CORE MOLDING TECHNOLOGIES INC
Form 4
September 02, 2015

FORM 4

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL

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(Print or Type Responses)

1. Name and Address of Reporting Person *
HELLMOLD RALPH O

(Last) (First) (Middle)

CORE MOLDING TECHNOLOGIES, INC., 800 MANOR PARK DRIVE

(Street)

COLUMBUS, OH 43228

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
CORE MOLDING TECHNOLOGIES INC [CMT]

3. Date of Earliest Transaction (Month/Day/Year)
08/31/2015

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director
_____ 10% Owner
_____ Officer (give title below)
_____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	08/31/2015		S		5,957	D	$ 21.9 (1)	10,604	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
								Date Exercisable	Expiration Date	Title	Amount or Number of Shares		
				Code	V	(A)	(D)						

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
HELLMOLD RALPH O CORE MOLDING TECHNOLOGIES, INC. 800 MANOR PARK DRIVE COLUMBUS, OH 43228	X			

Signatures

/s/ Michael Del Regno, as attorney-in-fact	09/02/2015
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) The price reported in Column 4 is a weighted average price. These shares were sold in multiple transactions at prices ranging from $21.85 to $21.95, inclusive. The reporting person undertakes to provide to Core Molding Technologies, Inc., any security holder of Core Molding Technologies, Inc., or the staff of the Securities and Exchange Commission, upon request, full information regarding the number of shares sold at each separate price within the ranges set forth in this footnote to this Form 4.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. td align="right" valign="bottom">360 19 22 **834** 653 270 107

Sir Anthony Greener

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M Alahuhta

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M van den Bergh

59 □ 59 □ □ □ **59** 55 □ □

C Brendish

50 □ 50 □ □ □ **50** 50 □ □

P Hodkinson

	8		8				**8**			
L R Hughes	38		38				**38**	21		
Baroness Jay	50		50				**50**	50		
J Nelson	52		52				**52**	50		
C G Symon	87		87				**87**	50		
	3,525	314	3,839	2,284	38	165	**6,326**	4,795		

[a]Balance or part of the pension allowance for the financial year 2005/06 see Pensions below. Retirement benefits are accruing to three directors under defined contribution arrangements and to three directors and one former director under defined benefit arrangements.
[b]Expenses allowance in the above table includes a monthly cash allowance in lieu of a company car equivalent to £18,500 received by Ian Livingston and Paul Reynolds.
Ben Verwaayen was entitled to an annual housing allowance of £250,000 until 13 January 2005. In the financial year 2004/05, £196,000 was paid in respect of that year.
[c]Other benefits includes some or all of the following: company car, fuel or driver, personal telecommunications facilities and home security, medical and dental cover for the director and immediate family, special life cover, professional subscriptions and personal tax planning and financial counselling. In addition, Paul Reynolds had an interest free loan see Loans below.
[d]Hanif Lalani joined the Board on 7 February 2005.
[e]Deferred annual bonuses payable in shares in three years time, subject to continued employment.
[f] Paul Reynolds sacrificed £225,000 of his total bonus of £360,000 and the company paid an equivalent amount into the BT Pension Scheme to provide him with additional benefits on a defined contribution basis.

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The annual salaries of the Chairman, Ben Verwaayen, Andy Green, Ian Livingston and Hanif Lalani remained unchanged during the financial year 2005/06. On 1 August 2005, the annual salary of Paul Reynolds was increased from £400,000 to £450,000. Following this year’s salary review, the Committee decided that there should be no general increase from 1 June 2006 in basic salaries, save that Ben Verwaayen’s annual salary will be increased from £700,000 to £750,000 and Hanif Lalani’s annual salary will be increased from £400,000 to £460,000, both on 1 June 2006.

A special retention arrangement was established for Hanif Lalani on 1 July 2004, when he was CFO, BT Wholesale, under which he will receive a lump sum cash payment of £150,000 on 30 June 2006, provided he is still an employee of the company on that date. The award will be forfeited without compensation if Mr Lalani resigns or his employment is terminated by the company with cause before that date.

Annual cash bonus awards in respect of the financial year 2005/06, which are not pensionable, to executive directors ranged from 80% to 112% of current salary (2005 – 38% to 64%).

Former directors

Sir Peter Bonfield received, under pre-existing arrangements, a pension of £352,153 payable in the financial year 2005/06 (2004/05 – £340,000).

Loans

Prior to the date of his appointment to the Board on 19 November 2001, Paul Reynolds had an interest-free loan of £300,000 from the company to assist with relocation. At 31 March 2006, he owed £200,000 (2005 – £230,000). During the financial year 2005/06, the maximum amount outstanding was £230,000. There are no outstanding loans granted by any member of the BT group to any other of the directors or guarantees provided by any member of the BT group for their benefit. The outstanding amount of a loan of £209,374 granted to a former director, Pierre Danon, was repaid during the year.

Pensions

Sir Christopher Bland is not a member of any of the company pension schemes, but the company matches his contributions, up to 10% of the earnings cap, to a personal pension plan. Company contributions of £10,560 were payable in respect of the financial year 2005/06. The earnings cap is a restriction on the amount of pay which can be used to calculate contributions and benefits due to a tax approved pension scheme.

Ben Verwaayen is not a member of any of the company pension schemes, but the company has agreed to pay an annual amount equal to 30% of his salary towards pension provision. The company paid £31,680 into his personal pension plan, the maximum permitted by HMRC, plus a cash payment of £178,320 representing the balance of the pension allowance for the financial year 2005/06. BT also provides him with a lump sum death in service benefit of four times his salary.

Ian Livingston is not a member of any of the company pension schemes, but the company has agreed to pay an annual amount equal to 30% of his salary towards pension provision. The company paid £21,120 into his personal pension plan, the maximum permitted by HMRC, plus a cash payment of £136,380 representing the balance of the pension allowance for the financial year 2005/06. BT also provides him with a lump sum death in service benefit of four times his salary.

Andy Green is a member of the BT Pension Scheme. From 31 December 1997 the company has been purchasing an additional 203 days of pensionable service each year to bring his pensionable service at age 60 up to 40 years. A two-thirds widow’s pension would be payable on his death.

Hanif Lalani is a member of the BT Pension Scheme. From 7 February 2005, the company has been purchasing an additional 27 days of pensionable service each year to bring his pensionable service at age 60 up to 40 years. A two-thirds widow’s pension would be payable on his death. He chose to opt out of future accrual of pensionable service from 1 April 2006 and, in its place, to receive a cash allowance of 30% of salary.

Paul Reynolds is a member of the BT Pension Scheme. From 1 July 1996 the company has been purchasing an additional 109 days of pensionable service each year to bring his pensionable service at age 60 up to 40 years. A two-thirds widow’s pension would be payable on his death. He chose to opt out of future accrual of pensionable service from 1 April 2006 and, in its place, to receive a cash allowance of 30% of salary.

The table below shows the increase in the accrued benefits, including those referred to above, to which each director, who is a member of the BT Pension Scheme, has become entitled during the year and the transfer value of the increase in accrued benefits:

	Accrued pension		Transfer value of accrued benefits		Change in transfer value c-d less directors contributions	Additional accrued benefits earned in the year	Transfer value of increase in accrued benefits less directors contributions
	2006 £000[a]	**2005 £000[b]**	**2006 £000[c]**	**2005 £000[d]**	**2006 £000**	**2006 £000[e]**	**2006 £000[f]**
A Green	**157**	131	**2,448**	1,848	**570**	**23**	**331**
H Lalani[h]	**112**	73	**1,144**	668	**452**	**38**	**362**
Dr. P Reynolds	**140**	123	**1,995**	1,578	**391**	**14**	**178**

[a-d]As required by the Companies Act 1985 Schedule 7A.
[a-b]These amounts represent the deferred pension to which the directors would have been entitled had they left the company on 31 March 2006 and 2005, respectively.
[c]Transfer value of the deferred pension in column (a) as at 31 March 2006 calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11. The transfer value represents a liability of the BT Pension Scheme rather than any remuneration due to the individual and cannot be meaningfully aggregated with annual remuneration, as it is not money the individual is entitled to receive.
[d]The equivalent transfer value but calculated as at 31 March 2005 on the assumption that the director left service at that date.
[e]The increase in pension built up during the year, net of inflation. The gross amount can be calculated by deducting the amount under column (b) from the amount under column (a).
[f] The transfer value of the pension in column (e), less directors contributions.
[g]Directors contributions in the financial year 2005/06 were as follows: Andy Green, £30,000.
(2005 £26,625); Hanif Lalani £24,000 (2005 £16,300) and Paul Reynolds, £26,000 (2005 £24,000).
[h]Hanif Lalani joined the Board on 7 February 2005.

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Share options held at 31 March 2006

	Number of shares under option						
	1 April 2005	**Granted**	**Lapsed**	**31 March 2006**	**Option price per share**	**Usual date from which exercisable**	**Usual expiry date**
Sir Christopher Bland	314,244[a]			**314,244**	318p	01/05/2004	01/05/2011
B Verwaayen	1,121,121[b]			**1,121,121**	250p	01/04/2005	11/02/2012
	935,830[c]			**935,830**	187p	29/07/2005	29/07/2012
	1,052,632[d]			**1,052,632**	199.5p	24/06/2006	24/06/2013
	546,875[e]			**546,875**	192p	24/06/2007	24/06/2014
	3,656,458			**3,656,458**			
A Green	568,190[c]			**568,190**	187p	29/07/2005	29/07/2012
	639,098[d]			**639,098**	199.5p	24/06/2006	24/06/2013
	332,032[e]			**332,032**	192p	24/06/2007	24/06/2014
	5,712[f]			**5,712**	165p	14/08/2007	13/02/2008
	1,545,032			**1,545,032**			
H Lalani	177,810[c]			**177,810**	187p	29/07/2005	29/07/2012
	210,527[d]			**210,527**	199.5p	24/06/2006	24/06/2013
	156,250[e]			**156,250**	192p	24/06/2007	24/06/2014
	5,346[g]			**5,346**	173p	14/08/2006	13/02/2007
	105,264[h]			**105,264**	199.5p	24/06/2004	24/06/2013
	655,197			**655,197**			
I Livingston	601,610[c]			**601,610**	187p	29/07/2005	29/07/2012
	676,692[d]			**676,692**	199.5p	24/06/2006	24/06/2013
	351,563[e]			**351,563**	192p	24/06/2007	24/06/2014
	7,290[i]			**7,290**	227p	14/08/2007	13/02/2008
	1,637,155			**1,637,155**			
Dr P Reynolds	534,760[c]			**534,760**	187p	29/07/2005	29/07/2012
	601,504[d]			**601,504**	199.5p	24/06/2006	24/06/2013
	312,500[e]			**312,500**	192p	24/06/2007	24/06/2014
	4,555[j]			**4,555**	218p	14/02/2007	13/08/2007
	1,453,319			**1,453,319**			
Total	9,261,405			**9,261,405**			

All of the above options were granted for nil consideration. No options were exercised during the year.
[a]Options granted under the GSOP on 22 June 2001. The option is not subject to a performance measure. It was a term of Sir Christopher Blands initial service contract that (i) he purchased BT shares to the value of at least £1 million; and (ii) as soon as

practicable after the purchase of the shares (invested shares), the company would grant a share option over shares to the value of at least £1 million. Sir Christopher Bland was the legal and beneficial owner of the invested shares on 1 May 2004, so the option became exercisable on that date.

[b] Option granted under the GSOP on 11 February 2002. The exercise of the option is subject to a performance measure being met. The performance measure is relative TSR compared with the FTSE 100 as at 1 April 2002. BTs TSR must be in the upper quartile for all of the option to become exercisable. At median, 40% of the option will be exercisable. Below that point, none of the option may be exercised. On 31 March 2005, BTs TSR was at 74th position against the FTSE 100 and on 31 March 2006, BTs TSR was at 73rd position against the FTSE 100. As a result, the option did not become exercisable. The TSR will be re-tested against a fixed base on 31 March 2007.

[c] Options granted under the GSOP on 29 July 2002. The exercise of options is subject to a performance measure being met. The performance measure is relative TSR compared with the FTSE 100 as at 1 April 2002. BTs TSR must be in the upper quartile for all of the options to become exercisable. At median, 30% of the options will be exercisable. Below that point, none of the options may be exercised. On 31 March 2005, BTs TSR was at 74th position against the FTSE 100 and on 31 March 2006, BTs TSR was at 73rd position against the FTSE 100. As a result, the options did not become exercisable. The TSR will be re-tested against a fixed base on 31 March 2007.

[d] Options granted under the GSOP on 24 June 2003. The exercise of options is subject to a performance measure being met. The performance measure is relative TSR compared with the FTSE 100 as at 1 April 2003. BTs TSR must be in the upper quartile for all of the options to become exercisable. At median, 30% of the options will be exercisable. Below that point, none of the options may be exercised. On 31 March 2006, BTs TSR was at 85th position against the FTSE 100. As a result, the options did not become exercisable. The TSR will be re-tested against a fixed base on 31 March 2008.

[e] Options granted under the GSOP on 24 June 2004. The exercise of options is subject to a performance measure being met. The performance measure is relative TSR compared with a group of companies from the European Telecom Sector as at 1 April 2004. BTs TSR must be in the upper quartile for all the options to become exercisable. At median 30% of the options will be exercisable. Below that point none of the options may be exercised.

[f] Option granted on 25 June 2004 under the Employee Sharesave Scheme, in which all employees of the company are eligible to participate.

[g] Option granted on 27 June 2003 under the Employee Sharesave Scheme, in which all employees of the company are eligible to participate.

[h] Option granted under the GSOP (Special Incentive Award) on 24 June 2003, prior to Mr Lalanis appointment as a director. This option is not subject to a performance measure as the grant was linked to personal performance.

[i] Option granted on 25 June 2002 under the Employee Sharesave Scheme, in which all employees of the company are eligible to participate.

[j] Option granted on 21 December 2001 under the Employee Sharesave Scheme, in which all employees of the company are eligible to participate.

The market price of a share at 31 March 2006 was 222p (2005 205.5p) and the range during the financial year 2005/06 was 196.5p 235p.

From 31 March 2006, two thirds of Hanif Lalanis option granted on 24 June 2003 was exercisable giving an unrealised gain as at that date of £15,790. There were no further unrealised gains on the above share options at 31 March 2006 (2005 £2,105), based on the market price of the shares on 31 March 2006.

Explanation of Responses:

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Share awards under long-term incentive plans held at 31 March 2006

Details of the company's ordinary shares provisionally awarded to directors, as participants under the ISP and RSP are as follows:

	1 April 2005	Awarded[a]	Dividends re-invested	Vested[e]	Lapsed	Total number of award shares 31 March 2006	Expected vested date	Price on grant	Market price at vesting	Monetary value of vested award £000
Sir Christopher Bland										
RSP 2003	299,753	–	15,032	–	–	**314,785**	2007[f]	182p		
B Verwaayen										
ISP 2004	252,798	–	12,677	–	–	**265,475**	31/03/07	193.42p		
ISP 2005	–	307,354	15,413	–	–	**322,767**	31/03/08	227.75p		
A Green										
ISP 2004	153,484	–	7,696	–	–	**161,180**	31/03/07	193.42p		
ISP 2005	–	219,538	11,008	–	–	**230,546**	31/03/08	227.75p		
H Lalani										
ISP 2004	72,224	–	3,621	–	–	**75,845**	31/03/07	193.42p		
ISP 2005	–	175,631	8,807	–	–	**184,438**	31/03/08	227.75p		
I Livingston										
ISP 2004	162,512	–	8,149	–	–	**170,661**	31/03/07	193.42p		
ISP 2005	–	230,515	11,559	–	–	**242,074**	31/03/08	227.75p		
RSP 2002[b]	183,698	–	–	183,698	–	–	20/05/05	273.5p	212.25p	390
RSP 2002[c]	123,307	–	–	123,307	–	–	20/05/05	202.0p	212.25p	262
RSP 2005[d]	–	511,169	25,634	–	–	**536,803**	09/11/07	213.25p		
Dr P Reynolds										
ISP 2004	144,456	–	7,244	–	–	**151,700**	31/03/07	193.42p		
ISP 2005	–	175,631	8,807	–	–	**184,438**	31/03/08	227.75p		

The number of shares subject to awards granted during the financial year 2005/06 was calculated using the average middle market price of a BT share for the three days prior to the grant.

[a] Awards under the ISP were granted on 3 August 2005. The awards will vest, subject to meeting a performance target, on 31 March 2008. The performance target is relative TSR compared with a group of companies from the European Telecom Sector. BT's TSR must be in the upper quartile for all of the awards to vest. At median, 25% of the shares will vest. Below that point, none of the shares will vest.

[b] In accordance with his service agreement, an award of 493,601 shares with an initial value of £1,350,000 was granted on 30 May 2002 to Ian Livingston under the RSP. This award vested in three equal tranches on the first three anniversaries of his joining BT.

[c] Ian Livingston purchased BT shares with a value of £300,000 on 20 May 2002 and was granted an award on that date under the RSP with a value of £300,000, which vested on the third anniversary of the date of purchase of his purchased shares.

[d] Ian Livingston was granted an award under the RSP on 31 May 2005. The award will vest in two tranches, 50% on 10 November 2006 and 50% on 9 November 2007.

[e] Vesting of RSP awards is not subject to a performance target being met.

[f] The award under the RSP granted to Sir Christopher Bland on 1 September 2003 will vest, subject to continued employment, at the conclusion of the 2007 AGM.

Vesting of outstanding share awards and options

Details of options granted under the GSOP in the financial years 2002/03 and 2003/04, which would vest based on BT Group’s TSR compared with the other companies in the FTSE 100 for the relevant performance periods up to 31 March 2006, and details of options granted under the GSOP in the financial year 2004/05 and awards of shares under the ISP in the financial years 2004/05 and 2005/06, which would vest based on BT Group’s TSR compared with a group of companies from the European Telecom Sector for the relevant performance periods up to 31 March 2006, are as follows:

		31 March 2006		31 March 2005	
	Expected vesting date	TSR position	Percentage of shares vesting	TSR position	Percentage of shares vesting
GSOP 2002[a]	29/07/05	**73**	–	74	–
GSOP 2003	24/06/06	**85**	–	84	–
GSOP 2004	24/06/07	**9**	**44%**	11	–
ISP 2004	31/03/07	**9**	**40%**	11	–
ISP 2005	31/03/08	**8**	**55%**	–	–

[a] The options are not exercisable because the performance target has not been met, see note c to the table on page 59.

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Deferred Bonus Plan awards at 31 March 2006

The following deferred bonuses have been awarded to the directors under the Deferred Bonus Plan. These shares will normally be transferred to participants at the end of the three-year deferred period if those participants are still employed by BT Group.

	1 April 2005	Awarded[a]	Vested[b]	Dividends re-invested	Lapsed	Total number of award shares 31 March 2006	Expected vesting date	Price at grant	Market price at vesting	Monetary value of vested award £000
B Verwaayen	84,009	–	84,009	–	–	–	–	202.0p	225.5p	189
	464,390	–	–	23,289	–	**487,679**	01/08/06	199.5p	–	–
	232,625	–	–	11,665	–	**244,290**	01/08/07	193.42p	–	–
	–	98,461	–	4,937	–	**103,398**	01/08/08	227.75p	–	–
A Green	55,268	–	55,268	–	–	–	–	202.0p	225.5p	125
	83,799	–	–	4,202	–	**88,001**	01/08/06	199.5p	–	–
	91,087	–	–	4,567	–	**95,654**	01/08/07	193.42p	–	–
	–	44,731	–	2,243	–	**46,974**	01/08/08	227.75p	–	–
H Lalani	12,985	–	12,985	–	–	–	–	202.0p	225.5p	29
	26,396	–	–	1,322	–	**27,718**	01/08/06	199.5p	–	–
	27,339	–	–	1,370	–	**28,709**	01/08/07	193.42p	–	–
	–	29,957	–	1,502	–	**31,459**	01/08/08	227.75p	–	–
I Livingston	92,291	–	–	4,627	–	**96,918**	01/08/06	199.5p	–	–
	87,967	–	–	4,411	–	**92,378**	01/08/07	193.42p	–	–
	–	43,440	–	2,177	–	**45,617**	01/08/08	227.75p	–	–
Dr P Reynolds	49,740	–	49,740	–	–	–	–	202.0p	225.5p	112
	78,868	–	–	3,954	–	**82,822**	01/08/06	199.5p	–	–
	79,985	–	–	4,010	–	**83,995**	01/08/07	193.42p	–	–
	–	46,774	–	2,345	–	**49,119**	01/08/08	227.75p	–	–

The number of shares subject to awards granted during the financial year 2005/06 was calculated using the average middle market price of a BT share for the three days prior to the grant.

[a] Awards granted on 3 August 2005 in respect of the financial year 2004/05.

[b] Awards granted on 24 June 2002 vested on 1 August 2005.

Details of deferred bonus awards in respect of the financial year 2005/06 are given in the table on page 57. Awards in respect of the deferred bonuses will be granted in June 2006. The number of shares subject to the awards will be calculated using the average middle market price of a BT share for the three days prior to the grant.

Share awards under the Employee Share Investment Plan (ESIP) at 31 March 2006

	1 April 2005	Awarded	Vested	Total number of award shares 31 March 2006	Expected vesting date
Sir Christopher Bland ESIP 2003	186	–	–	**186**	05/08/08

	1 April 2005	Awarded	Vested	Total number of award shares 31 March 2006	Expected vesting date
ESIP 2004	116	—	—	**116**	04/08/09
ESIP 2005	—	56[a]	—	**56**	27/06/10
	302	56		**358**	
A Green					
ESIP 2002	130	—	—	**130**	14/08/07
ESIP 2003	186	—	—	**186**	05/08/08
ESIP 2004	116	—	—	**116**	04/08/09
ESIP 2005	—	56[a]	—	**56**	27/06/10
	432	56	—	**488**	
H Lalani					
ESIP 2002	130	—	—	**130**	14/08/07
ESIP 2003	186	—	—	**186**	05/08/08
ESIP 2004	116	—	—	**116**	04/08/09
ESIP 2005	—	56[a]	—	**56**	27/06/10
	432	56	—	**488**	
I Livingston					
ESIP 2004	116	—	—	**116**	04/08/09
ESIP 2005	—	56[a]	—	**56**	27/06/10
	116	56	—	**172**	
P Reynolds					
ESIP 2002	130	—	—	**130**	14/08/07
ESIP 2003	186	—	—	**186**	05/08/08
ESIP 2004	116	—	—	**116**	04/08/09
ESIP 2005	—	56[a]	—	**56**	27/06/10
	432	56	—	**488**	

[a]Awards granted on 27 June 2005. On that date, the market price of a BT share was 220p.

Operating Committee

The one member of the Operating Committee (OC) who was not a member of the Board, left the company on 30 September 2005. The remuneration of that OC member for the financial year 2005/06 was £148,000 (2004/05 — £296,000), together with pension contributions of £17,000 (2004/05 — £34,000). No options or awards under the BT Group plans were granted to the OC member during the financial year 2005/06. The company met its contractual obligations in connection with the leaving arrangements and a number of outstanding options and share awards of the OC member were preserved under the terms of the relevant plans.

By order of the Board

Sir Anthony Greener
Deputy Chairman and Chairman of Remuneration Committee 17 May 2006

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STATEMENT OF DIRECTORS RESPONSIBILITY

for preparing the financial statements

The directors are responsible for preparing the groups financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union (EU), and for preparing the parent company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

The directors are responsible for preparing financial statements for each financial year which give a true and fair view, in accordance with IFRS as adopted by the EU, of the state of affairs of the group and of the profit or loss of the group and a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice (UK GAAP), of the state of affairs of the company and of the profit or loss of the company for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether the group financial statements comply with IFRS as adopted by the EU, and with regard to the parent company financial statements whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the group financial statements on the going concern basis unless it is inappropriate to presume that the group will continue in business.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and the group and to enable them to ensure that the group financial statements comply with the Companies Act 1985 and Article 4 of the IAS Regulation and the parent company financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the groups website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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REPORT OF THE INDEPENDENT AUDITORS

UNITED KINGDOM OPINION

Independent auditors report to the members of BT Group plc
We have audited the group financial statements of BT Group plc for the year ended 31 March 2006 which comprise the group income statement, the group balance sheet, the group cash flow statement, the group statement of recognised income and expense, accounting policies and the related notes. These group financial statements are set out on pages 65 to 122. These group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of BT Group plc for the year ended 31 March 2006 and on the information in the Report on directors remuneration that is described as having been audited. This separate report is set out on page 123.

Respective responsibilities of directors and auditors
The directors responsibilities for preparing the annual report and the group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU) are set out in the statement of directors responsibilities.

Our responsibility is to audit the group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the companys members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the group financial statements give a true and fair view and whether the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We report to you whether in our opinion the information given in the Report of the directors is consistent with the group financial statements. The information given in the directors report includes that specific information presented in the operating and financial review that is cross referred from the Report of the directors. We also report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors remuneration and other transactions is not disclosed.

We review whether the corporate governance statement reflects the companys compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the boards statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the groups corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited group financial statements. The other information comprises only the Financial headlines, Chairmans message, Chief Executives statement, the Operating and financial review, the Report of the directors, the Report of the audit committee, the Report of the nominating committee and the unaudited part of the Report on directors remuneration. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the group financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the group financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the group financial statements, and of whether the accounting policies are appropriate to the groups 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 group 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 group financial statements.

Opinion

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the groups affairs as at 31 March 2006 and of its profit and cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Report of the directors is consistent with the group financial statements.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
London
17 May 2006

UNITED STATES OPINION

Report of Independent Registered Public Accounting Firm to the board of directors and shareholders of BT Group plc

In our opinion, the accompanying group balance sheets and the related group statements of income, of cash flows and of statements of recognised income and expenses present fairly, in all material respects, the financial position of BT Group plc and its subsidiaries at 31 March 2006 and 2005, and the results of their operations and their cash flows for each of the two years in the period ended 31 March 2006, in conformity with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). These financial statements are the responsibility of the groups management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States), which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in the accounting policies section to the financial statements, the group has adopted prospectively from 1 April 2005 International Accounting Standards (IAS) 32 Financial Instruments: Disclosure and Presentation and IAS 39 Financial Instruments: Recognition and Measurement in accordance with IFRS as adopted by the EU.

IFRS, as adopted by the EU, vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in the United States Generally Accepted Accounting Principles note within the notes to the consolidated financial statements (note 35).

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
London
17 May 2006

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CONSOLIDATED FINANCIAL STATEMENTS

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ACCOUNTING POLICIES

(I) BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

These group financial statements have been prepared in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). For BT there are no differences between IFRS as adopted for use in the EU and full IFRS as published by the International Accounting Standards Board (IASB). The financial statements have been prepared under the historical cost convention, modified for the revaluation of certain financial assets and liabilities at fair value.

Where there are significant differences to US GAAP, these have been described in note 35.

IFRS 1, 'First-time Adoption of International Financial Reporting Standards', has been applied in preparing these group financial statements. These are the group's first financial statements to be prepared in accordance with IFRS; note 34 describes how the directors have applied the first-time adoption provisions as set out in IFRS 1.

The policies set out below have been consistently applied to all the years presented with the exception of those relating to financial instruments under IAS 32, 'Financial Instruments: Disclosure and Presentation' and IAS 39, 'Financial Instruments: Recognition and Measurement', which have been applied with effect from 1 April 2005.

The preparation of financial statements in conformity with IFRS requires the use of accounting estimates. It also requires management to exercise its judgement in the process of applying the group's accounting policies. The areas involving a higher degree of judgement or complexity or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed below in 'Critical accounting estimates and key judgements'.

The group's income statement and segmental analysis separately identifies material one-off or unusual items (termed 'specific items'). This is in accordance with IAS 1, 'Presentation of Financial Statements' and is consistent with the way that financial performance is measured by management and assists in providing a meaningful analysis of the trading results of the group. Specific items may not be comparable to similarly titled measures used by other companies. Items which have been considered material one-off or unusual in nature include disposals of businesses and investments, business restructuring and property rationalisation programmes. The directors intend to follow such a presentation on a consistent basis in the future. Specific items for the current and prior year are disclosed in note 4.

Accounting policies in respect of the parent company information for BT Group plc are set out on page 124. These are in accordance with UK GAAP.

(II) BASIS OF CONSOLIDATION

The group financial statements consolidate the financial statements of BT Group plc ('the company') and entities controlled by the company (its subsidiaries) and incorporate its share of the results of jointly controlled entities (joint ventures) and associates using the equity method of accounting.

The results of subsidiaries acquired or disposed of during the year are consolidated from the effective date of acquisition or up to the effective date of disposal, as appropriate. Where necessary, adjustments are made to the financial statements of subsidiaries, associates and joint ventures to bring the accounting policies used into line with those used by the group. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Investments in associates and joint ventures are carried at cost plus post-acquisition changes in the group's share of the net assets or liabilities of the associate or joint venture, less any impairment in value in individual investments. The income statement reflects the group's share of the results of operations after tax of the associate or joint venture using the equity method of accounting.

The group's principal operating subsidiaries and associate are detailed on page 127.

(III) REVENUE

Revenue represents the fair value of the consideration received or receivable for services provided and equipment sales, net of discounts and sales taxes. Revenue from the sale of equipment and rendering of services is recognised when it is probable that the economic benefits associated with a transaction will flow to the group, and the amount of revenue, and the associated costs incurred, or to be incurred, can be measured reliably. Where the group acts as agent in a transaction amounts collected on behalf of the principal are excluded from revenue.

Revenue arising from separable installation and connection activities is recognised when it is earned, upon activation. Revenue from the rental of analogue and digital lines and private circuits is recognised evenly over the period to which the charges relate. Revenue from calls is recognised at the time the call is made over the group's networks.

Subscription fees, consisting primarily of monthly charges for access to broadband and other internet access or voice services, are recognised as revenue over the associated subscription period. Revenue arising from the interconnection of voice and data traffic between other telecommunications operators is recognised at the time of transit across the group's network.

Sales of peripheral and other equipment are recognised when all of the significant risks and rewards of ownership are transferred to the buyer, which is normally the date the equipment is delivered and accepted by the customer.

Revenue and costs from long term contractual arrangements are recognised based on the percentage of completion method. The stage of completion is estimated using an appropriate measure according to the nature of the contract. For fixed price contracts, revenue and costs are recognised on the proportional performance basis. For milestone based contracts, revenue and costs are recognised at the time a milestone is achieved and accepted by the customer. In the case of time and materials contracts, revenue and costs are recognised as the service is rendered. An element of the costs incurred in the initial phase of contracts may be deferred when they relate directly to the specific contract, relate to future activity of the contract and will generate future economic benefits.

The percentage of completion method relies on estimates of total expected contract revenues and costs, as well as reliable measurement of the progress made towards completion. Unless the financial outcome of a contract can be estimated with reasonable certainty, no attributable profit is recognised. Recognised revenue and profits are subject to revisions during the contract in the event that the assumptions regarding the overall contract outcome are changed. The cumulative impact of a revision in estimates is recorded in the period in which such revisions become likely and can be estimated. Where the actual and estimated costs to completion exceed the estimated revenue for a contract, the full contract life loss is immediately recognised.

Where a contractual arrangement consists of two or more separate elements that have value to the customer on a standalone basis, revenue is recognised for each element as if it

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were an individual contract. The total contract consideration is allocated between the separate elements on the basis of fair value and the appropriate revenue recognition criteria applied to each element as described above.

(IV) LEASES

Leases of property, plant and equipment where the group holds substantially all the risks and rewards of ownership are classified as finance leases.

Finance lease assets are capitalised at the commencement of the lease at the lower of the present value of the minimum lease payments or the fair value of the leased asset. The obligations relating to finance leases, net of finance charges in respect of future periods, are recognised as liabilities. Leases are subsequently measured at amortised cost using the effective interest method. If a sale and leaseback transaction results in a finance lease, any excess of sale proceeds over the carrying amount is deferred and recognised in the income statement over the lease term.

Leases where a significant portion of the risks and rewards are held by the lessor are classified as operating leases. Rentals are charged to the income statement on a straight line basis over the period of the lease. If a sale and leaseback transaction results in an operating lease, any profit or loss is recognised in the income statement immediately.

(V) FOREIGN CURRENCIES

Items included in the financial statements of each of the group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in sterling, the functional and presentation currency of the group.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement in the line which most appropriately reflects the nature of the item or transaction. However, where monetary items form part of the net investment in a foreign operation or are designated as hedges of a net investment, or from 1 April 2005, as cash flow hedges, such exchange differences are initially recognised in equity.

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 (unless this average is not a reasonable approximation of the cumulative effects of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions). Foreign exchange differences arising on retranslation are recognised directly in a separate component of equity, the translation reserve. At the date of transition to IFRS, the cumulative translation differences for foreign operations have been set to zero.

In the event of the disposal of an undertaking with assets and liabilities denominated in foreign currency, the cumulative translation difference associated with the undertaking in the translation reserve is charged or credited to the gain or loss on disposal.

(VI) BUSINESS COMBINATIONS AND GOODWILL

The purchase method of accounting is used to account for the acquisition of subsidiaries. On transition to IFRS, the group has elected not to apply IFRS 3, "Business Combinations" retrospectively to acquisitions that occurred before 1 April 2004. Goodwill arising on the acquisition of a business which occurred between 1 January 1998 and 1 April 2004 is included in the balance sheet at original cost, less accumulated amortisation to the date of transition and any provisions for impairment. Goodwill arising on the acquisition of a business which occurred prior to 1 January 1998 was written off directly to retained earnings. From the date of transition, goodwill is not amortised but is tested for impairment annually, or more frequently if events and circumstances indicate that goodwill might be impaired.

On the acquisition of a subsidiary undertaking, joint venture or associate, from the transition date, fair values are attributed to the acquired identifiable tangible and intangible assets, liabilities and contingent liabilities. Goodwill, which is capitalised, represents the difference between the fair value of purchase consideration and the acquired interest in the fair values of those net assets. Any negative goodwill is credited to the income statement in the year of acquisition. Gains and losses on disposal of an entity include the carrying amount of goodwill relating to the entity or investment sold. Goodwill previously written off to retained earnings is not recycled to the income statement on disposal of an undertaking.

(VII) OTHER INTANGIBLE ASSETS

Other intangible assets include licence fees, trademarks, brands, customer relationships, licences, development costs and computer software.

When intangible assets are acquired in a business combination, their cost is generally based on fair market values.

Costs directly associated with the development of computer software for internal use are capitalised where technical feasibility can be demonstrated, the group is satisfied that future economic benefits will flow to the group and the cost can be separately identified and reliably measured.

Intangible assets are amortised on a straight line basis at rates sufficient to write off the cost, less any estimated residual value, over their estimated useful lives.

Licence fees paid to governments, which permit telecommunication activities to be operated for defined periods, are amortised from the time the network is available for use to the end of the licence period on a straight line basis. Subscriber acquisition costs are expensed as incurred, unless they meet the criteria for capitalisation, in which case the costs are capitalised and amortised over the shorter of the estimated customer life or contractual period.

The estimated useful lives assigned to the principal categories of intangible assets are as follows:

Telecommunication licences	1 to 5 years
Brands, customer lists and customer relationships	3 to 15 years
Computer software	2 to 5 years

(VIII) RESEARCH AND DEVELOPMENT

Research expenditure is recognised in the income statement in the year in which it is incurred.

Development expenditure, including internally developed software, is recognised in the income statement in the year in which it is incurred unless it is probable that economic benefits will flow to the group from the asset being developed, the cost of the asset can be reliably measured and technical feasibility

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can be demonstrated. When the recognition criteria are met, intangible assets are capitalised and amortised on a straight line basis over their estimated useful lives from the time the assets are available for use.

(IX) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is included in the balance sheet at historic cost, less accumulated depreciation and any provisions for impairment.

Cost

Included within the cost for network assets are direct labour, contractors charges, materials, payments on account and directly attributable overheads.

Depreciation

Depreciation is provided on property, plant and equipment on a straight line basis from the time the assets 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 principal categories of assets are as follows:

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
Exchange equipment	2 to 13 years
Computers and office equipment	3 to 6 years
Payphones, other network equipment, motor vehicles and cableships	2 to 20 years

Assets held under finance leases are depreciated over the shorter of the lease term or their useful economic life.
Residual values and useful lives are re-assessed annually and if necessary changes are recognised prospectively.

(X) ASSET IMPAIRMENT (NON-FINANCIAL ASSETS)

Intangible assets with finite useful lives and property, plant and equipment are tested for impairment if events or changes in circumstances (assessed at each reporting date) indicate that the carrying amount may not be recoverable. When an impairment test is conducted, the recoverable amount is assessed by reference to the higher of the net present value of expected future cash flows (value in use) of the relevant cash generating unit and the fair value less cost to sell.

Goodwill and other intangible fixed assets with an indefinite useful life are tested for impairment at least annually.

If a cash generating unit is impaired, provision is made to reduce the carrying amount of the related assets to their estimated recoverable amount. Impairment losses are allocated firstly against goodwill, and secondly on a pro rata basis against intangible and other assets.

Where an impairment loss is recognised against an asset it may be reversed in future periods where there has been a change in the estimates used to determine the recoverable amount since the last impairment loss was recognised, except in respect of impairment of goodwill which may not be reversed in any circumstances.

(XI) INVENTORY

Inventory mainly comprises items of equipment, held for sale or rental, and consumable items.

Equipment held and consumable items are stated at the lower of cost and estimated net realisable value, after provisions for obsolescence. Cost is calculated on a first-in-first-out basis.

(XII) TERMINATION BENEFITS

Termination benefits are payable when employment is terminated before the normal retirement date, or when an employee accepts voluntary redundancy in exchange for these benefits. The group recognises termination benefits when it is demonstrably committed to the employees leaving the group.

(XIII) POST RETIREMENT BENEFITS

The group operates a funded defined benefit pension scheme, which is administered by an independent trustee, for the majority of its employees.

The group's net obligation in respect of defined benefit pension schemes is calculated separately for each scheme by estimating the amount of future benefit that employees have earned in return for their service to date. That benefit is discounted to determine its present value, and the fair value of any plan assets is deducted. The discount rate used is the yield at the balance sheet date on AA credit rated bonds that have maturity dates approximating the terms of the group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method. The net obligation recognised in the balance sheet is the present value of the defined benefit obligation less the fair value of the scheme assets.

The income statement charge is split between an operating charge and a net finance charge. The operating charge reflects the service costs which are spread systematically over the working lives of the employees. The net finance charge relates to the unwinding of the discount applied to the liabilities of the scheme offset by the expected return on the assets of the scheme, based on conditions prevailing at the start of the year.

Actuarial gains and losses are recognised in full in the period in which they occur and are presented in the statement of recognised income and expense.

Actuarial valuations of the main defined benefit scheme are carried out by an independent actuary as determined by the trustees at intervals of not more than three years, to determine the rates of contribution payable. The pension cost is determined on the advice of the group's actuary, having regard to the results of these valuations. In any intervening years, the actuaries review the continuing appropriateness of the contribution rates.

The group also operates defined contribution pension schemes and the income statement is charged with the contributions payable.

(XIV) SHARE BASED PAYMENTS

The group has a number of employee share schemes and share option plans under which it makes equity settled share based payments to certain employees. The fair value of options granted is recognised as an employee expense after taking into account the company's best estimate of the number of awards expected to vest allowing for non market and service conditions. Fair value is measured at the date of grant and is spread over the vesting period of the award. The fair value of options granted is measured using either the Binomial or Monte Carlo model, whichever is most appropriate to the award. Any proceeds received are credited to share capital and share

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premium when the options are exercised. The group has applied IFRS 2 Share based payment retrospectively to all options granted after 7 November 2002 and not fully vested at 1 January 2005.

(XV) TAXATION

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is recognised, using the liability method, in respect of temporary differences between the carrying amount of the groups assets and liabilities and their tax base.

Deferred tax liabilities are offset against deferred tax assets within the same taxable entity or qualifying local tax group. Any remaining deferred tax asset is recognised only when, on the basis of all available evidence, it can be regarded as probable that there will be suitable taxable profits, within the same jurisdiction, in the foreseeable future against which the deductible temporary difference can be utilised.

Deferred tax is determined using tax rates that are expected to apply in the periods in which the asset is realised or liability settled, based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Current and deferred tax are recognised in the income statement, except when the tax relates to items charged or credited directly in equity, in which case the tax is also recognised in equity.

(XVI) DIVIDENDS

Final dividends are recognised as a liability in the year in which they are declared and approved by the company in general meeting. Interim dividends are recognised when they are paid.

(XVII) PROVISIONS

Provisions are recognised when the group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are discounted to present value where the effect is material.

(XVIII) SHARE CAPITAL

Ordinary shares are classified as equity. Shares held in the parent company, BT Group plc, by employee share ownership trusts and repurchased shares are recorded in the balance sheet as a deduction from shareholders equity at cost.

(XIX) FINANCIAL INSTRUMENTS (TO 31 MARCH 2005)

The accounting policies adopted in respect of financial instruments in periods up to, and including 31 March 2005, are set out below. However, to provide comparability, certain classification principles have been applied to financial assets and liabilities for periods up to, and including 31 March 2005.

Financial assets are classified as either financial assets at fair value through the income statement, loans and receivables or available-for-sale financial assets (see below). The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and re-evaluates this designation at each reporting date. Up to 31 March 2005, financial assets in these categories were held at the lower of cost and net realisable value in accordance with UK GAAP.

Debt instruments are stated at the amount of net proceeds adjusted to amortise any discount over the term of the debt.

The effect of the currency element of currency swaps acting as hedges against financial assets and debt is reported separately in current and non current derivative financial instruments.

Criteria to qualify for hedge accounting

The group considers its derivative financial instruments to be hedges when certain criteria are met. For foreign currency derivatives, the instrument must be related to actual foreign currency assets or liabilities or a probable commitment whose characteristics have been identified. It must involve the same currency or similar currencies as the hedged item and must also reduce the risk of foreign currency exchange movements on the group's operations. For interest rate derivatives, the instrument must be related to assets or liabilities or a probable commitment, such as a future bond issue, and must also change the interest rate or the nature of the interest rate by converting a fixed rate to a variable rate or vice versa.

Accounting for derivative financial instruments

Principal amounts underlying currency swaps are revalued at exchange rates ruling at the balance sheet date and are included in current and non-current derivative financial instruments.

Interest differentials, under interest rate swap agreements used to vary the amounts and periods for which interest rates on borrowings are fixed, are recognised by adjustment of net finance expense.

The forward exchange contracts used to change the currency mix of net debt are revalued to balance sheet rates with net unrealised gains and losses included in current and non-current derivative financial instruments. The difference between spot and forward rate for these contracts is recognised as part of net finance expense over the term of the contract.

The forward exchange contracts hedging transaction exposures are revalued at the prevailing forward rate on the balance sheet date with net unrealised gains and losses being shown as current and non-current derivative financial instruments.

(XX) FINANCIAL INSTRUMENTS (FROM 1 APRIL 2005)

The following are the key accounting policies used in the preparation of the restated 1 April 2005 opening balance sheet and subsequent periods to reflect the adoption of IAS 32, 'Financial Instruments: Disclosure and Presentation' and IAS 39, 'Financial Instruments: Recognition and Measurement'.

Financial assets

Purchases and sales of financial assets

All regular way purchases and sales of financial assets are recognised on the settlement date, which is the date that the asset is delivered to or by the group.

Financial assets at fair value through income statement

A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Financial assets held in this category are initially recognised and subsequently measured at fair value, with changes in value recognised in the income statement in the line which most appropriately reflects the nature of the item or transaction.

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Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than:

- those that the group intends to sell immediately or in the short term, which are classified as held for trading;
- those for which the group may not recover substantially all of its initial investment, other than because of credit deterioration, which are classified as available for sale.

Loans and receivables are initially recognised at fair value plus transaction costs and subsequently carried at amortised cost using the effective interest method, with changes in carrying value recognised in the income statement in the line which most appropriately reflects the nature of the item or transaction.

Available-for-sale financial assets

Non-derivative financial assets classified as available-for-sale are either specifically designated in this category or not classified in any of the other categories. Available-for-sale financial assets are carried at fair value, with unrealised gains and losses (except for changes in exchange rates for monetary items, interest, dividends and impairment losses which are recognised in the income statement) are recognised in equity until the financial asset is derecognised, at which time the cumulative gain or loss previously recognised in equity is taken to the income statement, in the line that most appropriately reflects the nature of the item or transaction.

Trade receivables

Trade receivables are initially recognised at fair value, which is usually the original invoiced amount and subsequently carried at amortised cost using the effective interest method less provisions made for doubtful receivables.

Provisions are made specifically where there is objective evidence of a dispute or an inability to pay. An additional provision is made based on an analysis of balances by age, previous losses experienced and general economic conditions.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and current balances with banks and similar institutions, which are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value and have an original maturity of three months or less.

For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts. Bank overdrafts are included within loans and other borrowings in current liabilities on the balance sheet.

Impairment of financial assets

The group assesses at each balance sheet date whether a financial asset or group of financial assets are impaired.

Where there is objective evidence that an impairment loss has arisen on assets carried at amortised cost, the carrying amount is reduced with the loss being recognised in the income statement. The impairment loss is measured as the difference between that asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The impairment loss is only reversed if it can be related objectively to an event after the impairment was recognised and is reversed to the extent the carrying value of the asset does not exceed its amortised cost at the date of reversal.

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its fair value is transferred from equity to the income statement. Reversals of impairment losses on debt instruments are taken through the income statement if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in the income statement. Reversals in respect of equity instruments classified as available-for-sale are not recognised in the income statement.

If there is objective evidence of an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be objectively measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, has been incurred, the amount of loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

Loans and other borrowings

Loans and other borrowings are initially recognised at fair value plus directly attributable transaction costs. Where loans and other borrowings contain a separable embedded derivative, the fair value of the embedded derivative is the difference between the fair value of the hybrid instrument and the fair value of the loan or borrowing. The fair value of the embedded derivative and the loan or borrowing is recorded separately on initial recognition. Loans and other borrowings are subsequently measured at amortised cost using the effective interest method and if included in a fair value hedge relationship are revalued to reflect the fair value movements on the hedged risk associated with the loans and other borrowings.

Derivative financial instruments

The group uses derivative financial instruments mainly to reduce exposure to foreign exchange risks and interest rate movements. The group does not hold or issue derivative financial instruments for financial trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Derivative financial instruments are classified as held for trading and initially recognised at cost. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The gain or loss on re-measurement to fair value is recognised immediately in the income statement in net finance expense. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the hedge. Derivative financial instruments are classified as current assets or current liabilities where they are not designated in a hedging relationship or have a maturity period within 12 months. Where derivative financial instruments have a maturity period greater than 12 months and are designated in a hedge relationship, they are classified within either non current assets or non current liabilities.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risk and characteristics are not closely related to those of host contracts and host contracts are not carried at fair value. Changes in the fair value of embedded derivatives are recognised in the income statement in the line which most appropriately reflects the nature of the item or transaction.

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Hedge accounting

Cash flow hedge

When a financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity.

For cash flow hedges of recognised assets or liabilities, the associated cumulative gain or loss is removed from equity and recognised in the same line in the income statement in the same period or periods during which the hedged transaction affects the income statement.

For highly probable transactions, when the transaction subsequently results in the recognition of a non-financial asset or non-financial liability the associated cumulative gain or loss is removed from equity and included in the initial cost or carrying amount of the non-financial asset or liability.

If a hedge of a highly probable transaction subsequently results in the recognition of a financial asset or a financial liability, then the associated gains and losses that were recognised directly in equity are reclassified into the income statement in the same period or periods during which the asset acquired or liability assumed affects the income statement.

Any ineffectiveness arising on a cash flow hedge of a recognised asset or liability is recognised immediately in the same income statement line as the hedged item. Where ineffectiveness arises on highly probable transactions, it is recognised in the line which most appropriately reflects the nature of the item or transaction.

Fair value hedge

When a derivative financial instrument is designated as a hedge of the variability in fair value of a recognised asset or liability, or unrecognised firm commitment, the change in fair value of the derivatives that are designated as fair value hedges are recorded in the same line in the income statement, together with any changes in fair value of the hedged asset or liability that is attributable to the hedged risk.

Hedge of net investment in a foreign operation

Exchange differences arising from the retranslation of currency instruments designated as hedges of net investments in a foreign operation are taken to shareholders equity on consolidation to the extent the hedges are deemed effective. Any ineffectiveness arising on a hedge of a net investment in a foreign operation is recognised in net finance expense.

Discontinuance of hedge accounting

Discontinuance of hedge accounting may occur when a hedging instrument expires or is sold, terminated or exercised, the hedge no longer qualifies for hedge accounting or the group revokes designation of the hedge relationship but the hedged financial asset or liability remains or highly probable transaction is still expected to occur. Under a cash flow hedge the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place or the underlying hedged financial asset or liability no longer exists, the cumulative unrealised gain or loss recognised in equity is recognised immediately in the income statement. Under a hedge of a net investment the cumulative gain or loss remains in equity when the hedging instrument expires or is sold, terminated or exercised, the hedge no longer qualifies for hedge accounting or the group revokes designation of the hedge relationship. The cumulative gain or loss is recognised in the income statement as part of the profit on disposal when the net investment in the foreign operation is disposed. Under a fair value hedge the cumulative gain or loss adjustment associated with the hedged risk is amortised to the income statement using the effective interest method over the remaining term of the hedged item.

CRITICAL ACCOUNTING ESTIMATES AND KEY JUDGEMENTS

The preparation of financial statements in conformity with IFRS requires the use of accounting estimates and assumptions. It also requires management to exercise its judgement in the process of applying the groups accounting policies. We continually evaluate our estimates, assumptions and judgements based on available information and experience. As the use of estimates is inherent in financial reporting, actual results could differ from these estimates. The areas involving a higher degree of judgement or complexity are described below.

Interconnect income and payments to other telecommunications operators

In certain instances BT rely on other operators to measure the traffic flows interconnecting with our networks. Estimates are used in these cases to determine the amount of income receivable from or payments we need to make to these other operators. The prices at which these services are charged are often regulated and are subject to retrospective adjustment and estimates are used in assessing the likely effect of these adjustments.

Providing for doubtful debts
BT provide services to around 20 million individuals and businesses, mainly on credit terms. We know that certain debts due to us will not be paid through the default of a small number of our customers. Estimates, based on our historical experience are used in determining the level of debts that we believe will not be collected. These estimates include such factors as the current state of the UK economy and particular industry issues.

Goodwill
The recoverable amount of cash-generating units have been determined based on value in use calculations. These calculations require the use of estimates.

Useful lives for property, plant and equipment
The plant and equipment in BTs networks is long-lived with cables and switching equipment operating for over ten years and underground ducts being used for decades. The annual depreciation charge is sensitive to the estimated service lives allocated to each type of asset. Asset lives are assessed annually and changed when necessary to reflect current thinking on their remaining lives in light of technological change, prospective economic utilisation and physical condition of the assets concerned. Changes to service lives of assets implemented from 1 April 2005 had no significant impact on the results for the year ended 31 March 2006.

Property arrangements
As part of the property rationalisation programme we have identified a number of surplus properties. Although efforts are being made to sub-let this space it is recognised that this may not be possible immediately in the current economic environment. Estimates have been made of the cost of vacant possession and any shortfall arising from the sub lease rental income being lower than the lease costs being borne by BT. Any such cost or shortfall has been recognised as a provision.

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Long term customer contracts
Long term customer contracts can extend over a number of financial years. During the contractual period, revenue, costs and profits may be impacted by estimates of the ultimate profitability of each contract. If, at any time, these estimates indicate the contract will be unprofitable, the entire estimated loss for the contract is recognised immediately. The company performs ongoing profitability reviews of its contracts in order to determine whether the latest estimates require updating. Key factors reviewed include transaction volumes, or other inputs, for which we get paid, future staff and third party costs and anticipated cost productivity, savings and efficiencies.

Pension obligations
BT has a commitment, mainly through the BT Pension Scheme, to pay pension benefits to approximately 354,000 people over more than 60 years. The cost of these benefits and the present value of our pension liabilities depend on such factors as the life expectancy of the members, the salary progression of our current employees, the return that the pension fund assets will generate in the time before they are used to fund the pension payments and the discount rate at which the future pension payments are discounted. We use estimates for all these factors in determining the pension costs and liabilities incorporated in our financial statements. The assumptions reflect historical experience and our judgement regarding future expectations.

Deferred tax
Deferred tax assets and liabilities require management judgement in determining the amounts to be recognised. In particular, judgement is used when assessing the extent to which deferred tax assets should be recognised with consideration given to the timing and level of future taxable income.

Income tax
The actual tax we pay on our profits is determined according to complex tax laws and regulations. Where the effect of these laws and regulations is unclear, we use estimates in determining the liability for the tax to be paid on our past profits which we recognise in our financial statements. We believe the estimates, assumptions and judgements are reasonable but this can involve complex issues which may take a number of years to resolve. The final determination of prior year tax liabilities could be different from the estimates reflected in the financial statements.

Determination of fair values
Certain financial instruments are carried on the balance sheet at fair value, with changes in fair value reflected in the income statement. Fair values are estimated by reference in part to published price quotations and in part by using valuation techniques.

ACCOUNTING STANDARDS, INTERPRETATIONS AND AMENDMENTS TO PUBLISHED STANDARDS NOT YET EFFECTIVE

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the group's accounting periods beginning on or after 1 April 2006 or later periods, but which the group has not early adopted. The new standards which are expected to be relevant to the group's operations are as follows:

Amendment to IAS 39 and IFRS 4 'Financial Guarantee Contracts' (effective from 1 April 2006)
This amendment requires issued financial guarantees, other than those previously asserted by the entity to be insurance contracts, to be initially recognised at their fair value and subsequently measured at the higher of: (a) the unamortised balance of the related fees received and determined; and (b) the expenditure required to settle the commitment at the balance sheet date. Management is currently assessing the impact of this amendment on the group's financial statements.

Amendment to IAS 39 'Cash Flow Hedge Accounting of Forecast Intragroup Transactions' (effective from 1 April 2006)
This amendment allows the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item in the consolidated financial statements, provided that: (a) the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction; and (b) the foreign currency risk will affect consolidated profit or loss. Management does not expect adoption of this amendment to have a significant impact on the group's financial statements.

Amendment to IAS 39 The Fair Value Option (effective from 1 April 2006)
This amendment changes the definition of the financial instruments classified at fair value through the income statement and restricts the ability to designate financial instruments as part of this category. Management does not expect adoption of this amendment to have a significant impact on the groups financial statements.

IFRIC 4 Determining whether an arrangement contains a lease (effective from 1 April 2006)
IFRIC 4 requires the determination of whether an arrangement is or contains a lease to be based on the substance of the arrangement. Management does not expect adoption of this interpretation to have a significant impact on the groups financial statements.

IFRS 7 Financial Instruments: Disclosures (effective from 1 April 2007) and amendment to IAS 1 Presentation of Financial Statements Capital Disclosures (effective from 1 April 2007)
IFRS 7 introduces new disclosures of qualitative and quantitative information about exposure to risks arising from financial instruments including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. The amendment to IAS 1 introduces disclosures about the level of an entitys capital and how it manages capital. Management is currently assessing the impact of IFRS 7 and the amendment to IAS 1 on the groups financial statements.

Amendment to IAS 21 Net Investment in a Foreign Operation (effective from 1 April 2006)
This amendment relaxes the requirement for a monetary item that forms part of a reporting entitys net investment in a foreign operation to be denominated in the functional currency of either the reporting entity or the foreign operation. It also clarifies the treatment of so called sister company loans. The group has assessed the impact of the amendment and concluded it is not likely to have a significant impact on the groups financial statements.

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IFRIC 7 Applying the restatement approach under IAS 29 (effective from 1 April 2006)
IFRIC 7 deals with the accounting when an entity identifies the existence of hyperinflation in the economy of its functional currency and how deferred tax items in the opening balance sheet should be restated. The group has operations in hyper-inflationary economies. The group has assessed the impact of the interpretation and concluded it is not likely to have a significant impact on the groups financial statements.

IFRIC 8 Scope of IFRS 2 (effective from 1 April 2007)
IFRIC 8 clarifies that transactions within the scope of IFRS 2 Share Based Payment include those in which the entity cannot specifically identify some or all of the goods and services received. The group has assessed the impact of this interpretation and has concluded it is not likely to have a significant impact on the groups financial statements.

IFRIC 9 Reassessment of embedded derivatives (effective from 1 April 2007)
IFRIC 9 clarifies that an entity should assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the contract terms, in which case it is required. The group has assessed the impact of this interpretation and has concluded it is not likely to have a significant impact on the groups financial statements.

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GROUP INCOME STATEMENT

For the year ended 31 March 2006

For the year ended 31 March 2006	Notes	Before specific items £m	Specific items[a] £m	Total £m
Revenue	1	**19,514**	—	**19,514**
Other operating income	2	**227**	—	**227**
Operating costs	3	**(17,108)**	**(138)**	**(17,246)**
Operating profit	1	**2,633**	**(138)**	**2,495**
Finance expense	5	**(2,740)**	—	**(2,740)**
Finance income	5	**2,268**	—	**2,268**
Net finance expense		**(472)**	—	**(472)**
Share of post tax profit of associates and joint ventures	16	**16**	—	**16**
Profit on disposal of joint venture		—	**1**	**1**
Profit before taxation		**2,177**	**(137)**	**2,040**
Taxation	6	**(533)**	**41**	**(492)**
Profit for the year		**1,644**	**(96)**	**1,548**
Attributable to:				
Equity shareholders of the parent		**1,643**	**(96)**	**1,547**
Minority interests		**1**	—	**1**
Earnings per share	8			
Basic				**18.4p**
Diluted				**18.1p**

For the year ended 31 March 2005	Notes	Before specific items £m	Specific items[a] £m	Total £m
Revenue	1	18,429	—	18,429
Other operating income	2	193	358	551
Operating costs	3	(15,929)	(59)	(15,988)
Operating profit	1	2,693	299	2,992
Finance expense	5	(2,773)	—	(2,773)
Finance income	5	2,174	—	2,174
Net finance expense		(599)	—	(599)
Share of post tax loss of associates and joint ventures	16	(14)	(25)	(39)
Profit before taxation		2,080	274	2,354

		Before specific	Specific	
Taxation	6	(541)	16	(525)
Profit for the year		1,539	290	1,829
Attributable to:				
Equity shareholders of the parent		1,540	290	1,830
Minority interests		(1)	—	(1)
Earnings per share	8			
Basic				21.5p
Diluted				21.3p

[a]For a definition of specific items, see accounting policies. An analysis of specific items is provided in note 4.

Dividends paid in the year were £912 million (2005: £786 million), as shown in note 7. Interim and final dividends proposed in respect of the 2006 financial year were 11.9 pence per share (2005: 10.4 pence) which amounts to £993 million (2005: £883 million).

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GROUP STATEMENT OF RECOGNISED INCOME AND EXPENSE

For the year ended 31 March 2006

	2006 £m	2005 £m
Profit for the year	**1,548**	1,829
Actuarial gains relating to retirement benefit obligations	**2,122**	294
Exchange differences:		
– on translation of foreign operations	**53**	27
– fair value loss on net investment hedges	**(20)**	–
– reclassified and reported in net profit	**(9)**	–
Fair value movements on available-for-sale assets:		
– fair value gains	**35**	–
– reclassified and reported in net profit	**(35)**	–
Fair value movements on cash flow hedges:		
– fair value gains	**4**	–
– reclassified and reported in net profit	**(204)**	–
Tax impact of above items	**(588)**	(79)
Net gains recognised directly in equity	**1,358**	242
Total recognised income and expense for the year	**2,906**	2,071
Attributable to:		
Equity shareholders of the parent	**2,905**	2,072
Minority interests	**1**	(1)
	2,906	2,071

The group has adopted IAS 32 and IAS 39, with effect from 1 April 2005. The adoption of IAS 32 and IAS 39 resulted in a decrease in equity at 1 April 2005 of £209 million, net of deferred tax, of which £nil was attributable to minority interests.

A reconciliation of the changes in other reserves and retained earnings is given in note 26.

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GROUP CASH FLOW STATEMENT

For the year ended 31 March 2006

	Notes	2006 £m	2005 £m
Cash flow from operating activities			
Profit before taxation		**2,040**	2,354
Depreciation and amortisation		**2,884**	2,844
Profit on sale of non current asset investments		**—**	(358)
Net finance expense		**472**	599
Other non cash charges		**88**	2
Share of (profits) losses of associates and joint ventures		**(16)**	39
Increase in inventories		**(13)**	(12)
(Increase) decrease in trade and other receivables		**(41)**	206
Increase in trade and other payables		**174**	59
Increase in provisions and other liabilities		**189**	173
Cash generated from operations		**5,777**	5,906
Income taxes paid		**(390)**	(332)
Net cash inflow from operating activities		**5,387**	5,574
Cash flow from investing activities			
Interest received		**185**	374
Dividends received		**1**	2
Proceeds on disposal of property, plant and equipment		**66**	111
Proceeds on disposal of associates and joint ventures		**—**	35
Proceeds on disposal of non current financial assets		**1**	539
Proceeds on disposal of current financial assets		**5,964**	3,754
Acquisition of subsidiaries, net of cash acquired	12	**(165)**	(426)
Purchases of property, plant and equipment and computer software		**(2,940)**	(3,056)
Investment in associates and joint ventures		**(2)**	(27)
Purchases of non current financial assets		**(2)**	(2)
Purchases of current financial assets		**(2,743)**	(3,044)
Net cash inflow (outflow) from investing activities		**365**	(1,740)
Cash flow from financing activities			
Equity dividends paid		**(907)**	(784)
Interest paid		**(1,086)**	(1,260)
Repayments of borrowings and derivatives		**(4,148)**	(1,022)
Repayment of finance lease liabilities		**(284)**	(275)
New bank loans raised		**1,022**	5
Net proceeds on issue of commercial paper		**464**	—
Repurchase of ordinary shares		**(348)**	(195)
Net proceeds on issue of treasury shares		**9**	2
Net cash used in financing activities		**(5,278)**	(3,529)
Net increase in cash and cash equivalents		**474**	305
Cash and cash equivalents at the start of the year		**1,310**	1,005
Cash and cash equivalents at the end of the year	9	**1,784**	1,310

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GROUP BALANCE SHEET

As at 31 March 2006

	Notes	2006 £m	2005 £m
Non current assets			
Intangible assets	13	**1,641**	1,254
Property, plant and equipment	14	**15,489**	15,391
Derivative financial instruments	19	**19**	18
Investments	15	**17**	13
Associates and joint ventures	16	**48**	102
Deferred tax assets	22	**764**	1,434
		17,978	18,212
Current assets			
Inventories		**124**	106
Trade and other receivables	17	**4,199**	4,269
Derivative financial instruments	19	**69**	143
Investments	15	**365**	3,491
Cash and cash equivalents	9	**1,965**	1,312
		6,722	9,321
Current liabilities			
Loans and other borrowings	18	**1,940**	4,261
Derivative financial instruments	19	**332**	375
Trade and other payables	20	**6,540**	6,763
Current tax liabilities		**598**	645
Provisions	21	**70**	60
		9,480	12,104
Total assets less current liabilities		**15,220**	15,429
Non current liabilities			
Loans and other borrowings	18	**7,995**	7,744
Derivative financial instruments	19	**820**	472
Other payables	20	**485**	394
Deferred tax liabilities	22	**1,505**	1,715
Retirement benefit obligations	29	**2,547**	4,807
Provisions	21	**261**	202
		13,613	15,334
Equity			
Ordinary shares	25	**432**	432
Share premium	25	**7**	3
Capital redemption reserve		**2**	2

		2006	2005
Other reserves	26	**364**	762
Retained earnings	26	**750**	(1,154)
Total parent shareholders equity		**1,555**	45
Minority interests	23	**52**	50
Total equity	24	**1,607**	95
		15,220	15,429

The consolidated financial statements on pages 64 to 122 were approved by the Board of Directors on 17 May 2006 and were signed on its behalf by

Sir Christopher Bland
Chairman

Ben Verwaayen
Chief Executive

Hanif Lalani
Group Finance Director

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. SEGMENTAL ANALYSIS

Primary reporting format business segments

The group provides communications services which include networked IT services, local and international telecommunications services, broadband and internet products and services. The group is organised into three primary business segments; BT Retail, BT Wholesale and BT Global Services, each with differing risks, rewards and customer profiles. Hence these lines of business are the groups primary reporting segments. The revenue of each business segment is derived as follows:

BT Retail derives its revenue from the supply of exchange lines and from the calls made over these lines, the leasing of private circuits and other private services. It also generates revenue from broadband, mobility, data, internet and multimedia services and from providing managed and packaged communications solutions to customers.

BT Wholesale derives its revenue from providing network services and solutions to communications companies, including fixed and mobile network operators, ISPs (internet service providers) and other service providers, including other BT lines of business, and from carrying transit traffic between telecommunications operators.

BT Global Services mainly generates its revenue from the provision of networked IT services, outsourcing and systems integration work to major corporates and from the fixed network operations of the groups worldwide subsidiaries.

Other includes the groups corporate and internal property, vehicle fleet and IT operations.

Openreach was launched on 21 January 2006. We will have completed the separation, configuration and implementation of the financial and operating systems to facilitate the separate reporting of Openreach by the first quarter of the 2007 financial year. This is in accordance with the timetable specified by the Undertakings. Therefore as Openreach is not a discrete segment at 31 March 2006 it is not presented as a separate business segment.

There is extensive trading between BTs lines of business and the line of business profitability is dependent on the transfer price levels. For regulated products and services those transfer prices are market based whilst for other products and services the transfer prices are agreed between the relevant lines of business. These intra-group trading arrangements are subject to periodic review.

Year ended 31 March 2006	BT Retail £m	BT Wholesale £m	BT Global Services £m	Other £m	Intra-group £m	Total £m
Revenue						
External revenue	8,119	4,226	7,151	18		19,514
Internal revenue	333	5,006	1,481		(6,820)	
Total revenue	**8,452**	**9,232**	**8,632**	**18**	**(6,820)**	**19,514**

Year ended 31 March 2005	BT Retail £m	BT Wholesale £m	BT Global Services £m	Other £m	Intra-group £m	Total £m
Revenue						
External revenue	8,430	3,820	6,154	25		18,429
Internal revenue	268	5,275	1,334		(6,877)	
Total revenue	**8,698**	**9,095**	**7,488**	**25**	**(6,877)**	**18,429**

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1. SEGMENTAL ANALYSIS continued

Year ended 31 March 2006	BT Retail £m	BT Wholesale £m	BT Global Services £m	Other £m	Total £m
Results					
Operating profit before specific items	644	1,992	363	(366)	**2,633**
Specific items				(138)	**(138)**
Segment result	644	1,992	363	(504)	**2,495**
Share of post tax profit of associates and joint ventures				16	**16**
Profit on disposal of joint venture				1	**1**
Net finance expense					**(472)**
Profit before tax					**2,040**
Taxation					**(492)**
Profit for the year					**1,548**
Capital additions[a]					
Intangible assets	55	270	93	31	**449**
Property, plant and equipment	98	1,743	609	243	**2,693**
	153	2,013	702	274	**3,142**
Depreciation	120	1,778	556	181	**2,635**
Amortisation	27	124	82	16	**249**

[a]Additions to intangible assets exclude goodwill.

Year ended 31 March 2005	BT Retail £m	BT Wholesale £m	BT Global Services £m	Other £m	Total £m
Results					
Operating profit before specific items	607	1,950	411	(275)	**2,693**
Specific items				299	**299**
Segment result	607	1,950	411	24	**2,992**
Share of post tax loss of associates and joint ventures				(39)	**(39)**
Net finance expense					**(599)**
Profit before tax					**2,354**
Taxation					**(525)**
Profit for the year					**1,829**
Capital additions					
Intangible assets[a]	51	198	30	36	**315**
Property, plant and equipment	119	1,783	575	219	**2,696**
	170	1,981	605	255	**3,011**
Depreciation	133	1,831	513	217	**2,694**

Amortisation	14	83	37	16	**150**

[a]Additions to intangible assets exclude goodwill.

As at 31 March 2006	BT Retail £m	BT Wholesale £m	BT Global Services £m	Other £m	Total £m
Assets					
Segment assets	2,517	13,159	6,253	(93)	21,836
Associates and joint ventures				48	48
Unallocated assets				2,816	2,816
Consolidated total assets	**2,517**	**13,159**	**6,253**	**2,771**	**24,700**
Liabilities					
Segment liabilities	2,419	1,400	3,776	(308)	7,287
Unallocated liabilities				15,806	15,806
Consolidated total liabilities	**2,419**	**1,400**	**3,776**	**15,498**	**23,093**

As at 31 March 2005	BT Retail £m	BT Wholesale £m	BT Global Services £m	Other £m	Total £m
Assets					
Segment assets	2,238	13,222	5,490	3,575	24,525
Associates and joint ventures				102	102
Unallocated assets				2,906	2,906
Consolidated total assets	**2,238**	**13,222**	**5,490**	**6,583**	**27,533**
Liabilities					
Segment liabilities	2,472	1,387	3,095	405	7,359
Unallocated liabilities				20,079	20,079
Consolidated total liabilities	**2,472**	**1,387**	**3,095**	**20,484**	**27,438**

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1. SEGMENTAL ANALYSIS continued

Segment assets consist primarily of property, plant and equipment, intangible assets, inventories, trade receivables and associates and joint ventures. Unallocated assets include deferred taxation, investments and derivatives.

Segment liabilities comprise trade and other payables and provisions. Unallocated liabilities include current and deferred taxation, retirement benefit obligations, finance lease liabilities, corporate borrowings and related derivatives.

Secondary reporting format – geographical segments

	2006 £m	2005 £m
Revenue by geographic area		
UK	**16,901**	16,863
Europe, excluding the UK	**1,900**	1,306
Americas	**627**	190
Asia and Pacific	**86**	70
Total	**19,514**	18,429

The analysis of revenue by geographical area is on the basis of the country of origin of the customer invoice. In an analysis of revenue by destination, incoming and transit international calls would be treated differently, but would not lead to a materially different geographical analysis.

	Total assets		Capital additions	
	2006 £m	2005 £m	2006 £m	2005 £m
Total assets and capital additions by geographic area				
UK	**16,240**	19,125	**2,872**	2,859
Europe, excluding the UK	**3,777**	4,316	**191**	114
Americas	**1,704**	1,014	**66**	31
Asia and Pacific	**163**	172	**13**	7
Unallocated assets	**2,816**	2,906	–	–
Total assets	**24,700**	27,533	**3,142**	3,011

Total assets and capital additions are allocated to geographical areas based on the location of the asset.

2. OTHER OPERATING INCOME

	2006 £m	2005 £m
Profits on disposal of property, plant and equipment	**2**	22
Income from repayment works	**74**	64
Other operating income	**151**	107

	2006	2005
Other operating income before specific items	227	193
Specific items (note 4)		358
Other operating income	**227**	551

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3. OPERATING COSTS

	2006 £m	2005 £m
Costs by nature		
Staff costs:		
Wages and salaries	**3,910**	3,645
Social security costs	**377**	319
Pension costs	**603**	540
Share-based payment	**76**	50
Total staff costs	**4,966**	4,554
Depreciation of property, plant and equipment		
Owned assets	**2,501**	2,536
Under finance leases	**134**	158
Amortisation of intangible assets	**249**	150
Payments to telecommunications operators	**4,045**	3,725
Other operating costs	**6,113**	5,528
Own work capitalised	**(900)**	(722)
Total operating costs before specific items	**17,108**	15,929
Specific items	**138**	59
Total operating costs	**17,246**	15,988

	2006 £m	2005 £m
Operating costs include the following:		
Early leaver costs	**133**	166
Research and development expenditure[a]	**486**	352
Rental costs relating to operating leases	**413**	419
Foreign currency losses	**12**	3

[a]Research and development expenditure includes amortisation of £160 million (2005: £95 million) in respect of internally developed computer software.

4. SPECIFIC ITEMS

The group separately identifies and discloses material one-off or unusual items (termed specific items, as defined in accounting policies). This is consistent with the way that financial performance is measured by management and we believe assists in providing a meaningful analysis of the trading results of the group.

	2006 £m	2005 £m
Other operating income		
Profit on sale of non current asset investments[a]		358
Operating costs		
Property rationalisation costs[b]	**(68)**	(59)
Creation of Openreach[c]	**(70)**	
	(138)	(59)
Share of results of associates and joint ventures		
Impairment of assets in joint ventures[d]		(25)
Profit on disposal of joint venture	**1**	

	2006	2005
Net specific items before tax	**(137)**	274
Tax credit on specific items	**41**	16
Net specific items after tax	**(96)**	290

[a]During the prior year the group disposed of some non-core investments. The resulting profit on disposal of £358 million comprised £236 million from the sale of the group's 15.8% interest in Eutelsat SA, £46 million from sale of the 4% interest in Intelsat, £38 million from the sale of the 11.9% interest in Starhub Pte Ltd and other gains of £38 million.
[b]In the current year £68 million (2005: £59 million) of property rationalisation charges were recognised in relation to the group's provincial office portfolio.
[c]During the current financial year a provision of £70 million was recognised for the estimated incremental and directly attributable costs arising from the group's obligation to set up Openreach in accordance with the Undertakings agreed with Ofcom on 21 September 2005.
[d]In the prior year the group incurred an impairment charge of £25 million representing its share of a write down of Albacom's assets prior to Albacom becoming a subsidiary.

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5. FINANCE INCOME AND FINANCE EXPENSE

	2006 £m	2005[a] £m
Finance expense		
Interest on listed bonds, debentures and notes[b]	**831**	963
Interest on finance leases	**62**	68
Interest on other borrowings	**20**	19
Unwinding of discount on provisions	**3**	3
Net charge on financial instruments in a fair value hedge[c]	**—**	—
Net foreign exchange on items in hedging relationships[d]	**—**	—
Fair value movements on derivatives not in a designated hedge relationship	**8**	—
Interest on pension scheme liabilities	**1,816**	1,720
Total finance expense	**2,740**	2,773

[a]The group adopted IAS 32 and IAS 39 from 1 April 2005. The comparative period has therefore applied the group's previous accounting policies in calculating the recognition and measurement basis for finance expense (see accounting policies).
[b]Includes a net charge of £41 million relating to fair value movements on derivatives recycled from the cash flow reserve.
[c]Includes a net charge of £71 million relating to fair value movements arising on hedged items and a net credit of £71 million relating to fair value movements arising on derivatives designated as fair value hedges.
[d]Includes a net charge of £330 million relating to foreign exchange movements on hedged loans and borrowings and a net credit of £330 million relating to fair value movements on derivatives recycled from the cash flow reserve.

	2006 £m	2005[a] £m
Finance income		
Income from listed investments[b]	**44**	47
Other interest and similar income[c]	**154**	209
Net foreign exchange on items in hedging relationships[d]	**—**	—
Expected return on pension scheme assets	**2,070**	1,918
Total finance income	**2,268**	2,174
Net finance expense	**472**	599

[a]The group adopted IAS 32 and IAS 39 from 1 April 2005. The comparative period has therefore applied the group's previous accounting policies in calculating the recognition and measurement basis for finance income (see accounting policies).
[b]Income from listed investments includes £37 million relating to gains on held for trading investments.
[c]On 11 August 2005, the group exercised its option to require early redemption of its US dollar convertible 2008 bond. Bondholders had the option to take redemption proceeds in the form of cash or shares in the group's interest in LG Telecom. The majority of bondholders exercised their option to take the redemption proceeds in the form of LG Telecom shares. Other interest includes a net bond redemption gain of £27 million. This reflects the write off of LG Telecom shares of £121 million and the associated release from the available-for-sale reserve of £35 million; the write off of the bond and transaction costs of £87 million and the associated option liability of £17 million; and the release from the translation reserve of £9 million credit relating to foreign exchange movements on the investment in LG Telecom to the date of disposal.
[d]Includes a net credit of £85 million relating to foreign exchange movements on hedged investments and a net charge of £85 million relating to fair value movements on derivatives recycled from the cash flow reserve.

6. TAXATION

	2006 £m	2005 £m
Analysis of taxation expense for the year		
United Kingdom:		
Corporation tax at 30% (2005: 30%)	**404**	542

	2006	2005
Adjustments in respect of prior periods	**(69)**	4
Non-UK taxation:		
Current	**12**	(4)
Adjustments in respect of prior periods	**1**	(3)
Total current tax	**348**	539
Deferred tax:		
Origination and reversal of temporary differences	**155**	(15)
Adjustment in respect of prior periods	**(11)**	1
Total deferred tax	**144**	(14)
Total taxation expense in the income statement	**492**	525

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6. TAXATION continued

Factors affecting taxation expense

The taxation expense on the profit for the year differs from the amount computed by applying the corporation tax rate to the profit before taxation as a result of the following factors:

	2006 £m	%	2005 £m	%
Profit before tax	**2,040**		2,354	
Notional taxation expense at UK rate of 30% (2005: 30%)	**612**	**30.0**	706	30.0
Effects of:				
Non deductible depreciation and amortisation	**8**	**0.4**	6	0.2
Non deductible non-UK losses	**29**	**1.4**	38	1.6
Lower taxes on non-UK profits	**(1)**	**—**	(14)	(0.6)
Lower taxes on gain on disposal of non-current investments and group undertakings	**—**	**—**	(107)	(4.5)
Other deferred tax assets not recognised	**(25)**	**(1.2)**	—	—
Associates and joint ventures	**(5)**	**(0.2)**	—	—
Adjustments in respect of prior periods	**(79)**	**(3.9)**	2	0.1
Other	**(47)**	**(2.4)**	(106)	(4.5)
Total taxation expense and effective tax rate	**492**	**24.1**	525	22.3
Specific items	**41**	**0.4**	16	3.7
Total taxation expense before specific items/effective tax rate	**533**	**24.5**	541	26.0

	2006 £m	2005 £m
Tax on items charged to equity		
Current tax charge on exchange movements offset in reserves	**—**	7
Deferred tax credit relating to losses on cash flow hedges	**(45)**	—
Deferred tax charge relating to ineffective hedges	**9**	—
Deferred tax charge on actuarial gain relating to retirement benefit obligations	**629**	72
Deferred tax credit relating to share based payments	**(5)**	—
Total taxation on items taken directly to equity	**588**	79

7. DIVIDENDS

	2006 pence per share	2005 pence per share	2006 £m	2005 £m
Final paid in respect of the prior year	**6.50**	5.30	**551**	454
Interim paid in respect of the current year	**4.30**	3.90	**361**	332
	10.80	9.20	**912**	786

	2006	2005

The directors are proposing that a final dividend in respect of the year ended 31 March 2006 of 7.6 pence per share will be paid to shareholders on 11 September 2006, taking the full year proposed dividend in respect of the 2006 financial year to 11.9 pence (2005: 10.4 pence). This dividend is subject to approval by shareholders at the Annual General Meeting and therefore the liability of £632 million (2005: £551 million) has not been included in these financial statements. The proposed dividend will be payable to all shareholders on the Register of Members on 18 August 2006.

8. EARNINGS PER SHARE

The basic earnings per share are calculated by dividing the profit attributable to equity shareholders by the weighted average number of shares in issue after deducting the company's shares held by employee share ownership trusts and treasury shares.

In calculating the diluted earnings per share, share options outstanding and other potential ordinary shares have been taken into account where the impact of these is dilutive. Options over 52 million shares (2005: 207 million shares) were excluded from the calculation of the total diluted number of shares as the impact of these is anti-dilutive.

The weighted average number of shares in the years were:

	2006 millions of shares	2005 millions of shares
Basic	**8,422**	8,524
Dilutive ordinary shares from share options and shares held in trust	**115**	57
Total diluted	**8,537**	8,581
Profit attributable to equity shareholders of the parent (£m)	**1,547**	1,830
Basic earnings per share (pence)	**18.4p**	21.5p
Diluted earnings per share (pence)	**18.1p**	21.3p

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8. EARNINGS PER SHARE continued

Basic earnings per share before specific items, and the per share impact of individual specific items, is as follows:

	2006 pence per share	2006 £m	2005 pence per share	2005 £m
Per share impact of specific items:				
Profit on sale of non current asset investments	—	—	4.2	358
Profit on sale of joint venture	—	1	—	—
Property rationalisation costs	(0.8)	(68)	(0.7)	(59)
Provision for the creation of Openreach	(0.8)	(70)	—	—
Impairment in associates and joint ventures	—	—	(0.3)	(25)
Tax credit on specific items	0.5	41	0.2	16
Basic (loss) earnings per share/(loss) profit for the year attributable to specific items	(1.1)	(96)	3.4	290
Basic earnings per share/profit for the year	18.4	1,548	21.5	1,829
Adjustment: Basic loss (earnings) per share/loss (profit) for the financial year attributable to specific items	1.1	96	(3.4)	(290)
Basic earnings per share/profit for the year before specific items	19.5	1,644	18.1	1,539

9. CASH AND CASH EQUIVALENTS

	2006 £m	2005 £m
Cash at bank and in hand	511	206
Cash equivalents		
Listed cash equivalents		
Euro treasury bills	8	20
Unlisted cash equivalents		
US corporate debt securities	422	223
UK deposits	914	818
European deposits	70	36
US deposits	40	9
Total cash equivalents	1,454	1,106
Total cash and cash equivalents	1,965	1,312
Bank overdrafts	(181)	(2)
Cash and cash equivalents per the cash flow statement	1,784	1,310

The group has a cross undertaking guarantee facility across certain bank accounts which allows a legally enforceable right of set off of the relevant cash and overdraft balances on bank accounts included within the scheme. At 31 March 2006, overdraft balances of £171 million had a legally enforceable right of set off against cash balances of £209 million. These balances have not been netted above as settlement is not intended to take place simultaneously or on a net basis.

10. NET DEBT

Net debt consists of loans and other borrowings less current asset investments and cash and cash equivalents. Loans and other borrowings are measured at the net proceeds raised, adjusted to amortise any discount over the term of the debt. For the purpose of this analysis current asset investments and cash and cash equivalents are measured at the lower of cost and net realisable value. Currency denominated balances within net debt are translated to sterling at swapped rates where hedged.

This definition of net debt measures balances at the future cash flows due to arise on maturity of financial instruments and removes the balance sheet adjustments made from the re-measurement of hedged risks under fair value hedges and the use of the amortised cost method as required by IAS 39. In addition, the gross balances are adjusted to take account of netting arrangements amounting to £171 million. Net debt is a non GAAP measure since it is not defined in IFRS but it is a key indicator used by management in order to assess operational performance.

	2006 £m	2005 £m
Analysis of net debt		
Loans and other borrowings (current and non current)	**9,935**	12,005
Less:		
Cash and cash equivalents	**1,965**	1,312
Current asset investments	**365**	3,491
	7,605	7,202
Adjustments:		
To retranslate currency denominated balances at swapped rates where hedged	**121**	691
To recognise borrowings and investments at net proceeds and unamortised discount	**(192)**	—
Net debt	**7,534**	7,893

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10. NET DEBT continued

After allocating the element of the adjustments which impacts loans and other borrowings as defined above, gross debt at 31 March 2006 was £9,685 million (31 March 2005: £12,696 million).

	2006 £m	2005 £m
Reconciliation of net cash flow to movement in net debt		
Net debt at 1 April	**7,893**	8,530
Decrease in net debt resulting from cash flows	**(199)**	(887)
Net debt assumed or issued on acquisitions	**–**	159
Currency movements	**(75)**	2
Other non-cash movements	**(85)**	89
Net debt at 31 March	**7,534**	7,893

Non-cash transactions

Other non-cash movements in 2006 includes £87 million relating to the early redemption of the group's US dollar convertible bond for shares in LG Telecom.

11. FREE CASH FLOW

Free cash flow is defined as the net increase in cash and cash equivalents less cash flows from financing activities (excluding interest paid) and less the acquisition or disposal of group undertakings. It is a non-GAAP measure since it is not defined in IFRS but it is a key indicator used by management in order to assess operational performance.

	2006 £m	2005 £m
Cash generated from operations before taxation	**5,777**	5,906
Income taxes paid	**(390)**	(332)
Net cash inflow from operating activities	**5,387**	5,574
Included in cash flows from investing activities		
Net purchase of property, plant and equipment, computer software and licences	**(2,874)**	(2,945)
(Sale) purchase of non current financial assets	**(1)**	537
Dividends received from associates	**1**	2
Interest received	**185**	374
Included in cash flows from financing activities		
Interest paid	**(1,086)**	(1,260)
Free cash flow	**1,612**	2,282

12. ACQUISITIONS

Year ended 31 March 2006	Atlanet[a] £m	Radianz[b] £m	Other[c] £m	Total £m
Fair value of consideration	65	143	69	277
Less: fair value of net assets acquired	35	104	17	156
Goodwill arising	**30**	**39**	**52**	**121**
Consideration:				
Cash	58	120	52	230
Deferred consideration	7	–	17	24

	Atlanet[a]	Radianz[b]	Other[c]	Total
Debt assumed	–	23	–	23
Total	**65**	**143**	**69**	**277**
The outflow of cash and cash equivalents is as follows:				
Cash consideration	58	115	52	225
Less: cash acquired	5	44	11	60
	53	**71**	**41**	**165**

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12. ACQUISITIONS continued

Year ended 31 March 2005	Infonet[d] £m	Albacom[e] £m	Other[f] £m	Total £m
Fair value of consideration	520	131	19	670
Less: fair value of net assets acquired	334	122	9	465
Goodwill arising	**186**	**9**	**10**	**205**
Consideration:				
Cash	520	93	23	636
Deferred consideration		38	1	39
Total	**520**	**131**	**24**	**675**
The outflow of cash and cash equivalents is as follows:				
Cash consideration	520	93	23	636
Less: cash acquired	205		5	210
	315	**93**	**18**	**426**

Year ended 31 March 2006

[a]Atlanet

On 28 February 2006 the group acquired 100% of the issued share capital of Atlanet SpA (Atlanet) for total consideration of £65 million, including deferred consideration of £7 million and acquisition costs of £1 million. The net assets acquired in the transaction and the goodwill arising were as follows:

	Book and fair value £m
Intangible assets	**2**
Property, plant and equipment	**25**
Receivables	**46**
Cash and cash equivalents	**5**
Payables	**(43)**
Group's share of original book value and fair value of net assets	**35**
Goodwill	**30**
Total consideration	**65**

The fair value adjustments relating to the acquisition of Atlanet are provisional due to the timing of the transaction and will be finalised during the 2007 financial year.

From the date of acquisition, Atlanet has contributed to the group's results revenue of £7 million and a net loss of £1 million. If the acquisition had occurred on 1 April 2005, the group's revenue would have been higher by £90 million, and profit for the year would have been lower by £1 million (year ended 31 March 2005, £112 million higher and £1 million lower, respectively). The residual excess over the net assets acquired is recognised as goodwill. Goodwill comprises principally the assembled workforce, expected cost savings and synergies.

[b]Radianz

On 29 April 2005, the group acquired 100% of the issued share capital of Radianz Limited (Radianz) for total consideration of £143 million, including acquisition costs of £5 million. The net assets acquired in the transaction, and the goodwill arising, were as follows:

	Book value £m	Fair value adjustments £m	Fair value £m
Intangible assets		22	**22**
Property, plant and equipment	55	(4)	**51**
Receivables	40		**40**
Cash and cash equivalents	44		**44**
Payables	(53)		**(53)**
Groups share of original book value and fair value of net assets	86	18	**104**
Goodwill			**39**
Total consideration			**143**

From the date of acquisition Radianz has contributed to the groups results £60 million of revenue and a net loss of £30 million. If the acquisition had occurred on 1 April 2005, the groups revenue and profit after tax would have been higher by £4 million and £nil, respectively (year ended 31 March 2005, £38 million and £1 million, respectively).

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12. ACQUISITIONS continued

Intangible assets, comprising a brand, customer lists and customer relationships, were recognised at their respective fair values. The residual excess over the net assets acquired is recognised as goodwill. Goodwill comprises principally the assembled work force, expected cost savings and synergies.

c Other

During the year ended 31 March 2006 the group acquired a number of other smaller subsidiary undertakings and businesses including principally SkyNet Systems Limited, the CARA Group and Total Network Solutions Limited. The combined net assets and goodwill arising in respect of these acquisitions were as follows:

	Book and fair value £m
Property, plant and equipment	5
Inventories	4
Receivables	26
Cash and cash equivalents	11
Payables	(29)
Group's share of original book value and fair value of net assets	17
Goodwill	52
Total consideration	69

If these acquisitions had occurred on 1 April 2005, the group's revenue and profit after tax would have been higher by £15 million and £nil, respectively.

Year ended 31 March 2005

d Infonet

On 25 February 2005 the group acquired 100% of the issued share capital of Infonet Services Corporation (Infonet) for total consideration of £520 million including acquisition costs of £10 million (£315 million, net of cash in the business). At 31 March 2005, the fair value adjustments relating to the acquisition of Infonet were provisional, however no further changes to these adjustments were necessary when the fair values were finalised in the 2006 financial year. The net assets acquired in the transaction, and the goodwill arising, were as follows:

	Book value £m	Fair value adjustments £m	Fair value £m
Intangible assets		78	78
Property, plant and equipment	200	(100)	100
Receivables	93	(19)	74
Cash and cash equivalents	205		205
Payables	(94)	4	(90)
Provisions and non current liabilities	(14)	(18)	(32)
Minority interest	(1)		(1)
Group's share of original book value and fair value of net assets	389	(55)	334
Goodwill			186

	Book	Fair value
Total consideration		520

Intangible assets, comprising a brand and customer relationships, were recognised at their respective fair values. The residual excess over the net assets acquired is recognised as goodwill. Goodwill comprises principally the assembled work force, expected cost savings and synergies.

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12. ACQUISITIONS continued

[e]Albacom

On 4 February 2005 the group acquired the 74% interest in Albacom SpA (Albacom) not already held for total consideration of £131 million, including deferred consideration of £38 million and acquisition costs of £5 million. The deferred consideration is dependent upon the financial performance of Albacom in the 2009 financial year and the minimum payable is £38 million. At 31 March 2005, the fair value adjustments relating to the acquisition of Albacom were provisional, however no further changes to these adjustments were necessary when the fair values were finalised in the 2006 financial year. The net assets acquired in the transaction, and the goodwill arising, were as follows:

	Book value £m	Fair value adjustments £m	Fair value £m
Intangible assets	190	—	190
Property, plant and equipment	188	(11)	177
Inventories	5	—	5
Receivables	206	—	206
Payables	(301)	(14)	(315)
Provisions and non current liabilities	(139)	—	(139)
Minority interest	(2)	—	(2)
Group’s share of original book value and fair value of net assets	147	(25)	122
Goodwill			9
Total consideration			131

The residual excess over the net assets acquired was recognised as goodwill. Goodwill comprises principally the assembled work force, expected cost savings and synergies.

[f]Other

During the year ended 31 March 2005 the group acquired a number of other smaller subsidiary undertakings and businesses, principally BIC Systems Group Limited. The combined net assets acquired in the transaction and goodwill arising in respect of these acquisitions were as follows:

	Book value £m	Fair value adjustments £m	Fair value £m
Intangible assets	—	6	6
Receivables	3	—	3
Cash and cash equivalents	5	—	5
Payables	(5)	—	(5)
Group’s share of original book value and fair value of net assets	3	6	9
Goodwill			10
Total consideration			19

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13. INTANGIBLE ASSETS

	Goodwill £m	Telecommunication licences and other £m	Brands, customer lists, and relationships £m	Computer software[a] £m	Total £m
Cost					
At 1 April 2004	202	9		713	924
Additions				319	319
Disposals		(5)		(81)	(86)
Exchange differences	(3)	1		3	1
Acquisitions through business combinations	205	192	84	81	562
At 1 April 2005	404	197	84	1,035	1,720
Additions				449	449
Disposals				8	8
Exchange differences	18	8		8	34
Acquisitions through business combinations	121	1	22	16	160
At 31 March 2006	**543**	**206**	**106**	**1,516**	**2,371**
Amortisation					
At 1 April 2004		7		289	296
Acquisitions		38		45	83
Disposals				(65)	(65)
Charge for the year		6		144	150
Exchange differences				2	2
At 1 April 2005		51		415	466
Charge for the year		9	11	229	249
Acquisitions				15	15
Disposals				(8)	(8)
Exchange differences		2		6	8
At 31 March 2006		**62**	**11**	**657**	**730**
Carrying amount					
At 31 March 2006	**543**	**144**	**95**	**859**	**1,641**
At 31 March 2005	404	146	84	620	1,254

[a]Includes additions in 2006 of £401 million (2005: £265 million) in respect of internally developed computer software.

Impairment tests of goodwill

Goodwill is not amortised but tested for impairment at least annually. For the purpose of impairment testing the groups cash generating units are considered to be the business segments. Goodwill has been allocated to cash generating units as follows:

	2006	2005

	2006 £m	2005 £m
BT Global Services	**488**	360
BT Retail	**55**	44
	543	404

The recoverable amount of each cash generating unit (CGU) is based on value in use calculations. These are determined using cash flow projections derived from financial budgets approved by the board covering a five year period. They reflect management's expectation of revenue growth, operating costs and margin for each CGU based on past experience. Cash flows beyond the five year period have been extrapolated using estimated terminal growth rates ranging from 0% to 2%. These rates have been determined with regard to projected growth rates for the specific markets in which the CGU participates and are not considered to exceed the long term average growth rates for those markets. Discount rates applied to the cash flow forecasts are derived from the group's pre-tax weighted average cost of capital for non-regulated products of 11.4%.

The forecasts are most sensitive to changes in projected revenue growth rates in the first five years of the forecast period. However there is significant headroom and based on the sensitivity analysis performed we have concluded that no reasonably possible changes in the base case assumptions would cause the carrying amount of the CGUs to exceed their recoverable amount.

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14. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings[a] £m	Plant and equipment[b] £m	Assets in course of construction £m	Total £m
Cost				
At 1 April 2004	1,029	34,963	724	36,716
Additions[c]	9	495	2,185	2,689
Acquisition through business combinations	96	643	23	762
Transfers	49	2,114	(2,163)	—
Exchange differences	2	50	1	53
Disposals and adjustments	(120)	(994)	(7)	(1,121)
31 March 2005	1,065	37,271	763	39,099
Additions[c]	17	653	2,038	2,708
Acquisition through business combinations	23	298	2	323
Transfers	50	1,817	(1,867)	—
Exchange differences	4	85	—	89
Disposals and adjustments	(39)	(1,757)	(41)	(1,837)
At 31 March 2006	**1,120**	**38,367**	**895**	**40,382**
Accumulated depreciation				
At 1 April 2004	346	21,277	—	21,623
Charge for the year	49	2,645	—	2,694
Acquisition through business combinations	41	444	—	485
Exchange differences	1	31	—	32
Disposals and adjustments	(66)	(988)	—	(1,054)
At 31 March 2005	371	23,409	—	23,780
Charge for the year	58	2,577	—	2,635
Acquisition through business combinations	14	228	—	242
Exchange differences	1	54	—	55
Disposals and adjustments	(32)	(1,730)	—	(1,762)
At 31 March 2006	**412**	**24,538**	**—**	**24,950**
Carrying amount				
At 31 March 2006	708	13,829	895	15,432
Engineering stores	—	—	57	57
Total carrying amount at 31 March 2006	**708**	**13,829**	**952**	**15,489**
At 31 March 2005	694	13,862	763	15,319
Engineering stores	—	—	72	72
Total carrying amount at 31 March 2005	694	13,862	835	15,391

	2006 £m	**2005 £m**
[a]The carrying amount of land and buildings comprised:		

	2006	2005
Freehold	**311**	373
Long leases (over 50 years unexpired)	**136**	50
Short leases	**261**	271
Total carrying amount of land and buildings	**708**	694

[b]The carrying amount of the group□s property, plant and equipment includes an amount of £460 million (2005: £593 million) in respect of assets held under finance leases. The depreciation charge on those assets for the year ended 31 March 2006 was £134 million (2005: £158 million).

	2006 £m	2005 £m
[c] Additions to property, plant and equipment comprised:		
Plant and equipment		
Transmission equipment	**1,429**	1,488
Exchange equipment	**80**	143
Other network equipment	**727**	648
Computers and office equipment	**281**	312
Motor vehicles and other	**123**	34
Land and buildings	**68**	64
Total additions to property, plant and equipment	**2,708**	2,689
(Decrease) increase in engineering stores	**(15)**	7
Total additions	**2,693**	2,696

15. INVESTMENTS

	2006 £m	2005[a] £m
Non current assets		
Available-for-sale	**9**	7
Loans and receivables	**8**	6
	17	13
Current assets		
Available-for-sale	**2**	1,149
Held for trading	**348**	339
Loans and receivables	**15**	2,003
	365	3,491

[a]The group adopted IAS 32 and IAS 39 from 1 April 2005. The comparative period has applied the group’s previous accounting policies in calculating the recognition and measurement basis for investments, with the exception of adjustments relating to derivatives which are now reclassified as derivative financial instruments (see accounting policies).

	2006 £m	2005[a] £m
Available-for-sale		
At 1 April	**1,156**	1,376
Additions	**195**	219
Transfer from associates and joint ventures	**86**	—
Revaluation surplus transfer to equity	**35**	—
Disposals	**(1,461)**	(439)
At 31 March	**11**	1,156
Less: Non-current available-for-sale assets	**9**	7
Current available-for-sale assets	**2**	1,149

[a]The group adopted IAS 32 and IAS 39 from 1 April 2005. The comparative period has applied the group’s previous accounting policies in calculating the recognition and measurement basis for investments, with the exception of adjustments relating to derivatives which are now reclassified as derivative financial instruments (see accounting policies).

Available-for-sale financial assets consist mainly of listed corporate debt securities and notes denominated in sterling.

	2006 £m	2005[a] £m
Held for trading		
US Government debt securities	**51**	46
US Corporate debt securities	**297**	293
	348	339

[a]The group adopted IAS 32 and IAS 39 from 1 April 2005. The comparative period has applied the group’s previous accounting policies in calculating the recognition and measurement basis for investments, with the exception of adjustments relating to derivatives which are now reclassified as derivative financial instruments (see accounting policies).

The investments included above represent listed short term debt securities with quoted market prices. The group has not designated any financial assets that are not classified as held for trading as financial assets at fair value through the income statement.

Loans and receivables

Loans and receivable financial assets mainly consist of term deposits and other fixed term debt securities denominated in sterling with a fixed coupon and options for early redemption.

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16. ASSOCIATES AND JOINT VENTURES

The group’s share of the assets, liabilities, revenue and expenses of its interest in associates and joint ventures, at 31 March, was as follows:

	Associates £m	Joint ventures £m	2006 Total £m	Associates £m	Joint ventures £m	2005 Total £m
Non current assets	20	3	**23**	12	207	219
Current assets	46	1	**47**	26	92	118
Non current liabilities	–	–	–	–	(98)	(98)
Current liabilities	(21)	(1)	**(22)**	(10)	(127)	(137)
Share of net assets	45	3	**48**	28	74	102
Revenue	74	113	**187**	53	355	408
Expenses[a]	(59)	(108)	**(167)**	(47)	(400)	(447)
Taxation	(1)	(3)	**(4)**	–	–	–
Share of post tax results	14	2	**16**	6	(45)	(39)

[a]Includes an impairment charge of £25 million recognised in the prior year, and included within specific items (see note 4).

During the 2006 financial year, the LG Telecom joint venture (carrying value £86 million), was transferred to available-for-sale assets in connection with the early redemption of the group’s US dollar convertible 2008 bond.

Details of the group’s principal associate at 31 March 2006 are set out on page 127.

17. TRADE AND OTHER RECEIVABLES

	2006 £m	2005 £m
Trade receivables	**1,662**	1,927
Prepayments	**991**	423
Accrued income	**1,254**	1,423
Other debtors	**292**	496
	4,199	4,269

Trade receivables are stated after deducting £315 million (2005: £338 million) for doubtful debts. The amount charged to the income statement for doubtful debts for the year ended 31 March 2006 was £170 million (2005: £150 million).

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18. LOANS AND OTHER BORROWINGS

	2006 £m	2005[a] £m
US dollar 8.875% notes 2030 (minimum 8.625%[b])[c]	**1,580**	1,413
Sterling 5.75% bonds 2028	**607**	596
Sterling 3.5% indexed linked notes 2025	**291**	278
Sterling 8.625% bonds 2020	**297**	297
Sterling 7.75% notes 2016 (minimum 7.5%[b])	**709**	692
Euro 7.125% notes 2011 (minimum 6.875%[b])[c]	**790**	771
US dollar 8.375% notes 2010 (minimum 8.125%[b])[c]	**1,713**	1,535
US dollar 8.765% bonds 2009[d]	**120**	106
US dollar convertible 2008 (0.75%)	****	90
US dollar 7% notes 2007[d]	**624**	529
Sterling 7.375% notes 2006 (minimum 7.125%[b])	**409**	399
Sterling 12.25% bonds 2006	****	229
Euro 6.375% notes 2006 (minimum 6.125%[b])[d]	****	2,061
US dollar 7.875% notes 2005 (minimum 7.624%[b])[d]	****	1,485
Total listed bonds, debentures and notes	**7,140**	10,481
Finance leases	**845**	1,100
Commercial paper[c,e]	**472**	
Sterling bank loans due 2007-2009 (average effective interest rate 9.7%)	**240**	240
Sterling floating rate note 2005-2009 (average effective interest rate 4.1%)	**49**	90
Sterling floating rate loan 2006 (average effective interest rate 10.3%)	****	92
Sterling floating rate loan 2009 (average effective interest rate 4.6%)	**1,003**	
Preference shares	**5**	
Bank overdrafts (of which £171 million had a legally enforceable right of set off see note 9)	**181**	2
Total other loans and borrrowings	**1,950**	424
Total loans and other borrowings	**9,935**	12,005

[a]The group adopted IAS 32 and IAS 39 from 1 April 2005. The group previously recognised the currency value of derivatives against the loans and other borrowings balance. These recognised amounts have been reclassified in the comparative period as derivative financial instruments. In addition, the underlying borrowing is stated based on previously applied UK GAAP at the amount of net proceeds adjusted to amortise any discount over the term of the debt (see accounting policies).
[b]The interest rate payable on these notes will be subject to adjustment from time to time if either Moodys or Standard and Poors (S&P) reduces the rating ascribed to the groups senior unsecured debt below A3 in the case of Moodys or below A minus in the case of S&P. In this event, the interest rate payable on the notes and the spread applicable to the floating notes will be increased by 0.25% for each ratings category adjustment by each rating agency. In addition, if Moodys or S&P subsequently increase the ratings ascribed to the groups senior unsecured debt, then the interest rate then payable on notes and the spread applicable to the floating notes will be decreased by 0.25% for each rating category upgrade by each rating agency, but in no event will the interest rate be reduced below the minimum interest rate reflected in the above table.
[c]Hedged in a designated cash flow hedge.
[d]Hedged in a designated cash flow and fair value hedge.
[e]Commercial paper is denominated in sterling (£35 million), US dollar (£66 million) and euro (£371 million).

The interest rates payable on loans and borrowings disclosed above reflect the coupons on underlying issued loans and borrowings and not the interest rates achieved through applying associated currency and interest rate swaps in hedge arrangements.

The carrying values disclosed above for the current year reflect balances at amortised cost adjusted for deferred and current fair value adjustments to the relevant loans or borrowings hedged risk in a fair value hedge. This does not reflect the final principal repayment that will arise after taking account of the relevant derivatives in hedging relationships which is reflected in the table below. Apart from finance leases all borrowings as at 31 March 2006 are unsecured.

	2006			2005		
	Carrying amount £m	Effect of hedging and interest[a] £m	Principal repayments at hedged rates £m	Carrying amount £m	Effect of hedging and interest[a] £m	Principal repayments at hedged rates £m
Repayments fall due as follows:						
Within one year, or on demand	1,940	(190)	1,750	4,261	344	4,605
Between one and two years	1,182	(3)	1,179	788	–	788
Between two and three years	337	–	337	806	43	849
Between three and four years	369	8	377	100	(2)	98
Between four and five years	2,467	55	2,522	258	17	275
After five years	3,628	63	3,691	5,792	289	6,081
Total due for repayment after more than one year	7,983	123	8,106	7,744	347	8,091
Total repayments	9,923	(67)	9,856	12,005	691	12,696
Fair value adjustments for hedged risk	12			–		
Total loans and other borrowings	**9,935**			12,005		

[a]Adjustment for hedging and interest reflects the impact of the currency element of derivatives and adjusts the repayments to exclude interest recognised in the carrying amount.

18. LOANS AND OTHER BORROWINGS continued

	Minimum lease payments 2006 £m	2005 £m	Repayment of outstanding lease obligations 2006 £m	2005 £m
Amounts payable under finance leases:				
Within one year	**361**	352	**318**	301
In the second to fifth years inclusive	**391**	695	**316**	587
After five years	**430**	439	**211**	212
	1,182	1,486	**845**	1,100
Less: future finance charges	**(337)**	(386)	—	—
Total finance lease obligations	**845**	1,100	**845**	1,100

The group's obligations under finance leases are secured by the lessors' title to the leased assets.

19. DERIVATIVE FINANCIAL INSTRUMENTS

	2006		2005[a]	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Interest rate swaps – cash flow hedge	—	**405**	—	—
Other interest rate swaps	**49**	**304**	—	—
Cross currency swaps – cash flow hedge	**20**	**417**	16	592
Cross currency swaps – fair value hedge	**12**	**16**	143	254
Forward foreign exchange contracts – cash flow hedge	**7**	**5**	—	—
Other forward foreign exchange contracts	—	**3**	2	1
Embedded derivatives – options	—	**2**	—	—
	88	**1,152**	161	847
Analysed as:				
Current	**69**	**332**	143	375
Non current	**19**	**820**	18	472
	88	**1,152**	161	847

[a]The group adopted IAS 32 and IAS 39 from 1 April 2005. The group previously recognised the currency value of derivatives against the hedged financial instrument or within other receivables and other payables. These recognised amounts have been reclassified in the comparative period as derivative financial instruments. As the balances in the comparative period only reflect the currency fair value of those instruments they are not directly comparable with those amounts disclosed in the 2006 financial year (see accounting policies).

Details of hedges in which the derivative financial instruments are utilised are disclosed in note 33.

20. TRADE AND OTHER PAYABLES

	2006 £m	2005 £m
Current		
Trade payables	**3,466**	2,921
Other taxation and social security	**521**	468
Other creditors	**945**	1,038
Accrued expenses	**488**	719
Deferred income	**1,120**	1,617
	6,540	6,763

	2006 £m	2005 £m
Non current		
Other creditors	**445**	352
Deferred income	**40**	42
	485	394

Non current payables relate to operating lease liabilities and deferred gains on a prior period sale and operating and finance leaseback transaction.

21. PROVISIONS

	Property provisions[a] £m	Other provisions[b] £m	Total £m
At 1 April 2005	192	70	262
Charged to income statement[c]	84	75	159
Unwind of discount	3	—	3
Utilised in the year	(53)	(40)	(93)
At 31 March 2006	**226**	**105**	**331**

	2006 £m	**2005 £m**
Analysed as:		
Current	**70**	60
Non-current	**261**	202
	331	262

[a]Property provisions comprise amounts provided for obligations to complete nearly finished new properties and remedial work to be undertaken on properties and the onerous lease provision on rationalisation of the group's property portfolio. The provisions will be utilised over the remaining lease periods, which range from 1 to 25 years.

[b]Other provisions include amounts provided for legal or constructive obligations arising from insurance claims and litigation which will be utilised as the obligations are settled. Also included are amounts provided for the estimated incremental and directly attributable costs arising from the group's obligation to set up Openreach, which will be utilised over two years.

[c]Includes specific items of £68 million for property rationalisation costs and £70 million for the creation of Openreach, see note 4.

22. DEFERRED TAXATION

	Excess capital allowances £m	Retirement benefit obligations £m	Share based payments £m	Other £m	Total £m
At 1 April 2004	1,988	(1,541)	—	(224)	223
Charge (credit) to income statement	(20)	35	(7)	(22)	(14)
Charge to equity	—	72	—	—	72
At 31 March 2005	1,968	(1,434)	(7)	(246)	281
Deferred tax (asset)	—	(1,434)	—	—	(1,434)
Deferred tax liability	1,968	—	(7)	(246)	1,715
At 31 March 2005	1,968	(1,434)	(7)	(246)	281
Transitional adjustment on adoption of IAS 39	—	—	—	(272)	(272)
Charge (credit) to income statement	(16)	41	(13)	132	144
Charge (credit) to equity	—	629	(5)	(36)	588
As 31 March 2006	**1,952**	**(764)**	**(25)**	**(422)**	**741**
Deferred tax (asset)	—	(764)	—	—	(764)

	Excess capital	Retirement benefit	Share based		
Deferred tax liability	1,952	–	(25)	(422)	1,505
At 31 March 2006	**1,952**	**(764)**	**(25)**	**(422)**	**741**

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22. DEFERRED TAXATION continued

At 31 March 2006 the group had operating losses, capital losses and other temporary differences carried forward in respect of which no deferred tax assets were recognised amounting to £21.8 billion. The group’s capital losses and other temporary differences have no expiry date restrictions. The expiry date of operating losses carried forward is dependent upon the tax law of the various territories in which the losses arise. A summary of expiry dates for losses in respect of which restrictions apply is set out below:

Territory	2006 £m	Expiry of losses
Restricted losses:		
Americas	**286**	2012-2026
Europe	**821**	2006-2022
Total restricted losses	**1,107**	
Unrestricted losses:		
Operating losses	**1,475**	No expiry
Capital losses	**18,311**	No expiry
Other	**902**	No expiry
Total unrestricted losses	**20,688**	
Total	**21,795**	

At the balance sheet date, the undistributed earnings of overseas subsidiaries was £8.6 billion. No deferred tax liabilities have been recognised in respect of those unremitted earnings because the group is in a position to control the timing of the reversal of these temporary differences and it is probable that such differences will not reverse in the foreseeable future. Temporary differences arising in connection with interests in associates and joint ventures are insignificant.

23. MINORITY INTERESTS

	2006 £m	2005 £m
At beginning of year	**50**	46
Acquisition	—	3
Share of profits	**1**	(1)
Disposal	—	1
Exchange adjustments	**1**	1
At end of year	**52**	50

24. RECONCILIATION OF MOVEMENTS IN EQUITY

	2006 £m	2005 £m

	2006	2005
Total equity at beginning of year	**95**	(1,039)
Transition to IAS 32 and IAS 39	**(209)**	
Profit for the year	**1,548**	1,829
Dividends	**(912)**	(786)
Share based payments	**65**	20
Issue of shares	**4**	1
Net purchase of treasury shares	**(344)**	(176)
Exchange differences on translation	**24**	27
Actuarial gains	**2,122**	294
Net fair value movements on cash flow hedges	**(200)**	
Tax on items taken directly to equity	**(588)**	(79)
Minority interest	**2**	4
Net movement in equity	**1,512**	1,134
Total equity at the end of year	**1,607**	95

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25. SHARE CAPITAL

	Share capital[a] £m	Share premium[b] £m
Balances at 1 April 2004	432	2
Arising on share issues	—	1
Balances at 31 March 2005	432	3
Arising on share issues	—	4
Balances at 31 March 2006	**432**	**7**

[a]The authorised share capital of the company throughout the years ended 31 March 2006 and 31 March 2005 was £13,463 million representing 269,260,253,468 ordinary shares of 5p each. The allotted, called up and fully paid ordinary share capital of the company at 31 March 2006 was £432 million (2005: £432 million), representing 8,635,377,801 ordinary shares of 5p each (2005: 8,634,629,038). Of the authorised but unissued share capital at 31 March 2006 26 million ordinary shares (2005: 26 million) were reserved to meet options granted under employee share option schemes.
[b]The share premium account, representing the premium on allotment of shares is not available for distribution.

26. OTHER RESERVES AND RETAINED EARNINGS

	Treasury shares[a] £m	Cash flow reserve[b] £m	Available-for -sale reserve[c] £m	Translation reserve[d] £m	Merger and other reserves[e] £m	Total other reserves £m	Retained earnings £m
At 1 April 2004	(80)	—	—	—	998	**918**	**(2,439)**
Profit for the year	—	—	—	—	—	—	**1,829**
Foreign exchange adjustments	—	—	—	27	—	**27**	—
Share based payments	—	—	—	—	—	—	**20**
Dividends	—	—	—	—	—	—	**(786)**
Net purchase of treasury shares	(176)	—	—	—	—	**(176)**	—
Actuarial gain	—	—	—	—	—	—	**294**
Tax on items taken directly to equity	—	—	—	(7)	—	**(7)**	**(72)**
At 31 March 2005	(256)	—	—	20	998	**762**	**(1,154)**
Transition to IAS 32 and IAS 39[f]	—	77	—	—	—	**77**	**(286)**
At 1 April 2005	(256)	77	—	20	998	**839**	**(1,440)**
Profit for the year	—	—	—	—	—	—	**1,548**
Foreign exchange adjustments	—	—	—	53	—	**53**	—
Share based payments	—	—	—	—	—	—	**65**
Dividends	—	—	—	—	—	—	**(912)**
Net purchase of treasury shares	(344)	—	—	—	—	**(344)**	—
Actuarial gain	—	—	—	—	—	—	**2,122**

	Treasury shares[a]	Cash flow reserve[b]	Available-for -sale reserve[c]	Translation reserve[d]	Merger and other reserves[e]	Total other reserves	Retained earnings
Net fair value gains	—	4	—	—	—	**4**	—
Gains on available for sale investments	—	—	35	—	—	**35**	—
Fair value loss on net investment hedge	—	—	—	(20)	—	**(20)**	—
Recognised in income and expense in the year	—	(204)	(35)	(9)	—	**(248)**	—
Tax on items taken directly to equity	—	45	—	—	—	**45**	**(633)**
At 31 March 2006	**(600)**	**(78)**	—	**44**	**998**	**364**	**750**

[a]During the year ended 31 March 2006 the company repurchased 165,772,145 (2005: 101,280,000) of its own shares of 5p each representing 2% of the called-up share capital, for an aggregate consideration of £365 million (2005: £195 million). At 31 March 2006 290,047,231 shares (2005: 134,497,000) shares with an aggregate nominal value of £15 million are held as treasury shares at cost.
[b]The cash flow reserve is used to record the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.
[c]The available-for-sale reserve is used to record the cumulative fair value gains and losses on available for sale financial assets. The cumulative gains and losses are recycled to the income statement on disposal of the assets. The gross gain in the period amounted to £35 million.
[d]The translation reserve is used to record cumulative translation differences on the assets and liabilities of foreign operations. The cumulative translation differences are recycled to the income statement on disposal of the foreign operation.
[e]The merger reserve arose on the group reorganisation that occurred in November 2001 and represents the difference between the nominal value of shares in the new parent company, BT Group plc, and the share capital, share premium and capital redemption reserve of the prior parent company, British Telecommunications plc. Other reserves included within this caption relate primarily to unrealised gains and losses on the transfer of assets and group undertakings to a joint venture.
[f] The total impact on reserves of the IAS 32 and IAS 39 transitional adjustments is a charge of £209 million.

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27. RELATED PARTY TRANSACTIONS

Amounts paid to the group's retirement benefit plans are set out in note 29. There were a number of transactions during the year between the company and its subsidiary undertakings, which are eliminated on consolidation and therefore not disclosed.

Key management personnel are deemed to be members of the Operating Committee. It is this committee which has responsibility for planning, directing and controlling the activities of the group. Key management personnel compensation, including the group's directors, is shown in the table below:

	2006 £m	2005 £m
Salaries and short-term benefits	**5.8**	5.2
Post employment benefits	**1.9**	1.1
Share based payments	**2.6**	1.8
	10.3	8.1

More detailed information concerning directors' remuneration, shareholdings, pension entitlements, share options and other long-term incentive plans is shown in the audited part of the Report on directors' remuneration.

28. FINANCIAL COMMITMENTS AND CONTINGENT LIABILITIES

Capital expenditure contracted for at the balance sheet date but not yet incurred was:

	2006 £m	2005 £m
Property, plant and equipment and software	**754**	735

Future minimum operating lease payments for the group were as follows:

	2006 £m	2005 £m
Payable in the year ending 31 March:		
2006		459
2007	**474**	450
2008	**449**	442
2009	**439**	430
2010	**429**	419
2011	**414**	410
Thereafter	**7,577**	7,574
Total future minimum operating lease payments	**9,782**	10,184

Operating lease commitments were mainly in respect of land and buildings. Leases have an average term of 25 years and rentals are fixed for an average of 25 years.

At 31 March 2006, other than disclosed below, there were no contingent liabilities or guarantees other than those arising in the ordinary course of the group's business and on these no material losses are anticipated. The group has insurance cover to certain limits for major risks on property and major claims in connection with legal liabilities arising in the course of its operations. Otherwise, the group generally carries its own risks.

The group has provided guarantees relating to certain leases entered into by O2 UK Limited prior to its demerger with O2 on 19 November 2001. O2 plc has given BT a counterindemnity for these guarantees. The maximum likely exposure is US$72 million (£42 million) as at 31 March 2006, although this could increase by a further US$545 million (£314 million) in the event of credit default in respect of amounts used to defease future lease obligations. The guarantee lasts until O2 UK Ltd has discharged all its obligations, which is expected to be when the lease ends on 30 January 2017.

The company does not believe there are any pending legal proceedings which would have a material adverse effect on the financial position or results of operations of the group.

There have been criminal proceedings in Italy against 21 defendants, including a former BT employee, in connection with the Italian UMTS auction. Blu, in which BT held a minority interest, participated in that auction process. On 20 July 2005, the former BT employee was found not culpable of the fraud charge brought by the Rome Public Prosecutor. All the other defendents were also acquitted. The Public Prosecutor is in the process of appealing the courts decision. If the appeal is successful, BT could be held liable, with others, for any damages. The company has concluded that it would not be appropriate to make a provision in respect of any such claim.

The European Commission is formally investigating the way the UK Government has set BTs property rates and those paid by Kingston Communications. The Commission is examining whether the Government has complied with EC Treaty rules on state aid in assessing BTs rates. BTs rates were set by the Valuation Office after lengthy discussions based on well established principles, in a transparent process. In BTs view, any allegation of state aid is groundless and BT is confident that the Government will demonstrate the fairness of the UK ratings system. A finding against HM Government could result in BT having to repay any amount of state aid it may be determined to have received. The company has concluded that it is not appropriate to make a provision in respect of any such potential finding.

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29. RETIREMENT BENEFIT PLANS

Background

The group offers retirement plans to its employees. The groups main scheme, the BT Pension Scheme (BTPS), is a defined benefit scheme where the benefits are based on employees length of service and final pensionable pay. The BTPS is funded through a legally separate trustee administered fund. This scheme has been closed to new entrants since 31 March 2001 and replaced by a defined contribution scheme. Under this defined contribution scheme the income statement charge represents the contribution payable by the group based upon a fixed percentage of employees pay. The total pension costs of the group, included within the staff costs, in the year was £603 million (2005: £540 million), of which £552 million (2005: £507 million) related to the groups main defined benefit pension scheme, the BTPS.

The increase in the pension cost in the 2006 financial year principally reflects the introduction part way through the 2005 financial year of Smart Pensions, a salary sacrifice scheme under which employees elect to stop making employee contributions and for the company to make additional contributions in return for a reduction in gross contractual pay. As a result there has been a switch between wages and salaries and pension costs of £19 million in the year.

The pension cost applicable to the groups main defined contribution scheme in the year ended 31 March 2006 was £19 million (2005: £11 million) and £2 million (2005: £1 million) of contributions to the scheme were outstanding at 31 March 2006.

The group occupies two properties owned by the BTPS scheme on which an annual rental of £2 million is payable. The BTPS assets are invested in UK and overseas equities, UK and overseas properties, fixed interest and index linked securities, deposits and short-term investments. At 31 March 2006, the UK equities included 15 million (2005: 17 million) ordinary shares of the company with a market value of £33 million (2005: £36 million).

IAS 19 accounting valuation

In accordance with the amendments to IAS 19 Employee Benefits the disclosures below are provided prospectively from the 2005 financial year onwards. BT has applied the accounting requirements of IAS 19 as follows:

 scheme assets are measured at market value at the balance sheet date;
 scheme liabilities are measured using a projected unit credit method and discounted at the current rate of return on high quality corporate bonds of equivalent term to the liability; and
 actuarial gains and losses are recognised in full in the period in which they occur, outside of the income statement, in retained earnings and presented in the statement of recognised income and expense.

The financial assumptions used for the purpose of the actuarial accounting valuations of the BTPS under IAS 19 at 31 March 2006 are:

	Real rates (per annum)		Nominal rates (per annum)	
	2006 %	**2005 %**	**2006 %**	**2005 %**
Rate used to discount liabilities	**2.19**	2.63	**5.00**	5.40
Average future increases in wages and salaries	**0.75**[a]	1.00	**3.52**[a]	3.73
Average increase in pensions in payment and deferred pensions			**2.75**	2.70
Inflation average increase in retail price index			**2.75**	2.70

[a]There is a short term reduction in the real salary growth assumption to 0.5% for the first three years.

The net pension obligation is set out below:

	2006	2005

	2006			2005		
	Assets £m	**Present value of liabilities £m**	**Deficit £m**	**Assets £m**	**Present value of liabilities £m**	**Deficit £m**
BTPS	**35,550**	**38,005**	**2,455**	29,550	34,270	4,720
Other schemes	**90**	**182**	**92**	78	165	87
	35,640	**38,187**	**2,547**	29,628	34,435	4,807
Deferred tax asset at 30%			**(764)**			(1,434)
Net pension obligation			**1,783**			3,373

Amounts recognised in the income statement on the basis of the above assumptions in respect of pension obligations are as follows:

	2006 £m	**2005 £m**
Current service cost	**603**	540
Total operating charge	**603**	540
Expected return on pension scheme assets	**(2,070)**	(1,918)
Interest on pension scheme liabilities	**1,816**	1,720
Net finance income	**(254)**	(198)
Total amount charged to the income statement	**349**	342

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29. RETIREMENT BENEFIT PLANS continued

Actuarial gains and losses have been recognised in the statement of recognised income and expense and the cumulative gain recognised is £2,416 million at 31 March 2006 (2005: £294 million). The actual return on plan assets was £6,925 million (2005: £3,582 million).

Changes in the present value of the defined benefit pension obligation are as follows:

	2006 £m	2005 £m
Opening defined benefit pension obligation	**(34,435)**	(32,125)
Service cost	**(568)**	(507)
Interest cost	**(1,816)**	(1,720)
Contributions by employees	**(21)**	(50)
Actuarial losses	**(2,733)**	(1,370)
Obligation on acquisition of subsidiaries	**—**	(25)
Benefits paid	**1,385**	1,364
Exchange differences	**1**	(2)
Closing defined benefit pension obligation	**(38,187)**	(34,435)

The present value of the obligation is derived from long term cash flow projections and is thus inherently uncertain.

Changes in the fair value of plan assets are as follows:

	2006 £m	2005 £m
Opening fair value of plan assets	**29,628**	26,963
Expected return	**2,070**	1,918
Actuarial gains	**4,855**	1,664
Contributions by employer	**452**	382
Contributions by employees	**21**	50
Assets on acquisition of subsidiaries	**—**	15
Benefits paid	**(1,385)**	(1,364)
Exchange differences	**(1)**	—
Closing fair value of plan assets	**35,640**	29,628

The expected long term rate of return and fair values of the assets of the BTPS at 31 March were:

	2006			2005		
	Expected long-term rate of return (per annum) %	Asset fair value £bn	%	Expected long-term rate of return (per annum) %	Asset fair value £bn	%
UK equities	**7.4**	**9.9**	**28**	8.0	9.6	32

			2006			2005
Non-UK equities	**7.4**	**12.5**	**35**	8.0	9.0	30
Fixed-interest securities	**4.9**	**5.6**	**16**	5.4	4.6	16
Index-linked securities	**4.1**	**3.2**	**9**	4.4	2.8	10
Property	**5.8**	**4.4**	**12**	6.8	3.6	12
Cash and other	**4.0**	**—**	**—**	4.0	—	—
	6.5	**35.6**	**100**	7.1	29.6	100

The assumption for the expected return in scheme assets is a weighted average based on the assumed expected return for each asset class and the proportions held of each asset class at the beginning of the year. The expected returns on fixed interest and interest linked securities are based on the gross redemption yields at the start of the year. Expected returns on equities and property are based on a combination of an estimate of the risk premium above, yields on government bonds and consensus economic forecasts of future returns. The long-term expected rate of return on investments does not affect the level of the obligation but does affect the expected return on pension scheme assets within the net finance income.

The history of experience gains and losses are as follows:

	2006 £m	2005 £m
Present value of defined benefit obligation	**38,187**	34,435
Less: Fair value of plan assets	**35,640**	29,628
Net pension obligation	**2,547**	4,807
Experience adjustment on defined benefit obligation	**(527)**	(437)
Percentage of the present value of the defined benefit obligation	**1.4%**	1.3%
Experience adjustment on plan assets	**4,855**	1,664
Percentage of the plan assets	**13.6%**	5.6%

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29. RETIREMENT BENEFIT PLANS continued

The group expects to contribute approximately £630 million to the BTPS, including £232 million of deficiency contributions, in the 2007 financial year.

The mortality assumption has been updated to reflect experience and expected future improvements in life expectancy. The average life expectancy assumptions, after retirement at 60 years of age, are as follows:

	2006 Number of years	2005 Number of years
Male	**23.8**	23.3
Female	**25.4**	25.0
Future improvement every 10 years	**1.0**	0.5

The assumed discount rate, salary increases and mortality all have a significant effect on the IAS 19 accounting valuation. The following table shows the sensitivity of the valuation to changes in these assumptions.

	Impact on deficit Increase/(Decrease) £bn
0.25 percentage point increase to:	
discount rate	**(1.4)**
salary increases	**0.3**
Additional 1.0 year increase to life expectancy	**1.5**

Funding valuation

A triennial valuation is carried out for the independent scheme trustees by a professionally qualified independent actuary, using the projected unit credit method. The purpose of the valuation is to design a funding plan to ensure that present and future contributions should be sufficient to meet future liabilities. The triennial valuation as at 31 December 2005, is currently being performed and reviewed in the context of recent regulatory developments and the impact of the Crown Guarantee granted on privatisation in 1984. Until that concludes contributions will continue to be paid in accordance with the 2002 funding plan. The contributions for the 2005 and 2006 financial years were based on the 31 December 2002 valuation. The funding valuation is performed at 31 December because this is the financial year end of the BTPS.

The valuation basis for funding purposes is broadly as follows:

- scheme assets are valued at market value at the valuation date; and,
- scheme liabilities are measured using a projected unit credit method and discounted at the estimated rate of return reflecting the assets of the scheme.

The last three triennial valuations were determined using the following long-term assumptions:

	Real rates (per annum)			Nominal rates (per annum)		
	2002 valuation %	1999 valuation %	1996 valuation %	2002 valuation %	1999 valuation %	1996 valuation %
Return on existing assets, relative to market values	4.52	2.38	3.80	7.13	5.45	7.95

	Real rates (per annum)			**Nominal rates (per annum)**		
(after allowing for an annual increase in dividends of)	1.00	1.00	0.75	3.53	4.03	4.78
Return on future investments	4.00	4.00	4.25	6.60	7.12	8.42
Average increase in retail price index	—	—	—	2.50	3.00	4.00
Average future increases in wages and salaries	1.5[a]	1.75	1.75	4.04[a]	4.80	5.82
Average increase in pensions	—	—	—	2.50	3.00	3.75-4.00

[a]There is a short term reduction in the real salary growth assumption to 1.25% for the first three years.

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29. RETIREMENT BENEFIT PLANS continued

At 31 December 2002, the assets of the BTPS had a market value of £22.8 billion (1999: £29.7 billion) and were sufficient to cover 91.6% (1999: 96.8%) of the benefits accrued by that date, after allowing for expected future increases in wages and salaries but not taking into account the costs of providing incremental pension benefits for employees leaving under release schemes since that date. This represents a funding deficit of £2.1 billion compared to £1.0 billion at 31 December 1999. The funding valuation uses conservative assumptions whereas, had the valuation been based on the actuarys view of the median estimate basis, the funding deficit would have been reduced to £0.4 billion. Although the market value of equity investments had increased and the investment income and contributions received by the scheme exceeded the benefits paid by £0.3 billion in the three years ended 31 December 2002, the deficit has not improved by the same amount as the liabilities have been calculated on a more prudent basis. As a result of the triennial funding valuation the group agreed to make employers contributions at a rate of 12.2% of pensionable pay from April 2006 and annual deficiency payments of £232 million. This compared to the employers contribution rate of 11.6% and annual deficiency payments of £200 million that were determined under the 1999 funding valuation.

In the year ended 31 March 2006, the group made regular contributions of £396 million (2005: £376 million). Additional special contributions were paid for enhanced pension benefits to leavers in the year ended 31 December 2004 of £nil (2005: £6 million). Deficiency contributions of £54 million were also made (2005: £nil) as a result of the early payment of £380 million made in the 2004 financial year that was scheduled for payment in subsequent years.

Under the terms of the trust deed that governs the BTPS, the group is required to have a funding plan that should address the deficit over a maximum period of 20 years. The agreed funding plan addresses the deficit over a period of 15 years. The group will continue to make deficiency payments until the deficit is made good. The BTPS was closed to new entrants on 31 March 2001 and the age profile of active members will consequently increase. Under the projected unit credit method, the current service cost, as a proportion of the active members pensionable salaries, is expected to increase as the members of the scheme approach retirement. Despite the scheme being closed to new entrants, the projected payment profile extends over more than 60 years.

30. EMPLOYEES

	2006		2005	
	Year end 000	Average 000	Year end 000	Average 000
Number of employees in the group:				
UK	**92.7**	**91.5**	90.8	90.7
Non-UK	**11.7**	**11.5**	11.3	8.9
Total employees	**104.4**	**103.0**	102.1	99.6

	2006		2005	
	Year end 000	Average 000	Year end 000	Average 000
Number of employees in the group:				
BT Retail	**20.6**	**19.9**	20.4	20.7
BT Wholesale	**45.3**	**44.5**	43.6	43.0
BT Global Services	**27.8**	**28.7**	28.4	26.0
Other	**10.7**	**9.9**	9.7	9.9
Total employees	**104.4**	**103.0**	102.1	99.6

	2006	2005

31. SHARE BASED PAYMENT PLANS

The total charge recognised in the income statement for the year in respect of share based payment plans was £76 million (2005: £50 million). The total value of share options and awards granted in the year ended 31 March 2006 was £64 million (2005: £77 million).

The company has an employee share investment plan and savings-related share option plans for its employees and those of participating subsidiaries, further share option plans for selected employees and an employee stock purchase plan for employees in the United States. It also has several share plans for executives. All share based payment plans are equity settled and details of these plans are provided below.

Share option plans

BT Group Employee Sharesave plans

There is an HM Revenue and Customs-approved savings related share option plan, under which employees save on a monthly basis, over a three or five year period, towards the purchase of shares at a fixed price determined when the option is granted. This price is usually set at a 20% discount to the market price for five year plans and 10% for three year plans. The options must be exercised within six months of maturity of the savings contract, otherwise they lapse. Options are granted annually, usually in June. Similar plans operate for BT's overseas employees.

Employees may cancel sharesave options and remain employed by the group. In such cases the options so cancelled do not vest and the monthly savings contributions are returned to the employee, with interest if applicable. Such events are accounted for by ceasing to record a share based payments charge from the date of the employee's withdrawal from the relevant plan. Previously recorded compensation expense is not reversed, and no charge is made for the accelerated vesting of future options that will not now vest.

31. SHARE BASED PAYMENT PLANS continued

For options outstanding at 31 March 2006 and 2005, the weighted average exercise prices are shown below.

	2006		**2005**	
	Number of share options millions	**Weighted average exercise price**	**Number of share options millions**	**Weighted average exercise price**
Outstanding at the beginning of the year	**262**	**169p**	233	180p
Granted during the year	**59**	**179p**	91	149p
Forfeited during the year	**(20)**	**173p**	(59)	176p
Exercised during the year	**(2)**	**215p**	–	–
Expired during the year	**(20)**	**216p**	(3)	176p
Outstanding at the end of the year	**279**	**166p**	262	169p
Exercisable at the end of the year	–	–	16	218p

Options were exercised regularly throughout the year. The weighted average option price of options exercised during the year was 205p (2005: 183p).

The weighted average fair value of savings related share options granted during the year ended 31 March 2006 has been estimated on the date of grant using a binomial option pricing model. The following weighted average assumptions were used in that model: an expected life extending three months later than the first exercise date; share price at date of grant of 223p; estimated annualised dividend yield of approximately 5% (2005: 5%); risk free interest rates of approximately 4% (2005: 5%); and expected volatility of approximately 25% (2005: 25%). Volatility has been determined by reference to BT’s historical volatility over a three-year period, which is expected to reflect the share price of BT in the future. The exercise prices are 192p for Sharesave options exercisable three years after the date of grant and 171p for Sharesave options exercisable five years after the date of grant. The weighted average fair value of the share options granted in the year ended 31 March 2006 was 44p (2005: 41p) for Sharesave options exercisable three years after the date of grant and 55p (2005: 52p) for Sharesave options exercisable five years after the date of grant.

Options granted under BT’s international sharesave, which is a three-year plan, have been valued using the same assumptions. The weighted average fair value of these share options is 49p (2005: 52p). The exercise price is 171p, and the share price at date of grant was 214p.

Global Share Option Plan (GSOP)

There were no options granted under the GSOP in the 2006 financial year. The options granted in previous years will be exercisable subject to continued employment and meeting corporate performance targets. These options were valued using Monte Carlo Simulations. The weighted average fair value of options granted under the 2005 GSOP was estimated as 36p. The following weighted average assumptions were used in that model: dividend yield of 5%, expected volatility of 25% and risk free interest rates of 4%. Details of this plan are provided in the Report on directors’ remuneration.

BT Group Legacy Option Plan

On the demerger of O2, BT’s share option plans ceased to operate and were replaced by similar BT Group Employee Sharesave plans and the BT Group Global Share Option Plan.

The BT Group Legacy Option Plan was launched on 17 December 2001 following the scheme of arrangement and demerger of O2 in November 2001, and is therefore outside the scope of IFRS 2. Replacement unapproved options over BT Group shares were granted to all participants in the executive option plans who had released their options over British Telecommunications plc shares. The value of the replacement options was determined by averaging the combined prices of BT Group plc and O2 plc shares over the 20 dealing days following the demerger on 19 November 2001. This resulted in a factor of 1.3198 being applied to the former option over British Telecommunications plc shares in order to give the number of BT Group shares under the new option. The option prices of the original options were also adjusted to take account of the different number of shares under option. The options are exercisable subject to continued employment and meeting corporate performance targets, on the third anniversary of the date of grant.

For options outstanding at 31 March 2006 and 2005 in respect of the BT Global Share Option Plan and the BT Group Legacy Option Plan, the weighted average exercise prices are shown below.

	2006		**2005**	
	Number of share options millions	**Weighted average exercise price**	**Number of share options millions**	**Weighted average exercise price**
Outstanding at the beginning of the year	**206**	**213p**	194	216p
Granted during the year	**—**	**—**	31	193p
Forfeited during the year	**(16)**	**205p**	(18)	193p
Exercised during the year	**(3)**	**199p**	—	—
Expired during the year	**—**	**—**	(1)	353p
Outstanding at the end of the year	**187**	**213p**	206	213p
Exercisable at the end of the year	**57**	**280p**	34	206p

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31. SHARE BASED PAYMENT PLANS continued

Outstanding options

Options outstanding under all share option plans at 31 March 2006 and 2005, together with their exercise prices and dates, were as follows:

Normal dates of exercise	2006 Option price per share	2006 millions	2005 Option price per share	2005 millions
BT Group Employee Sharesave plans				
2005	—	—	218p-255p	20
2006	**154p-173p**	**20**	154p-173p	22
2007	**146p-227p**	**50**	146p-227p	57
2008	**154p-192p**	**103**	154p	92
2009	**146p**	**66**	146p	71
2010	**171p**	**40**	—	—
Total		**279**		262
BT Group Legacy Option Plan				
2001-2011	**318p-602p**	**14**	318p-602p	15
Total		**14**		15
BT Group Global Share Option Plan				
2005-2012	**163p-263p**	**45**	163p-263p	51
2004-2014	**176p-199.5p**	**100**	176p-199.5p	110
2007-2015	**179p-215p**	**28**	179p-215p	30
Total		**173**		191
Total outstanding options		**466**		468

The options outstanding under all share option plans at 31 March 2006 and 2005 have weighted average remaining contractual lives as follows:

Executive plans

2006				2005			
Range of exercise prices	Weighted average exercise price	Number of outstanding share options (millions)	Weighted average contractual remaining life	Range of exercise prices	Weighted average exercise price	Number of outstanding share options (millions)	Weighted average contractual remaining life
150p - 249p	**195p**	**171**	**89 months**	150p - 249p	195p	190	100 months
250p - 349p	**302p**	**8**	**65 months**	250p - 349p	304p	8	77 months
350p - 650p	**552p**	**8**	**53 months**	350p - 650p	554p	8	65 months
Total		**187**				206	

All-employee plans

			2006				2005
Range of exercise prices	Weighted average exercise price	Number of outstanding options (millions)	Weighted average contractual remaining life	Range of exercise prices	Weighted average exercise price	Number of outstanding options (millions)	Weighted average contractual remaining life
100p - 199p	**158p**	**243**	**39 months**	100p - 199p	154p	203	47 months
200p - 300p	**220p**	**36**	**18 months**	200p - 300p	222p	59	22 months
Total		**279**				262	

Other share based payment plans

Incentive Share Plan, Deferred Bonus Plan and Retention Share Plan

The BT Group Incentive Share Plan (ISP) and the BT Group Retention Share Plan (RSP) were introduced for employees of the group in 2001. Under the plans, company shares are conditionally awarded to participants.

Under the ISP, participants are only entitled to these shares in full at the end of a three-year period if the company has met the relevant pre-determined corporate performance measure and if the participants are still employed by the group. The corporate performance measure is BTs total shareholder return (TSR) measured against a group of companies from the European Telecom Sector at the beginning of the relevant performance period. The ISP was operated in the 2006 financial year with 1,382 participants receiving awards over 23,183,408 shares (2005: 1,406 participants received awards over 12,654,013 shares). Awards under the ISP have been valued using Monte Carlo Simulations. TSRs were generated for BT and the comparator group at the end of the three-year performance period, using each companys volatility and dividend yield, as well as the cross correlations between pairs of stocks. Simulations were run using averaged one and three-year volatility and dividend yield for BT and the comparator group. The weighted average fair value of awards of shares granted under the ISP has been estimated at 124p (2005: 98p).

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31. SHARE BASED PAYMENT PLANS continued

Historical dividend yields of 4.8% and 4.1% and volatility of 18% and 24% were used in the one-year and three-year models respectively.

Under the RSP, the length of retention period before awards vest is flexible. Awards may vest in annual tranches. The shares are transferred at the end of a specified period, only if the participant is still employed by the group. During the 2006 financial year 1,107,330 shares vested in 16 participants in the RSP (2005: 1,340,256 shares vested in 11 participants).

The BT Deferred Bonus Plan (DBP) was established in 1998 and awards are granted annually to selected employees of the group. Under this plan, shares in the company are transferred to participants at the end of three years if they continued to be employed by the group throughout that period. On 1 August 2005, 1,966,496 shares (2 August 2004: 1,280,934 shares) were transferred to 193 participants (2 August 2004: 219 participants) at the end of the three-year deferred period. At 31 March 2006, 24.7 million shares (2005: 27.8 million shares) in the company were held in trust for employee share plans, of which 12.4 million shares (2005: 12.7 million shares) were held for the ISP, 2.9 million shares (2005: 2.8 million shares) were held for the RSP and 5.9 million shares (2005: 7.9 million shares) were held for the DBP. In accordance with the terms of the plans, dividends or dividend equivalents earned on the shares during the conditional periods are reinvested in company shares for the potential benefit of the participants.

Awards under the DBP and RSP were valued by reference to the weighted average market price of the shares on the date of grant of 223p and 216p respectively.

Employee Share Investment Plan

The BT Group Employee Share Investment Plan (ESIP) has been in operation since December 2001. The ESIP, which has been approved by HM Revenue & Customs, comprises directshare and allshare. Under directshare, UK employees are given an opportunity to purchase shares (partnership shares) out of pre-tax salary up to a maximum value of £1,500 per year. During the 2006 financial year, 6.4 million shares (2005: 6.1 million shares), including 0.8 million shares (2005: 0.2 million shares) purchased by dividend reinvestment, were purchased by the Trustee of the ESIP on behalf of 14,443 (2005: 13,017) employees at a total cost of £13.7 million (2005: £11.7 million). Allshare, the free shares element of the ESIP allows BT to provide free shares to UK employees which are held in trust for at least three years. Employees outside the UK receive cash awards equivalent to the value of the free shares. In 2006, 1% (2005: 0.5%) of pre-tax profits, amounting to £22 million, was allocated to allshare (2005: £11 million). Up to 2% of pre-tax profits would have been available subject to meeting two corporate performance targets; one of these to maintain earnings per share at the same level as in the 2005 financial year, and the other to have five percent more customers very or extremely satisfied with BT (provided the percentage of customers who are dissatisfied did not increase compared with the 2005 financial year). The earnings per share target was met but not the one for customer satisfaction. The ESIP replaced the BT Employee Share Ownership Scheme which operated for employee profit sharing until 2001.

Employee Stock Purchase Plan

The BT Group Employee Stock Purchase Plan (ESPP), for employees in the US, enables participants to purchase American Depositary Shares (ADS) quarterly at a price (the Initial Base Option Price) which is 85% of the fair market price of an ADS at the start of the Initial Enrolment Period (or, in the case of employees who enrol in the ESPP after the Initial Enrolment Period, 85% of the fair market price of an ADS on the last business day of the calendar quarter immediately following enrolment). From 15 May 2005 to 15 May 2006, 1,750,560 shares (175,056 ADSs) have been transferred to participants out of treasury under the ESPP (from 15 May 2004 to 15 May 2005, 934,782 shares (93,478 ADSs)). The third offer, with an Initial Base Option Price of US$31.52 ended in December 2005. A fourth offer was launched in December 2005 with an Initial Base Option Price of US$32.53 and will expire in December 2006.

32. AUDIT SERVICES

The auditors remuneration for the year ended 31 March 2006 for the group was £5,593,000 (2005: £4,396,000). The audit fees payable to the company's auditors, PricewaterhouseCoopers LLP, for the company and UK subsidiary undertakings statutory accounts were £3,351,000 (2005: £2,454,000). The audit fee of the company was £37,700 (2005: £35,000). The following fees for audit and non-audit services were paid or are payable to the company's auditors, PricewaterhouseCoopers LLP, for the years ended 31 March 2006 and 31 March 2005.

	2006 £000	2005 £000
Audit services		
Statutory audit	**5,538**	4,148
Regulatory audit	**1,065**	1,423
	6,603	5,571
Further assurance services		
Corporate finance advice	**317**	989
Other	**311**	110
	628	1,099
Tax services	**1,775**	2,912
Other services	**216**	434
Total	**9,222**	10,016

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32. AUDIT SERVICES continued

Total fees paid or payable to PricewaterhouseCoopers LLP in the UK for non audit services in the year ended 31 March 2006 were £3,015,000 (2005: £5,171,000).

In order to maintain the independence of the external auditors, the Board has determined policies as to what non audit services can be provided by the company's external auditors and the approval processes related to them. Under those policies work of a consultancy nature will not be offered to the external auditors unless there are clear efficiencies and value added benefits to the company.

BT's regulatory obligations require it to publish audited regulatory financial statements. The fees for regulatory work principally reflect the audit fees associated with those regulatory financial statements. The fees for tax services include tax compliance and tax advisory services.

33. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The group adopted IAS 32, 'Financial Instruments: Disclosure and Presentation' and IAS 39, 'Financial Instruments: Recognition and Measurement' with effect from 1 April 2005. Financial information was previously prepared under UK GAAP for the financial year ended 31 March 2005. Where applicable, information for the comparative period has been separately disclosed below in order to comply with the previous requirements of UK GAAP.

The group issues or holds financial instruments mainly to finance its operations; for the temporary investment of short-term funds; and to manage the currency and interest rate risks arising from its operations and from its sources of finance. In addition, various financial instruments, for example trade receivables and trade payables, arise directly from the group's operations.

The group finances its operations primarily by a mixture of issued share capital, retained profits, deferred taxation, long-term loans and short-term loans, principally by issuing commercial paper supported by a committed borrowing facility. The group borrows in the major long-term debt markets in major currencies. Typically, but not exclusively, the bond markets provide the most cost-effective means of long-term borrowing. The group uses derivative financial instruments primarily to manage its exposure to market risks from changes in interest and foreign exchange rates against these borrowings. The derivatives used for this purpose are principally interest rate swaps, cross currency swaps and forward currency contracts.

The group also uses financial instruments to hedge some of its currency exposures arising from its overseas short-term investment funds and other non-UK assets, liabilities and forward purchase commitments. The financial instruments used comprise borrowings in foreign currencies and forward currency contracts and interest and cross currency swaps.

The group does not hold or issue derivative financial instruments for trading purposes. All transactions in derivative financial instruments are undertaken to manage the risks arising from underlying business activities.

The group's profile of borrowings and short-term funds is managed with consideration of the cash flow from operations. These borrowings and short term funds are managed by the centralised treasury operation. The types of financial instrument used for investment of short-term funds are prescribed in group treasury policies with limits on the exposure to any one organisation. Short-term investment in financial instruments is partially undertaken on behalf of the group by substantial external fund managers who are limited to dealing in debt instruments and certain defined derivative instruments and are given strict guidelines on credit, diversification and maturity profiles.

The group has a centralised treasury operation whose 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 policy for the group's centralised treasury operation and its activities are subject to a set of controls commensurate with the magnitude of the borrowings and investments under its management. Counterparty credit risk is closely monitored and managed within controls set by the Board.

During the year ended 31 March 2006 the group's net debt (note 10) reduced from £7.9 billion to £7.5 billion mainly due to operational and working capital inflows. During the 2006 financial year two substantial notes matured, namely the 2005 US dollar 7.875% notes and 2006 Euro 6.375% notes amounting to £3.8 billion and were primarily funded from current financial assets and cash and cash equivalents. The group utilised its commercial paper programme during the year, which was supported by a committed borrowing facility, as well as raising a sterling floating rate borrowing of £1 billion.

During the year ended 31 March 2005, the group's net debt reduced from £8.5 billion to £7.9 billion mainly from working capital inflows and proceeds from the sale of investments. During the 2005 financial year, the group restructured some of its swaps portfolio. As a result, the group terminated cross currency and interest rate swaps with a total nominal of £2.9 billion. A number of new swaps were transacted which had the same risk management objective as some of those swaps which were terminated. This resulted in the group paying £107 million in reducing gross debt and receiving a net £14 million of interest receipts. The interest receipts and payments on restructuring were included within deferred income and other debtors respectively and were to be amortised to the income statement over the term of the underlying hedged debt. Upon adoption of IAS 32 and IAS 39 from 1 April 2005, a portion of the interest payments on restructuring was written off to reserves.

There has been no change in the nature of the group's risk profile between 31 March 2006 and the date of these financial statements.

Interest rate risk management

The group has interest bearing financial assets and financial liabilities. The group's policy is to ensure that at least 70% of net debt is at fixed rates. In order to manage this profile, the group has entered into interest rate swap agreements with commercial banks and other institutions to vary the amounts and periods for which interest rates on borrowings are fixed. Under interest rate swaps, the group agrees with other parties to exchange, at specified intervals, the differences between fixed rate and floating rate interest amounts calculated by reference to an agreed notional principal amount.

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33. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

The majority of the groups long-term borrowings have been, and are, subject to fixed sterling interest rates after applying the impact of hedging instruments. At 31 March 2006, the group had outstanding interest rate swap agreements with notional principal amounts totalling £5.1 billion compared to £5.3 billion at 31 March 2005.

At 31 March 2006, the groups fixed:floating interest rate profile, after hedging, on net debt was 86:14 (2005: 95:5).

Based on the composition of net debt at 31 March 2006, a one percentage point increase in interest rates would increase the groups annual net finance expense by approximately £10 million. This is consistent with the position at 31 March 2005.

Foreign exchange risk management

The purpose of the groups foreign currency hedging activities is to protect the group from the risk that the eventual net inflows and net outflows will be adversely affected by changes in exchange rates.

Most of the groups current revenue is invoiced in pounds sterling, and most of its operations and costs arise within the UK. The groups foreign currency borrowings which totalled £5.4 billion at 31 March 2006, are used to finance its operations. The borrowings have been predominantly swapped to sterling. Cross currency swaps and forward currency contracts have been entered into to reduce the foreign currency exposure on the groups operations and the groups net assets. The group also enters into forward currency contracts to hedge foreign currency investments, interest expense, capital purchases and purchase and sale commitments on a selective basis. The commitments hedged are principally US dollar and euro denominated. As a result of these policies, the groups exposure to foreign currency arises mainly on the residual currency exposure on its non-UK investments in its subsidiaries and on imbalances between the value of outgoing and incoming international calls.

A 10% strengthening in sterling against major currencies would cause the groups net assets at 31 March 2006 to fall by less than £150 million, with an insignificant effect on the groups profits. This is consistent with the position at 31 March 2005.

At 31 March 2006, the group had outstanding contracts to sell or purchase foreign currency with a total gross notional principal of £6.4 billion (2005: £9.8 billion). The majority of these instruments were cross currency swaps with a remaining term ranging from 1 to 25 years. The values of forward currency contracts included in the gross notional principal at 31 March 2006 were £809 million (2005: £427 million) for purchases of currency and £781 million (2005: £782 million) for sales of currency. The forward currency contracts had a term remaining ranging from three to 364 days.

Credit risk management

The group considers that it is not exposed to major concentrations of credit risk. The group, however, is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not expect any counterparties to fail to meet their obligations. The group limits the amount of credit exposure to any one counterparty. Where multiple transactions are undertaken with a single counterparty, or group of related counterparties, the group may enter into a netting arrangement to reduce the groups exposure to credit risk. Currently the group makes use of standard International Swaps and Derivative Association (ISDA) documentation. In addition, where management have a legal right of set off and the ability and intention to settle net, the relevant asset and liabilities are netted within the balance sheet. The group seeks collateral or other security where it is considered necessary.

The maximum credit risk exposure of the groups financial assets at 31 March 2006 is represented by the amounts reported under the corresponding balance sheet headings.

Liquidity risk management

The group ensures its liquidity is maintained by entering into long and short term financial instruments to support operational and other funding requirements. The groups liquidity and funding management process includes projecting cash flows and considering the level of liquid assets in relation thereto, monitoring balance sheet liquidity and maintaining a diverse range of funding sources and back-up facilities. Liquid assets surplus to immediate operating requirements of the group are generally invested and managed by the centralised treasury function. Requirements of group companies for operating finance are met whenever possible from central resources.The group manages liquidity risk by maintaining adequate committed borrowing facilities. During the year the group utilised its commercial paper programme which was supported by a committed borrowing facility of up to £1,535 million (2005: £145 million). Of this total, £1,500 million of the borrowing facility is available for a period of five years. Refinancing risk is managed by limiting the amount of borrowing that matures within any specified period.

Price risk management

The group has limited exposure to equity securities price risk on investments held by the group.

Hedging activities

The group entered into a combination of interest rate and cross currency swaps designated as a combination of fair value and cash flow hedges in order to hedge certain risks associated with the the group's US dollar and euro borrowings. The risks being hedged consist of currency cash flows associated with future interest and principal payments and the fair value risk of certain elements of borrowings arising from fluctuations in currency rates and interest rates.

At 31 March 2006, the group had outstanding interest rate swap agreements in cash flow hedges against borrowings with a total notional principal amount of £3.2 billion. The fair value of these interest rate swaps at the balance sheet date comprised liabilities of £405 million. The interest rate swaps have a remaining term ranging from four to 25 years to match the underlying hedged cash flows arising on the borrowings consisting of annual and semi-annual interest payments. The interest receivable under these swap contracts are at a weighted average rate of 4.6% and interest payable are at a weighted average rate of 5.9%.

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33. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

At 31 March 2006, the group had outstanding cross currency swap agreements in cash flow and fair value hedges against borrowings with a total notional principal amount of £4.8 billion. The fair value of these cross currency swaps at the balance sheet date comprised £32 million assets and £433 million liabilities. The cross currency swaps have a remaining term ranging from one to 25 years to match the underlying hedged borrowings consisting of annual and semi-annual interest payments. The interest receivable under these swap contracts are at a weighted average rate of 8.0% and interest payable are at a weighted average rate of 8.5%.

Forward currency contracts have been designated as cash flow hedges of currency cash flows associated with certain euro and US dollar step up interest payments on bonds. At 31 March 2006, the group had outstanding forward currency contracts with a total notional principal amount of £77 million. The fair value of the forward currency contracts at the balance sheet date comprised an asset of £1 million and had a remaining term of between three and 11 months after which they will be rolled into new contracts. The hedged interest cash flows arise on a semi-annual basis and extend over a period of up to 12 years.

Spot movements on forward currency contracts have been designated as cash flow hedges of currency cash flows associated with certain euro and US dollar commercial paper issues. At 31 March 2006, the group had outstanding forward currency contracts with a total notional principal amount of £434 million. The fair value of the forward currency contracts at the balance sheet date comprised assets of £6 million and had a remaining term of between one and two months to match the cash flows on maturity of the underlying commercial paper.

Spot movements on forward currency contracts have been designated as cash flow hedges against spot movements on currency cash flows associated with the forecast purchase of fixed assets and invoice cash flows arising on certain dollar denominated supplies. At 31 March 2006, the group had outstanding forward currency contracts with a total notional principal amount of £6 million assets and £197 million liabilities and a remaining term of less than one month after which they will be rolled into new contracts. The forecast cash flows are anticipated to arise over a period of one month to six years from the balance sheet date.

The group has hedged spot movements on currency cash flows associated with US dollar denominated investments using forward currency contracts. At 31 March 2006, the group had outstanding forward currency contracts with a total notional principal amount of £759 million. The fair value of the forward foreign currency contracts at the balance sheet date comprised liabilities of £5 million and had a remaining term of less than one month.

Other derivatives

At 31 March 2006, the group recognised the fair value of an option contained in a supplier contract which required separate recognition. The option allows the supplier to acquire a certain share in one of the group's investments based on the volume of trade. In addition, two embedded derivatives expired during the year. The first related to an option exercisable on the group's US dollar convertible bond (see note 5) and the second related to a put option whose value was based on an underlying interest differential between sterling fixed and floating interest rates.

At 31 March 2006, the group held certain foreign currency forward and interest rate swap contracts that were not in hedging relationships in accordance with IAS 39. Foreign currency forward contracts were economically hedging operational purchases and sales and had a notional principal amount of £16 million assets and £101 million liabilities as at 31 March 2006 and a maturity period of under 12 months. Interest rate swaps not in hedging relationships under IAS 39 had a notional principal amount of £1.9 billion at 31 March 2006 and mature between 2014 and 2030. The interest receivable under these swap contracts are at a weighted average rate of 6.1% and interest payable are at a weighted average rate of 7.7%. The volatility arising from these swaps is recognised through the income statement but is limited due to a natural offset in their valuation movements.

Fair value of financial instruments

The following table discloses the carrying amounts and fair values of all of the group's financial instruments which are not carried at an amount which approximates to its fair value on the balance sheet at 31 March 2006 and 2005. The carrying amounts are included in the group balance sheet under the indicated headings. The fair value of the financial instruments are the amounts at which the instruments could be exchanged in a current transaction between willing parties, other than in a forced liquidation or sale. In particular, the fair values of listed investments were estimated based on quoted market prices for those investments. The carrying amount of the short-term deposits and investments approximated to their fair values due to the short maturity of the investments held. The carrying amount of trade receivables and payables approximated to their fair values due to the short maturity of the amounts receivable and payable. The fair value of the group's bonds, debentures, notes, finance leases and other long-term borrowings has been estimated on the basis of quoted market prices for the same or similar issues with the same maturities where they existed, and on calculations of the present value of future cash flows using the appropriate discount rates in effect at the balance sheet dates, where market prices of similar issues did not exist. The fair value of the group's outstanding swaps and foreign exchange contracts where the estimated amounts, calculated using discounted cash flow models, that the group would receive or pay in order to terminate such contracts in an arms length transaction taking into account market rates of interest and foreign exchange of the balance sheet date.

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33. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

	Carrying amount		Fair value	
	2006 £m	2005 £m	2006 £m	2005 £m
Non-derivatives:				
Financial liabilities:				
Listed bonds, debentures and notes	**7,140**	10,481	**7,946**	11,793
Finance leases	**845**	1,100	**885**	1,108
Other loans and borrowings	**1,950**	424	**1,976**	452
Derivatives:[a]				
Current and non current assets	**88**	161	**88**	197
Current and non current liabilities	**1,152**	847	**1,152**	1,692

[a]The net fair values of derivatives under previously reported UK GAAP amounted to £1,435 million in the 2005 financial year, which compares to £1,495 million reported in the table above (being £197 million assets less £1,692 million liabilities). Under UK GAAP, the fair value excluded interest accruals which were carrying amounts reported within accrued income and accrued expenses.

Financial liabilities

The following tables set out the exposure of financial liabilities to market pricing, interest cash flow risk and currency risk. The maturity profile of financial liabilities reflects the contractual repricing dates.

	2006										
	Listed bonds, debentures and notes £m	Effect of hedging and interest[a] £m	Adjusted listed bonds, debentures and notes £m	Finance leases £m	Effect of hedging and interest[a] £m	Adjusted finance leases £m	Other loans and borrowings £m	Effect of hedging and interest[a] £m	Adjusted other loans and borrowings £m	Current and non-current trade and other payables[b] £m	Current and non-current provisions[c] £m
Fixed rate interest											
Pound sterling	2,022	4,077	6,099	108	—	108	275	429	704	—	—
Euro	790	(790)	—	—	—	—	371	(371)	—	—	—
US dollar	4,037	(4,037)	—	—	—	—	66	(66)	—	—	—
Total fixed rate interest financial liabilities	**6,849**	**(750)**	**6,099**	**108**	—	**108**	**712**	**(8)**	**704**	—	—
Floating rate interest											
Pound sterling	291	691	982	568	(9)	559	1,238	(3)	1,235	—	—

Euro	—	—	—	169	—	169	—	—	—	—	—
Total floating rate interest financial liabilities	**291**	**691**	**982**	**737**	**(9)**	**728**	**1,238**	**(3)**	**1,235**	—	—
Total interest bearing financial liabilities	**7,140**	**(59)**	**7,081**	**845**	**(9)**	**836**	**1,950**	**(11)**	**1,939**	—	—
Non-interest bearing financial liabilities											
Pound sterling	—	—	—	—	—	—	—	—	—	5,056	298
Euro	—	—	—	—	—	—	—	—	—	923	—
US dollar	—	—	—	—	—	—	—	—	—	402	—
Other	—	—	—	—	—	—	—	—	—	82	—
Total	**7,140**	**(59)**	**7,081**	**845**	**(9)**	**836**	**1,950**	**(11)**	**1,939**	**6,463**	**298**
Maturity profile of interest bearing financial liabilities based on contractual repricing dates											
Less than one year	700	682	1,382	737	(9)	728	1,810	(11)	1,799		
Between one and two years	624	(624)	—	—	—	—	—	—	—		
Between two and three years	—	—	—	—	—	—	140	—	140		
Between three and four years	120	(120)	—	—	—	—	—	—	—		
Between four and five years	2,503	7	2,510	—	—	—	—	—	—		
Greater than five years	3,193	(4)	3,189	108	—	108	—	—	—		
Total interest bearing financial liabilities	**7,140**	**(59)**	**7,081**	**845**	**(9)**	**836**	**1,950**	**(11)**	**1,939**		
Weighted average effective fixed interest rates											
	%		%	%		%	%		%		
Pound sterling	7.3		8.8	10.4		10.4	9.1		6.4		

Euro	7.6				2.6	
US dollar	8.8				4.7	

[a]Adjustment for hedging and interest reflects the effect of currency derivatives; reclassifies the carrying amount to reflect interest derivatives; and excludes interest and fair value adjustments for hedged risk recognised in carrying amounts.
[b]The carrying amount excludes £1,120 million of current and £40 million of non-current trade and other payables which relate to non-financial liabilities and includes current tax liabilities.
[c]The carrying amount excludes £9 million of current and £24 million of non-current provisions which relate to non-financial liabilities.

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33. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

The floating rate financial liabilities bear interest rates fixed in advance for periods ranging from one day to one year by reference to LIBOR.

Financial assets

The following tables set out the exposure of financial assets to market pricing and interest cash flow risk and currency risk. The maturity profile of financial assets reflects the contractual repricing dates.

	2006							
	Current investments £m	Effect of hedging and interest[a] £m	Adjusted current investments £m	Non-current investments £m	Cash and cash equivalents £m	Effect of hedging and interest[a] £m	Adjusted cash and cash equivalents £m	Trade and other receivables[b] £m
Fixed rate interest								
Pound sterling	3	—	3	—	19	—	19	—
Euro	—	—	—	—	6	—	6	—
Total fixed rate financial assets	**3**	—	**3**	—	**25**	—	**25**	—
Floating rate interest								
Pound sterling	14	342	356	—	1,127	422	1,549	—
Euro	—	—	—	—	215	—	215	—
US dollar	348	(348)	—	—	522	(422)	100	—
Other	—	—	—	—	76	—	76	—
Total floating rate financial assets	**362**	**(6)**	**356**	—	**1,940**	—	**1,940**	—
Total interest bearing financial assets	**365**	**(6)**	**359**	—	**1,965**	—	**1,965**	—
Non-interest bearing financial assets								
Pound sterling	—	—	—	12	—	—	—	1,955

				2006				
Euro	—	—	—	1	—	—	—	647
US dollar	—	—	—	2	—	—	—	269
Other	—	—	—	2	—	—	—	74
Total	**365**	**(6)**	**359**	**17**	**1,965**	**—**	**1,965**	**2,945**

[a]Adjustment for hedging and interest reflects the effect of currency derivatives; reclassifies the carrying amount to reflect interest derivatives; and excludes interest recognised in carrying amounts.
[b]The carrying amount excludes £1,254 million of current trade and other receivables which relate to non-financial assets.

The maturity profile of interest bearing financial assets based on contractual repricing dates is less than one year. The floating rate financial assets bear interest rate in their respective currencies, fixed in advance for periods ranging from one day to one year by reference to LIBOR and EURIBOR.

Additional financial instrument disclosures required under UK GAAP for the 2005 financial year

The following information is provided in accordance with the requirements of FRS 13 – ‘Derivatives and other financial instruments: disclosures’. The financial information excludes all of the group’s short-term receivables and payables.

Financial liabilities

After taking into account the various interest rate swaps and forward foreign currency contracts entered into by the group, the interest rate profile of the group’s financial liabilities at 31 March 2005 was:

				2005
Currency:	**Fixed rate financial liabilities £m**	**Floating rate financial liabilities £m**	**Financial liabilities on which no interest is paid £m**	**Total £m**
Total (Sterling)	7,488	5,101	—	12,589

For the fixed rate financial liabilities, the average interest rates and the average periods for which the rates are fixed are:

		2005
Currency:	**Weighted average interest rate %**	**Weighted average period for which rate is fixed Years**
Sterling	8.8	11

The floating rate financial liabilities bear interest at rates fixed in advance for periods ranging from one day to one year by reference to LIBOR.

The maturity profile of financial liabilities is as given in note 18.

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33. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

Financial assets

After taking into account the various interest rate swaps and forward foreign currency contracts entered into by the group, the interest rate profile of the group's financial assets at 31 March 2005 was:

	2005			
Currency:	Fixed rate financial assets £m	Floating rate Financial assets £m	Financial assets on which no interest is paid £m	Total £m
Sterling	106	4,697	8	4,811
Euro			1	1
Other			4	4
Total	106	4,697	13	4,816

The sterling fixed rate financial assets yield interest at a weighted average of 4.4% for a weighted average period of 22 months.

The floating rate financial assets bear interest at rates fixed in advance for periods up to one year by reference to LIBOR.

Fair values of financial assets held for trading

	2005 £m
Net gain included in profit and loss account	18
Fair value of financial assets held for trading at 31 March	546

The net gain was derived from government bonds, commercial paper and similar debt instruments. The average fair value of financial assets held during the year ended 31 March 2005 did not differ materially from the year end position.

Hedges

Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. Unrecognised and deferred gains and losses on instruments used for hedging and those recognised in the years ended 31 March 2005 are as follows:

	2005	
	Gains £m	Losses £m
Gains and losses:		

		2005
recognised in the year but arising in previous years[a]	124	59
unrecognised at the balance sheet date	47	799
carried forward in the year end balance sheet, pending recognition in the profit and loss account[a]	545	165
expected to be recognised in the following year:		
unrecognised at balance sheet date	36	51
carried forward in the year end balance sheet, pending recognition in the profit and loss account[a]	136	39

[a]Excluding gains and losses on hedges accounted for by adjusting the carrying amount of a fixed asset.

Currency exposures

The table below shows the currency exposures of the group's net monetary assets (liabilities), in terms of those transactional exposures that give rise to net currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and monetary liabilities of the group that are not denominated in the operating (or 'functional') currency of the operating unit involved, other than certain non-sterling borrowings treated as hedges of net investments in non-UK operations. At 31 March 2005, these exposures were as follows:

					2005
	Sterling £m	US dollar £m	Euro £m	Other £m	Total £m
Functional currency of group operation:					
Sterling	–	(53)	6	(1)	(48)
Euro	2	–	–	–	2
Total	2	(53)	6	(1)	(46)

The amounts shown in the table above take into account the effect of any currency swaps, forward contracts and other derivatives entered into to manage those currency exposures.

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34. EXPLANATION OF TRANSITION TO IFRS

These are the groups first consolidated financial statements prepared in accordance with EU-adopted IFRS.

The accounting policies set out on pages 65 to 72 have been applied in preparing the financial statements for the year ended 31 March 2006, the comparative information for the year ended 31 March 2005 and the preparation of an opening balance sheet at 1 April 2004, the groups date of transition. IAS 39, Financial Instruments: Recognition and Measurement and IAS 32, Financial Instruments: Disclosure and Presentation have not been applied to the comparative periods because the group has taken a transitional exemption and adopted these standards prospectively from 1 April 2005.

In preparing its opening IFRS balance sheet, the group has made adjustments to amounts previously reported in its financial statements under UK GAAP. IFRS and UK GAAP are not directly comparable. An explanation of how the transition from previous UK GAAP to IFRS has affected the groups financial position is set out below.

	Notes	31 March 2005 £m	1 April 2004 £m
Total equity under UK GAAP		3,901	3,112
Adjustments to equity to conform with IFRS (net of deferred tax):			
Employee benefits	a	(4,092)	(4,390)
Share based payments	b	7	
Goodwill and other intangibles	c	16	
Dividends	d	551	454
Leases	e	(288)	(215)
Total reduction in equity		(3,806)	(4,151)
Total equity (deficit) under IFRS		**95**	**(1,039)**

	Notes	2005 £m
Profit for the year under UK GAAP		1,821
Adjustments to profit to conform with IFRS (net of deferred tax):		
Employee benefits	a	86
Share based payments	b	(21)
Goodwill and other intangibles	c	16
Leases	e	(73)
Total adjustment to profit for the year		8
Profit for the year under IFRS		**1,829**

Under IAS 7 Cash Flow Statements movements in cash and cash equivalents are reconciled. Under UK GAAP movements in cash balances only are reconciled. The change in the presentation of the cash flow statement under IAS 7 has no impact on the cash flow generated by the group.

Effect of IAS 32 and IAS 39 transitional adjustment (note f)

	31 March 2005 £m	Transition adjustment £m	1 April 2005 £m
Non current assets			
Derivative financial instruments	18	5	23
Current assets			
Trade and other receivables	4,269	(275)	3,994
Derivative financial instruments	143	31	174
Loans and receivables	2,003	45	2,048
Available-for-sale investments	1,149	2	1,151
Current liabilities			
Trade and other payables	(6,763)	861	(5,902)
Derivative financial instruments	(375)	(321)	(696)
Loans and other borrowings	(4,261)	(111)	(4,372)
Non current liabilities			
Loans and other borrowings	(7,744)	(194)	(7,938)
Deferred tax liabilities	(1,715)	272	(1,443)
Derivative financial instruments	(472)	(524)	(996)
Reserves	(387)	(209)	(596)

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34. EXPLANATION OF TRANSITION TO IFRS continued

First Time adoption exemptions applied

IFRS 1, First-time Adoption of International Financial Reporting Standards sets out the transitional rules which must be applied when IFRS is applied for the first time. The group is required to select accounting policies in accordance with IFRS valid at its first IFRS reporting date and apply those policies retrospectively. The standard sets out certain mandatory exceptions to retrospective application and certain optional exemptions. The exemptions adopted by the group are as set out below.

Business combinations: the group has elected not to apply IFRS 3, Business Combinations retrospectively to business combinations that occurred before the date of transition (1 April 2004).

Employee benefits: the group has elected to recognise all cumulative actuarial gains and losses from employee benefits schemes at the date of transition. All subsequent actuarial gains and losses have been recognised in full in the period in which they occur in the statement of recognised income and expense in accordance with IAS 19, Employee Benefits (as amended on 16 December 2004).

Share based payments: the group has elected to apply IFRS 2, Share Based Payment retrospectively to all equity instruments granted after 7 November 2002 and which were not fully vested as at 1 January 2005.

Cumulative translation differences: the group has elected to reset the foreign currency translation reserve to zero at the transition date. Any gains and losses on subsequent disposals of foreign operations will exclude any translation differences arising prior to the date.

Financial instruments: the group has chosen to utilise the exemption from the requirements to restate comparative information for IAS 32, Financial Instruments: Disclosure and Presentation and IAS 39, Financial Instruments: Recognition and Measurement, and hence these standards have been applied prospectively as of 1 April 2005.

NOTES TO EXPLAIN THE EFFECTS OF IFRS IN THE FINANCIAL STATEMENTS

(a) Employee benefits

Under UK GAAP, the group previously measured pension commitments and other related post-retirement benefits in accordance with SSAP 24, Accounting for Pension Costs with additional disclosures provided in accordance with FRS 17, Retirement Benefits. Under IFRS the group measures pension commitments and other related post-retirement benefits in accordance with IAS 19, Employee Benefits.

Under IAS 19 the income statement charge is split between an operating charge and a net finance charge. The net finance charge relates to the unwinding of the discount applied to the liabilities of the scheme offset by the expected return on the assets of the scheme, based on conditions prevailing at the start of the year. Actuarial gains and losses are recognised immediately in reserves.

Under SSAP 24, the asset on the balance sheet represented the timing differences between the pension charge recognised in the profit and loss account and the payments made to the pension scheme. Under IAS 19, the liability on the balance sheet represents the deficit in the pension scheme. The scheme assets are valued at market value and the liabilities are discounted using a high quality corporate bond rate.

Under SSAP 24, pension charges for the year ended 31 March 2005 were £465 million, including a charge for the amortisation of the SSAP 24 deficit in the BTPS, and an interest credit relating to the balance sheet prepayment. Under IAS 19 the total charges for the year ended 31 March 2005 were £342 million, split between an operating charge and net finance income. Accordingly, for the year ended 31 March 2005 there is an additional £75 million charge to operating profit and £198 million of net finance income has been recognised under IAS 19. A related deferred tax charge of £37 million has also been recognised. The net effect has been an increase in profit of £86 million.

A pension liability has been recognised at 31 March 2005 of £4,807 million and a deferred tax asset of £1,434 million, offset by the reversal of provisions of £44 million for 31 March 2005. The pension prepayment on the UK GAAP balance sheet of £1,118 million has also been reversed, including the associated deferred tax liability. The net effect has been a reduction in equity at 31 March 2005 of £4,092 million.

A pension liability has been recognised at 1 April 2004 of £5,136 million and a deferred tax asset of £1,541 million, offset by the reversal of provisions of £36 million. The pension prepayment of £1,172 million has also been reversed, including the associated deferred tax liability. The net effect has been a reduction in equity at 1 April 2004 of £4,390 million.

(b) Share based payment

Under UK GAAP an expense was recognised for the award of share options and shares based on their intrinsic value (the difference between the exercise price and the market value at the date of the award). The majority of BTs share based payments are made under all employee Save As You Earn plans which were exempt under UK GAAP and the intrinsic value of many of the senior management schemes is nil.

Under IFRS 2, Share Based Payment, an expense is recognised in the income statement for all share based payments (both awards of options and awards of shares). This expense is based on the fair value at the date of grant of the award, using an option pricing model, and is charged to the income statement over the related performance period.

The adoption of IFRS 2 has resulted in an increased operating charge for the year ended 31 March 2005 of £28 million. A related deferred tax benefit of £7 million, has also been recognised, with the net effect being a decrease in profit of £21 million.

The credit entry for the share based payments is recognised directly in reserves as the awards are equity settled. The net effect has been an increase in equity of £7 million at 31 March 2005.

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34. EXPLANATION OF TRANSITION TO IFRS continued

(c) Goodwill and other intangible assets

UK GAAP required goodwill to be amortised over its expected useful economic life. Under IFRS 3, Business Combinations, goodwill is no longer amortised but held at its carrying value on the balance sheet and tested annually for impairment. In addition, IAS 38, Intangible Assets requires other intangible assets arising on acquisitions after the transition date to be separately identified and amortised over their useful economic life, often a shorter period than previously used for goodwill. As a result, intangible assets such as customer relationships and trademarks, need to be separately valued and recognised on business combinations, and then amortised over their useful economic lives.

The UK GAAP goodwill amortisation charge in the year to 31 March 2005 of £16 million has been reversed. The other intangible assets arising from acquisitions since 1 April, 2004 are being amortised over their estimated useful economic lives.

Computer software that is not an integral part of the associated hardware is classified as an intangible asset under IAS 38. Under UK GAAP, the groups policy was to categorise all capitalised software as tangible fixed assets. This has resulted in a balance sheet reclassification of £615 million as at 31 March 2005, but has had no impact on profit or equity.

(d) Dividends

Under UK GAAP, the dividend charge was recognised in the profit and loss account in the period to which it related. Under IAS 10, Events After The Balance Sheet Date, dividends are not recognised in the income statement but directly in reserves. In addition, the final dividend is recognised only when it has been declared and approved by the company in a general meeting.

The final dividend liabilities for the 2005 and 2004 financial years of £551 million and £454 million, respectively have been reversed at 31 March 2005 and 1 April 2004 as the associated dividends had not been approved at those dates.

(e) Leases

Under IAS 17 Leases there is a requirement to view leases of land separately from leases of buildings. Furthermore, there is a requirement to recognise operating lease charges as an expense on a straight line basis. As a result, the building elements of a small number of properties have been reclassified from operating leases under UK GAAP to finance leases under IFRS, and lease rentals under the groups 2001 sale and operating leaseback transaction are recognised on a straight line basis under IFRS.

For those properties reclassified as finance leases, profit before tax for the year ended 31 March 2005 has been reduced by approximately £3 million as a result of the recognition of depreciation and finance lease interest charges, and the removal of the UK GAAP operating lease charges. Recognising the operating lease charges, on a straight line basis has further reduced the profit before tax for the year ended 31 March, by £101 million. A deferred tax benefit of £31 million has also been recognised, with the net effect being a £73 million reduction in profit.

Those properties reclassified as finance leases have been capitalised and are included within property, plant and equipment at the lower of the present value of the minimum lease payments or the fair value of the lease asset, which was £93 million at 1 April 2004 and £90 million at 31 March 2005, respectively. The associated finance lease obligation has also been recognised, being £105 million and £107 million at 1 April 2004 and 31 March 2005, respectively. The excess of the sales proceeds over the previous carrying value has deferred, and is being recognised in the income statement over the lease term. The deferred gain included in deferred income at 1 April 2004 and 31 March 2005 was £44 million and £42 million respectively. Where the operating lease rentals are recognised on a straight line basis, the difference between the amounts recognised in the income statement and the lease payments is included in other creditors, and amounted to £251 million and £352 million at 1 April 2004 and 31 March 2005, respectively. A deferred tax liability of £100 million and £123 million at 1 April 2004 and 31 March 2005 has been recognised. The net effect of the above has been a reduction in equity of £215 million and £288 million at 1 April 2004 and 31 March 2005, respectively.

(f) Financial instruments

Under UK GAAP, the group previously measured financial assets and liabilities in accordance with the principles of FRS 4, Capital Instruments, FRS 5, Reporting the Substance of Transactions and SSAP 20, Foreign Currency Translation. Current asset investments were recognised at the lower of cost and net realisable value. Debt instruments were stated at the amount of the net proceeds adjusted to amortise any discount over the term of the debt. Debt and current asset investments were further adjusted for the effect of the currency element of swaps and forward contracts used as a hedge against these instruments. The group also provided disclosures in accordance with FRS 13, Derivatives and Other Financial Instruments: Disclosures setting out the objectives, policies and strategies for holding or issuing financial instruments, and the fair value of financial instruments held at the balance sheet date.

IAS 39 requires all derivative financial instruments to be recorded at fair value on the balance sheet. The fair value of derivative financial instruments recognised on the balance sheet on transition at 1 April, 2005 was a net liability of £1.5 billion. This fair value included a net liability of £0.7 billion which was previously recognised under UK GAAP, reflecting the currency element of financial instruments and accrued interest associated with derivatives. The additional net liability of £0.8 billion arising on transition resulted in a corresponding net decrease to equity. Future market interest rate and currency movements will give rise to adjustments to these fair values. Where hedge accounting cannot be applied under the prescriptive rules of IAS 39, changes in fair values of derivative financial instruments will impact the income statement.

In addition, the majority of the gains and losses associated with terminated derivative financial instruments that were deferred under UK GAAP have been reclassified to reserves in accordance with the transitional rules of IFRS 1, resulting in an additional net increase to equity of £0.3 billion.

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34. EXPLANATION OF TRANSITION TO IFRS continued

Certain financial assets and financial liabilities are required to be recorded at amortised cost under IAS 39. Under UK GAAP, the majority of this amortised cost value was reflected on the balance sheet but elements were separately recorded in current assets and current liabilities. These amounts have been reclassified on transition to either financial assets or loans and borrowings to recognise the respective instruments at amortised cost.

The adjustments described above, on adoption of IAS 32 and IAS 39, have resulted in an overall reduction in total equity as at 1 April, 2005 of £481 million (£209 million net of deferred taxation).

(g) Other adjustments and reclassifications

There are a number of other minor adjustments and reclassifications which include:

- The groups share of results of associates and joint ventures is presented net of tax and finance expense on the face of the income statement. Previously under UK GAAP the groups share of associates and joint ventures interest and tax was included in the relevant interest and tax line of the income statement.
- Liquid investments with maturities of less than three months at acquisition are classified within cash and cash equivalents under IAS 7, Cash Flow Statements rather than as current asset investments under UK GAAP.
- Cash flow statements prepared in accordance with IAS 7, Cash Flow Statements have a different presentational format. Although the underlying cash flows remain the same as previously reported, the cash flow statement reflects movements in cash and cash equivalents. In addition, certain leases are non classified as finance leases which had previously been treated as operating leases.
- Under UK GAAP, loans and borrowings and current asset investments were held at foreign currency rates prescribed in the hedging instrument where hedging had been applied in accordance with the groups accounting policies. Under IAS 21, The Effects of Changes in Foreign Exchanges Rates, such forward rate adjustments are required to be disclosed separately and have therefore been reclassified. On adoption of IAS 39 from 1 April, 2005, such forward rate adjustments form part of the overall fair value of derivative financial instruments.
- Foreign exchange gains and losses on certain intercompany loans are recognised in the income statement. Under UK GAAP these amounts were recognised in reserves.
- Profits on the sale of property fixed assets are classified within other operating income on the face of the income statement. Under UK GAAP, these amounts had previously been disclosed after operating profit.
- The group has historically recognised revenue arising from calls to our premium rate numbers on a gross basis, with amounts paid to service providers recorded separately within operating costs. In light of the transition to IFRS and changing market practice we have reviewed the presentation of these arrangements. We have decided to change our presentation to a net basis for these calls where we provide basic transmission and connectivity only. For those calls where we add value by providing interactivity and a more significant and valuable part of the service, the associated revenue will continue to be reported on a gross basis. Whilst reducing revenue and operating costs, this change has had no impact on reported profit, cash flows or the balance sheet. The impact on revenue and operating costs was £194 million for the year ended 31 March 2005.

35. UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The groups consolidated financial statements are prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS), which differ in certain respects from those applicable in the United States. For BT there are no differences between IFRS as adopted for use in the EU and IFRS as published by the IASB.

(i) DIFFERENCES BETWEEN IFRS AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (US GAAP)

The following are the main differences between IFRS and US GAAP which are relevant to the groups consolidated financial statements.

(a) Sale and leaseback of properties

Under IFRS, the sale of BTs property portfolio is treated as a disposal and the vast majority of the subsequent leaseback is an operating lease. Under US GAAP as BT has a continuing interest in the properties, these properties are recorded on the balance sheet at their net book value, a leasing obligation is recognised and the gain on disposal is deferred until the properties are sold and vacated by BT and the corresponding lease obligation is terminated. Rental payments made by BT are reversed and replaced by a finance lease interest charge and a depreciation charge.

(b) Pension costs

Under IFRS, pension costs are accounted for in accordance with IAS 19. Under US GAAP, pension costs are determined in accordance with the requirements of US Statements of Financial Accounting Standards (SFAS) Nos. 87 ‘Employers’ Accounting for Pensions’ and 88 ‘Employer’s Accounting for Settlements and Curtailments of Defined Benefit Plans and for Termination Benefits’. Differences between the IFRS and US GAAP amounts arise primarily due to differences in the recognition of actuarial gains and losses and the application of different measurement dates. Under IFRS, actuarial gains and losses are recognised in the statement of recognised income and expense whereas under US GAAP actuarial gains and losses are amortised over the average remaining service period.

Under US GAAP, if the accumulated benefit obligation (ABO) exceeds the fair value of plan assets, the employer is required to recognise a liability that is at least equal to the unfunded ABO.

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35. UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES continued

(c) Capitalisation of interest

Under IFRS, the group has chosen not to capitalise interest. Under US GAAP, the estimated amount of interest incurred whilst constructing major capital projects is included in property, plant and equipment, and depreciated over the lives of the related assets. The amount of interest capitalised is determined by reference to the average interest rates on outstanding borrowings. At 31 March 2006 under US GAAP, gross capitalised interest of £350 million (2005 – £349 million) was subject to depreciation over periods of 3 to 25 years determined by the nature of the related asset.

(d) Financial instruments

The group exercised the exemption available under IFRS 1 to adopt IAS 32, ‘Financial Instruments: Disclosure and Presentation’ and IAS 39, ‘Financial Instruments: Recognition and Measurement’ from 1 April 2005. The comparative periods are therefore presented in accordance with UK GAAP.

Under UK GAAP, investments are held on the balance sheet at historical cost. Gains and losses on instruments used for hedges are not recognised until the exposure being hedged is recognised. Certain derivative financial instruments which qualify for hedge accounting under UK GAAP do not qualify or were not designated as hedges under US GAAP.

From 1 April 2005 the group adopted IAS 32 and IAS 39 which gave rise to differences in accounting treatments applied under US GAAP SFAS No. 133 ‘Accounting for Derivative Instruments and Hedging Activities’. On adoption of IAS 39, all derivative financial instruments and the fair value of the hedged risks, where a hedged item is in a fair value hedge, were recognised as a one time transition adjustment to equity and resulted in a transitional difference between US GAAP and IFRS.

Under IFRS, certain cash flow hedges result in a hedged non-financial asset or liability being adjusted from the equity reserve for the applicable hedged amount. US GAAP does not allow the amounts taken to equity to be transferred to the initial carrying amount of the non-financial asset or liability. The amounts remain in equity and are recognised in earnings as the non-financial asset is depreciated or disposed.

The group did not claim hedge accounting under US GAAP for certain items designated as hedges under IFRS. As a result, certain gains or losses on derivatives held in the cash flow reserve or translation reserve are credited or charged to the income statement under US GAAP. In addition, under IFRS, the hedged risk associated with a hedged item is fair valued where the item has been designated in a fair value hedge. As hedge accounting has not been claimed for those items under US GAAP, this fair value adjustment will not be reflected. These differences will reverse out as the derivatives or hedged items mature, are sold or expire.

The fair value and book value of derivative instruments as at 31 March 2006 and 31 March 2005 is disclosed in note 33.

IFRS prescribes four investment categories, namely held for trading, available-for-sale, loans and receivables and held to maturity. US GAAP prescribes only three categories, namely held for trading, available-for-sale and held to maturity. Whilst the held for trading and available for sale categories are similar under both GAAPs, items held in loans and receivables under IFRS are generally classified as held to maturity under US GAAP.

(e) Foreign exchange

Under US GAAP, on the sale of a foreign enterprise, foreign exchange differences within the cumulative translation adjustment (CTA) are included in net income in arriving at a gain or loss on disposal. Although IFRS also requires inclusion of the cumulative translation differences held in reserves as part of the calculation of gains or losses on disposal, they were reset to zero on transition to IFRS on 1 April 2004.

(f) Deferred taxation

Under both IFRS and US GAAP, provision for deferred income tax is required on a full provision basis in accordance with IAS 12 ‘Income taxes’ and SFAS No. 109 ‘Accounting for Income Taxes’.

Under IFRS, deferred tax is recorded for temporary differences and deferred tax assets are recognised only to the extent that it is probable that taxable profits will be available against which the deductible temporary difference can be utilised. Deferred tax assets not recognised are disclosed in note 22.

Under US GAAP deferred taxes are recorded on all temporary differences and a valuation allowance is established in respect of those deferred tax assets where it is more likely than not that some portion will remain unrealised. Additionally, assets and liabilities are presented separately where the timing of further recognition does not match and deferred tax balances are split where applicable between current and non current.

Deferred tax adjustments in the IFRS to US GAAP reconciliation are primarily the result of the deferred tax impact of the other US GAAP adjustments made in the reconciliation. However, tax adjustments also arise in respect of the timing of recognition of deferred tax on share options and current tax benefits.

At 31 March 2006, total deferred tax liabilities were £1,767 million primarily in respect of accelerated capital allowances and total deferred tax assets were £1,454 million, primarily in respect of pension obligations.

The total valuation allowance recognised for deferred tax assets was as follows:

	2006 £m	**2005 £m**	**Movement in year £m**
Capital losses	**5,493**	4,436	1,057
Operating losses not utilised	**775**	860	(85)
Other	**271**	705	(434)
Total	**6,539**	6,001	538

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35. UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES continued

(g) Impairment of property, plant and equipment
Certain network assets previously impaired did not meet the US GAAP criteria for impairment under SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets.

US GAAP requires that an entity assess whether impairment has occurred based on the undiscounted future cash flows. An impairment exists if the sum of these cash flows is less than the carrying amount of the asset. The impairment loss recognised in the income statement is based on the assets fair value, being either market value or the sum of discounted future cash flows. The assets that were not impaired under US GAAP are continuing to be depreciated over their remaining useful lives.

(h) Revenue
Under IFRS, long-term contracts to design, build and operate software solutions are accounted for under IAS 18 Revenue under which revenue is recognised as earned over the contract period.

Under US GAAP these contracts are accounted for as multiple element arrangements under EITF 00-21 and SOP 97-2, Software Revenue Recognition. As vendor specific objective evidence to support the fair value of the separate elements to be delivered is unavailable, revenue of £109 million under certain contracts is deferred in the 2006 financial year (2005: £162 million). There was no impact on net income due to the deferral of costs on these contracts. Total deferred revenue and costs recorded under US GAAP at 31 March 2006 was £348 million (2005: £239 million).

(i) Share-Based Payments
Under IFRS 2 Share Based Payment, share options are fair valued at their grant date and the cost is charged to the income statement over the relevant vesting periods.

BT early adopted SFAS No. 123 (R) Share-Based Payment on 1 April 2005 using the modified prospective transition method. Previously the company adopted the disclosure-only provisions in SFAS No. 123 Accounting for Stock Based Compensation and accounted for share options in accordance with APB Opinion No. 25 Accounting for Stock Issued to Employees.

Under the transition method, compensation cost recognised during the year ended 31 March 2006 includes (a) compensation cost for all share based payments granted prior to but not yet vested at 1 April 2005 based on the grant date fair value estimated in accordance with the original provisions of SFAS 123 and (b) compensation cost for all share based payments granted subsequent to 1 April 2005 based on the grant date fair value estimated in accordance with the original provisions of SFAS 123 (R).

Results for prior periods have not been restated.

As required by SFAS 123(R) the following table illustrates the effects on income from continuing operations, income before tax, net income and basic and diluted earnings per share in respect of the 2005 financial year, when share-based payment arrangements were accounted for under Accounting Principles Board Opinion No.25. There were no impacts from adoption on the cash flows of the Group.

	2005 £m
Net income as reported	1,297
Share-based employee compensation cost included in net income	26
Share-based employee compensation cost that would have been included in net income if the fair-value-based method had been applied to all awards	(37)
Deferred tax	3
Pro forma net income as if the fair-value-based method had been applied to all awards	**1,289**

Basic and diluted earnings per share as reported were 15.2p and 15.1p respectively. Pro forma basic and diluted earnings per share as if the fair-value-based method had been applied to all awards were 15.1p and 15.0p respectively.

(j) Goodwill

The group wrote off goodwill arising from the purchase of subsidiary undertakings, associates and joint ventures on acquisition prior to 1 April 1998, against retained earnings. Goodwill arising on acquisitions completed after 1 April 1998 was capitalised and amortised on a straight line basis over its useful economic life. Following transition to IFRS, goodwill is no longer amortised but tested annually for impairment and the amount of goodwill previously recorded at the transition date was carried forward under IFRS.

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35. UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES continued

Under US GAAP up to 31 March 2002, goodwill arising on the acquisition of subsidiaries, associates and joint ventures was capitalised as an intangible asset and amortised over its useful life. BT adopted SFAS No. 142 on 1 April 2002 and goodwill is no longer amortised but tested annually for impairment. There was no goodwill impairment charge in the year ended 31 March 2006 (2005: nil).

(k) Property rationalisation provision

In the 2003 financial year, a provision in connection with the rationalisation of the group's London office property portfolio was recorded. Under US GAAP, in accordance with SFAS No 146, these costs are not recognised until the group fully exits and therefore ceases to use the affected properties. All these properties were exited by 31 December 2004.

(l) Contingent consideration

Under IFRS contingent consideration in respect of acquisitions is recorded when the outcome of the contingency is considered more likely than not. Under US GAAP the consideration is recorded when the contingent event has occurred.

(m) Termination benefits

Under US GAAP the fair value of termination benefits for employees who are to be retained beyond their minimum contractual retention period is recognised on a straight line basis over the future service period. Under IFRS these costs are recognised when the employees agree to leave the group.

(II) NET INCOME AND SHAREHOLDERS' EQUITY RECONCILIATION STATEMENTS

The following statements summarise the material estimated adjustments, gross of their tax effect, which reconcile net income and shareholders' equity from that reported under IFRS to that which would have been reported had US GAAP been applied.

Net income **Years ended 31 March**	**Note**	**2006** **£m**	**2005** **£m**
Profit attributable to equity shareholders of the parent under IFRS		**1,547**	1,830
Adjustment for:			
Sale and leaseback of properties	a	**(18)**	21
Pension costs	b	**(220)**	(333)
Capitalisation of interest	c	**(16)**	(13)
Financial instruments	d	**(436)**	(415)
Foreign exchange	e	**39**	–
Impairment of property, plant and equipment	g	**(38)**	(24)
Share based payment	i	**(1)**	13
Property rationalisation provision	k	**–**	(5)
Termination benefits	m	**–**	(20)
Deferred taxation	f	**3**	3
		860	1,057
Tax effect of US GAAP adjustments		**203**	240
Net income as adjusted for US GAAP		**1,063**	1,297
Basic earnings per American Depositary Share as adjusted for US GAAP[a]		**£1.26**	£1.52
Diluted earnings per American Depositary Share as adjusted for US GAAP[a]		**£1.25**	£1.51

[a]Each
American

Depositary
Share is
equivalent
to ten
ordinary
shares.

Shareholders equity **At 31 March**	**Note**	**2006** **£m**	**2005** **£m**
Total parent shareholders equity under IFRS		**1,555**	45
Adjustment for:			
Sale and leaseback of properties	a	**(1,067)**	(1,049)
Pension costs	b	**(1,228)**	636
Capitalisation of interest	c	**164**	178
Goodwill	j	**107**	113
Financial instruments	d	**3**	(371)
Impairment of property, plant and equipment	g	**40**	77
Current liabilities	c	**7**	
Deferred taxation	f	**(53)**	(56)
		(472)	(427)
Tax effect of US GAAP adjustments		**314**	(157)
Shareholders equity as adjusted for US GAAP		**(158)**	(584)

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35. UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES continued

Reclassifications

The following reclassifications would need to be made in addition to those disclosed elsewhere and in the above reconciliation of shareholders equity in order to present amounts in accordance with US GAAP.

- A pensions intangible asset of £31 million (2005 £55 million) would be recognised separately from retirement obligations.
- The current portion of pension obligations of £630 million (2005 £459 million) would be shown as a current liability.
- Cash and cash equivalents and current liabilities would increase by £181 million (2005 £2 million) in respect of bank overdrafts.
- Trade and other receivables and trade and other payables would be £348 million higher (2005 £239 million) see note (h).
- A finance lease obligation of £2,325 million and property, plant and equipment of £780 million would be shown and trade and other payables would be £478 million lower in respect of the property sale and finance leaseback transaction as described in note (a).
- Current assets would be £11 million lower (2005 £6 million lower), current liabilities would be £2 million lower (2005 £135 million higher) and long term borrowings would be £12 million lower (2005 £230 million higher) in respect of financial instruments.

(III) CONSOLIDATED STATEMENTS OF CASH FLOWS

The group cash flow statements are presented in accordance with IAS 7. The statements prepared under IAS 7 present substantially the same information as that required under SFAS No. 95, Statement of Cash Flows.

If the cash flow statement had been prepared in accordance with SFAS No 95, the net increase in cash and cash equivalents would have been higher by £179 million (2005: unchanged). This is because under IAS 7, bank overdrafts are classified as a movement in cash and cash equivalents, while under US GAAP, the movements in bank overdrafts are classified as a financing activity.

(IV) PENSION COSTS

The following position for the main pension scheme (BTPS) is computed in accordance with US GAAP pension accounting rules under SFAS No. 87 and SFAS No. 88, the effect of which is shown in the above reconciliation statements. The liabilities of the BTPS represent substantially all of the groups pension obligations.

The pension cost determined under SFAS No. 87 was calculated by reference to an expected long-term rate of return on scheme assets of 7.11% (2005 7.27%). The components of the net periodic pension cost for the main pension scheme comprised:

	2006 £m	2005 £m
Service cost	**538**	507
Interest cost	**1,784**	1,745
Expected return on scheme assets	**(2,042)**	(1,897)
Amortisation of prior service costs	**24**	24
Amortisation of loss	**215**	263
Net periodic pension cost under US GAAP	**519**	642

The information required to be disclosed in accordance with SFAS No. 132(R), Employers Disclosures about Pensions and Other Post Retirement Benefits concerning the funded status of the main scheme at 31 March 2005 and 31 March 2006, based on the valuations at 1 January 2005 and 1 January 2006, respectively, is given below.

	2006 £m	2005 £m
Minimum liability, intangible asset and other comprehensive income		

	2006	2005
Plan assets at fair value	**34,293**	29,169
Accumulated benefit obligation	**37,850**	33,160
Minimum liability	**3,557**	3,991
Net amount recognised at end of year	**(2,604)**	(2,535)
Minimum additional liability	**953**	1,456
Intangible asset as at 31 March		
Unrecognised prior service cost	**(31)**	(55)
Accumulated other comprehensive income	**922**	1,401

	2006 £m	2005 £m
Changes in benefit obligation		
Benefit obligation at the beginning of the year	**34,336**	32,448
Service cost	**538**	507
Interest cost	**1,783**	1,745
Employee contributions	**21**	50
Actuarial movement	**3,438**	943
Other changes	**—**	7
Benefits paid or payable	**(1,385)**	(1,364)
Translation	**(1)**	—
Benefit obligation at the end of the year	**38,730**	34,336

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35. UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES continued

The benefit obligation and pension cost for the main pension scheme were determined using the following assumptions at 1 January 2004, 2005 and 2006:

	2006 per annum %	**2005 per annum %**	**2004 per annum %**
Discount rate	**4.7**	5.3	5.5
Rate of future pay increases	**3.4**	3.6	3.6
Rate of future pension increases	**2.6**	2.6	2.6

Contributions expected to be paid to the BTPS during the 2007 financial year are estimated at £630 million, including £232 million of deficiency contributions.

Estimated future benefit payments are as follows:

	£m
Year ending 31 March 2007	**1,421**
Year ending 31 March 2008	**1,458**
Year ending 31 March 2009	**1,512**
Year ending 31 March 2010	**1,577**
Year ending 31 March 2011	**1,655**
1 April 2011 to 31 March 2016	**9,491**

	2006 £m	**2005 £m**
Changes in scheme assets		
Fair value of scheme assets at the beginning of the year	**29,169**	26,675
Actual return on scheme assets	**6,039**	3,419
Employer contributions[a]	**450**	382
Employee contributions	**21**	50
Other changes	—	7
Benefits paid or payable	**(1,385)**	(1,364)
Translation	**(1)**	—
Fair value of scheme assets at the end of the year	**34,293**	29,169

	2006 £m	**2005 £m**
Funded status under US GAAP		
Projected benefit obligation in excess of scheme assets	**(4,437)**	(5,167)
Unrecognised prior service costs[b]	**31**	55
Other unrecognised net actuarial losses	**1,802**	2,577
Net amount recognised under US GAAP	**(2,604)**	(2,535)

[a]The employer contributions for the year ended 31 March 2006 includes special contributions of £54 million (2005 £6 million).
[b]Unrecognised prior service costs on scheme benefit improvements are being amortised over periods of 15 or 16 years commencing in the years of the introduction of the improvements.

Asset allocation

The Trustees of the main pension scheme approve the target asset allocation as well as deviation limits. The objective of the investment activities is to maximise investment returns within an acceptable level of risk, taking into consideration the liabilities of the main pension scheme.

	Year ended 31 December 2005		
	Fair value £bn	%	Target %
Equities	**20.3**	**59**	**58**
Fixed interest bonds	**5.4**	**16**	**16**
Index linked securities	**3.2**	**9**	**9**
Property	**4.2**	**12**	**12**
Cash and other	**1.2**	**4**	**5**
	34.3	**100**	**100**

	Year ended 31 December 2005		
	Fair value £bn	%	Target %
Equities	18.3	63	63
Fixed interest bonds	4.4	15	16
Index linked securities	2.7	9	9
Property	3.8	13	12
	29.2	100	100

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35. UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES continued

The assumption for the expected return in scheme assets is a weighted average based on an assumed expected return for each asset class and the proportions held of each asset class at the beginning of the year. The expected returns on bonds are based on the gross redemption yields at the start of the year. Expected returns on equities and property are based on a combination of an estimate of the risk premium above, yields on government bonds and consensus economic forecasts of future returns. The expected return of 7.11% per annum used for the calculation of pension costs for the year ended 31 March 2006 is consistent with that adopted for IAS 19.

(V) INCOME STATEMENT IN US GAAP FORMAT

The group income statements on page 73 comply with IFRS and the directors believe they are in the most appropriate format for shareholders to understand the results of our business. We believe that it is important to show our results before deducting specific items because these items predominantly relate to corporate transactions rather than the trading activities of the group. For SEC reporting purposes this presentation may be considered non GAAP and therefore the group has also prepared the following income statement which meets the SEC reporting format set forth in Item 10 of Regulation S-X. The numbers disclosed in the following income statement are prepared under IFRS.

	2006 £m	2005 £m
Revenue	**19,514**	18,429
Operating expenses:		
Payroll costs	**4,066**	3,832
Depreciation and amortisation	**2,884**	2,844
Payments to telecommunication operators	**4,045**	3,725
Other operating expenses	**6,251**	5,587
Total operating expenses	**17,246**	15,988
Net operating income	**2,268**	2,441
Other income, net	**228**	551
Net interest expense	**(472)**	(599)
Income taxes	**(492)**	(525)
Equity in earnings (losses) of investees	**16**	(39)
Minority interests	**(1)**	1
Net income	**1,547**	1,830
Earnings per share basic	**18.4p**	21.5p
Earnings per share diluted	**18.1p**	21.3p

(VI) US GAAP DEVELOPMENTS

In November 2005, the FASB issued Financial Staff Position (FSP) FAS 115-1 and FAS 124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, which nullifies certain requirements of Emerging Issues Task Force (EITF) Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments and supersedes EITF Abstracts Topic No. D-44, Recognition of Other-Than-Temporary Impairment Upon the Planned Sale of a Security whose Cost Exceeds Fair Value. The guidance in this FSP is applied to reporting periods beginning after 15 December 2005. BT does not expect that the adoption of this guidance will have a material effect on its financial position, results of operations or cash flows.

In May 2005, the FASB issued SFAS No. 154 Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS No. 154 requires retrospective application of prior periods financial statements for changes in accounting principles. SFAS No. 154 applies to accounting periods beginning after 15 December 2005. The adoption of SFAS No. 154 is not expected to have a material effect on the results or net assets of the group.

In February 2006, the FASB issued FASB Staff Position No. FAS 123(R)-4, "Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event" ("FSP FAS 123(R)-4"). FSP FAS 123(R)-4 addresses the classification of options and similar instruments issued as employee compensation that allow for cash settlement upon the occurrence of a contingent event. An option or similar instrument that is classified as equity, but subsequently becomes a liability because the contingent cash settlement event is probable of occurring, shall be accounted for similar to a modification from an equity to liability award. The application of this FSP did not have a material impact on the results or net assets of the group.

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35. UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES continued

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140, that amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This Statement resolves issues addressed in SFAS No. 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitised Financial Assets. The Statement permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. Additionally it clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133. SFAS No. 155 also establishes a requirement to evaluate interests in securitised financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. It clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. Also SFAS No. 155 amends SFAS No. 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for BT for all financial instruments acquired or issued after 31 March 2007. BT is currently evaluating the impact of this statement.

In March 2006 the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets: an amendment of FASB Statement No. 140 that amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, with respect to the accounting for separately recognised servicing assets and servicing liabilities. SFAS No. 156 is effective for BT on 1 April 2007. BT does not anticipate that the adoption of this new statement at the required effective date will have a significant effect on its results of operations, financial position or cash flows.

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GLOSSARY OF TERMS AND US EQUIVALENTS

Term used in UK annual report	US equivalent or definition
Accounts	Financial statements
Associates	Equity investees
Capital allowances	Tax depreciation
Capital redemption reserve	Other additional capital
Finance lease	Capital lease
Financial year	Fiscal year
Freehold	Ownership with absolute rights in perpetuity
Gearing	Leverage
Inland calls	Local and long-distance calls
Interests in associates and joint ventures	Securities of equity investees
Loans to associates and joint ventures	Indebtedness of equity investees not current
Own work capitalised	Costs of labour engaged in the construction of plant and equipment for internal use
Provision for doubtful debts	Allowance for bad and doubtful accounts receivable
Provisions	Long-term liabilities other than debt and specific accounts payable
Statement of recognised income and expense	Comprehensive income
Reserves	Shareholders’ equity other than paid-up capital
Share premium account	Additional paid-in capital or paid-in surplus (not distributable)

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FINANCIAL STATEMENTS OF BT GROUP PLC

PARENT COMPANY AUDIT OPINION

Independent auditors' report to the members of BT Group plc

We have audited the parent company financial statements of BT Group plc for the year ended 31 March 2006 which comprise the balance sheet, accounting policies and the related notes. These parent company financial statements have been prepared under the accounting policies set out therein. These parent company financial statements are set out on pages 124 to 126. We have also audited the information in the Report on directors' remuneration that is described as having been audited.

We have reported separately on the group financial statements of BT Group plc for the year ended 31 March 2006. This separate report is set out on page 63.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report, the Report on directors' remuneration and the parent company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of directors' responsibilities.

Our responsibility is to audit the parent company financial statements and the part of the Report on directors' remuneration to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements and the part of the Report on directors' remuneration to be audited have been properly prepared in accordance with the Companies Act 1985. We report to you whether, in our opinion the information given in the Report of the directors is consistent with the parent company financial statements. The information given in the Report of the directors includes that specific information presented in the Operating and financial review that is cross referred from the Report of the directors. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and Form 20-F and consider whether it is consistent with the audited parent company financial statements. The other information comprises only the Financial headlines, Chairman's message, Chief Executive's statement, the Operating and financial Review, the Report of the directors, the Report of the audit committee, the Report of the nomination committee and the unaudited part of the Report on directors' remuneration. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial statements and the part of the Report on directors' remuneration to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the parent company 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 parent company financial statements and the part of the Report on directors' remuneration to be audited 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 parent company financial statements and the part of the Report on directors' remuneration to be audited.

Opinion

In our opinion

- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 March 2006;
- the parent company financial statements and the part of the Report on directors' remuneration to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Report of the directors is consistent with the parent company financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors

London
17 May 2006

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BT GROUP PLC ACCOUNTING POLICIES

(I) ACCOUNTING BASIS

The financial statements are prepared under the historical cost convention as modified by the revaluation of certain financial instruments in accordance with the Companies Act 1985 and applicable United Kingdom accounting standards (UK GAAP).

As permitted by Section 230(3) of the Companies Act 1985, the companys profit and loss account has not been presented.

The BT Group plc consolidated financial statements for the year ended 31 March 2006 contain a consolidated statement of cash flows. Consequently, the company has taken advantage of the exemption in FRS 1, (Revised 1996) Cash Flow Statements not to present its own cash flow statement.

The company has taken advantage of the exemption in FRS 8, Related Party Disclosures not to disclose transactions with other members of the BT Group.

The BT Group plc consolidated financial statements for the year ended 31 March 2006 contain financial instrument disclosures which comply with FRS 25, Financial Instruments: Disclosure and Presentation. Consequently, the company has taken advantage of the exemption in FRS 25 not to present separate financial instrument disclosures for the company.

(II) CHANGES IN ACCOUNTING POLICIES

The company has adopted FRS 17, Retirement benefits, FRS 20, Share based payment, FRS 21 Events after the balance sheet date, FRS 23, The effects of changes in foreign exchange rates, FRS 25, Financial instruments: Disclosure and Presentation, FRS 26, Financial instruments: Measurement, and FRS 28, Corresponding amounts in these financial statements. The adoption of each of these standards represents a change in accounting policy and the comparative figures have been restated accordingly, except where the exemption to restate comparatives have been taken.

As a result of adopting FRS 21, the companys profit for the year ended 31 March 2005 increased by £454 million to £1,024 million. Accrued dividend income of £454 million for the 2004 financial year was reversed and recognised in the 2005 financial year. In addition, the final dividends for the 2005 and 2004 financial years of £551 million and £454 million respectively have been reversed, as the associated dividends had not been approved at those dates. None of the other new accounting standards had any effect on the companys profit or net assets.

(III) INVESTMENTS

Fixed asset investments, which comprises investments in subsidiary undertakings, are stated at cost and reviewed for impairment if there are indicators that the carrying value may not be recoverable.

(IV) TAXATION

Full provision is made for deferred taxation on all timing differences which have arisen but not reversed at the balance sheet date. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that there will be sufficient taxable profits from which the underlying timing differences can be deducted. The deferred tax balances are not discounted.

(V) DIVIDENDS

Dividend distributions are recognised as a liability in the year in which the dividends are approved by the companys shareholders. Interim dividends are recognised when they are paid; final dividends when authorised in general meetings by shareholders.

(VI) SHARE CAPITAL

Ordinary shares are classified as equity. Repurchased shares of the company are recorded in the balance sheet as treasury shares and presented as a deduction from shareholders equity at cost.

(VII) CASH

Cash includes cash in hand, bank deposits repayable on demand and bank overdrafts.

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BT GROUP PLC COMPANY BALANCE SHEET

	2006 £m	2005 £m
Fixed assets		
Investments in subsidiary undertaking	**9,971**	9,971
Total fixed assets	**9,971**	9,971
Current assets		
Debtors[a]	**3**	22
Investments[b]	**1**	1
Cash at bank and in hand	**22**	118
Total current assets	**26**	141
Creditors: amounts falling due within one year[c]	**57**	28
Net current (liabilities) assets	**(31)**	113
Total assets less current liabilities	**9,940**	10,084
Capital and reserves[d]		
Called up share capital	**432**	432
Share premium account	**7**	3
Capital redemption reserve	**2**	2
Profit and loss account	**9,499**	9,647
Total equity shareholders funds	**9,940**	10,084

[a]Debtors consists of amounts owed by subsidiary undertakings of £3 million (2005: £22 million).
[b]The company holds an available-for-sale asset with a book value and market value of £1 million (2005: £1 million).
[c]Creditors consists of amounts owed to subsidiary undertakings of £27 million (2005: £17 million) and other creditors of £30 million (2005: £11 million).
[d]Capital and reserves are shown on page 126.

The financial statements of the company on pages 124 to 126 were approved by the board of the directors on 17 May 2006 and were signed on its behalf by

Sir Christopher Bland
Chairman

Ben Verwaayen
Chief Executive

Hanif Lalani
Group Finance Director

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BT GROUP PLC COMPANY BALANCE SHEET continued

	Share capital[e] £m	Share premium account[f] £m	Capital redemption reserve £m	Profit and loss account[g,h] £m	Total £m
Balances at 1 April 2004	432	2	2	9,585	10,021
Profit for the financial year	—	—	—	1,024	1,024
Dividends paid	—	—	—	(786)	(786)
Net purchase of treasury shares	—	—	—	(176)	(176)
Arising on share issues	—	1	—	—	1
At 31 March 2005	432	3	2	9,647	10,084
Profit for the financial year	—	—	—	1,108	1,108
Dividends paid	—	—	—	(912)	(912)
Net purchase of treasury shares	—	—	—	(344)	(344)
Arising on share issues	—	4	—	—	4
At 31 March 2006	**432**	**7**	**2**	**9,499**	**9,940**

[e]The authorised share capital of the company throughout the years ended 31 March 2006 and 31 March 2005 was £13,463 million representing 269,260,253,468 ordinary shares of 5p each.
The allotted, called up and fully paid ordinary share capital of the company at 31 March 2006 was £432 million (2005: £432 million), representing 8,635,377,801 ordinary shares of 5p each (2005: 8,634,629,038). Of the authorised but unissued share capital at 31 March 2006, 26 million ordinary shares (2005: 26 million) were reserved to meet options granted under employee share option schemes.
[f]The share premium account, representing the premium on allotment of shares is not available for distribution.
[g]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 £1,108 million (2005, restated: £1,024 million). As permitted by Section 230 of the Companies Act 1985, no profit and loss account of the company is presented.
[h]During the year ended 31 March 2006 the company repurchased 165,772,145 (2005: 101,280,000) of its own shares of 5p each, representing 2% (2005: 1%) of the called-up share capital, for an aggregate consideration of £365 million (2005: £195 million). At 31 March 2006 290,047,231 shares (2005: 134,497,000 shares) with an aggregate nominal value of £15 million are held as treasury shares at cost.
The movement in the available-for-sale reserve in the year was £nil.

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SUBSIDIARY UNDERTAKINGS AND ASSOCIATE

BT Group plc is the parent company of the group. Brief details of its principal operating subsidiaries and associate at 31 March 2006, other than the company, all of which were unlisted unless otherwise stated, were as follows:

	Group interest	Country

Subsidiary undertakings	Activity	Group interest in allotted capital[b]	Country of operations[c]
Albacom SpA[d]	Communication related services and products provider	100% ordinary	Italy
British Telecommunications plc[d]	Communication related services and products provider	100% ordinary	UK
BT Americas Inc.[c d f]	Communication related services, systems integration and products provider	100% common	International
BT Australasia Pty Limited[d]	Communication related services and products provider	100% ordinary 100% preference	Australia
BT C & S I France SA[d e]	Systems integration and application development	100% ordinary	France
BT Cableships Limited[d]	Cableship owner	100% ordinary	International
BT Centre Nominee 2 Limited[d]	Property holding company	100% ordinary	UK
BT Communications Ireland Limited[d]	Telecommunication service provider	100% ordinary	Ireland
BT Communications Management Limited[d]	Telecommunication service provider	100% ordinary	UK
BT ESPANA, Compania de Servicios Globales de Telecommunicaciones, S.A.[d]	Communication related services and products provider	100% ordinary	Spain
BT Fleet Limited[d]	Fleet management company	100% ordinary	UK
BT France SAS[d]	Communications related services and products provider	100% ordinary	France
BT (Germany) GmbH & Co. oHG[d]	Communications related services and products provider	100% ordinary	Germany
BT Global Services Limited[d]	International telecommunication network systems provider	100% ordinary	UK
BT Holdings Limited[d]	Investment holding company	100% ordinary	UK
BT Hong Kong Limited[d]	Communication related services and products provider	100% ordinary 100% preference	Hong Kong
BT Limited[d]	International telecommunication network systems provider	100% ordinary	International
BT Nederland NV[d]	Communication related services and products provider	100% ordinary	Netherlands
BT Subsea Cables Limited[d]	Cable maintenance and repair	100% ordinary	UK

		Group interest	Country
BT US Investments LLC[d]	Investment holding company	100% ordinary	USA
Communications Networking Services (UK)[d]	Communication related services and products provider	100% ordinary	UK
Communications Global Network Services Limited[c d]	Communication related services and products provider	100% ordinary	International
Farland BV[c d]	Provider of trans-border fibre network across BTs partners in Europe	100% ordinary	International
Infonet Services Corporation[d]	Global managed network service provider	100% common	USA
Infonet USA Corporation[d]	Global managed network service provider	100% common	USA
Radianz Americas Inc[d]	Global managed network service provider	100% common	USA
Syntegra Limited[d]	Systems integration and application development	100% ordinary	UK
Syntegra Groep BV[d]	Systems integration and application development	100% ordinary	Netherlands

[a]The group comprises a large number of companies and it is not practical to include all of them in this list. The list, therefore, only includes those companies that have a significant impact on the profit or assets of the group. A full list of subsidiaries, joint ventures and associates will be annexed to the companys next annual return filed with the Registrar of Companies.
[b]The proportion of voting rights held corresponds to the aggregate interest percentage held by the holding company and subsidiary undertakings.
[c]All overseas undertakings are incorporated in their country of operations. Subsidiary undertakings operating internationally are all incorporated in England and Wales, except Farland BV, BT Americas Inc. and Communications Global Network Services Limited which are incorporated in the Netherlands, the USA and Bermuda respectively.
[d]Held through intermediate holding company.
[e]In August 2005, Syntegra SA changed its name to BT C&SI France SA.
[f]In March 2006, Syntegra (USA) Inc was merged into BT Americas Inc.

		Share capital		
Associate	**Activity**	**Issued[a]**	**Percentage owned**	**Country of operations[b]**
Tech Mahindra Limited[d]	Telecommunications services provider	101,413,455	43%[c]	India

[a]Issued share capital comprises ordinary or common shares, unless otherwise stated.
[b]Incorporated in the country of operations.
[c]Held through an intermediate holding company.
[d]In February 2006, Mahindra British Telecom Limited changed its name to Tech Mahindra Limited.

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QUARTERLY ANALYSIS OF REVENUE AND PROFIT

Year ended 31 March 2006

Quarters	1st £m (Unaudited)	2nd £m (Unaudited)	3rd £m (Unaudited)	4th £m (Unaudited)	Total £m
Revenue	4,731	4,767	4,882	5,134	**19,514**
Other operating income	42	53	54	78	**227**
Operating costs	(4,137)	(4,234)	(4,265)	(4,610)	**(17,246)**
Operating profit	636	586	671	602	**2,495**
Net finance expense	(142)	(100)	(129)	(101)	**(472)**
Share of post tax profits of associates and joint ventures	5	3	3	5	**16**
Profit on disposal of joint venture	—	—	—	1	**1**
Profit before taxation	499	489	545	507	**2,040**
Taxation	(125)	(118)	(134)	(115)	**(492)**
Profit for the period	374	371	411	392	**1,548**
Basic earnings per share	4.4p	4.4p	4.9p	4.7p	**18.4p**
Diluted earnings per share	4.4p	4.3p	4.8p	4.6p	**18.1p**
Profit before specific items and taxation	511	559	545	562	**2,177**
Basic earnings per share before specific items	4.5p	5.0p	4.9p	5.1p	**19.5p**
Diluted earnings per share before specific items	4.5p	4.9p	4.8p	5.0p	**19.2p**

Year ended 31 March 2005

Quarters	1st £m (Unaudited)	2nd £m (Unaudited)	3rd £m (Unaudited)	4th £m (Unaudited)	Total £m
Revenue	4,519	4,554	4,536	4,820	18,429
Other operating income	44	83	339	85	551
Operating costs	(3,990)	(3,909)	(3,896)	(4,193)	(15,988)
Operating profit	573	728	979	712	2,992
Net finance expense	(155)	(154)	(149)	(141)	(599)
Share of post tax (losses) profits of associates and joint ventures	(7)	(3)	(35)	6	(39)
Profit before taxation	411	571	795	577	2,354
Taxation	(109)	(142)	(137)	(137)	(525)
Profit for the period	302	429	658	440	1,829
Basic earnings per share	3.5p	5.0p	7.7p	5.2p	21.5p
Diluted earnings per share	3.5p	5.0p	7.7p	5.1p	21.3p

Year ended 31 March 2005	**Unaudited**				
Profit before specific items and taxation	425	549	546	560	2,080
Basic earnings per share before specific items	3.6p	4.8p	4.8p	4.9p	18.1p
Diluted earnings per share before specific items	3.6p	4.7p	4.7p	4.8p	17.9p

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FINANCIAL STATISTICS

Years ended 31 March

IFRS	2006	2005
Financial ratios		
Basic earnings per share before specific items pence	**19.5**	18.1
Basic earnings per share pence	**18.4**	21.5
Return on capital employed before specific items[a] %	**16.8**	16.5
Interest cover before net pension finance income[b] times	**3.6**	3.4

	2006 £m	2005 £m
Expenditure on research and development		
Research and development expense	**326**	257
Amortisation of capitalised software development costs	**160**	95
Total	**486**	352

	2006 £m	2005 £m
Expenditure on property plant and equipment and software		
Plant and equipment		
Transmission equipment	**1,429**	1,488
Exchange equipment	**80**	143
Other network equipment	**727**	648
Computers and office equipment	**281**	312
Motor vehicles and other	**572**	349
Land and buildings	**68**	64
	3,157	3,004
Increase (decrease) in engineering stores	**(15)**	7
Total expenditure on property plant and equipment	**3,142**	3,011
(Increase) decrease in payables	**(202)**	45
Cash outflow on purchase of property plant and equipment and software	**2,940**	3,056

[a]The ratio is based on profit before taxation and net finance expense to average capital employed. Capital employed is represented by total assets less current liabilities (excluding corporation tax, current borrowings, derivative financial liabilities and finance lease creditors) less cash and cash equivalents, derivative financial assets and investments.

[b]The number of times net finance expense before net pension finance income is covered by total operating profit. Interest cover including net pension finance income is 5.6 times (2005: 4.5 times).

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FINANCIAL STATISTICS

Years ended 31 March

UK GAAP	2005	2004	2003	2002
Financial ratios				
Basic earnings per share on continuing activities before goodwill amortisation and exceptional items – pence	18.1	16.9	14.4	9.0
Basic earnings (loss) per share on continuing activities – pence	21.4	16.4	31.4	(34.6)
Basic earning (loss) per share – pence	21.4	16.4	31.4	12.1
Return on capital employed[a] – %	15.5[c]	15.1[c]	15.5	6.6
Interest cover[b] – times	3.5[d]	3.0[d]	2.0	0.6

	2005 £m	2004 £m	2003 £m	2002 £m
Expenditure on research and development				
Total expenditure	257	334	380	362

	2005 £m	2004 £m	2003 £m	2002 £m
Expenditure on property plant and equipment and software				
Plant and equipment				
Transmission equipment	1,488	1,324	1,277	1,373
Exchange equipment	143	150	228	428
Other network equipment	648	585	466	694
Computers and office equipment	312	205	281	273
Motor vehicles and other	349	316	162	189
Land and buildings	64	73	40	153
	3,004	2,653	2,454	3,110
Increase (decrease) in engineering stores	7	20	(9)	(10)
Total continuing activities	3,011	2,673	2,445	3,100
Total discontinued activities	–	–	–	808
Total expenditure on property plant and equipment	3,011	2,673	2,445	3,908
(Increase) decrease in payables	45	11	135	161
Cash outflow on purchase of property plant and equipment and software	3,056	2,684	2,580	4,069

[a]The ratio is based on profit before tax, goodwill amortisation and interest on long-term borrowings, to average capital employed.

[b]The number of times net interest payable is covered by total operating profit before goodwill amortisation.
[c]Return on capital employed before goodwill amortisation and exceptional items was 16.0% (2004 15.3%)
[d]Interest cover before goodwill amortisation and exceptional items was 3.6 times (2004 3.3 times)

OPERATIONAL STATISTICS

As at 31 March	2006 ’000	2005 ’000	2004 ’000	2003 ’000	2002 ’000
Retail					
Business voice/ISDN	**7,797**	8,358	8,824	9,062	9,030
Business broadband	**556**	422	287	146	42
Total Business connections (UK)	**8,353**	8,780	9,111	9,208	9,072
Residential voice/ISDN	**17,912**	19,520	19,870	20,065	20,027
Residential broadband	**2,028**	1,330	680	293	66
Total Residential connections (UK)	**19,940**	20,850	20,550	20,358	20,093
Total voice/ISDN connections	**25,709**	27,878	28,694	29,127	29,057
Total broadband connections	**2,584**	1,752	967	439	108
Total Retail connections (UK)	**28,293**	29,630	29,661	29,566	29,165
Wholesale					
Broadband (non BT ISPs)	**5,009**	3,180	1,248	361	59
Wholesale Line Rental	**2,874**	1,026	377	91	56
Full and shared loops (LLU)	**356**	41	11	3	n/a
Total Wholesale connections (UK)	**8,239**	4,247	1,636	455	115
Total broadband (Wholesale, Retail and LLU)	**7,949**	4,973	2,226	803	167
Mobility connections (’000)	**341**	372	145	27	n/a
Call growth (decline)					
% growth (decline) in UK fixed (geographic and fixed to mobile) volumes (minutes)	**(10)**	(13)	(7)	(4)	(5)
Average Revenue Per Consumer Household[a] (£)	**251**	254	265	271	265
People employed (Worldwide)					
Total employees (’000)	**104.4**	102.1	99.9	104.7	108.6
Year ended 31 March					
% Consumer contracted revenues[b]	**67**	64	58	56	55
Networked IT services sales order value (worldwide) (£m)	**5,391**	7,161	7,012	4,411	3,321

[a]Rolling 12 month consumer revenue, less mobile polos, divided by average number of primary lines
[b]Includes line rental, broadband, select services and packages

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this annual report are forward-looking and are made in reliance on the safe harbour provisions of the US Private Securities Litigation Reform Act of 1995. These statements relate to analyses and other information which are based on forecasts of future results and estimates of amounts not yet determinable. These statements include, without limitation, those concerning: BTs transformation strategy and its ability to achieve it; expected cost savings; growth of, and opportunities available in, the communications industry and BTs positioning to take advantage of those opportunities; expectations regarding competition, market shares, prices and growth; expectations regarding the convergence of technologies; growth and opportunities in new wave business (such as networked IT services, broadband and mobility); BTs network development and plans for the 21st century network; plans for the launch of new products and services; network performance and quality; the impact of regulatory initiatives on operations, including the regulation of the UK fixed wholesale and retail businesses and the impact of the Undertakings to Ofcom under the Enterprise Act; BTs possible or assumed future results of operations and/or those of its associates and joint ventures; BTs future dividend policy; capital expenditure and investment plans; adequacy of capital; financing plans; demand for and access to broadband and the promotion of broadband by third-party service providers; and those preceded by, followed by, or that include the words aims, believes, expects, anticipates, intends, will, should or similar expressions.

Although BT believes that the expectations reflected in these forward-looking statements are reasonable, it can give no assurance that these expectations will prove to have been correct. Because these statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by these forward-looking statements.

Factors that could cause differences between actual results and those implied by the forward-looking statements include, but are not limited to: material adverse changes in economic conditions in the markets served by BT and its lines of business; future regulatory actions and conditions in its operating areas, including competition from others; selection by BT and its lines of business of the appropriate trading and marketing models for its products and services; technological innovations, including the cost of developing new products, networks and solutions and the need to increase expenditures for improving the quality of service; the anticipated benefits and advantages of new technologies, products and services, including broadband and other new wave initiatives not being realised; developments in the convergence of technologies; prolonged adverse weather conditions resulting in a material increase in overtime, staff or other costs; the timing of entry and profitability of BT and its lines of business in certain communications markets; significant changes in market shares for BT and its principal products and services; fluctuations in foreign currency exchange rates and interest rates; and general financial market conditions affecting BTs performance. Certain of these factors are discussed in more detail elsewhere in this annual report including, without limitation, in **Group risk factors**. BT undertakes no obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

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LISTINGS

The principal listing of BT Groups ordinary shares is on the London Stock Exchange. American Depositary Shares (ADSs), each representing 10 ordinary shares, have been issued by JPMorgan Chase Bank, as Depositary for the American Depositary Receipts (ADRs) evidencing the ADSs, and are listed on the New York Stock Exchange. ADSs also trade, but are not listed, on the London Stock Exchange. Trading on the New York Stock Exchange is under the symbol BT.

SHARE AND ADS PRICES[a]

	Pence per ordinary share		US$ per ADS	
	High pence	**Low pence**	**High $**	**Low $**
Years ended 31 March				
2002	420.71	215.75	67.19	30.60
2003	286.25	141.00	41.95	23.16
2004	206.75	162.00	34.97	25.65
2005	216.25	169.25	40.93	30.34
2006	235.00	196.50	41.71	35.34
Year ended 31 March 2005				
1 April 30 June 2004	198.50	169.25	36.60	30.34
1 July 30 September 2004	197.50	177.50	36.80	32.66
1 October 31 December 2004	206.00	180.50	40.07	32.61
1 January 31 March 2005	216.25	196.50	40.93	37.71
Year ended 31 March 2006				
1 April 30 June 2005	230.00	196.50	41.71	36.83
1 July 30 September 2005	235.00	215.50	41.59	39.01
1 October 31 December 2005	224.75	202.50	39.56	35.34
1 January 31 March 2006	234.50	203.75	41.04	35.96
Month				
November 2005	216.75	203.50	37.69	35.34
December 2005	224.75	212.00	39.29	37.05
January 2006	223.25	203.75	39.67	35.96
February 2006	214.50	204.15	37.54	36.23
March 2006	234.50	208.00	41.04	36.75
April 2006	221.25	211.00	40.03	37.08
1 May to 12 May 2006	220.50	210.50	41.28	39.87

[a]The pre-19 November 2001 prices shown have been adjusted for the rights issue and demerger that occurred in the 2002 financial year.

The prices are the highest and lowest closing middle market prices for BT ordinary shares, as derived from the Daily Official List of the London Stock Exchange and the highest and lowest closing sales prices of ADSs, as reported on the New York Stock Exchange composite tape.

Fluctuations in the exchange rate between the pound sterling and the US dollar affect the dollar equivalent of the pound sterling price of the companys ordinary shares on the London Stock Exchange and, as a result, are likely to affect the market price of the ADSs on the New York Stock Exchange.

CAPITAL GAINS TAX (CGT)

The rights issue in June 2001 and the demerger of O2 in November 2001 adjusted the value for capital gains tax purposes of BT shares.

Rights issue

An explanatory note on the effects of the rights issue on the CGT position relating to BT shareholdings is available from the Shareholder Helpline (see page 143).

Demerger of O2 capital gains tax calculation

The confirmed official opening prices for BT Group and O2 shares on 19 November 2001 following the demerger were 285.75p and 82.75p, respectively. This means that, of the total (combined) value of 368.50p, 77.544% is attributable to BT Group and 22.456% to O2. Accordingly, for CGT calculations, the base cost of BT Group shares and O2 shares is calculated by multiplying the acquisition cost of a BT shareholding by 77.544% and 22.456%, respectively.

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ANALYSIS OF SHAREHOLDINGS

			Ordinary shares of 5p each	
Range	**Number of holdings**	**Percentage of total**	**Number of shares held (millions)**	**Percentage of total**
1 – 399	541,503	39.2	115	1.4
400 – 799	404,773	29.3	226	2.6
800 – 1,599	260,411	18.8	290	3.3
1,600 – 9,999	169,048	12.2	489	5.7
10,000 – 99,999	5,220	0.4	100	1.2
100,000 – 999,999	824	0.1	306	3.5
1,000,000 – 4,999,999	347	0.0	821	9.5
5,000,000 and above[a,b,c,d]	216	0.0	6,288	72.8
Total[e]	1,382,342	100.0	8,635	100.0

[a] 24 million shares were held in trust by Ilford Trustees (Jersey) Limited for allocation to employees under the employee share plans.
[b] Under the BT Group Employee Share Investment Plan, 58.57 million shares were held in trust on behalf of 83,102 participants who were beneficially entitled to the shares. 132 million shares were held in the corporate nominee BT Group EasyShare on behalf of 116,643 beneficial owners.
[c] 268 million shares were represented by ADSs. Analysis by size of holding is not available for this holding.
[d] 290 million shares were held as treasury shares.
[e] 14.6% of the shares were in 1,359,282 individual holdings, of which 111,955 were joint holdings, and 85.4% of the shares were in 23,060 institutional holdings.

So far as the company is aware, the company is not directly or indirectly owned or controlled by another corporation or by the UK Government or any other foreign government or by any other natural or legal person severally or jointly. There are no arrangements known to the company the operation of which may at a subsequent date result in a change in control of the company.

At 12 May 2006, there were 8,635,453,557 ordinary shares outstanding including 289,613,278 shares held as treasury shares. At the same date, approximately 27 million ADSs (equivalent to 270 million ordinary shares, or approximately 3.11% of the total number of ordinary shares outstanding on that date) were outstanding and were held by 2,792 record holders of ADRs.

At 31 March 2006, there were 3,615 shareholders with a US address on the register of shareholders.

DIVIDENDS

Since shortly after its incorporation in 1984, British Telecommunications plc paid interim dividends annually in February and final dividends in September. However, as part of BT's debt reduction and restructuring plans, neither a final dividend for the year ended 31 March 2001 nor an interim dividend for the year ended 31 March 2002 was paid to shareholders.

A final dividend in respect of the year ended 31 March 2005 was paid on 5 September 2005 to shareholders on the register on 5 August 2005, and an interim dividend in respect of the year ended 31 March 2006 was paid on 13 February 2006 to shareholders on the register on 31 December 2005.

The dividends paid or payable on BT shares and ADSs for the last five years are shown in the following table. The dividends on the ordinary shares exclude the associated tax credit. The amounts shown are not those that were actually paid to holders of ADSs. For the tax treatment of dividends paid see **Taxation of dividends** below. Dividends have been translated from pounds sterling into US dollars using exchange rates prevailing on the date the ordinary dividends were paid.

	Per ordinary share			Per ADS			Per ADS		
Years ended 31 March	**Interim pence**	**Final pence**	**Total pence**	**Interim £**	**Final £**	**Total £**	**Interim US$**	**Final US$**	**Total US$**
2002	—	2.00	2.00	—	0.200	0.200	—	0.311	0.311
2003	2.25	4.25	6.50	0.225	0.425	0.650	0.366	0.673	1.039
2004	3.20	5.30	8.50	0.320	0.530	0.850	0.590	0.938	1.528
2005	3.90	6.50	10.40	0.390	0.650	1.040	0.724	1.195	1.919
2006	**4.30**	**7.60**	**11.90**	**0.430**	**0.760**	**1.190**	**0.747**	[a]	[a]

[a] Qualifying holders of ADSs on record as of 18 August 2006 are entitled to receive the final dividend which will be paid on 18 September 2006, subject to approval at the annual general meeting. The US dollar amount of the final dividend of 76 pence per ADS to be paid to holders of ADSs will be based on the exchange rate in effect on 11 September 2006, the date of payment to holders of ordinary shares.

As dividends paid by the company are in pounds sterling, exchange rate fluctuations will affect the US dollar amounts received by holders of ADSs on conversion by the Depositary of such cash dividends.

DIVIDEND MANDATE

Any shareholder wishing dividends to be paid directly into a bank or building society account should contact the Shareholder Helpline (see page 143). Dividends paid in this way will be paid through the Bankers Automated Clearing System (BACS). Alternatively, a form may be downloaded from the Dividends page of our website at **www.bt.com/sharesandperformance**

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DIVIDEND INVESTMENT PLAN

The Dividend investment plan replaced the share dividend plan for shareholders following the 1999 interim dividend. Under the Dividend investment plan, cash from participants dividends is used to buy further BT shares in the market.

Shareholders could elect to receive additional shares in lieu of a cash dividend for the following dividends:

	Date paid	Price per share pence
2001 interim	12 February 2001	621.80
2002 final	9 September 2002	191.19
2003 interim	10 February 2003	178.23
2003 final	8 September 2003	184.41
2004 interim	9 February 2004	175.98
2004 final	6 September 2004	183.69
2005 interim	7 February 2005	209.95
2005 final	5 September 2005	220.25
2006 interim	**13 February 2006**	**214.50**

GLOBAL INVEST DIRECT

Details of the direct purchase plan run by the ADR Depositary, JPMorgan Chase Bank, Global Invest Direct, including reinvestment of dividends, are available from JPMorgan Chase Bank on +1 800 634 8366 (toll free within the USA) or +1 201 680 6630 (from outside the USA), or on written request to the ADR Depositary.

TOTAL SHAREHOLDER RETURN

Total Shareholder Return (TSR) is the measure of the returns that a company has provided for its shareholders, reflecting share price movements and assuming reinvestment of dividends. It is therefore, a good indicator of a companys overall performance.

Over the last five years (as shown in the first TSR chart below), BTs TSR (as adjusted for the rights issue and demerger) was negative 25% compared to a FTSE 100 TSR of positive 25%. This was primarily due to a fall in BTs share price which, like many stocks in the telecoms, media and technology (TMT) sector, declined in the early part of the period.

In the period between the demerger on 19 November 2001 and 31 March 2006, BTs TSR was negative 6%, compared to negative 15% for the FTSEurofirst 300 Telco Index and positive 31% for the FTSE 100. BT has also outperformed the FTSEurofirst 300 Telco Index in the last 12 months with a return of 13.4% compared to 1.6% for that index.

RESULTS ANNOUNCEMENTS

Expected announcements of results:

Explanation of Responses:

1st quarter	27 July 2006
2nd quarter and half year	9 November 2006
3rd quarter and nine months	February 2007
4th quarter and full year	May 2007
2007 annual report and accounts published	June 2007

INDIVIDUAL SAVINGS ACCOUNTS (ISAs)

Information about investing in BT shares through an ISA may be obtained from Halifax Share Dealing Limited, Trinity Road, Halifax, W.Yorkshire HX1 2RG (telephone 0870 242 5588). ISAs are also offered by other organisations.

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SHAREGIFT

The Orr Mackintosh Foundation operates a charity share donation scheme for shareholders with small parcels of shares whose value makes it uneconomic to sell them. Details of the scheme are available from ShareGift at **www.sharegift.org** or telephone 020 7828 1151, or can be obtained from the Shareholder Helpline.

UNCLAIMED ASSETS REGISTER

BT is among a growing number of companies which subscribe to the Unclaimed Assets Register, which provides a search facility for financial assets, such as shareholdings and dividends which have become separated from their owners. The Register donates a proportion of its public search fees to charity via ShareGift. For further information on the Unclaimed Assets Register, visit **www.uar.co.uk** or telephone 0870 241 1713.

EXCHANGE RATES

BT publishes its consolidated financial statements expressed in pounds sterling. The following tables detail certain information concerning the exchange rates between pounds sterling and US dollars based on the noon buying rate in New York City for cable transfers in pounds sterling as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate).

Year ended 31 March	2002	2003	2004	2005	2006
Period end	1.43	1.57	1.84	1.89	**1.74**
Average[a]	1.43	1.55	1.71	1.85	**1.78**
High	1.48	1.65	1.90	1.95	**1.92**
Low	1.37	1.43	1.55	1.75	**1.71**

[a]The average of the Noon Buying Rates in effect on the last day of each month during the relevant period.

						Month
	November 2005	December 2005	January 2006	February 2006	March 2006	April 2006
High	1.78	1.77	1.79	1.78	1.76	1.80
Low	1.71	1.72	1.74	1.73	1.73	1.74

On 12 May 2006, the most recent practicable date for this annual report, the Noon Buying Rate was US$1.89 to £1.00.

SHARE BUY BACK

The following table gives details of the purchase by BT of its own shares during the 2006 financial year.

Calendar month[a]	Total number of shares purchased	Average price paid per share (pence net of dealing costs)	Total number of shares purchased as part of publicly announced plans or programmes	Maximum number of shares that may yet be purchased under the plans or programmes[b]

			Total number of	Maximum[b] number
April 2005	Nil	N/A	Nil	774,250,000
May	500,000	213	500,000	773,750,000
June	11,250,000	220	11,250,000	762,500,000
July	Nil	N/A	Nil	850,000,000
August	24,000,000	220	24,000,000	826,000,000
September	19,500,000	221	9,500,000	806,500,000
October	6,500,000	221	6,500,000	800,000,000
November	22,772,145	210	22,772,145	777,227,855
December	28,500,000	218	28,500,000	748,727,855[c]
January 2006	2,500,000	219	2,500,000	746,227,855
February	27,950,000	211	27,950,000	718,277,855
March	22,300,000	222	22,300,000	695,977,855
Total	165,772,145	217.5	165,772,145	695,977,855

[a]Purchases from April to June 2005 were made in accordance with a resolution passed at the AGM held on 14 July 2004. Purchases from August 2005 to March 2006 were made in accordance with a resolution passed at the AGM on 13 July 2005.
[b]There are no plans or programmes BT has determined to terminate prior to expiration, or under which BT does not intend to make further purchases.
[c]Authority was given to purchase up to 859 million shares on 14 July 2004 and 850 million shares on 13 July 2005. These authorities expire at the close of the following AGM, or 15 months following the date of approval if earlier. The authority given in July 2004 expired on 13 July 2005.

MEMORANDUM AND ARTICLES OF ASSOCIATION

The following is a summary of the principal provisions of BT's memorandum and articles of association ("Memorandum" and "Articles"), a copy of which has been filed with the Registrar of Companies.

Memorandum

The Memorandum provides that the company's principal objects are, among other things, to carry on any business of running, operating, managing and supplying telecommunication systems and systems of any kind for conveying, receiving, storing, processing or transmitting sounds, visual images, signals, messages and communications of any kind.

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Articles

In the following description of the rights attaching to the shares in the company, a holder of shares and a shareholder is, in either case, the person entered on the companys register of members as the holder of the relevant shares. Shareholders can choose whether their shares are to be evidenced by share certificates (i.e. in certificated form) or held in electronic (i.e. uncertificated) form in CREST (the electronic settlement system in the UK).

(a) Voting rights

Subject to the restrictions described below, on a show of hands, every shareholder present in person or by proxy at any general meeting has one vote and, on a poll, every shareholder present in person or by proxy has one vote for each share which they hold.

Voting at any meeting of shareholders is by a show of hands unless a poll is demanded by the chairman of the meeting or by at least five shareholders at the meeting who are entitled to vote (or their proxies), or by one or more shareholders at the meeting who are entitled to vote (or their proxies) and who have, between them, at least 10% of the total votes of all shareholders who have the right to vote at the meeting.

No person is, unless the Board decide otherwise, entitled to attend or vote at any general meeting or to exercise any other right conferred by being a shareholder if he or any person appearing to be interested in those shares has been sent a notice under section 212 of the Companies Act 1985 (which confers upon public companies the power to require information with respect to interests in their voting shares) and he or any interested person has failed to supply to the company the information requested within 14 days after delivery of that notice. These restrictions end seven days after the earlier of the date the shareholder complies with the request satisfactorily or the company receives notice that there has been an approved transfer of the shares.

(b) Variation of rights

Whenever the share capital of the company is split into different classes of shares, the special rights attached to any of those classes can be varied or withdrawn either:

(i) with the sanction of an extraordinary resolution passed at a separate meeting of the holders of the shares of that class; or

(ii) with the consent in writing of the holders of at least 75% in nominal value of the issued shares of that class.

At any separate meeting, the necessary quorum is two persons holding or representing by proxy not less than one-third in nominal amount of the issued shares of the class in question (but at any adjourned meeting, any person holding shares of the class or his proxy is a quorum).

The company can issue new shares and attach any rights and restrictions to them, as long as this is not restricted by special rights previously given to holders of any existing shares. Subject to this, the rights of new shares can take priority over the rights of existing shares, or existing shares can take priority over them, or the new shares and the existing shares can rank equally.

(c) Changes in capital

The company may by ordinary resolution:

(i) consolidate and divide all or any of its share capital into shares of a larger amount;

(ii) divide all or part of its share capital into shares of a smaller amount;

(iii) cancel any shares which have not, at the date of the ordinary resolution, been taken or agreed to be taken by any person and reduce the amount of its share capital by the amount of the shares cancelled; and

(iv) increase its share capital.

The company may also:

(i) buy back its own shares; and

(ii) by special resolution reduce its share capital, any capital redemption reserve and any share premium account.

(d) Dividends

The companys shareholders can declare dividends by passing an ordinary resolution provided that no dividend can exceed the amount recommended by the directors. Dividends must be paid out of profits available for distribution. If the directors consider that the profits of the company justify such payments, they can pay interim dividends on any class of shares of the amounts and on the dates and for the periods they decide. Fixed dividends will be paid on any class of shares on the dates stated for the payments of those dividends.

The directors can offer ordinary shareholders the right to choose to receive new ordinary shares, which are credited as fully paid, instead of some or all of their cash dividend. Before they can do this, the company's shareholders must have passed an ordinary resolution authorising the directors to make this offer.

Any dividend which has not been claimed for ten years after it was declared or became due for payment will be forfeited and will belong to the company unless the directors decide otherwise.

(e) Distribution of assets on winding up

If the company is wound up (whether the liquidation is voluntary, under supervision of the court or by the court) the liquidator can, with the authority of an extraordinary resolution passed by the shareholders, divide among the shareholders all or any part of the assets of the company. This applies whether the assets consist of property of one kind or different kinds. For this purpose, the liquidator can place whatever value the liquidator considers fair on any property and decide how the division is carried out between shareholders or different groups of shareholders. The liquidator can also, with the same authority, transfer any assets to trustees upon any trusts for the benefit of shareholders which the liquidator decides. The liquidation of the company can then be finalised and the company dissolved. No past or present shareholder can be compelled to accept any shares or other property under the Articles which could give that shareholder a liability.

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(f) Transfer of shares

Certificated shares of the company may be transferred in writing either by an instrument of transfer in the usual standard form or in another form approved by the Board. The transfer form must be signed or made effective by or on behalf of the person making the transfer. The person making the transfer will be treated as continuing to be the holder of the shares transferred until the name of the person to whom the shares are being transferred is entered in the register of members of the company.

The Board may refuse to register any transfer of any share held in certificated form:

- which is in favour of more than four joint holders; or
- unless the transfer form to be registered is properly stamped to show payment of any applicable stamp duty and delivered to the company's registered office or any other place the Board decide. The transfer must have with it the share certificate for the shares to be transferred; any other evidence which the Board ask for to prove that the person wanting to make the transfer is entitled to do this; and if the transfer form is executed by another person on behalf of the person making the transfer, evidence of the authority of that person to do so.

Transfers of uncertificated shares must be carried out using a relevant system (as defined in the Uncertificated Securities Regulations 1995 (the Regulations)). The Board can refuse to register a transfer of an uncertificated share in the circumstances stated in the Regulations.

If the Board decide not to register a transfer of a share, the Board must notify the person to whom that share was to be transferred no later than two months after the company receives the transfer or instruction from the operator of the relevant system.

The Board can decide to suspend the registration of transfers, for up to 30 days a year, by closing the register of shareholders. The register must not be closed without the consent of the operator of a relevant system (as defined in the Regulations) in the case of uncertificated shares.

(g) Untraced shareholders

BT may sell any shares after advertising its intention and waiting for three months if the shares have been in issue for at least ten years, during that period at least three dividends have become payable on them and have not been claimed and BT has not heard from the shareholder or any person entitled to the dividends by transmission. The net sale proceeds belong to BT, but it must pay those proceeds to the former shareholder or the person entitled to them by transmission if that shareholder, or that other person, asks for them.

(h) General meetings of shareholders

Every year the company must hold an annual general meeting. The Board can call an extraordinary general meeting at any time and, under general law, must call one on a shareholders' requisition.

(i) Limitations on rights of non-resident or foreign shareholders

The only limitation imposed by the Articles on the rights of non-resident or foreign shareholders is that a shareholder whose registered address is outside the UK and who wishes to receive notices of meetings of shareholders or documents from BT must give the company an address within the UK to which they may be sent.

(j) Directors

Directors' remuneration

Excluding remuneration referred to below, each director will be paid such fee for his services as the Board decide, not exceeding £50,000 a year and increasing by the percentage increase of the UK Retail Prices Index (as defined by Section 833(2) Income and Corporation Taxes Act 1988) for any 12-month period beginning 1 April 1999 or an anniversary of that date. The company may by ordinary resolution decide on a higher sum. This resolution can increase the fee paid to all or any directors either permanently or for a particular period. The directors may be paid their expenses properly incurred in connection with the business of the company.

The Board can award extra fees to a director who holds an executive position; acts as chairman or deputy chairman; serves on a Board committee at the request of the Board; or performs any other services which the Board consider extend beyond the ordinary duties of a director.

The directors may grant pensions or other benefits to, among others, any director or former director or persons connected with them. However, BT can only provide these benefits to any director or former director who has not been an employee or held any other office or executive position in the company or any of its subsidiary undertakings, or to relations or dependants of, or people connected to, those directors or former directors, if the shareholders approve this by passing an ordinary resolution.

Directors votes

A director need not be a shareholder, but a director who is not a shareholder can still attend and speak at shareholders meetings.

Unless the Articles say otherwise, a director cannot vote on a resolution about a contract in which the director has a material interest (this will also apply to interests of a person connected with the director). The director can vote if the interest is only an interest in BT shares, debentures or other securities. A director can, however, vote and be counted in a quorum in respect of certain matters in which he is interested as set out in the Articles.

Subject to the relevant legislation, the shareholders can by passing an ordinary resolution suspend or relax, among other things, the provisions relating to the interest of a director in any contract or arrangement or relating to a directors right to vote and be counted in a quorum on resolutions in which he is interested to any extent or ratify any particular contract carried out in breach of those provisions.

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Directors interests

If the legislation allows and the director has disclosed the nature and extent of the interest to the Board, the director can:

(i) have any kind of interest in a contract with or involving BT (or in which BT has an interest or with or involving another company in which BT has an interest);

(ii) have any kind of interest in a company in which BT has an interest (including holding a position in that company or being a shareholder of that company);

(iii) hold a position (other than auditor) in BT or another company in which BT has an interest on terms and conditions decided by the Board; and

(iv) alone (or through some firm with which the director is associated) do paid professional work (other than as auditor) for BT or another company in which BT has an interest on terms and conditions decided by the Board.

A director does not have to hand over to BT any benefit received or profit made as a result of anything permitted to be done under the Articles.

When a director knows that they are interested in a contract with BT they must tell the other directors.

Retirement of directors

Provisions of the legislation which, read with the Articles, would prevent a person from being or becoming a director because that person has reached the age of 70 do not apply to the company.

At every annual general meeting, any director who was elected or last re-elected a director at or before the annual general meeting held in the third year before the current year, shall retire by rotation. Any director appointed by the directors automatically retires at the next following annual general meeting. A retiring director is eligible for re-election.

Directors borrowing powers

To the extent that the legislation and the Articles allow, the Board can exercise all the powers of the company to borrow money, to mortgage or charge its business, property and assets (present and future) and to issue debentures and other securities, and give security either outright or as collateral security for any debt, liability or obligation of the company or another person. The Board must limit the borrowings of the company and exercise all the companys voting and other rights or powers of control exercisable by the company in relation to its subsidiary undertakings so as to ensure that the aggregate amount of all borrowings by the group outstanding, net of amounts borrowed intra-group among other things, at any time does not exceed £35 billion.

MATERIAL CONTRACTS

Excluding contracts entered into in the ordinary course of business, no contracts have been entered into in the two years preceding the date of this document by BT or another member of the group which are, or may be, material to the group or contain a provision under which a member of the group has an obligation or entitlement which is, or may be, material to BT or such other member of the group.

TAXATION (US HOLDERS)

This is a summary only of the principal US federal income tax and UK tax consequences of the ownership and disposition of ordinary shares or ADSs by US Holders (as defined below) who hold their ordinary shares or ADSs as capital assets. It does not address all aspects of US federal income taxation and does not address aspects that may be relevant to persons who are subject to special provisions of US federal income tax law, including US expatriates, insurance companies, tax-exempt organisations, banks, regulated investment companies, financial institutions, securities broker-dealers, traders in securities who elect a mark-to-market method of accounting, persons subject to alternative minimum tax, investors that directly, indirectly or by attribution own 10% or more of the outstanding share capital or voting power of BT, persons holding their ordinary shares or ADSs as part of a straddle, hedging transaction or conversion transaction, persons who acquired their ordinary shares or ADSs pursuant to the exercise of options or otherwise as compensation, or persons whose functional currency is not the US dollar, amongst others. Those holders may be subject to US federal income tax consequences different from those set forth below.

For the purposes of this summary, a US Holder is a beneficial owner of ordinary shares or ADSs that, for US federal income tax purposes, is: a citizen or individual resident of the United States, a corporation (or other entity taxable as a corporation for US federal income tax purposes) created or organised in or under the laws of the United States or any political subdivision thereof, an estate the income of which is subject to US federal income taxation regardless of its source, or a trust if a US court can exercise primary supervision over the administration of the trust and one or more United States persons are authorised to control all substantial decisions of the trust. If a partnership holds ordinary shares or ADSs, the US tax treatment of a partner generally will depend upon the status of the partner and the activities of the partnership. A partner in a partnership that holds ordinary shares or ADSs is urged to consult its own tax advisor regarding the specific tax consequences of owning and disposing of the ordinary shares or ADSs.

In particular, this summary is based on (i) current UK tax law and the practice of Her Majesty's Revenue & Customs (HMRC) and US law and US Internal Revenue Service (IRS) practice, including the Internal Revenue Code of 1986, as amended, existing and proposed Treasury regulations, rulings, judicial decisions and administrative practice, all as currently in effect and available, (ii) the United Kingdom-United States Convention relating to estate and gift taxes, and (iii) the United Kingdom-United States Tax Convention that entered into force on 31 March 2003 and the protocol thereto (the Convention), all as in effect on the date of this annual report, all of which are subject to change or changes in interpretation, possibly with retroactive effect.

US Holders should consult their own tax advisors as to the applicability of the Convention and the consequences under UK, US federal, state and local, and other laws, of the ownership and disposition of ordinary shares or ADSs.

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Taxation of dividends

Under current UK tax law, BT will not be required to withhold tax at source from dividend payments it makes.

For US federal income tax purposes, a distribution will be treated as ordinary dividend income. The amount of the distribution includible in gross income of a US Holder will be the US dollar value of the distribution calculated by reference to the spot rate in effect on the date the distribution is actually or constructively received by a US Holder of ordinary shares, or by the Depositary, in the case of ADSs. A US Holder who converts the British pounds into US dollars on the date of receipt generally should not recognise any exchange gain or loss. A US Holder who does not convert the British pounds into US dollars on the date of receipt generally will have a tax basis in the British pounds equal to their US dollar value on such date. Foreign currency gain or loss, if any, recognised by the US Holder on a subsequent conversion or other disposition of the British pounds generally will be US source ordinary income or loss. Dividends paid by BT to a US Holder will not be eligible for the US dividends received deduction that may otherwise be available to corporate shareholders.

For purposes of calculating the foreign tax credit limitation, dividends paid on the ordinary shares or ADSs will be treated as income from sources outside the United States and generally will constitute "passive income" or, for certain Holders, "financial services income" for tax years beginning before 1 January 2007, and for tax years beginning after 31 December 2006, will be treated as "passive category income" or "general category income". The rules relating to the determination of the foreign tax credit are very complex. US Holders who do not elect to claim a credit with respect to any foreign taxes paid in a given taxable year may instead claim a deduction for foreign taxes paid. A deduction does not reduce US federal income tax on a dollar for dollar basis like a tax credit. The deduction, however, is not subject to the limitations applicable to foreign credits.

There will be no right to any UK tax credit or to any payment from HMRC in respect of any tax credit on dividends paid on ordinary shares or ADSs.

Certain US Holders (including individuals) are eligible for reduced rates of US federal income tax (currently at a maximum rate of 15%) in respect of "qualified dividend income" received in taxable years beginning before 1 January 2009. For this purpose, qualified dividend income generally includes dividends paid by a non-US corporation if, among other things, the US Holders meet certain minimum holding periods and the non-US corporation satisfies certain requirements, including that either (i) the shares (or ADSs) with respect to which the dividend has been paid are readily tradeable on an established securities market in the United States, or (ii) the non-US corporation is eligible for the benefits of a comprehensive US income tax treaty (such as the Convention) which provides for the exchange of information. BT currently believes that dividends paid with respect to its ordinary shares and ADSs should constitute qualified dividend income for US federal income tax purposes. Each individual US Holder of ordinary shares or ADSs is urged to consult his own tax advisor regarding the availability to him of the reduced dividend tax rate in light of his own particular situation and regarding the computations of his foreign tax credit limitation with respect to any qualified dividend income paid by BT to him, as applicable.

Taxation of capital gains

Unless a US Holder of ordinary shares or ADSs is resident in or ordinarily resident for United Kingdom tax purposes in the United Kingdom or unless a US Holder of ordinary shares or ADSs carries on a trade, profession, or vocation in the United Kingdom through a branch, agency, or permanent establishment in the UK, and the ordinary shares and/or ADSs have been used, held, or acquired for purposes of that trade, the holder should not be liable for UK tax on capital gains on a disposal of ordinary shares and/or ADSs.

A US Holder who is an individual and who has ceased to be resident or ordinarily resident for tax purposes in the United Kingdom on or after 17 March 1998 or who falls to be regarded as resident outside the United Kingdom for the purposes of any double tax treaty (Treaty non-resident) on or after 16 March 2005 and continues to not be resident or ordinarily resident in the United Kingdom or continues to be Treaty non-resident for a period of less than five years of assessment and who disposes of his ordinary shares or ADSs during that period may also be liable on his return to the United Kingdom to United Kingdom tax on capital gains, subject to any available exemption or relief, even though he is not resident or ordinarily resident in the United Kingdom or is Treaty non-resident at the time of disposal.

For US federal income tax purposes, a US Holder generally will recognise capital gain or loss on the sale, exchange or other disposition of ordinary shares or ADSs in an amount equal to the difference between the US dollar value of the amount realised on the disposition and the US Holder's adjusted tax basis (determined in US dollars) in the ordinary shares or ADSs. Such gain or loss generally will be US source gain or loss, and will be treated as long-term capital gain or loss if the ordinary shares have been held for more than one year at the time of disposition. Long-term capital gains recognised by an individual US Holder generally are subject to US federal income tax at preferential rates. The deductibility of capital losses is subject to significant limitations.

Passive foreign investment company status

A non-US corporation will be classified as a Passive Foreign Investment Company for US federal income tax purposes (a PFIC) for any taxable year if at least 75% of its gross income consists of passive income or at least 50% of the average value of its assets consist of assets that produce, or are held for the production of, passive income. BT currently believes that it did not qualify as a PFIC for the taxable year ending 31 March 2006. If BT were to become a PFIC for any taxable year, US Holders would suffer adverse tax consequences. These consequences may include having gains realised on the disposition of ordinary shares or ADSs treated as ordinary income rather than capital gains and being subject to punitive interest charges on certain dividends and on the proceeds of the sale or other disposition of the ordinary shares or ADSs. Furthermore, dividends paid by BT would not be qualified dividend income which may be eligible for reduced rates of taxation as described above. US Holders should consult their own tax advisors regarding the potential application of the PFIC rules to BT.

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US information reporting and backup withholding
Dividends paid on and proceeds received from the sale, exchange or other disposition of ordinary shares or ADSs may be subject to information reporting to the IRS and backup withholding at a current rate of 28% (which rate may be subject to change). Certain exempt recipients (such as corporations) are not subject to these information reporting requirements. Backup withholding will not apply, however, to a US Holder who provides a correct taxpayer identification number or certificate of foreign status and makes any other required certification or who is otherwise exempt. Persons that are United States persons for US federal income tax purposes who are required to establish their exempt status generally must furnish IRS Form W-9 (Request for Taxpayer Identification Number and Certification). Holders that are not United States persons for US federal income tax purposes generally will not be subject to US information reporting or backup withholding. However, such holders may be required to provide certification of non-US status in connection with payments received in the United States or through certain US-related financial intermediaries.

Backup withholding is not an additional tax. Amounts withheld as backup withholding may be credited against a holder's US federal income tax liability. A holder may obtain a refund of any excess amounts withheld under the backup withholding rules by timely filing the appropriate claim for refund with the IRS and furnishing any required information.

UK stamp duty
A transfer of an ordinary share will generally be subject to UK stamp duty or UK stamp duty reserve tax SDRT at 0.5% of the amount or value of any consideration provided rounded up (in the case of stamp duty) to the nearest £5. SDRT is generally the liability of the purchaser. It is customarily also the purchaser who pays UK stamp duty. A transfer of an ordinary share to, or to a nominee or agent of, a person whose business is or includes issuing depositary receipts gives rise to a 1.5% charge to stamp duty or SDRT of either the amount of the consideration provided or the value of the share issued rounded up (in the case of stamp duty) to the nearest £5. No UK stamp duty will be payable on the transfer of an ADS (assuming it is not registered in the UK), provided that the transfer documents are executed and always retained outside the UK.

Transfers of ordinary shares into CREST will generally not be subject to stamp duty or SDRT unless such a transfer is made for a consideration in money or money's worth, in which case a liability to SDRT will arise, usually at the rate of 0.5% of the value of the consideration. Paperless transfers of ordinary shares within CREST are generally liable to SDRT at the rate of 0.5% of the value of the consideration. CREST is obliged to collect SDRT from the purchaser of the shares on relevant transactions settled within the system.

UK inheritance and gift taxes in connection with ordinary shares and/or ADSs
The rules and scope of domicile are complex and action should not be taken without advice specific to the individual's circumstances. A lifetime gift or a transfer on death of ordinary shares and/or ADSs by an individual holder, who is US domiciled (for the purposes of the UK/US Estate and Gift Tax Convention) and who is not a UK national (as defined in the Convention) will not generally be subject to UK inheritance tax if the gift is subject to US federal gift or US estate tax unless the tax is not paid.

LIMITATIONS AFFECTING SECURITY HOLDERS

There are no limitations under the laws of the United Kingdom restricting the right of non-residents to hold or to vote shares in the company.

DOCUMENTS ON DISPLAY

All reports and other information that BT files with the US Securities and Exchange Commission (SEC) may be inspected at the SEC's public reference facilities at Room 1580, 100 F Street, NE Washington, DC, 20549, USA. These reports may be accessed via the SEC's website at **www.sec.gov**

PUBLICATIONS

BT produces a series of reports on the company's financial, economic, compliance, social and environmental performance. Most of these reports (as well as the EAB Annual Report on BT's compliance with the Undertakings), are available to shareholders on request and can be accessed on the internet at **www.bt.com/aboutbt** More detailed disclosures on BT's implementation of social, ethical and environmental policies and procedures are available online through our fully and independently verified social and environment report at

www.bt.com/betterworld

Document	**Publication date**
Annual Review and Notice of Meeting	May
Annual Report and Form 20-F	May
Social and Environment Report	May
EAB Annual Report	May
Quarterly results releases	July, November, February and May
Current Cost Financial Statements	September
Statement of Business Practice	July 2004

For printed copies, when available, contact the Shareholder Helpline on Freefone 0808 **100 4141** or, alternatively, contact the Registrar in the UK, at the address on page 143.

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ELECTRONIC COMMUNICATION

Shareholders can now choose to receive their shareholder documents electronically rather than by post. Shareholders may elect to receive documents in this way by going to **www.bt.com/signup** and following the online instructions, or by calling the Shareholder Helpline.

SHAREHOLDER COMMUNICATION

BT is committed to communicating openly with each of its stakeholder audiences in the manner most appropriate to their requirements.

All investors can visit our website at **www.bt.com/sharesandperformance** for more information about BT. There are direct links from this page to sites providing information particularly tailored for shareholders, institutional investors and analysts, industry analysts and journalists.

An electronic copy of this document is available at **www.bt.com/annualreport**

Private shareholders

If private shareholders have any enquiries about their shareholding, they should contact the Registrar (the address can be found below).

Lloyds TSB Registrars maintain BT Groups share register and the separate BT Group EasyShare register. They also provide a Shareholder Helpline service on Freefone 0808 **100 4141**.

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CROSS REFERENCE TO FORM 20-F

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