

# **BAE Systems (Oman) Limited**

## **Annual report and financial statements**

**31 December 2016**

Registered number: 03135337



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## Strategic report

### Review of business

#### Overview

In December 2012 the Company was awarded a contract for the provision of Typhoon and Hawk Aircraft and attendant Support Services to the Sultanate of Oman. Deliveries to the customer under this contract are due to commence in 2017. The principal activities of the Company during the year have been the assembly activities for Typhoon and Hawk aircraft and the provisioning of aircraft spares.

### Key performance indicators

Key financial performance indicators are shown below:

	2016	2015
	£000's	£000's
Order intake	3,539	7,287
Revenue	616,462	6,291
Operating profit/(loss)	34,217	(758)

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

**Revenue** represents the amounts derived from the provision of goods and services.

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

### Principal risks and uncertainties

The Company's principal risks are identified below.

#### **The Company is dependent on defence spending.**

The Company's core business is primarily defence-related, selling products and services to the Royal Air Force of Oman.

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

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

#### **The Company operates in an international market.**

The Company conducts business in the Middle East.

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

The Company is exposed to volatility in currency exchange rates, particularly in respect of the Omani Rial and US Dollar.

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

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

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

**Strategic report (continued)**

**The Company has few contracts, including two large contracts and several small contracts.**

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

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

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

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

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

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

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

**The Company's strategy is dependent on its ability to recruit and retain people with appropriate talent and skills. All employees are required to act in accordance with the Company's policies.**

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

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

**On behalf of the Board**



D A Cole  
Director

16 June 2017

## **Directors' report**

### **Company registration**

BAE Systems (Oman) Limited is a private company, limited by shares and registered in England and Wales with the registered number 03135337.

### **Results and dividends**

The Company's profit for the financial year is £34,054k (2015: loss £879k). The directors propose a nil dividend for 2016 (2015: nil).

### **Looking forward**

The Company has a strong order backlog. Sales are underpinned by the sale of Typhoon and Hawk aircraft and the provision of long-term in country support of those aircraft.

### **Going concern**

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

### **Overseas branch office**

The Company has an overseas branch office in Oman.

### **Employees**

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

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

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

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

### **Financial instruments**

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

### **Directors and their interests**

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

Mr D A Cole  
Mr I G King  
Sir Simon Bryant KCB CBE

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

### **Disclosure of information to auditor**

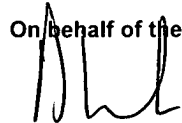
The directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each director has taken all the steps that he ought to have taken to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

**Directors' report** *(continued)*

**Auditor**

The auditor, KPMG LLP, has indicated its willingness to continue in office and in accordance with section 487(2) of the Companies Act 2006, has been reappointed.

**On behalf of the Board**



D A Cole  
Director

16 June 2017

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

## **Statement of directors' responsibilities in respect of the annual report and the financial statements**

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 they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 101 *Reduced Disclosure Framework*.

Under Company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- 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 have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

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

We have audited the financial statements of BAE Systems (Oman) Limited for the year ended 31 December 2016 set out on pages 9 to 30. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice), including FRS 101 *Reduced Disclosure Framework*.

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

### Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 7, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### Scope of the audit of the financial statements

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

### Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### Opinion on other matters prescribed by the Companies Act 2006

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

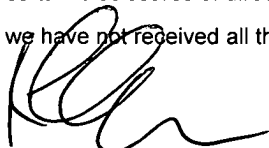
Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic Report and the Directors' Report:

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

### Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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



**Richard Evans**  
for and on behalf of KPMG LLP, Statutory Auditor  
Chartered Accountants  
KPMG LLP  
1 St Peters' Square  
Manchester  
M2 3AE

24 June 2017



## Income statement

for the year ended 31 December 2016

	Notes	2016 £'000	2015 £'000
Revenue	2	616,462	6,291
Operating costs	3	(582,245)	(7,049)
<b>Operating profit/(loss)</b>		<b>34,217</b>	<b>(758)</b>
<b>Profit/(loss) before finance costs and taxation</b>		<b>34,217</b>	<b>(758)</b>
Financial expense	4	(200)	(114)
<b>Profit/(loss) before taxation</b>		<b>34,017</b>	<b>(872)</b>
Taxation income/(expense)	6	37	(7)
<b>Profit/(loss) for the year</b>		<b>34,054</b>	<b>(879)</b>

## Statement of comprehensive income

for the year ended 31 December 2016

	Notes	2016 £'000	2015 £'000
<b>Profit/(loss) for the year</b>		<b>34,054</b>	<b>(879)</b>
<b>Other comprehensive income</b>			
<b>Items that will not be reclassified to the income statement:</b>			
Remeasurements on retirement benefit schemes		(4,400)	1,193
Tax on items that will not be reclassified to the income statement	6	792	(239)
Tax rate adjustment	6	(70)	(52)
<b>Items that may be reclassified to the income statement:</b>			
Amounts credited to hedging reserve		12,134	4,306
Tax on items that may be reclassified to the income statement	6	(2,184)	(861)
Tax rate adjustment	6	(229)	123
<b>Total other comprehensive income for the year (net of tax)</b>		<b>6,043</b>	<b>4,470</b>
<b>Total comprehensive income for the year</b>		<b>40,097</b>	<b>3,591</b>

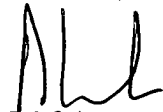
The notes on pages 12 to 30 form part of the financial statements.

The results for 2016 and 2015 arise from continuing activities.

**Balance sheet**  
as at 31 December 2016

	Notes	2016 £'000	2015 £'000
<b>Non-current assets</b>			
Intangible assets	7	80	-
Property, plant and equipment	8	105	147
Other financial assets	9	14,510	6,073
		<b>14,695</b>	<b>6,220</b>
<b>Current assets</b>			
Trade and other receivables including amounts due from customers for contract work	11	282,388	291,667
Other financial assets	9	4,151	357
Cash and cash equivalents		727	150
		<b>287,266</b>	<b>292,174</b>
<b>Total assets</b>		<b>301,961</b>	<b>298,394</b>
<b>Non-current liabilities</b>			
Retirement benefit obligations	13	(7,212)	(2,612)
Other financial liabilities	9	(129)	(66)
Deferred tax liabilities	10	(2,282)	(628)
		<b>(9,623)</b>	<b>(3,306)</b>
<b>Current liabilities</b>			
Trade and other payables	12	(253,124)	(296,005)
Other financial liabilities	9	(279)	(245)
		<b>(253,403)</b>	<b>(296,250)</b>
<b>Total liabilities</b>		<b>(263,026)</b>	<b>(299,556)</b>
<b>Net assets/(liabilities)</b>		<b>38,935</b>	<b>(1,162)</b>
<b>Capital and reserves</b>			
Issued share capital	14	-	-
Other reserves	14	14,739	5,018
Retained earnings/(deficit)		24,196	(6,180)
<b>Total equity</b>		<b>38,935</b>	<b>(1,162)</b>

Approved by the Board on 16 June 2017 and signed on its behalf by:



D A Cole  
Director

Registered number: 03135337

**Statement of changes in equity**  
for the year ended 31 December 2016

	Other reserves	Retained earnings	Total equity
	£'000	£'000	£'000
At 1 January 2015	1,450	(6,203)	(4,753)
Loss for the year	-	(879)	(879)
Total other comprehensive income for the year	3,568	902	4,470
At 31 December 2015	5,018	(6,180)	(1,162)
Profit for the year	-	34,054	34,054
Total other comprehensive income for the year	9,721	(3,678)	6,043
<b>At 31 December 2016</b>	<b>14,739</b>	<b>24,196</b>	<b>38,935</b>

## Notes to the financial statements

### 1 Accounting policies

#### Basis of preparation

BAE Systems Oman Limited is a private company incorporated, domiciled and registered in England and Wales in the UK. The registered number is 03135337 and the registered address is Warwick House PO Box 87, Farnborough Aerospace Centre, Farnborough, Hampshire, GU14 6YU.

These financial statements were prepared in accordance with Financial Reporting Standard (FRS) 101 Reduced Disclosure Framework. Amendments to FRS 101 (2014/15 cycle and other minor amendments) and Amendments to FRS 101 (2015/16 cycle), both effective for periods beginning on or after 1 January 2016, have been applied.

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards (IFRS) as adopted by the EU (EU-adopted IFRS), but makes amendments where necessary in order to comply with the Companies Act 2006 and has set out below where advantage of the FRS 101 disclosure exemptions has been taken:

- the requirements of IFRS 7, Financial Instruments: Disclosures;
- the requirement in paragraph 38 of IAS 1, Presentation of Financial Statements, to present comparative information in respect of: paragraph 79(a)(iv) of IAS 1; paragraph 73(e) of IAS 16, Property, Plant and Equipment; paragraph 118(e) of IAS 38, Intangible Assets; and paragraphs 76 and 79(d) of IAS 40, Investment Property;
- the requirements of paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 38D, 40A, 40B, 40C, 40D, 111 and 134 to 136 of IAS 1, Presentation of Financial Statements;
- the requirements of IAS 7, Statement of Cash Flows;
- the requirements of paragraphs 30 and 31 of IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors;
- the requirements of paragraphs 17 and 18A of IAS 24, Related Party Disclosures; and
- 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.

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

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

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of relevant financial assets and financial liabilities (including derivative instruments). The going concern basis has been applied in these accounts.

## Notes to the financial statements (continued)

### 1 Accounting policies (continued)

#### Revenue and profit recognition

Revenue represents income derived from the provision of goods and services by the Company.

##### *Long-term contracts*

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

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

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

##### *Goods supplied and services rendered*

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

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

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

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

##### *Interest income and borrowing costs*

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

##### *Dividends*

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

##### *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.

##### *Property, plant and equipment*

###### *Cost*

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

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

##### *Depreciation*

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

Computing equipment and motor vehicles - 3 to 4 years

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

##### *Intangible assets*

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

## Notes to the financial statements *(continued)*

### 1. Accounting policies *(continued)*

#### Trade and other receivables

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

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

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

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

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

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

#### Cash and cash equivalents

Cash and cash equivalents includes cash in hand.

#### Trade and other payables

Trade and other payables are stated at their cost.

#### Tax

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

##### Current tax

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

##### Deferred tax

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

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

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

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

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

## Notes to the financial statements (continued)

### 1 Accounting policies (continued)

#### Retirement benefit obligations

##### *Defined contribution pension schemes*

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

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

##### *Defined benefit pension schemes*

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

The retirement benefit 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 pages 25. 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.

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.

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.

#### Financial instruments

##### *Derivative financial instruments and hedging activities*

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

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

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

##### *Cash flow hedges*

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

##### *Fair value hedges*

Where a derivative financial instrument is designated as a fair value hedge, changes in the fair value of the underlying asset or liability attributable to the hedged risk, and gains and losses on the derivative instrument, are recognised in the income statement for the period.

## Notes to the financial statements *(continued)*

### 2 Segmental analysis

Revenue by customer location	2016 £'000	2015 £'000
Middle East	616,462	6,291
	616,462	6,291

Revenue by category	2016 £'000	2015 £'000
Long-term contracts	613,969	3,700
Sale of goods	2,074	1,966
Provision of services	419	625
	616,462	6,291

### 3 Operating costs

	2016 £'000	2015 £'000
Raw materials, subcontracts and other bought-in items	340,860	(483,758)
Change in inventories of finished goods and work-in-progress	236,301	480,619
Cost of inventories expensed	577,161	(3,139)
Staff costs (note 5)	3,024	1,849
Depreciation, amortisation and impairment	42	36
Other operating charges	2,018	8,303
Operating costs	582,245	7,049

The remuneration of the auditor for the year ended 31 December 2016 for statutory audit work was £10,000 (2015: £10,000) and £nil (2015: £nil) in respect of non-audit work.

### 4 Financial expense

	2016 £'000	2015 £'000
Net interest expense on retirement benefit obligations (note 13)	200	114
Financial expense	200	114



## Notes to the financial statements (continued)

### 5 Employees

#### Employees

The average number of Company employees was as follows:

	2016	2015
Platforms & Services (International)	32	24
	32	24

The aggregate staff costs of Company employees were as follows:

	2016 £'000	2015 £'000
Wages and salaries	2,372	1,538
Social security costs	197	118
Pension costs – defined benefit plans (note 13)	400	193
Other pension costs	55	-
	3,024	1,849

#### Directors' emoluments

Of the directors, I. G. King and D. A. Cole did not receive any emoluments from the Company during the year as they are employed by other BAE Systems companies and were remunerated through those companies. Neither provided any material qualifying services to the Company.

The emoluments received directly by the directors to reflect their qualifying services to the Company were:

	2016 £'000	2015 £'000
Directors' remuneration	252	245
	252	245

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

	2016 Number of directors	2015 Number of directors
Money purchase schemes	-	-
Defined benefit schemes	-	-

	2016 Number of directors	2015 Number of directors
The number of directors who exercised share options was	-	-
The number of directors in respect of whose qualifying services shares were received or receivable under long-term incentive schemes was	1	-

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

	2016 £'000	2015 £'000
Remuneration and amounts receivable under long-term incentive schemes	252	245

The highest paid director's defined benefit accrued pension and accrued lump sum at 31 December 2016 was £nil (2015: nil) and £nil (2015: nil), respectively.

During the year, the highest paid director did not exercise share options and received shares under a long-term incentive scheme.

## Notes to the financial statements (continued)

### 6 Taxation expense

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

Taxation expense	2016 £'000	2015 £'000
<b>Current taxation</b>		
UK:		
Current tax	-	-
	-	-
<b>Deferred taxation</b>		
Origination and reversal of temporary differences	40	(7)
Tax rate adjustment <sup>1</sup>	(3)	-
	37	(7)
<b>Taxation income/(expense)</b>	<b>37</b>	<b>(7)</b>

1 The UK corporation tax rate was reduced from 20% to 19% with effect from 1 April 2017, and will be reduced to 17% with effect from 1 April 2020. In line with this change, the rate applying to long-term UK deferred tax assets and liabilities has been reduced from the prior year's enacted tax rate of 18% to 17%, creating a rate adjustment in 2016 which is partly reflected in the income statement and partly in the statement of other comprehensive income. The deferred tax asset/liability has been calculated at the tax rates that are expected to apply to the temporary differences when they reverse, based on the laws enacted or substantively enacted by the reporting date.

#### Reconciliation of taxation expense

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

	2016 £'000	2015 £'000
<b>Profit/(loss) before taxation</b>	<b>34,017</b>	<b>(872)</b>
UK corporation tax rate	20.00%	20.25%
Expected tax (expense)/income on loss	(6,803)	177
Pensions	(6)	-
Imputed interest expense/(income)	433	(609)
Losses received from group companies	6,409	422
Other	4	3
<b>Taxation income/(expense)</b>	<b>37</b>	<b>(7)</b>

#### Tax recognised in other comprehensive income

	2016			2015		
	Before tax £'000	Tax benefit/ (expense) £'000	Net of tax £'000	Before tax £'000	Tax benefit/ (expense) £'000	Net of tax £'000
<b>Items that will not be reclassified to the income statement:</b>						
Remeasurements on retirement benefit schemes	(4,400)	792	(3,608)	1,193	(239)	954
Tax rate adjustment <sup>1</sup>	-	(70)	(70)	-	(52)	(52)
<b>Items that may be reclassified to the income statement:</b>						
Amounts charged/(credited) to hedging reserve	12,134	(2,184)	9,950	4,306	(861)	3,445
Tax rate adjustment	-	(229)	(229)	-	123	123
	<b>7,734</b>	<b>(1,691)</b>	<b>6,043</b>	<b>5,499</b>	<b>(1,029)</b>	<b>4,470</b>

Notes to the financial statements (continued)

6 Taxation expense (continued)

	2016			2015		
	Other reserves	Retained earnings	Total	Other reserves	Retained earnings	Total
	£'000	£'000	£'000	£'000	£'000	£'000
<b>Current tax</b>						
Financial instruments	-	-	-	-	-	-
Pensions	-	-	-	-	-	-
	-	-	-	-	-	-
<b>Deferred tax</b>						
Financial instruments	(2,184)	-	(2,184)	(861)	-	(861)
Pensions	-	792	792	-	(239)	(239)
Tax rate adjustment <sup>1</sup>	(229)	(70)	(299)	123	(52)	71
	(2,413)	722	(1,691)	(738)	(291)	(1,029)
<b>Tax on other comprehensive income</b>	(2,413)	722	(1,691)	(738)	(291)	(1,029)

7 Intangible assets

	Software £'000
<b>Cost</b>	
At 1 January 2016	-
Additions	80
<b>At 31 December 2016</b>	<b>80</b>
<b>Amortisation</b>	
At 1 January 2016	-
Amortisation charge	-
<b>At 31 December 2016</b>	<b>80</b>
<b>Net book value</b>	
<b>At 31 December 2016</b>	<b>80</b>
At 31 December 2015	-

Notes to the financial statements *(continued)*

**8 Property, plant and equipment**

	Plant and machinery £'000	Total £'000
<b>Cost or valuation</b>		
At 1 January 2016	199	199
Additions	-	-
<b>At 31 December 2016</b>	<b>199</b>	<b>199</b>
<b>Depreciation and impairment</b>		
At 1 January 2016	52	52
Depreciation charge for the year	42	42
<b>At 31 December 2016</b>	<b>94</b>	<b>94</b>
<b>Net book value</b>		
<b>At 31 December 2016</b>	<b>105</b>	<b>105</b>
At 31 December 2015	147	147

**Capital commitments**

Capital expenditure contracted for but not provided for in full in the accounts is £nil (2015: £nil).

**9 Other financial assets and liabilities**

	2016		2015	
	Assets £'000	Liabilities £'000	Assets £'000	Liabilities £'000
<b>Non-current</b>				
Cash flow hedges – foreign exchange contracts	14,510	(129)	6,073	(66)
<b>Current</b>				
Cash flow hedges – foreign exchange contracts	4,151	(279)	357	(245)

**Contracted cash flows**

The net contractual cash flows on derivative financial instruments at the reporting date are £nil (2015: £nil).

**Notes to the financial statements (continued)**

**10 Deferred tax**

**Deferred tax assets/(liabilities)**

	Deferred tax assets		Deferred tax liabilities		Net balance at 31 December	
	2016 £'000	2015 £'000	2016 £'000	2015 £'000	2016 £'000	2015 £'000
Property, plant and equipment	6	3	-	-	6	3
Pension/retirement schemes: deficits	1,226	470	-	-	1,226	470
Financial instruments	-	-	(3,514)	(1,101)	(3,514)	(1,101)
<b>Net deferred tax assets/(liabilities)</b>	<b>1,232</b>	<b>473</b>	<b>(3,514)</b>	<b>(1,101)</b>	<b>(2,282)</b>	<b>(628)</b>

**Movement in temporary differences during the year**

	At 1 January 2016 £'000	Recognised in income £'000	Recognised in equity £'000	At 31 December 2016 £'000
Property, plant and equipment	3	3	-	6
Pension schemes: deficits	470	34	722	1,226
Financial instruments	(1,101)	-	(2,413)	(3,514)
	(628)	37	(1,691)	(2,282)

	At 1 January 2015 £'000	Recognised in income £'000	Recognised in equity £'000	At 31 December 2015 £'000
Property, plant and equipment	2	1	-	3
Provisions and accruals	9	(9)	-	-
Pension schemes: deficits	760	1	(291)	470
Financial instruments	(363)	-	(738)	(1,101)
	408	(7)	(1,029)	(628)

Notes to the financial statements (continued)

11 Trade and other receivables

	2016 £'000	2015 £'000
<b>Current</b>		
Long-term contract balances	864,496	1,100,877
Less: attributable progress payments	(690,398)	(962,669)
Amounts due from contract customers	10,113	152,605
Amounts due from customers for contract work	184,211	290,813
Trade receivables	240	509
Amounts owed by group companies	130	30
Amounts owed by ultimate parent company	97,447	-
Prepayments and accrued income	360	315
	<b>282,388</b>	<b>291,667</b>

12 Trade and other payables

	2016 £'000	2015 £'000
<b>Current</b>		
Trade payables	76	5
Amounts due to ultimate parent company	193	101,486
Amounts due to long term contract customers	248,201	190,437
Amounts owed to group companies	1,540	630
Accruals and deferred income	3,114	3,447
	<b>253,124</b>	<b>296,005</b>
Included above:		
Advances from long-term contract customers	248,201	190,437

## Notes to the financial statements (continued)

### 13 Retirement benefit obligations

#### Background

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

At 31 December 2016, the weighted average durations of the UK defined benefit pension obligations were 19 years (2015: 18 years).

The Company participates in the following BAE Systems plc schemes: Main Scheme.

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

	Active %	Deferred %	Pensioner %
Main Scheme <sup>1</sup>	32	19	49

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

#### Regulatory framework

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

#### Benefits

The UK defined benefit schemes provide benefits to members in the form of a set level of pension payable for life based on members' final salaries. The benefits attract inflation-related increases both in deferment and payment. All UK defined benefit schemes are closed to new entrants, with benefits for new employees being provided through a defined contribution scheme. The normal retirement age for active members of the Main Scheme 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](http://www.baesystemspensions.com).

#### Funding

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, whilst the liabilities are determined based on prudent assumptions set by the trustees following consultation with scheme actuaries.

The separate actuarial valuations for funding purposes include assumptions which differ from the actuarial assumptions used for IAS 19 accounting purposes shown on page 25. The latest valuation of the Main Scheme was performed as at 31 March 2014 and showed a funding deficit of £2.6bn. Deficit recovery plans agreed with the trustees of the relevant schemes run until 2026.

The next UK triennial funding valuations, as at 31 March 2017, commenced in April 2017 and, in conjunction with the trustees of the schemes and other stakeholders, BAE Systems plc will be looking at various options with a focus on the longer-term view. The results of future triennial valuations and associated funding requirements will be impacted by the future performance of investment markets, and interest and inflation rates.

The total Company contributions made to the defined benefit schemes in the year ended 31 December 2016 were £0.4m (2015: £0.4m) in line with the schedule of contributions. In 2017, the Company expects to make contributions at a similar level to the recurring contributions and deficit funding as made in 2016.

## Notes to the financial statements *(continued)*

### 13 Retirement benefit obligations *(continued)*

#### Risk management

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

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



## Notes to the financial statements (continued)

### 13 Retirement benefit obligations (continued)

#### Principal actuarial assumptions

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

	2016	2015	2014
<b>Financial assumptions</b>			
Discount rate (%)	2.7	3.9	3.6
Inflation (%)	3.2	3.2	3.2
Rate of increase in salaries (%)	3.2	3.2	3.2
Rate of increase in deferred pensions (%)	2.2/3.2	2.3/3.2	2.3/3.2
Rate of increase in pensions in payment (%)	1.7-3.7	1.8 – 3.6	1.8 – 3.6
<b>Demographic assumptions</b>			
Life expectancy of a male currently aged 65 (years)	86 – 89	87 – 89	87 – 89
Life expectancy of a female currently aged 65 (years)	89 – 90	89 – 90	89 – 90
Life expectancy of a male currently aged 45 (years)	88 – 91	89 – 91	89 – 91
Life expectancy of a female currently aged 45 (years)	91 – 92	91 – 92	91 – 92

#### Discount rate

The discount rate assumptions are derived through discounting the projected benefit payments of the principal schemes 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. Further information on the duration of the schemes is detailed on page 23.

#### Inflation

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

#### Rate of increase in salaries

The rate of increase in salaries for the UK schemes is assumed to be Retail Prices Index (RPI) inflation of 3.2% (2015: RPI inflation of 3.2%), plus a promotional scale.

#### Rate of increase in pensions in payment

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

#### Rate of increase in deferred pensions

The rate of increase in deferred pensions for the UK schemes is based on CPI inflation of 2.2% (2015: CPI inflation of 2.3%), with the exception of the 2000 Plan, which is based on RPI inflation of 3.2% (2015: RPI inflation of 3.2%). The rate of increase in deferred pensions is subject to inflation caps.

#### Life expectancy

The Company has used the Self-Administered Pension Schemes S2 mortality tables based on year of birth (as published by the Institute of Actuaries) for both pensioner and non-pensioner members in conjunction with the results of an investigation into the actual mortality experience of scheme members. In addition, to allow for future improvements in longevity, the Continuous Mortality Investigation 2015 tables (published by the Institute of Actuaries) have been used, with an assumed long-term rate of future annual mortality improvements of 1.25% (2015: 1.25%), for both pensioner and non-pensioner members.

## Notes to the financial statements *(continued)*

### 13 Retirement benefit obligations *(continued)*

The disclosures below relate to post-retirement benefit schemes in the UK which are accounted for as defined benefit schemes in accordance with IAS 19. The valuations used for the IAS 19 disclosures are based on the most recent actuarial valuation undertaken by independent qualified actuaries as updated to take account of the requirements of IAS 19 to assess the deficits of the schemes at 31 December each year. In 2015, the Company presented the total fair value of scheme assets and the total present value of the defined benefit obligations for the schemes in which the Company participated, together with a reconciliation to the Company's share of the net deficit. For 2016, the Company has presented the Company's share of the fair value of scheme assets and the present value of the defined benefit obligations and, therefore, the 2015 disclosures have been re-presented on this basis. This provides more relevant information since only those assets, obligations and associated movements relating to the Company's share of the schemes in which it participates are now presented.

#### Summary of movements in retirement benefit obligations

	£m
Company's share of IAS 19 deficit at 1 January 2016	(3)
Actual return on assets excluding amounts included in interest expense	13
Increase in liabilities due to changes in assumptions and experience	(17)
<b>Company's share of IAS 19 deficit at 31 December 2016</b>	<b>(7)</b>

#### Amounts recognised on the balance sheet

The table below shows the Company's share of the Group's UK pension schemes after allocation to other participating employers.

	2016 £m	2015 £m
Present value of funded obligations	(29)	(12)
Fair value of scheme assets	22	9
<b>Company's share of IAS 19 deficit, net</b>	<b>(7)</b>	<b>(3)</b>
Represented by:		
Retirement benefit surpluses	-	-
Retirement benefit obligations	(7)	(3)
	(7)	(3)

## Notes to the financial statements (continued)

### 13 Retirement benefit obligations (continued)

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

	UK defined benefit pension schemes £m
Company's value of scheme assets at 1 January 2015	10.4
Interest income	0.3
Actual return on assets excluding amounts included in interest income	(1.8)
Actual return on assets	(1.5)
Contributions by employer	0.3
Contributions by employer in respect of employee salary sacrifice arrangements	0.1
Total contributions by employer	0.4
Benefits paid	(0.4)
Company's value of scheme assets at 31 December 2015	8.9
Interest income	0.7
Actual return on assets excluding amounts included in interest income	12.9
Actual return on assets	13.6
Contributions by employer	0.3
Contributions by employer in respect of employee salary sacrifice arrangements	0.1
Total contributions by employer	0.4
Benefits paid	(0.9)
Company's value of scheme assets at 31 December 2016	22.0

#### Assets of defined benefit pension schemes

	2016			2015 <sup>4</sup>		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equities:						
UK	5.3	0.0	5.3	2.2	0.0	2.2
Overseas	3.8	0.0	3.8	1.7	0.0	1.7
Pooled investment vehicles <sup>1</sup>	0.3	2.3	2.6	0.1	0.8	0.9
Fixed interest securities:						
UK gilts	1.6	0.0	1.6	0.8	0.0	0.8
UK corporates	2.4	0.1	2.5	1.1	0.1	1.2
Overseas government	0.1	0.0	0.1	0.0	0.0	0.0
Overseas corporates	1.0	0.4	1.4	0.0	0.1	0.1
Index-linked securities:						
UK gilts	1.6	0.0	1.6	0.6	0.0	0.6
UK corporates	0.9	0.5	1.4	0.4	0.3	0.7
Property <sup>2</sup>	0.0	1.6	1.6	0.0	0.7	0.7
Derivatives <sup>3</sup>	0.0	(0.3)	(0.3)	0.0	(0.1)	(0.1)
Cash:						
Sterling	0.4	0.0	0.4	0.1	0.0	0.1
Foreign currency	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0
<b>Company total</b>	<b>17.4</b>	<b>4.6</b>	<b>22.0</b>	<b>7.0</b>	<b>1.9</b>	<b>8.9</b>

1. Primarily invested in equities. The amounts classified as unquoted primarily comprise investments in private equity, 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 interest rate, inflation and longevity swaps. The valuations are based on valuation techniques using underlying market data and discounted cash flows.

4. Restated following reinterpretation of the classifications, including the allocation between quoted and unquoted assets.

**Notes to the financial statements (continued)**

**13 Retirement benefit obligations (continued)**

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

	UK defined benefit pension schemes £m
Company's defined benefit obligations at 1 January 2015	(14.2)
<i>Current service cost</i>	(0.1)
<i>Contributions by employer in respect of employee salary sacrifice arrangements</i>	(0.1)
Total current service cost	(0.2)
Members' contributions	-
Past service cost – plan amendments	-
Actuarial gain/(loss) due to changes in assumptions and experience	2.9
Interest expense	(0.4)
Benefits paid	0.4
Company's defined benefit obligations at 31 December 2015	(11.5)
<i>Current service cost</i>	(0.3)
<i>Contributions by employer in respect of employee salary sacrifice arrangements</i>	(0.1)
Total current service cost	(0.4)
Members' contributions	-
Past service cost – plan amendments	-
Actuarial (loss)/gain due to changes in assumptions and experience	(17.3)
Interest expense	(0.9)
Benefits paid	0.9
Company's defined benefit obligations at 31 December 2016	(29.2)

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

	2016 £'000	2015 £'000
<b>Included in operating costs:</b>		
Current service cost	(400)	(193)
	(400)	(193)
<b>Included in finance costs:</b>		
Net interest expense on retirement benefit obligations	(200)	(114)

## Notes to the financial statements *(continued)*

### 13 Retirement benefit obligations *(continued)*

#### Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 31 December 2016 and keeping all other assumptions as set out on page 25.

#### Financial assumptions

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

	(Increase)/ decrease in pension obligation £m
<b>Discount rate:</b>	
0.1 percentage point increase	1
0.1 percentage point decrease	(1)
<b>Inflation:</b>	
0.1 percentage point increase	(1)
0.1 percentage point decrease	1

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

	(Increase)/ decrease in pension obligation £m
<b>Inflation:</b>	
0.5 percentage point increase	(2)
0.5 percentage point decrease	2
1.0 percentage point increase	(4)
1.0 percentage point decrease	4

#### Demographic assumptions

Changes in the life expectancy assumption would have the following effect on the total net IAS 19 deficit after allocation to other participating employers:

	(Increase)/ decrease in net deficit £m
<b>Life expectancy:</b>	
One-year increase	(1)
One-year decrease	1

## Notes to the financial statements (continued)

### 14 Share capital and other reserves

#### Share capital

	£1 Ordinary shares	Nominal value £
<b>Issued and fully paid</b>		
At 1 January and 31 December 2016	2	2

#### Other reserves

	Hedging reserve £'000
<b>At 1 January 2015</b>	<b>1,450</b>
Amounts credited to hedging reserve	4,306
Tax on other comprehensive income	(738)
<b>At 31 December 2015</b>	<b>5,018</b>
Amounts credited to hedging	12,134
Tax on other comprehensive income	(2,413)
<b>At 31 December 2016</b>	<b>14,739</b>

#### 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.

### 15 Controlling parties

The immediate parent company is BAE Systems (Holdings) Limited and the ultimate parent company is BAE Systems plc. Both companies are incorporated in Great Britain and registered in England and Wales.

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

6 Carlton Gardens  
London  
SW1Y 5AD

Website: [www.baesystems.com](http://www.baesystems.com)