

BAE Systems (Defence Systems) Limited

Annual Report and Financial Statements

31 December 2019

Registered number: 00236538



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Strategic Report
for the year ended 31 December 2019

Review of business

Principal activities

BAE Systems (Defence Systems) Limited (the "Company") is principally engaged in the design, development and support of the Falcon mobile battlefield communication system for the UK Army and RAF.

Overview

The development phase of the contract concluded during the 2013 financial year and has now progressed into the support phase. A significant order was won in December 2015 to enhance the overall capability of the Falcon platform. The contract was 95% complete at December 2018 and is 96.4% complete at December 2019. The contract is expected to complete in 2021 at which point the Company will continue to operate as a leasing and holding company.

During the year the Company adopted IFRS 16, this resulted in the recognition of a new asset and liability on the Balance Sheet.

Key performance indicators

Key financial performance indicators are shown below:

	2019	2018
	£000	£000
Order intake	8,158	5,575
Revenue	12,406	13,420
Profit before tax	5,969	9,416
Return on sales	48.11%	70.16%

Order intake represents the value of funded orders received from customers in the year. It is a measure of in year performance and supports future years' sales performance.

Revenue represents the amounts derived from the provision of goods and services. Revenue has reduced in line with the direct costs traded under IFRS 15.

Profit before tax is used for internal performance analysis as a measure of operating profitability that is comparable over time. This has decreased due to a reduction in the Fair value gain on equity investments at fair value through profit and loss in the current year.

Return on sales this shows the percentage of profit before tax as a function of sales. This has decreased due to a reduction in the Fair value gain on equity investments at fair value through profit and loss in the current year.

Strategic Report (continued)
for the year ended 31 December 2019

Principal risks and uncertainties

The Company's principal risks are identified below:

The outbreak of contagious diseases may have a material adverse effect on the Company's business, financial condition and results of operations.

Contagious diseases can have an adverse effect on the Company's business, financial condition and results of operations. There is currently a COVID-19 coronavirus pandemic across the world. Governments are taking a number of steps to mitigate the impact of this pandemic, including implementing quarantines. Many people have contracted the disease across the world and many deaths have occurred. It is not clear for how long this pandemic will last or how much more extensive it will become, or the further measures that will be taken by governments and others to seek to control this pandemic and its impact.

Since the outbreak of the COVID-19 coronavirus pandemic, the Company has taken a number of responsive measures including reducing site operational levels and introducing new cleaning regimes, safe working distance measures and providing protective equipment. While the Company is liaising closely with its customers and suppliers to understand any changes in requirements and priorities during this time, the uncertainties surrounding the development of this pandemic make it difficult to predict the extent to which the Company may be affected.

The COVID-19 coronavirus pandemic could also result in changes to the outlook in the Company's markets. Areas of the Company's business that could be impacted include a decrease in defence spending by the Company's major customers, the failure to obtain awards for defence contracts, the failure of suppliers to deliver parts to the Company, the requirement for the Company or its suppliers to close plants, the inability of the Company to meet contractual delivery requirements on time, the inability to adequately staff and manage the business, and an increase in the cost or lack of availability of funding. If the Company were unable to obtain appropriate funding, it could be forced to make reductions in spending, seek to extend payment terms with suppliers and/or suspend or curtail planned programmes. Any of the above could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company's only customer is the UK Government

The Company has long-standing relationships and security arrangements with the UK government and its agencies. It is important that these relationships and arrangements are maintained.

In the defence and security industries, governments can typically modify contracts or terminate them at short notice.

The Company's performance on its contracts with its customer is subject to financial audits and other reviews which can result in adjustments to prices and costs.

Reduction in recoveries from external tenants

The lease for the Christchurch site is managed through the Company. There is a risk that a reduction in recoveries from external tenants will have an adverse effect on future cash flows.

Strategic Report (continued)
for the year ended 31 December 2019

Section 172(1) Statement

This Statement contains an overview of how the directors have performed their duty to promote the success of the Company as set out in section 172(1) of the UK's Companies Act 2006. That section requires a director of a company to act in the way he considers, in good faith, would most likely promote the success of the company for the benefit of its shareholders. In doing this, the director must have regard, amongst other matters, to:

- a) the likely consequences of any decision in the long term,
- b) the interests of the company's employees,
- c) the need to foster the company's business relationships with suppliers, customers and others,
- d) the impact of the company's operations on the community and the environment,
- e) the desirability of the company maintaining a reputation for high standards of business conduct, and
- f) the need to act fairly as between members of the company.

Decision Making

The Operational Framework sets out the principles of good governance to which Group subsidiaries are required to adhere, together with BAE Systems group's values, policies and processes. Decisions affecting a subsidiary are required to be taken in line with the Operational Framework, including in accordance with applicable delegations of authority.

Pursuant to the Operational Framework, BAE Systems' businesses each produce a strategic plan, a financial forecast for the current year and financial projections for the next five years. The directors of the Company contribute towards this process and are also responsible for identifying and managing principal and emerging risks. In so doing the directors have regard to a variety of matters including the interests of various stakeholders, the consequences of their decisions in the long term and the long-term reputation of the Company and its businesses.

Employees

The Company has no employees.

Fostering Business Relationships with Suppliers, Customers and Others

The directors recognise that fostering business relationships with key stakeholders, such as customers and suppliers, is essential to the Company's success. The Company has close relationships with its principal customer, suppliers and industry partners which help us to create best-in-class, cost-effective equipment, goods, services and solutions.

Our only customer is the UK Government. Strong and collaborative relationships with our principal customers help us to identify its requirements and to help position the Company as a trusted provider. The directors are in regular contact with the principal customer of the Company.

The Company, together with the Groups procurement and supply chain function, works with its suppliers and their supply chains to provide goods and services that meet its customer's requirements. The Company's supplier relationships are often long-term due to the length of the product life-cycles and the directors meet with key suppliers and work with the BAE Systems group's procurement function to develop deeper relationships with business in the supply chain and develop strategic relationships with key suppliers.

Strategic Report (continued)
for the year ended 31 December 2019

The Community and the Environment

The directors recognise the importance of leading a company that not only generates value for shareholders but also contributes to wider society. Through the Operational Framework the Company implements the requirements of the BAE Systems group's Community Investment Policy, which looks to ensure that we build and nurture mutually beneficial relationships between our business, our people and local stakeholders. Giving back to the communities in which we operate, and to charities that have meaning to our business, is vitally important to the BAE Systems group, allowing us to make a positive difference and have an impact where it counts.

We recognise that our operations have an impact on the environment – from the energy and resources we use, to the products we supply and the waste that we generate. As an organisation, the BAE Systems group is committed to reducing the environmental impact of our operations and products, minimising our environmental footprint and, in turn, decreasing our operational costs. Through the Operational Framework the Company implements the requirements of the BAE Systems group's Environmental Policy, which details our commitment to high standards of environmental management.

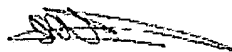
These activities form part of the Company's implementation of the BAE Systems group-wide community and environment processes and policies and the BAE Systems group's impacts thereon which are described in the Environment and climate change and Fostering strong community partnerships sections (pages 40-42) of BAE Systems plc's Annual Report 2019.

Maintaining a reputation for high standards of business conduct

The BAE Systems group aims to be a recognised leader in business conduct which helps us to earn and maintain stakeholder trust and sustain business success. The directors consider it fundamental to maintain a culture focused on embedding responsible business behaviours. All employees of the BAE Systems group are expected to act in accordance with the requirements of BAE Systems group policies, including the Code of Conduct, at all times. As well as being the right thing to do, this reduces the risk of compliance failure and supports us in attracting and retaining high-calibre employees.

Detailed information on the BAE Systems group-wide business conduct processes and policies are described in BAE Systems plc's Annual Report 2019 and in particular the Ethics and business conduct section on pages 38-39.

Approved by the Board and signed on its behalf by



J E Fothergill
Director
Date: 25th June 2020

Directors' Report

Company registration

BAE Systems (Defence Systems) Limited (the "Company") is a private company, limited by shares and registered in England and Wales with the registered number 00236538.

Results and dividends

The Company's profit for the financial year is £5,756k (2018 £9,619k profit). The directors do not propose a dividend for 2019 (2018 £nil).

Looking forward

The Company expects to continue with its current contracts until 2021 when it will focus on managing its investments as a leasing and holding company.

The future potential impact of the COVID-19 pandemic on the Company is not yet known but may be significant. While the Company cannot currently quantify what the effects might be, it continues to monitor the pandemic and its impact, to ensure appropriate actions can be taken to mitigate risks to the Company.

The terms of the UK's relationship with the European Union after the end of the Transition Period are currently uncertain, rendering it difficult for the Company to prepare for potential changes in the regulatory environment.

Going concern

After making due enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for at least 12 months from the date of approval of the financial statements. While there remains significant uncertainty as to the future impact of the COVID-19 pandemic, the Company and its ultimate parent entity BAE Systems plc continue to conduct ongoing risk assessments of the potential impact of the pandemic on its business operations and liquidity. The impact on the Company to date is set out in Note 21. Having undertaken these assessments, the directors consider that the Company will be able to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

Directors and their interests

The directors who served throughout the year and up to the date of this report, unless otherwise stated, were as follows:

R Checkley

J E Fothergill (appointed 30 September 2019)

A P Varney (resigned 30 September 2019)

The Board is not aware of any contract of significance in relation to the Company in which any director has, or has had, a material interest.

Disclosure of information to auditor

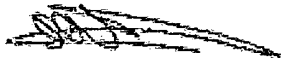
The directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each director has taken all the steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of S418 of the Companies Act 2006.

Directors' Report (continued)

Auditor

The auditor, Deloitte LLP, has indicated its willingness to continue in office and, in accordance with Section 487(2) of the Companies Act 2006, has been re-appointed.

Approved by the Board and signed on its behalf by



J E Fothergill
Director

Date 25th June 2020

Registered office:
BAE Systems (Defence Systems) Limited
Warwick House
PO Box 87
Farnborough Aerospace Centre
Hampshire
GU14 6YU
United Kingdom

Directors' Responsibilities Statement

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including Financial Reporting Standard 101 (FRS 101) "Reduced Disclosure Framework".

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent Auditor's Report to the Members of BAE Systems (Defence Systems) Limited

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of BAE Systems (Defence Systems) Limited (the "Company"):

- give a true and fair view of the state of the Company's affairs as at 31 December 2019 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the Income Statement;
- the Statement of Comprehensive Income;
- the Balance Sheet;
- the Statement of Changes in Equity; and
- the related notes 1 to 22.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the "FRC's") Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of these matters.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material

Independent Auditor's Report to the Members of BAE Systems (Defence Systems) Limited (continued)

misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

Responsibilities of directors

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Matters on which we are required to report by exception

Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters

Independent Auditor's Report to the Members of BAE Systems (Defence Systems) Limited (continued)

Use of our report

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.



Douglas King (Senior Statutory Auditor)

for and on behalf of

Deloitte LLP

Statutory Auditor

Manchester

M3 3HF

Date: 25th June 2020

Income Statement
for the year ended 31 December 2019

	Note	2019 £000	2018 £000
Revenue	3	12,406	13,420
Operating costs	4	(14,044)	(19,707)
Other operating income	5	4,810	10,544
Fair value gain on equity investments at fair value through profit and loss		3,198	5,447
Operating profit		6,370	9,704
Income from other fixed asset investments	6	-	775
Financial expense	7	(401)	(1,063)
Profit before tax		5,969	9,416
Tax expense	10	(213)	203
Profit for the year		5,756	9,619

Statement of Comprehensive Income
for the year ended 31 December 2019

	2019 £000	2018 £000
Profit for the year	5,756	9,619
Total comprehensive income for the year	5,756	9,619

The notes on pages 15 to 37 form part of these financial statements.

The results for 2019 and 2018 arise from continuing activities.

Balance Sheet
as at 31 December 2019

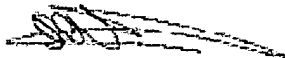
	Note	2019 £000	2018 £000
Non-current assets			
Property, plant and equipment	12	463	78
Investment property	14	13,586	-
Investments	13	21,854	18,656
Deferred tax assets	15	276	489
		<u>36,179</u>	<u>19,223</u>
Current assets			
Trade, other and contract receivables	16	97,727	102,260
		<u>133,906</u>	<u>121,483</u>
Total assets			
Non-current liabilities			
Lease liabilities	11	(14,264)	-
Provisions	18	(48)	(4,833)
		<u>(14,312)</u>	<u>(4,833)</u>
Current liabilities			
Trade and other payables	17	(39,878)	(45,302)
Lease liabilities	11	(1,243)	-
Provisions	18	(2,054)	(685)
		<u>(43,175)</u>	<u>(45,987)</u>
Total liabilities		<u>(57,487)</u>	<u>(50,820)</u>
Net assets		<u><u>76,419</u></u>	<u><u>70,663</u></u>

BAE Systems (Defence Systems) Limited
Annual Report and Financial Statements
31 December 2019

Balance Sheet (continued)
as at 31 December 2019

	Note	2019 £000	2018 £000
Capital and reserves			
Issued share capital	19	1,009	1,009
Other reserves	19	81,035	81,035
Retained deficit		(5,625)	(11,381)
Total equity		<u>76,419</u>	<u>70,663</u>

Approved by the Board on 25th June 2020 and signed on its behalf



J E Fothergill
Director

Registered number: 00236538

Statement of Changes in Equity
for the year ended 31 December 2019

	Issued share capital £000	Other reserves £000	Retained deficit £000	Total equity £000
At 1 January 2018	1,009	81,035	(21,000)	61,044
Profit for the year	-	-	9,619	9,619
At 31 December 2018	1,009	81,035	(11,381)	70,663
Profit for the year	-	-	5,756	5,756
At 31 December 2019	1,009	81,035	(5,625)	76,419

Notes to the Financial Statements

1. General information

BAE Systems (Defence Systems) Limited (the "Company") is a private company, limited by shares, and registered in England and Wales and incorporated in the United Kingdom. Its ultimate controlling party is BAE Systems plc. The address of the Company's registered office is shown on page 6.

The principal activity of the Company is set out in the Strategic Report on page 1. These financial statements, which have been prepared in accordance with the Companies Act 2006, are presented in pounds sterling and, unless otherwise stated, rounded to the nearest thousand.

2. Accounting policies

2.1 Basis of preparation

These financial statements have been prepared in accordance with Financial Reporting Standard 101 (FRS 101) "Reduced Disclosure Framework". The Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards (IFRS), but makes amendments where necessary in order to comply with the Companies Act 2006 and has set out below where advantage of the FRS 101 disclosure exemptions has been taken:

- the requirements of IFRS 7 Financial Instruments: Disclosures;
- the requirements of paragraphs 91-99 of IFRS 13 Fair Value Measurement;
- the requirements of the second sentence of paragraph 110 and paragraphs 113(a), 114, 115, 118, 119(a) to (c), 120 to 127 and 129 of IFRS 15 Revenue from Contracts with Customers;
- the requirements of paragraph 52, the second sentence of paragraph 89, and paragraphs 90, 91 and 93 of IFRS 16 Leases. The requirements of paragraph 58 of IFRS 16, provided that the disclosure of details in indebtedness relating to amounts payable after 5 years required by company law is presented separately for lease liabilities and other liabilities, and in total;
- the requirement in paragraph 38 of IAS 1 'Presentation of Financial Statements' to present comparative information in respect of:
 - paragraph 79(a)(iv) of IAS 1;
 - paragraph 73(e) of IAS 16 Property, Plant and Equipment;
 - paragraph 118(e) of IAS 38 Intangible Assets; and
 - paragraphs 76 and 79(d) of IAS 40 Investment Property;
- the requirements of paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 38D, 40A, 40B, 40C, 40D, 111 and 134 to 136 of IAS 1 Presentation of Financial Statements;
- the requirements of IAS 7 Statement of Cash Flows;
- the requirements of paragraphs 30 and 31 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors;
- the requirements of paragraph 17 and 18A of IAS 24 Related Party Disclosures;
- the requirements in IAS 24 Related Party Disclosures to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member; and

Notes to the Financial Statements

2. Accounting policies (continued)

2.1 Basis of preparation (continued)

- the requirements of paragraphs 130(f)(ii), 130(f)(iii), 134(d)-134(f) and 135(c)-135(e) of IAS 36 Impairment of Assets.

The Company intends to continue to prepare its financial statements in accordance with FRS 101.

The Company is exempt under section 400 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as it and its subsidiary undertakings are included by full consolidation in the consolidated financial statements of its ultimate parent, BAE Systems plc, a company registered in England and Wales. Accordingly, these financial statements present information about the Company as an individual undertaking and not as a group.

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of relevant financial assets and financial liabilities (including derivative instruments).

Critical accounting policies

There were no significant accounting policies that are considered by the directors to be critical because of the level of complexity, judgement or estimation involved in their application and their impact on the financial statements.

Judgements made in applying accounting policies

In the course of preparing the financial statements, no judgements have been made in the process of applying the Company's accounting policies, other than those involving estimates, that have had a significant effect on the amounts recognised in the financial statements.

Sources of estimation uncertainty

The application of the Company's accounting policies requires the use of estimates. In the event that these estimates prove to be incorrect, there may be an adjustment to the carrying amounts of assets and liabilities within the next financial year.

There are none recognised in the financial statements.

Changes in accounting policies

IFRS 16 Leases became effective on 1 January 2019. The impact of adoption is set out in note 11.

Several other standards, interpretations and amendments to existing standards became effective on 1 January 2019, none of which had a material impact on the Company.

Significant accounting policies

The significant accounting policies applied in the preparation of these financial statements are set out below. These policies have been applied consistently to all the years presented, unless otherwise stated. The directors believe that the financial statements reflect appropriate judgements and estimates, and provide a true and fair view of the Company's financial performance and position.

Notes to the Financial Statements

2. Accounting policies (continued)

2.2 Revenue and profit recognition

Revenue represents income derived from contracts for the provision of goods and services, over time or at a point in time, by the Company to customers in exchange for consideration in the ordinary course of the Company's activities.

Performance obligations

Upon approval by the parties to a contract, the contract is assessed to identify each promise to transfer either a distinct good or service or a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. Goods and services are distinct and accounted for as separate performance obligations in the contract if the customer can benefit from them either on their own or together with other resources that are readily available to the customer and they are separately identifiable in the contract. The Company provides warranties to its customers to give them assurance that its products and services will function in line with agreed-upon specifications. Warranties are not provided separately and, therefore, do not represent separate performance obligations.

Transaction price

At the start of the contract, the total transaction price is estimated as the amount of consideration to which the Company expects to be entitled in exchange for transferring the promised goods and services to the customer, excluding sales taxes. Variable consideration, such as price escalation, is included based on the expected value or most likely amount only to the extent that it is highly probable that there will not be a reversal in the amount of cumulative revenue recognised. The transaction price does not include estimates of consideration resulting from contract modifications, such as change orders, until they have been approved by the parties to the contract. The total transaction price is allocated to the performance obligations identified in the contract in proportion to their relative stand-alone selling prices. Given the bespoke nature of many of the Company's products and services, which are designed and/or manufactured under contract to the customer's individual specifications, there are typically no observable stand-alone selling prices. Instead, stand-alone selling prices are typically estimated based on expected costs plus contract margin consistent with the Company's pricing principles. Whilst payment terms vary from contract to contract, on many of the Company's contracts, an element of the transaction price is received in advance of delivery. The Company therefore has significant contract liabilities. The Company's contracts are not considered to include significant financing components on the basis that there is no difference between the consideration and the cash selling price either as a result of UK Ministry of Defence contracting rules which prohibit the inclusion of financing in the sales price or negotiations on competitive international export contracts which do not make allowance for the cash payment profile.

Revenue and profit recognition

Revenue is recognised as performance obligations are satisfied as control of the goods and services is transferred to the customer. For each performance obligation within a contract, the Company determines whether it is satisfied over time or at a point in time. Performance obligations are satisfied over time if one of the following criteria is satisfied:

- the customer simultaneously receives and consumes the benefits provided by the Company's performance as it performs;
- Company's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- the Company's performance does not create an asset with an alternative use to the Company and it has an enforceable right to payment for performance completed to date.

The Company has determined that most of its contracts satisfy the over-time criteria, either because the customer simultaneously receives and consumes the benefits provided by the Company's performance as it performs (typically services or support contracts) or the Company's performance does not create an

Notes to the Financial Statements

2. Accounting policies (continued)

2.2 Revenue and profit recognition (continued)

asset with an alternative use to the Company and it has an enforceable right to payment for performance completed to date (typically development or production contracts).

For each performance obligation to be recognised over time, the Company recognises revenue using an input method, based on costs incurred in the period. Revenue and attributable margin are calculated by reference to reliable estimates of transaction price and total expected costs, after making suitable allowances for technical and other risks. Revenue and associated margin are therefore recognised progressively as costs are incurred, and as risks have been mitigated or retired. The Company has determined that this method faithfully depicts the Company's performance in transferring control of the goods and services to the customer.

If the over-time criteria for revenue recognition are not met, revenue is recognised at the point in time that control is transferred to the customer, which is usually when legal title passes to the customer and the business has the right to payment, for example, on delivery.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised immediately as an expense.

Contract modifications

The Company's contracts are often amended for changes in customers' requirements and specifications. A contract modification exists when the parties to the contract approve a modification that either changes existing or creates new enforceable rights and obligations. The effect of a contract modification on the transaction price and the Company's measure of progress towards the satisfaction of the performance obligation to which it relates is recognised in one of the following ways:

1. prospectively, as an additional, separate contract; or
2. prospectively, as a termination of the existing contract and creation of a new contract; or
3. as part of the original contract using a cumulative catch-up.

The majority of the Company's contract modifications are treated under either 1 (for example, the requirement for additional distinct goods or services) or 3 (for example, a change in the specification of the distinct goods or services for a partially completed contract), although the facts and circumstances of any contract modification are considered individually as the types of modifications will vary contract-by-contract and may result in different accounting outcomes.

Costs to obtain a contract

The Company expenses pre-contract bidding costs which are incurred regardless of whether a contract is awarded. The Company does not typically incur costs to obtain contracts that it would not have incurred had the contracts not been awarded, such as sales commission.

Costs to fulfil a contract

Contract fulfilment costs in respect of over-time contracts are expensed as incurred. Contract fulfilment costs in respect of point in time contracts are accounted for under IAS 2 Inventories.

Notes to the Financial Statements

2. Accounting policies (continued)

2.3 Leases

The Company as lessee

All leases in which the Company is lessee (except as noted below) are recognised as a right-of-use asset and a corresponding lease liability at the date at which the leased asset is available for use by the Company. Each lease payment is allocated between repayment of the lease liability and finance cost. The finance cost is charged to the Income Statement over the lease term to produce a constant periodic rate of interest on the lease liability. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

The lease liability is initially measured as the present value of future lease payments, discounted using the interest rate implicit in the lease. Where this rate is not determinable, the Company's incremental borrowing rate is used, which is the interest rate the Company would have to pay to borrow the amount necessary to obtain an asset of similar value, in a similar economic environment with similar terms and conditions.

The right-of-use asset is initially measured at cost, comprising the initial value of the lease liability, any lease payments made (net of any incentives received from the lessor) before the commencement of the lease, any initial direct costs and any restoration costs.

The carrying amounts of the Company's right-of-use assets are reviewed at each balance sheet date to determine whether there is any indication of impairment.

Payments in respect of short-term leases, low-value leases and leases of intangible assets are charged to the income statement on a straight-line basis over the lease term.

Comparative amounts for the year ended 31 December 2018 have not been restated on adoption of IFRS 16 Leases and are presented in accordance with IAS 17 Leases, whereby lease payments made under operating leases are recognised in the Income Statement on a straight-line basis over the lease term. See note 11 for further details.

The Company as lessor

Leases in which the Company is lessor are classified as finance leases or operating leases. If the lease transfers substantially all of the risks and rewards of ownership to the lessee, the lease is classified as a finance lease. All other leases are classified as operating leases.

Lease income under operating leases is recognised in the Income Statement on a straight-line basis over the lease term.

2.4 Property, plant and equipment

Cost

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads. The cost of demonstration assets is written off as incurred.

Assets held for leasing out under operating leases are included in property, plant and equipment at cost less accumulated depreciation and impairment losses.

Notes to the Financial Statements

2. Accounting policies (continued)

2.4 Property, plant and equipment (continued)

Depreciation

Depreciation is provided, normally on a straight-line basis, to write off the cost of property, plant and equipment over their estimated useful lives to any estimated residual value, using the following rates:

Plant and machinery	- 10 years,
---------------------	-------------

No depreciation is provided on freehold land and assets in the course of construction.

The assets' residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each Balance Sheet date.

Impairment

The carrying amounts of the Company's property, plant and equipment are reviewed at each Balance Sheet date to determine whether there is any indication of impairment.

2.5 Investments

Fixed asset investments in shares in subsidiary undertakings and in shares in participating interests are stated at cost less provision for impairment.

Equity investments in companies over which the Company does not have control or significant influence are measured at fair value through profit and loss.

2.6 Impairment

The carrying amounts of the Company's intangible assets are reviewed at each Balance Sheet date to determine whether there is any indication of impairment as required by IAS 36, Impairment of Assets. If any such indication exists, the asset's recoverable amount is estimated. For goodwill and intangible assets that are not yet available for use, impairment testing is performed annually.

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

The recoverable amount is the greater of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using an appropriate pre-tax discount rate. For an asset that does not generate largely independent cash flows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Impairment losses are recognised in the Income Statement.

An impairment loss in respect of other intangible assets, property, plant and equipment, investment property and right-of-use assets is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised or if there has been a change in the estimate used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Notes to the Financial Statements

2. Accounting policies (continued)

2.7 Investment property

Cost

Land and buildings that are leased to BAE Systems plc Group or non-BAE Systems plc Group entities are classified as investment property. The Company measures investment property at its cost less accumulated depreciation and impairment losses.

Depreciation

Depreciation is provided, on a straight-line basis, to write off the cost of investment property over its estimated useful life of up to 50 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each Balance Sheet date.

Impairment

The carrying amounts of the Company's investment property are reviewed at each Balance Sheet date to determine whether there is any indication of impairment.

2.8 Trade, other and contract receivables

Trade and other receivables are stated at amortised cost including a provision for expected credit losses. The Company measures the provision at an amount equal to lifetime expected credit losses, estimated by reference to past experience and relevant forward-looking factors.

The Company writes off a trade receivable when there is objective evidence that the debtor is in significant financial difficulty and there is no realistic prospect of recovery, for example, when a debtor enters bankruptcy or financial reorganisation.

Contract receivables represent amounts for which the Company has an unconditional right to consideration in respect of unbilled revenue recognised at the Balance Sheet date and comprise costs incurred plus attributable margin.

2.9 Trade and other payables

Trade and other payables are stated at amortised cost.

Notes to the Financial Statements

2. Accounting policies (continued)

2.10 Provisions

A provision is recognised in the Balance sheet when the Company has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and the amount has been reliably estimated. If the effect is material, provisions are determined by discounting the expected future cash flows at an appropriate pre-tax discount rate.

Legal, contractual and environmental

The Company holds provisions for expected legal, contractual and environmental costs that it expects to incur over an extended period. Management exercises judgement to determine the amount of these provisions. Provision is made for known issues based on past experience of similar items and other known factors. Each provision is considered separately and the amount provided reflects the best estimate of the most likely amount, being the single most likely amount in a range of possible outcomes.

Other

Other provisions include provisions for onerous contracts, which are recognised when the expected benefits to be derived by the Company from a contract are lower than the unavoidable cost of meeting its obligations under the contract.

Notes to the Financial Statements

2. Accounting policies (continued)

2.11 Tax

Tax expense comprises current and deferred tax. Current and deferred tax is recognised in profit or loss except to the extent that it relates to a business combination or items recognised directly in equity or other comprehensive income.

Current tax

Current tax is the expected tax payable or receivable on the taxable profit or loss for the year, using tax rates enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for temporary differences:

- on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- related to investments in subsidiaries and equity accounted investments to the extent that it is probable that they will not reverse in the foreseeable future; and
- arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to corporate income taxes levied by the same tax authority and they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

Notes to the Financial Statements

3. Revenue

	2019	2018
	£000	£000
Revenue by category		
Long-term contracts	12,406	13,420
	<u>12,406</u>	<u>13,420</u>
	<u><u>12,406</u></u>	<u><u>13,420</u></u>
	2019	2018
	£000	£000
Revenue by customer location		
United Kingdom	12,406	13,420
	<u>12,406</u>	<u>13,420</u>
	<u><u>12,406</u></u>	<u><u>13,420</u></u>

4. Operating Costs

	2019	2018
	£000	£000
Raw materials, subcontracts and other bought-in items used	8,645	12,508
Depreciation, amortisation and impairment	1,275	23
Other operating charges	4,124	7,176
	<u>14,044</u>	<u>19,707</u>
	<u><u>14,044</u></u>	<u><u>19,707</u></u>

The remuneration of the auditor for the year ended 31 December 2019 for auditing of the financial statements was £5,000 (2018 £5,000) and £nil (2018 £nil) in respect of non-audit work and was borne by fellow group undertaking, BAE Systems (Operations) Limited.

5. Other income

	2019	2018
	£000	£000
Operating lease income (note 11)	1,205	1,194
Provisions release	3,537	9,350
Other	68	-
	<u>4,810</u>	<u>10,544</u>
	<u><u>4,810</u></u>	<u><u>10,544</u></u>

Notes to the Financial Statements

6. Income from investments

	2019	2018
	£000	£000
Dividends received	-	775
	<u>-</u>	<u>775</u>
	<u><u>-</u></u>	<u><u>775</u></u>

7. Financial expense

	2019	2018
	£000	£000
Net present value adjustments	-	1,063
Interest expense on lease liabilities (note 11)	401	-
	<u>401</u>	<u>1,063</u>
	<u><u>401</u></u>	<u><u>1,063</u></u>

8. Employees

The monthly average number of Company employees was nil (2018 nil).

Notes to the Financial Statements

9. Directors' remuneration

The disclosures below represent an allocation of the emoluments received by the directors to reflect their qualifying services to the Company.

	2019	2018
	£000	£000
Directors' remuneration	32	30
Company contributions to defined benefit pension schemes	10	9
Compensation for loss of office	12	-
	<u>54</u>	<u>39</u>

Retirement benefits are accruing to the following number of directors under:

	2019	2018
	Number of	Number of
	directors	directors
Defined benefit schemes	<u>3</u>	<u>2</u>

Notes to the Financial Statements

10. Tax

The Company has not provided for current tax for the year as any taxable profits will be covered by the surrender of losses from fellow group companies, in respect of which no payment will be made.

	2019 £000	2018 £000
Deferred tax		
Origination and reversal of temporary differences	(213)	(61)
Adjustments in respect of prior years	-	264
Tax (expense)/income	(213)	203

Reconciliation of tax expense

The following reconciles the expected tax (expense) using the UK corporation tax rate, to the reported tax (expense)/income:

	2019 £000	2018 £000
Profit before tax	5,969	9,416
UK corporation tax rate	19.00%	19.00%
Expected tax expense on profit	(1,134)	(1,789)
Expenses not tax effected	(6)	-
Income not subject to tax	-	147
Property, plant and equipment	-	3
Provisions and accruals	-	16
Investment fair value adjustment	608	1,035
Imputed interest income	(188)	(179)
Losses received from fellow group companies	481	705
Adjustments in respect of prior years	-	264
Tax rate adjustment ¹	25	-
Other	1	1
Tax (expense)/income	(213)	203

¹The UK corporation tax rate was expected to reduce from 19% to 17% with effect from 1 April 2020 and in line with this change the deferred tax liability has been calculated at 17% (see note 15).

Notes to the Financial Statements

11. Leases

IFRS 16 Leases became effective on 1 January 2019. The impact of adoption is set out in note 20.

The Company leases land, buildings, vehicles and equipment under non-cancellable lease arrangements. The leases have varying terms, including escalation clauses, renewal rights and purchase options. None of these terms represent unusual arrangements or create material onerous or beneficial rights or obligations.

	31 December 2019
	Investment Property £000
Additions during the year	152
Depreciation expense for the year	1,206
Impairment charge for the year	48
Net book value	13,586

Lease liabilities

A maturity analysis of the future undiscounted lease payments in respect of the Company's lease liabilities is presented in the table below.

	2019 £000
Payments due:	
Within one year	1,613
Between one and five years	6,451
Later than five years	9,676
	17,740

The total cash outflow for leases in the year ended 31 December 2019, including short-term leases and low-value leases, amounted to £1,612k.

Notes to the Financial Statements

11. Leases (continued)

Amounts recognised in the Income Statement

	2019 £000
Included in operating costs:	
Depreciation on right-of-use assets	1,206
	<u>1,206</u>
Included in other income:	
Operating lease income from subleasing right-of-use assets	1,205
	<u>1,205</u>
Included in net finance costs:	
Interest expense on lease liabilities	401
	<u>401</u>

Operating leases

The Company is party to operating leases in which it is the lessor, primarily relating to investment property. Under the terms of the lease agreements, no contingent rents are receivable. The leases have varying terms including escalation clauses and renewal rights. None of these terms represent unusual arrangements or create material onerous or beneficial rights or obligations.

A maturity analysis of the future undiscounted lease receipts from operating leases in which the Company is lessor is presented in the table below.

	2019 £000
Receipts due:	
Within one year	143
Between one and two years	173
Between two and three years	182
Between three and four years	182
Between four and five years	195
Later than five years	906
	<u>1,781</u>

Notes to the Financial Statements

12. Property, plant and equipment

	Plant and machinery £000
Cost or valuation	
At 1 January 2019	306
Additions	406
At 31 December 2019	712
Depreciation	
At 1 January 2019	228
Depreciation charge for the year	21
At 31 December 2019	249
Net book value	
At 31 December 2019	463
At 31 December 2018	78

Notes to the Financial Statements

13. Investments

	Subsidiary companies £000	Investments at fair value £000	Total £000
Value			
At 1 January 2019	-	18,656	18,656
Revaluations	-	3,198	3,198
At 31 December 2019	-	21,854	21,854

Impairment testing

During the year, management conducted an impairment review of the investments held by the Company. As a result of this review, there were impairment reversals of £3,198,000 in respect of BAE Systems Electronics Ltd.

The recoverable amount of the investments held by the Company has been calculated with reference to their value in use. The value in use calculations use risk-adjusted future cash flow projections based on the five-year Integrated Business Plan (IBP) and include a terminal value based on the projections for the final year of that plan, with growth rate assumptions in the range 0% to 2% applied. The IBP process includes the use of historic experience, available government spending data and the BAE Systems plc group's order backlog. Pre-tax discount rates, derived from the group's post-tax weighted average cost of capital of 6.62% (2018 7.24%) (adjusted for risks specific to the market in which the cash-generating unit operates), have been used in discounting these projected risk-adjusted cash flows.

Subsidiary undertakings and participating interests at 31 December 2019

In accordance with section 409 of the Companies Act 2006, a full list of subsidiary undertakings and significant holdings as at 31 December 2019 is disclosed below. Unless otherwise stated, all subsidiary undertakings and significant holdings are owned directly by the Company.

Company name	Class of shares held	Proportion of class (%)
British Aerospace (Malaysia) Sdn Bhd <i>Unit 30-01, Level 30, Tower A, Vertical Business Suite, Avenue 3 Bangsar South, No 8, Jalan Kerinchi, 59200, Kuala Lumpur Malaysia</i>	Ordinary shares of RM1	100%
British Aerospace (Far East) Limited <i>Level 54, Hopewell Centre, 183 Queen's Road East, Hong Kong</i>	Ordinary shares of HKD1	100%
Both the above companies have the financial year end 30 September.		
BAE Systems Electronics Limited <i>Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hampshire GU14 6YU, United Kingdom</i>	Ordinary shares of £0.50	2.3%
The above company has the financial year end 31 December.		

Notes to the Financial Statements

14. Investment property

	Investment property £000
Cost	
At 1 January 2019 (as previously stated)	-
Recognised on transition to IFRS 16	17,078
	<hr/> 17,078
At 1 January 2019 (as restated)	17,078
Additions	152
	<hr/> 17,230
At 31 December 2019	<hr/> 17,230
Depreciation and impairment	
At 1 January 2019	-
Recognised on transition to IFRS 16	2,390
	<hr/> 2,390
At 1 January 2019 (as restated)	2,390
Depreciation charge for the year	1,206
Impairment charge	48
	<hr/> 3,644
At 31 December 2019	<hr/> 3,644
Net book value	
At 31 December 2019	<hr/> 13,586
At 31 December 2018	<hr/> -
Fair Value	
At 31 December 2019	<hr/> 13,586
At 31 December 2018	<hr/> -

The fair values above are based on and reflect current market values as prepared by in-house professionals who have the appropriate professional qualifications and recent experience of valuing properties in the location and of the type being valued.

Notes to the Financial Statements

15. Deferred taxation

Deferred tax assets/(liabilities)

	Deferred tax assets		Deferred tax liabilities		Net balance at 31 December	
	2019	2018	2019	2018	2019	2018
	£000	£000	£000	£000	£000	£000
Property, plant and equipment	85	114	-	-	85	114
Provisions and accruals	338	375	-	-	338	375
Other	-	-	(147)	-	(147)	-
	<u>423</u>	<u>489</u>	<u>(147)</u>	<u>-</u>	<u>276</u>	<u>489</u>
Deferred tax assets/(liabilities)	423	489	(147)	-	276	489
Set off of tax	(147)	-	147	-	-	-
	<u>276</u>	<u>489</u>	<u>-</u>	<u>-</u>	<u>276</u>	<u>489</u>
Net Deferred tax assets	276	489	-	-	276	489

Movement in temporary differences during the year

	At 1 January 2019	Recognised in income	At 31 December 2019
	£000	£000	£000
Property, plant and equipment	114	(29)	85
Provisions and accruals	375	(37)	338
Other	-	(147)	(147)
	<u>489</u>	<u>(213)</u>	<u>276</u>

	At 1 January 2018	Recognised in income	At 31 December 2018
	£000	£000	£000
Property, plant and equipment	130	(16)	114
Provisions and accruals	254	121	375
Other	(98)	98	-
	<u>286</u>	<u>203</u>	<u>489</u>

Notes to the Financial Statements

15. Deferred taxation (continued)

The deferred tax asset has been prepared applying a closing tax rate of 17% on the basis that any deferred assets or liabilities released or settled are likely to reverse after April 2020. However, in the Spring Budget 2020, the Government announced that from 1 April 2020 the corporation tax rate would remain at 19% (rather than reducing to 17%, as previously enacted). This new law was substantively enacted on 17 March 2020. As the proposal to keep the rate at 19% had not been substantively enacted at the Balance Sheet date, its effects are not included in these financial statements and the rate of 17% is used.

16. Trade, other and contract receivables

	2019 £000	2018 £000
Current		
Amounts owed by BAE Systems plc and its subsidiaries	91,452	91,748
Prepayments and accrued income	80	521
Contract receivables	6,021	9,910
Other receivables	174	81
	<u>97,727</u>	<u>102,260</u>

17. Trade and other payables

	2019 £000	2018 £000
Current		
Trade payables	412	412
Amounts owed to BAE Systems plc and its subsidiaries	38,865	44,414
Accruals and deferred income	297	476
Other payables	304	-
	<u>39,878</u>	<u>45,302</u>

Notes to the Financial Statements

18. Provisions

	Legal, contractual and environmental £000	Other £000	Total £000
Non-current	4,371	462	4,833
Current	437	248	685
At 1 January 2019	4,808	710	5,518
Released	(883)	(2,654)	(3,537)
Created	108	2,438	2,546
Impact of adoption of IFRS 16	(2,425)	-	(2,425)
At 31 December 2019	1,608	494	2,102
Represented by:			
Non-current	-	48	48
Current	1,608	446	2,054
	1,608	494	2,102

Legal, contractual and environmental

Reflecting the inherent uncertainty within many legal proceedings, the timing and amount of the outflows could differ significantly from the amount provided. The Company continues to hold a £1.5m provision in respect of the legal fees relating to overseas activities.

Other

There are no individually significant provisions included within other provisions.

19. Share capital

	£1 Ordinary shares	Nominal value £000
Issued and fully paid		
At 1 January 2018, 31 December 2018 and 31 December 2019	1,009,297	1,009

Notes to the Financial Statements

20. Change in accounting policies

IFRS 16 Leases became effective on 1 January 2019 and replaced IAS 17 Leases, and related interpretations. It results in almost all leases being recognised on the Balance Sheet by lessees, as the distinction between operating and finance leases is removed. Under the new standard, a right-of-use asset and a financial liability for future lease payments have been recognised. See note 11. The only exceptions are short-term leases, low-value leases and leases of intangible assets.

The Company has applied the modified retrospective transition approach and has not restated comparative amounts for the year ended 31 December 2018. The Company has elected to measure right-of-use assets at the amount of the lease liability on adoption (adjusted for any lease prepayments or accrued lease expenses, onerous lease provisions, and leased assets which have subsequently been subleased).

The Company has elected to adopt the following practical expedients on transition:

- not to capitalise a right-of-use lease asset or related lease liability where the lease expires before 31 December 2019;
- not to reassess contracts to determine if the contract contains a lease and not to separate lease and non-lease elements;
- where an onerous lease provision is in existence, to utilise this provision to reduce the right-of-use asset value rather than undertaking an impairment review;
- to use hindsight in determining the lease term;
- to exclude initial direct costs from the measurement of the right-of-use asset; and
- to apply the portfolio approach where a group of leases has similar characteristics.

Accounting policy

The accounting policy in respect of leases applied from 1 January 2019 is set out in note 2.3. Comparative amounts for the year ended 31 December 2018 have not been restated and are presented in accordance with IAS 17 Leases, whereby lease payments made under operating leases are recognised in the Income Statement on a straight-line basis over the lease term.

Reconciliation between operating lease commitments and lease liability

The following table explains the difference between the operating lease commitments disclosed applying IAS 17 at 31 December 2018 and the lease liability recognised on adoption of IFRS 16 at 1 January 2019.

	£000
Total minimum lease payments reported at 31 December 2018 under IAS 17	19,353
Change in assessment of lease term under IFRS 16	-
Leases outside the scope of IFRS 16	-
Impact of discounting lease liability under IFRS 16	(2,647)
Lease liability recognised on transition to IFRS 16 at 1 January 2019	16,706

The weighted average incremental borrowing rate applied to lease liabilities was 2.49%.

Notes to the Financial Statements

21. Events after the reporting period

The outbreak of the COVID-19 coronavirus was confirmed to be a global pandemic by the World Health Organisation on 11 March 2020 and only after that date did major governments, such as the UK, start taking significant mitigating steps. As such the Company considers this to be a non-adjusting post balance sheet event. The full impact of the COVID-19 pandemic on medium- and long-term economic activity is not yet known, although is likely to be significant. The Company continues to monitor the impact on its business, however while the uncertainty continues, the Company is not able to quantify the possible financial effect of the pandemic. Some asset and liability carrying values may be impacted, particularly where they are reliant on management's use of estimates and judgements when applying accounting policies. Potential areas of the Company's financial statements which could be materially impacted may include, but are not limited to:

- Recognition of revenue and associated margin recognised as costs are incurred and as risks are mitigated or retired;
- The carrying value of property, plant and equipment, right-of-use assets, investment property and investments in other group companies;
- Potential credit losses on receivables; and
- Amendments to existing provisions, or new provisions, being required as a consequence of the pandemic.

22. Controlling parties

The immediate parent company is BAE Systems (Holdings) Limited and the ultimate controlling party is BAE Systems plc, which is both the smallest and largest parent company preparing group financial statements. Both companies are incorporated in the United Kingdom and registered in England and Wales.

The consolidated financial statements of BAE Systems plc are available to the public and may be obtained from its registered address:

6 Carlton Gardens
London
SW1Y 5AD

Website: www.baesystems.com