

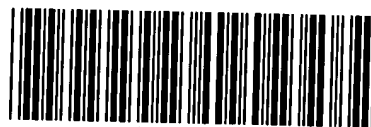
BAE Systems Applied Intelligence Limited

Annual Report and Financial Statements

31 December 2021

Registered number: 01337451

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Contents

Strategic Report	2
Directors' Report	6
Directors' Responsibilities Statement	10
Independent Auditor's Report to the Members of BAE Systems Applied Intelligence Limited	11
Income Statement	15
Statement of Comprehensive Income	15
Balance Sheet	16
Statement of Changes in Equity	17
Notes to the Financial Statements	18

Strategic Report

Review of business and principal activities

Review of business

Revenue for the year amounted to £420 million (2020: £360 million) and included Intercompany Service Fees of £28m (2020: £14m) and Licence Revenue of £13m (2020: £4m). The profit for the year after taxation and exceptional items amounted to £23 million (2020: restated loss of £8 million).

The business performed strongly in 2021 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. The BAE Systems Applied Intelligence business group ('Applied Intelligence') provides data intelligence solutions which enable governments and commercial organisations to defend against national scale threats, protect their networks and data against sophisticated attacks and operate successfully in cyber space.

Key performance indicators

The directors consider revenue and operating profit/loss as the principal key performance indicators to assess progress towards achieving the Company's strategy. This information for the current and prior periods is set out in the Company's Income Statement on page 15.

Across the BAE Systems Applied Intelligence business, total performance is reviewed on a regular basis in terms of order book. However, this is not monitored and reported on a legal entity basis so no further information has been provided here.

Principal risks and uncertainties

The significant high level risks identified by the Board have not changed substantially over the last 12 months.

Global economic climate

As with all technology businesses, the Company is exposed to any downturn in technology spending that may result from instability in the global economy caused, for example, by rising commodity prices, acts of terrorism or significant pressure on selected government spending programmes including spending by government impacted by the COVID-19 outbreak due to reprioritisation of funds.

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, we maintain staff base flexibility in order that we can move resources to those sectors where demand is greatest.

Recruitment market

The current 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. The Company addresses 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.

Strategic Report *(continued)*

Pricing pressure from off-shore providers

Low-cost providers in off-shore locations continue to exert pressure on pricing in some sectors of the organisations markets. Applied Intelligence operates a UK delivery centre in Leeds, and through local subsidiaries, a similar centre in Poland and a larger global delivery centre in Malaysia to provide more efficient and cost-effective offerings to our clients. Some of the Company's work is unsuitable for off-shore resourcing for security reasons, which is a constraint the organisation has sought to address by investing in secure facilities in our UK locations.

Delivery risk

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 client expectations and/or its contractual obligations could damage the organisation'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.

Security

Much of Applied Intelligence's work relies on its reputation for strong security, in particular that for the national security community, where the Company is subject to particular rules applied by national governments. Security breaches could materially damage the Company's business. Security matters are therefore carefully managed and are overseen by a director-level security committee, which ensures that the business systematically embeds rigorous security practice in its everyday operations. The Company is investing to ensure its own security keeps pace with the evolving threat environment.

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

Many people have contracted the disease across the world and many deaths have occurred as a result of the COVID-19 pandemic. Although there has been an effective roll-out of vaccination programmes in certain countries, it is still not clear how long this pandemic will last or how enduring its long-term impact will be, or the further measures that will be taken by governments and others to seek to control this pandemic and its impact. The uncertainties surrounding the development of this pandemic make it difficult to predict the extent to which the Company may be affected.

Areas of the Company's business that could be impacted include a decrease in spending by the Company's major customers, the failure to obtain awards for contracts, the failure of suppliers to deliver services to the Company, the inability of the Company to meet contractual delivery requirements on time, the inability to adequately staff and manage the business, and an increase in the cost or lack of availability of funding. If the Company were unable to obtain appropriate funding, it could be forced to make reductions in spending, seek to extend payment terms with suppliers. Any of the above could have a material adverse effect on the Company's business, financial condition and results of operations. Each of the identified risks is regularly reviewed and actively managed by the Board. Since the outbreak of the COVID-19 coronavirus pandemic, the Company has taken a number of responsive measures including reducing site operational levels and introducing new cleaning regimes, safe working distance measures and protective equipment for its employees. The Company continues to build on the experience gained to date in dealing with the pandemic. This includes the use of safe working practices and the effective use of home working.

Strategic Report *(continued)*

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:

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

Decision making

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

Pursuant to the Operational Framework, BAE Systems' businesses each produce a strategic plan, a financial forecast for the current year and financial projections for the next five years. The directors of the Company contribute towards this process 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. We keep the Company's employees informed about what is happening across the BAE Systems group through the group's intranet and email, podcasts, newsletters, and leadership calls, notices, business updates and briefings.

Keeping employees connected, informed and engaged has never been more important as the Company's employees continued to experience major impacts on their personal circumstances and ways of working through the pandemic. The Company used a range of channels to make sure its employees had access to the information and support they needed 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 engagement through the Group intranet, employee app, email, videos, podcasts, newsletters, leadership communications, virtual discussions and briefings, and through our line managers who played a key role in keeping their teams connected and engaged. This includes continuing to focus on 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.

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 11, 18, 23, 56-58 and 153 of BAE Systems plc's Annual Report 2021 (available at: www.baesystems.com/investors).

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

Strategic Report (continued)

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 us to create best-in-class, cost-effective products, services and solutions.

Our largest customers are UK and International government bodies as well as Financial Institutions. 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 in 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.

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 of 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 in the Environment and Social sections (pages 38-47 and pages 58-63 respectively) of BAE Systems plc's Annual Report 2021 (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 us in attracting and retaining high-calibre employees.

Detailed information on the BAE Systems group-wide business conduct processes and policies are described in BAE Systems plc's Annual Report 2021 and in particular the Governance and business conduct section on pages 64-66 available at: www.baesystems.com/investors.

Approved by the Board and signed on its behalf by



D J Lawton
Director

1 July 2022

Directors' Report

Company registration

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

Revenue for the year amounted to £420 million (2020: £360 million) and the profit for the year after taxation and exceptional items amounted to £23 million (2020 restated: loss of £8 million).

The directors do not recommend payment of a final dividend in respect of the year ended 31 December 2021 (2020: £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.

We continue to invest in the Financial Services division to deliver growth given the ongoing market demand for anti-fraud and regulatory compliance solutions.

Effective from 2022, a new operating business, BAE Systems Digital Intelligence, has been formed, bringing 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. This includes the whole of the Applied Intelligence business.

Going concern

The future developments of the Company are reviewed above and in the Strategic Report along with the current decision on this year's dividend payment, above. The Company was profitable in 2021 and anticipates being so in the near future. It is also in a net current asset position at year end.

The ultimate parent company, BAE Systems plc, has indicated in writing that, for at least 12 months from the date of approval of these financial statements, it will continue to make available funds as are needed by the Company to meet its liabilities as they fall due and in particular will not seek repayment of amounts currently made available.

For these reasons they continue to adopt the going concern basis in preparing the financial statements.

Research and development

The Company performs both customer funded research and development as well as investing in internal research and development activities.

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.

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 UK employees has been considered on page 4 in the Strategic Report.

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

Engagement with suppliers, customers and others

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

Directors' Report *(continued)*

Qualifying indemnity provisions

The directors of BAE Systems Pension Funds Trustees Limited, BAE Systems 2000 Pension Plan Trustees Limited and BAE Systems Executive 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 BAE Systems Executive 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.

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 36-39 in the consolidated accounts 2021 Annual Report of its ultimate parent, BAE Systems plc (available at: www.baesystems.com/investors).

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 set out its purpose, which connects to its strategy – see page 1 of the BAE Systems Annual Report 2021 (available at: www.baesystems.com/investors). The 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's business 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 business.

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 includes the managing director and finance director 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.

Directors' Report *(continued)*

Those requirements ensure that internal controls are 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 businesses of the 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 Leadership Framework is a core business process designed to enable business performance and support delivery of the Group's strategy. It is an integrated set of activities, supporting people managers with identifying, selecting, managing, developing and rewarding employees across the Group 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 incentive 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. Pursuant to the policy; employees are 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.

Directors' Report *(continued)*

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 Report, unless otherwise stated, were as follows:

J F C Cracknell – resigned 31 March 2022

D Armstrong – appointed 31 March 2022

A G Jordan – resigned 28 January 2022

D J Lawton

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.

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 (872(2) of the Companies Act 2006, has been re-appointed.

Approved by the Board and signed on its behalf by:



D J Lawton
Director

1 July 2022

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 they have elected to prepare the financial statements in accordance with UK accounting standards and applicable law (UK Generally Accepted Accounting Practice), including Financial Reporting Standard 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 are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent Auditor's Report to the Members of BAE Systems Applied Intelligence Limited

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 2021 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;
- the related notes 1 to 23.

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 which included the impact of COVID-19 and Brexit;
- 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.

Independent Auditor's Report to the Members of BAE Systems Applied Intelligence Limited *(continued)*

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.

Independent Auditor's Report to the Members of BAE Systems Applied Intelligence Limited *(continued)*

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:

- obtaining licence agreements and validating delivery of the licence;
- 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 understanding the impact of COVID-19 and remote working on the nature and operation of controls, to inform our risk assessment and conclusions on their effectiveness; 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:

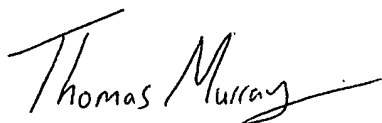
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law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

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

Use of our report

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

A handwritten signature in black ink that reads "Thomas Murray". The signature is written in a cursive style with a long horizontal line extending to the right from the end of the name.

Thomas Murray BSc ACA (Senior Statutory Auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

Reading, United Kingdom

1 July 2022

Income Statement

for the year ended 31 December 2021

	Notes	2021 £'000	2020 Restated' £'000
Revenue	2	420,487	359,743
Other operating costs	3	(394,138)	(365,543)
Exceptional operating costs	4	-	(605)
Operating costs		(394,138)	(366,148)
Operating profit/(loss)		26,349	(6,405)
Financial income	7	30	19
Financial expense	7	(750)	(696)
Profit/(Loss) before tax		25,629	(7,082)
Tax	8	(2,994)	(800)
Profit/(Loss) for the year		22,635	(7,882)

Statement of Comprehensive Income

for the year ended 31 December 2021

	Notes	2021 £'000	2020 Restated' £'000
Profit/(Loss) for the year		22,635	(7,882)
Other comprehensive income			
Items that will not be reclassified to the Income Statement:			
Remeasurements on defined benefit pension schemes	19	9,700	(6,900)
Tax on items that will not be reclassified to the Income Statement		(979)	1,835
Items that may be reclassified to the Income Statement:			
Amounts debited to hedging reserve		(1,156)	(5)
Tax on items that may be reclassified to the Income Statement		179	(35)
Total other comprehensive income for the year (net of tax)		7,744	(5,105)
Total comprehensive expense for the year		30,379	(12,987)

1. Prior year comparatives for tax has been restated. Please refer to Note 8 for details regarding the restatement.

The notes on pages 18 to 45 form part of the financial statements.

The results for 2021 and 2020 arise from continuing activities.

Balance Sheet

as at 31 December 2021

	Notes	2021 £'000	2020 Restated' £'000
Non-current assets			
Right-of-use assets	9	15,937	10,734
Intangible assets	10	158	287
Property, plant and equipment	11	10,572	11,406
Investments	12	184	184
Amounts owed by subsidiary undertakings	17	1,170	1,170
Retirement benefit surpluses	19	-	-
Other financial assets	13	338	1,198
Deferred tax assets ¹	14	9,923	11,211
		38,282	36,190
Current assets			
Inventories	16	3,358	3,945
Trade, other and contract receivables	17	236,881	208,562
Other financial assets	13	804	1,403
Current tax asset	15	1,752	507
Cash and cash equivalents		-	-
		242,795	214,417
Total assets		281,077	250,607
Current liabilities			
Lease liabilities	9	(5,324)	(4,290)
Trade and other payables	18	(142,862)	(141,091)
Provisions	20	(2,132)	(2,587)
		(150,318)	(147,968)
Non-current liabilities			
Lease liabilities	9	(12,193)	(7,761)
Retirement benefit obligations	19	(14,400)	(23,800)
		(26,593)	(31,561)
Total liabilities		(176,911)	(179,529)
Net assets		104,166	71,078
Equity			
Issued share capital	21	125	125
Other reserves	21	26,033	24,301
Retained earnings ¹		78,008	46,652
Total shareholders equity		104,166	71,078

1. Prior year comparatives for deferred tax and retained earnings have been restated. Please refer to Note 14 for details regarding the restatement.

Approved by the Board on 1 July 2022 and signed on its behalf by:



D J Lawton
Director

Registered number: 01337451

Statement of Changes in Equity
for the year ended 31 December 2021

	Notes	Issued share capital £'000	Share premium £'000	Other reserves £'000	Retained earnings Restated ¹ £'000	Total equity £'000
At 1 January 2021		125	-	24,301	46,652	71,078
Profit for the year		-	-	-	22,635	22,635
Total other comprehensive income for the year *		-	-	(977)	8,721	7,744
Share-based payments (inclusive of tax)	21	-	-	2,709	-	2,709
At 31 December 2021		125	-	26,033	78,008	104,166
At 1 January 2020		125	-	21,903	64,810	86,838
Restatement		-	-	-	(5,211)	(5,211)
At 1 January 2020 restated		125	-	21,903	59,599	81,627
Loss for the year		-	-	-	(7,882)	(7,882)
Total other comprehensive income for the year*		-	-	(40)	(5,065)	(5,105)
Share-based payments (inclusive of tax)	21	-	-	2,438	-	2,438
At 31 December 2020		125	-	24,301	46,652	71,078

1. Prior year comparatives for retained earnings have been restated. Please refer to Note 14 for details regarding the restatement.

* The transactions in the year in the other comprehensive income statement impacting other reserves relate to changes in the hedging reserve.

Notes to the Financial Statements

1 Accounting policies

BAE Systems Applied Intelligence Limited (the Company) is a private company, limited by shares, and registered in England and Wales and incorporated in the United Kingdom. Its ultimate parent and controlling party is BAE Systems plc. The address of the Company's registered office is shown on page 9.

These financial statements, which have been prepared in accordance with the Companies Act 2006, are presented in pounds sterling and, unless otherwise stated, rounded to the nearest thousand.

Basis of preparation

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

- the requirements of 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 to 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 requirement in paragraph 38 of International Accounting Standards (IAS) 1 Presentation of Financial Statements, to present comparative information in respect of: paragraph 79(a)(iv) of IAS 1; paragraph 73(e) of IAS 16 Property, Plant and Equipment; paragraph 118(e) of IAS 38 Intangible Assets; and paragraphs 76 and 79(d) of IAS 40 Investment Property;
- the requirements of paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 38D, 40A, 40B, 40C, 40D, 111 and 134 to 136 of IAS 1 Presentation of Financial Statements;
- the requirements of IAS 7 Statement of Cash Flows;
- the requirements of paragraphs 30 and 31 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors;
- the requirements of paragraphs 17 and 18A of IAS 24 Related Party Disclosures;
- the requirements in IAS 24 Related Party Disclosures, to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member; and
- the requirements of paragraphs 130(f)(ii), 130(f)(iii), 134(d) to 134(f) and 135(c) to 135(e) of IAS 36 Impairment of Assets.

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 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). These financial statements have been prepared using the going concern basis of accounting.

Notes to the Financial Statements *(continued)*

1 Accounting policies *(continued)*

Judgements made in applying accounting policies

The classification of exceptional items requires significant management judgement to determine the nature and intentions of a transaction. In 2021 there are no exceptional items.

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

Sources of estimation uncertainty

The application of the Company's accounting policies requires the use of estimates. In the event that these estimates prove to be incorrect, there may be an adjustment to the carrying amounts of assets and liabilities within the next financial year. The key significant risk of a material adjustment to the carrying amounts of assets and liabilities during 2021 relates to the determination of the life expectancy, discount rate and inflation assumptions underpinning the valuation of the liabilities of the Company's defined benefit pension schemes. A description of the discount rate and inflation assumptions, together with sensitivity analysis, is set out in note 18.

Changes in accounting policies

There are no amendments to existing standards, or interpretations that became effective on 1 January 2021 and have had a material impact on the Company.

Notes to the Financial Statements (continued)

1 Accounting policies (continued)

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.

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.

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;
- the 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 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.

Notes to the Financial Statements (*continued*)

1 Accounting policies (*continued*)

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;
- 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

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:

- prospectively, as an additional, separate contract; or
- prospectively, as a termination of the existing contract and creation of a new contract; or
- 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 fulfilment costs in respect of over time contracts are expensed as incurred. Contract fulfilment costs in respect of point in time contracts are accounted for under IAS 2 Inventories.

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.

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.

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 (continued)

1 Accounting policies (continued)

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.

Exceptional items

Exceptional items are those which are considered significant by virtue of their nature, size or incidence. These items are presented as *exceptional within their relevant Income Statement category to assist in the understanding of the trading and financial results of the Company as these types of cost/credit do not form part of the underlying business.* Within the year the Company undertook a reorganisation which resulted in redundancy costs to staff.

Intangible assets

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

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

The estimated useful lives are as follows:

Software development costs	2 to 5 years
Other intangible	Up to 10 years

The Company has no indefinite-life intangible assets other than goodwill.

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.

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 premises	Over the period of the lease
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.

Investments

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

Notes to the Financial Statements (*continued*)

1 Accounting policies (*continued*)

Impairment

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

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

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

Impairment losses are recognised in the Income Statement.

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

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

Foreign currencies

Transactions in foreign currencies are translated at the exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the exchange rates ruling at the Balance Sheet date. These exchange differences are recognised in the Income Statement.

Inventories

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

Trade, other and contract receivables

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

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

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

Cash and cash equivalents

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

Loans and overdrafts

Loans and overdrafts are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, loans and overdrafts are stated at either amortised cost or, where hedge accounting has been adopted, fair value in respect of the hedged risk. Any difference between the amount initially recognised and the redemption value is recognised in the Income Statement over the period of the borrowings.

Trade and other payables

Trade and other payables are stated at amortised cost.

Notes to the Financial Statements *(continued)*

1 Accounting policies *(continued)*

Tax

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

Current tax

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

Deferred tax

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

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

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

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

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

Provisions

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

Warranties and after-sales service

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

Reorganisations

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

Legal, contractual and environmental

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

Other

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

Notes to the Financial Statements (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.

Defined benefit pension scheme accounting valuations are prepared by independent actuaries. The liabilities of the pension schemes are valued based on a number of actuarial assumptions.

For each of the actuarial assumptions used there is a range of possible values and management estimates the point within that range that most appropriately reflects the Company's circumstances. Small changes in these assumptions can have a significant impact on the size of the deficit.

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 38. 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. Gains and losses resulting from changes to the relative payroll contributions of active members year on year are included within actual return 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.

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.

Notes to the Financial Statements (continued)

1 Accounting policies (continued)

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. 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 Revenue

The Company's revenue from customers by geographical location are:	2021	2020
	£'000	£'000
United Kingdom	411,995	348,606
Europe	5,584	6,258
North America	893	1,892
Rest of the World	2,015	2,987
	420,487	359,743

The Company's revenue from customers by class of business are:	2021	2020
	£'000	£'000
Fixed Price	184,810	152,396
Time and Materials	167,110	158,102
Intercompany Service Fees	27,750	13,537
Maintenance and Software Support	18,425	14,502
Licence	12,500	4,304
Other	9,892	16,902
	420,487	359,743

3 Operating costs

Included within operating costs are the following expenses:	2021	2020
	£'000	£'000
Staff costs (note 5)	(213,327)	(207,938)
Intercompany expense ¹	(13,598)	(19,686)
Depreciation and amortisation	(7,831)	(10,231)
Loss on disposal of property, plant and equipment	-	(1,011)
Operating lease rental costs	(1,362)	(1,662)
Research and development expenditure credits/(expenses)	6,558	(185)

¹ Relates to certain operating arrangements with fellow wholly owned subsidiaries.

The remuneration of the auditor for the year ended 31 December 2021 for the audit of the financial statements of the Company was £211k (2020: £172k) and £nil (2020: £nil) in respect of non-audit work.

Notes to the Financial Statements (continued)

4 Exceptional operating costs

	2021 £'000	2020 £'000
Reorganisation costs	-	-
Costs incurred with sale of related party	-	605
Exceptional items included within operating profit before tax	-	605
Taxation on exceptional items	-	(115)
Exceptional items after tax	-	490

5 Employees

The average number of Company employees was 2,509 (2020: 2,465).

	2021	2020
Engineering	1,297	1,252
Consulting	472	454
Product & Project Management	301	277
Overhead	439	482
	2,509	2,465

The aggregate staff costs of Company employees were as follows:

	2021 £'000	2020 £'000
Wages and salaries	176,854	171,927
Social security costs	21,696	19,016
Pension costs – defined contribution plans (note 19)	10,473	13,073
Pension costs – defined benefit plans (note 19)	1,500	1,200
Share-based payments (note 22)	2,804	2,722
	213,327	207,938

6 Directors emoluments

The disclosures below represent an allocation of the emoluments received by the directors to reflect their qualifying services to the Company. Qualifying services are recognised in respect of the external revenue contracts recognised in the year as a percentage based on the directors emoluments (2021: 83% 2020: 69%). Payments to directors totalled £1,143k (2020: £1,135k) in the year and were paid fully by the Company.

	2021 £'000	2020 £'000
Directors' remuneration	1,111	1,112
Company contributions to defined benefit pension schemes	32	23
	1,143	1,135

The number of directors for whom retirement benefits were accruing in respect of qualifying services under money purchase pension schemes amounted to 3 (2020: 3) and under defined benefit schemes amounted to 3 (2020: 3).

The disclosure below represents an allocation of the emoluments received by the highest paid directors to reflect their qualifying services to the Company. As per the directors emoluments as above, qualifying services are recognised in respect of the external revenue contracts recognised in the year as a percentage based on the Director emoluments (2021: 83% 2020: 69%).

	2021 £'000	2020 £'000
Remuneration	616	464
Company contributions to defined benefit pension schemes	3	4
	619	468

The highest paid director's defined benefit accrued pension and accrued lump sum at 31 December 2021 was £nil (2020: £nil) and £nil (2020: £nil), respectively.

Notes to the Financial Statements (continued)

7 Financial income and expense

	2021	2020
	£'000	£'000
Interest income	30	19
Financial income	30	19
Interest expense	350	296
Net interest expense on retirement benefit obligations (note 18)	400	400
Financial expense	750	696

8 Tax

Tax expense	2021	2020
	£'000	(Restated ¹) £'000
Current tax		
UK	2,594	-
Overseas	8	175
	2,602	175
Deferred taxation		
Origination and reversal of temporary differences	1,748	1,108
Adjustments in respect of prior years	(173)	199
Tax rate adjustment ¹	(1,183)	(683)
	392	625
Tax result	2,994	800

1 Amounts relating to deferred tax have been restated in the prior year. See Note 14 for details regarding the restatement.

Reconciliation of tax result

The following reconciles the expected tax result, using the UK corporation tax rate, to the reported tax result:

	2021	2020
	£'000	(Restated ¹) £'000
Profit/(Loss) before tax	25,629	(7,082)
UK corporation tax rate	19.00%	19.00%
Expected tax expense/(income)	4,869	(1,346)
Expenses not tax effected	(41)	650
Research and development expenditure credits	(810)	116
Effect of tax rates in foreign jurisdictions	8	175
Pensions	19	-
Share based payments	310	204
Imputed interest	454	234
Losses surrendered to/(received from) group companies	(459)	1,250
Adjustments in respect of prior years	(173)	199
Tax rate adjustment ¹	(1,183)	(683)
Tax result	2,994	800

1 Amounts relating to deferred tax have been restated in the prior year. See Note 14 for details regarding the restatement.

Notes to the Financial Statements (continued)

8 Tax (continued)

Tax recognised in other comprehensive income

	2021			2020		
	Before tax	Tax benefit/ (expense)	Net of tax	Before tax	Tax benefit/ (expense)	Net of tax
	£'000	£'000	£'000	£'000	£'000	£'000
Items that will not be reclassified to the Income Statement:						
Remeasurements on retirement benefit schemes	9,700	(1,843)	7,857	(6,900)	1,311	(5,589)
Tax rate adjustment ¹		864	864		524	524
Items that may be reclassified to the Income Statement:						
Amounts credited to hedging reserve	(1,156)	220	(936)	(5)	1	(4)
Tax rate adjustment ¹		(41)	(41)		(36)	(36)
	8,544	(800)	7,744	(6,905)	1,800	(5,105)

	2021			2020		
	Other reserves	Retained earnings	Total	Other reserves	Retained earnings	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Deferred tax						
Pensions	-	(1,843)	(1,843)	-	1,311	1,311
Financial instruments	220	-	220	1	-	1
Tax rate adjustment ¹	(41)	864	823	(36)	524	488
Tax on other comprehensive income	179	(979)	(800)	(35)	1,835	1,800

¹ 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.

9 Right-of-use asset

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

Right-of-use-assets

	2021		2020	
	Land and buildings	Total	Land and buildings	Total
	£'000	£'000	£'000	£'000
Opening balance at 1 January 2021	10,734	10,734	12,220	12,220
Disposed during the year	(415)	(415)	(383)	(383)
Modifications during the year	8,738	8,738	3,160	3,160
Depreciation expense for the year	(3,535)	(3,535)	(4,263)	(4,263)
Depreciation eliminated on disposal	415	415	-	-
Net book value	15,937	15,937	10,734	10,734

Notes to the Financial Statements (continued)

9 Right-of-use asset (continued)

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.

	2021 £'000	2020 £'000
Payments due:		
Within one year	5,324	4,290
Between one and five years	12,193	7,761
	17,517	12,051

Amounts recognized in the income statement

Depreciation of £3,535k (2020 £4,263k) has been recognised in the Income Statement for the year, along with a finance cost of £350k (2020 £273k) in respect of Right-of-use assets and liabilities.

Future commitments

There are no future commitments to the Company.

Cash outflow

Cash outflow for the leases in the year were £5,903k (2020 £5,413k).

10 Intangible assets

	Goodwill	Software	Assets in the course of construction	Other	Total
	£'000	£'000	£'000	£'000	£'000
Cost					
At 1 January 2021	27,531	711	-	4,742	32,984
Additions	-	27	-	-	27
Transfers	-	-	-	-	-
Disposals	-	-	-	-	-
At 31 December 2021	27,531	738	-	4,742	33,011
Amortisation					
At 1 January 2021	27,531	424	-	4,742	32,697
Amortisation charge	-	156	-	-	156
Disposals	-	-	-	-	-
At 31 December 2021	27,531	424	-	4,742	32,853
Net book value					
At 31 December 2021	-	158	-	-	158
At 31 December 2020	-	287	-	-	287

Notes to the Financial Statements (continued)

11 Property, plant and equipment

	Short leasehold improvements	Office furniture and equipment	Computers and ancillary equipment	Electronic test equipment	Assets in the course of construction	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Cost or valuation						
At 1 January 2021	25,999	2,177	7,671	3,625	2,627	42,099
Additions	1,450	265	137	568	886	3,306
Disposals	-	-	-	-	-	-
Transfers	24	-	1,957	583	(2,564)	-
At 31 December 2021	27,473	2442	9,766	4,777	949	45,406
Depreciation and impairment						
At 1 January 2021	20,329	1,644	6,842	1,878	-	30,693
Depreciation charge for the year	2,281	10	875	975	-	4,140
Disposals	-	-	-	-	-	-
At 31 December 2021	22,610	1,654	7,717	2,853	-	34,833
Net book value						
At 31 December 2021	4,863	788	2,049	1,923	949	10,572
At 31 December 2020	5,670	533	829	1,747	2,627	11,406

Capital commitments

Capital expenditure contracted for but not provided for in full in the accounts is £nil (2020: £nil).

Notes to the Financial Statements (continued)

12 Investments

Carrying value	£'000
At 1 January 2020	333
Impairment	(149)
At 31 December 2020	184
Impairment	-
At 31 December 2021	184

Subsidiary undertakings at 31 December 2021

In accordance with Section 409 of the Companies Act 2006, the subsidiary as at 31 December 2021 is disclosed below. The subsidiary undertaking is owned directly the Company and has a financial year end of 31 December.

Company name	Class of shares	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 shares of RM1	99.9999

13 Other financial assets/liabilities

	2021		2020	
	Assets £'000	Liabilities £'000	Assets £'000	Liabilities £'000
Non-current				
Cash flow hedges – foreign exchange contracts	357	(19)	1,198	-
Current				
Cash flow hedges – foreign exchange contracts	357	(10)	643	-

Notes to the Financial Statements (continued)

14 Deferred tax

Deferred tax assets/ (liabilities)

	Deferred tax assets		Deferred tax liabilities		Net balance at 31 December	
	2021	2020	2021	2020	2021	2020
	(Restated) ¹		(Restated) ¹		(Restated) ¹	
	£'000	£'000	£'000	£'000	£'000	£'000
Property, plant and equipment	5,108	4,546	-	-	5,108	4,546
Provisions and accruals	431	702	-	-	431	702
Retirement benefit schemes:						
Deficits	3,600	4,522	-	-	3,600	4,522
Additional contributions and other	892	1,467	-	-	892	1,467
Share-based payments	64	324	-	-	64	324
Financial instruments	-	-	(171)	(350)	(171)	(350)
Deferred tax assets/(liabilities)	10,095	11,561	(171)	(350)	9,923	11,211
Set off of tax	(171)	(350)	171	350	-	-
Net deferred tax assets/(liabilities)	9,923	11,211	-	-	9,923	11,211

Movement in temporary differences

	At 1 January	Recognised	Recognised	At 31 December
	2021			
	(Restated) ¹			
	£'000	£'000	£'000	£'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)	-	179	(171)
	11,211	(392)	(896)	9,923

	At 1 January	Recognised	Recognised	At 31 December
	2020			
	(Restated) ¹			(Restated) ¹
	£'000	£'000	£'000	£'000
Property, plant and equipment	4,241	305	-	4,546
Provisions and accruals	1,207	(505)	-	702
Retirement benefit schemes:				
Deficits	4,471	(588)	639	4,522
Additional contributions and other		271	1,196	1,467
Share-based payments	716	(108)	(284)	324
Financial instruments	(315)	-	(35)	(350)
	10,320	(625)	1,516	11,211

¹ On transition to IFRS 15 in 2018, the Company deferred revenue relating to a specific contract, and established a deferred tax asset of £5,211k to reflect the fact that corporation tax had already been levied against those profits in prior years. However, on submission of the 2018 corporation tax return a deduction was claimed to recover the effect of the historical tax charge which then aligned the accounting and tax positions from that point. As a result of this, the deferred tax asset was no longer required but it was not derecognised, in error. At 31 December 2020 the deferred tax asset totalled £5,824k. The restatement reflects the de-recognition of the deferred tax asset in the opening balance sheet with £5,211k reducing retained earnings brought forward at 1 January 2020 with a £613k tax rate change recognised in the 2020 tax charge, to correctly reflect the treatment of accounting and tax.

Notes to the Financial Statements (continued)

14 Deferred tax (continued)

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.

15 Current tax asset

The current tax receivable of £1,752k consists of an amount being claimed in relation to RDEC of £4,372k, of which £1,778k relates to claims for prior years, offset by a current tax creditor of £2,620k. The full claim in relation to RDEC of £6,558k is recognised within operating costs in the current year and forms part of the profit before tax on which the standard rate of tax is then applied. £2,487k of this total claim is being reclaimed separately from other group companies.

16 Inventories

	2021	2020
	£'000	£'000
Short-term work in progress	1,061	342
Raw materials	2,297	3,603
	3,358	3,945

The Company recognised £nil (2020: £nil) as a write down of inventories to net realisable value.

17 Trade, other and contract receivables

	2021	2020
	£'000	£'000
Non-current assets		
Amounts owed by BAE systems plc and it's subsidiaries	1,170	1,170
Current assets		
Amounts falling due within one year:		
Amounts due from customers for contract work	28,623	25,989
Trade receivables	35,664	31,391
Amounts owed by BAE systems plc and it's subsidiaries	167,554	143,455
Prepayments	4,398	5,158
Other receivables	642	2,569
	236,881	208,562

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

18 Trade and other payables

	2021	2020
	£'000	£'000
Amounts falling due within one year:		
Trade payables	5,490	7,053
Amounts due to customers for contract work	34,463	41,230
Amounts owed to BAE systems plc and it's subsidiaries	32,946	39,379
Other taxes and social security costs	16,386	15,126
Accruals	52,356	36,968
Other payables	1,221	1,335
	142,862	141,091

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

Notes to the Financial Statements (continued)

19 Retirement benefits

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 25.

At 31 December 2021, the weighted average duration of the UK defined benefit pension obligations was 17 years (2020 18 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	31	21	48

1. Source: 31 October 2019 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 2021, 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 2021.

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 39 to 42.

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 38. 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.

Notes to the Financial Statements *(continued)*

19 Retirement benefits *(continued)*

Valuations

Funding valuations of the UK defined benefit schemes are performed every three years. Following the merger of several of the UK pension schemes in October 2019, BAE Systems plc and the trustees agreed to carry out an early triennial funding valuation for the Main Scheme as at 31 October 2019.

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 October 2019 £bn	Other schemes as at 31 March 2020 £bn
Market value of assets	20.6	2.1
Present value of liabilities	(22.5)	(2.0)
Funding (deficit)/surplus	(1.9)	0.1
Percentage of accrued benefits covered by the assets at the valuation date	92%	105%

The valuations in 2019 and 2020 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 – 91
Life expectancy of a male currently aged 45 (years)	87 - 91
Life expectancy of a female currently aged 45 (years)	89 - 92

The discount rate assumptions used in the 2019 and 2020 valuations were directly based on prudent levels of expected returns for the assets held by the schemes, reflecting the planned investment strategies and maturity profiles of each scheme. The discount rates are curves which provide a different rate for each year into the future.

The inflation assumptions 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.

The funding valuations resulted in a significantly lower deficit than under IAS 19, largely due to lower liabilities reflecting the higher discount rate assumption. 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, which are expected overall to yield higher returns than bonds.

The 2019 funding agreement is underpinned by a contingency plan, which includes a commitment by BAE Systems plc to a further £50m of deficit funding in each of 2021 and 2022 into the Main Scheme prior to the next triennial valuation in the event that the scheme funding level were to fall below pre-determined parameters. In addition, BAE Systems plc would be required to pay £187m in respect of the Main Scheme if the funding level were to fall significantly and were to remain at or below those levels for nine months.

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 2021 were £1,600k (2020 £11,000k).

Notes to the Financial Statements (continued)

19 Retirement benefits (continued)

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.

Risk	Mitigation
<p>Market (investment) risk Asset returns may not move in line with the liabilities and may be subject to volatility.</p>	<p>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.</p> <p>Some 51% (2020: 49%) 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.</p> <p>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 £2.9bn 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.</p>
<p>Interest rate risk Liabilities are sensitive to movements in interest rates, with lower interest rates leading to an increase in the valuation of liabilities.</p>	<p>In addition to investing in bonds as part of the matching portfolio, 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. The current level of interest rate protection is expressed as a hedge ratio of 79.0% (2020 72.4%).</p> <p>The discount rate assumptions set as part of the UK funding valuations directly reflect the expected returns on assets held by the schemes and provide a natural hedge against interest rate risk. The planned investment strategy, which is reflected in the discount rate and liability calculation, is for the schemes to increase their investments in bonds or other assets which match the liabilities as the schemes mature. Under the UK funding valuations, the Company expects the schemes to be fully hedged against interest rate movements following a five-year transition period to the planned investment strategy.</p>
<p>Inflation risk Liabilities are sensitive to movements in inflation, with higher inflation leading to an increase in the valuation of liabilities.</p>	<p>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. The current level of inflation protection is expressed as a hedge ratio of 107.8% (2020 100.2%).</p> <p>The UK funding valuations provide a natural hedge against inflation movements within the discount rate. The Company is already fully hedged against inflation movements and, under the planned investment strategy, aims to maintain a fully hedged position.</p> <p>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</p>
<p>Longevity risk Liabilities are sensitive to life expectancy, with increases in life expectancies leading to an increase in the valuation of liabilities.</p>	<p>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.</p> <p>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.</p>

Notes to the Financial Statements (continued)

19 Retirement benefits (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.

	2021	2020	2019
Financial assumptions			
Discount rate – past service (%)	1.9	1.4	2.1
Discount rate – future service (%)	1.9	1.6	2.2
Retail Prices Index (RPI) inflation (%)	3.1	2.7	2.8
Rate of increase in salaries (%)	3.1	2.7	2.8
Rate of increase in deferred pensions (%)	2.4/3.1	2.0/2.7	2.0/2.8
Rate of increase in pensions in payment (%)	1.7 – 3.7	1.6 – 3.6	1.5 – 3.6
Demographic assumptions			
Life expectancy of a male currently aged 65 (years)	86 – 89	86 – 88	87 – 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)	86 – 90	87 – 89	88 – 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 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. 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 35.

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 (2020 0.5%) and the CPI assumption has been set at 0.7% per annum (2020 0.7%) lower than RPI. The resulting RPI assumption is 3.1% per annum and the CPI assumption is 2.4% 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 3.1% (2020 RPI inflation of 2.7%), plus a promotional scale.

Rate of increase in deferred pensions

The rate of increase in deferred pensions for the UK schemes is based on CPI inflation of 2.4% (2020 CPI inflation of 2.0%), with the exception of the legacy 2000 Plan, which is based on RPI inflation of 3.1% (2020 RPI inflation of 2.7%). 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 2020 tables (published by the Institute of Actuaries) have been used (in 2020, the Continuous Mortality Investigation 2019 tables were used), with an assumed long-term rate of future annual mortality improvements of 1.0% per annum (2020 1.0%), an initial rate adjustment parameter ('A') of 0.25% (2020 0.25%) in conjunction with a smoothing parameter ('S_k') of 7 for all members (2020 7). The Group has chosen to apply a weighting to the 2020 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.

Notes to the Financial Statements (continued)

19 Retirement benefits (continued)

The disclosures below are in respect of the Company's share of the IAS 19 deficit using the allocation methodology outlined on page 25.

Summary of movements in retirement benefit obligations

	£'000
Company's share of IAS 19 deficit at 1 January 2021	(23,800)
Actual return on assets excluding amounts included in interest expense	34,100
Increase in liabilities due to changes in assumptions and experience	(24,400)
Contributions in excess of service cost	100
Net interest expense	(400)
Company's share of IAS 19 deficit at 31 December 2021	(14,400)

Amounts recognised in the Balance Sheet

	2021 £'000	2020 £'000
Present value of unfunded obligations	(1,700)	(1,300)
Present value of funded obligations	(169,600)	(147,400)
Fair value of scheme assets	156,900	124,900
Company's share of IAS 19 deficit, net	(14,400)	(23,800)
Represented by:		
Retirement benefit surpluses	-	-
Retirement benefit obligations	(14,400)	(23,800)
	(14,400)	(23,800)

Notes to the Financial Statements (continued)

19 Retirement benefits (continued)

Changes in the fair value of scheme assets

	£'000
Company's share of the value of scheme assets at 1 January 2020	136,300
Interest income	2,400
Actual return on assets excluding amounts included in interest income	(19,900)
Actual return on assets	(17,500)
Contributions by employer	11,000
Contributions by employer in respect of employee salary sacrifice arrangements	400
Total contributions by employer	11,400
Administrative expenses	(100)
Benefits paid	(5,200)
Company's share of the value of scheme assets at 31 December 2020	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
Members' contributions	-
Administrative expenses	-
Benefits paid	(6,100)
Company's share of the value of scheme assets at 31 December 2021	156,900

Assets of defined benefit pension schemes

	2021			2020		
	Quoted £'000	Unquoted £'000	Total £'000	Quoted £'000	Unquoted £'000	Total £'000
Equities:						
UK	7,500	-	7,500	5,600	-	5,600
Overseas	21,200	-	21,200	14,900	-	14,900
Pooled investment vehicles ¹	1,500	49,900	51,400	4,400	36,000	40,400
Fixed interest securities:						
UK gilts	4,500	-	4,500	3,200	-	3,200
UK corporates	9,000	19,500	28,500	7,500	16,700	24,200
Overseas government	400	-	400	300	-	300
Overseas corporates	6,200	300	6,500	9,500	-	9,500
Index-linked securities:						
UK gilts	15,700	-	15,700	10,100	2,400	12,500
UK corporates	-	7,500	7,500	-	5,400	5,400
Property ²	-	12,100	12,100	-	9,700	9,700
Derivatives ³	-	(4,400)	(4,400)	-	(5,400)	(5,400)
Cash:						
Sterling	5,800	-	5,800	4,100	-	4,100
Foreign currency	100	-	100	100	-	100
Other	200	(100)	100	-	400	400
Company total	72,100	84,800	156,900	59,700	65,200	124,900

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.

Notes to the Financial Statements (continued)

19 Retirement benefits (continued)

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.

As at 31 December 2021, 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 2020	(162,600)
Current service cost	(1,100)
Contributions by employer in respect of employee salary sacrifice arrangements	(400)
Total current service cost	(1,500)
Actuarial gain due to changes in assumptions and experience	13,000
Interest expense	(2,800)
Benefits paid	5,200
Company's share of the defined benefit obligations at 31 December 2020	(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)

Amounts recognised in the Income Statement

	2021 £'000	2020 £'000
Included in operating costs:		
Current service cost	(1,500)	(1,100)
Administrative expenses	-	(100)
	(1,500)	(1,200)
Included in finance costs:		
Net interest expense on retirement benefit obligations	(400)	(400)

The Company incurred a charge of £10,473k (2020 £13,073k) in relation to defined contribution schemes for employees.

Notes to the Financial Statements (continued)

19 Retirement benefits (continued)

Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 31 December 2020 and keeping all other assumptions as set out on page 38.

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 19, 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.

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 £m	Increase/ (decrease) in scheme assets £m
Discount rate:		
0.1 percentage point increase	3.0	(1.0)
0.1 percentage point decrease	(3.0)	1.0
0.5 percentage point increase	14.0	(7.0)
0.5 percentage point decrease	(16.0)	8.0
Inflation:		
0.1 percentage point increase	(3.0)	1.0
0.1 percentage point decrease	3.0	(1.0)
0.5 percentage point increase	(9.0)	6.0
0.5 percentage point decrease	9.0	(5.0)
1.0 percentage point increase	(17.0)	13.0
1.0 percentage point decrease	17.0	(10.0)

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:

	(Increase)/ decrease in net deficit £m
Life expectancy:	
One-year increase	(7.0)
One-year decrease	7.0

Notes to the Financial Statements (continued)

20 Provisions

	Warranty £'000	Reorganisation £'000	Other £'000	Total £'000
At 1 January 2021	333	1,007	1,247	2,587
Created	43		1,081	1,081
Released		(1,007)	-	(1,007)
Utilised			(572)	(572)
At 31 December 2021	376	-	1,756	2,089
Represented by:				
Non-current				
Current	376	-	1,756	2,089
	376	-	1,756	2,089

Reorganisation

Reorganisation provisions made during 2020 have been released during 2021.

Other

There are no single significant provisions included within other provisions.

21 Share capital and other reserves

Share capital

	£1 Ordinary shares	Nominal value £'000
Authorised, allotted, issued and fully paid		
At 1 January 2021	125,046	125
Issued in year	-	-
At 31 December 2021	125,046	125

Equity dividends

No dividends were paid in respect of the years ended 31 December 2021 or 31 December 2020.

The directors do not propose a final dividend for 2021.

Notes to the Financial Statements (continued)

21 Share capital and other reserves (continued)

Other reserves

	Capital redemption £'000	Share based payments reserve £'000	Hedging reserve £'000	Total £'000
At 1 January 2020	31	20,340	1,532	21,903
Other comprehensive income	-	-	(40)	(40)
Share-based payments	-	2,438	-	2,438
At 31 December 2020	31	22,778	1,492	24,301
Other comprehensive income	-	-	(1,156)	(1,156)
Share-based payments	-	2,804	-	2,804
At 31 December 2021	31	25,582	336	25,949

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 (note 22).

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.

22 Share-based payments

Options over shares of the ultimate parent undertaking, BAE Systems plc, have been granted to employees of the Company under various schemes. Details of the terms and conditions of each share-based payment plan are given in the Annual Remuneration Report of the BAE Systems Annual Report 2020.

For options outstanding at the end of the year:

	2021		2020	
	Range of exercise price of outstanding options (£)	Weighted average remaining contracted life (years)	Range of exercise price of outstanding options (£)	Weighted average remaining contracted life (years)
Executive Share Option Plan	3.89 - 6.49	7	3.01-6.49	7
Performance Share Plan	-	5	-	5

The average share price in the year was £5.33 (2020 £5.24)

Notes to the Financial Statements *(continued)*

23 Controlling parties

The Company's immediate parent company is Detica Group Limited and the ultimate controlling party is BAE Systems plc, which is both the smallest and largest only parent company preparing group financial statements. Both companies are incorporated in 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