British Midland Airways Limited

Directors' report and financial statements

Registered number 464648

31 December 2002

Contents

Company information

Directors	Sir Michael Bishop CBE (Chairman) JT Wolfe (non-executive) SF Balmforth (non-executive) A Reid CA NO Turner GN Elliott CBE FCA (non-executive)
Secretary and registered office	TJ Bye Donington Hall Castle Donington Derby DE74 2SB
Registered number	464648
Auditors	KPMG LLP St Nicholas House Park Row Nottingham NG1 6FQ
Bankers	National Westminster Bank Plc Colmore Centre 103 Colmore Row Birmingham B3 3NS

Directors' report

The directors present their report and the financial statements for the year ended 31 December 2002.

Business review

The principal activity of the company is that of an airline operator.

	2002	2001
	£000	£000
Turnover	**721,215**	739,544
(Loss)/profit before taxation	**(20,442)**	10,783

Dividends and transfers to reserves

The company has not proposed a final dividend in respect of the year ended 31 December 2002 *(2001: £nil)*.

The accumulated loss for the financial year of £12,627,000 has been transferred to reserves *(2001 as restated: £5,329,000 profit)*.

Directors and their interests

The directors named on page 1 served throughout the year except for Mr SF Balmforth and Mr JT Wolfe who both resigned on 31 July 2002. None of the directors who held office at the end of the financial year had any disclosable interest in the shares of the company. The interests of the directors in the shares of British Midland PLC, the immediate parent company, and The BBW Partnership Limited, the ultimate parent company, are disclosed in the financial statements of those companies.

Employees

The company recognises the importance of promoting and maintaining good communications with its employees. During the year regular meetings were held with employee representatives.

The company continues to employ disabled persons and affords them the same training, career development and promotional opportunities as for all other employees and provides all possible assistance to persons temporarily or permanently disabled whilst in the company's employment.

Creditor payment policy

It is the company's policy to pay suppliers in accordance with the terms agreed provided that the supplier has also complied with the relevant terms and conditions. The trade creditors at 31 December 2002 represented 47 days of annual purchases.

Directors' report *(continued)*

Auditors

KPMG were re-appointed auditors at the last Annual General Meeting. However, since that date their business has been transferred to a limited liability partnership, KPMG LLP. Accordingly KPMG resigned as auditors in the year and the directors thereupon appointed KPMG LLP to fill the vacancy arising. In accordance with section 348 of the Companies Act 1985, a resolution for the re-appointment of KPMG LLP as auditors of the company is to be proposed at the forthcoming Annual General Meeting.

By order of the board

TJ Bye
Secretary

28 March 2003

Statement of directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss for that period. In preparing those 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 accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

KPMG

KPMG LLP
St Nicholas House
Park Row
Nottingham
NG1 6FQ

Independent auditors' report to the members of British Midland Airways Limited

We have audited the financial statements on pages 6 to 23.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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 auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the directors' report and, as described on page 4, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the company is not disclosed.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 2002 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG LLP

28 March 2003

Chartered Accountants
Registered Auditor

Profit and loss account
for the year ended 31 December 2002

	Note	2002 £000	2002 £000	2001 As restated £000	2001 As restated £000
Turnover	*2*		**721,215**		739,544
Continuing operations		**721,215**		731,310	
Discontinued operations		**-**		8,234	
Cost of sales	*3*		**(649,721)**		(651,834)
Gross profit			**71,494**		87,710
Administrative expenses	*3*		**(94,043)**		(101,307)
Operating loss before exceptional items			**(22,549)**		(13,597)
Administrative expenses - exceptional items	*3*		**-**		(16,995)
Operating (loss)/profit			**(22,549)**		(30,592)
Continuing operations		**(22,549)**		(31,404)	
Discontinued operations		**-**		812	
Profit on disposal of fixed assets – continuing operations			**1,427**		2,709
Profit on the sale of discontinued operations			**-**		40,918
Other interest receivable and similar income	*4*		**4,141**		3,974
Interest payable and similar charges	*5*		**(3,461)**		(6,226)
(Loss)/profit on ordinary activities before taxation	*6*		**(20,442)**		10,783
Tax on (loss)/profit on ordinary activities	*7*		**7,815**		(5,454)
(Loss)/profit on ordinary activities after taxation and (accumulated loss)/retained profit for the financial year	*18*		**(12,627)**		5,329

Statement of total recognised gains and losses
for the year ended 31 December 2002

	2002	2001
		As restated
	£000	£000
(Loss)/profit for the financial year	(12,627)	5,329
Exchange movements	(7,449)	4,191
Total recognised gains and losses relating to the year	(20,076)	9,520
Prior year adjustment (notes 1 and 18)	(2,790)	
Total gains and losses recognised since last annual report	(22,866)	

Balance sheet
as at 31 December 2002

	Notes	2002		2001 As restated	
		£000	£000	£000	£000
Fixed assets					
Tangible assets	*10*	**275,197**		324,236	
Investments	*11*	**11,055**		11,063	
			286,252		335,299
Current assets					
Stocks		**15,060**		15,657	
Debtors	*12*	**69,711**		93,508	
Cash at bank and in hand		**118,470**		95,024	
		203,241		204,189	
Creditors: amounts falling due within one year	*13*	**(201,114)**		(206,204)	
Net current assets/(liabilities)					
Due within one year		**(8,784)**		(15,101)	
Debtors due after one year	*12*	**10,911**		13,086	
			2,127		(2,015)
Total assets less current liabilities			**288,379**		333,284
Creditors: amounts falling due after more than one year	*14*		**(185,702)**		(217,200)
Provisions for liabilities and charges	*16*		**(52,140)**		(45,471)
Net assets			**50,537**		70,613
Capital and reserves					
Called up share capital	*17*		**13,080**		13,080
Profit and loss account	*18*		**37,457**		57,533
Equity shareholders' funds			**50,537**		70,613

These financial statements were approved by the board of directors on 28 March 2003 and were signed on its behalf by:

Sir Michael Bishop
Director

Austin Reid
Director

Reconciliation of movements in equity shareholders' funds
for the year ended 31 December 2002

		2002	2001
		£000	£000
Opening equity shareholders' funds	- as previously reported	**73,403**	62,310
	- prior year adjustment	**(2,790)**	(1,217)
	- as restated	**70,613**	61,093
(Loss)/profit for the financial year		**(12,627)**	5,329
Other recognised gains and losses relating to the year		**(7,449)**	4,191
Closing equity shareholders' funds		**50,537**	70,613

Notes

(forming part of the financial statements)

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the company's financial statements except as noted below. The company has adopted FRS 18 'Accounting policies' and FRS 19 'Deferred tax' in these financial statements. The comparative figures have been restated accordingly. The company has followed the transitional arrangements of FRS 17 'Retirement benefits' in these financial statements.

Basis of accounting

The financial statements have been prepared under the historical cost convention and in accordance with applicable accounting standards.

Consolidation

The company is exempt by virtue of s228 of the Companies Act 1985 from the requirement to prepare group financial statements. These financial statements present information about the company as an individual entity and not about its group.

Depreciation

Aircraft and technical spares are depreciated using a straight line basis calculated to write down their cost to the current estimated residual values on the anticipated date of withdrawal from service or disposal. These estimates are reviewed regularly and adjusted as appropriate.

Depreciation rates:

Asset type	
Aircraft	7 years to residual value
Rotables	5 - 15 years

The aircraft which the company owns are expected to have an operational life of between 15 and 20 years. However, the company has a policy of operating recently manufactured aircraft. Depreciation is charged to reduce the net book value of an aircraft to its estimated resale value at that time.

All other plant and equipment is depreciated on a straight line basis over five years except for motor vehicles (four years) and certain computer equipment which is depreciated over three years.

Freehold premises are being written down at 2% on cost per annum on the structure of the building and at 20% on cost per annum on refurbishments. Leasehold properties and improvements are written down over 5 to 20 years.

Stocks

Stocks consist of raw materials, consumable spares and sundry supplies, and are valued at the lower of cost and net realisable value.

Aircraft maintenance costs

For owned aircraft, the costs of periodic aircraft overhauls are capitalised within fixed assets. Depreciation, in addition to that charged against the original capital value is then charged against these maintenance assets at a variable rate dependant on the actual usage of the aircraft, such that, over time, the depreciation charge will match the related maintenance expenditure.

Provisions for periodic overhaul costs on an aircraft held under an operating lease are made with reference to the number of hours flown or similar basis over the period to the next major overhaul.

Routine maintenance is expensed in the year in which it is incurred.

Notes *(continued)*

1 Accounting policies *(continued)*

Foreign currency translations

Monetary assets and liabilities denominated in foreign currencies are expressed at the rate prevailing at the balance sheet date or at the contracted rate where applicable. Transactions during the year denominated in foreign currencies are translated using the rate prevailing at the date the transaction occurred, or at the contracted rate where applicable.

The company operates aircraft which are purchased and sold in US dollars. Aircraft which are purchased are funded through dollar denominated loans. On the future disposal of the aircraft, the dollar proceeds will be used to repay the balances remaining on the dollar loans. The company considers that a natural hedge exists and therefore under SSAP 20, both owned aircraft and associated loans are re-translated to the year end exchange rate with the resultant differences being taken to reserves. Associated tax movements are also taken to reserves.

Leased assets

The cost of assets held under finance leases (or similar hire purchase contracts) is capitalised within the appropriate tangible fixed asset heading. The interest cost is charged over the term of the lease on a sum of the digits basis and the capital element of future lease payments is included in creditors.

Annual rentals payable or receivable under operating leases are charged or credited to the profit and loss account on a straight line basis over the lease term, unless another systematic and more rational basis is appropriate.

Introductory costs

Introductory costs on aircraft fleet additions and new routes are written off as incurred.

Deferred taxation

The charge for taxation is based on the profit or loss for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Deferred tax is recognised, with discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19.

Pension costs

The company operates a funded defined benefit pension scheme, and contributes to this scheme in accordance with recommendations from independent actuaries. Contributions are charged to the profit and loss account so as to spread the costs over the remaining working lives of the employees with the company.

The company also operates a defined contribution pension scheme. Contributions are charged to the profit and loss account as they are incurred.

Fixed asset investments

Fixed asset investments are stated at cost less provision made for impairment in the carrying value.

Cash flow statement

Under FRS 1 the company is exempt from the requirement to prepare a cash flow statement on the grounds that it is a wholly owned subsidiary undertaking.

Notes *(continued)*

2 Turnover

It is the view of the directors that all activities of the company fall within one class of business, that of airline operator.

Analysis of turnover by geographical area:

	2002	2001
	£000	£000
Within the British Isles	**312,147**	308,796
Between the British Isles and Europe	**353,332**	403,047
Other	**55,736**	27,701
	721,215	739,544

Turnover within the British Isles comprises revenue from domestic flights. Turnover between the British Isles and other areas comprises revenue from inbound and outbound flights between the British Isles and other areas.

The activities of the company are managed and administered on a central basis within the British Isles. As a result it would not be possible to provide a meaningful analysis of the operating results and net assets of the company on a route by route basis. Consequently the operating results and net assets of the company are not shown across the geographical areas defined.

3 *Discontinued operations and exceptional items*

	2002		2001	
	Total	Continuing	Discontinued	Total
	£000	£000	£000	£000
Cost of sales	**649,721**	644,412	7,422	651,834
Administrative expenses	**94,043**	101,307	-	101,307
Administrative expenses - exceptional items	**-**	16,995	-	16,995
	94,043	118,302	-	118,302

In 2002 there were no discontinued operations and no exceptional items.

Exceptional items in 2001 relate to restructuring charges of £13,442,000 including redundancy costs, onerous lease obligations and accelerated depreciation on computer systems, and start-up costs incurred in respect of transatlantic operations of £3,553,000.

Notes *(continued)*

4 Other interest receivable and similar income

	2002 £000	2001 £000
Bank interest	3,492	3,684
Other	649	290
	4,141	3,974

5 Interest payable and similar charges

	2002 £000	2001 £000
On bank loans and overdrafts whenever repayable and other loans wholly repayable within five years	473	783
On other loans repayable after more than five years	2,988	5,443
	3,461	6,226

6 (Loss)/profit on ordinary activities before taxation

(Loss)/profit on ordinary activities before taxation is stated after charging the following :	2002 £000	2001 £000
Depreciation of tangible fixed assets (note 10)	31,520	35,749
Hire of plant, machinery and aircraft	107,513	108,172
Other operating leases payable	10,721	11,080
Auditors' remuneration - audit fee	75	64
- other fees	296	336
Net losses on foreign currency	781	592

7 Tax on (loss)/profit on ordinary activities

	2002 £000	2001 As restated £000
Amounts (credited)/charged in the year:		
Corporation tax	-	-
Deferred tax - origination and reversal of timing differences	(3,052)	(314)
- reduction in discount	575	1,887
	(2,477)	1,573
Shown in the financial statements as :		
Tax (credit)/charge on (loss)/profit on ordinary activities	(7,815)	5,454
Tax charge/(credit) on exchange movements within the statement of total recognised gains and losses	5,338	(3,881)
	(2,477)	1,573

Notes *(continued)*

7 Tax on (loss)/profit on ordinary activities *(continued)*

The company has adopted FRS 19 'Deferred tax' in the current year. FRS 19 requires full recognition of all deferred tax assets and liabilities, whereas previously no liability was recognised in respect of accelerated capital allowances which were not expected to reverse in the foreseeable future. This has resulted in the restatement of the comparative results and financial position by increasing the tax charge in the profit and loss account for the year ended 31 December 2001 by £2,160,000, reducing the tax charge in the statement of total recognised gains and losses for the year ended 31 December 2001 by £587,000 and increasing the deferred tax liability at 31 December 2001 by £2,790,000.

Factors affecting the tax charge for the current year

The current tax charge for the year is higher *(2001: lower)* than the standard rate of corporation tax in the UK of 30% *(2001: 30%)*. The differences are explained below:

	2002	2001
	£000	£000
Current tax reconciliation:		
(Loss)/profit on ordinary activities before tax	(20,442)	10,783
Current tax at 30% *(2001: 30%)*	(6,133)	3,235
Effects of:		
Expenses not deductible for tax purposes	644	906
Capital allowances for the period in excess of depreciation	(4,837)	(2,830)
Foreign exchange movements	5,338	(3,881)
Other timing differences	(472)	(2,109)
Tax losses carried forward	5,460	4,679
Total current tax charge	-	-

8 Staff numbers and costs

	2002	2001
	Number	Number
The average number of persons employed by the company during the year was:		
Flight deck and cabin crew	1,682	2,099
Service	1,343	1,766
Other	1,494	1,672
	4,519	5,537
	£000	£000
The aggregate payroll costs of these persons were:		
Wages and salaries	107,352	119,152
Social security costs	9,581	10,786
Other pension costs	8,404	8,823
	125,337	138,761

Notes *(continued)*

9 Emoluments of directors

	2002	2001
	£000	£000
Directors' emoluments	**962**	1,499
Compensation for loss of office	-	292
	962	1,791

The aggregate emoluments of the highest paid director were £390,000 *(2001: £544,000).* He is a member of a defined benefit scheme, under which the accrued pension to which he would be entitled from normal retirement date if he were to retire at the year end was £262,500 *(2001: £245,000).*

	Number of directors	
	2002	2001
Retirement benefits are accruing to the following number of directors under:		
Defined benefit schemes	**2**	3

Notes *(continued)*

10 Tangible fixed assets

	Property			Aircraft, engines and spares				Plant and machinery			Motor vehicles	Payments on account	Total
	Freehold property £000	*Short leasehold and leasehold improvements* £000	*Sub-Total* £000	*Refurbishment of operating leased aircraft* £000	*Owned* £000	*Held under finance lease* £000	*Sub-Total* £000	*Owned* £000	*Held under finance lease and hire purchase contracts* £000	*Sub-Total* £000	*Owned* £000	£000	£000
Cost:													
At 1 January 2002	10,675	30,419	41,094	49,479	270,567	1,114	321,160	53,615	6,079	59,694	427	16,407	438,782
Exchange movements	-	-	-	-	(22,223)	-	(22,223)	-	-	-	-	(2,249)	(24,472)
Additions	-	416	416	2,032	3,350	-	5,382	2,922	-	2,922	66	-	8,786
Transfers	-	-	-	(30,833)	30,833	-	-	-	-	-	-	-	-
Disposals	(1,177)	(51)	(1,228)	(4,752)	(7,259)	-	(12,011)	(877)	-	(877)	(11)	-	(14,127)
At 31 December 2002	**9,498**	**30,784**	**40,282**	**15,926**	**275,268**	**1,114**	**292,308**	**55,660**	**6,079**	**61,739**	**482**	**14,158**	**408,969**
Accumulated depreciation:													
At 1 January 2002	3,457	14,015	17,472	21,344	37,677	1,114	60,135	30,628	6,079	36,707	232	-	114,546
Exchange movements	-	-	-	-	(2,320)	-	(2,320)	-	-	-	-	-	(2,320)
Charged in year	204	2,865	3,069	3,141	18,341	-	21,482	6,904	-	6,904	65	-	31,520
Transfers	-	-	-	(7,674)	7,674	-	-	-	-	-	-	-	-
Disposals	(680)	(51)	(731)	(4,663)	(3,930)	-	(8,593)	(643)	-	(643)	(7)	-	(9,974)
At 31 December 2002	**2,981**	**16,829**	**19,810**	**12,148**	**57,442**	**1,114**	**70,704**	**36,889**	**6,079**	**42,968**	**290**	**-**	**133,772**
Net book value:													
At 31 December 2002	**6,517**	**13,955**	**20,472**	**3,778**	**217,826**	**-**	**221,604**	**18,771**	**-**	**18,771**	**192**	**14,158**	**275,197**
At 31 December 2001	7,218	16,404	23,622	28,135	232,890	-	261,025	22,987	-	22,987	195	16,407	324,236

Notes *(continued)*

10 Tangible fixed assets *(continued)*

(a) At 31 December 2002 the company had authorised and contracted for capital commitments totalling £57,892,000 *(2001: £114,234,000)*.

(b) Freehold property includes £1,031,000 *(2001: £1,360,000)* relating to land which is not depreciated.

11 Investments

	Unlisted investment £000	Subsidiary undertakings £000	Quoted investments £000	Total £000
Cost at 1 January 2002	8,921	2,134	8	11,063
Disposals	-	-	(8)	(8)
Cost at 31 December 2002	8,921	2,134	-	11,055
Net book value at 31 December 2002	**8,921**	**2,134**	**-**	**11,055**
Net book value at 31 December 2001	8,921	2,134	8	11,063

The directors have considered the carrying value of the unlisted investment in light of both its strategic value for the airline and the long-term return that it is expected to generate. No adjustment to the carrying value has been proposed but this will continue to be monitored on an annual basis.

12 Debtors

	2002 £000	2001 £000
Amounts falling due within one year:		
Trade debtors	**40,882**	62,417
Amounts owed by group undertaking	**-**	334
Other debtors	**2,499**	2,498
Prepayments and accrued income	**15,419**	15,173
	58,800	80,422
Amounts falling due after more than one year:		
Prepayments and accrued income	**10,911**	13,086
	69,711	93,508

Notes *(continued)*

13 Creditors: amounts falling due within one year

	2002 £000	2001 £000
Loans and obligations under finance leases and hire purchase contracts	**12,970**	23,928
Trade creditors	**64,243**	58,445
Amounts owed to group undertakings	**6,814**	8,725
Corporation tax	**1,070**	1,070
Other taxation and social security	**2,891**	2,696
Accruals and deferred income	**113,126**	111,340
	201,114	206,204

The loans, finance leases and hire purchase contracts are secured on the assets which form the object of the lease or contract.

14 Creditors: amounts falling due after more than one year

	2002 £000	2001 £000
Loans and obligations under finance leases and hire purchase contracts repayable:		
In one to two years	**17,541**	14,350
In two to five years	**44,710**	49,716
After more than five years	**123,451**	151,402
	185,702	215,468
Accruals and deferred income	**-**	1,732
	185,702	217,200

The loans, finance leases and hire purchase contracts are secured on the assets which form the object of the lease or contract.

The total amount repayable by instalments after 31 December 2002 in respect of loans and obligations under finance leases and hire purchase contracts which expire after more than five years is £188,813,000 *(2001: £219,079,000)* of which £123,451,000 *(2001: £151,402,000)* falls due after more than five years from the balance sheet date.

Interest on principal loans is at rates varying from 1.94% to 4.53% per annum.

15 Operating lease commitments

The minimum non-cancellable operating lease payments to which the company was committed, as at 31 December, to pay during the following year, analysed into the year in which the lease commitment expires, are as follows:

	Land and buildings		Other assets	
	2002 £000	2001 £000	2002 £000	2001 £000
Lease expiry within:				
One year	**650**	1,218	**7,307**	2,120
Two to five years	**352**	959	**51,814**	60,661
More than five years	**2,809**	2,814	**29,135**	38,291
	3,811	4,991	**88,256**	101,072

Notes *(continued)*

16 Provisions for liabilities and charges

		Maintenance £000	Deferred taxation £000	Total £000
At 1 January 2002	- as previously stated	30,084	12,597	42,681
	- prior year adjustment (note 18)	-	2,790	2,790
	- as restated	30,084	15,387	45,471
Profit and loss account	- charged/(credited) in the year	43,049	(7,815)	35,234
Statement of total recognised gains and losses	- charged in the year	-	5,338	5,338
Utilised		(33,903)	-	(33,903)
At 31 December 2002		**39,230**	**12,910**	**52,140**

The elements of deferred taxation are as follows:

	2002 £000	2001 As restated £000
Difference between accumulated depreciation and capital allowances	**26,739**	19,097
Tax losses carried forward	**(6,289)**	(903)
Other timing differences	**(3,213)**	2,095
ACT recoverable	**(208)**	(208)
Undiscounted provision	**17,029**	20,081
Discount	**(4,119)**	(4,694)
Discounted provision	**12,910**	15,387

17 Share capital

	2002 £000	2001 £000
Authorised, issued and fully paid:		
13,080,000 ordinary shares of £1 each	**13,080**	13,080

Notes *(continued)*

18 Reserves

Profit and loss account		2002 £000	2001 £000
At 1 January	- as previously stated	**60,323**	49,230
	- prior year adjustment	**(2,790)**	(1,217)
	- as restated	**57,533**	48,013
(Accumulated loss)/retained profit for the financial year		**(12,627)**	5,329
Exchange movements		**(7,449)**	4,191
At 31 December		**37,457**	57,533

As set out in note 1, the requirements of accounting standard FRS 19 were implemented in the year, resulting in a prior year adjustment. This change resulted in the following adjustments to the profit and loss account and balance sheet for the year ended 31 December 2001.

	2001 per financial statements £000	*Prior year* adjustments £000	*2001* as restated £000
Retained profit for the financial year	7,489	(2,160)	5,329
Other recognised gains and losses for the year	3,604	587	4,191
Provisions for liabilities and charges	(42,681)	(2,790)	(45,471)
Profit and loss account reserve	60,323	2,790	57,533

19 Pensions

The company operates a funded defined benefit pension scheme. The assets of the scheme are held separately from those of the company and are invested with insurance companies / investment managers. Contributions to the scheme are charged to the profit and loss account so as to spread the cost of the pensions over the employees' remaining working lives with the company. The contributions are determined by an independent qualified actuary on the basis of triennial valuations using the defined accrued benefit method. The most recent valuation was at 1 August 1999. The assumptions which have the most significant effect on the result of the valuation are those relating to the growth of investments and the rates of increases in salaries. It was assumed that investment returns would be 8.0%, that salaries would increase by 5.0% and that dividends would grow by 5.0% per annum.

The pension charge for the period (excluding members own contributions) was £8,404,000 *(2001: £8,823,000)*. A pension prepayment included within debtors, at 31 December 2002 amounted to £2,250,000 *(2001: £2,475,000)* and is being spread over the remaining service lives of the employees in the scheme.

The most recent actuarial valuation showed that the value of the Schemes' investments was 90% of the value of the benefits that had accrued to members. The contributions of the company and employees during 2002, as a percentage of annual earnings, range between 10.9% and 16.5% and 5.6% and 10.0% respectively.

At the date of the latest actuarial valuation the market value of the Scheme's assets was £110,599,000.

Notes *(continued)*

19 Pensions *(continued)*

Additional FRS 17 disclosures

Whilst the company continues to account for pension costs in accordance with SSAP 24 'Accounting for pension costs', under FRS 17 'Retirement benefits', the following transitional disclosures are required.

The company operates a defined benefit scheme called the British Midland Airways Limited Pension & Life Assurance Scheme.

An actuarial valuation is currently in progress and has been updated on an approximate basis to 31 December 2002 by a qualified independent actuary. The major assumptions used by the actuary were:

Actuarial assumptions	**31 December 2002**	31 December 2001
Discount rate	5.60%	6.08%
Salary escalation (including merit increases)	0% up to 1 April 2004, thereafter 2.47%	2.60%
Inflation assumption	2.47%	2.60%
Rate of increase to deferred pensions	2.47%	2.60%
Limited price indexation	2.47%	2.60%
Expected return on scheme assets	7.15%	6.60%

Balance sheet items	**31 December 2002**	31 December 2001
	£000	£000
Total market value of scheme assets	121,103	136,778
Present value of scheme liabilities	(178,803)	(155,943)
Deficit in the scheme	(57,700)	(19,165)
Related deferred tax asset	17,310	5,750
Net pension deficit	(40,390)	(13,415)

The assets in the scheme and the expected rates of return were:

	31 December 2002 Expected rate of return	**31 December 2002**	31 December 2001 Expected rate of return	31 December 2001
	% pa	**£000**	% pa	£000
Equities	**8.00**	**85,781**	7.04	101,443
Bonds	**5.10**	**35,273**	5.56	31,697
Cash	**2.50**	**49**	2.60	3,638
Total market value of assets	**7.15%**	**121,103**	6.60%	136,778

Notes *(continued)*

19 Pensions *(continued)*

If the company had adopted the full requirements of FRS17 the following entries would have been made:

Analysis of amount charged to operating profit

	£000
Current service cost	6,241
Settlement	(645)
Past service cost	-
Total operating charge	**5,596**

Analysis of amount charged to other finance income

	£000
Expected return on pension scheme assets	9,293
Interest on pension scheme liabilities	(9,707)
Total financing costs	**(414)**

Analysis of amount recognised in statement of total recognised gains and losses ('STRGL')

		£000
Actual return less expected return on pension scheme assets		(32,672)
Percentage of scheme assets	27.0%	
Experience gains/(losses) arising on pension scheme liabilities		(3,236)
Percentage of scheme liabilities (at present value)	1.8%	
Changes in financial assumptions underlying pension scheme liabilities		(5,020)
Percentage of scheme liabilities (at present value)	2.8%	
Actuarial gain/(loss) recognised in the STRGL		**(40,928)**

Percentages above are given as a proportion of scheme assets or liabilities as appropriate.

20 Subsidiary undertakings

British Midland Airways Limited has the following direct interests in the ordinary share capital of its subsidiary undertakings:

	% owned	Where registered	Nature of business
BMI Airways Limited	100	England and Wales	Dormant
International Cargo Marketing Limited	100	England and Wales	Dormant
British Midland Regional Limited	100	Scotland	Airline operator

Notes *(continued)*

21 Related party transactions

As the company is a wholly owned subsidiary of British Midland PLC ('BM PLC') the company has taken advantage of the exemption contained in FRS 8 and has therefore not disclosed transactions or balances with entities which form part of the group. The consolidated financial statements of BM PLC, within which this company is included, can be obtained from the address given in note 23.

Scandinavian Airlines System Denmark, Norway, Sweden ('SAS')

The company had net receipts of £36,720,000 *(2001: £37,109,000)* in respect of interline billing, other passenger revenue sharing arrangements, handling and other services from SAS and its subsidiaries. The net balance owing to British Midland Airways Limited at 31 December 2002 was £6,126,000 *(2001: £13,178,000).*

Deutsche Lufthansa Aktiengesellschaft ('Lufthansa')

The company had net receipts of £27,340,000 *(2001: £26,142,000)* in respect of interline billing, handling and other passenger revenue sharing arrangements from Lufthansa and its subsidiaries. The net balance owing to British Midland Airways Limited at 31 December 2002 was £6,504,000 *(2001: £17,701,000).*

A loan taken out during the year ended 31 December 2001 for US$43 million is guaranteed by Lufthansa.

22 Commitments

A substantial portion of capital expenditure, leasing commitments, fuel and other purchases are payable in US Dollars and Euros. Forward purchase contracts amounting in aggregate to US$381,000,000 *(2001: US$170,000,000)* and €nil *(2001: €32,000,000)* outstanding at 31 December 2002, have been made to cover part of the exposure risk.

Capital commitments are disclosed in note 10.

23 Parent company and ultimate holding company

The company is a wholly owned subsidiary of British Midland PLC, a company registered in England and Wales. The company is exempt from the requirement to prepare group financial statements because its results are included in the consolidated financial statements of that company.

The ultimate holding company and controlling party is The BBW Partnership Limited, a company registered in England and Wales, which also prepares consolidated financial statements.

Copies of the financial statements of British Midland PLC and The BBW Partnership Limited can be obtained from the Registrar of Companies, Crown Way, Cardiff.