BAE Systems (Operations) Limited

Annual report and financial statements

31 December 2015

Registered number: 01996687

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Strategic report

Review of business

Overview

In the UK, the Company continued to perform well, benefiting from good programme execution and continuity in UK customer requirements. UK government commitments in July 2015 to protect defence and security spend, in a still tightly constrained UK economic environment, were helpful.

In November, the UK government published its Strategic Defence and Security Review (SDSR). The SDSR identified defence and security priorities and set out a plan to spend £178bn on defence equipment and support over the next ten years.

A number of important SDSR commitments for the Company included continued investment in expanding Typhoon capabilities and an extension of the aircraft's expected service life until at least 2040. There was also a commitment to continued joint investment with France in the development of a future unmanned combat air capability. Also in the air domain, the SDSR identified an accelerated UK procurement of F-35 Lightning II aircraft. The Company is a major participant in the F-35 programme, supplying airframe assemblies and electronics equipment.

In September, an agreement between Kuwait and Italy was announced relating to the supply of Typhoon aircraft to the Kuwait Air Force. On 5 April 2016, Italian Eurofighter partner, Finmeccanica, signed a contract for the supply of 28 Typhoon aircraft to Kuwait. The contract is expected to result in airframe manufacture and Electronic Scanned (E-Scan) radar integration work valued at approximately £1bn.

In November, the Company announced a reduction in its build rate for Typhoon assemblies to ensure production continuity at competitive costs over the medium term. The Company also announced a proposal to reduce the workforce of the Military Air & Information business, within Platforms & Services (UK).

The UK government continues to provide strong support for Typhoon and other export campaigns. Although there can be no certainty as to the timing of orders, discussions with current and prospective operators of the Typhoon aircraft continue to support our expectations for additional Typhoon contract awards.

In Saudi Arabia, the Company continued to deliver Typhoon aircraft during 2015 and the Company's extensive in-Kingdom training and support activities are at a high tempo. The Royal Saudi Air Force (RSAF) has achieved high utilisation and aircraft availability across its Typhoon and Tornado fleets, operating under demanding conditions.

The Company reached agreement with the Saudi customer for the provision of a further 22 Hawk Advanced Jet Trainer aircraft, associated ground equipment and training aids for the RSAF, which form part of an enhancement to the Kingdom's pilot training capacity.

Platforms & Services (UK)

In the year, 18 Typhoon aircraft were delivered from the UK final assembly facility, of which 12 were delivered to Saudi Arabia. Cumulative aircraft deliveries to the UK, Germany, Italy and Spain total 227 of the contracted 236 Tranche 2 aircraft and 22 of the contracted 88 Tranche 3 aircraft. The 2014 issues delaying acceptance of Typhoon Tranche 3 aircraft from the Company's partners in Germany, Italy and Spain were resolved.

The Oman Typhoon and Hawk aircraft programme continues to meet all contractual milestones and is on track for commencement of deliveries in 2017.

In order to meet existing and anticipated orders and delivery schedules, the Company is reducing the rate of Typhoon major unit production. This will help reduce production discontinuity and provide a more sustainable and competitive position for Typhoon manufacturing in the years ahead. The action involves a proposed workforce reduction.

Typhoon's capabilities continue to expand with the integration of the Captor E-Scan radar and Brimstone 2 missile.

The Company continues to successfully support its UK and European customers' Typhoon and Tornado aircraft in delivering their operational commitments. The business supports its UK customer through availability-based service contracts, and contract extensions totalling £147m were received in the year.

On the F-35 Lightning II programme, the Company completed delivery of 43 aft fuselage assemblies for the Low-Rate Initial Production (LRIP) Lot 8 contract. A £203m contract on LRIP Lot 9 for 57 aircraft sets was received in the year, with 11 aft fuselage assemblies completed. The forward price for LRIP Lot 10 for 94 aircraft sets has been agreed, with full contract award for both Lots 9 and 10 anticipated during 2016. A proposal for LRIP Lot 11 has been submitted to Lockheed Martin in advance of negotiations commencing in 2016.

Support continues to be provided to users of Hawk trainer aircraft around the world. In 2015, the Indian Navy and Air Force received five and 15 Hawk aircraft, respectively, built under the Batch 2 licence for 57 aircraft by Hindustan Aeronautics Limited. An order for a further 20 Hawk aircraft from the Indian Air Force is currently being negotiated. Orders for £255m were received in the year for continued support to the RAF advanced jet training facility in North Wales.

Strategic report *(continued)*

Working jointly with Dassault Aviation, progress is being made in maturing and demonstrating critical technology and operational aspects for an unmanned combat air system.

Taranis, the stealthy unmanned combat air vehicle demonstrator designed and built by the Company with UK industry partners and the Ministry of Defence, has successfully completed further phases of flight trials in the year.

During 2015, the Company concluded 236 management redundancies following the announcement in October 2014, with a further 204 potential redundancies mitigated through redeployment within either the business or the wider BAE Systems group.

On 31 December 2015, the Company acquired the trade and net liabilities of the defence and information business from BAE Systems Integrated System Technologies Limited at their book value. The aggregate value of the net liabilities acquired was £26m. The principal activities of the business acquired are the design, supply and support of secure communication and training systems to the UK Ministry of Defence.

Platforms & Services (International)

On the Salam Typhoon programme, 12 aircraft were delivered in the year and, as at 31 December, 57 aircraft had been delivered to the RSAF. Work on enhancing Typhoon's air-to-ground capability is progressing to schedule.

The Typhoon support contracts are operating well with all Key Performance Indicators meeting contractual levels.

Through the Saudi British Defence Co-operation Programme, the business continues to support the operational capabilities of the Royal Saudi Air Force (RSAF) and Royal Saudi Naval Forces. The modernisation of the RSAF's training aircraft fleet has been extended with an agreement for the supply of a further 22 Hawk aircraft, associated ground equipment and training aids. The original contract continues on schedule, with all 22 Hawk aircraft in advanced stages of production and the first aircraft having flown in September. Deliveries are due to commence in 2016. As at 31 December, a total of 46 of the 55 Pilatus PC-21 aircraft had been delivered. Training and support under five-year contracts continues.

The upgrade of Tornado aircraft and associated equipment procurement continues.

Electronic Systems

This reporting segment provides safety critical flight control systems for the defence and commercial aerospace market, active inceptor systems, advanced displays for military aircraft, defence and civil aftermarket support and hybrid electric drive systems.

Key performance indicators

Key financial performance indicators are shown below:

	2015	2014[1]
	£	£
Order intake	**2.8bn**	4.0bn
Revenue	**6.4bn**	5.6bn
Operating profit	**651m**	572m

[1] Restated on adoption of Financial Reporting Standard (FRS) 101 Reduced Disclosure Framework.

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.

Operating profit is used for internal performance analysis as a measure of operating profitability that is comparable over time.

The increase in revenue is primarily due to a higher number of Saudi aircraft deliveries and the trading of Radar Defensive Aids Sub-System equipment on the European Typhoon Tranche 3 programme.

The increase in operating profit includes the increase in profit on disposal of investment property (£44m), and the impact of optional entry into a new scheme where research and development expenditure credits (RDEC) are now recognised in operating profit (£45m) rather than taxation expense.

Strategic report *(continued)*

Principal risks and uncertainties

The Company's principal risks are identified below.

The Company is dependent on defence spending.

The Company's core businesses are primarily defence-related, selling products and services directly and indirectly, mainly to the UK and Saudi Arabian governments.

Defence spending by governments can fluctuate depending on political considerations, budgetary constraints, specific threats and movements in the international oil price.

There have been constraints on government expenditure in the UK.

With the Eurozone area experiencing financial difficulties, affordability continues to be a key focus for customers.

Some countries' economies may be influenced by oil prices, with consequent reduced defence spending.

The Company's largest customers are governments.

The Company has long-standing relationships and security arrangements with the governments of the UK and Saudi Arabia and their 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 some government customers is subject to financial audits and other reviews which can result in adjustments to prices and costs.

The Company operates in an international market.

The Company conducts business in a number of regions, including the Middle East.

The risks of operating in some countries include: political changes impacting the business environment; economic downturns, political instability and civil disturbances; changes in government regulations and administrative policies; the imposition of restraints on the movement of capital; the introduction of burdensome taxes or tariffs; and the inability to obtain or maintain the necessary export licenses.

The Company is exposed to volatility in currency exchange rates, particularly in respect of the Euro and Saudi Riyal.

The Company's business is subject to significant competition in international markets.

The Company's business plan depends upon its ability to win and contract for high-quality new programmes, an increasing number of which are expected to be in markets outside the UK.

The Company is dependent upon UK government support in relation to a number of its business opportunities in export markets.

The Company is subject to risk from a failure to comply with laws and regulations.

The Company operates in a highly-regulated environment across many jurisdictions and is subject, without limitation, to regulations relating to import-export controls, money laundering, false accounting, anti-bribery and anti-boycott provisions. It is important that the Company maintains a culture in which it focuses on embedding responsible business behaviours and that all employees act in accordance with the requirement of the Company's policies, including the Code of Conduct, at all times.

Export restrictions could become more stringent and political factors or changing international circumstances could result in the Company being unable to obtain necessary export licences.

The Company has many contracts, including a small number of large contracts and fixed-price contracts.

A significant portion of the Company's revenue is derived from fixed-price contracts. Actual costs may exceed the projected costs on which the fixed prices are agreed and, since these contracts can extend over many years, it can be difficult to predict the ultimate outturn costs.

It is important that the Company maintains a culture in which it delivers on its projects within tight tolerances of quality, time and cost performance in a reliable, predictable and repeatable manner.

The Company is dependent on the award timing and cash profile of its contracts.

The Company's profits and cash flows are dependent, to a significant extent, on the timing of, or failure to receive, award of defence contracts and the profile of cash receipts on its contracts.

Strategic report *(continued)*

BAE Systems has an aggregate funding deficit in its defined benefit pension schemes in which the Company participates.

In aggregate, there is an actuarial deficit between the value of the projected liabilities of BAE Systems' defined benefit pension schemes and the assets they hold.

The deficits may be adversely affected by changes in a number of factors, including investment returns, long-term interest rate and price inflation expectations, and anticipated members' longevity.

The Company could be negatively impacted by information technology security threats.

The security threats faced by the Company include threats to its information technology infrastructure, unlawful attempts to gain access to its proprietary or classified information and the potential for business disruptions associated with information technology failures.

The Company's strategy is dependent on its ability to recruit and retain people with appropriate talent and skills.

Delivery of the Company's strategy and business plan is dependent on its ability to compete to recruit and retain people with appropriate talent and skills, including those with innovative technological capabilities.

With constraints on defence spending in the UK market, the Company's business plan is targeting an increasing level of business in international export markets. It is important that the Company recruits and retains management with the necessary international skills and experience in the relevant jurisdictions.

On behalf of the Board

I G King

Director

5 July 2016

Directors' report

Company registration

BAE Systems (Operations) Limited is a private company, limited by shares and registered in England and Wales with the registered number 01996687.

Results and dividends

The Company's profit for the financial year is £631m (2014 £519m).

The directors do not propose a dividend for 2015.

Looking forward

Platforms & Services (UK) has a strong order backlog of long-term committed programmes and an enduring support business. The Strategic Defence and Security Review announced in November 2015 provided clarity, continuity and stability for the UK business. Sales are underpinned by Typhoon and F-35 Lightning II aircraft production and in-service support. There are opportunities to secure future Typhoon export sales.

In Platforms & Services (International), the Company expects to sustain its long-term presence in Saudi Arabia through delivering current programmes and industrialisation, and developing new business in support of the Saudi military forces.

Going concern

After making due enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

Overseas branch office

The Company has an overseas branch office in India.

Employees

The diversity, skills and innovation of our people drives performance across the Company.

The Company is committed to creating a diverse and inclusive work environment where a diverse range of talented people can work together to ensure business delivery. We are creating this environment by striving to build a diverse workforce from entry level to senior management which reflects the populations that we recruit from.

Engaging and developing our workforce for current and future business is key to successfully delivering our strategy and customer commitments. We are continuously looking to attract, recruit, develop and reward people of the highest calibre.

We want every employee to fulfil their potential while contributing to the success of the Company. We do this through our career frameworks, comprehensive development programmes and the breadth of our operations around the world that enable employees to make the most of their talents. Our focus is on continuous professional development that supports personal and professional growth.

The Company has a number of programmes in place to improve diversity and inclusion across the business, including Executive Committee sponsored work streams to foster a culture of inclusion, accelerate the development of high-potential women and increase leadership diversity. This is underpinned by activities across the Company to improve diversity and inclusion locally.

To support our operations and the industry sectors, we partner with the education system in countries to ensure the future workforce has the core skills and capabilities to develop careers and support industrial strategies. We place particular emphasis on encouraging young people to pursue careers in Science, Technology, Engineering and Mathematics (STEM).

The safety of our employees, and anybody who works on, or visits, our sites, remains a priority for the Company. During 2015, the Company continued to focus on raising awareness of employees' role in identifying, managing and reducing safety risks. Throughout the year, employees were encouraged to review work processes to design out potential accidents and suggest improvements to drive standards of safety across the Company.

The Company is committed to creating environments that enable employees to contribute to improving business performance through our engagement activities, including regular feedback to support their success, and drive responsible behaviour and safe working practices. The Company seeks to listen to employees' views and opinions, and keep them informed about what is happening across the business through a variety of media, including e-enabled channels, leadership blogs, newsletters, management and team meetings, monthly team briefs, and the intranet. Employees also have the opportunity to provide feedback via our engagement surveys.

The Company welcomes employees becoming shareholders in BAE Systems plc and offers a number of employee share plans to support this.

Research and Development (R&D)

The Company is focused on technology innovation and engineering excellence and invests in next-generation research and technology programmes to improve the manufacturing and service of products, generating substantial intellectual property. Total research and development expenditure in the year was £424m (2014 £480m), of which £41m (2014 £43m) was funded by the Company.

Financial instruments

The global nature of the Company's business means it is exposed to volatility in currency exchange rates. In order to protect itself against currency fluctuations, the Company's policy is to hedge all material firm transactional exposures.

Directors and their interests

The directors who served during the year and at the date of this report were as follows:

Mr K B Taylor
Mr B W Ierland
Mr I G King
Mr P J Lynas
Mr P R Earl
Mr G R Griffiths
Mr N G Whitehead

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 he ought to have taken to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Auditor

The auditor, KPMG 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.

On behalf of the Board

I G King

Director

5 July 2016

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

Statement of directors' responsibilities in respect of the strategic report and directors' report and the financial statements

The directors are responsible for preparing the Strategic Report, the Directors' 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 they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice), including 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 estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and

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 have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Independent auditor's report to the members of BAE Systems (Operations) Limited

We have audited the financial statements of BAE Systems (Operations) Limited for the year ended 31 December 2015 set out on pages 11 to 44. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice), including FRS 101 *Reduced Disclosure Framework*.

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.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 9, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2015 and of its profit for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year is consistent with the financial statements.

Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic report and the Directors' report:

- we have not identified material misstatements in those reports; and.
- in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you 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; or
- the directors were not entitled to take advantage of the small companies exemption from the requirement to prepare a strategic report.

Ian Starkey (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
KPMG LLP
15 Canada Square
London
E14 5GL

5 July 2016

Income statement
for the year ended 31 December 2015

	Notes	2015 £m	2014[1] £m
Revenue	2	**6,386**	5,571
Operating costs	3	**(5,836)**	(5,031)
Other income	4	**101**	32
Operating profit		**651**	572
Income from subsidiary undertakings and participating interests		**3**	3
Profit before finance costs and taxation		**654**	575
Financial income	5	**7**	-
Financial expense	6	**(96)**	(87)
Profit before taxation		**565**	488
Taxation credit	8	**66**	31
Profit for the year		**631**	519

[1] Restated on adoption of Financial Reporting Standard (FRS) 101 Reduced Disclosure Framework.

Statement of comprehensive income
for the year ended 31 December 2015

	2015 £m	2014[1] £m
Profit for the year	**631**	519
Other comprehensive income		
Items that will not be reclassified to the income statement:		
Remeasurements on retirement benefit schemes	**340**	(839)
Tax on items that will not be reclassified to the income statement	**(84)**	158
Items that may be reclassified to the income statement:		
Currency translation on foreign currency branches	**(1)**	(1)
Amounts charged to hedging reserve	**(1)**	(102)
Tax on items that may be reclassified to the income statement	**(1)**	20
Total other comprehensive income for the year (net of tax)	**253**	(764)
Total comprehensive income for the year	**884**	(245)

[1] Restated on adoption of Financial Reporting Standard (FRS) 101 Reduced Disclosure Framework.

The notes on pages 14 to 44 form part of the financial statements.

The results for 2015 and 2014 arise from continuing activities.

Balance sheet
as at 31 December 2015

	Notes	2015 £m	2014[1] £m
Non-current assets			
Intangible assets	9	**54**	51
Property, plant and equipment	10	**348**	299
Investment property	11	**7**	13
Other investments	12	**4**	4
Other receivables	13	**4**	5
Retirement benefit surpluses	18	**25**	19
Other financial assets	14	**20**	16
Deferred tax assets	15	**410**	495
		872	902
Current assets			
Inventories	16	**82**	64
Trade and other receivables including amounts due from customers for contract work	13	**6,880**	6,180
Current tax		**-**	28
Other financial assets	14	**29**	24
Cash and cash equivalents		**32**	40
		7,023	6,336
Total assets		**7,895**	7,238
Non-current liabilities			
Other payables	17	**(488)**	(169)
Retirement benefit obligations	18	**(2,177)**	(2,411)
Other financial liabilities	14	**(51)**	(63)
Provisions	19	**(23)**	(21)
		(2,739)	(2,664)
Current liabilities			
Trade and other payables	17	**(4,646)**	(4,795)
Other financial liabilities	14	**(93)**	(71)
Current tax		**(71)**	(227)
Provisions	19	**(69)**	(90)
		(4,879)	(5,183)
Total liabilities		**(7,618)**	(7,847)
Net assets /(liabilities)		**277**	(609)
Capital and reserves			
Issued share capital	20	**1,008**	1,008
Share premium		**25**	25
Other reserves	20	**(80)**	(77)
Retained earnings – deficit		**(676)**	(1,565)
Total equity		**277**	(609)

[1] Restated on adoption of Financial Reporting Standard (FRS) 101 Reduced Disclosure Framework.

Approved by the Board on 5 July 2016 and signed on its behalf by:

I G King
Director

Registered number: 01996687

Statement of changes in equity
for the year ended 31 December 2015

	Notes	Issued share capital £m	Share premium £m	Other reserves £m	Retained earnings[1] £m	Total equity £m
At 1 January 2014 (as previously reported)		1,008	25	24	941	1,998
Effect of transition to FRS 101		-	-	(18)	(1,298)	(1,316)
At 1 January 2014 (restated)		1,008	25	6	(357)	682
Profit for the year		-	-	-	519	519
Total other comprehensive income for the year		-	-	(83)	(681)	(764)
Share-based payments		-	-	-	2	2
Ordinary share dividends	20	-	-	-	(1,048)	(1,048)
At 31 December 2014 (restated)		1,008	25	(77)	(1,565)	(609)
Profit for the year		-	-	-	631	631
Total other comprehensive income for the year		-	-	(3)	256	253
Share-based payments		-	-	-	2	2
At 31 December 2015		**1,008**	**25**	**(80)**	**(676)**	**277**

Notes to the financial statements

1 Accounting policies

Basis of preparation
These financial statements were prepared in accordance with Financial Reporting Standard (FRS) 101 Reduced Disclosure Framework. Amendments to FRS 101 (2013/14 Cycle), issued in July 2014, and effective for periods beginning on or after 1 January 2015, has been applied. Amendments to FRS 101 (2014/15 cycle and other minor amendments), issued in July 2015, and effective for periods beginning on or after 1 January 2016, has been early adopted and applied.

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards (IFRS) as adopted by the EU (EU-adopted 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 paragraphs 45(b) and 46 to 52 of IFRS 2, Share-based Payment;
- the requirements of paragraphs 62, B64(d), B64(e), B64(g), B64(h), B64(j) to B64(m), B64(n)(ii), B64(o)(ii), B64(p), B64(q)(ii), B66 and B67 of IFRS 3, Business Combinations;
- the requirements of paragraph 33(c) of IFRS 5, Non-current Assets Held for Sale and Discontinued Operations;
- the requirements of IFRS 7, Financial Instruments: Disclosures;
- the requirements of paragraphs 91 to 99 of IFRS 13, Fair Value Measurement;
- 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 paragraphs 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
- the requirements of paragraphs 130(f)(ii), 130(f)(iii), 134(d) to 134(f) and 135(c) to 135(e) of IAS 36, Impairment of Assets.

In its transition to FRS 101, the Company has applied IFRS 1 First-time Adoption of International Financial Reporting Standards, whilst ensuring that its assets and liabilities are measured in compliance with FRS 101. An explanation of how the transition to FRS 101 has affected the company's reported financial performance and position is provided in note 25.

Following the adoption of FRS 101, the Company has not taken advantage of the exemption available under the transition rules of IFRS 1 to use fair value as deemed cost for properties previously measured at fair value. Accordingly, the Company has reversed the previously recognised revaluations and has reverted to using historical cost for land and buildings.

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 following paragraphs summarise the main accounting policies of the Company and have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

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). The going concern basis has been applied in these financial statements.

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

Notes to the financial statements *(continued)*

1 Accounting policies *(continued)*

Revenue and profit recognition
Revenue comprises the value of work completed, goods supplied or services rendered during the year, net of value added tax.

Long-term contracts
The majority of the Company's long-term contract arrangements are accounted for under IAS 11, Construction Contracts. Sales are recognised when the Company has obtained the right to consideration in exchange for its performance. This is usually when title passes or a separately identifiable phase (milestone) of a contract or development has been completed.

No profit is recognised on contracts until the outcome of the contract can be reliably estimated. Profit is calculated by reference to reliable estimates of contract revenue and forecast costs after making suitable allowances for technical and other risks related to performance milestones yet to be achieved. Profit is recognised progressively as risks have been mitigated or retired.

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

Goods supplied and services rendered
Revenue is measured at the fair value of the consideration received or receivable, net of returns, rebates and other similar allowances.

Revenue from the sale of goods not under a long-term contract is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, there is no continuing management involvement with the goods, and the amount of revenue and costs can be measured reliably. Profit is recognised at the time of sale.

Revenue from the provision of services not under a long-term contract is recognised in the income statement in proportion to the stage of completion of the contract at the reporting date. The stage of completion is measured on the basis of direct expenses incurred as a percentage of total expenses to be incurred for material contracts and labour hours delivered as a percentage of total labour hours to be delivered for time contracts.

Sales and profits on intercompany trading are determined on an arm's length basis.

Rental income
Rental income is recognised in other income on a straight-line basis over the term of the relevant lease.

Lease costs
Payments, including any incentives, made under operating leases are recognised in the income statement on a straight-line basis over the lease term.

Lease incentives granted are charged to the income statement over the term of the lease.

Research and development
The Company undertakes research and development activities either on its own behalf or on behalf of customers.

Company-funded expenditure on both research and development activities not meeting the conditions for capitalisation is written off as incurred and charged to the income statement.

Customer-funded expenditure on research and development activities is held in long-term contract balances as a contract cost within trade and other receivables and recognised in the income statement in accordance with the Company's revenue recognition policy.

Interest income and borrowing costs
Interest income and borrowing costs are recognised in the income statement in the period in which they are incurred.

Dividends
Dividends received and receivable are credited to the Company's income statement. Equity dividends paid on ordinary share capital are recognised as a liability in the period in which they are declared.

Intangible assets
Intangible assets are carried at cost or valuation, less accumulated amortisation and impairment losses.

Goodwill
Goodwill on business asset purchases is included in intangible assets. Goodwill is not amortised, but is tested annually for impairment. This is not in accordance with The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 which require that all goodwill is amortised. The directors consider that this would fail to give a true and fair view of the profit for the year and that the economic measure of performance in any period is properly made by reference only to any impairment that may have arisen.

Notes to the financial statements *(continued)*

1 Accounting policies *(continued)*

Other intangible assets
Other intangible assets include:

– Computer software licences acquired for use within the Company are capitalised as an intangible asset on the basis of the costs incurred to acquire and bring to use the specific software;
– Software development costs that are directly associated with the production of identifiable and unique software products controlled by the Company, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Company-funded expenditure associated with enhancing or maintaining computer software programs for sale is recognised as an expense as incurred;

Amortisation
Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of the intangible assets. For programme-related intangibles, amortisation is set on a programme-by-programme basis over the life of the individual programme. Amortisation for customer-related intangibles is also set on an individual basis. The Company has no indefinite life intangible assets other than goodwill.

The estimated useful lives are as follows:

Computer software licences acquired	2 to 5 years
Software development costs	2 to 5 years

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 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 and investment property 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.

Foreign currencies
Transactions in foreign currencies are translated at the exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the exchange rates ruling at the balance sheet date. These exchange differences are recognised in the income statement.

The assets and liabilities of foreign currency branches are translated at the exchange rates ruling at the balance sheet date. The income statements of these branches are translated at average rates of exchange during the year. All resulting exchange differences are recognised in the Foreign Translation Reserve.

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.

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:

Buildings	- up to 50 years, or the lease term if shorter
Computing equipment and motor vehicles	- 4 to 5 years
Other equipment	- 10 years, or the project life if shorter

Notes to the financial statements *(continued)*

1 Accounting policies *(continued)*

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.

Investment property
Cost
Land and buildings that are leased to group or non-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.

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

Inventories
Inventories are stated at the lower of cost, including all relevant overhead expenditure, and net realisable value.

Trade and other receivables
Trade and other receivables are stated at their cost less provision for bad debts. A provision for bad debt is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. Receivables with a short-term duration are not discounted.

A loss on provision for bad debt is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

Amounts due from customers for contract work includes long-term contract balances and amounts due from contract customers, less attributable progress payments.

Long-term contract balances are stated at cost less provision for any anticipated losses. Provisions for losses on contracts are recorded when it becomes probable that total estimated contract costs will exceed total contract revenues. Such provisions are recorded as write downs of long-term contract balances for that portion of the work which has already been completed, and the remainder is included as amounts due to long-term contract customers within trade and other payables. Losses are determined on the basis of estimated results on completion of contracts and are updated regularly.

Progress payments are amounts received from customers in accordance with the terms of contracts which specify payments in advance of delivery and are credited, as progress payments, against any expenditure incurred for the particular contract. Any unexpended balance in respect of progress payments is held in trade and other payables as customer stage payments or, if the amounts are subject to advance payment guarantees unrelated to group performance, as cash received on customers' account.

Amounts due from contract customers represent unbilled income and are stated at cost, plus attributable profit.

Cash and cash equivalents
Cash and cash equivalents includes cash in hand, call and term deposits, and other short-term liquid investments with original maturities of three months or less and which are subject to an insignificant risk of change in value.

Trade and other payables
Trade and other payables are stated at their cost.

Notes to the financial statements *(continued)*

1 Accounting policies *(continued)*

Tax
Income 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 or substantively 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 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.

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.

Warranties and after-sales service
Warranties and after-sales service are provided in the normal course of business with provisions for associated costs being made based on an assessment of future claims with reference to past experience. A provision for warranties is recognised when the underlying products and services are sold. The provision is based on historical warranty data and a weighting of possible outcomes against their associated probabilities.

Reorganisations
A provision for restructuring is recognised when the Company has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been publicly announced. The costs associated with the reorganisation programmes are supported by detailed plans and based on previous experience as well as other known factors. Future operating costs are not provided for.

Legal, contractual and environmental
The Company holds provisions for expected legal, contractual and environmental costs that it expects to incur over an extended period. These costs are based on past experience of similar items and other known factors and represent management's best estimate of the likely outcome.

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 *(continued)*

1 Accounting policies *(continued)*

Retirement benefit obligations
Defined contribution pension schemes
A defined contribution pension scheme is a post-employment benefit plan under which the Company pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts.

Obligations for contributions are recognised as an expense in the income statement as incurred.

Defined benefit pension schemes
The cost of providing benefits is determined periodically by independent actuaries and charged to the income statement in the period in which those benefits are earned by the employees. Remeasurements, including actuarial gains and losses, are recognised in the Statement of comprehensive income in the period in which they occur. Past service costs resulting from a plan amendment or curtailment are recognised immediately in the income statement.

The retirement benefit obligation recognised in the Company's balance sheet represents an estimate of the present value of the defined benefit obligations calculated using a number of actuarial assumptions with the principal assumptions, set out on page 32, reduced by an estimate of the fair value of scheme assets.

The Company participates in a number of group and multi-employer schemes administered by its ultimate parent company, BAE Systems plc. A share of the IAS 19, Employee Benefits, pension deficit has been allocated to all participating employers. This allocation has been calculated based on membership data, where known. Where this is not available, it has been calculated using the Company's share of current payroll.

In the event that an employer who participates in BAE Systems plc's pension schemes fails or cannot be compelled to fulfil its obligations as a participating employer, the remaining participating employers are obliged to collectively take on its obligations. The Company considers the likelihood of this event arising as remote.

Share-based payments
BAE Systems plc issues equity-settled share options to employees of the Company. In accordance with the requirements of IFRS 2, Share-based Payment, the Company has recognised a charge for the equity-settled share options issued to its employees.

Equity-settled share options and LTIP arrangements are measured at fair value at the date of grant using an option pricing model.

The fair value is expensed on a straight-line basis over the vesting period, based on the Company's estimate of the number of shares that will actually vest.

Financial instruments
Derivative financial instruments and hedging activities
The global nature of the Company's business means it is exposed to volatility in currency exchange rates. In order to protect itself against currency fluctuations, the Company's policy is to hedge all material firm transactional exposures. The Company aims to achieve hedge accounting treatment for all derivatives that hedge material foreign currency exposures.

In accordance with its treasury policy, the Company does not hold derivative financial instruments for trading purposes.

Derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition, such instruments are stated at fair value at the balance sheet date. Gains and losses on derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement for the period.

Cash flow hedges
Where a derivative financial instrument is designated as a hedge of cash flows relating to a highly probable forecast transaction (income or expense), the effective portion of any change in the fair value of the instrument is recognised in other comprehensive income and presented in the hedging reserve in equity. Amounts recognised in equity are reclassified from reserves into the cost of the underlying transaction and recognised in the income statement when the underlying transaction affects profit or loss. The ineffective portion of any change in the fair value of the instrument is recognised in the income statement immediately.

Notes to the financial statements *(continued)*

2 Segmental analysis

Revenue by reporting segment

	2015 £m	2014 £m
Electronic Systems	**285**	257
Platforms & Services (UK)	**4,247**	3,639
Platforms & Services (International)	**2,343**	2,049
	6,875	5,945
Intra-Company	**(489)**	(374)
	6,386	5,571

Revenue by customer location

	2015 £m	2014 £m
United Kingdom	**610**	528
Rest of Europe	**1,588**	1,206
Middle East	**3,575**	3,094
USA and Canada	**481**	470
Asia and Pacific	**119**	240
Africa, Central and South America	**13**	33
	6,386	5,571

Revenue by category

	2015 £m	2014 £m
Long-term contracts	**5,453**	4,614
Sale of goods	**196**	169
Provision of services	**732**	776
Royalty income	**5**	12
	6,386	5,571

3 Operating costs

	2015 £m	2014[1] £m
Raw materials and other bought-in items	**3,187**	3,257
Change in inventories of finished goods and work in progress	**921**	29
Cost of inventories expensed	**4,108**	3,286
Staff costs (note 7)	**1,077**	1,029
Depreciation, amortisation and impairment	**43**	45
Other operating charges	**608**	671
Operating costs	**5,836**	5,031
Included within the above analysis are the following expenses:		
Lease and sublease expense	**20**	20

[1] Restated on adoption of Financial Reporting Standard (FRS) 101 Reduced Disclosure Framework.

The remuneration of the auditors for the year ended 31 December 2015 for statutory audit work was £0.8m (2014 £0.8m) and £nil (2014 £nil) in respect of non-audit work

Total research and development expenditure was £424m (2014 £480m), of which £41m (2014 £43m) was funded by the Company.

Notes to the financial statements *(continued)*

4 Other income

	2015 £m	2014 £m
Research and development expenditure credits[1]	45	-
Rental income from operating leases – investment property	5	4
Rental income from operating leases – other	2	2
Profit on disposal of property, plant and equipment	1	15
Profit on disposal of investment property[2]	45	1
Recharges from group companies	1	7
Other	2	3
Other income	**101**	32

[1] In 2013, UK legislation changed so that UK government credits for research and development spend are now accounted for as part of operating profit rather than as part of taxation expense. This treatment was optional for the first three years. During 2015, the Company exercised that option, effective from 2013, and has reflected this change in the 2015 financial statements.

[2] In 2015, the Company sold investment property with a net book value of £5m for net proceeds of £50m.

5 Financial income

	2015 £m	2014 £m
Interest income	6	-
Foreign exchange gains	1	-
Financial income	**7**	-

6 Financial expense

	2015 £m	2014[1] £m
Net interest expense on retirement benefit obligations (note 18)	90	72
Net present value adjustments	6	15
Financial expense	**96**	87

[1] Restated on adoption of Financial Reporting Standard (FRS) 101 Reduced Disclosure Framework.

7 Employees

The average number of Company employees was as follows:

	2015	2014
Electronic Systems	1,374	1,388
Platforms & Services (UK)	12,465	12,634
Platforms & Services (International)	5,076	4,897
	18,915	18,919

The aggregate staff costs of Company employees were as follows:

	2015 £m	2014[1] £m
Wages and salaries	856	839
Social security costs	59	58
Pension costs – defined contribution plans (note 18)	11	8
Pension costs – defined benefit plans (note 18)	149	122
Share-based payments (note 23)	2	2
	1,077	1,029

[1] Restated on adoption of Financial Reporting Standard (FRS) 101 Reduced Disclosure Framework.

None of the directors received any emoluments from the Company during the year. All directors who served during the year were employed by BAE Systems plc and were remunerated through that company.

Notes to the financial statements *(continued)*

8 Taxation

Taxation expense	2015 £m	2014[1] £m
Current taxation		
UK:		
Current tax	**(83)**	(36)
Adjustments in respect of prior years	**50**	24
	(33)	(12)
Overseas:		
Current tax	**-**	(1)
Adjustments in respect of prior years	**82**	51
	82	50
	49	38
Deferred taxation		
Origination and reversal of temporary differences	**23**	(4)
Adjustments in respect of prior years	**(2)**	(3)
Tax rate adjustment[2]	**(4)**	-
	17	(7)
Taxation credit	**66**	31

[1] Restated on adoption of Financial Reporting Standard (FRS) 101 Reduced Disclosure Framework.

[2] The UK current tax rate was reduced from 21% to 20% with effect from 1 April 2015, and will be reduced to 19% with effect from 1 April 2017 and to 18% with effect from 1 April 2020. In line with this change, the rate applying to UK deferred tax assets and liabilities has been reduced from 20% to 18%, creating a rate adjustment in 2015, which is partly reflected in the income statement and partly in the statement of comprehensive income.

Reconciliation of taxation expense

The following table reconciles the theoretical income tax expense, using the UK corporation tax rate, to the reported tax expense.

	2015 £m	2014 £m
Profit before taxation	**565**	488
UK corporation tax rate	**20.25%**	21.5%
Expected income tax expense	**(114)**	(105)
Expenses not tax effected	**(5)**	(26)
Income not subject to tax	**41**	32
Research and development tax credits and patent box benefits	**11**	17
Losses received from group companies	**-**	49
Adjustments in respect of prior years[3]	**130**	72
Tax rate adjustment	**(4)**	-
Other	**7**	(8)
Taxation credit	**66**	31

[3] 2015 includes credits totalling £134m in respect of the adjustment of certain UK and overseas tax provisions in the light of clarification and rulings received. 2014 included a £51m credit in respect of the re-assessment of existing tax provisions where information received in the year enabled the estimate to be updated.

Notes to the financial statements *(continued)*

8 Taxation *(continued)*

Tax recognised in other comprehensive income

	2015			2014		
	Before tax £m	**Tax benefit/ (expense) £m**	**Net of tax £m**	Before tax £m	Tax benefit/ (expense) £m	Net of tax £m
Items that will not be reclassified to the income statement:						
Remeasurements on retirement benefit schemes	**340**	**(43)**	**297**	(839)	158	(681)
Tax rate adjustment[1]	**-**	**(41)**	**(41)**	-	-	-
Items that may be reclassified to the income statement:						
Currency translation on foreign currency branches	**(1)**	**-**	**(1)**	(1)	-	(1)
Amounts charged to hedging reserve	**(1)**	**-**	**(1)**	(102)	20	(82)
Tax rate adjustment[1]	**-**	**(1)**	**(1)**	-	-	-
	338	**(85)**	**253**	(942)	178	(764)

	2015			2014		
	Other reserves £m	**Retained earnings £m**	**Total £m**	Other reserves £m	Retained earnings £m	Total £m
Current tax						
Pensions	**-**	**17**	**17**	-	-	-
	-	**17**	**17**	-	-	-
Deferred tax						
Financial instruments	**-**	**-**	**-**	20	-	20
Pensions	**-**	**(60)**	**(60)**	-	158	158
Tax rate adjustment[1]	**(1)**	**(41)**	**(42)**	-	-	-
	(1)	**(101)**	**(102)**	20	158	178
Tax on other comprehensive income	**(1)**	**(84)**	**(85)**	20	158	178

[1]The UK current tax rate was reduced from 21% to 20% with effect from 1 April 2015, and will be reduced to 19% with effect from 1 April 2017 and to 18% with effect from 1 April 2020. In line with this change, the rate applying to UK deferred tax assets and liabilities has been reduced from 20% to 18%, creating a rate adjustment in 2015, which is partly reflected in the income statement and partly in the statement of comprehensive income.

Notes to the financial statements *(continued)*

9 Intangible assets

	Goodwill[1] £m	Software £m	Development costs £m	Total £m
Cost				
At 1 January 2015	29	38	11	78
Additions	-	1	4	5
At 31 December 2015	**29**	**39**	**15**	**83**
Amortisation				
At 1 January 2015	-	25	2	27
Amortisation charge	-	2	-	2
At 31 December 2015	**-**	**27**	**2**	**29**
Net book value				
At 31 December 2015	**29**	**12**	**13**	**54**
At 31 December 2014	29	13	9	51

Impairment testing
In order to calculate the recoverable amount of the Company's goodwill, all goodwill balances have been considered with regard to value-in-use calculations. The value-in-use calculations use risk-adjusted future cash flow projections based on the Company's 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 applied. The IBP process includes the use of historic experience, available government spending data and the group's order backlog. Pre-tax discount rates, derived from the group's post-tax weighted average cost of capital of 7.47% (2014 7.12%) (adjusted for risks specific to the market in which the Cash-Generating Unit (CGU) operates), have been used in discounting these projected risk-adjusted cash flows.

[1] Restated on adoption of Financial Reporting Standard (FRS) 101 Reduced Disclosure Framework.

Notes to the financial statements *(continued)*

10 Property, plant and equipment

	Land and Buildings[1] £m	Plant and equipment[1] £m	Total[1] £m
Cost or valuation			
At 1 January 2015	194	809	1,003
Additions	15	88	103
Acquisitions	2	1	3
Disposals	(31)	(144)	(175)
At 31 December 2015	**180**	**754**	**934**
Depreciation and impairment			
At 1 January 2015	142	562	704
Depreciation charge for the year	7	33	40
Acquisitions	1	1	2
Disposals	(23)	(137)	(160)
At 31 December 2015	**127**	**459**	**586**
Net book value			
At 31 December 2015	**53**	**295**	**348**
At 31 December 2014	52	247	299
Non-depreciated assets:			
Assets in the course of construction	7	95	102
	7	**95**	**102**
Net book value:			
Freehold land and buildings	53	-	53
Plant and machinery	-	226	226
Fixtures, fittings and equipment	-	69	69
	53	**295**	**348**

[1] Restated on adoption of Financial Reporting Standard (FRS) 101 Reduced Disclosure Framework.

Notes to the financial statements *(continued)*

11 Investment property

	£m
Cost	
At 1 January 2015	19
Additions	2
Disposals	(9)
At 31 December 2015	**12**
Depreciation and impairment	
At 1 January 2015	6
Disposals	(2)
Impairment	1
At 31 December 2015	**5**
Net book value	
At 31 December 2015	**7**
At 31 December 2014	13
Fair value	
At 31 December 2015	**15**
At 31 December 2014	62

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.

12 Other investments

Carrying value	**£m**
At 1 January 2015 and 31 December 2015	**4**

Subsidiary undertakings and participating interests at 31 December 2015

In accordance with Section 409 of the Companies Act 2006, a full list of subsidiary undertakings and significant holdings as at 31 December 2015 is disclosed below. Unless otherwise stated, all subsidiary undertakings and significant holdings are owned directly by BAE Systems (Operations) Limited and have a financial year end of 31 December.

Company name	Class of shares held	Proportion of class (%)
BAE Systems (Aviation Services) Limited Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hampshire, GU14 6YU, United Kingdom	Ordinary shares of £1	50
BAE Systems (Kazakhstan) Limited Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hampshire, GU14 6YU, United Kingdom	Ordinary shares of £1	100
Gripen International KB – Partnership[1] SE-581 88, Linköping, Sweden	-	-
BAE Systems Deployed Systems Limited Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hampshire, GU14 6YU, United Kingdom	Ordinary shares of £1	60

[1] Gripen International KP is a limited liability partnership in which the Company has a 50% equity interest.

Notes to the financial statements *(continued)*

13 Trade and other receivables

	2015 £m	2014[1] £m
Non-current		
Other receivables	**4**	5
	4	5
Current		
Long-term contract balances	**2,913**	3,806[2]
Less: Attributable progress payments	**(2,634)**	(3,328)[2]
Amounts due from contract customers	**21**	86
Amounts due from customers for contract work	**300**	564
Trade receivables	**467**	264
Amounts owed by group subsidiaries	**5,836**	5,132
Amounts owed by group joint ventures (note 22)	**58**	84
Prepayments and accrued income	**91**	49
Other receivables	**128**	87
	6,880	6,180

[1] Restated on adoption of Financial Reporting Standard (FRS) 101 Reduced Disclosure Framework.

[2] Restated.

The aggregate amount of costs incurred and recognised profits (less recognised losses) to date in respect of contracts in progress at 31 December 2015 is estimated to be £11.5bn (2014 £14.3bn).

14 Other financial assets and liabilities

	2015		2014	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Current				
Cash flow hedges – foreign exchange contracts	**29**	**(93)**	24	(71)
Non-current				
Cash flow hedges – foreign exchange contracts	**20**	**(51)**	16	(63)

Contracted cash flows
The net contractual cash flows on derivative financial instruments at the reporting date are £nil (2014: £nil).

Notes to the financial statements *(continued)*

15 Deferred tax

Deferred tax assets

	2015	2014
	£m	£m
Property, plant and equipment	**8**	10
Provisions and accruals	**14**	11
Pension/retirement schemes	**369**	454
Share-based payments	**2**	2
Financial instruments	**17**	18
Deferred tax assets	**410**	495

Movement in temporary differences during the year

	At 1 January 2015 £m	Recognised in income £m	Recognised in equity £m	**At 31 December 2015 £m**
Property, plant and equipment	10	(2)	-	**8**
Provisions and accruals	11	3	-	**14**
Pension/retirement schemes	454	16	(101)	**369**
Share-based payments	2	-	-	**2**
Financial instruments	18	-	(1)	**17**
	495	17	(102)	**410**

	At 1 January 2014 £m	Recognised in income £m	Recognised in equity £m	At 31 December 2014 £m
Property, plant and equipment	13	(3)	-	10
Provisions and accruals	5	6	-	11
Pension/retirement schemes	306	(10)	158	454
Share-based payments	2	-	-	2
Financial instruments	(2)	-	20	18
	324	(7)	178	495

Notes to the financial statements *(continued)*

16 Inventories

	2015 £m	2014[1] £m
Short-term work in progress	**10**	14
Raw materials and consumables	**58**	40
Finished goods and goods for resale	**14**	10
	82	64

[1] Restated on adoption of Financial Reporting Standard (FRS) 101 Reduced Disclosure Framework.

The Company recognised a net £4m write back of inventories to net realisable value (2014: £6m write down), which included a £5m inventory provision release.

17 Trade and other payables

	2015 £m	2014 £m
Non-current		
Amounts due to long-term contract customers	**397**	75
Accruals and deferred income	**11**	-
Other payables	**80**	94
	488	169
Current		
Trade payables	**228**	170
Amounts due to long-term contract customers	**2,089**	2,509
Amounts due to other customers	**-**	3
Amounts owed to group subsidiaries	**1,646**	1,546
Amounts owed to group joint ventures (note 22)	**41**	41
Other taxes and social security costs	**72**	16
Accruals and deferred income	**532**	408
Other payables	**38**	102
	4,646	4,795

	2015 £m	2014 £m
Included above:		
Amounts due to long-term contract customers, including contract losses	**2,486**	2,584
Advances from long-term contract customers	**2,433**	2,563

Notes to the financial statements *(continued)*

18 Retirement benefit obligations

Background
BAE Systems plc operates pension schemes for qualifying employees in the UK, US and other countries. The principal schemes in the UK are funded defined benefit schemes and the assets are held in separate trustee administered funds. The two largest funded defined benefit schemes are the BAE Systems Pension Scheme (Main Scheme) and the BAE Systems 2000 Pension Plan (2000 Plan).

At 31 December 2015, the weighted average durations of the UK defined benefit pension obligations were 18 years (2014 19 years).

The Company participates in the following BAE Systems plc schemes: Main Scheme, 2000 Plan, Executive Pension Scheme, Royal Ordnance Pension Scheme, Royal Ordnance Senior Staff Pension Scheme, Alvis Pension Scheme and Shipbuilding Industries Pension Scheme.

The split of the defined benefit pension liability on a funding basis between active, deferred and pensioner members for the Main Scheme and 2000 Plan is set out below:

	Active %	Deferred %	Pensioner %
Main Scheme[1]	32	19	49
2000 Plan[2]	14	29	57

1. Source: Main Scheme actuarial valuation report as at 31 March 2014.
2. Source: 2000 Plan actuarial valuation report as at 31 March 2014.

Regulatory framework
The funded UK schemes are registered and subject to the statutory scheme specific-funding requirements outlined in UK legislation, including the payment of levies to the Pension Protection Fund as set out in the Pension Act 2004. These schemes were established under trust and the responsibility for their governance lies jointly with the trustees and BAE Systems plc.

Benefits
The UK defined benefit schemes provide benefits to members in the form of a set level of pension payable for life based on members' final salaries. The benefits attract inflation-related increases both in deferment and payment. All UK defined benefit schemes are closed to new entrants, with benefits for new employees being provided through a defined contribution scheme. The Normal Retirement Age for active members of the Main Scheme and 2000 Plan is 65. Specific benefits applicable to members differ between schemes. Further details on the benefits provided by each scheme are provided on the BAE Systems Pensions website: www.baesystemspensions.com.

Notes to the financial statements *(continued)*

18 Retirement benefit obligations *(continued)*

Funding

The majority of the UK defined benefit pension schemes are funded by BAE Systems plc and its subsidiaries, equity accounted investments and other participating employers. The individual pension schemes' funding requirements are based on actuarial measurement frameworks set out in their funding policies.

For funding valuation purposes, pension scheme assets are included at market value, whilst the liabilities are determined based on prudent assumptions set by the trustees following consultation with scheme actuaries.

The separate actuarial valuations for funding purposes include assumptions which differ from the actuarial assumptions used for IAS 19 accounting purposes shown on page 32. The latest valuations of the Main Scheme and 2000 Plan were performed as at 31 March 2014 and showed a funding deficit of £2.6bn. The total net funding deficit in respect of all of the UK schemes was £2.7bn. Deficit recovery plans agreed with the trustees of the relevant schemes run until 2026.

The results of future triennial valuations and associated funding requirements will be impacted by the future performance of investment markets, and interest and inflation rates.

The total Company contributions made to the defined benefit schemes in the year ended 31 December 2015 were £232m (2014 £250m). In 2016, the Company expects to make contributions at a similar level to those made in 2015.

The Company incurred a charge in respect of cash contributions of £11m (2014 £8m) paid to defined contribution schemes for employees.

Risk management

The defined benefit pension schemes expose BAE Systems plc to actuarial risks, including market (investment) risk, interest rate risk, inflation risk and longevity risk.

Risk	Mitigation
Market (investment) risk	
Asset returns may not move in line with the liabilities and may be subject to volatility.	The investment portfolios are highly diversified, investing in a wide range of assets, in order to provide reasonable assurance that no single security or type of security could have a materially adverse impact on the total portfolio. To reduce volatility, certain assets are held in a matching portfolio, which largely consists of index-linked bonds, gilts and swaps, designed to mirror movements in corresponding liabilities. Some of the BAE Systems group's pension schemes use derivative financial instruments as part of their investment strategy to manage the level of market risk.
Interest rate risk	
Liabilities are sensitive to movements in interest rates, with lower interest rates leading to an increase in the valuation of liabilities.	In addition to investing in bonds as part of the matching portfolio, the principal UK schemes invest in interest rate swaps to reduce the exposure to movements in interest rates. The swaps are held with several banks to reduce counterparty risk.
Inflation risk	
Liabilities are sensitive to movements in inflation, with higher inflation leading to an increase in the valuation of liabilities.	In addition to investing in index-linked bonds as part of the matching portfolio, the principal UK schemes invest in long-term inflation swaps to reduce the exposure to movements in inflation. The swaps are held with several banks to reduce counterparty risk.
Longevity risk	
Liabilities are sensitive to life expectancy, with increases in life expectancies leading to an increase in the valuation of liabilities.	Longevity Adjustment Factors are used in the majority of the UK pension schemes in order to adjust the pension benefits payable so as to share the cost of people living longer with employees.

Notes to the financial statements *(continued)*

18 Retirement benefit obligations *(continued)*

Principal actuarial assumptions
The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the long-term nature of the obligation covered, may not necessarily occur in practice.

	2015	2014	2013
Financial assumptions			
Discount rate (%)	**3.9**	3.6	4.5
Inflation (%)	**3.2**	3.2	3.4
Rate of increase in salaries (%)	**3.2**	3.2	3.4
Rate of increase in pensions in payment (%)	**1.8 - 3.6**	1.8 – 3.6	1.9 – 3.7
Rate of increase in deferred pensions (%)	**2.3/3.2**	2.3/3.2	2.5/3.4
Demographic assumptions			
Life expectancy of a male currently aged 65 (years)	**87 – 89**	87 – 89	87 – 89
Life expectancy of a female currently aged 65 (years)	**89 – 90**	89 – 90	89 – 90
Life expectancy of a male currently aged 45 (years)	**89 – 91**	89 – 91	88 – 90
Life expectancy of a female currently aged 45 (years)	**91 – 92**	91 – 92	91 – 92

Discount rate
Discount rate assumptions are based on third-party AA corporate bond indices and yields that reflect the maturity profile of the expected benefit payments.

Inflation
The inflation assumptions are derived by reference to the difference between the yields on index-linked and fixed-interest long-term government bonds, or advice from the local actuary depending on the available information.

Rate of increase in salaries
The rate of increase in salaries is assumed to be Retail Prices Index (RPI) inflation of 3.2% (2014 RPI inflation of 3.2%), plus a promotional scale.

Rate of increase in pensions in payment
The rate of increase in pensions in payment differs between schemes. Different tranches of the schemes increase at rates based on either RPI or Consumer Prices Index (CPI) inflation, and some are subject to an inflation cap. With the exception of two smaller schemes, the rate of increase in pensions in payment is based on RPI inflation.

Rate of increase in deferred pensions
The rate of increase in deferred pensions is based on CPI inflation of 2.3% (2014 CPI inflation of 2.3%), with the exception of the 2000 Plan, which is based on RPI inflation of 3.2% (2014 RPI inflation of 3.2%). The rate of increase in deferred pensions is subject to inflation caps.

Life expectancy
The BAE Systems group has used the Self-Administered Pension Schemes S2 mortality tables based on year of birth (as published by the Institute of Actuaries) for both pensioner and non-pensioner members in conjunction with the results of an investigation into the actual mortality experience of scheme members. In addition, to allow for future improvements in longevity, the Continuous Mortality Investigation 2013 tables (published by the Institute of Actuaries) have been used, with an assumed long-term rate of future annual mortality improvements of 1.25% (2014 1.25%), for both pensioner and non-pensioner members.

Notes to the financial statements *(continued)*

18 Retirement benefit obligations *(continued)*

The disclosures below relate to the post-retirement benefit schemes listed on page 30 which are accounted for as defined benefit schemes in accordance with IAS 19. The valuations used for the IAS 19 disclosures are based on the most recent actuarial valuation undertaken by independent qualified actuaries as updated to take account of the requirements of IAS 19 to assess the deficits of the schemes at 31 December each year.

Summary of movements in retirement benefit obligations

	£m
Total IAS 19 deficit at 1 January 2015 (before allocation to other participating employers)	(5,999)
Change in scheme membership[1]	(66)
Actual return on assets excluding amounts included in interest expense	(338)
Decrease in liabilities due to changes in assumptions and experience	1,578
Recurring contributions in excess of service cost	220
Past service cost – plan amendments	(10)
Net interest expense	(206)
Total IAS 19 deficit at 31 December 2015 (before allocation to other participating employers)	**(4,821)**
Allocated to other participating employers	2,669
Company's share of IAS 19 deficit at 31 December 2015	**(2,152)**

[1] The Company discloses the total pension deficit for all defined benefit schemes of which its employees are members. During 2015, there were employee transfers into the Company from other companies in the BAE Systems group. These employees are members of schemes of which the Company had no members prior to 2015. The Company's share of the deficit related to these new employees recognised on the Company's balance sheet is insignificant.

Amounts recognised on the balance sheet

The bid values of scheme assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present values of scheme liabilities, which are derived from cash flow projections over long periods and therefore inherently uncertain, as at 31 December are shown in the following tables.

	2015 £m	2014 £m
Present value of obligations	**(25,019)**	(25,912)
Fair value of scheme assets	**20,198**	19,913
Total IAS 19 (deficit), net	**(4,821)**	(5,999)
Allocated to other participating employers	**2,669**	3,607
Company's share of IAS 19 (deficit), net	**(2,152)**	(2,392)
Represented by:		
Retirement benefit surpluses	**25**	19
Retirement benefit obligations	**(2,177)**	(2,411)
	(2,152)	(2,392)

Notes to the financial statements *(continued)*

18 Retirement benefit obligations *(continued)*

Changes in the fair value of scheme assets before allocation to other participating employers

	£m
Value of scheme assets at 1 January 2014	18,111
Interest income	811
Actual return on assets excluding amounts included in interest income	1,212
Actual return on assets	2,023
Contributions by employer	541
Contributions by employer in respect of employee salary sacrifice arrangements	104
Total contributions by employer	645
Members' contributions	12
Administrative expenses	(30)
Benefits paid	(848)
Value of scheme assets at 31 December 2014	19,913
Change in scheme membership	250
Interest income	720
Actual return on assets excluding amounts included in interest income	(338)
Actual return on assets	382
Contributions by employer	459
Contributions by employer in respect of employee salary sacrifice arrangements	103
Total contributions by employer	562
Members' contributions	11
Benefits paid	(920)
Value of scheme assets at 31 December 2015	**20,198**

Assets of defined benefit pension schemes before allocation to other participating employers

	2015			2014		
	Quoted £m	**Unquoted £m**	**Total £m**	Quoted £m	Unquoted £m	Total £m
Equities:						
UK	**4,131**	**-**	**4,131**	4,119	-	4,119
Overseas	**2,881**	**-**	**2,881**	2,887	-	2,887
Pooled investment vehicles[1]	**3,254**	**-**	**3,254**	2,415	270	2,685
Fixed interest securities:						
UK gilts	**2,102**	**-**	**2,102**	2,332	-	2,332
UK corporates	**2,770**	**-**	**2,770**	2,464	-	2,464
Overseas corporates	**389**	**-**	**389**	377	-	377
Index-linked securities:						
UK gilts	**1,754**	**-**	**1,754**	2,166	-	2,166
UK corporates	**1,676**	**-**	**1,676**	1,508	-	1,508
Property	**1,279**	**153**	**1,432**	1,176	151	1,327
Derivatives	**-**	**(678)**	**(678)**	-	(509)	(509)
Cash:						
Sterling	**253**	**-**	**253**	275	-	275
Foreign currency	**55**	**-**	**55**	157	-	157
Other	**-**	**179**	**179**	-	125	125
Total	**20,544**	**(346)**	**20,198**	19,876	37	19,913

1. Primarily comprises equities.

Notes to the financial statements *(continued)*

18 Retirement benefit obligations *(continued)*

Changes in the present value of the defined benefit obligations before allocation to other participating employers

	£m
Defined benefit obligations at 1 January 2014	(22,312)
Current service cost	(193)
Contributions by employer in respect of employee salary sacrifice arrangements	(104)
Total current service cost	(297)
Members' contributions	(12)
Past service cost – plan amendments	(3)
Actuarial loss due to changes in assumptions and experience	(3,151)
Interest expense	(985)
Benefits paid	848
Defined benefit obligations at 31 December 2014	(25,912)
Change in scheme membership	(316)
Current service cost	(239)
Contributions by employer in respect of employee salary sacrifice arrangements	(103)
Total current service cost	(342)
Members' contributions	(11)
Past service cost – plan amendments	(10)
Actuarial gain due to changes in assumptions and experience	1,578
Interest expense	(926)
Benefits paid	920
Defined benefit obligations at 31 December 2015	**(25,019)**

Amounts recognised in the income statement after allocation to other participating employers

	2015 £m	2014 £m
Included in operating costs:		
Current service cost	**(140)**	(120)
Past service cost – plan amendments	**(9)**	(2)
	(149)	(122)
Administrative expenses	**(10)**	(11)
	(159)	(133)
Included in finance costs:		
Net interest expense on retirement benefit obligations	**(90)**	(72)

Notes to the financial statements *(continued)*

18 Retirement benefit obligations *(continued)*

Sensitivity analysis
The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 31 December 2015 and keeping all other assumptions as set out on page 32.

Financial assumptions
Changes in the following financial assumptions would have the following effect on the defined benefit pension obligation before allocation to other participating employers:

	(Increase)/ decrease £bn
Discount rate:	
0.1 percentage point increase	0.4
0.1 percentage point decrease	(0.4)
Inflation:	
0.1 percentage point increase	(0.4)
0.1 percentage point decrease	0.4

The sensitivity of the valuation of the liabilities to changes in the inflation assumption presented above assumes that a 0.1 percentage point change to expectations of future inflation results in a 0.1 percentage point change to all inflation-related assumptions used to value the liabilities. However, upper and lower limits exist on the majority of inflation-related benefits such that a change in expectations of future inflation may not have the same impact on the inflation-related benefits, and hence will result in a smaller change to the valuation of the liabilities. Accordingly, extrapolation of the above results beyond the specific sensitivity figures shown may not be appropriate. To illustrate this, the (increase)/decrease in the defined benefit pension obligation before allocation to other participating employers resulting from larger changes in the inflation assumption would be as follows:

	(Increase)/ decrease £bn
Inflation:	
0.5 percentage point increase	(1.6)
0.5 percentage point decrease	1.5
1.0 percentage point increase	(3.2)
1.0 percentage point decrease	3.0

Demographic assumptions
Changes in the life expectancy assumption, would have the following effect on the total IAS 19 deficit before allocation to other participating employers:

	(Increase)/ decrease £bn
Life expectancy:	
One-year increase	(0.7)
One-year decrease	0.8

Notes to the financial statements *(continued)*

19 Provisions

	Warranties and after-sales service £m	Reorganisations £m	Legal, contractual and environmental £m	Other £m	Total £m
Non-current	10	-	11	-	21
Current	3	48	20	19	90
At 1 January 2015	13	48	31	19	111
Created	7	28	20	4	59
Acquisitions	-	-	-	1	1
Released	(1)	(14)	(4)	(8)	(27)
Utilised	(4)	(33)	(13)	(2)	(52)
At 31 December 2015	**15**	**29**	**34**	**14**	**92**
Represented by:					
Non-current	11	-	12	-	23
Current	4	29	22	14	69
	15	**29**	**34**	**14**	**92**

Warranties and after-sales service

Warranty and after-sales service costs are generally incurred within three years post-delivery. Whilst actual events could result in potentially significant differences to the quantum, but not the timing, of the outflows in relation to the provisions, management has reflected current knowledge in assessing the provision levels.

Reorganisations

Reorganisation costs are generally incurred within one to three years. There is limited volatility around the timing of the ultimate outflows related to these provisions.

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.

Other
There are no individually significant provisions within other provisions.

Notes to the financial statements *(continued)*

20 Share capital and other reserves

Share capital

	£1 'A' Ordinary shares '000	£1 'B' Ordinary shares '000	Nominal value £m
Issued and fully paid			
At 1 January and 31 December 2015	**1,007,340**	**180**	**1,008**

The 'A' and 'B' Ordinary shares rank pari passu in all respects.

Equity dividends

	2015 £m	2014 £m
Final dividend for 'A' and 'B' ordinary shares paid in respect of the previous year	-	801
Interim dividend for 'A' and 'B' ordinary shares paid	-	247
	-	1,048

The directors do not propose a final dividend for 2015.

Other reserves

	Revaluation reserve £m	Hedging reserve £m	Foreign translation reserve £m	Total £m
At 1 January 2014 (as previously reported)	24	-	-	24
Effect of transition to FRS 101	(24)	6	-	(18)
At 1 January 2014 (restated)	-	**6**	-	**6**
Amounts charged to hedging reserve	-	(102)	-	(102)
Currency translation on foreign currency branches	-	-	(1)	(1)
Tax on other comprehensive income	-	20	-	20
At 31 December 2014 (restated)	-	**(76)**	**(1)**	**(77)**
Amounts charged to hedging reserve	-	(1)	-	(1)
Currency translation on foreign currency branches	-	-	(1)	(1)
Tax on other comprehensive income	-	(1)	-	(1)
At 31 December 2015	-	**(78)**	**(2)**	**(80)**

Hedging reserve
The hedging reserve comprises 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.

Translation reserve
The translation reserve comprises all foreign currency differences arising from the translation of the results of foreign operations.

Notes to the financial statements *(continued)*

21 Acquisitions

On 31 December 2015, the Company acquired the trade and net liabilities of the defence information business from BAE Systems Integrated System Technologies Limited. The consideration was equal to the carrying amount of the net liabilities of the business, therefore no goodwill has been recognised as a result of this acquisition. The Company has not applied IFRS 3, Business Combinations to this transaction as this standard does not apply to combinations of businesses under common control.

	2015
	£m
Property, plant and equipment	1
Trade and other receivables	87
Retirement benefit obligations, net	(93)
Trade and other payables	(20)
Provisions	(1)
Net liabilities acquired	**(26)**

22 Related party transactions

The Company has a related party relationship with BAE Systems group subsidiaries not wholly-owned and BAE Systems group joint ventures. Transactions occur with related parties in the normal course of business, are priced on an arm's-length basis and settled on normal trade terms. The significant transactions are disclosed below:

	Amounts owed to related party		Amounts owed by related party		Sales to related party		Purchases from related party	
	2015	2014	**2015**	2014	**2015**	2014	**2015**	2014
Related party	**£m**	£m	**£m**	£m	**£m**	£m	**£m**	£m
Advanced Electronics Company Limited	-	-	-	-	-	-	**46**	56
International Systems Engineering Company Limited	**2**	2	-	-	-	-	**15**	13
Saudi Development Training Limited (SDT)	**6**	2	-	-	-	-	**11**	14
Saudi Maintenance & Supply Chain Management Company Limited	**49**	32	-	-	-	-	**259**	202
Non wholly-owned group subsidiaries	**57**	36	-	-	-	-	**331**	285
Eurofighter Jagdflugzeug GmbH	**41**	40	**37**	64	**1,417**	1,087	-	11
Gripen International KB	-	-	**19**	15	-	-	-	-
MBDA SAS	-	1	-	-	**2**	3	**286**	90
Panavia Aircraft GmbH	-	-	**2**	5	**53**	34	**47**	44
Group joint ventures	**41**	41	**58**	84	**1,472**	1,124	**333**	145
	98	77	**58**	84	**1,472**	1,124	**664**	430

Notes to the financial statements *(continued)*

23 Share-based payments

Options over shares of the ultimate parent undertaking, BAE Systems plc, have been granted to employees of the Company under various plans. Details of the terms and conditions of each share-based payment plan are given in the Annual Remuneration Report of the BAE Systems plc Annual Report.

For options outstanding at the end of the year:

	2015		2014	
	Range of exercise price of outstanding options (£)	**Weighted average remaining contracted life (years)**	Range of exercise price of outstanding options (£)	Weighted average remaining contracted life (years)
Executive Share Option Plan (ExSOP)	**3.01 – 5.43**	**8**	2.64 - 4.57	7
Restricted Share Plan (RSP)	**-**	**5**	4.12	5
Performance Share Plan (PSP)	**-**	**5**	-	1
Share Matching Plan (SMP)	**-**	**-**	2.82	5

The average share price in the year was £4.87 (2014 £4.33)

24 Contingent liabilities and commitments

The Company has entered into a number of guarantee and performance bond arrangements in the normal course of business and regards these as insurance contracts. Provision is made for any amounts that the directors consider may become payable under such arrangements.

Operating lease commitments
The Company leases various offices and factories under non-cancellable operating lease agreements. The leases have varying terms and none of these terms represent unusual arrangements or create material onerous or beneficial rights or obligations.

The future aggregate minimum lease payments under non-cancellable operating leases and associated future minimum sublease income are as follows:

	2015 £m	2014 £m
Payments due:		
Not later than one year	**23**	18
Later than one year and not later than five years	**76**	66
Later than five years	**238**	213
	337	297
Total of future minimum sublease income under non-cancellable subleases	**48**	51

Capital commitments
Capital expenditure contracted for but not provided for in full in the financial statements is £81m (2014 £79m).

Notes to the financial statements *(continued)*

25 Explanation of transition to FRS 101

As stated in note 1, these are the Company's first financial statements prepared in accordance with FRS 101.

The accounting policies set out in note 1 have been applied in preparing the financial statements for the year ended 31 December 2015, the comparative information for the year ended 31 December 2014 and the opening FRS 101 balance sheet at 1 January 2014 (the Company's date of transition).

In preparing its FRS 101 balance sheets, the Company has adjusted amounts reported in financial statements prepared in accordance with its previous basis of accounting. An explanation of how the transition to FRS 101 has affected the Company's financial performance and position is set out in the following tables.

Impact of transition to FRS 101 on the Company income statement

	Year ended 31 December 2014					
	As previously reported	Pension schemes adjustment[1]	Financial instruments adjustment[2]	Revaluation reserve adjustment[3]	Other transition adjustments	FRS 101
	£m	£m	£m	£m	£m	£m
Revenue	**5,571**	-	-	-	-	**5,571**
Operating costs	**(5,153)**	117	-	1	4	**(5,031)**
Other income	**32**	-	-	-	-	**32**
Operating profit	**450**	117	-	1	4	**572**
Income from subsidiary undertakings and participating interests	**3**	-	-	-	-	**3**
Profit before finance costs and taxation	**453**	117	-	1	4	**575**
Financial (expense)/income	**(16)**	(72)	-	-	1	**(87)**
Profit before taxation	**437**	45	-	1	5	**488**
Taxation expense	**39**	(9)	-	-	1	**31**
Profit for the year	**476**	36	-	1	6	**519**

Impact of transition to FRS 101 on the Company statement of comprehensive income

	Year ended 31 December 2014					
	As previously reported	Pension schemes adjustment[1]	Financial instruments adjustment[2]	Revaluation reserve adjustment[3]	Other transition adjustments	FRS 101
	£m	£m	£m	£m	£m	£m
Profit for the year	**476**	36	-	1	6	**519**
Other comprehensive income						
Items that will not be reclassified to the income statement:						
Remeasurements on retirement benefit schemes	-	(839)	-	-	-	**(839)**
Tax on items that will not be reclassified to the profit and loss account	-	158	-	-	-	**158**
Items that may be reclassified to the income statement:						
Currency translation on foreign currency branches	-	-	-	-	(1)	**(1)**
Amounts charged to hedging reserve	-	-	(102)	-	-	**(102)**
Tax on items that may be reclassified to the income statement	-	-	20	-	-	**20**
Total other comprehensive income for the year (net of tax)	-	(681)	(82)	-	(1)	**(764)**
Total comprehensive income for the year	**476**	(645)	(82)	1	5	**(245)**

Notes to the financial statements *(continued)*

25 Explanation of transition to FRS 101 *(continued)*

Impact of transition to FRS 101 on the Company balance sheet

	1 January 2014 (the Company's date of transition)					
	As previously reported £m	Pension schemes adjustment[1] £m	Financial instruments adjustment[2] £m	Revaluation reserve adjustment[3] £m	Other transition adjustments £m	FRS 101 £m
Non-current assets						
Intangible assets	**36**	-	-	-	8	**44**
Property, Plant and equipment	**292**	-	-	(3)	(43)	**246**
Investment property	-	-	-	(22)	35	**13**
Other investments	**4**	-	-	-	-	**4**
Other receivables	**17**	-	-	-	-	**17**
Retirement benefit surpluses	-	14	-	-	-	**14**
Other financial assets	-	-	36	-	-	**36**
Deferred tax assets	**25**	303	(2)	-	(2)	**324**
	374	317	34	(25)	(2)	**698**
Current assets						
Inventories	**391**	-	-	-	(305)	**86**
Trade and other receivables	**5,642**	-	-	-	277	**5,919**
Current tax	-	-	-	-	28	**28**
Other financial assets	-	-	56	-	-	**56**
Cash and cash equivalents	**44**	-	-	-	-	**44**
	6,077	-	56	-	-	**6,133**
Total assets	**6,451**	317	90	(25)	(2)	**6,831**
Non-current liabilities						
Other payables	**(151)**	-	-	-	(15)	**(166)**
Retirement benefit obligations	-	(1,612)	-	-	-	**(1,612)**
Other financial liabilities	-	-	(34)	-	-	**(34)**
Provisions	**(46)**	-	-	-	15	**(31)**
	(197)	(1,612)	(34)	-	-	**(1,843)**
Current liabilities						
Trade and other payables	**(3,801)**	-	-	-	(9)	**(3,810)**
Other financial liabilities	-	-	(50)	-	-	**(50)**
Current tax	**(408)**	-	-	-	-	**(408)**
Provisions	**(47)**	-	-	-	9	**(38)**
	(4,256)	-	(50)	-	-	**(4,306)**
Total liabilities	**(4,453)**	(1,612)	(84)	-	-	**(6,149)**
Net assets	**1,998**	(1,295)	6	(25)	(2)	**682**
Capital and reserves						
Issued share capital	**1,008**	-	-	-	-	**1,008**
Share premium	**25**	-	-	-	-	**25**
Other reserves	**24**	-	6	(24)	-	**6**
Retained earnings – surplus/(deficit)	**941**	(1,295)	-	(1)	(2)	**(357)**
Total equity	**1,998**	(1,295)	6	(25)	(2)	**682**

Notes to the financial statements *(continued)*

25 Explanation of transition to FRS 101 *(continued)*

	31 December 2014					
	As previously reported	Pension schemes adjustment[1]	Financial instruments adjustment[2]	Revaluation reserve adjustment[3]	Other transition adjustments	FRS 101
	£m	£m	£m	£m	£m	£m
Non-current assets						
Intangible assets	**34**	-	-	-	17	**51**
Property, Plant and equipment	**349**	-	-	(2)	(48)	**299**
Investment property	-	-	-	(22)	35	**13**
Other investments	**4**	-	-	-	-	**4**
Other receivables	**5**	-	-	-	-	**5**
Retirement benefit surpluses	-	19	-	-	-	**19**
Other financial assets	-	-	16	-	-	**16**
Deferred tax assets	**26**	452	18	-	(1)	**495**
	418	471	34	(24)	3	**902**
Current assets						
Inventories	**542**	-	-	-	(478)	**64**
Trade and other receivables	**5,730**	-	-	-	450	**6,180**
Current tax	-	-	-	-	28	**28**
Other financial assets	-	-	24	-	-	**24**
Cash and cash equivalents	**40**	-	-	-	-	**40**
	6,312	-	24	-	-	**6,336**
Total assets	**6,730**	471	58	(24)	3	**7,238**
Non-current liabilities						
Other payables	**(155)**	-	-	-	(14)	**(169)**
Retirement benefit obligations	-	(2,411)	-	-	-	**(2,411)**
Other financial liabilities	-	-	(63)	-	-	**(63)**
Provisions	**(35)**	-	-	-	14	**(21)**
	(190)	(2,411)	(63)	-	-	**(2,664)**
Current liabilities						
Trade and other payables	**(4,788)**	-	-	-	(7)	**(4,795)**
Other financial liabilities	-	-	(71)	-	-	**(71)**
Current tax	**(227)**	-	-	-	-	**(227)**
Provisions	**(97)**	-	-	-	7	**(90)**
	(5,112)	-	(71)	-	-	**(5,183)**
Total liabilities	**(5,302)**	(2,411)	(134)	-	-	**(7,847)**
Net assets/ (liabilities)	**1,428**	(1,940)	(76)	(24)	3	**(609)**
Capital and reserves						
Issued share capital	**1,008**	-	-	-	-	**1,008**
Share premium	**25**	-	-	-	-	**25**
Other reserves	**23**	-	(76)	(23)	(1)	**(77)**
Retained earnings – surplus/(deficit)	**372**	(1,940)	-	(1)	4	**(1,565)**
Total equity	**1,428**	(1,940)	(76)	(24)	3	**(609)**

Notes to the financial statements *(continued)*

25 Explanation of transition to FRS 101 *(continued)*

[1] It had been the Company's policy to account for the UK defined benefit pension schemes in which it participates as defined contribution schemes as permitted by FRS 17, Retirement Benefits. Upon transition to FRS 101, the Company has been allocated a share of the assets and liabilities of the group's UK defined benefit pension schemes in which the Company's employees participate, using an allocation method intended to reflect a reasonable approximation of its share of the deficit.

[2] If a trading transaction was covered by a forward foreign exchange contract, it had been the Company's policy to translate the transaction at the exchange rate implied in the contract. Upon transition to FRS 101, the Company translates monetary items at the closing balance sheet rate and accounts for the forward foreign exchange contracts as derivatives at fair value.

[3] It had been the Company's policy to revalue its land and buildings until FRS 15, Tangible Fixed Assets, was adopted in 2000. At that point, the Company elected that no further revaluation of land and buildings would be undertaken. The Company will not be adopting the exemption under the transition rules of IFRS 1 that allows the previous GAAP valuation to be used as the deemed cost on transition to FRS 101. Accordingly, the Company has reversed the previously recognised revaluations and has reverted to the historical cost for land and buildings.

26 Controlling parties

The Company is a subsidiary undertaking of BAE Systems Enterprises Limited. The ultimate parent company is BAE Systems plc, a company incorporated in Great Britain and registered in England and Wales.

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

6 Carlton Gardens,
London,
SW1Y 5AD

Website: www.baesystems.com