BAE Systems Applied Intelligence Limited

Annual Report and Financial Statements

31 December 2022

Registered number: 01337451

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Strategic Report
for the year ended 31 December 2022

Review of business and principal activities

BAE Systems Applied Intelligence Limited (the "Company") is a member of the BAE Systems plc Group ("BAE Systems Group" or "Group") of companies, iits principal activities are the provision of data intelligence solutions which enable their customers, principally governments and government bodies, to defend against national scale threats, protect their networks and data against sophisticated attacks and operate successfully in cyber space.

The business performed strongly in 2022 delivering revenue growth and increasing profitability. We have continued to see strong levels of demand for our products and services, as our core customers continue to invest in building cyber, data, digital and analytical capabilities.

During the year the company sold the trade and assets in its financial crime detection business.

Key performance indicators

Key financial performance indicators are shown below:

	2022	2021
	£000	£000
Revenue	**458,348**	420,487
Operating profit	**41,834**	26,349

Revenue represents the amounts derived from the provision of goods and services. Revenue in the core business grew in the year and the financials also benefit from the final recognition of a licence contract sold some years ago. This offset the impact of the sale of the financial crime detection business during the year.

Operating profit is used for internal performance analysis as a measure of operating profitability that is comparable over time. Operating profit has risen as a result of the revenue growth, sale of SOCOS investment (detailed in note 5) and disposal of the financial crime detection business referred to above.

Strategic Report (continued)
for the year ended 31 December 2022

Principal risks and uncertainties

The Company's principal risks are identified below, along with their potential impact on the Company and how these are currently being managed:

The Company's largest customers are governments. The Company is dependent on government defence spending, and the timing and terms of trade of government contracts

Defence spending

Description: The Company's core businesses are primarily defence related, selling products and services directly and indirectly, mainly to the UK government. Defence spending by governments can fluctuate depending on change of government policy, other political considerations, budgetary constraints, specific threats and movements in the international oil price.

Impact: Lower defence spending by the Company's major customers could have a material adverse effect on the Company's future results and financial condition.

Mitigation: The directors believe that the diversified markets covered by the business and, in particular, the Company's focus on the counter threat agenda and intellectual property led solutions to provide clients with greater value for money, provide some mitigation against this risk. In addition, the Company maintains flexibility in its employee base, enabling it to move resources to those areas where demand is greatest.

Government contracting

Description: The Company has long-standing relationships and security arrangements with the UK government and its agencies. It is important that these relationships and arrangements are maintained. In the defence and security industries, governments can typically modify contracts for their convenience or terminate them at short notice. Governments also from time to time review their terms of trade and underlying policies and seek to impose such new terms and policies when entering into new contracts.

Impact: Lower defence spending by the Company's major customers could have a material adverse effect on the Company's future results and financial condition.

Mitigation: Government customers have sophisticated procurement and security organisations with which the Company can have long-standing relationships with well-established and understood terms of business. In the event of a customer terminating a contract for convenience, the Company would typically be paid for work done and commitments made at the time of termination.

Delivery risk and supply chain

Contract risk and execution

Description: 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.

Impact: The inability of the Company to deliver on its contractual commitments, the loss, expiration, suspension, cancellation or termination of any of its large contracts or its failure to anticipate technical problems or estimate accurately and control costs could have a material adverse effect on the Company's future results and financial condition.

Mitigation: The Company has, over many years, built a track record of very strong project management and technical delivery of the most complex and business critical programmes. Any failure to meet customer expectations and/or its contractual obligations could damage the Company's reputation in the marketplace. The Company manages this risk through rigorous bid approval controls, peer review of technical solutions and project plans and regular monitoring of high risk projects by project boards.

Strategic Report (continued)
for the year ended 31 December 2022

Supply chain
Description: The Company is dependent upon the delivery of materials by suppliers and the assembly of components and subsystems by subcontractors used in its products in a timely and satisfactory manner, on satisfactory commercial terms and in full compliance with applicable terms and conditions. The external supply chain environment is very dynamic at this time, with both lead-time and availability issues, but also pricing pressures, including from inflationary increases in labour, energy and other key materials.

Impact: Some of the Company's suppliers or subcontractors may be impacted by the economic environment (including inflationary pressures) which could impair their ability to meet their obligations to the Company and to supply on satisfactory commercial terms. In some instances, the Company is dependent on one or a limited number of suppliers. If any of these suppliers or subcontractors fail to meet the Company's needs, the Company may not, in the short term, have readily available alternatives, thereby impacting its ability to complete its customer obligations satisfactorily and in a timely manner. The above events could have a negative impact on the Company's future results of operations and financial condition.

Mitigation: The Company seeks to manage the inflation risk through its contracting arrangements on many of its major programmes, effective cost management and improved efficiency of the Company's own operations and through its long-term supplier agreements.

The Company could be negatively impacted by threats to the security of its information technology and operational technology systems
Description: Much of the Company's work relies on its reputation for strong security, in particular the services it provides for the national security community, which are subject to particularly stringent security requirements. Security breaches could materially damage the Company's business. Security matters are therefore carefully managed and are overseen at Board level, which ensures that the business systematically embeds rigorous security practice in its every day operations. The Company is investing to ensure its own security keeps pace with the evolving threat environment. The cyber security threats faced by the Company include: the potential for business disruptions due to an attack impacting the availability of its information technology and operational technology infrastructure and systems; unlawful attempts to gain access to both the Company's proprietary or classified information and that of its customers, partners and suppliers; and the potential for business disruptions and loss or compromise of classified, proprietary or personal information through an attack on the Company's supply chain.

Impact: Failure to combat these risks effectively could disrupt business operations, compromise the security of the Company's products and services, erode the Company's competitive advantage, harm staff and negatively impact the Company's reputation among its customers and the public, resulting in a negative impact on the Company's future results and financial condition.

Mitigation: It is critical that the Company's networks, as well as the products and services that it sells, are cyber resilient and the intellectual property and confidential information held and processed on them is appropriately secured.

The cyber risk is constantly reviewed through the Group's IT and Security functions and an agile, proactive approach to mitigating the risk is taken. The Group does this by efficiently leveraging its core internal capabilities in cyber security, including its specialist threat intelligence service, to maintain a managed risk position as we digitally transform and the threat landscape evolves.

The Company's strategy is dependent on its ability to recruit and retain people with appropriate talent and skills
Description: The current recruitment market sees a strong demand for the best people. This has been particularly the case for people with advanced technical skills and those with UK government clearances.

Strategic Report (continued)
for the year ended 31 December 2022

Impact: The loss of key employees or inability to attract the appropriate people on a timely basis could adversely impact the Company's ability to deliver its strategy, meet the business plan and, accordingly, have a negative impact on the Company's future results and financial condition

Mitigation: The Company recognises that its employees are key to delivering its strategy and business plan. The Company focuses on developing the existing workforce and hiring talented people to meet current and future requirements, addressing the risk of a competitive recruitment market through a portfolio of measures, including a strengthened HR recruitment team, attractive staff reward schemes such as flexible benefits, and through new career development programmes.

In order to seek to maximise its talent pool, the Company is committed to creating a diverse and inclusive environment for its employees.

Section 172(1) statement

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

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

Decision making
The BAE Systems Group Operational Framework sets out the principles of good governance to which BAE Systems Group subsidiaries are required to adhere (see page 9), together with BAE Systems Group's values, policies and processes. Decisions affecting a subsidiary are required to be taken in line with the Operational Framework, including in accordance with applicable delegations of authority.

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

Employees
Employee engagement is a primary focus for the directors of the Company – connecting employees to the Company's and the BAE Systems Group's strategy and purpose, empowering them to contribute to improving business performance and creating an environment in which everyone can fulfil their potential.

The Company used a range of channels to engage with employees throughout the year, as well as keeping employees informed about the performance, developments and prospects of the business and the BAE Systems Group. This included in-person and virtual meetings, engagement through the Group intranet, employee app, email, videos, podcasts, newsletters, leadership communications, virtual discussions, and briefings, and through our line managers who play a key role in keeping their teams connected and engaged. The Company recognises the importance of two-way communications, ensuring there are channels through which employees can express their views, feedback and any concerns, helping the Company understand employee sentiment on an ongoing basis and respond appropriately.

Strategic Report (continued)
for the year ended 31 December 2022

The Company operates incentive schemes which entitle all employees to a financial benefit against the achievement of a set of business objectives. This ensures that all employees feel connected with, and are invested in, the Company's achievements.

These engagement activities form part of the Company's implementation of the BAE Systems Group-wide employee engagement processes and policies which are described on pages 32, 35 and 72 of BAE Systems plc's Annual Report 2022 (the "Group Annual Report") (available at: www.baesystems.com/investors).

Pursuant to the Group's People Policy, directors and employees are required to contribute to creating an engaged and inclusive working environment, where individuals are respected and where the value of a diverse workforce is recognised. Also, pursuant to the Policy, employees are to be provided with the means to give their views and feedback.

Through the implementation by the Company of these processes and policies, the directors have regard to the interests of the Company's employees.

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

Our largest customers are government and government bodies. Strong and collaborative relationships with our principal customers help us to identify their requirements and to position the Company as a trusted provider. The directors and their delegates are in regular contact with the principal customers of the Company.

The Company, together with its procurement and supply chain function, works with its suppliers to provide goods and services that meet its customers' requirements. The Company's supplier relationships are often long-term and the directors and their teams meet with key suppliers and work with the BAE Systems Group's procurement function to ensure broader engagement with the supply chain and develop strategic relationships with key suppliers.

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

Strategic Report (continued)
for the year ended 31 December 2022

We recognise that our operations have an impact on the environment – from the energy and resources we use, to the products and services we supply and the waste that we generate. As an organisation, the BAE Systems Group is committed to reducing the environmental impact of our operations and products, minimising our environmental footprint and, in turn, decreasing our operational costs. Through the Operational Framework the Company implements the requirements of the BAE Systems Group's Environmental Policy, which details our commitment to high standards of environmental management. In particular, the Company is supporting the Group's target of achieving net zero greenhouse gas emissions across the Group's operations (scope 1 and 2) by 2030 and its target of working towards a net zero value chain by 2050.

All the above activities form part of the Company's implementation of the BAE Systems Group-wide community and environment processes and policies and the BAE Systems Group's impacts thereon which are described on pages 40-53 and 64-67 of the Group Annual Report (available at: www.baesystems.com/investors).

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

Detailed information on the BAE Systems Group-wide business conduct processes and policies are described in the Group Annual Report (available at: www.baesystems.com/investors) on pages 75-77.

Approved by the Board and signed on its behalf by:

D J Lawton
Director

Date: 29 June 2023

Directors' Report

Company registration

BAE Systems Applied Intelligence Limited is a private company, limited by shares and registered in England and Wales with the registered number 01337451.

Results and dividends

The Company's profit for the financial year is £34,848k (2021: £22,635k profit). The directors propose a dividend of £34,848k (2021: £nil).

The dividend proposed per share is £278.68 (2021: £nil).

Looking forward

The services and products we offer in our Government businesses ensure that we are well placed to deliver growth as UK cyber, data and digital budgets increase and cyber security and information advantage continue to be an important part of a nation's security and economic prosperity.

During 2023 the Company continues to work within the BAE Systems Digital Intelligence group of companies, which brings together many of the Group's world-leading digital transformation, cyber security, complex data analysis and communication and information capabilities from across the BAE Systems Group.

Going concern

After making due enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue operational existence for at least 12 months from the date of approval of the financial statements. The Company has net assets of £159,821k , made a profit of £34,848k and order intake continues to be positive. For this reason they continue to adopt the going concern basis in preparing the financial statements.

Energy and carbon reporting exemption

The Company has taken advantage of the exemption granted under The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 as this information is disclosed on pages 47--53 in the 2022 consolidated accounts of its ultimate parent, BAE Systems plc (available at www.baesystems.com/investors).

Employees

The Company is committed to giving full and fair consideration to applications for employment from disabled people who meet the requirements for roles, and making available training opportunities and appropriate accommodation to disabled people employed by the Company. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the Company continues and that appropriate training is arranged.

Employee engagement enables our employees to contribute to improving business performance and helps us to gauge our performance in creating an environment in which everyone can fulfil their potential. Engagement with employees has been considered within the Strategic Report on page 5.

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

Directors' Report (continued)

Research and development

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 £13,300k (2021: £19,110k), of which £13,300k (2021: £19,110k) was funded by the Company.

Financial instruments

The international 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.

Qualifying indemnity provisions

The directors of BAE Systems Pension Funds Trustees Limited, BAE Systems 2000 Pension Plan Trustees Limited and Alvis Pension Scheme Trustees Limited benefit from indemnities in the governing documentation of the BAE Systems Pension Scheme, the BAE Systems 2000 Pension Plan and the Alvis Pension Scheme, respectively, given by the Company, which are qualifying indemnity provisions for the purpose of the Companies Act 2006. All such indemnity provisions are in force at the date of this Directors' Report.

Engagement with suppliers, customers and others

Engagement with suppliers, customers and others has been considered within the Strategic Report on page 5.

Directors' Report (continued)

Corporate governance statement

BAE Systems plc, the ultimate parent company of the Company, adheres to the UK Corporate Governance Code. The UK Corporate Governance Code's principles are embedded in the BAE Systems Group Operational Framework, which sets out the principles of good governance and encapsulates the BAE Systems Group's values, policies and processes. Each company in the BAE Systems Group is required to adhere to the Operational Framework, which enables the Group to deliver operational excellence in a clear, accountable and consistent way.

The policies and processes in the Operational Framework are enacted at a local level by each of the businesses in the BAE Systems Group. The Operational Framework is underpinned by an Operational Assurance Statement which is a six-monthly process used to monitor compliance with the Operational Framework and policies.

Accordingly, the Company has not applied any separate corporate governance code for the financial year as it believes the corporate arrangements described in this statement are appropriate for the Company.

Set out below is a summary of how principles of good corporate governance, as set out in the Operational Framework, apply to the Company:

Purpose, strategy, values and culture
The BAE Systems Group has a strategic framework that sets out the Group's vision, mission and strategy and sets out three strategic priorities which are embedded throughout each business in the Group. This provides the link between the Group's long-term strategy and the near-term business objectives for all employees in the Company. The Company produces a strategic plan, a financial forecast for the current year and financial projections for the next five years, aligning resources with the delivery of forecast financial performance and the BAE Systems Group's strategic objectives. In so doing the directors have regard to a variety of matters including the interests of various stakeholders, the consequences of their decisions in the long term and the long-term reputation of the Company and its businesses.

The BAE Systems Group's strategy is supported by the Group's values of trusted, innovative and bold. The Group has a Code of Conduct which lays out the standards that are expected of each employee in the Company, to support the employees in doing the right thing. All employees in the Company receive annual training designed to stimulate conversations about ethical decision making.

Board and directors' accountability
The directors of the Company consist of the managing director and finance director of the main business of the Company. The managing director is responsible for ensuring local policies, processes and charters are in place in the businesses of the Company to implement the requirements of the Operational Framework and for ensuring those requirements are met.

Those requirements ensure that internal controls are in place and documented that are designed to provide effective and measurable management of operational risk and performance, in line with BAE Systems Group requirements. These controls provide assurance regarding:

the reliability and integrity of information;
compliance with policies, processes, laws, regulations and contracts;
the safeguarding of assets and protection against fraud; and
the economical and efficient use of resources.

The requirements also regulate how the BAE Systems Group expects the employees of the businesses of the Company to be managed and the obligations placed on all employees concerning avoiding conflicts of interest, anti-bribery, and managing the security of employees, information and other assets.

As part of a robust system of internal controls, the authority of the managing director of the business of the

Directors' Report (continued)

Company is subject to financial limits and other restrictions, above which matters must be referred upwards and ultimately to the Board of BAE Systems plc.

Risk
Responsibility for identifying, analysing, evaluating and managing principal and emerging risks in the businesses lies with the managing directors of the businesses for which they are responsible. As mentioned the managing director of the main business of the Company is a director of the Company. The Managing Director is also responsible for the reporting and monitoring of key risks in accordance with established processes under the BAE Systems Group's Operational Framework.

The BAE Systems plc's risk management process is set out in the Risk Management Policy, a mandated policy under the Operational Framework, and, in respect of projects, in the Lifecycle Management Framework, a core business process under the Operational Framework. The Lifecycle Management Policy sets out how the Company must plan and manage the execution of projects above a certain minimum level, providing decision gate reviews at key stages from initial opportunity to final closure.

Further guidance is provided by a Risk Management Maturity self-assessment tool. Identified risks are documented in risk registers showing: the risks that have been identified; characteristics of the risk; the basis for determining mitigation strategy; and what reviews and monitoring are necessary. Each risk is allocated an owner who has authority and responsibility for assessing and managing it.

The Board of BAE Systems plc has overall responsibility for determining the nature and extent of the risk the BAE Systems Group is willing to take and ensuring that risks are managed effectively across the Group.

Remuneration
The BAE Systems Group's Performance Leadership framework is a core business process designed to support the development of a diverse and inclusive culture that delivers the Group's strategy. The framework provides a principled approach to performance, assessment, development and reward for employees and is required to be implemented within the businesses of the Company.

The BAE Systems plc Remuneration Committee is responsible for reviewing the BAE Systems Group's workforce remuneration and related policies and the alignment of incentives and rewards with culture, and take these into account when setting the policy for executive remuneration.

Stakeholders
As regards employees, the Operational Framework includes a People Policy, pursuant to which the directors and employees are required to contribute to creating an engaged and inclusive work environment, where individuals are respected and where the value of a diverse workforce is recognised. The policy also requires employees to be provided with the means to give their views and feedback, and for the feedback to be responded to appropriately.

As regards customers, the Operational Framework makes it a priority of each business to understand their customers' evolving needs and expectations, and deliver on their commitments throughout the life of the business's products and services. The Operational Framework requires businesses to measure the delivery of such customer focus through reviews with customers and measurement of schedule adherence.

As regards suppliers, the BAE Systems Group's policy is to identify and select suppliers which meet the Group's standards and to support them by managing risks throughout the lifecycle of any commercial arrangement. The businesses manage risk with their suppliers in accordance with the BAE Systems Group's Procurement Policy, Lifecycle Management Framework and Supplier Principles. The directors of the businesses of the Company are required to oversee compliance with these policies and principles for the businesses for which they are responsible.

The BAE Systems Group's Environmental Policy outlines the Group's commitment to improving standards of environmental management, and compliance with the Policy is directed by environmental teams across the Group.

Pursuant to the BAE Systems Group's Community Investment Policy, the Global Community Investment Strategy aims to build and nurture mutually beneficial relationships between the Group's businesses and local stakeholders, including employee involvement in charitable activities and donations to local, national and international charities.

Directors and their interests

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

D J Lawton	
D I Armstrong	(appointed 31 March 2022)
A G Jordon	(resigned 28 January 2022)
J F C Cracknell	(resigned 31 March 2022)

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.

Post balance sheet events

There have been no significant events affecting the Company since the year end.

Disclosure of information to auditor

The directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each director has taken all the steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

Auditor

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

Directors' Report (continued)

Approved by the Board and signed on its behalf by:

D J Lawton
Director

Date: 29 June 2023

Registered office:
BAE Systems Applied Intelligence Limited
Surrey Research Park
Guildford
Surrey
GU2 7RQ

Directors' Responsibilities Statement

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

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

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

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

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of BAE Systems Applied Intelligence Limited (the "company"):

- give a true and fair view of the state of the company's affairs as at 31st December 2022 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:
- the Income Statement;
- the Statement of Comprehensive Income;
- the Balance Sheet;
- the Statement of Changes in Equity; and
- the related notes 1 to 25.

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

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

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

Conclusions relating to going concern
In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the directors' assessment of the company's ability to continue to adopt the going concern basis of accounting included:

- understanding the cash position of the company and the extent to which the company is reliant on Group support for liquidity purposes;
- considering the nature of the support being provided, whether it represents a firm commitment and if the entity providing the support has the means to do so by assessing approved budgets and forecasts and the assumptions behind them;
- testing the accuracy of management's models, including agreement to the most recent approved budgets and forecasts;
- challenging the key assumptions of these forecasts by assessing analyst reports/industry data and other external information, comparing forecast revenue with the company's order book and historical performance, evaluating the historical accuracy of forecasts prepared by management, and assessing the sensitivity of these forecasts; and
- assessing the sufficiency of the company's disclosure surrounding the going concern basis.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Other information

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

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Responsibilities of directors

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

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

Auditor's responsibilities for the audit of the financial statements

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

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

Extent to which the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

We considered the nature of the company's industry and its control environment, and reviewed the company's documentation of their policies and procedures relating to fraud and compliance with laws and regulations. We also enquired of management about their own identification and assessment of the risks of irregularities.

We obtained an understanding of the legal and regulatory framework that the company operates in, and identified the key laws and regulations that:

- had a direct effect on the determination of material amounts and disclosures in the financial statements, which included the UK Companies Act, pension legislation and taxation legislation; and
- do not have a direct effect on the financial statements, but compliance with which may be fundamental to the company's ability to operate or to avoid a material penalty, including in respect of export controls, defence contracting and anti-bribery and corruption legislation.

We discussed among the audit engagement team regarding the opportunities and incentives that may exist within the organisation for fraud and how and where fraud might occur in the financial statements.

As a result of performing the above, we identified the area with the greatest potential risk of fraud to be in relation to revenue recognition on certain software licence agreements. The specific procedures we performed to respond to this risk included:

- assessing closing position of deferred revenue to ensure appropriate amount deferred in the year, and;
- assessing the terms of the licence to ensure appropriate recognition of revenue in line with the performance obligation.

In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override. In addressing the risk of fraud through management override of controls, we tested the appropriateness of journal entries and other adjustments; assessed whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluated the business rationale of any significant transactions that are unusual or outside the normal course of business.

In addition to the above, our procedures to respond to the risks identified included the following:

- reviewing financial statement disclosures by testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- enquiring of management concerning actual and potential litigation and claims, and instances of non-compliance with laws and regulations; and
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with relevant regulatory authorities.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

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

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

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

Matters on which we are required to report by exception

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

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

We have nothing to report in respect of these matters.

Use of our report

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

Jamie Mander

Jamie Mander ACA (Senior Statutory Auditor)

For and on behalf of Deloitte LLP
Statutory Auditor

Reading, United Kingdom

29 June 2023

Income Statement
for the year ended 31 December 2022

	Note	2022 £000	2021 £000
Revenue	3	**458,348**	420,487
Operating costs	4	**(423,405)**	(394,138)
Other income	5	**6,891**	-
Operating profit		**41,834**	26,349
Financial income	6	**-**	30
Financial expense	7	**(722)**	(750)
Profit before tax		**41,112**	25,629
Tax	10	**(6,264)**	(2,994)
Profit for the financial year		**34,848**	22,635

The notes on pages 23 to 65 form part of these financial statements.

Statement of Comprehensive Income
for the year ended 31 December 2022

	Note	2022 £000	2021* £000
Profit for the financial year		**34,848**	22,635
Other comprehensive income:			
Items that will not be reclassified to profit or loss:			
Remeasurements on defined benefit pension schemes	19	**21,500**	9,700
Tax on items that will not be reclassified to the Income Statement		**(3,600)**	(979)
		17,900	8,721
Items that may be reclassified to the Income Statement:			
Fair value loss arising on hedging instruments during the year		**(63)**	(514)
Cumulative fair value gain on hedging instruments reclassified to the income statement		**(173)**	(321)
Tax on items that may be reclassified to the Income Statement		**59**	129
		(177)	(706)
Total comprehensive income for the year		**52,571**	30,650

The notes on pages 23 to 65 form part of these financial statements.

The results for 2022 and 2021 arise from continuing activities.

*Prior year comparatives have been re-presented to present amounts on matured hedging instruments recognised through profit and loss separately from those recognised on the balance sheet, within the year.

Balance Sheet
as at 31 December 2022

	Note	2022 £000	2021 £000
Non-current assets			
Intangible assets	11	**53**	158
Property, plant and equipment	12	**16,131**	10,572
Right-of-use assets	13	**19,955**	15,937
Investments	14	**180**	184
Other financial assets	15	**-**	338
Other receivables	16	**1,170**	1,170
Retirement benefit surpluses	19	**7,300**	-
Deferred tax assets	17	**5,998**	9,923
		50,787	38,282
Current assets			
Inventories	18	**8,659**	3,358
Trade, other and contract receivables	16	**299,327**	236,881
Other financial assets	15	**508**	804
Current tax		**3,072**	1,752
		311,566	242,795
Total assets		**362,353**	281,077

Balance Sheet (continued)
as at 31 December 2022

	Note	2022 £000	2021 £000
Non-current liabilities			
Lease liabilities	13	**(18,414)**	(12,193)
Retirement benefit obligations	19	**(500)**	(14,400)
Provisions	20	**(1,132)**	-
		(20,046)	(26,593)
Current liabilities			
Trade, other and contract payables	21	**(159,612)**	(142,862)
Lease liabilities	13	**(3,555)**	(5,324)
Other financial liabilities		**(232)**	-
Provisions	20	**(19,087)**	(2,132)
		(182,486)	(150,318)
Total liabilities		**(202,532)**	(176,911)
Net assets		**159,821**	104,166
Capital and reserves			
Issued share capital	22	**125**	125
Other reserves	22	**28,940**	26,033
Retained earnings		**130,756**	78,008
Total equity		**159,821**	104,166

Approved by the Board on 29 June 2023 and signed on its behalf by:

D J Lawton
Director

Registered number: 01337451

Statement of Changes in Equity
for the year ended 31 December 2022

	Issued share capital £000	Other reserves £000	Retained earnings £000	Total equity £000
At 1 January 2021	125	24,301	46,652	71,078
Profit for the year	-	-	22,635	22,635
Other comprehensive income for the year*	-	(706)	8,721	8,015
Cumulative fair value gain on hedging instruments reclassified to the balance sheet (net of tax)*	-	(271)	-	(271)
Share-based payments (inclusive of tax)	-	2,709	-	2,709
At 31 December 2021	125	26,033	78,008	104,166
Profit for the year	-	-	34,848	34,848
Other comprehensive income for the year	-	(177)	17,900	17,723
Cumulative fair value gain on hedging instruments reclassified to the balance sheet (net of tax)	-	(130)	-	(130)
Share-based payments (inclusive of tax)	-	3,214	-	3,214
At 31 December 2022	**125**	**28,940**	**130,756**	**159,821**

Other reserves are defined in note 21.

*Prior year comparatives have been re-presented to present amounts on matured hedging instruments recognised through profit and loss separately from those recognised on the balance sheet, within the year.

An analysis of other reserves is provided in note 21.

The notes on pages 23 to 65 form part of these financial statements.

Notes to the Financial Statements

1. General information

BAE Systems Applied Intelligence Limited is a private company, limited by shares, and registered in England and Wales and incorporated in the United Kingdom. Its ultimate controlling party is disclosed in note 25. The address of the Company's registered office is shown on page 12.

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

2. Accounting policies

2.1 Basis of preparation

These financial statements have been prepared in accordance with FRS 101. The Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards ("IFRS") and International Accounting Standards ("IAS"), 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 IFRS 7 Financial Instruments: Disclosures;

the requirements of paragraphs 91-99 of IFRS 13 Fair Value Measurement;

the requirements of the second sentence of paragraph 110 and paragraphs 113(a), 114, 115, 118, 119(a) to (c), 120 to 127 and 129 of IFRS 15 Revenue from Contracts with Customers;

the requirements of paragraph 52, the second sentence of paragraph 89, and paragraphs 90, 91 and 93 of IFRS 16 Leases. The requirements of paragraph 58 of IFRS 16, provided that the disclosure of details in indebtedness relating to amounts payable after 5 years required by company law is presented separately for lease liabilities and other liabilities, and in total;

the requirement in paragraph 38 of IAS 1 Presentation of Financial Statements to present comparative information in respect of:

- paragraph 79(a)(iv) of IAS 1 Presentation of Financial Statements;
- paragraph 73(e) of IAS 16 Property, Plant and Equipment;
- paragraph 118(e) of IAS 38 Intangible Assets; and
- paragraphs 76 and 79(d) of IAS 40 Investment Property;

the requirements of paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 38D, 40A, 40B, 40C, 40D, 111 and 134 to 136 of IAS 1 Presentation of Financial Statements;

the requirements of IAS 7 Statement of Cash Flows;

the requirements of paragraphs 30 and 31 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors;

the requirements of paragraph 17 and 18A of IAS 24 Related Party Disclosures;

the requirements in IAS 24 Related Party Disclosures to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member; and

2. Accounting policies (continued)

2.1 Basis of preparation (continued)

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

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

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

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

These financial statements have been prepared using the going concern basis of accounting. As discussed in the Director's Report (page 7).

Key sources of estimation uncertainty
The application of the Company's accounting policies requires the use of estimates. In the event that these estimates or assumptions prove to be incorrect, there may be an adjustment to the carrying values of assets and liabilities within the next year. Potential areas of the Company's financial statements which could be materially impacted may include, but are not limited to:

2. Accounting policies (continued)

2.1 Basis of preparation (continued)

Accounting policy	Description
Valuation of retirement benefit obligations	A number of actuarial assumptions are made in assessing the value of post-employment benefit obligations, including discount rate, inflation rate, and mortality assumptions. For each of the actuarial assumptions used there is a wide range of possible values and management estimates a point within that range that most appropriately reflects the Company's circumstances. If estimates relating to these actuarial assumptions are no longer valid or change due to changing economic and social conditions, then the potential obligations due under these schemes could change significantly. Discount and inflation rates could change significantly as a result of a prolonged economic downturn, monetary policy decisions and interventions or other macro-economic issues resulting from the pandemic. The impact of estimates made with regard to mortality projections may also change significantly, given the uncertainty in this area resulting from the pandemic. Similarly, the values of many assets are subject to estimates and assumptions, in particular those which are held in unquoted pooled investment vehicles. The associated fair value of these unquoted pooled investments is estimated with consideration of the most recently available valuations provided by the investment or fund managers. These valuations inherently incorporate a number of assumptions including the impact of climate change on the underlying investments. The overall level of estimation uncertainty in valuing these assets could therefore give rise to a material change in valuation within the next 12 months. Note 19 provides information on the key assumptions and analysis of their sensitivities.
IT provisions	There is estimation uncertainty in the calculation of some of the elements of IT provisions with regards to how long the separation takes to complete. The reason for the uncertainty is due to the complexity of the work required. Management has assessed that the majority of the work is expected to take ten months to complete. If the work takes two months more or less to complete, this could result in higher or lower costs of approximately £2m.

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

2. Accounting policies (continued)

2.1 Basis of preparation (continued)

Changes in accounting policies

Several standards, interpretations and amendments to existing standards became effective on 1 January 2022, none of which had a material impact on the Company.

The following standards, interpretations and amendments to existing standards became effective on 1 January 2022 and have not had a material impact on the Company:

- Amendments to IFRS 3: Business Combinations, effective from 1 January 2022;
- Amendments to IAS 16: Property, Plant and Equipment, effective from 1 January 2022;
- Amendments to IAS 37: Provisions, Contingent Liabilities and Contingent Assets, effective from 1 January 2022; and
- Annual Improvements to IFRS Standards 2018-2020 Cycle, effective from 1 January 2022.

The following other standards, interpretations and amendments to existing standards have been issued but were not mandatory for accounting periods beginning on 1 January 2022. These are expected to be endorsed by the UK Endorsement Board and are not expected to have a material impact on the Company:

- IFRS 17 Insurance Contracts, effective from 1 January 2023;
- Amendments to IAS 1: Presentation of Financial Statements, effective from 1 January 2023;
- Amendments to IAS 1 and IFRS Practice Statement 2: Disclosure of Accounting Policies, effective from 1 January 2023;
- Amendments to IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors, effective from 1 January 2023;
- Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture;
- Amendments to IAS 12: Income Taxes, effective from 1 January 2023; and
- Amendment to FRS 101 reduced disclosure framework, effective from 1 January 2023.

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

2.2 Revenue and profit recognition

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

The Company accounts for revenue in accordance with IFRS 15 Revenue from Contracts with Customers. For most of the Company's contracts, revenue and associated margin are recognised progressively over time as costs are incurred, and as risks have been mitigated or retired.

2. Accounting policies (continued)

2.2 Revenue and profit recognition (continued)

The ultimate profitability of contracts is based on estimates of revenue and costs, including allowances for technical and other risks, which are reliant on the knowledge and experience of the Company's project managers, engineers, and finance and commercial professionals. Material changes in these estimates could affect the profitability of individual contracts. Revenue and cost estimates are reviewed and updated at least quarterly, and more frequently as determined by events or circumstances.

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

Transaction price
At the start of the contract, the total transaction price is estimated as the amount of consideration to which the Company expects to be entitled in exchange for transferring the promised goods and services to the customer, excluding sales taxes. Variable consideration, such as price escalation, is included based on the expected value or most likely amount only to the extent that it is highly probable that there will not be a reversal in the amount of cumulative revenue recognised. The transaction price does not include estimates of consideration resulting from contract modifications, such as change orders, until they have been approved by the parties to the contract. The total transaction price is allocated to the performance obligations identified in the contract in proportion to their relative stand-alone selling prices. Given the bespoke nature of many of the Company's products and services, which are designed and/or manufactured under contract to the customer's individual specifications, there are typically no observable stand-alone selling prices. Instead, stand-alone selling prices are typically estimated based on expected costs plus contract margin consistent with the Company's pricing principles. The Company therefore has significant contract liabilities.

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

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

The Company has determined that most of its contracts satisfy the over time criteria, either because the customer simultaneously receives and consumes the benefits provided by the Company's performance as it performs (typically services or support contracts) or the Company's performance does not create an asset with an alternative use to the Company and it has an enforceable right to payment for performance completed to date (typically development or production contracts).
For each performance obligation to be recognised over time, the Company recognises revenue using an

2. Accounting policies (continued)

2.2 Revenue and profit recognition (continued)

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

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

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

Software licences
The Company sells software licences either separately or together with other goods and services, including computer hardware and implementation, hosting and support. Revenue recognition in respect of software licences sold as part of a bundle of goods and services is considered separately when the licence is determined to be a separate performance obligation. Software licences either represent a right-to-access the Company's intellectual property as it exists throughout the licence period or a right to use the Company's intellectual property as it exists at the point in time at which the licence is granted. Revenue in respect of right-to-access licences is recognised over the licence term or, in relation to perpetual licences, over the related customer relationship, and revenue in respect of right-to-use licences is recognised up front on delivery to the customer. A software licence is considered to be a right-to-access the Company's intellectual property as it exists throughout the licence period if all of the following criteria are satisfied:

the contract requires, or the customer reasonably expects, that the Company will undertake activities that significantly affect the intellectual property; and
the licence directly exposes the customer to the effects of those activities; and
those activities do not result in the transfer of a good or service to the customer.

If one or more of the above criteria is not met then the licence revenue is recognised at the point in time control of the licence passes to the customer

Outstanding commitments
The Company regularly reviews outstanding commitment for purchases in its supply chain in order to inform revenue recognition under IFRS 15 trading principles. Where the Company has received notification that the supplier has completed the manufacture of goods, but has not yet delivered and invoiced for them and the ultimate customer controls the asset, i.e. neither the subcontractor or the Company have an alternative use for the asset, the Company will accrue for these costs and recognise revenue in line with overtime trading principles under IFRS 15.

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

2. Accounting policies (continued)

2.2 Revenue and profit recognition (continued)

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

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

Costs to fulfil a contract
Contract fulfillment costs in respect of over-time contracts are expensed as incurred. Contract fulfillment costs in respect of point-in-time contracts are accounted for under IAS 2 Inventories.

2.3 Leases

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

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

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

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

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

2.4 Research and development

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

Company-funded expenditure on research, and on development activities not meeting the conditions for capitalisation, is written off as incurred and charged to the Income Statement.

Where the research and development activity is performed on behalf of customers, the revenue arising is recognised in the Income Statement in accordance with the Company's revenue recognition policy.

Notes to the Financial Statements

2. Accounting policies (continued)

2.5 Interest income and borrowing costs

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

2.6 Intangible assets

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

Goodwill
Under the acquisition method for business combinations, goodwill is the acquisition-date fair value of the consideration transferred, less the net of the acquisition-date fair values of the identifiable assets acquired and liabilities assumed. Goodwill on acquisitions of businesses is included in intangible assets. Gains and losses on the disposal of a business include the carrying amount of goodwill relating to the business sold.

Software
Software includes:
Computer software licences acquired for use within the Company which are capitalised as an intangible asset on the basis of the costs incurred to acquire and bring to use the specific software; and
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, which 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
Goodwill is not amortised. Amortisation on intangible assets, excluding goodwill, is charged to the Income Statement on a straight-line basis over their estimated useful lives.

The non-amortisation of goodwill can conflict with the Companies Act 2006 which requires goodwill to be written off over it's useful economic life. As such the Company applies the 'true and fair' override available to entities.

The estimated useful lives are as follows:

Software	-	2 to 5 years
Other	-	Up to 10 years

2.7 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, testing costs 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.

2. Accounting policies (continued)

2.7 Property, plant and equipment (continued)

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

Leasehold buildings	- the lease term
Office furniture and equipment	- 20%
Computer, ancillary equipment and electronic test equipment	- 20-33%

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

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

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

2.8 Impairment

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

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

2. Accounting policies (continued)

2.9 Investments

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

2.10 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.

2.11 Inventories

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

2.12 Trade, other and contract 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.

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

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

2.13 Trade, other and contract payables

Trade and other payables are stated at amortised cost.

Contract liabilities represent the obligation to transfer goods or services to a customer for which consideration has been received, or consideration is due, from the customer.

2. Accounting policies (continued)

2.14 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.

IT provisions
IT costs that will be incurred as a result of separating the Digital Intelligence networks from the Financial Crime business.

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.

2.15 Financial instruments

Derivative financial instruments and hedging activities
The international nature of the Company's business means that 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.

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

The Company aims to achieve hedge accounting treatment for all derivatives that hedge material foreign currency exposures.

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. Fair values are estimated by discounting expected future cash flows.

Fair value through profit or loss
Gains and losses on derivative financial instruments that are not designated as cash flow hedges are recognised in the Income Statement for the period.

Cash flow hedges
Where a derivative financial instrument is designated as a hedge of the exposure to variability in cash flows relating to a highly probable forecast transaction (income or expense), or recognised asset or liability, 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 the hedging reserve into the cost of the underlying transaction and recognised in the Income Statement when the underlying transaction affects profit or loss.

2. Accounting policies (continued)

2.15 Financial instruments (continued)

The ineffective portion of any change in the fair value of the instrument is recognised in the Income Statement immediately. The Company treats the foreign currency basis element of the designated foreign exchange derivative hedging instrument as a cost of hedging and as such it is excluded from the hedge designation.

2.16 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 surpluses and obligations recognised in the Company's Balance Sheet represents the fair value of scheme assets, less the present value of the defined benefit obligations calculated using a number of actuarial assumptions as set out on page 56. The bid values of scheme assets are not intended to be realised in the short term and may be subject to significant change before they are realised. The present values of scheme liabilities are derived from cash flow projections over long periods and are, therefore, inherently uncertain.

IAS 19 Employee Benefits, limits the measurement of a defined benefit surplus to the lower of the surplus in the defined benefit scheme and the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the scheme or reductions in future contributions to the scheme. IFRIC 14 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction, issued in 2007, provides an interpretation of the requirements of IAS 19, clarifying that a refund is available if the entity has an unconditional right to a refund in certain circumstances. The Company has applied IFRIC 14 and has determined that there is no limit on the recognition of the surpluses in its defined benefit pension schemes as at 31 December 2022. The surpluses have been recognised on the basis that the future economic benefits are unconditionally available to the Company, which is assumed to be via a refund. These have been recognised after deducting a 35% withholding tax which would be levied prior to the future refunding of any surplus and have been presented on a net basis as this is not deemed to be an income tax of the Company.

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 is based on the relative payroll contributions of active members which is consistent with prior years.

Whilst this methodology is intended to reflect a reasonable estimate of the share of the deficit, it may not accurately reflect the obligations of the participating employers. Gains and losses resulting from changes to the relative payroll contributions of active members year on year are included within the actual return

2. Accounting policies (continued)

2.16 Retirement benefit obligations (continued)

on assets and actuarial gains and losses for the disclosures in respect of changes in the fair value of scheme assets and changes in the present value of defined benefit obligations, respectively.

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.

2.17 Tax

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

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

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

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

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

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

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

2. Accounting policies (continued)

2.18 Share-based payments

BAE Systems plc, the Company's ultimate parent company, 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 long-term incentive plan 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.

3. Revenue

Revenue by class of business

	2022 £000	2021 £000
Fixed Price	**204,245**	184,810
Time and Materials	**173,262**	167,110
Intercompany Service Fees	**32,135**	27,750
Maintenance and Software Support	**20,173**	18,425
Licence	**17,127**	12,500
Other	**11,406**	9,892
	458,348	420,487

Revenue by customer location:

	2022 £000	2021 £000
United Kingdom	**451,790**	411,995
Europe	**4,425**	5,584
North America	**1,437**	893
Rest of World	**696**	2,015
	458,348	420,487

4. Operating costs

	2022 £000	2021 £000
Inventory recognised as an expense	**4,203**	5,089
Staff costs (note 8)	**227,740**	213,327
Depreciation of fixed assets	**3,627**	4,262
Depreciation of right of use assets	**3,485**	3,535
Amortisation of intangible assets	**106**	156
Lease and sublease expense	**1,055**	1,362
Other operating charges	**183,189**	166,407
	423,405	394,138

The remuneration of the auditor for the year ended 31 December 2022 for auditing of the financial statements was £254k (2021: £211k) and £nil (2021: £nil) in respect of non-audit work.

Total research and development expenditure was £13,300k (2021: £19,110k), of which £13,300k (2021: £19,110k) was funded by the Company.

5. Other income

	2022 £000	2021 £000
Gain on sale of shares	**6,891**	-

On 21 April 2022 the Company sold its minority holding in SOC.OS Cyber Security Limited. The consideration received was £6,930k and the carrying value of the investment was £Nil. After disposal costs of £39k the gain on disposal before tax was £6,891k.

6. Financial income

	2022 £000	2021 £000
Interest income	**-**	30
	-	30

Notes to the Financial Statements

7. Financial expense

	2022	2021
	£000	£000
Net interest expense on retirement benefit obligations (note 19)	**200**	400
Interest expense on lease liabilities (note 13)	**522**	350
	722	750

8. Employees

The average monthly number of employees during the year was as follows:

	2022	2021
	No.	No.
Engineering	**1,473**	1,297
Consulting	**526**	472
Production & Product Management	**321**	301
Overhead	**418**	439
	2,738	2,509

The aggregate staff costs of Company employees were as follows:

	2022	2021
	£000	£000
Wages and salaries	**190,523**	176,854
Social security costs	**21,971**	21,696
Cost of defined benefit pension scheme (note 19)	**1,600**	1,500
Cost of defined contribution pension scheme (note 19)	**10,897**	10,473
Share-based payments (note 23)	**2,749**	2,804
	227,740	213,327

9. *Directors' remuneration*

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

	2022	2021
	£000	£000
Directors' remuneration	**1,076**	1,111
Amounts receivable under long-term incentive schemes	**16**	-
Company contributions to defined benefit pension schemes	**50**	23
	1,142	1,134

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

	2022 Number of directors	2021 Number of directors
Defined contribution schemes	**-**	3
Defined benefit schemes	**2**	3

Amounts paid in respect of the highest paid director were as follows:

	2022	2021
	£000	£000
Remuneration and amounts receivable under long-term incentive schemes	**577**	616
Company contributions to defined benefit pension schemes	**25**	3
	602	619

The highest paid director's defined benefit accrued pension and accrued lump sum at 31 December 2022 were £240k (2021: £nil) and £nil (2021: £nil), respectively.

During the year, the highest paid director received shares under a long-term incentive scheme.

Notes to the Financial Statements

10. Tax

Tax expense

	2022 £000	2021 £000
Current tax		
UK:		
Current tax	**4,680**	2,594
Adjustments in respect of prior years	**583**	-
	5,263	2,594
Overseas:		
Current tax	**108**	8
	5,371	2,602
Deferred tax		
Origination and reversal of temporary differences	**893**	1,748
Adjustments in respect of prior years[1]	**189**	(173)
Tax rate adjustment	**(189)**	(1,183)
	893	392
Tax expense	**6,264**	2,994

1

Notes to the Financial Statements

10. Tax (continued)

Reconciliation of tax expense

The following reconciles the expected tax expense, using the UK corporation tax rate, to the reported tax expense.

	2022 £000	2021 £000
Profit before tax	**41,112**	25,629
UK corporation tax rate	**19.00%**	19.00%
Expected tax credit	**7,811**	4,869
Effect of tax rates in foreign jurisdictions	**108**	8
(Expenses)/*income not tax effected*	**(110)**	(41)
Research and development tax credits	**(393)**	(810)
Property, plant and equipment	**111**	-
Pensions	**57**	19
Share-based payments	**(374)**	310
Imputed interest expense	**484**	454
Losses received from group companies	**(2,012)**	(459)
Adjustments in respect of prior years	**771**	(173)
Tax rate adjustment [1]	**(189)**	(1,183)
Tax expense	**6,264**	2,994

10. Tax (continued)

Tax recognised in other comprehensive income

	2022			2021		
	Before tax £000	**Tax benefit/ (expense) £000**	**Net of tax £000**	Before tax £000	Tax benefit/ (expense) £000	Net of tax £000
Items that will not be reclassified to the Income Statement:						
Remeasurements on retirement benefit schemes	**21,500**	**(3,600)**	**17,900**	9,700	(1,843)	7,857
Tax rate adjustment	**-**	**-**	**-**	-	864	864
Items that may be reclassified to the Income Statement:						
Fair value gain arising on hedging instruments during the period[1]	**(63)**	**16**	**(47)**	(514)	98	(416)
Cumulative fair value loss on hedging instruments reclassified to the income statement[1]	**(173)**	**43**	**(130)**	(321)	61	(260)
Tax rate adjustment[2]	**-**	**-**	**-**	-	(30)	(30)
	21,264	**(3,541)**	**17,723**	8,865	(850)	8,015

10. Tax (continued)

	2022			2021		
	Other reserves £000	**Retained earnings £000**	**Total £000**	Other reserves £000	Retained earnings £000	Total £000
Deferred tax						
Financial instruments	**59**	**-**	**59**	159	-	159
Pensions	**-**	**(3,600)**	**(3,600)**	-	(1,843)	(1,843)
Tax rate adjustment[2]	**-**	**-**	**-**	(30)	864	834
Tax on other comprehensive income	**59**	**(3,600)**	**(3,541)**	129	(979)	(850)

[1]Prior year comparatives have been re-presented to separately present amounts on matured hedging instruments recognised through profit and loss, separately from those recognised on the balance sheet, within the year.

[2]The Government announced in 2021 that from 1 April 2023 the UK corporation tax rate would increase from 19% to 25%. The deferred tax asset at each Balance Sheet date has been calculated at the tax rates, enacted at that date, expected to apply to the temporary differences when they reverse. The resulting tax rate adjustments have been recorded partly in the Income Statement and partly in the Statement of Other Comprehensive Income and Statement of Changes in Equity.

11. Intangible assets

	Goodwill £000	Software £000	Other £000	Total £000
Cost				
At 1 January 2022	**27,531**	**738**	**4,742**	**33,011**
At 31 December 2022	**27,531**	**738**	**4,742**	**33,011**
Amortisation				
At 1 January 2022	**27,531**	**580**	**4,742**	**32,853**
Amortisation charge for the year	**-**	**105**	**-**	**105**
At 31 December 2022	**27,531**	**685**	**4,742**	**32,958**
Net book value				
At 31 December 2022	**-**	**53**	**-**	**53**
At 31 December 2021	-	158	-	158

Capital commitments
Capital expenditure contracted for but not provided for in full in the financial statements is £nil (2021: £nil).

Notes to the Financial Statements

12. Property, plant and equipment

	Short leasehold improvements £000	Office furniture and equipment £000	Computer and ancillary equipment £000	Electronic test equipment £000	Assets in the course of construction £000	Total £000
Cost						
At 1 January 2022	27,473	2,442	9,766	4,776	949	45,406
Additions	132	43	-	535	8,530	9,240
Disposals	(11,972)	(1,119)	(5,571)	(260)	-	(18,922)
Transfers between classes	753	(103)	146	79	(875)	-
At 31 December 2022	**16,386**	**1,263**	**4,341**	**5,130**	**8,604**	**35,724**
Depreciation						
At 1 January 2022	22,610	1,654	7,717	2,853	-	34,834
Depreciation charge for the year	1,713	136	602	1,176	-	3,627
Disposals	(11,953)	(1,117)	(5,538)	(260)	-	(18,868)
At 31 December 2022	**12,370**	**673**	**2,781**	**3,769**	**-**	**19,593**
Net book value						
At 31 December 2022	**4,016**	**590**	**1,560**	**1,361**	**8,604**	**16,131**
At 31 December 2021	4,863	788	2,049	1,923	949	10,572

13. Leases

The Company leases land, buildings, under non-cancelable lease arrangements. There are no terms that represent unusual arrangements or create material onerous or beneficial rights or obligations.

	2022	2021
	Land and buildings £000	Land and buildings £000
Opening NBV	**15,937**	10,734
Additions during the year	**2,558**	-
Disposals during the year	**(547)**	(415)
Modifications	**5,267**	8,738
Depreciation expense for the year	**(3,485)**	(3,535)
Depreciation eliminated on disposal	**225**	415
Net book value	**19,955**	15,937

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

	2022 £000	2021 £000
Payments due:		
Within one year	**3,555**	5,324
Between one and five years	**13,054**	12,193
Later than five years	**7,170**	-
	23,779	17,517
Reconciliation to Balance Sheet:		
Undiscounted lease liability	**23,779**	17,517
Impact of discounting	**(1,810)**	-
Total discounted lease liability	**21,969**	17,517

The total cash outflow for leases recognised on the Balance Sheet in the year ended 31 December 2022, amounted to £5,324k (2021: £5,903k).

13. Leases (continued)

Amounts recognised in the Income Statement

	2022 £000	2021 £000
Included in operating costs:		
Depreciation on right-of-use assets	**3,485**	3,535
Short-term lease expense	**1,055**	1,362
	4,540	4,897
Included in net finance costs:		
Interest expense on lease liabilities	**522**	350
	522	350

14. Investments

	Subsidiary companies £000
Carrying value	
At 1 January 2022	184
Disposals	(4)
At 31 December 2022	**180**

Impairment testing
During the year, management conducted an impairment review of the investments held by the Company. As a result of this review, no impairment charges were recognised

The recoverable amount of the investments held by the Company has been calculated with reference to their value in use. The value-in-use calculations use risk-adjusted future cash flow projections based on the five-year Integrated Business Plan (IBP) and include a terminal value based on the projections for the final year of that plan, with growth rate assumptions in the range 0% to 2% applied. The IBP process includes the use of historic experience, available government spending data and the Company's order backlog. Pre-tax discount rates, derived from the Group's post-tax weighted average cost of capital of 8.0% (2021: 6.0%) (adjusted for risks specific to the market in which the cash-generating unit operates), have been used in discounting these projected risk-adjusted cash flows.

14. Investments (continued)

Subsidiary undertakings and participating interests at 31 December 2022

In accordance with Section 409 of the Companies Act 2006, a full list of subsidiary undertakings and significant holdings as at 31 December 2022 is disclosed below. The subsidiary undertaking is owned directly by the Company and has a financial year end of 31 December.

Company name	Class of shares held	Proportion of class (%)
BAE Systems Applied Intelligence Malaysia Sdn Bhd *Level 25, Menara Hong Leong, No 6 Jalan Damanlela, Bukit Damansara 50490 Kuala Lumpur, Malaysia*	Ordinary	99.99%

15. Financial instruments

	2022 £000	2021 £000
Financial assets		
Non-current		
Cash flow hedges – foreign exchange contracts	-	338
Current		
Cash flow hedges – foreign exchange contracts	508	804
Financial liabilities		
Current		
Cash flow hedges – foreign exchange contracts	(232)	-

16. Trade, other and contract receivables

	2022 £000	2021 £000
Non current		
Amounts owed by BAE Systems plc subsidiaries	**1,170**	1,170
	1,170	1,170
Current		
Contract receivables	**33,654**	28,623
Trade receivables	**31,525**	35,664
Amounts owed by BAE Systems plc subsidiaries	**31,289**	39,905
Amounts owed by BAE Systems plc	**184,885**	127,649
Prepayments	**12,819**	4,398
Amounts owed by former related parties	**2,533**	-
Other receivables	**2,622**	642
	299,327	236,881

Receivables are disclosed net of any provision for bad debt.

Amounts owed by BAE Systems plc and its subsidiaries are payable on demand. No interest is applied to amounts owed.

Amounts owed by former related parties are in connection with the disposal of the financial crime detection business.

The impact of discounting non-current amounts owed by BAE Systems plc and its subsidiaries is not material so has not been applied.

17. Deferred taxation

Deferred tax assets

	2022 £000	2021 £000	2022 £000	2021 £000	2022 £000	2021 £000
Property, plant and equipment	**4,606**	5,108	**-**	-	**4,606**	5,108
Provisions and accruals	**87**	431	**-**	-	**87**	431
Retirement benefit schemes:						
Deficits	**-**	3,600	**-**	-	**-**	3,600
Additional contributions and other	**493**	892	**-**	-	**493**	892
Share-based payments	**881**	64	**-**	-	**881**	64
Financial instruments	**-**	-	**(69)**	(172)	**(69)**	(172)
Deferred tax assets	**6,067**	10,095	**(69)**	(172)	**5,998**	9,923
Set off of tax	**(69)**	(172)	**69**	172	**-**	-
Deferred tax assets	**5,998**	9,923	**-**	-	**5,998**	9,923

Deferred tax assets
Movement in temporary differences during the year

	At 1 January 2022 £000	Recognised in income £000	Recognised in equity £000	**At 31 December 2022 £000**
Property, plant and equipment	5,108	(502)	-	**4,606**
Provisions and accruals	431	(344)	-	**87**
Retirement benefit schemes:				
Deficits	3,600	-	(3,600)	**-**
Additional contributions and other	892	(399)	-	**493**
Share-based payments	64	352	465	**881**
Financial instruments	(172)	-	102	**(70)**
	9,923	(893)	(3,033)	**5,997**

17. Deferred taxation (continued)

	At 1 January 2021 £000	Recognised in income £000	Recognised in equity £000	At 31 December 2021 £000
Property, plant and equipment	4,546	562	-	5,108
Provisions and accruals	702	(271)	-	431
Retirement benefit schemes:				
Deficits	4,522	57	(979)	3,600
Additional contributions and other	1,467	(575)	-	892
Share-based payments	324	(165)	(95)	64
Financial instruments	(350)	-	178	(172)
	11,211	(392)	(896)	9,923

The Government announced in 2021 that from 1 April 2023 the UK corporation tax rate would increase from 19% to 25%. The deferred tax asset has been calculated at the tax rates, enacted at each Balance Sheet date, expected to apply to the temporary differences when they reverse. The resulting tax rate adjustment has been recorded in the Income Statement and partly recorded in the Income Statement and partly in the Statement of Comprehensive Income and Statement of Changes in Equity.

The deferred tax assets continue to be recognised to the extent that there is evidence that future taxable profits will be available against which the temporary differences to which they relate will reverse. This conclusion is reached from an annual review of the Company's forecasts for the next five years.

18. Inventories

	2022 £000	2021 £000
Raw materials and consumables	**863**	2,297
Work in progress (goods to be sold)	**5,663**	1,061
Finished goods	**2,133**	-
	8,659	3,358

19. 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 allocation of each Company's share of the pension deficit is based on the relative payroll contributions of active members, as outlined on page 34.

At 31 December 2022, the weighted average durations of the UK defined benefit pension obligations was 13 years (2021 17 years).

The Company participates in the following BAE Systems plc scheme: BAE Systems Pension Scheme (Main Scheme).

The split of the defined benefit pension liability on a funding basis between active, deferred and pensioner members for the most significant schemes (based on the size of the closing net deficit/surplus) is set out below:

	Active %	Deferred %	Pensioner %
Main Scheme (merged)[1]	28	21	51

1. *Source: 31 March 2021 actuarial valuation reports.*

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 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.

A UK High Court judgment was delivered on 26 October 2018 concerning gender equalisation for the effect of Guaranteed Minimum Pensions (GMPs) for occupational pension schemes..

A further UK High Court judgment was delivered on 20 November 2020 which rules that past cash-equivalent transfer values needed to account for gender equalisation for the effect of GMPs. In 2018 and 2020, a non-recurring past service cost was included in the income statement to reflect the expectation that the impact of GMP equalisation would increase the pension deficit in the balance sheet. In 2022, an allowance was included within the pension deficit which is a consistent proportion of the UK liabilities as applied in prior years and reflects the updated UK IAS 19 valuations as at 31 December 2022.

19. Retirement benefit obligations (continued)

Funding

Introduction

Disclosures in respect of pension funding provided below reflect the pension schemes as a whole. Disclosures in respect of pension accounting under IAS 19 are provided on pages 56 - 61.

The majority of the UK defined benefit pension schemes are funded by BAE Systems plc's subsidiaries and equity accounted investments. 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 at the valuation date, whilst the liabilities are measured on an actuarial funding basis using the projected unit credit method and discounted to their present value based on prudent assumptions set by the trustees following consultation with scheme actuaries.

The funding valuations are performed by professionally qualified independent actuaries and include assumptions which differ from the actuarial assumptions used for IAS 19 accounting purposes shown on page 56. The purpose of the funding valuations is to design funding plans which ensure that the schemes have sufficient funds available to meet future benefit payments.

Valuations

Funding valuations of the UK defined benefit schemes are performed every three years. Following the accelerated payment in 2021 of the remaining sponsor deficit reduction contributions under the previously agreed deficit recovery plan, BAE Systems plc and the Trustees agreed to carry out an early triennial funding valuation for the Main Scheme as at 31 March 2021, this valuation was concluded and signed off on 30 June 2022.

The results of the most recent triennial valuations are shown below. These valuations and, where necessary, deficit recovery plans were agreed with the trustees and certified by the scheme actuaries after consultation with The Pensions Regulator in the UK.

	Main Scheme as at 31 March 2021 £bn
Market value of assets	22.9
Present value of liabilities	(22.9)
Funding surplus	-
Percentage of accrued benefits covered by the assets at the valuation date	100%

The valuations in 2021 were determined using the following mortality assumptions:

Life expectancy of a male currently aged 65 (years)	86 – 89
Life expectancy of a female currently aged 65 (years)	87 – 90
Life expectancy of a male currently aged 45 (years)	88 – 91
Life expectancy of a female currently aged 45 (years)	90 – 93

19. Retirement benefit obligations (continued)

As part of the process of the Main Scheme's 2021 valuation, the Trustees and BAE Systems plc agreed to update the methodology to use a cash flow matching strategy, such that assets are invested with the aim of the expected income directly matching the expected benefit payments of the Scheme. The cash flow matching strategy aims to manage risk through a defined amount of risk buffer assets, which equate to the agreed prudence margin in the valuation. The risk buffer assets are measured over time to assure the Scheme is sufficiently funded. The asset portfolio is currently invested in a selection of bonds designed to match the pension payments for current pensioners, as well as a mix of growth seeking assets aimed to generate returns for the pension payments for future pensioners. Over time, assets from the return seeking portfolio will be realised to purchase additional, lower risk assets to match the increasing current pensioner portfolio.

The inflation assumptions for each of the valuations were derived using data from the Bank of England which is based on the difference between the yields on index-linked and fixed interest long-term government bonds. The inflation assumption is a curve which provides a different rate for each year into the future.

Under IAS 19, the discount rate for accounting purposes is based on third-party AA corporate bond yields whereas, for funding valuation purposes, the discount rate is based on a prudent level of expected returns from the broader and mixed types of investments reflected in the schemes' investment strategies.

There have been no changes to the contributions or benefits, as set out in the rules of the schemes, for pension scheme members as a result of the new funding valuations.

The results of future triennial valuations and associated funding requirements will be impacted by a number of factors, including the future performance of investment markets and anticipated members' longevity.

Contributions
Under the terms of the trust deeds of the UK schemes, BAE Systems plc is required to have a funding plan determined at the conclusion of the triennial funding valuations.

The total Company contributions made to the defined benefit schemes in the year ended 31 December 2022 were £1,500k (2021: £1,600k).

Risk management
The defined benefit pension schemes expose the Company to actuarial risks, including market (investment) risk, interest rate risk, inflation risk and longevity risk.

19. Retirement benefit obligations (continued)

Risk	Mitigation
Market (investment) risk	
Asset returns may not move in line with the liabilities and may be subject to volatility.	Following the 23 September 2022 UK "mini budget", gilt yields increased at an unprecedented rate causing significant market turmoil. Throughout the period following the mini budget, the Group and Trustees monitored the schemes closely with the help of independent advisors. The schemes remained in a strong position throughout and continued to have sufficient liquidity to meet all payments as they fell due. The investment portfolios are highly diversified, investing in a wide range of assets, in order to reduce the exposure of the total portfolio to a materially adverse impact from a single security or type of security. 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 46% (2021 51%) of the UK pension scheme assets are held in equities and pooled investment vehicles due to the higher expected level of return over the long term. Some of the pension schemes use derivative financial instruments as part of their investment strategy to manage the level of market risk. The Main Scheme has an equity option strategy protecting £0.9bn of assets against a significant fall in equity markets, in line with the prior year. The strategy also caps the upside if equity markets increase more than an agreed percentage.
Interest rate risk	
Liabilities are sensitive to movements in interest rates, with lower interest rates leading to an increase in the valuation of liabilities.	As part of the funding valuation finalised during 2022, the main UK Scheme has adopted a cash flow matching strategy, whereby contractual income from assets is designed to directly match benefits paid to members each year. A portfolio of assets with contractual income has been structured to match benefits already in payment, representing around half of the liabilities. This inherently hedges the associated interest rate risk. As members retire and become pensioners, additional matching assets will be purchased to keep pace. Interest rate risk associated with the remaining purchase of matching assets is mitigated via a hedging strategy involving mainly physical assets rather than derivatives and only modest levels of leverage. The overall level of interest rate hedging on the funding basis has increased compared to 2021..
Inflation risk	
Liabilities are sensitive to movements in inflation, with higher inflation leading to an increase in the valuation of liabilities.	The main UK Scheme's cash flow matching strategy includes aligning asset income to the inflation-linked members' benefit payments. Inflation risk associated with benefits already in payment is inherently hedged by the portfolio of contractual income assets structured to match them, as well as an overlay of inflation swaps held with several banks to reduce counterparty risk. The overall level of inflation hedging on the funding basis is broadly similar to 2021. In 2014, the Main Scheme implemented a pension increase exchange to allow retired members to elect for a higher current pension in exchange for foregoing certain rights to future pension increases.
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. In 2013, with the agreement of BAE Systems plc, the trustees of the 2000 Plan, Royal Ordnance Pension Scheme and Shipbuilding Industries Pension Scheme (SIPS) entered into arrangements with Legal & General to insure against longevity risk for the current pensioner population, covering a total of £4.4bn of pension scheme liabilities. These arrangements reduce the funding volatility relating to increasing life expectancy. This longevity risk cover with Legal & General remains in place following the merger of the 2000 Plan and SIPS into the Main Scheme.

19. Retirement benefit obligations (continued)

IAS 19 Accounting
The disclosures below relate to pension schemes in the UK which are accounted for as defined benefit schemes in accordance with IAS 19.

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.

	2022	2021	2020
Financial assumptions			
Discount rate – past service (%)	**4.8**	1.9	1.4
Discount rate – future service (%)	**4.8**	1.9	1.6
Retail Prices Index (RPI) inflation (%)	**3.0**	3.1	2.7
Rate of increase in salaries (%)	**3.0**	3.1	2.7
Rate of increase in deferred pensions (%)	**2.3/3.0**	2.4/3.1	2.0/2.7
Rate of increase in pensions in payment (%)	**1.7 – 3.6**	1.7 – 3.7	1.6 – 3.6
Demographic assumptions			
Life expectancy of a male currently aged 65 (years)	**86 – 89**	86 – 89	86 – 88
Life expectancy of a female currently aged 65 (years)	**88 – 90**	88 – 90	88 – 90
Life expectancy of a male currently aged 45 (years)	**87 – 90**	86 – 90	87 – 89
Life expectancy of a female currently aged 45 (years)	**89 – 91**	89 – 91	89 – 91

Discount rate
The discount rate assumptions are derived through discounting the projected benefit payments using a third-party AA corporate bond yield curve to produce a single equivalent discount rate. This inherently captures the maturity profile of the expected benefit payments. The discount rate used for future service differs from that used for past service as it only uses the cash flows relating to active members, which have a different duration. Further information on the duration of the schemes is detailed on page 52.

Retail Prices Index (RPI) and Consumer Prices Index (CPI) 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. Index-linked government bonds contain a premium that investors are willing to pay to mitigate the risk that RPI inflation is higher than expected. To account for this, the RPI assumption includes an inflation risk premium deduction.

As a consequence of RPI reform announcements the Company has reviewed its approach to setting inflation assumptions. The inflation risk premium deduction has been set at 0.55% per annum (2021: 0.55%) and the CPI assumption has been set at 0.7% per annum (2021: 0.7%) lower than RPI. The resulting RPI assumption is 3.0% per annum and the CPI assumption is 2.3% per annum. The 0.7% per annum RPI-CPI differential is a weighted average of a 1% per annum differential pre-2030 and 0.1% per annum differential post-2030; this reflects the anticipated change to the RPI index from 2030.

Rate of increase in salaries
The rate of increase in salaries for the UK schemes is assumed to be RPI inflation of 3.0% (2021: 3.1%), plus a promotional scale.

19. Retirement benefit obligations (continued)

Rate of increase in deferred pensions
The rate of increase in deferred pensions for the UK schemes is based on CPI inflation of 2.3% (2021: CPI inflation of 2.4%), with the exception of the legacy 2000 Plan, which is based on RPI inflation of 3.0% (2021: RPI inflation of 3.1%). For all UK schemes, the rate of increase in deferred pensions is subject to inflation caps.

Rate of increase in pensions in payment
The rate of increase in pensions in payment differs between UK schemes. Different tranches of the schemes' benefits increase at rates based on either RPI or 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.

Life expectancy
The Company has used the Self-Administered Pension Schemes S3 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 and information on the demographic profile of the scheme's membership.

In addition, to allow for future improvements in longevity, the Continuous Mortality Investigation 2021 tables (published by the Institute of Actuaries) have been used (in 2021, the Continuous Mortality Investigation 2020 tables were used), with an assumed long-term rate of future annual mortality improvements of 1.0% per annum (2021 1.0%), an initial rate adjustment parameter ('A') of 0.25% (2021 0.25%) in conjunction with a smoothing parameter ('Sk') of 7 for all members (2021 7). The Group has chosen to apply a weighting to the 2021 data in recognition of the abnormal excess deaths as a result of COVID-19. No further adjustments have been made to improvements expected in future years. The impacts of COVID-19 will continue to be monitored and assessed at future reporting dates.

The disclosures below are in respect of the Company's share of the IAS 19 deficit using the allocation methodology outlined on page 34.

Summary of movements in retirement benefit obligations

	£000
Company's share of IAS 19 deficit at 1 January 2022	**(14,400)**
Actual return on assets excluding amounts included in interest expense	(29,800)
Decrease in liabilities due to changes in assumptions and experience	55,300
Contributions in excess of service cost	(100)
Net interest expense	(200)
	10,800
Withholding tax on surpluses	(4,000)
Company's share of IAS 19 surplus at 31 December 2022	**6,800**

Notes to the Financial Statements

19. Retirement benefit obligations (continued)

Amounts recognised in the Balance Sheet

	2022 £000	2021 £000
Present value of unfunded obligations	**(500)**	(1,700)
Present value of funded obligations	**(113,900)**	(169,600)
Fair value of scheme assets	**125,200**	156,900
	10,800	(14,400)
Withholding tax on surpluses	**(4,000)**	-
Company's share of IAS 19 surplus/(deficit), net	**6,800**	(14,400)
Represented by:		
Retirement benefit surpluses	**7,300**	-
Retirement benefit obligations	**(500)**	(14,400)
	6,800	(14,400)

Surplus recognition

All UK schemes are in an accounting surplus position. The surpluses have been recognised on the basis that the future economic benefits are unconditionally available to the Company, which is assumed to be via a refund. These have been recognised after deducting a 35% withholding tax, which would be levied prior to the refunding of any surplus and have been presented on a net basis as this is not deemed to be an income tax of the group.

Changes in the fair value of scheme assets

	£000
Company's share of the value of scheme assets at 1 January 2021	**124,900**
Interest income	2,000
Actual return on assets excluding amounts included in interest income	34,100
Actual return on assets	36,100
Contributions by employer	1,600
Contributions by employer in respect of employee salary sacrifice arrangements	400
Total contributions by employer	2,000
Benefits paid	(6,100)
Company's share of the value of scheme assets at 31 December 2021	**156,900**
Interest income	2,800
Actual return on assets excluding amounts included in interest income	(29,800)
Actual return on assets	(27,000)
Contributions by employer	1,500
Contributions by employer in respect of employee salary sacrifice arrangements	400
Total contributions by employer	1,900
Members' contributions	0
Administrative expenses	(100)
Benefits paid	(6,500)
Company's share of the value of scheme assets at 31 December 2022	**125,200**

19. Retirement benefit obligations (continued)

Assets of defined benefit pension schemes

	2022			2021		
	Quoted £'000	**Unquoted £'000**	**Total £'000**	Quoted £'000	Unquoted £'000	Total £'000
Equities:						
UK	**1,300**	**-**	**1,300**	7,500	-	7,500
Overseas	**3,600**	**-**	**3,600**	21,200	-	21,200
Pooled investment vehicles[1]	**-**	**53,300**	**53,300**	1,500	49,900	51,400
Fixed interest securities:	**-**	**-**	**-**			
UK gilts	**12,300**	**-**	**12,300**	4,500	-	4,500
UK corporates	**10,500**	**14,800**	**25,300**	9,000	19,500	28,500
Overseas government	**200**	**-**	**200**	400	-	400
Overseas corporates	**6,400**	**300**	**6,700**	6,200	300	6,500
Index-linked securities:	**-**	**-**	**-**			
UK gilts	**8,900**	**-**	**8,900**	15,700	-	15,700
UK corporates	**-**	**5,600**	**5,600**	-	7,500	7,500
Overseas corporates	**100**	**-**	**100**	-	-	-
Property[2]	**-**	**10,700**	**10,700**	-	12,100	12,100
Derivatives[3]	**-**	**(6,300)**	**(6,300)**	-	(4,400)	(4,400)
Cash:	**-**	**-**	**-**			
Sterling	**3,500**	**-**	**3,500**	5,800	-	5,800
Foreign currency	**100**	**-**	**100**	100	-	100
Other	**-**	**(100)**	**(100)**	200	(100)	100
Company total	**46,900**	**78,300**	**125,200**	72,100	84,800	156,900

1. Primarily invested in private markets and exchange traded funds. The amounts classified as unquoted primarily comprise investments in private markets, with the majority held in infrastructure, alternatives and direct funds, valued in accordance with International Private Equity and Venture Capital Valuation Guidelines.
2. Valued on the basis of open market value at the end of the year determined in accordance with the Royal Institution of Chartered Surveyors' Appraisal and Valuation Standards and the Practice Note *contained therein.*
3. Includes equity protection options, forward foreign exchange contracts, futures, and interest rate, inflation and longevity swaps. The valuations are based on valuation techniques using underlying market data and discounted cash flows.

Longevity swap

The Company holds longevity insurance contracts for some of its UK defined benefit pension schemes. These provide long-term protection and income to the underlying pension scheme in the event that insured members live longer than expected.

The value of the longevity insurance contracts held by the Company are calculated by an actuary. At a high level, they are measured by discounting the difference between the projected fixed and floating cash flows payable under the contracts, excluding the value of future projected fees. The significant assumptions used for this valuation are the discount rate and mortality assumptions; fair values for these assumptions are advised by an actuary based on external data and characteristics of the insured member population.

19. Retirement benefit obligations (continued)

As at 31 December 2022, the longevity swap valuation leads to a negative adjustment to the assets which reflects that experience to date on the contracts has been higher than expected deaths.

Changes in the present value of the defined benefit obligations

	£000
Company's share of the defined benefit obligations at 1 January 2021	**(148,700)**
Current service cost	(1,500)
Contributions by employer in respect of employee salary sacrifice arrangements	(400)
Total current service cost	(1,900)
Actuarial loss due to changes in assumptions and experience	(24,400)
Interest expense	(2,400)
Benefits paid	6,100
Company's share of the defined benefit obligations at 31 December 2021	**(171,300)**
Current service cost	(1,500)
Contributions by employer in respect of employee salary sacrifice arrangements	(400)
Total current service cost	(1,900)
Actuarial gain due to changes in assumptions and experience	55,300
Interest expense	(3,000)
Benefits paid	6,500
Company's share of the defined benefit obligations at 31 December 2022	**(114,400)**

Amounts recognised in the Income Statement

	2022 **£000**	2021 £000
Included in operating costs:		
Current service cost	**(1,500)**	(1,500)
Administrative expenses	**(100)**	-
	(1,600)	(1,500)
Included in finance costs:		
Net interest expense on retirement benefit obligations	**(200)**	(400)

The Company incurred a charge of £10,897k (2020 £10,473k) in relation to defined contribution schemes for employees.

Sensitivity analysis
The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 31 December 2022 and keeping all other assumptions as set out on page 56.

The pension schemes hold a number of unquoted pooled investment vehicles, which are investments in private markets. These are valued based on latest available valuation reports, and as noted on page 22, these valuations are subject to estimation uncertainty as their valuation techniques incorporate a number of assumptions, including those associated with the COVID-19 pandemic and the impact of climate change.

19. Retirement benefit obligations (continued)

Financial assumptions
The estimated impact of changes in the discount rate and inflation assumptions on the defined benefit pension obligation, together with the estimated impact on scheme assets after allocation to other participating employers, is shown in the table below. The estimated impact on scheme assets takes into account the risk management activities in respect of interest rate and inflation risk. The sensitivity analysis on the defined benefit obligation is measured on an IAS 19 accounting basis and, therefore, does not reflect the natural hedging in the discount rate used for funding valuation purposes.

	(Increase)/ decrease in pension obligation[1]	Increase/ (decrease) in scheme assets[1]
	£m	£m
Discount rate:		
0.5 percentage point increase	7	(6)
0.5 percentage point decrease	(8)	7
1.0 percentage point increase	13	(11)
1.0 percentage point decrease	(16)	14
2.0 percentage point increase	24	(20)
2.0 percentage point decrease	(37)	32
3.0 percentage point increase	33	(28)
3.0 percentage point decrease	(64)	56
Inflation:		
0.1 percentage point increase	(1)	1
0.1 percentage point decrease	1	(1)
0.5 percentage point increase	(4)	3
0.5 percentage point decrease	4	(3)
1.0 percentage point increase	(9)	7
1.0 percentage point decrease	9	(6)

[1] Before deduction of withholding tax

Demographic assumptions
Changes in the life expectancy assumption, including the benefit of longevity swap arrangements, would have the following effect on the net IAS 19 deficit:

	(Decrease)/ increase in net surplus[1]
	£m
Life expectancy:	
One-year increase	(4)
One-year decrease	4

1 Before deduction of withholding tax

20. Provisions

	IT provisions £000	Warranty £000	Other £000	Total £000
Non-current	-	-	-	-
Current	-	376	1,756	2,132
At 1 January 2022	-	376	1,756	2,132
Released	-	(96)	(293)	(389)
Created	14,815	8	3,956	18,779
Utilised in year	-	(73)	(230)	(303)
At 31 December 2022	**14,815**	**215**	**5,189**	**20,219**
Represented by:				
Non-current	1,132	-	-	1,132
Current	13,683	215	5,189	19,087
	14,815	**215**	**5,189**	**20,219**

IT provisions
IT costs that will be incurred as a result of separating the Digital Intelligence networks from the Financial Crime business. The majority of costs are expected to be incurred within 1 year, with some licence costs to be incurred by December 2025

Warranty
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.

Other
There are no single significant provisions included within other provisions.

21. Trade, other and contract payables

	2022 £000	2021 £000
Current		
Contract payables	**23,746**	34,463
Trade payables	**13,764**	5,490
Amounts owed to BAE Systems plc subsidiaries	**28,014**	19,961
Amounts owed to BAE Systems plc	**15,448**	12,985
Other taxation and social security costs	**16,000**	16,386
Other payables	**2,087**	1,221
Accruals	**60,553**	52,356
	159,612	142,862

Included in the opening balance of contract payables is £31,271k (2021: £22,509k) which has been recognised as revenue in the current year.

Amounts owed to BAE Systems plc and its subsidiaries are payable on demand and are unsecured. No interest is applied to amounts owed.

22. Share capital and other reserves

Share capital

	£1 Ordinary shares	Nominal value £000
Authorised, issued and fully paid		
At 1 January 2021, 31 December 2021 and 31 December 2022	**125,046**	**125**

Other reserves

	Capital redemption £000	Share-based payments £000	Hedging reserve £000	**Total £000**
At 1 January 2021	31	22,778	1,492	**24,301**
Amounts debited to hedging reserve	-	-	(977)	**(977)**
Share-based payments	-	2,709	-	**2,709**
At 31 December 2021	31	25,487	515	**26,033**
Amounts debited to hedging reserve	-	-	(409)	**(409)**
Share-based payments	-	2,749	-	**2,749**
At 31 December 2022	31	28,236	106	**28,373**

Capital redemption reserve
The capital redemption reserve represents the amount transferred following the purchase of the company's own shares out of distributable profits.

Share-based payment reserve
The share-based payment reserve represents the credit to reserves in relation to the share-based payments expense recognised in the Company's Income Statement.

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.

Notes to the Financial Statements

23. Share based payments

Share-based payment awards in respect of shares in the ultimate parent company, 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.

	Range of exercise price of outstanding options (£) 2022	**Weighted average remaining contracted life (years) 2022**	Range of exercise price of outstanding options (£) 2021	Weighted average remaining contracted life (years) 2021
Executive Share Option Plan	**7.83-4.12**	**7**	6.49-3.89	7
Restricted Share Plan		**7**		-
Performance Share Plan		**5**		5

The average share price of BAE Systems plc in the year was £7.53 (2021: £5.33).

24. Events after the reporting period

There have been no significant events affecting the Company since the year end.

25. Controlling parties

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

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

6 Carlton Gardens
London
SW1Y 5AD

Website: www.baesystems.com