NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1 Basis of preparation and accounting policies

These condensed consolidated financial statements ("the financial statements") comprise the financial results of BT Group plc for the quarter to 30 June 2009 and 2008.

Except as described below, the financial statements have been prepared in accordance with the accounting policies as set out in the financial statements for the year to 31 March 2009 and have been prepared under the historical cost convention as modified by the revaluation of financial assets and liabilities (including derivative financial instruments) at fair value.

The financial statements do not constitute statutory accounts within the meaning of Section 240 of the Companies Act 1985. Statutory accounts for the year to 31 March 2009 were approved by the Board of Directors on 13 May 2009, published on 27 May 2009 and delivered to the Registrar of Companies. The report of the auditors on those accounts was unqualified and did not contain any statement under Section 237 of the Companies Act 1985. The financial statements for the quarter to 30 June 2009 have been reviewed by the auditors and their review opinion is on page 24. The financial statements should be read in conjunction with the annual financial statements for the year to 31 March 2009.

The following new standards, amendments to new standards and interpretations which are relevant for the group have been adopted with effect from 1 April 2009:

- IAS 1 (revised), '*Presentation of financial statements';*
- IAS 23 (amended), *'Borrowing costs';*
- IFRS 2, *'Share-based Payment – vesting conditions and cancellations';*
- IFRS 8, *'Operating segments';*
- IFRIC 12, *'Service concession arrangements';*
- IFRIC 13, *'Customer loyalty programmes'; and*
- IFRIC 16, *'Hedges of a net investment in a foreign operation'.*

The adoption of the amendment to IFRS 2 'Share-based Payment – vesting conditions and cancellations' has resulted in a change in the group's accounting policy for share based payments. The amendment clarifies that only service and performance conditions are vesting conditions. Any other conditions are non-vesting conditions which have to be taken into account to determine the fair value of the equity instruments granted. In the case that the award does not vest as a result of a failure to meet a non-vesting condition that is within the control of either the group or the counterparty, this must be treated as a cancellation. Cancellations are treated as accelerated vestings and all remaining future charges are immediately recognised in the income statement with the credit recognised directly in equity. Hence the overall impact on net assets and cash flow is nil. Prior to the adoption of the amendment to IFRS 2 the monthly savings requirement under the group's all employee sharesave plans was classified as a vesting condition and any cancellations made by employees prior to the normal vesting date resulted in the reversal of all charges recognised to date.

None of the other new standards, amendments or interpretations referred to above has a significant impact on the group's results.

Restatements – impact of new accounting standards

The amendment to IFRS 2 requires retrospective adoption and hence the quarterly and annual comparative periods for FY 2008/09 have been restated. Due to the change in accounting policy as explained above, this has resulted in a reduction in EBITDA of £16m for Q1 2008/09, £22m for Q2 2008/09, £35m for Q3 2008/09, £37m for Q4 2008/09 and £110m for FY 2008/09. The impact of these changes on all relevant income statement line items is shown in Note 14. The restatements have been included in the 'Other' segment.

The adoption of IAS 1 (revised), 'Presentation of financial statements' has resulted in a change in accounting policy applied to the classification of derivatives which have not been allocated to a specific hedge relationship. Where such derivatives have a maturity of and are expected to be held for more than twelve months after the reporting period, they will now be presented as non current assets or liabilities. Prior period balance sheets have been reclassified to be on a consistent basis. The impact of these changes on all relevant balance sheet line items is shown in Note 14.

Restatements – internal changes
We have also restated the line of business 2008/09 income statement comparatives for the impact of customer account moves between BT Global Services and BT Retail and other internal trading model changes effective from 1 April 2009. The impact of these changes on the line of business results is shown in Note 14. These restatements have no impact on total group results.

2 Operating results – by line of business

	External revenue £m	Internal revenue £m	Group revenue £m	EBITDA[1] £m	Group operating profit (loss)[1] £m
First quarter to 30 June 2009					
BT Global Services	**2,079**	**-**	**2,079**	**62**	**(124)**
BT Retail	**2,027**	**83**	**2,110**	**476**	**359**
BT Wholesale	**836**	**306**	**1,142**	**320**	**149**
Openreach	**280**	**1,026**	**1,306**	**503**	**302**
Other	**13**	**-**	**13**	**10**	**(53)**
Intra-group items[2]	**-**	**(1,415)**	**(1,415)**	**-**	**-**
Total	**5,235**	**-**	**5,235**	**1,371**	**633**
First quarter to 30 June 2008[3]					
BT Global Services	1,994	-	1,994	182	1
BT Retail	2,090	68	2,158	377	277
BT Wholesale	849	307	1,156	324	154
Openreach	237	1,069	1,306	491	307
Other	7	-	7	43	(13)
Intra-group items[2]	-	(1,444)	(1,444)	-	-
Total	5,177	-	5,177	1,417	726

[1] Before specific items and leaver costs.
[2] Elimination of intra-group revenue between businesses, which is included in the total revenue of the originating business.
[3] Restated – see Note 1 for details.

3 Capital expenditure – by line of business

	First quarter to 30 June			
	2009	2008	Change	
	£m	£m	£m	%
BT Global Services	**131**	245	(114)	(47)
BT Retail	**81**	127	(46)	(36)
BT Wholesale	**71**	120	(49)	(41)
Openreach	**203**	227	(24)	(11)
Other	**73**	83	(10)	(12)
	559	802	(243)	(30)

The above table reflects a revised methodology for allocating shared infrastructure capital expenditure to the market facing lines of business. This methodology will be used on a consistent basis going forward. 'Other' comprises capital expenditure relating to the group's regulatory, property, fleet and corporate operations.

4 (a) Operating costs

	First quarter to 30 June	
	2009	2008[1]
	£m	£m
Staff costs before leaver costs	**1,266**	1,386
Leaver costs	**45**	73
Staff costs	**1,311**	1,459
Own work capitalised	**(144)**	(158)
Net staff costs	**1,167**	1,301
Depreciation and amortisation	**738**	691
Payments to telecommunication operators	**1,048**	1,037
Other operating costs	**1,773**	1,585
Total before specific items	**4,726**	4,614
Specific items (Note 5)	**41**	27
Total	**4,767**	4,641

[1] Restated – see Note 1 for details

(b) Leaver costs

	First quarter to 30 June	
	2009	2008
	£m	£m
BT Global Services	**-**	6
BT Retail	**6**	3
BT Wholesale	**-**	-
Openreach	**28**	4
Other	**11**	60
Total	**45**	73

5 Specific items

BT separately identifies and discloses any significant one-off or unusual items (termed "specific items"). 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. Specific items may not be comparable to similarly titled measures used by other companies.

	First quarter to 30 June	
	2009	2008
	£m	£m
BT Global Services restructuring charges	**41**	-
Group transformation and reorganisation costs	**-**	27
Net specific items charge before tax	**41**	27
Tax credit on specific items	**(11)**	(8)
Net specific items charge after tax	**30**	19

6 Net finance expense

	First quarter to 30 June	
	2009	2008
	£m	£m
Finance expense[1] before pension interest	**215**	219
Interest on pension scheme liabilities	**552**	577
Finance expense	**767**	796
Finance income before pension income	**(1)**	(11)
Expected return on pension scheme assets	**(483)**	(655)
Finance income	**(484)**	(666)
Net finance expense	**283**	130
Net finance expense before pensions	**214**	208
Net interest expense (income) on pensions	**69**	(78)
Net finance expense	**283**	130

[1] Finance expense in the first quarter to 30 June 2009 includes a £1m net credit (30 June 2008: £3m), respectively, arising from the re-measurement of financial instruments on a fair value basis which under IAS 39, are not in hedging relationships.

7 (a) Earnings per share

The basic earnings per share is calculated by dividing the profit attributable to shareholders by the 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. The average number of shares in the periods were:

	First quarter to 30 June	
	2009	2008
	millions of shares	
Basic	**7,735**	7,731
Diluted	**7,814**	7,856

7 (b) Reconciliation of adjusted earnings per share

	First quarter to 30 June	
	2009	2008[1]
	pence per share	
Reported earnings per share	**2.8**	4.9
Per share impact of:		
- Leaver costs	**0.4**	0.7
- Specific items	**0.4**	0.2
- Net interest expense (income) on pensions	**0.6**	(0.7)
Adjusted earnings per share	**4.2**	5.1

[1] Restated – see Note 1 for details

8 (a) Reconciliation of profit before tax to cash generated from operations

	First quarter to 30 June	
	2009	2008[1]
	£m	£m
Profit before tax	**272**	497
Depreciation and amortisation	**738**	691
Net finance expense	**283**	130
Decrease in net working capital	**(599)**	(962)
Associates and joint ventures	**(8)**	(1)
Provisions movements, pensions and other non-cash movements	**(57)**	32
Cash generated from operations	**629**	387

[1] Restated – see Note 1 for details

(b) Free cash flow

	First quarter to 30 June	
	2009	2008
	£m	£m
Cash generated from operations	**629**	387
Income taxes received	**210**	-
Net cash inflow from operating activities	**839**	387
Included in cash flows from investing activities		
Net purchase of property, plant, equipment and software	**(678)**	(836)
Dividends received from associates	**1**	-
Interest received	**1**	7
Included in cash flows from financing activities		
Interest paid	**(285)**	(292)
Free cash flow	**(122)**	(734)

Free cash flow is defined as the net increase in cash and cash equivalents less cash flows from financing activities (except interest paid), less the acquisition or disposal of group undertakings and less the net sale of short term investments. It is not a measure recognised under IFRS but is a key indicator used by management in order to assess operational performance.

(c) Cash and cash equivalents

	First quarter to 30 June	
	2009	2008
	£m	£m
Cash at bank and in hand	**381**	577
Short term deposits	**76**	459
Cash and cash equivalents	**457**	1,036
Bank overdrafts	**(10)**	(194)
Total	**447**	842

9 Net debt

Net debt at 30 June 2009 was £10,517m (31 March 2009: £10,361m, 30 June 2008: £10,581m). 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 expected value of future undiscounted 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 effective interest method as required by IAS 39. 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.

(a) Analysis of net debt

	First quarter to 30 June	
	2009	2008
	£m	£m
Loans and other borrowings	**12,940**	11,834
Cash and cash equivalents	**(457)**	(1,036)
Investments	**(996)**	(302)
	11,487	10,496
Adjustments:		
To re-translate currency denominated balances at swapped rates where hedged	**(728)**	277
To recognise borrowings at net proceeds adjusted to amortise discount and investments at the lower of cost and net realisable value	**(242)**	(192)
Net debt	**10,517**	10,581

After allocating the element of the adjustments which impacts loans and other borrowings, gross debt at 30 June 2009 was £11,970m (30 June 2008: £11,738m, 31 March 2009: £11,663m). The adjustment to re-translate currency denominated balances at swapped rates where hedged reflects the foreign exchange impact of currency swaps which offset the foreign exchange movement on revaluing currency loans and borrowings.

(b) Reconciliation of movement in net debt

	First quarter to 30 June	
	2009	2008
	£m	£m
Net debt at beginning of period	**10,361**	9,460
Increase in net debt resulting from cash flows	**135**	1,099
Net debt assumed or issued on acquisitions	**-**	18
Currency movements	**25**	1
Other non-cash movements	**(4)**	3
Net debt at end of period	**10,517**	10,581

10 Statement of changes in equity

	First quarter to 30 June	
	2009	2008
	£m	£m
Shareholders' funds	**142**	5,409
Minority interest	**27**	23
Equity at beginning of period	**169**	5,432
Total comprehensive loss for the period	**(3,357)**	(2,420)
Share-based payment	**19**	35
Net sale (purchase) of treasury shares	**1**	(186)
Minority interest	**(5)**	(1)
Net changes in equity for the period	**(3,342)**	(2,572)
Equity at end of period		
Shareholders' (deficit) funds	**(3,192)**	2,837
Minority interest	**19**	23
Total (deficit) equity	**(3,173)**	2,860

11 Earnings before interest, taxation, depreciation and amortisation (EBITDA)

	First quarter to 30 June	
	2009	2008
	£m	£m
Operating profit	**547**	626
Depreciation and amortisation (Note 4(a))	**738**	691
Leaver costs (Note 4(b))	**45**	73
Specific items (Note 5)	**41**	27
EBITDA before specific items and leaver costs	**1,371**	1,417

Earnings before interest, taxation, depreciation and amortisation (EBITDA) before specific items and leaver costs is not a measure recognised under IFRS, but it is a key indicator used by management in order to assess operational performance.

12 Reconciliation of adjusted profit before tax

	First quarter to 30 June	
	2009	2008
	£m	£m
Reported profit before tax	**272**	497
Leaver costs (Note 4(b))	**45**	73
Specific items (Note 5)	**41**	27
Net interest on pensions (Note 6)	**69**	(78)
Adjusted profit before tax	**427**	519

13 Dividends

BT’s final dividend of 1.1 pence per share for the 2008/09 financial year will be paid on 7 September 2009 to shareholders on the register on 14 August 2009. The ex-dividend date is 12 August 2009.

14 Prior period restatements

(a) Customer account moves and trading model changes (before leaver costs, specific items and contract and financial review charges)

	As reported - 2008/09					Adjustments					Restated - 2008/09				
	Q1 £m	Q2 £m	Q3 £m	Q4 £m	FY £m	Q1 £m	Q2 £m	Q3 £m	Q4 £m	FY £m	Q1 £m	Q2 £m	Q3 £m	Q4 £m	FY £m
Global Services															
Revenue	2,052	2,157	2,253	2,366	8,828	(58)	(62)	(59)	(62)	(241)	1,994	2,095	2,194	2,304	8,587
EBITDA	195	119	17	43	374	(13)	(14)	(10)	(11)	(48)	182	105	7	32	326
Retail															
Revenue	2,109	2,127	2,134	2,101	8,471	49	49	46	48	192	2,158	2,176	2,180	2,149	8,663
EBITDA	368	421	428	435	1,652	9	8	6	7	30	377	429	434	442	1,682
Wholesale															
Revenue	1,156	1,168	1,183	1,151	4,658	-	-	-	-	-	1,156	1,168	1,183	1,151	4,658
EBITDA	322	320	319	311	1,272	2	4	2	3	11	324	324	321	314	1,283
Openreach															
Revenue	1,306	1,303	1,329	1,293	5,231	-	-	-	-	-	1,306	1,303	1,329	1,293	5,231
EBITDA	491	489	533	512	2,025	-	-	-	-	-	491	489	533	512	2,025
Other															
Revenue	7	11	11	13	42	-	1	(1)	(2)	(2)	7	12	10	11	40
EBITDA	57	80	39	53	229	2	2	2	1	7	59	82	41	54	236
Intra-group items															
Revenue	(1,453)	(1,463)	(1,473)	(1,451)	(5,840)	9	12	14	16	51	(1,444)	(1,451)	(1,459)	(1,435)	(5,789)
EBITDA	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
TOTAL															
Revenue	5,177	5,303	5,437	5,473	21,390	-	-	-	-	-	5,177	5,303	5,437	5,473	21,390
EBITDA	1,433	1,429	1,336	1,354	5,552	-	-	-	-	-	1,433	1,429	1,336	1,354	5,552

14 (b) Accounting standards

IFRS 2 (amended)[1]	As reported - 2008/09					IFRS 2 (amended) adjustment					Restated - 2008/09				
	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3	Q4	FY
Share-based payment	£m	£m	£m	£m	£m	£m	£m	£m	£m		£m	£m	£m	£m	£m
Adjusted EBITDA [2]	1,433	1,429	1,336	1,354	5,552	(16)	(22)	(35)	(37)	(110)	1,417	1,407	1,301	1,317	5,442
EBITDA	1,333	1,355	967	(354)	3,301	(16)	(22)	(35)	(37)	(110)	1,317	1,333	932	(391)	3,191
Profit after tax	398	400	97	(976)	(81)	(16)	(22)	(35)	(37)	(110)	382	378	62	(1,013)	(191)
Basic earnings per share (p)	5.1	5.2	1.3	(12.6)	(1.1)	(0.2)	(0.3)	(0.5)	(0.5)	(1.4)	4.9	4.9	0.8	(13.1)	(2.5)
Diluted earnings per share (p)	5.1	5.2	1.3	(12.6)	(1.1)	(0.3)	(0.3)	(0.5)	(0.4)	(1.4)	4.8	4.9	0.8	(13.0)	(2.5)

IAS 1 (revised)[1]	As reported - 2008/09				IAS 1 (revised) adjustment				Restated - 2008/09			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Derivatives classification	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Non Current Assets	281	345	2,730	2,456	-	5	104	86	281	350	2,834	2,542
Current Assets	16	86	470	244	-	(5)	(104)	(86)	16	81	366	158
Current Liabilities	(213)	(267)	(373)	(340)	191	198	309	284	(22)	(69)	(64)	(56)
Non Current liabilities	(801)	(464)	(491)	(427)	(191)	(198)	(309)	(284)	(992)	(662)	(800)	(711)
Total	(717)	(300)	2,336	1,933	-	-	-	-	(717)	(300)	2,336	1,933

[1] See Note 1 for further explanation.
[2] Before leaver costs, specific items and contract and financial review charges.