP, the cost of classified advertising directories in progress deferred in stock represents direct fixed and variable costs as well as directly attributable overhead costs. Under US GAAP, the deferred costs associated with directories in progress comprise only the incremental direct costs associated with selling and creating the directories. Directories in progress acquired in a business purchase are valued at replacement value under UK GAAP and at retail value under US GAAP. Under UK GAAP, this difference is included in goodwill.

(p) Disposals of businesses

There are timing differences between UK GAAP and US GAAP for recognition of gains on the sale of certain businesses. Foreign exchange movements taken to reserves under UK GAAP are reported in the income statement under US GAAP. Historical GAAP differences on disposed businesses are also shown under this line item.

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	2002	2001	2000
Years ended 31 March	£m	£m	£m
Net income (loss) applicable to shareholders under UK GAAP	995	(1,870)	1,995
Restatement for deferred tax under FRS 19	–	60	60
Net income (loss) applicable to shareholders under UK GAAP as previously reported	995	(1,810)	2,055
Adjustment for:			
Sale and leaseback of properties	(1,178)	–	–
Pension costs	(106)	(42)	(209)
Redundancy charges	(140)	(453)	(300)
Capitalisation of interest, net of related depreciation	398	348	(14)
Goodwill amortisation	(34)	(55)	(64)
Mobile licences, software and other intangible asset capitalisation and amortisation, net	(32)	(32)	(33)
Financial instruments	23	(133)	(129)
Deferred gain	313	(71)	(19)
Impairment	192	–	–
Employee share plans	(8)	(38)	–
Deferred taxation	(1,409)	11	106
Directories in progress	–	(82)	–
Disposals of businesses	254	–	–
Net income (loss) as adjusted for US GAAP	(732)	(2,357)	1,393
Basic earnings (loss) per American Depositary Share as adjusted for US GAAP ^a	£(0.88)	£(3.24)	£1.93
Diluted earnings (loss) per American Depositary Share as adjusted for US GAAP ^a	£(0.88)	£(3.24)	£1.88

^aEach American Depositary Share is equivalent to 10 ordinary shares.

The adjustments to net income relating to discontinued operations are £282 million (2001 – £276 million, 2000 – £18 million loss).

II Net income and shareholders' equity reconciliation statements continued

Shareholders' equity At 31 March	2002 £m	2001 £m
Shareholders' equity under UK GAAP	(358)	12,054
Restatement for deferred tax under FRS 19	–	2,015
Shareholders equity under UK GAAP as previously reported	(358)	14,069
Adjustment for:		
Sale and leaseback of properties	(1,178)	–
Pension costs	(3,003)	(2,755)
Redundancy costs	–	(25)
Capitalisation of interest, net of related depreciation	250	620
Goodwill, net of accumulated amortisation	141	122
Mobile licences, software and other intangible asset capitalisation and amortisation	482	521
Financial instruments	(592)	(620)
Deferred gain	–	(323)
Impairment	192	–
Deferred taxation	(474)	(1,296)
Directories in progress	–	(82)
Disposals of businesses	120	–
Dividend declared after the financial year end	173	–
Shareholders' equity as adjusted for US GAAP	(4,247)	10,231

III Minority interests

Under US GAAP, the income to minority interests would have been reduced by £26 million (2001 – income reduced by £122 million, 2000 – loss increased by £10 million) after adjusting for goodwill amortisation and accounting for associates and joint ventures. Net assets attributable to minority interests would have been £26 million higher (2001 – £32 million higher) after adjusting for financial instruments.

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". 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 (loss), basic earnings (loss) per share and diluted earnings (loss) per share under US GAAP would have been £(792) million loss (2001 – £(2,419) million loss, 2000 – £1,347 million profit), (9.5)p loss (2001 – (33.2)p loss, 2000 – 18.6p) and (9.5)p loss (2001 – (33.2)p loss, 2000 – 18.2p), 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 34 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.

V Consolidated statements of cash flows continued

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.

	2002 £m	2001 £m	2000 £m
Net cash provided by operating activities	1,455	5,515	4,003
Net cash used in investing activities	3,049	(22,785)	(9,104)
Net cash provided by (used in) financing activities	(5,611)	18,311	4,697
Net increase (decrease) in cash and cash equivalents	(1,107)	1,041	(404)
Effect of exchange rate changes on cash	(50)	(15)	(1)
Cash and cash equivalents under US GAAP at beginning of year	2,281	1,255	1,660
Cash and cash equivalents under US GAAP at end of year	1,124	2,281	1,255
Short-term investments with original maturities of less than three months	(966)	(1,869)	(1,002)
Cash at bank and in hand under UK GAAP at end of year	158	412	253

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 2002, the group held trading investments (as defined by US GAAP) at a carrying amount of £1,245 million (2001 – £390 million) with fair values totalling £1,260 million (2001 – £394 million). Held-to-maturity securities at 31 March 2001 and 2002 consisted of the following:

	Amortised cost £m	Estimated fair value £m
Commercial paper, medium-term notes and other investments	2,372	2,372
Total at 31 March 2002	2,372	2,372
UK Government securities and other UK listed investments	8	8
Commercial paper, medium-term notes and other investments	30	30
Total at 31 March 2001	38	38

The contractual maturities of the held-to-maturity debt securities at 31 March 2002 were as follows:

	Cost £m	Fair value £m
Maturing on or before 31 March 2003	2,370	2,370
Maturing after 31 March 2003	2	2
Total at 31 March 2002	2,372	2,372

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 6.5% (2001 – 6.25%, 2000 – 6.5%). The components of the pension cost for the main pension scheme comprised:

	2002 £m	2001 £m	2000 £m
Service cost	564	580	498
Interest cost	1,739	1,673	1,459
Expected return on scheme assets	(1,863)	(1,850)	(1,600)
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	(67)	(133)	(65)
Additional cost of termination benefits	140	349	263
Pension cost for the year under US GAAP	589	695	631

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 2001 and 31 March 2002, based on the valuations at 1 January 2001 and 1 January 2002, respectively, is given below.

Changes in benefit obligation	2002 £m	2001 £m
Benefit obligation at the beginning of the year	31,184	31,024
Service cost	564	580
Interest cost	1,739	1,673
Employees' contributions	180	183
Additional cost of termination benefits	140	349
Actuarial movement	(3,428)	(1,342)
Other changes	27	31
Benefits paid or payable	(1,309)	(1,314)
Benefit obligation at the end of the year	29,097	31,184

Changes in scheme assets	2002 £m	2001 £m
Fair value of scheme assets at the beginning of the year	29,031	29,876
Actual return on scheme assets	(2,355)	(350)
Employers' contributions ^a	1,023	605
Employees' contributions	180	183
Other changes	27	31
Benefits paid or payable	(1,309)	(1,314)
Fair value of scheme assets at the end of the year	26,597	29,031

Funded status under US GAAP	2002 £m	2001 £m
Projected benefit obligation in excess of scheme assets	(2,500)	(2,153)
Unrecognised net obligation at date of initial application of SFAS No. 87 ^b	54	106
Unrecognised prior service costs ^c	127	151
Other unrecognised net actuarial gains	(324)	(1,181)
Accrued pension costs under US GAAP	(2,643)	(3,077)

^aThe employers' contributions for the year ended 31 March 2002 includes special contributions of £300 million paid on 21 November 2001 and £300 million paid on 4 December 2001 (2001 – £200 million paid on 21 December 2000 and £100 million paid on 30 March 2001).

^bThe unrecognised net obligation at the date of initial application is being amortised over 15 years from 1 April 1988.

^cUnrecognised 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 2001 and 1 January 2002:

	2002 per annum %	2001 per annum %
Discount rate	6.0	5.7
Rate of future pay increases	4.0	4.8
Rate of future pension increases	2.5	3.0

The accumulated benefit obligation at 31 March 2002 was £27,127 million (2001 – £28,694 million).