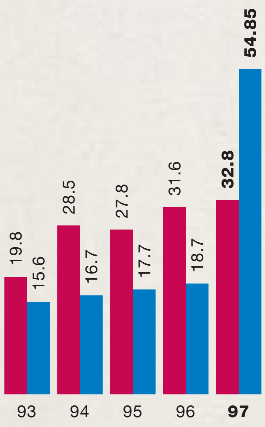
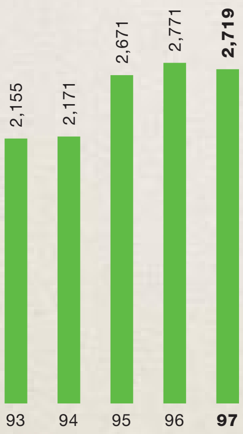
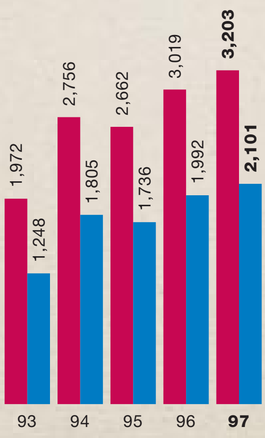
Earnings & dividends per share (pence)



Capital expenditure (£m)



Profit before and after tax (£m)



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- **Proposed merger with MCI announced to form group with annual turnover of around £26 billion**
- **Prices reduced by over £800 million in the year**
- **Strategic alliances and joint ventures in Europe and Asia announced or completed in year**
- **Operating cash flow grew by 6 per cent to £6.2 billion**
- **Capital expenditure maintained at over £2.7 billion**
- **6.1 per cent increase in ordinary dividends per share with a special dividend of 35 pence per share**

Chairman's statement

1996/97 was the most significant year for BT since its privatisation some 12 years ago. It was the year in which BT and MCI made history by announcing our intention to merge and form Concert, a leading player in the global telecommunications industry of the future.

A great deal has to happen between the announcement of a proposed merger and eventual closure. But we have already safely passed a number of key milestones. The merger has received overwhelming shareholder approval on both sides of the Atlantic and we have made good progress towards the necessary regulatory clearances.

BT and MCI, between us, have driven many of the dramatic changes that have taken place in our industry over the last decade. We are now seizing the chance to build one of the first great companies of the twenty-first century.

In my remarks at the Extraordinary General Meeting held in April, I described the merger as a "rite of passage" for BT – on the journey from nationalised monopoly to leading global competitor. In some of the press coverage this was reported as a "right of passage" and, as so often happens, such a slip revealed a new truth.

Concert is indeed a "right of passage" for your company, in the sense that it is something that we have earned.

If BT had not become so customer-focused, so responsive to competition, innovative, and committed to quality, we would simply not have been in a position to make this merger work. The fact that we are is a splendid testimony to the BT people who have reshaped this company over the last decade, and to the enlightened policies of privatisation, liberalisation and rigorous regulation pursued by the outgoing UK Government.

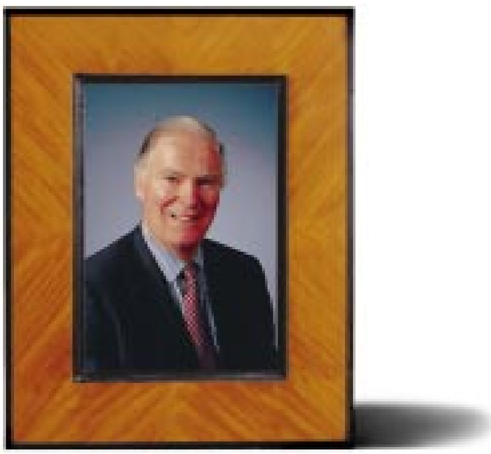
We have yet to see how the policies of the incoming Government will develop. But I am encouraged by its clear enthusiasm for the benefits that information technology can bring.

Things have not stood still while merger talks were in progress, and your company has had a most satisfactory year. Turnover grew by 3.4 per cent, helped by innovative and successful marketing and by growth in the demand for advanced services, such as FeatureNet and high-speed ISDN connections.

Our reputation as a company that offers excellent value for money was further enhanced by price reductions on a range of call types and other services worth a total of over £800 million in the year.

Earnings per share increased to 32.8p and I am pleased to report a final dividend for the year of 11.95p per share. This will be paid at the same time as the 35p per share special dividend, which was announced in connection with the merger and which brings the total dividend for the year to 54.85p.

Excluding the special dividend, this represents an increase of 6.1 per cent on last year.



Your company has continued to make substantial investments in its UK network, over the year, to match the ever-rising level and scope of service our customers expect. The growth in demand for advanced services is especially marked.

For personal customers, the benefits are clear. Particularly in such areas as education, healthcare and public information, your company is developing products and services that really do add value to our customers' lives.

This has been a record year, too, for awards to BT on its unique community programme.

For business customers, the Internet and corporate intranet markets are growing at an exhilarating rate and BT and MCI in Concert will carry around half of the world's Internet traffic.

We are focusing on developing integrated solutions that meet the whole range of a company's needs, helping it to gain competitive advantage in its own marketplace. Electronic commerce, for example, has the capacity to revolutionise the way businesses bring their products to market and interact with their customers.

On the international front, as we approach the liberalisation of telecommunications markets throughout the European Union from 1 January 1998, we are building a presence across the continent. BT is now particularly well positioned in all the major European countries.

Financial highlights

FOR THE YEAR ENDED 31 MARCH 1997

	1997	1996
Turnover	**£14,935m**	£14,446m
Profit before taxation	**£3,203m**	£3,019m
Profit after taxation	**£2,101m**	£1,992m
Earnings per share	**32.8p**	31.6p
Dividends per share – ordinary	**19.85p**	18.70p
– special	**35.00p**	–
Capital expenditure	**£2,719m**	£2,771m

The recent agreements that we have put in place with Spain's Telefonica and with Portugal Telecom illustrate the opportunities that abound in global telecommunications markets. We will be especially well positioned to seize opportunities in Latin America and among the Spanish-speaking communities of the USA.

The Asia-Pacific region is also of great importance to us. We are already a leading supplier of value-added data networks in Japan. We have significant initatives underway in each of the sub-regions.

One particularly encouraging development was the announcement, in March, that BT and Japan's NTT had joined forces to bid, with local partners, for a second telecoms licence in Singapore.

There is no apparent slowing in the rate at which new markets and new opportunities – both geographical and technical – are emerging. The demand for communications services around the world is intense and it is growing.

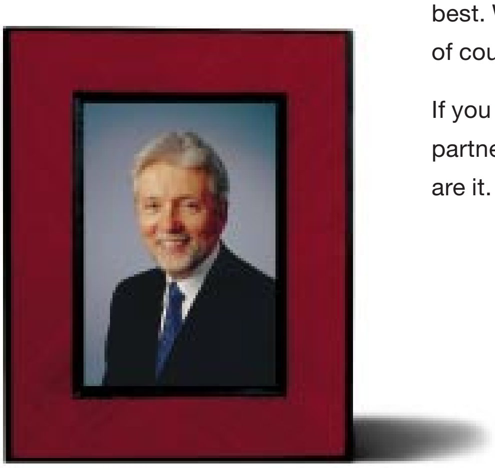
This is the world of opportunity in which Concert will find its place. Our task is to convert that opportunity into long-term shareholder value.

Iain Vallance

Sir Iain Vallance
Chairman
20 MAY 1997

An interview with Chief Executive, Sir Peter Bonfield

Sir Peter Bonfield, Chief Executive Officer (designate) of Concert plc explains why the merger is such a major opportunity for both BT and MCI and why he believes the new company will be a force to be reckoned with in the global communications markets of the future.



Why are you so convinced that the Concert merger is the right thing for BT?

For a start, the timing of the merger is perfect. BT has done great things in the 12 years since privatisation, but we now need to become a global player. MCI also finds itself with opportunities to develop and grow. It has, of course, been fantastically successful, but now faces new challenges in markets it wishes to break into, primarily local services in the US and Latin America.

The global telecoms market is growing at an extraordinary pace. The local market in the US will be worth $100 billion a year; the European Union, post 1 January 1998, could be worth $190 billion; and other markets – the Asia-Pacific region and Latin America in particular – could be even more valuable.

So, we are confronted by a wealth of opportunity in a huge and varied market. No one company can hope to go it alone; so you have to do it with partners. But not just any partner. One of the great advantages of moving early, as we did, is that you can choose the best. Which is what we did – and, of course, what MCI did.

If you can talk about natural partners in business, BT and MCI are it.

In what ways are BT and MCI natural partners?

The two companies complement each other extremely well. We share a commitment to free competition and customer choice, we have a shared view of the future of our industry, and a shared strategy for making the most of the opportunities that we face.

BT has a worldwide reputation for research and development; MCI is famous for its innovative marketing. They bring speed of action - they get new products and services from the drawing board to the marketplace in a matter of months; we bring unrivalled strategic management skills.

BT has 12 years' experience of competition in the local telecommunications market, which will be of enormous importance to MCI as it moves into the local services market in the USA. MCI, on the other hand, has come of age as the main contender in the US long-distance market, competing against the incumbent AT&T. This experience will be invaluable, particularly in those European markets in which Concert is up against the incumbent operator. You would be hard pressed to come up with two partners more likely to succeed.

Besides, we have shown that we can work together - we have a highly successful track record. For the past three years, BT and MCI have been involved in a joint venture – Concert Communications – which now has over 3,000 major customers and around £900 million revenue under contract.

How big is Concert going to be?

On day one, Concert will have about 43 million customers in more than 70 countries, and revenues of around £26 billion. It will have around 180,000 employees and will operate in hundreds of cities around the world.

But, rather than focus on the size of Concert, I would prefer to stress the scope and scale of its opportunities. At the moment, the global communications market is worth around $650 billion and it is growing dramatically fast. Estimates are that the market could exceed $1 trillion within the next few years.

And not only is the market large, it is opening up around the world, creating new opportunities all the time. Today, only about 17 per cent of the market outside the UK and the US is open to competition; by the year 2000 that could be 95 per cent.

At the moment, BT and MCI between them have about six per cent of the market. If we were to do nothing other than hold on to that six per cent, we would be a £36 billion company within a few years. But, of course, we are going after a chunk of that other 94 per cent.

What are your priorities for Concert's early days?

I have five priorities for Concert's first year:

- First, to continue to grow and develop our core operations, in the UK through BT and in the US through MCI.
- Second, to stake a major claim in the US local services market.
- Three, to prepare for rapid growth in Europe. 1 January 1998 really is the opportunity of a lifetime for us and we can't wait.
- Four, to grow our systems integration business by more than 20 per cent. Increasingly, major corporate customers are looking for suppliers to manage the whole of their communications requirements – in-house and external – around the world. Success in this market comes from winning the trust of customers and working with them in partnership – something that both BT and MCI know a lot about.
- And finally, to create and develop a series of joint venture partnerships in targeted countries around the world, specifically in Europe, Latin America and the Far East.

What will the merger mean for customers, shareholders and employees?

Concert is all about bringing genuine competition into all the markets in which it operates, and competition has been shown in those markets where it is already operative to result in more choice for customers, a wider range of services, improving quality of service and falling prices.

The results for shareholders will, I believe, prove equally tangible. Concert gives BT's shareholders access to the dynamic US market, the world's largest, while MCI's shareholders gain exposure to the opportunities that will follow deregulation in Europe. Both will benefit from Concert's expansion into the wider international market – into the Asia-Pacific region and into Latin America.

Concert offers shareholders a stake in a company that is big enough to be able to balance a more speculative, potentially high-yield investment in one market, and proven, substantial returns in another. In effect, it offers shareholders the benefits of a diverse portfolio in a single share.

The commitment of our employees has been fundamental in placing BT in the position whereby this merger could take place. For the future there should be great opportunities for our employees as we become closer to achieving our vision of becoming the most successful worldwide telecommunications group. People are crucial to our success because if we want to be the best we must be in a position to attract and retain the best people. We shall strive to do this by becoming an employer of choice and give even greater emphasis to developing and training our people.

Sir Peter Bonfield CBE
Chief Executive
20 MAY 1997

Business review

The most significant event of the year occurred on 3 November 1996 when BT and MCI announced that they had entered into a merger agreement to create Concert. The new company will be a world-leading communications provider with annual revenues of around £26 billion.

On day one, Concert will have 43 million customers in 72 countries, including 70 of the world's top 100 multinational companies.

Both BT and MCI believe that the merger has a compelling logic and offers strategic fit and complementary expertise. For example, BT has more than 12 years' experience of competing successfully in local markets, and this will be invaluable as the local telecommunications market in the USA opens up. MCI has a history of being the new entrant and competing with the established incumbent, and Concert will be able to call on that experience once it has the chance to compete against the established operators as markets in the European Union liberalise.

BT and MCI have been working successfully together for some time. Our existing joint venture – Concert Communications – already has some 3,000 customers and approximately £900 million revenue under contract.

Outside the UK

In the past few years, BT has been putting together the pieces of a detailed international strategy, and now has one of the most comprehensive global networks of any operator. We have more than 25 equity joint ventures worldwide, together with 44 partnerships and distributorships for Concert Communications.

Europe is a key target market for BT. From 1 January 1998 the telecommunications markets in most of the European Union open up to full competition and BT now has a significant presence in all the key countries. Our strategy is to work in partnership with local companies – for example, with VIAG in Germany, Banca Nazionale del Lavoro in Italy, NS in the Netherlands and with Spain's Telefonica – to ensure that we are well placed to take advantage of the opportunities that liberalisation presents.

During the year, BT announced a number of new alliances and partnerships in Europe. One of the most significant indicated our commitment to the French market. We have signed an agreement with Compagnie Generale des Eaux to take a 26 per cent stake in CEGETEL, a new French telecommunications group which holds a majority stake in SFR – the highly successful second mobile operator in France. This alliance was given a further boost earlier this year when SNCF, the French railway company, chose CEGETEL as its joint venture partner to develop its telecoms network.

In Germany, Europe's largest telecommunications market, BT and VIAG have been awarded the fourth mobile licence, bringing us an important step closer to becoming a leading full-service provider. Telenor, the Norwegian telecommunications operator, has agreed to participate in the joint venture.

In the Netherlands, BT teamed up with NS, the Dutch railway company, to create a joint venture - Telfort – to address the telecommunications needs of Dutch business. In Switzerland, BT and Tele Danmark have been selected as the international partners for Newtelco, which intends to become the second licensed operator.

In Greece, BT and Space Hellas SA offer Concert Packet Services to companies requiring international data connectivity, while in Hungary and the Czech Republic, BT appointed GTS as its distributor for Concert services. And, in March, Logic Telecom SA was appointed as a distributor of Concert services in Romania.

In April 1997, BT and MCI announced strategic alliances with Spain's Telefonica and with Portugal Telecom that will enable them to pursue opportunities across three continents. With BT, Telefonica will explore investment possibilities in Europe and, with MCI, it will create a joint venture – Telefonica Panamerica MCI – to compete in the fast-growing Latin American markets, including Argentina, Brazil, Chile, Peru and Puerto Rico.

These markets are currently valued at $36 billion and expected to be worth $60 billion by 2000. In the US, MCI and Telefonica will provide customised products, promotions and marketing programmes targeted on the US Hispanic community.

Portugal Telecom becomes the exclusive distributor of Concert Communications' voice products in Portugal and, with MCI, will also explore opportunities in Brazil – Latin America's largest communications market.

Industry experts predict that, within the next ten years, the economy and telecommunications activity of the Asia-Pacific region will be similar in size to those of Europe or North America. BT already has offices in Japan, Australia, China, Taiwan, South Korea, Singapore, Malaysia, Indonesia, Thailand, the Philippines and India. Our sales also reach into New Zealand, Brunei and Vietnam.

BT is a leading supplier of value-added data networks in Japan and, in March, announced a strengthening of its relationship with Marubeni Corporation. Network Information Services, in which BT has a 36 per cent stake and Marubeni 41 per cent, joined forces with BT Japan on 1 April 1997 to form BT Network Information Service. The new company – which will provide business customers in Japan with the full range of domestic products and services currently available, as well as access to Concert Communications' portfolio - will be 51 per cent owned by BT, 31 per cent by Marubeni and 18 per cent by minority shareholders.

In March, BT teamed up with a number of partners, including NTT - Japan's principal telecommunications operator – to bid for Singapore's second telecommunications licence, which will be awarded next year. The Singapore market – one of the most important international communications hubs in the world - will be open for competition in 2000 and could be worth around £3.5 billion per annum.

Inside the UK

BT's UK network is one of the most advanced in the world, and we have invested more than £27 billion since we were privatised in 1984 to ensure that we can continue to deliver the most up-to-date, reliable and well-managed services to our customers. Over £2 billion was invested in 1996/97.

BT provides around seven million business customer connections and over 20 million residential customer lines, served by more than three million kilometres of optical fibre and 100,000 kilometres of copper cable, 7,500 local telephone exchanges and 69 main switching units.

The volume of traffic carried by the network is increasing rapidly as people spend longer on the phone, use more telephone services, such as Call Return 1471 and Call Minder, and take advantage of new communications media, such as the Internet.

We are introducing new technologies to carry traffic – phone conversations, data, video and documents – around the network in order to give our customers a faster, more reliable, and more flexible service. By the end of March 1997, for example, BT had installed around one million high-speed ISDN (Integrated Services Digital Network) channels.

To prepare for the future, BT will be enhancing its network and systems significantly over the next few years, building in greater intelligence to enable us to introduce new services more quickly, and to make them available to even more of our customers.

Innovation

BT has a world-class reputation for technological innovation. Our investment in research and development amounts to about two per cent of annual turnover – £291 million for 1996/97. Our aim is to develop and enhance products and services which will add value to our customers' personal and business lives.

One market of vital importance for them, and for us, is the Internet. To get started on the Internet, people need a link into it and BT has developed BT Internet to provide this connection for the mass market. Once on-line, people can send electronic mail (e-mail) to friends worldwide, shop or search for information on everything from astrology to zoology.

BT's Internet access product for business customers, BTnet, provides an "industrial strength" managed link to the Internet. And business customers will further benefit from Concert InternetPlus, the world's first high-speed, high-reliability global Internet service, developed by BT and MCI. This network is making it possible, for the first time, to offer worldwide guaranteed levels of service for businesses which use the Internet for their global communications.

LineOne – a new, mass-market Internet service – was launched in March by Springboard Internet Services, a joint venture company formed by BT and News International. LineOne will build on BT's technical skills in providing Internet access and News International's editorial and publishing skills in providing content, including constantly updated information from its titles, including *The Times* and *The Sun.*

The benefits of the Internet – access to millions of people and almost infinite amounts of information – are now being sought by more and more businesses around the world, and their communications now account for more than half of all information carried. Such customers are concerned about the security issues raised by sending sensitive information over a public network. To help allay such fears, BT is working with other companies, such as Microsoft and Digital, to develop private Internets – or intranets. Intranet services are particularly useful for corporate customers wanting to make available their Internet information sources to their own employees. They are also useful to communities of interest wanting to share information. The global intranet market is growing extraordinarily fast and could be worth around £5 billion by the end of 1998.

One intranet, provided and managed by BT and the first of its kind in the world, is BT HealthNet which links hospitals and GPs around the UK.

Another IT initiative, which generated considerable media interest, was the launch of Touchpoint – an interactive multimedia kiosk. There are currently around 200 Touchpoint kiosks on trial, located in public areas across London, where anyone can look up information, including an entertainment guide, news, sport and weather updates, as well as buy products and services, from wine and flowers to airline tickets.

Pricing

Pricing has been a major BT success story. Since privatisation, we have made major changes in the costs and pricing structures of calls: charging bands and tariff periods have been simplified; itemised billing is universally available; per second charging has been introduced to replace unit charging; and, overall, call prices have been cut by more than half in real terms.

Three minute national call

Aug 1984 (pence)	*Feb 1997 (pence)*	*Real terms % change*	
66.0	22.4	–80.1	Daytime (peak)
52.8	22.4	–75.1	Daytime (standard)
17.6	11.9	–60.6	Evening/nights (cheap)
17.6	8.4	–72.1	Weekends (cheap)

BT's inland call charges now make the UK one of the cheapest countries in the world in which to make a call. For example, a three minute daytime call from London to Manchester costs less than 23 pence (excluding VAT and discounts), whilst an equivalent peak rate call in Germany is more than twice as expensive.

Three minute local call

Aug 1984 (pence)	*Feb 1997 (pence)*	*Real terms % change*	
8.8	10.1	–33.0	Daytime (peak)
8.8	10.1	–33.0	Daytime (standard)
4.4	4.2	–42.2	Evening/nights (cheap)
4.4	4.2	–42.2	Weekends (cheap)

In addition, BT's international call prices as a whole have been cut by more than 56 per cent in real terms since privatisation and the UK is now one of the cheapest places in the world *from* which to make a call.

In 1996/97, BT continued to announce major price cuts on calls for its customers, the combined effects of which will result in total customer savings of around £460 million in a full year.

Three minute call to the USA/Canada

	Aug 1984 (pence)	Feb 1997 (pence)	Real terms % change
Daytime (peak)	176.0	60.3	–79.9
Daytime (standard)	167.2	60.3	–78.9
Evening/nights (cheap)	140.8	57.3	–76.2
Weekends (cheap)	140.8	53.3	–77.9

During the year, UK national daytime call prices were cut by ten per cent and national evening call prices by 20 per cent. In addition, business customers benefited from an improved range of Business Choices discount packages. There were also a number of permanent price reductions on international calls, worth around £170 million in a full year.

At the end of April 1997, BT announced another ten per cent cut in its national daytime call prices and further simplified charging, with effect from 29 May 1997.

The costs of calls to mobile phones on the Cellnet and Vodafone networks were cut by up to 55 per cent; a new, cheaper weekend rate was introduced; and, in March, Cellnet brought in new, lower prices for customers with digital mobile phones.

There were seasonal offers for our customers, too. The Summer Saver, run in July and August 1996, cut the cost of all direct-dialled UK and international calls by a quarter after the first ten minutes. And, over Christmas, BT made it cheaper for friends and family to keep in touch with a "three for the price of two" offer for its millions of residential customers which meant that every third minute on the phone was free.

In October, BT introduced new pricing options for some of its ISDN services. Since an increasing number of our customers are using ISDN to access the Internet and our range of on-line information services, the major reductions we announced during the year in the cost of high-speed ISDN Internet access should help encourage the growth and use of the digital information highway.

In addition, BT cut more than 20 per cent off the flat monthly subscription fee for our Internet access product – BT Internet – and, in March, we launched Plan 180, a new type of Internet account which provides three hours of access to BT Internet for a fixed monthly fee.

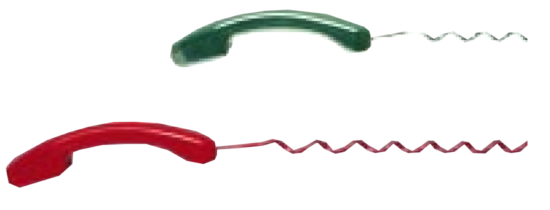
As well as widespread price cuts, BT has also offered customers improved value-for-money with its discount schemes. In April 1996, Friends & Family was made twice as valuable when BT doubled the discount rate to ten per cent. And, in January 1997, we doubled the number of friends and family members that our customers could nominate to ten. We now have more than half our personal customers signed up to Friends & Family - that's more than 11 million people.

Marketing

In the past year, BT put significant marketing effort and investment into growing the UK market – the volume of BT's inland calls rose by seven per cent. Telemarketing services, including 0800 numbers, contributed to this strong volume growth.

BT's message that its prices are getting lower and lower is communicated through its advertising campaigns. *It's good to talk* – the advertising campaign for residential customers – was recently judged to be the most effective advertising campaign in Britain between 1994 and 1996. This campaign has helped to drive up the average time that residential customers spend on the telephone.

On average people used to use the phone for just over 8 minutes a day . . .



. . . they now spend 1 min 35 seconds a day longer on the phone.

Business customers have responded warmly to BT's *Work smarter, not just harder* campaign, which explains how telecommunications technology can help businesses work in new and exciting ways.

Research shows that people tend to overestimate the true cost of calls – sometimes by as much as four times. Such misconceptions are being addressed in a number of ways, including the *Be Smart – BT* television advertising campaign fronted by Brian Walden, which focuses on the real price of calls.

BT also communicates with customers via the press, radio, telemarketing and through direct mail. In the last year, this activity resulted in 25 million customer transactions.

Mobile communications

In the past ten years, the mobile communications market has developed at an extraordinary pace as growing numbers of customers have signed up, attracted by expanding international coverage, ever-improving quality and, above all, lower prices. The demand for mobile connections now outstrips the demand for new fixed lines.

BT has a 60 per cent stake in Cellnet, the mobile network operator and, through BT Mobile, offers customers a range of mobile communications services. At the end of 1985, there were just 25,000 mobile phone users in the UK. By the middle of 1996, the UK market had grown to nearly seven million people, with two and a half million registered as Cellnet customers. Analysts predict that, by the year 2000, around 12-14 million people in the UK will have a mobile phone – that's nearly one person in four.

Now that people are increasingly taking for granted the ability to keep in touch by phone while out and about, they are also looking to stay in touch with the office by e-mail or fax while on the move. BT has developed a new range of mobile data products to meet this need. By connecting a portable computer to a digital mobile phone using a special slot-in (SIM) card, it is now possible to send charts, graphs and other documents over the mobile network, as well as to access critical business computer systems and e-mail.

Outside the UK, BT has mobile interests in a number of countries, including Japan and Germany. And, in March 1997, BT acquired a significant stake in Bharti Cellular, one of the largest mobile operators in India.

Regulation

During the year, BT reached agreement with Oftel, the telecommunications industry regulatory body, on a set of fair-trading powers for the Director General of Oftel and on price controls for residential services which take effect in August this year.

The revised fair-trading powers will allow the Director General to regulate the behaviour of all telecommunications operators in a fast-moving market.

The price cap of RPI minus 4.5 is based on the services used by those residential customers whose bill size is in the lowest 80 per cent.

Various other licence amendments were agreed with Oftel and a vigorous compliance programme was put in place to ensure that BT continues to comply with the requirements of its licences and Oftel's orders.

Quality of service

BT recognises that success in competitive markets requires a resolute focus on customer requirements and a commitment to the continuous improvement of the quality of all its services.

Industry-wide comparative performance indicators covering the period July to December 1996 were recently published. These show that BT's performance continues to compare favourably with that of its competitors in almost every area.

To ensure that our customers really are receiving the kind of service they require, we have put in place a comprehensive programme of customer opinion research. Our customer satisfaction measures are based on around 25,000 interviews every month – telephone and face-to-face – with our residential customers and more than 10,000 with our business customers. The most recent figures show that 87 per cent of residential customers and 88 per cent of business customers expressed overall satisfaction with BT.

For the six months to March 1997, more than 98 per cent of business and residential orders were completed by a date confirmed with the customer. In spite of adverse weather conditions, nearly 89 per cent of faults experienced by business customers were cleared within five working hours or by means of a successful appointment and almost 80 per cent of faults experienced by residential customers were cleared within nine working hours or by means of a successful appointment.

Almost 95 per cent of BT's 136,000 public payphones were working at any one time. The number of multipayment payphones, which accept coins, phonecards or credit cards, increased from 12,500 to more than 32,000.

Operator Services, including Directory Assistance, continued to offer high levels of performance. Our network is more reliable than ever, with fewer than one call in 200 failing because of the network, and a customer should not, on average, experience a network fault more than once every seven years on each of their lines.

Competition

The year saw an acceleration in the consolidation of the telecommunications industry worldwide, typified by the formation of Cable & Wireless Communications in the UK and, of course, the announcement of the proposed BT/MCI merger.

In the UK, to date, more than 200 licences have been issued to more than 150 different competitors, creating the world's most open telecommunications market.

More than 40 new international facilities licences were issued in December, liberalising international telecommunications in the UK and ending BT and Mercury's duopoly in international facilities. BT is facing increasingly fierce competition from a number of resellers, all of whom are targeting the international call market.

Education

Education is an important public policy issue for BT because we believe that it is one of the aspects of people's lives that new technology will touch earliest and most profoundly.

BT CampusWorld, one of the world's largest education networks, links thousands of pupils and teachers around the UK. Recognising the vital part that parents play in their children's education, BT has also developed HomeCampus to enable parents to get more involved by working on shared projects and helping develop the curriculum.

BT has recently completed phase one of a world-leading trial, in partnership with the University of Exeter School of Education and computer manufacturer ICL, to examine the impact of information technology on education, BEON – Bristol Education Online Network – in Withywood, Bristol. ICL supplied the terminals and BT the networking and access to remote services and the Internet to a number of schools in the area.

Communications technology also has a key role to play in educating and training the workforce of the future, the quality of which will be a key determinant of UK competitiveness in global markets.

All major companies in the UK, and elsewhere, have a need to ensure their people are trained and have their skills continually updated to meet the needs of today's markets. At the other end of the scale, but just as important, are individuals with special educational needs. Here too we have solutions to help develop basic skills in numeracy which we intend to expand into other subject areas and develop "on-line". BT is working, on its own and with others, to develop these services.

One example of BT's involvement in adult education is the "televersity" in Suffolk. Small companies, with few opportunities to acquire up-to-date management, IT and engineering skills, will be able to tap into the latest thinking at local centres packed with videoconferencing technology.

BT people

BT sees its relationship with its people as critical to the future and its employee relations agenda focuses on ensuring that employees feel valued, on managing change constructively, and on creating an environment and culture within which every employee can maximise his or her contribution.

BT is committed to providing the necessary development and training opportunities to equip our people with the skills they will need in the future. Our approach integrates development and training with business objectives, job performance and personal development needs. Last year, employees received an average of more than three days "formal" training and a similar amount of "in job" training and coaching. BT continues to be a strong advocate of the National and Scottish Vocational Qualification Schemes and many BT managers are now fully-trained assessors.

By the end of March 1997, around 127,000 people were employed by BT, compared with 227,000 six years ago. In the year, the company recruited 500 university graduates and 250 modern apprentices and, in the next 12 months, we expect to take on a further 800 graduates and 500 modern apprentices.

This year, the BT Board has doubled the allocation of shares to the BT Employee Share Ownership Scheme to two per cent of annual pre-tax profits. This move underlines the Board's commitment to recognising the significant contribution that BT people make to the company's success and strengthens the link between company performance and individual reward.

BT takes the health and safety of all its people very seriously and has adopted a wide-ranging strategy, Health and Safety 2000, to promote this into the new millennium.

The company remains committed to providing equal opportunities for all its people and continues actively to encourage the employment, training and career development of people with disabilities.

Employee opinions are actively sought and an annual company-wide attitude survey gives people full scope to air their views. Some 75 per cent of BT people participated in the last survey and results overall continue to improve. Managers are required to develop appropriate action plans to address the issues raised by their teams.

BT continues to consult and negotiate with recognised unions in the UK as an integral part of its approach to employee relations. Building on this platform, the BT European Consultative Council met for the first time, in June 1996, under the chairmanship of Chief Executive, Sir Peter Bonfield. This provided the opportunity for dialogue with employee representatives from the UK and other European operations. The second meeting is planned for July 1997.

Corporate citizenship

BT is pledged to make a fitting contribution to the community and, during the year, made contributions in cash and kind worth £15.6 million, including total donations to charity exceeding £2.7 million. No contributions were made to any political party.

At the European Business Excellence Forum in Edinburgh, BT was one of just four companies to win a European Quality Awards prize. BT, the largest company ever to be awarded a prize at the first attempt, was praised by the assessors for having a long-term commitment to Total Quality Management, a well-defined human resources policy and a positive impact on society.

In the annual *Management Today* survey of the UK's most admired companies, BT's overall ranking moved up from eighth to fifth and, on issues of community and environmental responsibility, we moved up from tenth to seventh.

There is a clear link between the health of the community and the well-being of our business, so it makes good business sense for BT to be active in the community. BT's latest corporate advertising campaign focuses on BT's contribution to the community. The advertisements show, for example, how BT satellite links enabled soldiers in Bosnia to keep in touch with their families, and how we have supported ChildLine, which takes more than a million calls each year.

Through our BT Community Partnership Programme, we support a variety of organisations and good causes in partnership.

The projects that we support must:

- be of positive relevance to BT;
- bring demonstrable benefit to the community;
- offer clearly understood and recorded mutual benefits;
- provide opportunities for BT people to be involved; and
- enhance our reputation.

Participative fund-raising initiatives, such as the annual BT Swimathon, demonstrate how BT's financial involvement can spur further funding for good causes. The main beneficiary this year is the Prince's Trust.

The environment

BT is committed to minimising the impact of its operations on the environment by continuously improving our processes and procedures.

New targets for environmental improvement are set each year and progress is documented in our *Environmental Performance Report.*

Further information

More information about BT and its operations can be found on our Internet site at **http://www.bt.com**

Financial review

Introduction

BT's earnings of 32.8 pence per share for the year ended 31 March 1997 were 3.7% above the previous year's. The results have benefited from the strong growth in demand for the group's products and services, particularly the newer advanced services such as FeatureNet, together with reduced redundancy charges. These factors were partially offset by substantial price reductions in the year benefiting customers by over £800 million. The group's results are summarised in the following table:

	1997 £m	1996 £m	Increase (decrease) %
Turnover	**14,935**	14,446	3.4
Operating costs before redundancy costs	**(11,323)**	(10,925)	3.6
Redundancy costs	**(367)**	(421)	(12.8)
Operating profit	**3,245**	3,100	4.7
Group's share of profits of associated undertakings	**139**	82	
Profit on sale of group undertakings	**8**	7	
Net interest and premium payable	**(189)**	(170)	
Profit before taxation	**3,203**	3,019	6.1
Taxation	**(1,102)**	(1,027)	
Profit after taxation	**2,101**	1,992	5.5
Minority interests	**(24)**	(6)	
Profit for the financial year	**2,077**	1,986	4.6
Earnings per share	**32.8p**	31.6p	3.7

Regulation and prices

The year to 31 March 1997 was the last full financial year in which the majority of BT's main UK services were subject to price regulation. Under current price controls which are in force up to 31 July 1997, BT has had to reduce its overall prices for its main UK services, principally inland and outgoing international call services and exchange line rentals, under the RPI minus 7.5 formula. In the current price control year to 31 July 1997, BT has reduced its prices by about 5% after reducing them by nearly 2% in the previous year. This price control is estimated to have affected slightly over 50% of the group's total turnover for the year ended 31 March 1997.

From 1 August 1997, a new retail price control will apply under which a cap of RPI minus 4.5 will apply to the services used by the lowest 80% of BT's residential customers by bill size. This new retail price control is estimated to cover services representing about 18% of the group's total turnover for the year to 31 March 1997.

Interconnect charges are a key element in the development of network competition. Oftel is planning to introduce changes to the current controls on network charges later this year. The proposed arrangements are likely to shift the basis for setting charges from fully allocated historic costs to long-run incremental costs and to replace annual determinations of each interconnect charge with a system based on RPI minus price caps.

Competition and the UK economy

BT has a significant share in its main UK markets for telephone calls and provision of exchange lines. But competition is eroding BT's share in key market sectors in particular areas of the UK and for certain products and services. Figures published by Oftel indicated that BT had 79% of the market for national calls for the quarter ended 30 September 1996, compared with 80% a year earlier, and supplied 91% of the exchange lines in the UK at 30 September 1996, compared with 94% a year earlier. In the mobile telecommunications market, Cellnet continues to face strong competition from its direct competitor and the two personal communications operators in the UK.

BT expects the competitive pressure to persist and it will continue to defend its market share vigorously and fairly.

The strength of the UK economy is an important determinant of BT's business volumes and the gross domestic product grew by 3.0% in the year ended 31 March 1997, compared with 2.0% in the previous year.

Turnover

Total turnover grew by 3.4% to £14,935 million in the year. The strong growth in demand for the group's products and services of approximately 8% was partially offset by the effect of price reductions which averaged over 5% across the business.

The group's turnover is analysed as follows:

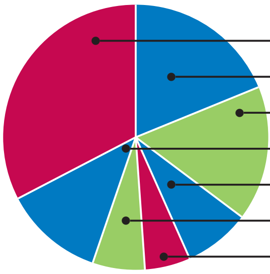
	1997 £m	1996 £m	Change %
Inland telephone calls	**4,874**	4,882	(0.2)
International telephone calls	**1,809**	1,980	(8.6)
Telephone exchange line rentals	**2,811**	2,685	4.7
Private circuits	**1,124**	1,056	6.4
Mobile communications	**949**	856	10.9
Customer premises equipment supply	**914**	946	(3.4)
Yellow Pages and other directories	**438**	408	7.4
Other sales and services	**2,016**	1,633	23.5
Total turnover	**14,935**	14,446	3.4

Price reductions had a major impact on inland telephone call turnover for the third year in succession. Innovative marketing programmes included enhancements to the successful Friends & Family package, an extension to Business Options and reductions in local and national call prices. The combined effect of these price changes totalled over £300 million, which was equivalent to a 7% reduction in call prices following falls of 7% and 12% in the previous two years.

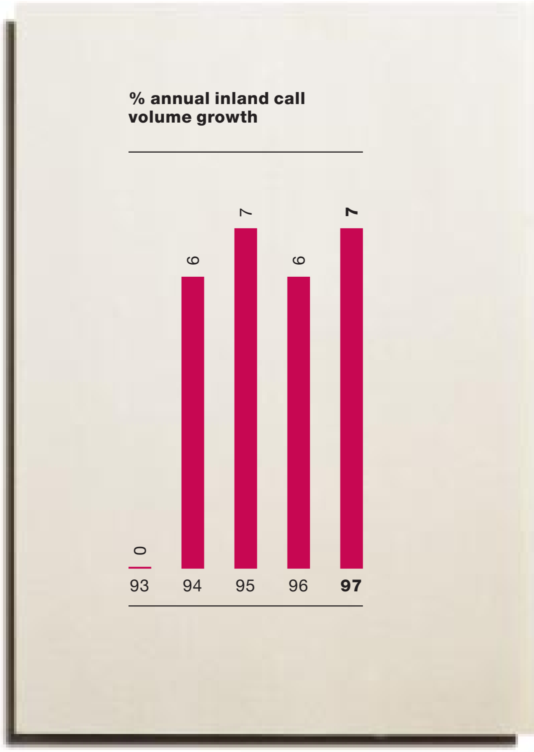
Call volume growth of 7% almost wholly mitigated the price reduction effect, resulting in total inland call turnover remaining static in the year. ISDN calls and telemarketing services, including 0800 numbers, were the main areas of this strong volume growth, together with fixed to mobile and local fixed network calls.

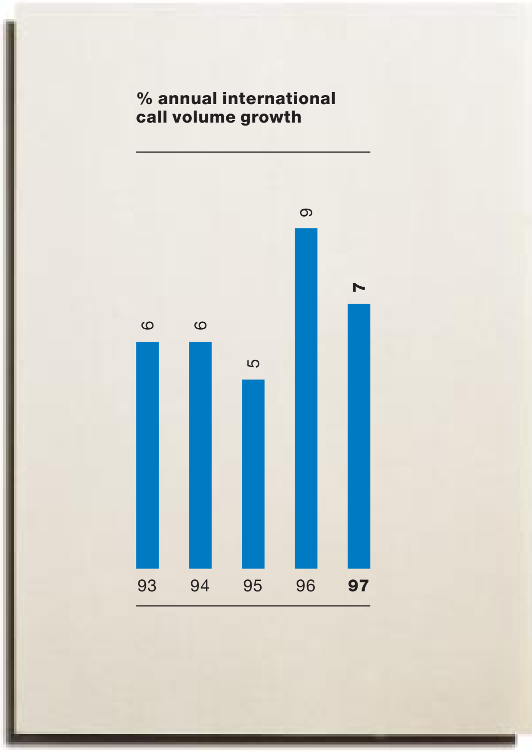
International call turnover declined by 8.6% as a result of price reductions averaging over 13% and the impact of the strengthening of sterling in the year, partially offset by the strong volume growth of 7%. BT is reducing prices substantially on most international routes in the face of increasing competition.

Turnover by category £m *Total* **14,935**



Turnover from exchange line rentals grew by 4.7%. The increased turnover was the combined result of the growth in business line connections and a 3% price increase in July 1996. The number of business line connections grew by 5.3% in the year with high-speed ISDN services mainly contributing to this growth. The number of residential lines declined slightly due to the competition from cable operators. Overall, BT's total exchange line connections grew by 0.9% to 27.6 million.

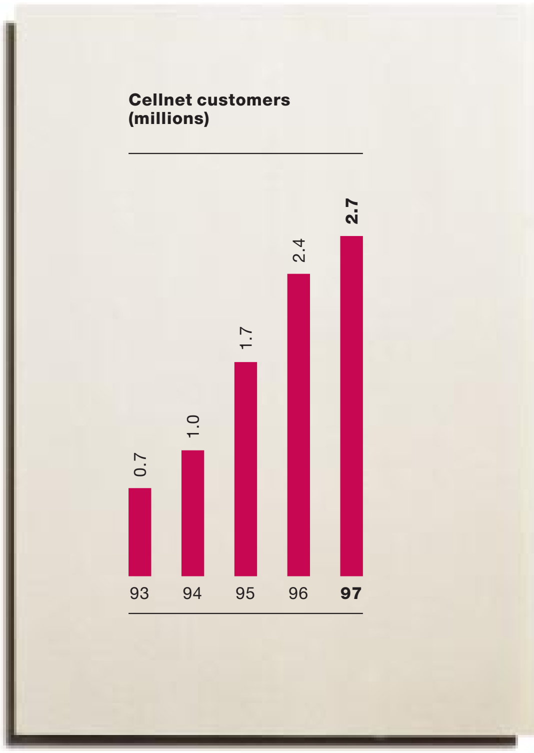




Private circuit turnover rose by 6.4% with the demand for KiloStream and MegaStream services continuing at a high level.

Mobile communications turnover increased by 10.9% in the year to £949 million, reflecting the 12.9% growth in Cellnet's customer base, offset by the effect of substantial reductions in mobile call prices. Cellnet had 2.7 million customer connections, of which over 1.1 million were digital, at 31 March 1997.

BT's expanding overseas operations in Continental Europe, including the group's systems integration business and the sales of advanced and managed network services, were the main elements behind the growth of 23.5% in other sales and services. Concert Communications' services were in increasing demand with turnover rising rapidly. The acquisition of a business based in the Netherlands in April 1996 largely contributed to the growth in systems integration turnover.



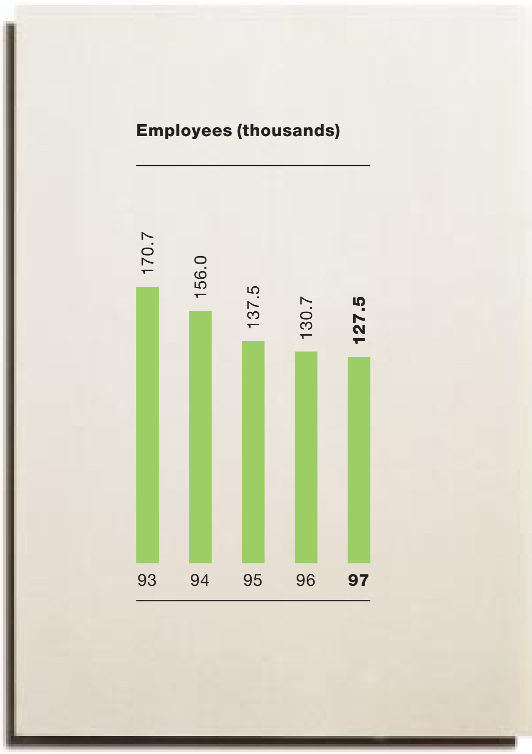
Operating costs

Total operating costs increased by 3.0% in the year. As a percentage of turnover, operating costs decreased from 78.5% in the previous financial year to 78.3%.

	1997 £m	1996 £m	Change %
Staff costs	**3,778**	3,680	2.7
Own work capitalised	**(399)**	(417)	(4.3)
Depreciation	**2,265**	2,189	3.5
Payments to telecommunication operators	**1,476**	1,383	6.7
Other operating costs	**4,309**	4,193	2.8
Other operating income	**(106)**	(103)	2.9
Total operating costs, before redundancy charges	**11,323**	10,925	3.6
Redundancy charges	**367**	421	(12.8)
Total operating costs	**11,690**	11,346	3.0

Staff costs increased by 2.7% as a result of the effects of the annual pay awards, acquired subsidiaries, and a higher allocation for the employee share ownership scheme, offset by savings resulting from the continuing staff reductions.

There was a 3,200 net reduction in group staff numbers in the year with over 5,500 people leaving under early release terms. This reduction is a substantially lower figure than in recent years.



In recognition of the contribution made by BT's employees, the allocation of £64 million for the employee share ownership scheme was set by the Board during the year at 2% of pre-tax profit, compared with a figure of approximately 1% allocated in previous years.

The depreciation charge increased by 3.5% reflecting BT's continuing high level of investment in its network.

Payments to other telecommunication operators grew by 6.7% as a result of BT's expanding operations overseas and the growing number of calls terminating on UK competitors' networks. Payments to overseas operators for incoming calls terminating in the UK fell significantly as a consequence of falling prices and the strengthening of sterling in the year more than offsetting call volume growth.

Other operating costs, which rose by 2.8% in the year, include the maintenance and support of the networks, the costs of occupancy, marketing and BT's overseas operations and the cost of sales of customer premises equipment. In the UK's increasingly competitive telecommunications market, BT is spending significantly more on its marketing programmes, including extensive TV advertising, and this has been one of the two main factors behind the increase in costs. The other has been the costs incurred in supporting Cellnet's recent rapid expansion.

The redundancy costs of £367 million were incurred as a result of the workforce reductions discussed above. These costs include £258 million relating to incremental pension benefits. In view of the surplus in the group's main pension scheme described below, redundancy charges for the year ending 31 March 1998 will not include the costs of these benefits under BT's current accounting policies.

Operating profit

Operating profit for the year of £3,245 million was £145 million (4.7%) higher than in the previous year.

Associates, bond repurchase and interest charge

The group's £139 million share of profits of associated undertakings consists primarily of the company's share of MCI's profits less BT's share of losses in its joint ventures in Germany and elsewhere in Europe which are in the course of establishing their businesses. BT's share of MCI's pre-tax profit for the year amounted to £175 million, under BT's accounting policies, compared with £101 million for the previous year which had been adversely affected by a restructuring charge, BT's share of which was £73 million.

During August 1996, the company took the opportunity to repurchase two of the then remaining series of Government held bonds for £422 million, at an effective premium of £60 million which has been charged against profit in accordance with UK accounting standards. The last remaining series was repaid on its maturity in March 1997. The repurchase has reduced the overall effective interest rate on BT's borrowings.

The net interest charge of £129 million, excluding the bond repurchase premium, was £41 million or 24% lower than the interest charge in the previous year. The group's strong positive cash flow was the main contributor to this lower charge which was covered 25 times by operating profit.

Following the completion of the proposed merger with MCI and the payment of the special dividend described below, the group's borrowings will increase significantly and its interest charge will rise commensurately. Interest cover, however, is expected to be at a comfortable level.

Profit and taxation

The group's profit before taxation for the year was £3,203 million, an increase of 6.1% on the previous year. The tax charge of £1,102 million as a percentage of profit before taxation was 34.4%, compared with 34.0% for the previous year. The higher effective rate in the year was due to the premium on the bond repurchase not being wholly allowable for tax relief.

HM Government, newly elected on 1 May 1997, has stated that it is proposing to levy a windfall tax on those regulated companies privatised since 1979. The company has no knowledge whether such a tax will be levied upon it, nor the basis on which it would be levied or the amount if the tax was to apply to the company. HM Government has indicated that it will be announcing tax measures in June or July 1997.

Earnings and dividends

Earnings per share, based on a profit for the financial year of £2,077 million, were 32.8 pence.

The ordinary dividends paid and recommended of 19.85 pence per share represent a 6.1% increase on the previous year and are covered 1.7 times by earnings. These dividends comprise the interim dividend of 7.9 pence per share, which was paid in February 1997, and the proposed final dividend of 11.95 pence per share which, if approved at the annual general meeting, will be paid on 22 September 1997 to shareholders on the register on 15 August 1997. The proposed final dividend is that forecast by the Board in its announcement of the MCI merger in November 1996. These ordinary dividends will absorb £1,266 million.

Additionally, as originally announced in November 1996, the company will be paying a special dividend of 35 pence per share. This dividend, which absorbs £2,244 million, will also be paid on 22 September 1997 to shareholders on the register on 15 August 1997. The Board believes that shareholder value and earnings growth will be enhanced through the introduction of more gearing which will be achieved with this payment. In the event that the merger with MCI is completed before this record date, alternative arrangements for the final and special dividends will be made. The majority of the group's employees participate in one or more of the BT option schemes. Since share option holders are not entitled to the special dividend and could be otherwise disadvantaged by its payment, arrangements will be put in place to compensate the option holders.

The Board intends to adjust the level of ongoing annual dividends to take into account the effect of the special dividend in order broadly to maintain the yield on the company's shares. This adjustment will first be made for the interim dividend for the year ending 31 March 1998.

Dividends will continue to be an important component of shareholder value. The Board believes that earnings and cash flow will continue to be strong enough to support a growing dividend (as adjusted for the effect of the special dividend). The intention will be to grow earnings at a higher level, which would lead to an increase in dividend cover over time.

Financing

	1997 £m	1996 £m
Net cash inflow from operating activities	**6,192**	5,834
Net cash outflow for returns on investments and servicing of finance	**(220)**	(150)
Tax paid	**(1,045)**	(784)
Capital expenditure and financial investment	**(2,820)**	(2,500)
Acquisitions and disposals	**(252)**	(132)
Equity dividends paid	**(1,217)**	(1,138)
Net cash inflow before use of liquid resources and financing	**638**	1,130
Management of liquid resources	**(504)**	(1,317)
Net cash inflow (outflow) from financing	**(224)**	215
Net increase (decrease) in cash and cash equivalents	**(90)**	28
Decrease in net debt	**849**	1,319

The cash flow statement presentation has been modified to conform with the 1996 revision of Financial Reporting Standard 1.

Net cash inflow from operating activities of £6,192 million in the year was 6.1% higher than in the previous year.

Tax paid in the year, principally on the prior year's profit, amounted to £1,045 million. The increase of £261 million on the previous year is mainly due to the higher level of profit made in the year to 31 March 1996 compared to the prior year.

Net cash outflow for capital expenditure and financial investment mainly comprises expenditure on plant, equipment and property of £2,823 million.

In the year, the group drew down £235 million in loans and repaid debt of £670 million, including £501 million of Government held bonds discussed above. During the year, the group also received £160 million for new shares subscribed by employees, principally following the exercise of savings-related share options.

The Board believes that, after the merger with MCI, the enlarged group's cash flow will be more than adequate to cover its capital commitments and the dividend payments on the enlarged capital.

Treasury policy

The group has a centralised treasury operation. Its primary role is to manage liquidity, funding, investment and the group's financial risk, including risk from volatility in currency and interest rates and counterparty credit risk. The treasury operation is not a profit centre and the objective is to manage risk at optimum cost.

The Board sets the department's policy, and its activities are subject to a set of controls commensurate with the magnitude of the investments and borrowings under its management. Counterparty credit risk is closely monitored and managed within controls set by the Board. Derivative instruments, including forward foreign exchange contracts, are entered into for hedging purposes only.

Capital resources

At 31 March 1997, the group had cash and short-term investments of £3,000 million. At that date, £221 million of short-term debt was outstanding.

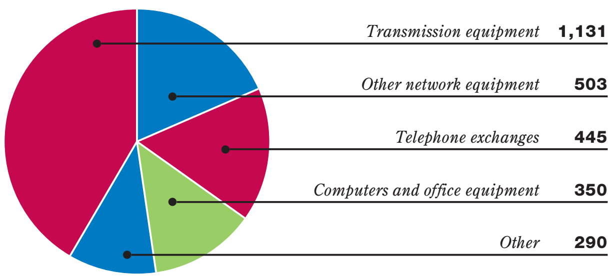
The gearing or ratio of debt (borrowings net of cash and short-term investments) to shareholders' equity and minority interests was 1.6% at 31 March 1997, compared with 7.4% at 31 March 1996. The group had £176 million net debt at 31 March 1997, a decrease of £849 million in the year through cash flow. Gearing is planned to increase substantially during the course of 1997 as a result of the special dividend and the merger with MCI, but the Board believes that it will begin to fall after 1998. BT issued a \$1.5 billion five-year 6¾% Eurobond in April 1997 and has subsequently announced the issue of a \$1.0 billion ten-year 7% Eurobond in preparation for the group's cash requirements later in 1997.

The directors have a reasonable expectation that the group has adequate resources to continue in operational existence for the forseeable future and therefore they continue to adopt the going concern basis in preparing the financial statements.

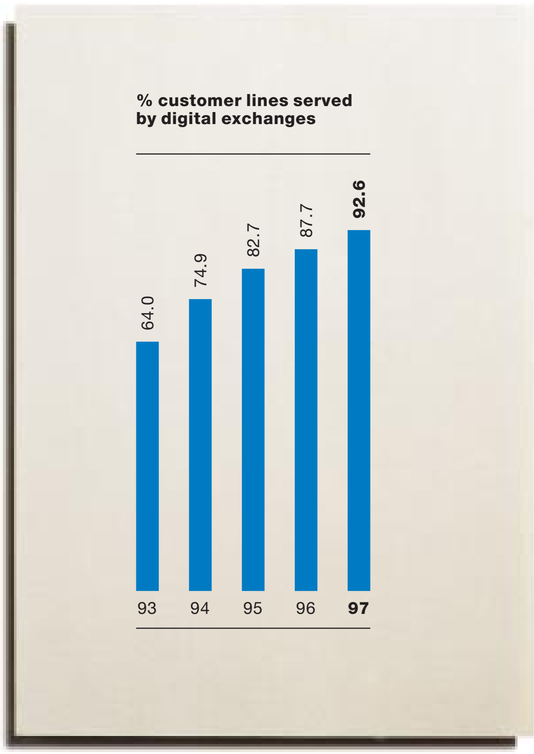
Capital expenditure

Capital expenditure on plant, equipment and property totalled £2,719 million in the year, and was similar to the level of the previous year. Investment has been concentrated on improving the quality of the local access network and extending the reach of advanced services by making further progress in converting the UK's few remaining electronic telephone exchanges to full digital operation. Additionally, Cellnet has continued the construction of the digital cellular GSM network.

Expenditure on tangible fixed assets £m *Total* **2,719**



The group expects capital expenditure by the business, as currently constituted, in the year ending 31 March 1998 to be at a level commensurate with that of the year under review. BT expects that future capital expenditure will be provided from net cash inflows from operating activities supplemented, if appropriate, by external financing.



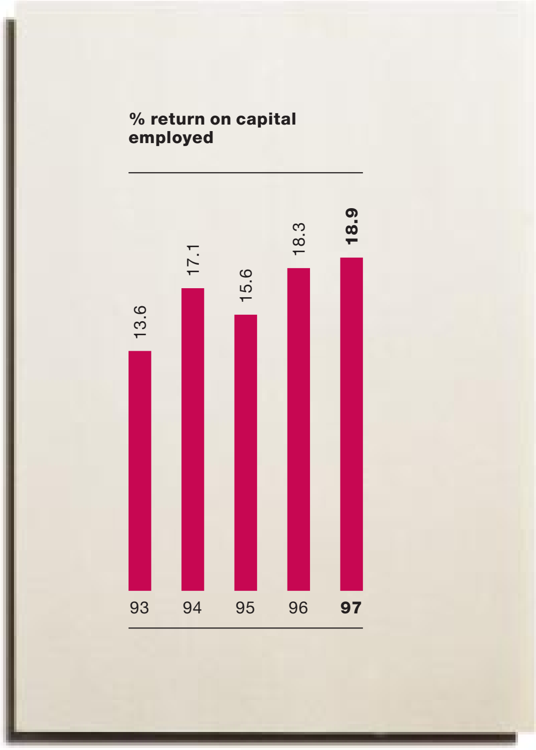
Acquisitions and joint ventures

In April 1996 the group acquired the Rijnhaave group, a Netherlands-based systems integration business and, in March 1997, completed the formation of a joint venture with the Dutch railways organisation to offer telecommunication services in that country. In February 1997, BT agreed to acquire the 50% interest in its Spanish joint venture it did not already own, thereby obtaining full control. Also, in March 1997, the group acquired a 22.5% interest in Bharti Cellular, a mobile telecommunications operator based in India. The goodwill arising on these acquisitions amounted to £166 million; the remaining goodwill of £33 million taken to reserves in the year mainly related to BT's share of goodwill arising on MCI's acquisitions, principally on its new joint venture in Mexico.

In September 1996, BT announced that it would be taking a 26% interest in CEGETEL, the French telecommunications operator which has a majority interest in SFR, a leading mobile provider in France, for a consideration of approximately £1 billion. This transaction is due to be completed later in 1997.

Return on capital employed

The group made a return of 18.9% on the average capital employed, on a historical cost basis, in its business in the year ended 31 March 1997, compared with a return of 18.3% in the previous year.



Pensions

BT has recently received the preliminary results of an actuarial valuation, as at 31 December 1996, of its main pension fund made for the purposes of determining the future pension charges in the accounts of the group. These results revealed the fund to be in surplus to an amount of approximately £600 million, with assets of the fund at £19,879 million covering 103% of the fund's liabilities, in contrast to an asset coverage of 97% at 31 December 1993. The surplus principally arose from the return on the fund's assets in the three intervening years being higher than the long-term actuarial assumptions.

The major assumptions used in the December 1996 valuation were that, over the long-term, the return on the existing assets of the fund, relative to market values, would be 8.2% per annum and on future investments the return would be 8.7% per annum (allowing for real equity dividend growth of 0.5% per annum), the retail price index would increase at an average of 4.0%, and wages and salary rates would increase at an average of 5.8%.

From 1 April 1997, the annual pension charge based on the December 1996 valuation is expected to be lower than the charge of £291 million in the year to 31 March 1997. This revised charge will take into account the amount of the pension provision which has been established over the past eight years in the group's accounts and which stood at £1,291 million at 31 March 1997. Additionally, from 1 April 1997, in accordance with current UK accounting standards, the cost of providing incremental pension benefits for early leavers will no longer be charged against the profit in the period in which people leave, whilst the most recent valuation shows the fund to be in surplus.

BT expects to continue making cash contributions to its fund at broadly the current level of 9.5% of pay in order to maintain the fund's financial strength.

Merger with MCI

The proposed merger with MCI, having been approved by both BT and MCI shareholders, is now awaiting regulatory approval. On completion, which is expected in the autumn of 1997, BT will change its name to Concert plc and issue, in the form of American Depositary Shares ("ADSs"), 5.4 ordinary shares in the company and $6 cash for every MCI share outstanding, except those already owned by BT or subject to dissenters' rights. Each ADS represents 10 ordinary shares of the company and will be traded on the New York Stock Exchange. Options over Concert shares will be issued to MCI share option holders who do not exercise their MCI options before the completion date using similar conversion terms. As a result of the merger, the company's issued share capital will be enlarged by approximately 50% and the cash consideration is expected to total between £2.0 billion and £2.3 billion, depending primarily on the number of MCI share options exercised before completion.

Following the merger and based on MCI's revenues for 1996, the group's annual turnover is expected to increase by around 80%. Earnings per share of the enlarged group are expected, however, to suffer some dilution in the first year after the merger.

The directors of BT and MCI are targeting pre-tax synergy benefits arising from the full integration of the two businesses at approximately £1.5 billion cumulatively over five years following the merger. No significant capital expenditure is expected to be required to realise these savings, although some one-off restructuring costs are expected to be incurred in the first few years following the merger.

If market conditions are appropriate, the company will consider making purchases of its own shares following the merger and in ensuing years. Authority to purchase up to 10% of the company's share capital was granted to the directors at the extraordinary general meeting of shareholders held in April 1997. Decisions on the amount of cash to be used in buying back shares and the precise timing will depend in part on market conditions and other opportunities that exist for the deployment of the group's resources.

Foreign currency exposure

Most of the group's current turnover is invoiced in pounds sterling, and most of its operations and costs arise within the UK. The group's foreign currency borrowings, which totalled £1,053 million at 31 March 1997, are used to finance its UK operations and to finance the group's overseas investments, including MCI, in order to reduce the currency exposure on the underlying assets. Cross currency swaps have been entered into to minimise the foreign currency exposure on the borrowings used to finance the group's operations. The group also enters into forward foreign exchange contracts to hedge interest expense, purchase and sale commitments. The commitments hedged are principally US dollars. As a result of these policies, the group's exposure to foreign currency arises mainly on the residual currency exposure on overseas investments and on any imbalances between the value of outgoing, transit and incoming international calls with overseas telecommunication operators. To date, these imbalances have not been material. As a result, the group's profit has not been materially affected by movements in exchange rates.

The merger with MCI will naturally lead to an increase in the group's foreign currency exposure in the future and the company will be adopting suitable policies and procedures on completion of the merger to manage this change in circumstances.

Report of the directors

The directors submit their report and the audited financial statements of the company, British Telecommunications plc, and the group, which includes its subsidiary undertakings, for the year ended 31 March 1997.

Introduction

The business review on pages 6 to 12, the financial review on pages 13 to 20, the discussion on corporate governance on pages 24 and 25 and the report of the *Board Committee on Executive Remuneration* on pages 27 to 33 form part of this report. The audited financial statements are presented on pages 36 to 62.

The group's principal activity is the supply of telecommunication services and equipment. In the year, 97% of group turnover arose from operations in the United Kingdom.

Directors

The current directors of the company are shown on pages 22 and 23. All served throughout the financial year with the exception of Mr Gerald Taylor who was appointed to the Board as from 4 November 1996. In addition, Lord Tebbit served on the Board until his retirement as a director on 2 November 1996.

In accordance with the articles of association, Mr Gerald Taylor, having been appointed to the Board since the last annual general meeting, retires at the forthcoming annual general meeting and will be proposed for election. Mr Keith Oates, Mr Bert Roberts and Dr Alan Rudge retire by rotation and will be proposed for re-election. Details of these directors' service contracts or contracts of appointment are shown in the report of the *Board Committee on Executive Remuneration* on page 29.

Substantial shareholdings

At 20 May 1997, the company had received a notification from the Prudential Corporation group of companies under Part VI of the Companies Act 1985 in respect of a holding of 205 million shares representing 3.2% of the company's issued ordinary share capital.

Policy on the payment of suppliers

BT's policy is to use its purchasing power fairly and to pay promptly and as agreed.

BT has a variety of payment terms with its suppliers. The terms for payments for purchases under major contracts are settled when agreeing the other terms negotiated with the individual suppliers. It is BT's policy to make payments for other purchases within thirty working days of the invoice date, provided that the relevant invoice is presented to the company in a timely fashion and is complete. BT's payment terms are printed on the company's standard purchase order forms or, where appropriate, specified in individual contracts agreed with suppliers. The ratio, expressed in days, between the amounts invoiced to the company by its suppliers in the year ended 31 March 1997 and the amounts owed to its trade creditors at the end of the year was 32 days.

Auditors

A resolution to reappoint Coopers & Lybrand as the company's auditors and authorise the directors to settle their remuneration will be proposed at the annual general meeting.

Annual general meeting resolutions

The resolutions to be proposed at the annual general meeting to be held on 16 July 1997, together with explanatory notes, appear in the separate *Notice of 1997 Annual General Meeting* sent to all shareholders.

By order of the Board

C R Green
Secretary and Chief Legal Adviser
20 MAY 1997

Registered office: 81 Newgate Street, London EC1A 7AJ
Registered in England: No 1800000

Board of directors

EXECUTIVE DIRECTORS

Sir Iain Vallance *Chairman* (a) (i) (j)
Sir Iain was appointed a director of the company in 1984. He served as Chief Executive from 1986 until December 1995 and has been Chairman since 1987. Sir Iain is also a non-executive vice-chairman of the Royal Bank of Scotland, a non-executive director of Mobil Corporation and chairman of the Princess Royal Trust for Carers. Aged 54.

Sir Peter Bonfield CBE *Chief Executive* (a) (b) (c) (i)
Sir Peter was appointed to the Board on 1 January 1996 as Chief Executive. He is also a director of BT's associated company, MCI Communications Corporation. Sir Peter is a Fellow of the Royal Academy of Engineering and the Institution of Electrical Engineers. From 1981 to 1995, he worked for ICL, most recently as chairman and chief executive. Sir Peter is currently non-executive deputy chairman of ICL, a non-executive director of Zeneca and vice-president of the British Quality Foundation. Aged 52.

Dr Alan W Rudge CBE *Deputy Chief Executive* (a) (b) (c)
Dr Rudge FRS FEng FIEE joined BT in 1987 and was appointed to the Board in 1989. He became Deputy Chief Executive in January 1996. Dr Rudge is also a non-executive director of ERA Technology and LucasVarity. He is chairman of The Engineering Council and The Engineering and Physical Sciences Research Council, and a past president of the Institution of Electrical Engineers. Aged 59.

Robert P Brace FCA *Group Finance Director* (a) (b) (c) (e) (g)
Mr Brace joined the company in 1989 and was appointed to the Board in 1993 as Group Finance Director. A career-long finance professional, he started with Peat Marwick Mitchell (KPMG) in 1971 and subsequently held senior finance roles with Unipart and Black & Decker. Mr Brace chairs BT's Welsh Advisory Forum. Aged 47.

NON-EXECUTIVE DIRECTORS

Sir Colin Marshall *Deputy Chairman* (a) (d) (h) (j)
Sir Colin was appointed to the Board in April 1995 and became Deputy Chairman in January 1996. He is also a director of MCI Communications Corporation. Sir Colin ceased to be chairman and chief executive of British Airways at the end of 1995, but remains chairman. He is also chairman of Inchcape, a non-executive director of HSBC Holdings and the New York Stock Exchange and president of the Confederation of British Industry. Aged 63.

Dr Iain Anderson (d) (e) (h) (j)
Dr Anderson was appointed to the Board in November 1995. He is chairman of the chemicals sector of Unilever, for whom he has worked since 1965. Dr Anderson joined the Unilever board in 1988. He has post-doctorate qualifications in microbiology from both Glasgow and Massachusetts Universities. Aged 58.

LEFT TO RIGHT: *Gerald H Taylor, Sir Iain Vallance, Birgit Breuel, Sir Colin Marshall, Dr Alan Rudge, Keith Oates, Malcolm Argent, Sir Ewen Fergusson, Sir Peter Bonfield, Dr Iain Anderson, Robert Brace, Bert C Roberts Jnr, Yve Newbold, Colin Green.*

Malcolm Argent CBE *(c) (d) (e) (f) (g) (j)*
Company secretary from 1984 to 1994, Mr Argent was appointed to the Board in 1989. Since retiring in August 1994, he has served on the Board as a non-executive director. Mr Argent is deputy chairman of the Civil Aviation Authority, chairman of National Air Traffic Services and a non-executive director of Clerical Medical Investment Group and Westminster Health Care Holdings. Aged 61.

Birgit Breuel Germany
Appointed to the Board in April 1995, Mrs Breuel is general commissioner of EXPO 2000 and was previously president of Treuhandanstalt, the agency responsible for the privatisation of industry in the former East Germany. Mrs Breuel is also a non-executive director of Daimler-Benz and Novartis. Aged 59.

Sir Ewen Fergusson GCMG, GCVO *(h) (j)*
Sir Ewen was appointed a director in 1993, having retired as HM Ambassador to France after a 36-year career in the Diplomatic Service. He is non-executive chairman of Coutts & Co and the Savoy Hotel. Sir Ewen chairs BT's Scottish Advisory Forum. Aged 64.

Yve Newbold *(d) (f)*
Appointed to the Board in 1991, Mrs Newbold is a solicitor and chief executive of PRO NED. She was company secretary of Hanson from 1986 to 1995. Mrs Newbold is also a non-executive director of Coutts & Co and a governor of the London Business School. Aged 56.

Keith Oates *(d) (h) (j)*
Mr Oates was appointed to the Board in 1994. He is also a director of MCI Communications Corporation. Mr Oates is deputy chairman and managing director of Marks and Spencer. His international experience includes working for IBM and Black & Decker. Mr Oates is also a non-executive director of Guinness, a member of the English Sports Council and a former governor of the BBC. Aged 54.

Bert C Roberts Jnr USA
Mr Roberts joined the Board in 1994. He is chairman of MCI Communications Corporation, based in Washington DC, and a non-executive director of Avantel and News Corporation. Aged 54.

Gerald H Taylor USA
Mr Taylor joined the Board on 4 November 1996. He is chief executive officer of MCI Communications Corporation and a non-executive director of Avantel. Aged 55.

COMPANY SECRETARY

Colin R Green *(b) (g)*
Mr Green, a solicitor, was appointed Secretary and Chief Legal Adviser in 1994.

(a) Member of *Chairman's Committee*
(b) Member of *Executive Committee*
(c) Member of *Investment Committee*
(d) Member of *Board Audit Committee*
(e) Member of *Board Committee on Pensions*
(f) Member of *Board Community and Charities Committee*
(g) Member of *Board Committee on Incentive Schemes*
(h) Member of *Board Committee on Executive Remuneration*
(i) Member of *Board Committee on Non-Executive Remuneration*
(j) Member of *Nominating Committee*

Corporate governance

The directors consider that throughout the year BT has fully complied with the *Code of Best Practice* published by the *Committee on the Financial Aspects of Corporate Governance* (the "Cadbury Committee") and has complied throughout the year with Section A of the best practice provisions of the Stock Exchange Listing Rules introduced following the publication of *Directors' Remuneration – Report of a Study Group chaired by Sir Richard Greenbury* (the "Greenbury Report").

The Board

The Board meets regularly to consider matters specifically reserved for its attention. It sets the strategic direction of the group and monitors overall performance.

The majority of the directors are non-executive and, between them, have a wide range of experience at a senior level in international, legal, marketing, government and diplomatic affairs. Six of the nine non-executive directors are independent of the management of BT, either being free from any business or other relationships which could materially interfere with the exercise of their judgement or not previously involved in the management of BT.

Non-executive directors are normally 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 non-executive directors provide a strong independent element on the Board, with Sir Colin Marshall, Deputy Chairman, as senior member. However, the Board operates as a single team.

The executive directors have service agreements which are reviewed by the *Board Committee on Executive Remuneration.* Information about the periods of these contracts is in the report of the Committee on page 29.

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 company secretary, the removal of whom would be a matter for the whole Board.

Board committees

The *Executive Committee* is chaired by the Chief Executive, Sir Peter Bonfield. The other members are the Deputy Chief Executive, the Group Finance Director, the heads of BT's three customer-facing divisions and the network and systems division, the Secretary and Chief Legal Adviser, the Group Personnel Director and the two executives responsible for developing the group's strategy and plans. The Committee develops the group's strategy, for Board approval, and oversees implementation. It also finalises (before Board approval) annual quality plans and budgets and reviews operational activities.

The *Nominating Committee* of the Chairman, Deputy Chairman and four other non-executive directors ensures the Board has an appropriate balance of expertise and ability among the non-executive directors. 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 Committee also assesses candidates for executive directorships before it recommends an appointment.

The *Board Audit Committee,* consisting solely of non-executive directors, is chaired by Sir Colin Marshall. Its terms of reference include reviewing BT's internal controls and published financial reports for statutory compliance and against standards of best practice, and recommending appropriate disclosure to the Board. It also reviews annually the services and fees of the company's auditors, to ensure that an objective and professional relationship is maintained.

There are also two Board remuneration committees. The *Board Committee on Executive Remuneration* consists solely of non-executive directors and is chaired by Sir Colin Marshall. It agrees the service agreements of the Chairman and the members of the *Executive Committee* and their remuneration, including performance-related bonuses. The separate report by the Committee is set out on pages 27 to 33.

Non-executive directors' remuneration

In line with the recommendations contained in the Greenbury Report, the remuneration of the non-executive directors is set by the Board, on the recommendation of the *Board Committee on Non-Executive Remuneration*. The non-executive directors' remuneration is discussed in the report of the *Board Committee on Executive Remuneration* on page 29.

Internal financial control

The directors are responsible for the group's systems of internal financial control. Such systems 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. Annual appraisal procedures have been established to maintain 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, with an investment committee, comprising members of the Board, considering major investment projects.
- The *Board 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 *Board Audit Committee* has reviewed the effectiveness of the systems of internal financial control in existence in the group for the year ended 31 March 1997 and for the period up to the date of approval of the financial statements.

Statement of BT 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 adopted a *Statement of Business Practice* which sets out the principles the group will observe. A copy has been sent to every employee. We also 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 34.

A report to the company by the auditors, Coopers & Lybrand, on corporate governance matters is set out on page 26.

Auditors' report on corporate governance matters

TO BRITISH TELECOMMUNICATIONS plc

In addition to our audit of the financial statements, we have reviewed the directors' statements on pages 18, 24 and 25 concerning the company's compliance with the paragraphs of the Cadbury Code of Best Practice specified for our review by the London Stock Exchange's Listing Rules and their adoption of the going concern basis in preparing the financial statements. The objective of our review is to draw attention to non-compliance with paragraphs 12.43(j) and 12.43(v) of the Listing Rules.

Basis of opinion

We carried out our review in accordance with guidance issued by the Auditing Practices Board. That guidance does not require us to perform the additional work necessary to, and we do not, express any opinion on the effectiveness of either the company's system of internal financial control or its corporate governance procedures nor on the ability of the company to continue in operational existence.

Opinion

With respect to the directors' statements on internal financial control on page 25 and going concern on page 18, in our opinion the directors have provided the disclosures required by the Listing Rules referred to above and such statements are not inconsistent with the information of which we are aware from our audit work on the financial statements.

Based on enquiry of certain directors and officers of the company, and examination of relevant documents, in our opinion the directors' statement on page 24 appropriately reflects the company's compliance with the other aspects of the Code specified for our review by paragraph 12.43(j) of the Listing Rules.

Coopers & Lybrand
Chartered Accountants
London
20 MAY 1997

Report of the Board Committee on Executive Remuneration

The *Board Committee on Executive Remuneration* comprises independent non-executive directors only. It determines the remuneration, benefits and terms and conditions of employment of the executive directors and members of the company's Executive Committee. It has been chaired since 1 January 1996 by Sir Colin Marshall and its other members during the year were:

Dr Iain Anderson
Sir Ewen Fergusson
Yve Newbold (until 30 November 1996)
Keith Oates
Lord Tebbit (until 2 November 1996)

The Committee, which has formal terms of reference, met eight times during the year ended 31 March 1997.

The Committee's constitution and operation have fully complied throughout the year with Section A of the best practice provisions of the Stock Exchange Listing Rules. The Committee also confirms that full consideration has been given to Section B of the best practice provisions in framing its remuneration policy.

Remuneration policy

BT's executive remuneration policy is to reward senior executives competitively. The Committee does not seek to maintain any strict market position but rather to ensure that pay is set appropriately and in the knowledge of pay practice amongst appropriate comparators. The Committee focuses on the largest companies by market capitalisation, ie the FT-SE 100 and in particular on those organisations where the complexity of roles, of the business and the extent of international scope are comparable. The Committee obtains advice and information from external experts.

The remuneration package for executive directors is made up of the following elements:

- **Basic salary**
  Salaries are normally reviewed annually or on a change of responsibilities although it has been the Committee's practice not to increase salaries automatically in times of low market movement. Salaries are increased only where the Committee believes that market adjustments are necessary to reflect responsibilities and contributions to the business. Salary adjustments were made during the course of the year for a number of key executives, including Sir Iain Vallance, Sir Peter Bonfield and Robert Brace. From 1 January 1997, Sir Iain's salary was increased from £480,000 to £500,000, Sir Peter's salary was increased from £475,000 to £570,000 and Robert Brace's salary was increased from £275,000 to £300,000.

- **Annual bonus**
  The annual bonus plan is designed to provide a focus on key annual objectives and to reward senior executives who have achieved results against these objectives. For the Executive Committee the bonus plan is currently capped at 50% of salary with an on-target bonus (payable if all objectives are fully met) of 30 to 35%.

  Targets are set at the start of the financial year based on key corporate objectives – such as profitability, quality of service, customer satisfaction and revenue growth; specific weighted targets are attached to each item. Objectives are set on the basis of the BT Corporate Scorecard. This enables the Committee to assess the performance of the executives under four headings: shareholder value, customer satisfaction, process improvement and organisational learning. For the executive directors, with the exception of Robert Brace, bonus awards are based wholly on the achievement of group-wide objectives and results. For Robert Brace, and members of the Executive Committee, bonus payments are based on the achievement of a mix of group, divisional and personal objectives.

  Following his decision to step down as Chief Executive from January 1996, the Chairman was not included in the formal bonus plan for the year ended 31 March 1997. The Committee took the view that he should, however, be considered for a discretionary bonus award in the light of his contribution over the year. It is intended that, as a result of the significant change in his responsibilities following the merger with MCI, he will participate again in the bonus plan from 1997/98 onwards with an on-target level of 50% and a maximum of 100% of salary. In the case of Sir Peter Bonfield, the Committee will take account of his contribution to the closing and effective implementation of the merger. Any additional bonus in respect of the merger will be within a total maximum annual bonus of 100% of salary and subject to an overall maximum of £500,000 over the two years, 1997/98 and 1998/99.

Mr Brace's maximum bonus for 1997/98 will be increased to 100% of salary, to allow the Committee to take account of his contribution to completion of the merger and the successful integration of the two companies.

Bonus awards for executive directors for the year under review ranged from 37% to 40% of current salary. The structure of bonus arrangements will be reviewed on completion of the merger.

- **Long-term remuneration**

Long Term Remuneration Plan

The Long Term Remuneration Plan (LTRP) was approved by shareholders at the 1995 AGM. It was designed to ensure that BT's remuneration package remains competitive, to encourage personal investment in BT shares; to foster community of interest with shareholders; to encourage key executives to stay with BT and to link reward and long-term corporate performance more effectively. Under the plan, company shares are acquired by an employee share ownership trust and are conditionally awarded to participants, although participants will only be entitled to these shares in full at the end of a five-year period if the company has met a pre-determined corporate performance measure and the participants are still employed by the BT Group. The performance measure is total shareholder return relative to the FT-SE 100.

The LTRP was operated for a third time in 1996. Over 80 senior executives now participate in the plan and the initial value of awards as a percentage of salary under the 1996 operation ranged from 18% to 99%. It is expected to be operated in 1997 for the last time. The Chairman has not participated in the LTRP.

The future

The Committee believes it has a duty to shareholders to ensure that Concert plc will be able to attract, retain and develop senior executives with the right skills. New share plans to operate for Concert plc after the proposed merger are being put to shareholders for approval at the 1997 annual general meeting. These new share plans are designed to enable Concert plc to achieve these objectives in all the markets in which it will operate. A more detailed explanation of the new plans is contained in the *Notice of 1997 Annual General Meeting* circular sent to all shareholders.

- **Pensions**

For executive directors and other senior executives, the policy is to provide pension benefits from all sources of two-thirds of final salary at normal retirement age of 60 with a two-thirds surviving spouse's pension. On death in service a lump sum equal to four times annual salary is payable together with a surviving spouse's pension of two-thirds of the director's prospective pension. Pensions are based on salary alone – bonuses, other benefits and long-term incentives are excluded. The primary means of providing pensions for the executive directors and their dependants is through the BT Pension Scheme (BTPS). All the executive directors, except Sir Peter Bonfield, are members of the BTPS. For members of the BTPS the company contributed 9.5% of salary to the scheme and the individual contributed 6% of salary in the year ended 31 March 1997. Where an individual will not achieve the target level of pension benefit at normal retirement age, the company may make up the shortfall by purchasing additional service in the BTPS and/or through non-approved, unfunded arrangements.

Sir Iain Vallance is a member of the BTPS and his pension arrangements provide him with the flexibility to retire at any time after age 55 with a pension equivalent to two-thirds of his final salary. His surviving spouse's pension is two-thirds of his pension. As a result of his intention to remain as Co-Chairman of Concert plc for at least three years after the proposed merger, Sir Iain will not take his pension while he remains in full time employment but the value of his pension will be increased in line with inflation from his 55th birthday in May 1998. The excess of Sir Iain's pension entitlement above that provided by the BTPS is unfunded.

Sir Peter Bonfield's pension arrangements are non-approved and unfunded and provide for a pension of two-thirds of his final salary at age 60, inclusive of any retained benefits from his previous employment, and a surviving spouse's pension of two-thirds of his pension.

The table below shows the increase in the accrued benefits to which each director has become entitled during the year and the transfer value of the increase in accrued benefit:

	Increase in accrued annual pension in year ended 31 March 1997*(a)* £000	Total accrued annual pension as at 31 March 1997*(b)* £000	Transfer value of increase in accrued benefit *(c)* £000
Sir Iain Vallance	9	312	98
Sir Peter Bonfield	18	22	184
AW Rudge	24	179	297
RP Brace	15	64	107

(a) The increase in accrued pension during the year excludes any increase for inflation.

(b) The pension entitlement is that which would be paid annually on retirement based on service to the end of the year.

(c) The transfer value has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11 and excludes directors' contributions.

Members of the BTPS have the option to pay additional voluntary contributions; neither the contributions, if any, nor any resulting benefits are included in the above table.

- **Other benefits**
  These include car and driver, personal telecommunications facilities, medical cover for the director and immediate family and financial counselling.

Service agreements

All the executive directors have service agreements which contain provisions for the removal of a director through poor performance.

Sir Iain Vallance entered into a new contract during the year which is subject to twelve months' notice on either side. Sir Iain has confirmed his intention to serve as Co-Chairman of Concert plc for at least three years from the completion of the proposed merger with MCI. During that period, a two-thirds majority decision of the Concert plc Board will be required for the company to terminate his contract.

The initial term of Sir Peter Bonfield's contract has been extended to 31 December 1999. The contract can be terminated by either party giving twelve months' notice expiring after 31 December 1999, the date on which MCI's most senior executives' contracts also expire. Dr Alan Rudge's contract expires on 31 October 1997. Robert Brace's service agreement can be terminated at any time after 31 August 1997 on twelve months' notice by either side.

Gerald Taylor, who joined the Board on 4 November 1996, Keith Oates and Bert Roberts have contracts of appointment as non-executive directors which expire on 3 November 1999, 31 May 1997 and 13 October 1997, respectively. The Board has agreed to continue Keith Oates' appointment from 1 June 1997 subject to a one-year period of notice on either side.

Outside appointments

The Committee believes there are significant benefits to both the company and the individual from executive directors accepting non-executive directorships of companies outside the BT group. The Committee will normally consider approving up to two external appointments for which the director may retain the fees.

Non-executive directors' remuneration

Fees for non-executive directors are determined by the Board as a whole, based on the recommendations of the Board Committee on Non-Executive Remuneration whose members are currently the Chairman and the Chief Executive.

During the year, the Board agreed a revised fee structure for non-executive directors with effect from 1 January 1997. The basic fee for non-executive directors, which includes membership of one committee, is now £25,000 per year (1996 equivalent – £22,500). Additional fees for membership of most other Board committees range from £3,000 to £5,000 per year. Committee chairmen receive an additional fee of £2,000 for each committee they chair. Sir Colin Marshall receives an inclusive fee of £65,000 per year as Deputy Chairman.

Directors' remuneration

The remuneration (excluding pension arrangements) of the directors was as follows:

	Salary and fees		Bonus		Benefits excluding pension*(a)*		Total	
	1997 £000	1996 £000	**1997 £000**	1996 £000	**1997 £000**	1996 £000	**1997 £000**	1996 £000
Sir Iain Vallance	**485.0**	476.3	**185.0**	162.0	**28.9**	19.2	**698.9**	657.5
Sir Peter Bonfield	**498.8**	118.8	**225.0**	42.5	**27.1**	4.5	**750.9**	165.8
A W Rudge	**286.3**	268.8	**116.0**	100.0	**14.6**	13.4	**416.9**	382.2
R P Brace	**272.5**	233.8	**110.0**	85.0	**16.6**	14.2	**399.1**	333.0
M L Hepher	**–**	373.1*(b)*	**–**	154.0*(b)*	**–**	16.2*(b)*	**–**	543.3
Sir Colin Marshall	**65.0**	34.1	**–**	–	**0.2**	0.4	**65.2**	34.5
J I W Anderson	**31.0***(c)*	11.4*(c)*	**–**	–	**–**	–	**31.0**	11.4
M Argent	**46.4**	82.1	**–**	–	**0.4**	32.7*(d)*	**46.8**	114.8
B E Breuel	**20.1**	19.5	**–**	–	**–**	–	**20.1**	19.5
Sir Ewen Fergusson	**33.4**	30.0	**–**	–	**0.2**	0.2	**33.6**	30.2
Y M Newbold	**28.6**	27.1*(c)*	**–**	–	**0.2**	0.2	**28.8**	27.3
J K Oates	**30.1**	26.8	**–**	–	**0.2**	0.2	**30.3**	27.0
B C Roberts	**–**	–	**–**	–	**–**	–	**–**	–
G H Taylor	**–**	–	**–**	–	**–**	–	**–**	–
Rt Hon Lord Tebbit	**17.5**	27.7	**–**	–	**–**	–	**17.5**	27.7
Sir Michael Bett	**–**	31.3	**–**	–	**–**	1.4	**–**	32.7
P G Bosonnet	**–**	56.3	**–**	–	**–**	–	**–**	56.3
Total remuneration	**1,814.7**	1,817.1	**636.0**	543.5	**88.4**	102.6	**2,539.1**	2,463.2

(a) Includes such benefits as company car, petrol, driver, personal telephone facilities, medical cover, financial counselling and share schemes.

(b) Under the terms for his leaving the company on 31 December 1995, Mr Hepher continues to receive his salary and contractual benefits until his service contract expires on 5 August 1997. The total salary payable during the year ended 31 March 1997 was £430,000 and he received £80,000 in lieu of benefits. Other benefits for the year ended 31 March 1997 were £14,239. In the prior year for the period 1 January to 31 March 1996 he received salary of £107,500 and benefits of £9,033.

(c) Payments to non-executive directors include fees paid to their principal employer of £30,996 (1996 – £24,125).

(d) Benefits include a company car, valued at £19,500, transferred to Mr Argent.

The directors' long-term remuneration benefits, through the exercise of share options, were as follows:

	1997 £000	1996 £000
Sir Iain Vallance	**3.0**	3.0
A W Rudge	**–**	3.3
R P Brace	**6.1**	–
M Argent	**83.8**	–

The figures in the above table are based on the amount by which the market value of the shares on the date of exercise exceeded the option price.

Gerald Taylor joined the Board on 4 November 1996 and Lord Tebbit retired on 2 November 1996. Gerald Taylor has agreed to waive fees of £8,587 for the year ended 31 March 1997. Bert Roberts receives no remuneration as a non-executive director of the company. In the previous financial year, Sir Peter Bonfield joined the Board on 1 January 1996, Sir Colin Marshall and Birgit Breuel on 1 April 1995 and Dr Iain Anderson on 1 November 1995. Michael Hepher and Paul Bosonnet retired on 31 December 1995. Sir Michael Bett retired on 31 January 1996; he remains chairman of Cellnet Group Limited, a subsidiary company, for which he received fees of £15,000 during the year ended 31 March 1997.

Directors' interests

The interests of directors and their families in the company's shares at 31 March 1997 and 1 April 1996, or date of appointment if later, are shown below:

Beneficial holdings	**1997**	1996
Sir Iain Vallance	**185,756**	182,616
Sir Peter Bonfield	**8,305** *(a)*	–
A W Rudge	**42,207** *(a)*	41,693 *(a)*
R P Brace	**20,231** *(a)*	13,110 *(a)*
Sir Colin Marshall	**2,000**	2,000
J I W Anderson	**–**	–
M Argent	**17,988**	17,988
B E Breuel	**–**	–
Sir Ewen Fergusson	**–**	92
Y M Newbold	**1,190**	1,150
J K Oates	**3,764**	3,660
B C Roberts	**5,000**	5,000
G H Taylor	**–**	– *(b)*

(a) Includes 8,305 shares (1996 – nil) purchased and held by Sir Peter Bonfield, 12,945 shares (1996 – 12,498 shares) by Dr Rudge and 16,710 shares (1996 – 10,495 shares) by Mr Brace in the Long Term Remuneration Plan (see note 26 to the financial statements).

(b) Date of appointment.

Details of share options held at 1 April 1996, granted and exercised under the share option schemes during the year, and the balance held at 31 March 1997 are as follows:

	Number of share options				**Option exercise price per share**	Market price at date of exercise	Usual date from which exercisable	Usual expiry date
	1 April 1996	Granted	Exercised	**31 March 1997**				
Sir Iain Vallance	55,189	–	–	**55,189**	**264p**		07/09/92	07/09/99
	100,207	–	–	**100,207**	**289p**		07/12/93	07/12/00
	57,957	–	–	**57,957**	**333p**		09/03/95	09/03/02
	20,770	–	–	**20,770**	**430p**		04/03/96	04/03/03
	3,073	–	3,073*(b)*	**–**	244p	341.5p	14/06/96	14/12/96
	3,760	–	–	**3,760**	**375p**		08/12/97	08/12/04
	240,956	–	3,073	**237,883**				
Sir Peter Bonfield	–	6,460	–	**6,460**	**267p**		14/08/01	14/02/02
A W Rudge	60,000	–	–	**60,000**	**264p**		07/09/92	07/09/99
	65,622	–	–	**65,622**	**289p**		07/12/93	07/12/00
	34,534	–	–	**34,534**	**333p**		09/03/95	09/03/02
	10,940	–	–	**10,940**	**430p**		04/03/96	04/03/03
	2,745	–	–	**2,745**	**265p**		14/06/97	14/12/97
	2,460	–	–	**2,460**	**375p**		08/12/97	08/12/04
	2,254	–	–	**2,254**	**306p**		14/06/00	14/12/00
	178,555	–	–	**178,555**				
R P Brace	136,890	–	–	**136,890**	**263p**		06/09/92	06/09/99
	18,680	–	–	**18,680**	**289p**		07/12/93	07/12/00
	18,020	–	–	**18,020**	**333p**		09/03/95	09/03/02
	24,890	–	–	**24,890**	**430p**		04/03/96	04/03/03
	4,610	–	4,610*(b)*	**–**	244p	375.5p	14/06/96	14/12/96
	30,180	–	–	**30,180**	**460p**		15/11/96	15/11/03
	23,470	–	–	**23,470**	**375p**		08/12/97	08/12/04
	2,265	–	–	**2,265**	**320p**		14/06/98	14/12/98
	–	3,876	–	**3,876**	**267p**		14/08/01	14/02/02
	259,005	3,876	4,610	**258,271**				
M Argent	82,975	–	82,975*(c)*	**–**	289p	373.5p	07/12/93	07/12/00
	33,873	–	33,873*(c)*	**–**	333p	373.5p	09/03/95	09/03/02
	10,940	–	–*(d)*	**–**	430p		04/03/96	04/03/03
	127,788	–	116,848	**–**				

(a) All of the above options were granted for nil consideration.

(b) Sir Iain Vallance and Mr Brace each exercised options under the BT Employee Sharesave Scheme, in which all employees of the company are eligible to participate, on 8 July and 7 August 1996, respectively.

(c) Mr Argent exercised options under the BT Employee Share Option Scheme on 21 August 1996.

(d) Options lapsed on 3 September 1996.

Unrealised gains on the above share options at 31 March 1997, based on the market price of the shares at that date, were as follows:

	Options exercisable			Options not exercisable		
		Unrealised gains			Unrealised gains	
	Number of shares	**1997 £000**	1996*(a)* £000	Number of shares	**1997 £000**	1996*(a)* £000
Sir Iain Vallance	**234,123**	**325**	159	**3,760**	**3**	4
Sir Peter Bonfield	**–**	**–**	–	**6,460**	**12**	–
A W Rudge	**171,096**	**252**	128	**7,459**	**10**	4
R P Brace	**228,660**	**303**	166	**29,611**	**26**	7
	633,879	**880**	453	**47,290**	**51**	15

(a) Based on options outstanding at 31 March 1996 and the market price of the shares at that date.

The market price of the shares at 31 March 1997 was 445.5p (1996 – 369p) and the range during the year ended 31 March 1997 was 326.5p to 461.5p.

Details of the company's ordinary shares provisionally awarded to each director, as a participant under the Long Term Remuneration Plan (note 26 to the financial statements), were as follows:

	Total number of award shares*(a)*				Range of value of award*(b)*	
	1 April 1996	Awarded	Dividends reinvested	**31 March 1997**	Minimum £000	Maximum £000
Sir Peter Bonfield	–	122,934	2,203	**125,137**	93	557
A W Rudge	105,006	–	5,039	**110,045**	98	490
R P Brace	88,448	75,125	5,588	**169,161**	135	754

(a) Excluding shares purchased by each director under the plan (see page 31).

(b) Based on the market value of the company's shares at 31 March 1997. The minimum figure represents those shares held at 31 March 1997 which will transfer to each director at the end of year five of the plan (1999 to 2001) provided the individual is still employed by the group. The maximum figure represents all shares held at 31 March 1997 which will transfer to each director at the end of year five (1999 to 2001) provided the individual is still employed by the group and that the corporate performance measure has been fully met.

At 31 March 1997, Sir Iain Vallance, Sir Peter Bonfield, Dr Rudge and Mr Brace each had a non-beneficial interest in 62,891 shares (1996 – 95,841) purchased by BT Employee Shares Trustees Limited for allocation to employees under the BT Employee Share Ownership Scheme, and 6,206,481 shares (1996 – 3,292,627) held in trust by Ilford Trustees (Jersey) Limited for allocation to participating employees under the Long Term Remuneration Plan and the Performance Share Plan.

No director had any interest in the debentures of the company or in the share capital or debentures of its subsidiaries.

Subsequent to 31 March 1997, the company has been notified of an acquisition of a beneficial holding of 16 ordinary shares by Mr Brace under a personal equity plan. There have been no other changes in the directors' interests in the share capital or in the debentures of the company and its subsidiaries between 31 March 1997 and 20 May 1997.

By order of the Board

Sir Colin Marshall

Chairman of the Board Committee on Executive Remuneration

20 MAY 1997

Statement of directors' responsibility

FOR PREPARING THE FINANCIAL STATEMENTS

The directors are required by law to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the group as at the end of the financial year and of the profit or loss, total recognised gains or losses and cash flows of the group for that period.

The directors consider that, in preparing the financial statements for the year ended 31 March 1997 on pages 36 to 62, the company has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates. The directors also consider that all accounting standards which they consider to be applicable have been followed and confirm that the financial statements have been prepared on the going concern basis.

The directors are responsible for ensuring that the company keeps accounting records which disclose with reasonable accuracy the financial position of the company and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The directors are also responsible for taking such steps that are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

The auditors' responsibilities are stated in their report to the shareholders.

Report of the auditors

TO THE SHAREHOLDERS OF BRITISH TELECOMMUNICATIONS plc

We have audited the financial statements on pages 36 to 62 including the information on directors' remuneration and directors' interests on pages 29 to 33.

Respective responsibilities of directors and auditors

As described in the statement of directors' responsibility, the company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company and the group at 31 March 1997 and of the profit, total recognised gains and cash flows of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Coopers & Lybrand
Chartered Accountants and Registered Auditors
London
20 MAY 1997

Five year financial summary

YEARS ENDED 31 MARCH

	1993 £m	1994 £m	1995 £m	1996 £m	**1997 £m**
Profit and loss account					
Turnover	13,242	13,675	13,893	14,446	**14,935**
Operating profit	2,403	2,982	2,663	3,100	**3,245**
Group's share of profits of associated undertakings	13	18	92	82	**139**
Profit (loss) on sale of group undertakings	(132)	(14)	241	7	**8**
Net interest payable	(256)	(230)	(259)	(170)	**(129)**
Premium on repurchase of bonds	(56)	–	(75)	–	**(60)**
Profit on ordinary activities before taxation	1,972	2,756	2,662	3,019	**3,203**
Tax on profit on ordinary activities	(724)	(951)	(926)	(1,027)	**(1,102)**
Profit on ordinary activities after taxation	1,248	1,805	1,736	1,992	**2,101**
Minority interests	(28)	(38)	(5)	(6)	**(24)**
Profit for the financial year	1,220	1,767	1,731	1,986	**2,077**
Earnings per share	19.8p	28.5p	27.8p	31.6p	**32.8p**
Dividends per share (including 1997 special dividend of 35p)	15.6p	16.7p	17.7p	18.7p	**54.85p**
Cash flow statement *(a)*					
Cash flow from operating activities	5,130	4,917	5,119	5,834	**6,192**
Returns on investments and servicing of finance	(331)	(202)	(348)	(150)	**(220)**
Taxation	(975)	(605)	(1,175)	(784)	**(1,045)**
Capital expenditure and financial investment	(2,078)	(2,123)	(2,535)	(2,500)	**(2,820)**
Acquisitions and disposals	(5)	(482)	(2,260)	(132)	**(252)**
Equity dividends paid	(917)	(999)	(1,065)	(1,138)	**(1,217)**
Cash inflow (outflow) before use of liquid resources and financing	824	506	(2,264)	1,130	**638**
Management of liquid resources	197	(797)	2,557	(1,317)	**(504)**
Financing	(1,044)	273	(207)	215	**(224)**
Increase (decrease) in cash for the period	(23)	(18)	86	28	**(90)**
Decrease (increase) in net debt	877	563	(2,146)	1,319	**849**
Balance sheet					
Tangible fixed assets	15,736	15,584	16,012	16,496	**16,802**
Fixed asset investments	735	1,312	1,082	1,057	**1,273**
Net current assets (liabilities)	322	125	(725)	(106)	**(2,667)**
Total assets less current liabilities	16,793	17,021	16,369	17,447	**15,408**
Loans and other borrowings falling due after one year	(3,386)	(3,199)	(3,361)	(3,322)	**(2,693)**
Provisions for liabilities and charges	(1,117)	(701)	(879)	(1,267)	**(1,391)**
Minority interests	(72)	(95)	(132)	(180)	**(208)**
Total assets less liabilities	12,218	13,026	11,997	12,678	**11,116**

(a) Cash flow information for 1993 to 1996 has been restated to comply with Financial Reporting Standard 1 (Revised).

Accounting policies

I Basis of preparation of the financial statements

The financial statements are prepared under the historical cost convention and in accordance with applicable accounting standards. The group financial statements consolidate those of the company and all of its subsidiary undertakings. Where the financial statements of subsidiary and associated undertakings do not conform with the group's accounting policies, appropriate adjustments are made on consolidation in order to present the group financial statements on a consistent basis. The principal subsidiary undertakings' financial years are all coterminous with those of the company. Cash flow statement information has been restated to comply with Financial Reporting Standard 1 (Revised).

II Turnover

Turnover, which excludes value added tax and other sales taxes, comprises the value of services provided and equipment sales excluding those between group undertakings.

III Research and development

Expenditure on research and development is written off as incurred.

IV Interest

Interest payable, including that related to financing the construction of tangible fixed assets, is written off as incurred. Discounts or premiums and expenses on the issue of debt securities are amortised over the term of the related security and included within interest payable. Premiums payable on early redemptions of debt securities, in lieu of future interest costs, are written off when paid.

V Foreign currencies

On consolidation, assets and liabilities of foreign undertakings are translated into sterling at year-end exchange rates. The results of foreign undertakings are translated into sterling at average rates of exchange for the year.

Exchange differences arising from the retranslation at year-end exchange rates of the net investment in foreign undertakings, less exchange differences on borrowings which finance or provide a hedge against those undertakings, are taken to reserves and are reported in the statement of total recognised gains and losses.

All other exchange gains or losses are dealt with through the profit and loss account.

VI Goodwill

Goodwill, arising from the purchase of subsidiary and associated undertakings, representing the excess of the fair value of the purchase consideration over the fair value of the net assets acquired, is written off on acquisition against group reserves. If an undertaking is subsequently divested, or if there has been a permanent diminution in value, the appropriate goodwill is dealt with through the profit and loss account in the period of disposal as part of the calculation of gain or loss on divestment or in the period of permanent diminution.

VII Intangible assets

Broadcasting licences, which are held in an associated undertaking, are stated at historical cost. No amortisation is provided on these assets, but their value is reviewed annually by the directors and the cost is written down if permanent diminution in value has occurred.

VIII Tangible fixed assets

Tangible fixed assets are stated at historical cost less depreciation.

(a) Cost

Cost in the case of network services comprises expenditure up to and including the last distribution point and includes contractors' charges and payments on account, materials, direct labour and related overheads.

(b) Depreciation

Depreciation is provided on tangible fixed assets on a straight line basis from the time they are available for use, so as to write off their costs over their estimated useful lives taking into account any expected residual values. No depreciation is provided on freehold land.

The lives assigned to other significant tangible fixed assets are:

Freehold buildings –	40 years
Leasehold land and buildings –	Unexpired portion of lease or 40 years, whichever is the shorter
Transmission equipment:	
duct –	25 years
cable –	3 to 25 years
radio and repeater equipment –	2 to 25 years
Digital telephone exchange equipment –	2 to 13 years
Computers and office equipment –	2 to 7 years
Payphones, other network equipment, motor vehicles and cableships –	3 to 20 years

The remaining semi-electronic telephone exchange equipment is in the course of being replaced by digital equipment and will be substantially written off by 2000.

(c) Engineering stores
Most engineering stores items are used in the construction of new plant and the remainder for maintenance. When issued, these stores are charged to the cost of specific plant or to the profit and loss account, as appropriate. They are stated at cost, less a provision for excess and obsolete items.

IX Fixed asset investments
Investments in subsidiary and associated undertakings are stated in the balance sheet of the company at cost less amounts written off. Amounts denominated in foreign currency are translated into sterling at year-end exchange rates.

Investments in associated undertakings are stated in the group balance sheet at the group's share of their net assets.

The group's share of profits less losses of associated undertakings is included in the group profit and loss account.

Investments in other participating interests and other investments are stated at cost less amounts written off.

X Stocks
Stocks mainly comprise items of equipment, held for sale or rental, consumable items and work in progress on long-term contracts.

Equipment held and consumable items are stated at the lower of cost and estimated net realisable value, after provisions for obsolescence.

Work in progress on long-term contracts is stated at cost, after deducting payments on account, less provisions for any foreseeable losses.

XI Redundancy costs
Redundancy costs arising from periodic reviews of staff levels are charged against profit in the year in which employees leave the group.

If the most recent actuarial valuation of the group's pension scheme shows a deficit, the estimated cost of providing incremental pension benefits in respect of employees leaving the group is charged against profit in the year in which the employees leave the group, within redundancy charges.

XII Pension scheme
The group operates a defined benefit pension scheme, which is independent of the group's finances, for the substantial majority of its employees. Actuarial valuations of the scheme are carried out as determined by the trustees at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. In any intervening years, the actuaries review the continuing appropriateness of the contribution rates.

The cost of providing pensions is charged against profits over employees' working lives with the group using the projected unit method. Variations from this regular cost are allocated over the average remaining service lives of current employees to the extent that these variations do not relate to the estimated cost of providing incremental pension benefits in the circumstances described in XI above.

Interest is accounted for on the provision in the balance sheet which results from differences between amounts recognised as pension costs and amounts funded. The regular pension cost, variations from the regular pension cost, described above, and interest are all charged within staff costs.

XIII Taxation
The charge for taxation is based on the profit for the year and takes into account deferred taxation. Provision is made for deferred taxation only to the extent that timing differences are expected to reverse in the foreseeable future, with the exception of timing differences arising on pension costs where full provision is made irrespective of whether they are expected to reverse in the foreseeable future.

XIV Financial instruments
Interest differentials, under swap agreements used to vary the amounts and periods for which interest rates on borrowings are fixed, are recognised by adjustment of interest payable.

Currency swap agreements and forward exchange contracts, used to reduce the impact of changes in currency rates on certain of the group's long-term borrowings denominated in foreign currency, are valued at year-end exchange rates. The resulting gains or losses are offset against foreign exchange gains or losses on the related borrowings.

Premiums or discounts on financial instruments designated as hedges are reflected as adjustments to interest payable.

Group profit and loss account

FOR THE YEAR ENDED 31 MARCH 1997

	Notes	**1997 £m**	1996 £m
Turnover	*1*	**14,935**	14,446
Operating costs *(a)*	*2*	**(11,690)**	(11,346)
Operating profit		**3,245**	3,100
Group's share of profits of associated undertakings		**139**	82
Profit on sale of group undertakings	*3*	**8**	7
Interest receivable	*4*	**206**	201
Interest payable	*4*	**(335)**	(371)
Premium on repurchase of bonds	*4*	**(60)**	–
Profit on ordinary activities before taxation		**3,203**	3,019
Tax on profit on ordinary activities	*5*	**(1,102)**	(1,027)
Profit on ordinary activities after taxation		**2,101**	1,992
Minority interests		**(24)**	(6)
Profit for the financial year		**2,077**	1,986
Dividends:	*6*		
Ordinary		**(1,266)**	(1,184)
Special		**(2,244)**	–
		(3,510)	(1,184)
Retained profit (transfer from reserves) for the financial year	*19*	**(1,433)**	802
Earnings per share	*7*	**32.8p**	31.6p
(a) including redundancy charges		**367**	421

Group statement of total recognised gains and losses

FOR THE YEAR ENDED 31 MARCH 1997

	1997 £m	1996 £m
Profit for the financial year	**2,077**	1,986
Currency movements arising on consolidation of foreign subsidiary and associated undertakings	**(76)**	42
Total recognised gains and losses	**2,001**	2,028

Group cash flow statement

FOR THE YEAR ENDED 31 MARCH 1997

	Notes	1997 £m	1996 £m
Net cash inflow from operating activities	*8*	**6,192**	5,834
Returns on investments and servicing of finance			
Interest received		**196**	202
Interest paid, including finance costs		**(342)**	(332)
Premium paid on repurchase of bonds		**(60)**	–
Dividends paid to minorities		**(14)**	(20)
Net cash outflow for returns on investments and servicing of finance		**(220)**	(150)
Taxation			
UK corporation tax paid		**(1,032)**	(738)
Overseas tax paid		**(13)**	(46)
Tax paid		**(1,045)**	(784)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(2,823)**	(2,547)
Sale of tangible fixed assets		**124**	88
Purchase of fixed asset investments		**(172)**	(85)
Disposal of fixed asset investments		**51**	44
Net cash outflow for capital expenditure and financial investment		**(2,820)**	(2,500)
Acquisitions and disposals			
Purchase of subsidiary undertakings, net of £2m (1996 – £1m) cash acquired		**(126)**	(26)
Purchase of associated undertakings		**(148)**	(122)
Sale of subsidiary undertakings		**11**	16
Sale of associated undertakings		**11**	–
Net cash outflow for acquisitions and disposals		**(252)**	(132)
Equity dividends paid		**(1,217)**	(1,138)
Cash inflow before use of liquid resources and financing		**638**	1,130
Management of liquid resources	*9*	**(504)**	(1,317)
Financing			
Issue of ordinary share capital		**160**	130
Minority shares issued		**51**	59
New loans		**235**	177
Loan repayments		**(670)**	(151)
Net cash inflow (outflow) from financing		**(224)**	215
Increase (decrease) in cash in the period		**(90)**	28
Decrease in net debt in the period	*10*	**849**	1,319

Group balance sheet

AT 31 MARCH 1997

	Notes	**1997 £m**	1996 £m
Fixed assets			
Tangible assets	*11*	**16,802**	16,496
Investments	*12*	**1,273**	1,057
Total fixed assets		**18,075**	17,553
Current assets			
Stocks		**180**	212
Debtors	*13*	**3,807**	3,082
Investments	*14*	**2,974**	2,568
Cash at bank and in hand		**26**	121
Total current assets		**6,987**	5,983
Creditors: amounts falling due within one year			
Loans and other borrowings	*15*	**483**	315
Other creditors	*16*	**9,171**	5,774
Total creditors: amounts falling due within one year		**9,654**	6,089
Net current liabilities		**(2,667)**	(106)
Total assets less current liabilities		**15,408**	17,447
Creditors: amounts falling due after more than one year			
Loans and other borrowings	*15*	**2,693**	3,322
Provisions for liabilities and charges	*17*	**1,391**	1,267
Minority interests		**208**	180
Capital and reserves			
Called up share capital	*18*	**1,589**	1,573
Share premium account	*19*	**675**	531
Other reserves	*19*	**777**	777
Profit and loss account	*19*	**8,075**	9,797
Total equity shareholders' funds	*20*	**11,116**	12,678
		15,408	17,447

Debtors include amounts receivable after more than one year of £546m (1996 – £87m).

Balance sheet of the company

AT 31 MARCH 1997

	Notes	1997 £m	1996 £m
Fixed assets			
Tangible assets	*11*	**14,493**	14,313
Investments	*12*	**6,599**	5,825
Total fixed assets		**21,092**	20,138
Current assets			
Stocks		**159**	180
Debtors	*13*	**4,013**	3,098
Investments	*14*	**2,909**	1,983
Total current assets		**7,081**	5,261
Creditors: amounts falling due within one year			
Loans and other borrowings	*15*	**2,316**	607
Other creditors	*16*	**9,005**	5,818
Total creditors: amounts falling due within one year		**11,321**	6,425
Net current liabilities		**(4,240)**	(1,164)
Total assets less current liabilities		**16,852**	18,974
Creditors: amounts falling due after more than one year			
Loans and other borrowings	*15*	**3,493**	3,876
Provisions for liabilities and charges	*17*	**1,341**	1,050
Capital and reserves			
Called up share capital	*18*	**1,589**	1,573
Share premium account	*19*	**675**	531
Capital redemption reserve	*19*	**750**	750
Profit and loss account	*19*	**9,004**	11,194
Total equity shareholders' funds	*20*	**12,018**	14,048
		16,852	18,974

Debtors include amounts receivable after more than one year of £741m (1996 – £119m).

The financial statements on pages 36 to 62 were approved by the board of directors on 20 May 1997 and were signed on its behalf by

Sir Iain Vallance *Chairman*

Sir Peter Bonfield CBE *Chief Executive*

R P Brace *Group Finance Director*

Notes to the financial statements

1. Turnover

	1997 £m	1996 £m
Inland telephone calls	**4,874**	4,882
International telephone calls	**1,809**	1,980
Telephone exchange line rentals	**2,811**	2,685
Private circuits	**1,124**	1,056
Mobile communications	**949**	856
Customer premises equipment supply	**914**	946
Yellow Pages and other directories	**438**	408
Other sales and services	**2,016**	1,633
Total turnover	**14,935**	14,446

Turnover included income from telecommunication operators of £1,165m (1996 – £1,166m). In the year 3% (1996 – 2%) of turnover arose from operations outside the United Kingdom. There are no discontinued operations or acquisitions which require disclosure under Financial Reporting Standard 3.

2. Operating costs

	1997 £m	1996 £m
Staff costs:		
Wages and salaries	**3,161**	3,105
Social security costs	**262**	261
Pension costs *(note 22)*	**291**	284
Employee share ownership scheme *(a)*	**64**	30
Total staff costs	**3,778**	3,680
Own work capitalised	**(399)**	(417)
Depreciation *(note 11)*	**2,265**	2,189
Payments to telecommunication operators	**1,476**	1,383
Redundancy charges *(b)*	**367**	421
Other operating costs	**4,309**	4,193
Other operating income	**(106)**	(103)
Total operating costs	**11,690**	11,346
Operating costs included the following:		
Research and development	**291**	282
Rental costs relating to operating leases, including plant and equipment hire £10m (1996 – £23m)	**215**	250

(a) Amount set aside for the year for allocation of ordinary shares in the company to eligible employees.

(b) Redundancy charges for the year ended 31 March 1997 included £258m (1996 – £266m) being the cost of providing incremental pension benefits for employees taking early retirement.

The directors believe that the nature of the group's business is such that the analysis of operating costs required by the Companies Act 1985 is not appropriate. As required by the Act, the directors have therefore adapted the prescribed format so that operating costs are disclosed in a manner appropriate to the group's principal activity.

3. Profit on sale of group undertakings

In the years ended 31 March 1996 and 31 March 1997 the subsidiary undertakings disposed of had a negligible effect on the group's operating profit and cash flows and their net assets were immaterial to the group's financial position.

4. Interest

	1997 £m	1996 £m
Interest payable and similar charges in respect of:		
Bank loans and overdrafts	**(76)**	(74)
Other borrowings	**(259)**	(297)
Total interest payable	**(335)**	(371)
Premium on repurchase of bonds *(note 15)*	**(60)**	–
Income from listed investments	**12**	29
Other interest receivable	**194**	172
Total interest receivable	**206**	201
Net interest payable (including premium on repurchase of bonds)	**(189)**	(170)

5. Tax on profit on ordinary activities

	1997 £m	1996 £m
United Kingdom:		
Corporation tax at 33%	**1,135**	1,000
Deferred taxation credit at 33%	**(100)**	(20)
Taxation on the group's share of results of associated undertakings	**–**	1
Prior year adjustments	**1**	(1)
Total UK taxation	**1,036**	980
Overseas taxation:		
Current	**17**	8
Taxation on the group's share of results of associated undertakings	**49**	39
Total tax on profit on ordinary activities	**1,102**	1,027

The total tax charge for the year was £45m (1996 – £31m) higher than the result of applying the UK corporation tax rate of 33% to the group's profit on ordinary activities. This was primarily due to depreciation on certain tangible fixed assets not deductible for tax purposes and because tax relief was not wholly available against the premium paid on the repurchase of bonds from HM Government. The higher tax charge in 1996 occurred mainly due to depreciation on tangible fixed assets not deductible for tax purposes. Deferred taxation of £28m (1996 – £30m) arising on excess capital allowances and £19m (1996 – £11m) on associated undertakings' profits was not provided in the year ended 31 March 1997.

6. Dividends

	1997 pence per share	1996 pence per share	1997 £m	1996 £m
Interim dividend paid	**7.90**	7.45	**502**	469
Proposed final dividend	**11.95**	11.25	**764**	715
Total ordinary dividends	**19.85**	18.70	**1,266**	1,184
Special dividend	**35.00**	–	**2,244**	–
Total dividends	**54.85**	18.70	**3,510**	1,184

7. Earnings per share

Earnings per share are calculated by dividing the profit for the financial year ended 31 March 1997, amounting to £2,077m (1996 – £1,986m), by 6,336 million shares, the average number of shares in issue during the financial year (1996 – 6,283 million). A fully diluted earnings per share figure based on share options outstanding is not provided as the effect on the earnings per share is not significant.

8. Reconciliation of operating profit to operating cash flows

	1997 £m	1996 £m
Operating profit, including share of profit of associated undertakings	**3,384**	3,182
Depreciation	**2,265**	2,189
Share of profit of associated undertakings, net of dividends received £7m (1996 – £5m)	**(132)**	(77)
Decrease in stocks	**31**	36
Increase in debtors	**(168)**	(335)
Increase in creditors	**478**	493
Increase in provisions	**321**	309
Other	**13**	37
Net cash inflow from operating activities	**6,192**	5,834

9. Management of liquid resources

	1997 £m	1996 £m
Purchase of short-term investments and payments into short-term deposits over 3 months	**(2,242)**	(2,520)
Sale of short-term investments and withdrawals from short-term deposits over 3 months	**2,790**	1,996
Net movement of short-term investments and short-term deposits under 3 months not repayable on demand	**(1,052)**	(793)
Net cash outflow from management of liquid resources	**(504)**	(1,317)

Movements in all short-term investments and deposits not repayable on demand are reported under the heading of management of liquid resources.

10. Net debt

	At 1 April 1996 £m	Cash flow £m	Other non-cash changes £m	Currency movement £m	At 31 March 1997 £m
Analysis of net debt					
Cash in hand and at bank	121	(95)	–	–	**26**
Overnight deposits	28	3	–	(1)	**30**
Bank overdrafts	(13)	2	–	–	**(11)**
	136	(90)	–	(1)	**45**
Other current asset investments	2,540	504	(5)	(95)	**2,944**
Short-term investments and cash, less bank overdrafts	**2,676**	**414**	**(5)**	**(96)**	**2,989**
Debt due within one year, excluding bank overdrafts	(302)	108	(279)	1	**(472)**
Debt due after one year	(3,322)	327	254	48	**(2,693)**
Total debt, excluding bank overdrafts	**(3,624)**	**435**	**(25)**	**49**	**(3,165)**
Net debt	**(948)**	**849**	**(30)**	**(47)**	**(176)**

10. Net debt (continued)

Reconciliation of net cash flow to movement in net debt	1997 £m	1996 £m
Increase (decrease) in cash in the year	**(90)**	28
Cash (inflow) outflow from (increase) decrease in debt	**435**	(26)
Cash outflow from increase in liquid resources	**504**	1,317
Decrease in net debt resulting from cash flows	**849**	1,319
Currency and translation movements	**(47)**	(60)
Other non-cash movements	**(30)**	(54)
Decrease in net debt in the year	**772**	1,205
Net debt at 1 April	**(948)**	(2,153)
Net debt at 31 March	**(176)**	(948)

11. Tangible fixed assets

	Land and buildings *(a)* £m	Plant and equipment £m	Assets in course of con-struction £m	Total £m
Group				
Cost				
Balances at 1 April 1996	2,763	27,586	1,001	31,350
Acquisitions of subsidiary undertakings	–	11	–	11
Additions	14	849	1,884	2,747
Transfers	99	1,774	(1,873)	–
Disposals and adjustments	(75)	(1,014)	(33)	(1,122)
Total cost at 31 March 1997	**2,801**	**29,206**	**979**	**32,986**
Depreciation				
Balances at 1 April 1996	1,258	13,708	–	14,966
Acquisitions of subsidiary undertakings	–	2	–	2
Charge for the year	109	2,156	–	2,265
Disposals and adjustments	(51)	(914)	–	(965)
Total depreciation at 31 March 1997	**1,316**	**14,952**	**–**	**16,268**
Net book value at 31 March 1997	1,485	14,254	979	16,718
Engineering stores	–	–	84	84
Total tangible fixed assets at 31 March 1997	**1,485**	**14,254**	**1,063**	**16,802**
Net book value at 31 March 1996	1,505	13,878	1,001	16,384
Engineering stores	–	–	112	112
Total tangible fixed assets at 31 March 1996	1,505	13,878	1,113	16,496

11. Tangible fixed assets (continued)	Land and buildings *(a)* £m	Plant and equipment £m	Assets in course of construction £m	Total £m
Company				
Cost				
Balances at 1 April 1996	776	26,046	806	27,628
Additions	6	537	1,795	2,338
Transfers	33	1,731	(1,764)	–
Other disposals and adjustments	(19)	(960)	(64)	(1,043)
Total cost at 31 March 1997	**796**	**27,354**	**773**	**28,923**
Depreciation				
Balances at 1 April 1996	369	13,056	–	13,425
Charge for the year	35	1,948	–	1,983
Other disposals and adjustments	(13)	(882)	–	(895)
Total depreciation at 31 March 1997	**391**	**14,122**	**–**	**14,513**
Net book value at 31 March 1997	**405**	**13,232**	**773**	**14,410**
Engineering stores	–	–	83	83
Total tangible fixed assets at 31 March 1997	**405**	**13,232**	**856**	**14,493**
Net book value at 31 March 1996	407	12,990	806	14,203
Engineering stores	–	–	110	110
Total tangible fixed assets at 31 March 1996	407	12,990	916	14,313

	Group		Company	
	1997 £m	1996 £m	**1997 £m**	1996 £m
(a) The net book value of land and buildings comprised:				
Freehold	**1,317**	1,255	**239**	218
Long leases (over 50 years unexpired)	**53**	101	**53**	60
Short leases	**115**	149	**113**	129
Total net book value of land and buildings	**1,485**	1,505	**405**	407

12. Fixed asset investments

	Interests in associated undertakings *(a) (b)*					
	Shares £m	Loans £m	Share of post acquisition profits £m	Other participating interests £m	Other investments *(c)* £m	Total £m
Group						
Cost						
Balances at 1 April 1996	3,011	18	114	117	67	3,327
Additions	149	13	–	72	99	333
Share of retained profits for the year	–	–	83	–	–	83
Repayments, disposals and other transfers	–	(11)	–	(49)	(2)	(62)
Currency movements	(60)	–	–	–	(9)	(69)
Balances at 31 March 1997	**3,100**	**20**	**197**	**140**	**155**	**3,612**
Provisions and amounts written off						
Balances at 1 April 1996	(2,263)	–	–	–	(7)	(2,270)
Goodwill	(48)	–	–	–	–	(48)
Decrease (increase) in the year	(22)	–	–	–	1	(21)
Balances at 31 March 1997	**(2,333)**	**–**	**–**	**–**	**(6)**	**(2,339)**
Net book value at 31 March 1997	**767**	**20**	**197**	**140**	**149**	**1,273**
Net book value at 31 March 1996	748	18	114	117	60	1,057

	Subsidiary undertakings *(a)*					
	Shares £m	Loans £m	Associated undertakings *(a)(b)* £m	Other participating interests £m	Other investments *(c)* £m	Total £m
Company						
Cost						
Balances at 1 April 1996	3,037	12	2,901	117	163	6,230
Additions	1,106	–	4	72	13	1,195
Repayments, disposals and other transfers	–	–	(2)	(49)	–	(51)
Currency movements	(3)	(1)	(180)	–	–	(184)
Balances at 31 March 1997	**4,140**	**11**	**2,723**	**140**	**176**	**7,190**
Provisions and amounts written off						
Balances at 1 April 1996	(226)	–	(27)	–	(152)	(405)
Increase in the year	(186)	–	–	–	(1)	(187)
Disposals and transfers	1	–	–	–	–	1
Balances at 31 March 1997	**(411)**	**–**	**(27)**	**–**	**(153)**	**(591)**
Net book value at 31 March 1997	**3,729**	**11**	**2,696**	**140**	**23**	**6,599**
Net book value at 31 March 1996	2,811	12	2,874	117	11	5,825

(a) Subsidiary and associated undertakings
Details of the principal operating subsidiary and associated undertakings are set out on pages 61 and 62.

12. Fixed asset investments (continued)

(b) MCI Communications Corporation

The group's most significant associated undertaking is MCI Communications Corporation (MCI), the second largest carrier of long-distance telecommunication services in the USA, in which it holds a 20% interest.

On 3 November 1996, the company entered into a merger agreement with MCI whereby the group will acquire the entire share capital of MCI, not already owned. On 15 April 1997, the company's shareholders approved the merger at an extraordinary general meeting, MCI shareholders having given their approval on 2 April 1997. Completion of the merger is subject to certain conditions, including the required regulatory approvals. The company expects to complete the merger in Autumn 1997 at which time the company will change its name to Concert plc. On completion MCI shareholders (other than the company, MCI or their respective subsidiaries and MCI shareholders who successfully exercise statutory dissenters' rights of appraisal) will be entitled to receive 5.4 ordinary shares of the company and $6 in cash for each MCI common share. MCI shareholders will not be entitled to the company's special dividend nor the final dividend for the year ended 31 March 1997. They will be entitled to the interim dividend for the year ending 31 March 1998 and all subsequent dividends provided the merger is completed before 31 March 1998. Up to 3,400 million ordinary shares of the company will be issued on completion of the merger and the cash consideration is expected to total a maximum of £2,300m, at $1.64 to £1, the rate ruling at 31 March 1997, with the final amounts being determined by the number of outstanding MCI shares at completion. The merger will be accounted for under the acquisition method of accounting.

During the year ended 31 March 1997, MCI made certain acquisitions of subsidiary and associated undertakings and the group's share of goodwill arising from these, amounting to £21m, has been written off to reserves under the group's accounting policies.

At 31 March 1997, the group's 20% share of the net assets of MCI, calculated in accordance with group accounting policies, amounted to £834m (1996 – £804m). This value comprised tangible fixed assets of £1,238m (1996 – £1,179m), intangible fixed assets of £115m (1996 – nil), fixed asset investments of £209m (1996 – £166m) and other assets of £677m (1996 – £657m), from which are deducted borrowings of £721m (1996 – £524m) and other liabilities of £684m (1996 – £674m). In the year ended 31 March 1997, the group's turnover with MCI amounted to £134m (1996 – £92m) and the group purchased £87m (1996 – £77m) in services and products from MCI.

The company's holding in MCI at 31 March 1997 comprised 136 million (1996 – 136 million) unlisted common shares and 0.7 million (1996 – 0.7 million) listed common shares. The listed common shares were purchased in the market in November 1995 at a cost of £12m and had a market value of £16m (1996 – £14m) at 31 March 1997.

(c) Other investments

Other investments include ordinary shares of the company, with a net book value of £20m (1996 – £9m) and a market value of £28m (1996 – £12m), held in trust for the Long Term Remuneration Plan and the Performance Share Plan (note 26). Also, in the group balance sheet at 31 March 1997, a listed investment was held with a book value of £72m and a market value of £61m.

(d) Subsidiary company acquisition

In February 1997, the company entered into an agreement to purchase from Banco Santander SA its 50% holding in the share capital of BT Telecomunicaciones SA, a joint venture between a wholly owned subsidiary of the company and Banco Santander SA, for the equivalent of £76m. The transaction is to be completed before the end of 1997.

(e) Other related party transactions with associates

In the year ended 31 March 1997, the group's turnover with its other associated undertakings amounted to £23m and the group purchased £30m in services and products from these undertakings.

13. Debtors

	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
Trade debtors	**1,757**	1,548	**1,552**	1,349
Amounts owed by subsidiary undertakings	**–**	–	**438**	414
Amounts owed by associated undertakings	**72**	29	**29**	–
Other debtors	**304**	217	**190**	118
Advance corporation tax recoverable *(a)*	**456**	–	**651**	–
Accrued income	**1,084**	1,135	**1,055**	1,095
Prepayments	**134**	153	**98**	122
Total debtors	**3,807**	3,082	**4,013**	3,098

	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
Total debtors included amounts receivable after more than one year:				
Amounts owed by subsidiary undertakings	**–**	–	**–**	32
Advance corporation tax recoverable *(a)*	**456**	–	**651**	–
Accrued income	**80**	65	**80**	65
Prepayments	**10**	22	**10**	22
Total	**546**	87	**741**	119

	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
(a) Advance corporation tax recoverable				
Advance corporation tax on special dividend and proposed final dividend	**752**	179	**752**	179
Amount offset against deferred tax provision *(note 17)*	**(296)**	(179)	**(101)**	(179)
Balance included within debtors	**456**	–	**651**	–

14. Current asset investments

	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
Listed investments	**115**	179	**16**	65
Other short-term deposits and investments	**2,859**	2,389	**2,893**	1,918
Total current asset investments	**2,974**	2,568	**2,909**	1,983
Market value of listed investments	**115**	179	**16**	65

15. Loans and other borrowings

	Average effective interest rates *(a)* %	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
US dollar 7⅝% guaranteed bonds 1996	5.6	**–**	164	**–**	–
US dollar 6½% guaranteed notes 1997	7.7	**230**	246	**–**	–
US dollar 9⅜% guaranteed bonds 1998	6.0	**153**	164	**–**	–
US dollar 8¾% guaranteed bonds 1999	8.8	**123**	131	**–**	–
US dollar 9⅜% guaranteed notes 1999	9.6	**184**	196	**–**	–
Zero coupon bonds 2000 (less unamortised discount £55m (1996 – £71m))	5.6	**145**	129	**145**	129
12¼% bonds 2003	12.3	**180**	180	**180**	180
7⅛% bonds 2003 (less unamortised discount £4m (1996 – £5m))	7.3	**496**	495	**496**	495
12¼% bonds 2006	12.3	**229**	229	**229**	229
US dollar 9⅝% guaranteed debentures 2019	9.8	**122**	130	**–**	–
8⅝% bonds 2020 (less unamortised discount £5m (1996 – £5m))	8.8	**295**	295	**295**	295
Total listed bonds, debentures and notes		**2,157**	2,359	**1,345**	1,328
Bonds held by HM Government (less unamortised increase in face value in 1996 of £42m) *(b)*	11.4	**–**	496	**–**	496
Lease finance		**2**	4	**2**	3
Bank loans due 1997-2009	9.0	**796**	765	**–**	–
Bank overdrafts and other short-term borrowings	5.8	**11**	13	**1,597**	144
Commercial paper	6.5	**210**	–	**210**	–
Loans from subsidiary undertakings		**–**	–	**2,655**	2,512
Total loans and other borrowings		**3,176**	3,637	**5,809**	4,483

Apart from the lease finance, all borrowings are unsecured. Lease finance is repayable by instalments.

15. Loans and other borrowings (continued)

	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
Repayments fall due as follows:				
Within one year, or on demand	**483**	315	**2,316**	607
Between one and two years	**338**	248	**331**	241
Between two and three years	**418**	359	**450**	342
Between three and four years	**–**	410	**774**	410
Between four and five years	**–**	165	**1**	742
After five years	**1,937**	2,140	**1,937**	2,141
Total due for repayment after more than one year	**2,693**	3,322	**3,493**	3,876
Total loans and other borrowings	**3,176**	3,637	**5,809**	4,483

(a) The average effective interest rates in the table on page 50 take into account the effect of interest rate swaps.

The interest basis of interest rate swap agreements used, the notional amounts, their average maturities and weighted average interest rates are shown below:

	Average maturity	Notional amount £m	Average interest receivable rate %	Average interest payable rate %
Pay fixed interest and receive variable interest	Over 5 years	837	6.2	9.5
Pay variable interest and receive fixed interest	Under 5 years	410	9.4	6.2

The rates of the variable rate portion of the swaps are based on LIBOR. In calculating the average variable rates, the latest rates agreed with the counterparty on each swap have been used. Changes in LIBOR interest rates will affect the variable-rate information disclosed above.

(b) The bonds held by HM Government were formerly a series of unsecured loan stock which was issued to the Secretary of State in 1984, each series of which was modified in 1992 to form a corresponding series of bonds, repayable at par. In July 1994, the six series, maturing on or after 31 March 1997 then outstanding, were converted into series of bonds with new higher face values and lower interest rates attaching to them. In August 1994, three series of bonds were repurchased by the company from HM Government and cancelled. The increase in the face value on the three series of bonds, that were converted but not repurchased in 1994, was being amortised over the lives of those bonds; at 31 March 1996, £42m remained to be amortised. In August 1996, two further series of bonds were repurchased by the company for £422m and cancelled and the final bond series with a face value of £140m was repaid on maturity on 31 March 1997. The premium of £60m paid on the repurchase, which included the remaining unamortised increase in face values, has been charged against the profit for the year ended 31 March 1997 (note 4).

16. Other creditors

	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
Trade creditors	**1,858**	1,732	**1,483**	1,455
Amounts owed to subsidiary undertakings	**–**	–	**898**	726
Amounts owed to associated undertakings	**46**	37	**–**	2
Corporation taxes	**1,774**	1,091	**1,503**	1,007
Other taxation and social security	**332**	354	**321**	359
Other creditors	**1,134**	853	**931**	701
Accrued expenses	**313**	282	**203**	168
Deferred income	**706**	710	**658**	685
Dividends *(a)*	**3,008**	715	**3,008**	715
Total other creditors	**9,171**	5,774	**9,005**	5,818
Total other creditors included amounts due after more than one year:				
Deferred income	**13**	28	**13**	28

(a) The 1997 figures include the special dividend of £2,244m.

17. Provisions for liabilities and charges

	Deferred taxation *(a)* £m	Pension provisions £m	Other provisions £m	Total £m
Group				
Balances at 1 April 1996	375	980	91	1,446
Charged (credited) against profit for the year:				
Regular pension cost	–	291	–	291
Redundancy charges	–	258	–	258
Other charges (credits)	(79)	–	27	(52)
Utilised in the year	–	(238)	(18)	(256)
	296	1,291	100	1,687
Advance corporation tax recoverable	(296)	–	–	(296)
Total provisions at 31 March 1997	**–**	**1,291**	**100**	**1,391**
Company				
Balances at 1 April 1996	200	980	49	1,229
Charged (credited) against profit for the year:				
Regular pension cost	–	281	–	281
Redundancy charges	–	258	–	258
Other charges (credits)	(99)	–	5	(94)
Utilised in the year	–	(228)	(4)	(232)
	101	1,291	50	1,442
Advance corporation tax recoverable	(101)	–	–	(101)
Total provisions at 31 March 1997	**–**	**1,291**	**50**	**1,341**

17. Provisions for liabilities and charges (continued)

(a) Deferred taxation

The elements of deferred taxation provided in the accounts at 31 March were as follows:	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
Tax effect of timing differences due to:				
Excess capital allowances	**763**	712	**669**	654
Pension provisions	**(426)**	(323)	**(426)**	(323)
Other	**(41)**	(14)	**(142)**	(131)
Total deferred taxation provided	**296**	375	**101**	200
Advance corporation tax recoverable	**(296)**	(179)	**(101)**	(179)
Total provision for deferred taxation	**–**	196	**–**	21

The total potential liability to deferred taxation at 31 March was as follows:

	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
Tax effect of timing differences due to:				
Excess capital allowances	**2,781**	2,700	**2,687**	2,642
Pension provisions	**(426)**	(323)	**(426)**	(323)
Other	**(41)**	(14)	**(142)**	(131)
Total	**2,314**	2,363	**2,119**	2,188
Advance corporation tax recoverable	**(752)**	(179)	**(752)**	(179)
Total potential liability for deferred taxation	**1,562**	2,184	**1,367**	2,009

18. Called up share capital

The authorised share capital of the company throughout the year ended 31 March 1997 was £2,625,000,001 divided into one special rights redeemable preference share of £1 and 10,500,000,000 ordinary shares of 25p each.

The allotted, called up and fully paid share capital of the company was £1,589m at 31 March 1997 (1996 – £1,573m), representing 6,355,115,816 ordinary shares (1996 – 6,291,457,275) and one special rights redeemable preference share (1996 – 1).

Certain special rights, set out in the company's articles of association, attach to the special rights redeemable preference share issued to HM Government. This share, which carries no right to capital or profits beyond its nominal value, is redeemable at par at the option of the shareholder.

Of the authorised but unissued share capital at 31 March 1997, 263 million ordinary shares were reserved to meet options granted under the employee share option schemes described in note 26.

Ordinary shares allotted during the year were as follows:

	Number	Nominal value £	Consideration £
Savings related schemes	60,730,180	15,182,545	150,812,817
Other share option schemes	2,928,361	732,090	9,251,305
Totals for the year ended 31 March 1997	**63,658,541**	**15,914,635**	**160,064,122**

19. Reserves

	Share premium account £m	Other reserves: Capital redemption reserve £m	Other reserves: Other reserves £m	Profit and loss account £m	Total £m
Group					
Balances at 1 April 1996	531	750	27	9,797	11,105
Premium on allotment of ordinary shares	144	–	–	–	144
Transfer from reserves for the financial year	–	–	–	(1,433)	(1,433)
Goodwill, on acquisition of subsidiary and associated undertakings, written off *(a)*	–	–	–	(199)	(199)
Goodwill, previously written off to reserves, taken back to profit and loss account *(a)*	–	–	–	5	5
Currency movements arising on consolidation of foreign subsidiary and associated undertakings *(b)*	–	–	–	(76)	(76)
Other movements	–	–	–	(19)	(19)
Balances at 31 March 1997	**675**	**750**	**27**	**8,075**	**9,527**
Company					
Balances at 1 April 1996	531	750	–	11,194	12,475
Premium on allotment of ordinary shares	144	–	–	–	144
Transfer from reserves for the financial year *(c)*	–	–	–	(2,035)	(2,035)
Currency movements arising on investments in subsidiary and associated undertakings *(b)*	–	–	–	(155)	(155)
Balances at 31 March 1997	**675**	**750**	**–**	**9,004**	**10,429**

(a) Aggregate goodwill in respect of acquisitions in the current and earlier years of £2,671m (1996 – £2,477m) has been written off against the group's reserves. The goodwill written off in the year mainly arose in connection with the acquisition of shares not already owned in BT Telecomunicaciones SA and the acquisition of Rijnhaave Groep BV.

(b) The currency movements for the group and the company included net gains, in respect of currency borrowings, of £29m.

(c) The profit for the financial year, dealt with in the profit and loss account of the company and after taking into account dividends from subsidiary undertakings, was £1,475m (1996 – £2,339m). As permitted by Section 230 of the Companies Act 1985, no profit and loss account of the company is presented.