BAE Systems Global Combat Systems Munitions Limited

Annual Report and Financial Statements

31 December 2018

Registered number: 01842252

Contents

Strategic Report

Principal activities

The principal activities of BAE Systems Global Combat Systems Munitions Limited (the "Company") are the design, development, manufacture and supply of a wide range of defence systems, sub systems and components.

Review of business

The Company is a wholly owned subsidiary of BAE Systems (Holdings) Limited. The main activity of the Company is the supply of small, medium and large calibre munitions to the UK Ministry of Defence ("MoD"). The Company has a strong order book which includes a 15 year contract with UK MoD for the delivery of munitions capability and the supply of a range of munitions. This contract was awarded in 2008 with the final 5 year price being agreed in 2016.

Key performance indicators

Key financial performance indicators are shown below:

	2018	As restated 2017*
	£m	£m
Order intake	**206**	117
Revenue	**193**	211
Profit before tax	**12**	15
Return on sales	**6.2%**	7.1%

* Prior year comparatives have been restated upon the Company's adoption of International Financial Reporting Standard (IFRS) 15 Revenue from Contracts with Customers. See note 19 for details regarding the restatement.

Order intake represents the value of funded orders received from customers in the year. It is a measure of in-year performance and supports future years' sales performance.
Revenue represents the amounts derived from the provision of goods and services.
Profit before tax is used for internal performance analysis as a measure of operating profitability that is comparable over time.
Return on sales this shows the percentage of profit as a function of sales.

Principal risks and uncertainties

UK public sector spending
The 2015 UK Strategic Defence and Security Review provided additional clarity regarding future Army programmes and we believe that our advanced planning work with the UK Ministry of Defence will generate revenues that remain in line with the overall business plan.

Delivery risk
Undertaking work within our core competencies and skills built on many years' experience in this market reduces the overall execution risks. However, although most risks are negligible, the high technical requirements within our development contracts need careful management to minimise the inherent risks in that aspect of our work.

Approved by the Board and signed on its behalf by:

A R Collins
Director
Date: 21 JUNE 2019

Directors' Report

Company registration

BAE Systems Global Combat Systems Munitions Limited (the "Company") is a private company, limited by shares and registered in England and Wales with the registered number 01842252.

Results and dividends

The Company's profit for the financial year is £14m (2017 £13m profit restated). The directors do not propose a dividend for 2018 (2017 £25m).

Looking forward

The Company expects to continue with its current contracts for the foreseeable future.

The terms of the UK's exit from the EU are currently uncertain, rendering it difficult for the Company to prepare for potential changes in the regulatory environment. In particular, a no-deal Brexit could have an impact on programmes which depend on the movement of goods between the UK and the EU but near-term impacts for the Company are likely to be limited.

Going concern

After making due enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue operational existence for at least 12 months from the date of approval of the financial statements. For this reason they continue to adopt the going concern basis in preparing the financial statements.

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.

We keep employees informed about what is happening across the business, including Company results, major business decisions and other matters which affect them, using a variety of media, including our intranet and e-mail, through podcasts, newsletters and leadership blogs, and also through team briefs and team meetings where we seek to listen to employees' views and opinions. Employees have the opportunity to provide feedback through our engagement surveys.

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

Research and development

The Company is focused on technology innovation and engineering excellence and invests in next-generation research and technology programmes to improve the manufacturing and service of products, generating substantial intellectual property. Total research and development expenditure in the year was £1.9m (2017 £0.9m), of which £0.7m (2017 £0.6m) was funded by the Company.

Directors' Report (continued)

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.

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:

A R Collins
J B Osbaldestin

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 they ought to have taken to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of S418 of the Companies Act 2006.

Auditor

Following a Group audit retender by the Company's ultimate parent company, BAE Systems plc, Deloitte LLP was appointed as auditor to the Company on 10 September 2018.

Deloitte LLP have indicated their willingness to be re-appointed as the Company's auditor and a resolution proposing their re-appointment will be put to the member(s).

Approved by the Board and signed on its behalf by:

A R Collins
Director

21 June 2019

Registered office:
BAE Systems Global Combat Systems Munitions Limited
Warwick House
PO Box 87
Farnborough Aerospace Centre
Farnborough
Hampshire
GU14 6YU
United Kingdom

Directors' Responsibilities Statement

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including Financial Reporting Standard 101 ("FRS 101") Reduced Disclosure Framework. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

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

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern.

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 Global Combat Systems Munitions Limited

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of BAE Systems Global Combat Systems Munitions Limited (the "Company"):

- give a true and fair view of the state of the Company's affairs as at 31 December 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the Income Statement;
- the Statement of Comprehensive Income;
- the Balance Sheet;
- the Statement of Changes in Equity; and
- the related notes 1 to 22.

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

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of these matters.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our Auditor's Report thereon. 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.

In connection with our audit of the financial statements, 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 audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. 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 respect of these matters.

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.

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; or

We have nothing to report in respect of these matters.

Use of our Report

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

Douglas King (Senior Statutory Auditor)

for and on behalf of Deloitte LLP

2 Hardman Street
Manchester
M3 3HF
Date: 21 June 2019

Income Statement
for the year ended 31 December 2018

	Note	2018 £m	As restated 2017* £m
Revenue	2	**193**	211
Operating costs	6	**(184)**	(200)
Other income	3	**2**	6
Operating profit		**11**	17
Financial income	4	**2**	1
Financial expense	5	**(1)**	(3)
Profit before taxation		**12**	15
Tax	8	**2**	(2)
Profit for the financial year		**14**	13

The notes on pages 13 to 51 form part of these financial statements.

* Prior year comparatives have been restated upon the Company's adoption of International Financial Reporting Standard ("IFRS") 15 Revenue from Contracts with Customers. See note 19 for details regarding the restatement.

Statement of Comprehensive Income
for the year ended 31 December 2018

	2018 £m	2017 £m
Profit for the year	**14**	13
Items that will not be reclassified to profit or loss:		
Remeasurements on retirement benefit schemes*	**(22)**	54
Tax on items that will not be reclassified to the income statement	**4**	(9)
Items that may be reclassified to the Income Statement:		
Amounts credited/(charged) to hedging reserve	**1**	(1)
Total comprehensive (loss)/income for the year	**(3)**	57

The notes on pages 13 to 51 form part of the financial statements.

* 2018 includes a charge of £0.3m to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Company's defined benefit pension schemes. This error has not been corrected retrospectively because it is not material to the Company's financial statements.

The results for 2018 and 2017 arise from continuing operations.

Balance Sheet
as at 31 December 2018

	Note	2018 £m	As restated 2017* £m
Non-current assets			
Property, plant and equipment	9	**93**	101
Retirement benefit surpluses	16	**93**	120
		186	221
Current assets			
Inventories	12	**19**	18
Trade, other and contract receivables	13	**206**	187
Other financial assets	15	**-**	1
		225	206
Total assets		**411**	427
Non-current liabilities			
Retirement benefit obligations	16	**(43)**	(48)
Other financial liabilities	15	**-**	(1)
Deferred tax liabilities	11	**(14)**	(20)
Provisions	17	**(1)**	(3)
		(58)	(72)
Current liabilities			
Trade and other payables	14	**(285)**	(252)
Other financial liabilities	15	**(1)**	(1)
Provisions	17	**(4)**	(12)
		(290)	(265)
Total liabilities		**(348)**	(337)
Net assets		**63**	90

Balance Sheet (continued)
as at 31 December 2018

	Note	2018 £m	As restated 2017* £m
Capital and reserves			
Issued share capital	18	**50**	50
Other reserves	18	**-**	(1)
Retained earnings		**13**	41
Total equity		**63**	90

* Prior year comparatives have been restated upon the Company's adoption of ("IFRS") 15 Revenue from Contracts with Customers. See note 19 for details regarding the restatement.

Approved by the Board on 21 Jun 19 **and signed on its behalf by:**

A R Collins
Director

Registered number: 01842252

Statement of Changes in Equity
for the year ended 31 December 2018

	Called up share capital £m	Other reserves £m	Retained earnings £m	Total equity £m
At 1 January 2017 as restated see note 19	50	-	(18)	32
Profit for the year restated*	-	-	13	13
Tax in respect of items of other comprehensive income	-	-	(9)	(9)
Other comprehensive income	-	(1)	54	53
Share-based payments	-	-	1	1
At 31 December 2017*	50	(1)	41	90
Profit for the year	-	-	14	14
Taxation in respect of items of other comprehensive income	-	-	4	4
Other comprehensive income	-	1	(22)	(21)
Dividends paid	-	-	(25)	(25)
Share-based payments	-	-	1	1
At 31 December 2018	**50**	**-**	**13**	**63**

*Prior year comparatives have been restated upon the Company's adoption of ("IFRS") 15 Revenue from Contracts with Customers. See note 19 for details regarding the restatement.

1. Accounting policies

BAE Systems global Combat Systems Munitions Limited (the "Company") is a private company, limited by shares, and registered in England and Wales and incorporated in the United Kingdom. Its ultimate controlling party is BAE Systems plc. The address of the Company's registered office is shown on page 3. The principal activities of the Company are the design, development, manufacture and supply of a wide range of defence systems, sub systems and components.

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 million.

1.1 Basis of preparation

These financial statements were prepared in accordance with FRS 101 Reduced Disclosure Framework issued in September 2015. The amendments to FRS 101 (2015/16 cycle) issued in July 2016 and FRS 101 (2016/17 cycle) issued in July 2017 have no impact on the Company.

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

- the requirements of IFRS 7 Financial Instruments: Disclosures;
- the 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 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)(iii), 134(d) 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.

1. Accounting policies (continued)

1.1 Basis of preparation (continued)

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.

Critical accounting policies
Certain of the Company's significant accounting policies are considered by the directors to be critical because of the level of complexity, judgement or estimation involved in their application and their impact on the financial statements. The critical accounting policies are listed below:

Critical accounting policy	Description
Valuation of retirement benefit obligations	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.

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

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 significant estimates in relation to the Company's critical accounting policies are set out above.

1. Accounting policies (continued)

1.1 Basis of preparation (continued)

Changes in accounting policies
IFRS 9 Financial instruments and IFRS 15 Revenue from Contracts with Customers became effective on 1 January 2018. *The impact of adoption is set out in note 19.*

Several other standards, interpretations and amendments to existing standards became effective on 1 January 2018, none of which had a material impact on the Company.

IFRS 16 Leases is effective from 1 January 2019. The standard replaces IAS 17 Leases. Whilst lessor accounting under IFRS 16 is similar to IAS 17, lessee accounting is significantly different. Under IFRS 16, the Company will recognise within the Balance Sheet a right-of-use asset and a lease liability for future lease payments in respect of all leases, unless the underlying assets are of low value or the lease term is 12 months or less. Within the Income Statement, rental expense on the impacted leases will be replaced with depreciation on the right-of-use asset and interest on the lease liability.

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.

1.2 Revenue and profit recognition

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

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.

1. Accounting policies (continued)

1.2 Revenue and profit recognition (continued)

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. Whilst payment terms vary from contract to contract, on many of the Company's contracts, an element of the transaction price is received in advance of delivery. The Company therefore has significant contract liabilities. The Company's contracts are not considered to include significant financing components on the basis that there is no difference between the consideration and the cash selling price either as a result of UK Ministry of Defence contracting rules which prohibit the inclusion of financing in the sales price or negotiations on competitive international export contracts which do not make allowance for the cash payment profile.

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.

1. Accounting policies (continued)

1.2 Revenue and profit recognition (continued)

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

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:

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

The majority of the Company's contract modifications are treated under either 1 (for example, the requirement for additional distinct goods or services) or 3 (for example, a change in the specification of the distinct goods or services for a partially completed contract), although the facts and circumstances of any contract modification are considered individually as the types of modifications will vary contract-by-contract and may result in different accounting outcomes.

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

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

1.3 Leases

Lease income under operating leases is recognised in the Income Statement on a straight-line basis over the lease term.

Lease payments made under operating leases, including incentives granted, are recognised in the Income Statement on a straight-line basis over the lease term.

1.4 Research and development

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

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

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

1. Accounting policies (continued)

1.5 Interest income and borrowing costs

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

1.6 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.

1.7 Property, plant and equipment

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

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

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

Buildings	- up to 50 years, or the lease term if shorter
Computing equipment and motor vehicles	- 4 to 5 years
Other equipment	- 10 to 20 years, or project life if shorter years

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.

1. Accounting policies (continued)

1.8 Impairment

The carrying amounts of the Company's intangible assets are reviewed at each Balance Sheet date to determine whether there is any indication of impairment as required by IAS 36 Impairment of Assets. If any such indication exists, the asset's recoverable amount is estimated. For 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 other intangible assets, property, plant and equipment, investment property and equity accounted investments 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.

1.9 Inventories

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

1.10 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.

1. Accounting policies (continued)

1.11 Trade and other payables

Trade and other payables are stated at their amortised cost.

1.12 Provisions for liabilities

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.

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.

1. Accounting policies (continued)

1.13 Retirement benefits

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

Obligations for contributions are recognised as an expense in the Income Statement as incurred.

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

The retirement benefit surpluses and obligations recognised in the Company's Balance Sheet represents the fair value of scheme assets, less the present value of the defined benefit obligations calculated using a number of actuarial assumptions as set out on page 39. The bid values of scheme assets are not intended to be realised in the short term and may be subject to significant change before they are realised. The present values of scheme liabilities are derived from cash flow projections over long periods and are, therefore, inherently uncertain.

IAS 19 Employee Benefits, limits the measurement of a defined benefit surplus to the lower of the surplus in the defined benefit scheme and the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the scheme or reductions in future contributions to the scheme. IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction, issued in 2007, provides an interpretation of the requirements of IAS 19, clarifying that a refund is available if the entity has an unconditional right to a refund in certain circumstances. The Company has applied IFRIC 14 and has determined that there is no limit on the recognition of the surpluses in its defined benefit pension schemes as at 31 December 2018.

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.

1. Accounting policies (continued)

1.14 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.

The Company recognises an increase in its investments in subsidiary undertakings in respect of the cost of share-based payment awards issued by the Company's ultimate parent company, BAE Systems plc, to employees of the Company's operating subsidiary companies, with a corresponding entry to equity.

1.15 Financial instruments

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

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 cashflows.

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.

1. Accounting policies (continued)

1.16 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.

2. Revenue

	2018	2017
	£m	£m
Revenue by customer location		
United Kingdom	**172**	181
Rest of Europe	**15**	22
USA and Canada	**6**	7
Asia and Pacific	**-**	1
	193	211

Notes to the Financial Statements

	2018 £m	2017 £m
Revenue by category		
External sales	**182**	204
Intercompany sales	**11**	7
	193	211

3. Other income

	2018 £m	2017 £m
Other operating income	**1**	6
Royalty receivable	**1**	-
	2	6

4. Finance income

	2018 £m	2017 £m
Net interest income on retirement benefit obligations	**2**	1
	2	1

5. Finance expense

	2018 £m	2017 £m
Foreign exchange losses	**-**	2
Interest payable on intra group loans	**1**	1
	1	3

6. Operating costs

The operating costs are stated after charging:

	2018 £m	As restated 2017* £m
Change in inventories of finished goods and work-in-progress	**7**	15
Raw materials, subcontracts and other bought in items	**60**	45
Depreciation, amortisation and impairment	**13**	13
Staff costs	**53**	53
Sublease costs	**9**	11
Other operating charges	**42**	63
	184	200

*Prior year comparatives have been restated upon the Company's adoption of (IFRS) 15 Revenue from Contracts with Customers. See note 19 for details regarding the restatement.

The remuneration of the auditor for the year ended 31 December 2018 for auditing of the financial statements was £0.2m (2017 £0.3m) and nil (2017 nil) in respect of non-audit work. As noted in the Directors' Report, Deloitte LLP was appointed as statutory auditor for 2018, replacing KPMG LLP, who resigned following the 2017 audit. Accordingly, references related to 2018 relate to Deloitte LLP and 2017 to KPMG LLP.

Total research and development expenditure which has not been capitalised was £1.9m (2017 £0.9m), of which £0.7m (2017 £0.6m) was funded by the Company.

7. Employees

The weekly average number of Company employees was 932 (2017 1,109).

The aggregate staff costs of Company employees were as follows:

	2018 £m	2017 £m
Wages and salaries	**38**	39
Social security costs	**4**	4
Cost of defined benefit scheme	**9**	8
Cost of defined contribution scheme	**1**	1
Share-based payments	**1**	1
	53	53

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

Notes to the Financial Statements

	2018 £'000	2017 £'000
Directors' remuneration	**200**	216
Company contribution to defined benefit pension schemes	**36**	26
Amounts receivable under long term incentives	**-**	11
	236	253

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

	2018 Number of directors	2017 Number of directors
Defined benefit schemes	**2**	3

	2018 Number of directors	2017 Number of directors
The number of directors who exercised share options was	**-**	-
The number of directors in respect of whose qualifying services were received or receivable under long term incentive schemes was	**1**	1
	1	1

7. Employees (continued)

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

	2018	2017
	£'000	£'000
Remuneration and amounts receivable under long-term incentive plans	131	127
Company contributions to defined benefit pension schemes	22	14
	153	141

The highest paid director's defined benefit accrued pension and accrued lump sum at 31 December 2018 was £13k (2017 £13k) and £nil (2017 £104k).

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

8. Tax

	2018	As restated* 2017
	£m	£m
Current tax		
UK:		
Current tax	-	-
	-	-
Deferred tax		
Origination and reversal of temporary differences	2	(1)
Adjustment in respect of prior years	-	(1)
Tax	2	(2)

The UK Corporation tax rate was reduced from 20% to 19% with effect from 1 April 2017, and will be reduced to 17% with effect from 1 April 2020. In line with these changes, the deferred tax liability has been calculated at the rates that are expected to apply to temporary differences when they reverse, based on the laws enacted or substantially enacted by the reporting date.

8. Tax (continued)

Reconciliation of tax result

The following reconciles expected tax expense using the UK corporate tax rate, to reported tax result

	2018 £m	As restated* 2017 £m
Profit before tax	**12**	15
UK corporation tax rate	**19.00%**	19.25%
Expected tax (expense) on profit	**(2)**	(3)
Adjustment in respect of prior years	**-**	(1)
Other	**(1)**	-
Accelerated capital allowances	**-**	(1)
Pensions and other provisions	**-**	1
Losses received from BAE Systems plc group companies free of charge	**5**	2
Tax result	**2**	(2)

Tax recognised in other comprehensive income

	2018 Before tax £m	2018 Tax benefit/ expense £m	2018 Net of tax £m
Items that will not be reclassified to the income statement:			
Remeasurements on retirement benefit schemes	**(22)**	**4**	**(18)**
	(22)	**4**	**(18)**
Items that may be reclassified to the income statement:			
Amounts credited to hedging reserves	**1**	**-**	**1**
	1	**-**	**1**
	(21)	**4**	**(17)**

8. Tax (continued)

	2017 Before tax £m	2017 Tax benefit/ expense £m	2017 Net of tax £m
Items that will not be reclassified to the income statement:			
Remeasurements on retirement benefit schemes	54	(9)	45
Items that may be reclassified to the income statement:			
Amounts charged to hedging reserve	(1)	-	(1)
	53	(9)	44

	2018 Retained earnings £m	**2018 Total £m**
Deferred tax		
Retirement benefit schemes	**4**	**4**
Tax on other comprehensive income	**4**	**4**

	2017 Retained earnings £m	2017 Total £m
Deferred tax		
Retirement benefit schemes	(9)	(9)
Tax on other comprehensive income	(9)	(9)

* Prior year comparatives have been restated upon the Company's adoption of ("IFRS") 15 Revenue from Contracts with Customers. See note 19 for details regarding the restatement.

9. Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Total £m
Cost or valuation			
At 1 January 2018	37	156	193
Additions	-	5	5
Disposals	-	(1)	(1)
At 31 December 2018	**37**	**160**	**197**
Depreciation			
At 1 January 2018	10	82	92
Depreciation charge for the year	1	12	13
Disposals	-	(1)	(1)
At 31 December 2018	**11**	**93**	**104**
Net book value			
At 31 December 2018	**26**	**67**	**93**
At 31 December 2017	27	74	101

	Land and buildings £m	Plant and machinery £m	Total £m
Non-depreciated assets (included in the above):			
Assets in the course of construction	1	13	14
	1	**13**	**14**

Notes to the Financial Statements

10. Investments

	£m
Carrying value	
At 1 January and 31 December 2018	-

During the year, management conducted an impairment review of the investments held by the Company. As a result of this review there were no impairments or impairment reversals required.

The recoverable amount of the investments held by the Company has been calculated with reference to their value in use. The value in use calculations use risk-adjusted future cash flow projections based on the five-year Integrated Business Plan ("IBP") and include a terminal value based on the projections for the final year of that plan, with growth rate assumptions in the range 0% to 2% applied. The IBP process includes the use of historic experience, available government spending data and the BAE Systems plc group's order backlog. Pre-tax discount rates, derived from the group's post-tax weighted average cost of capital of 6.36% (2017 6.60%) (adjusted for risks specific to the market in which the cash-generating unit operates), have been used in discounting these projected risk-adjusted cash flows.

Subsidiary undertakings and participating interests at 31 December 2018

In accordance with Section 409 of the Companies Act 2006, a full list of subsidiary undertakings and significant holdings as at 31 December 2018 is disclosed below. Unless otherwise stated, all subsidiary undertakings and significant holdings are owned directly by the Company and have a financial year end of 31 December.

Company name	Class of shares held	Proportion of class (%)
Royal Ordnance (Crown Service) Pension Scheme Trustees Limited *Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hampshire GU14 6YU, United Kingdom*	Ordinary shares of £1	100 %
Royal Ordnance Senior Staff Pension Scheme Trustees Limited *Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hampshire GU14 6YU, United Kingdom*	Ordinary shares of £1	100 %
International Military Sales Limited *Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hampshire GU14 6YU, United Kingdom*	Ordinary shares of £1	100 %

Notes to the Financial Statements

11. Deferred tax

Deferred tax assets/(liabilities)

	Deferred tax assets		Deferred tax liabilities		Net balance at 31 December	
	2018 £m	2017 £m	**2018 £m**	2017 £m	**2018 £m**	2017 £m
Property, plant and equipment	**-**	-	**(6)**	(6)	**(6)**	(6)
Retirement benefit schemes:-	**-**	-	**(8)**	(12)	**(8)**	(12)
Other*	**-**	-	**-**	(2)	**-**	(2)
Deferred tax liabilities	**-**	-	**(14)**	(20)	**(14)**	(20)

Movement in temporary differences during the year

	At 1 January 2018* £m	Recognised in income £m	Recognised in equity £m	**At 31 December 2018 £m**
Property, plant and equipment	(6)	-	-	**(6)**
Retirement benefit schemes surplus	(12)	-	4	**(8)**
Other*	(2)	2	-	**-**
Deferred tax liabilities	(20)	2	4	**(14)**

	At 1 January 2017 £m	Recognised in income £m	Recognised in equity £m	At 31 December 2017 £m
Property, plant and equipment	(7)	1	-	(6)
Provisions and accruals	2	(2)	-	-
Retirement benefit schemes surplus	(3)	-	(9)	(12)
Other*	(1)	(1)	-	(2)
Deferred tax liabilities	(9)	(2)	(9)	(20)

* Prior year comparatives have been restated upon the Company's adoption of ("IFRS") 15 Revenue from Contracts with Customers. See note 19 for details regarding the restatement.

Notes to the Financial Statements

12. Inventories

	2018 £m	As restated 2017* £m
Work in progress	**19**	18
	19	18

* Prior year comparatives have been restated upon the Company's adoption of ("IFRS") 15 Revenue from Contracts with Customers. See note 19 for details regarding the restatement.

13. Trade, other and contract receivables

	2018 £m	As restated 2017* £m
Current		
Contract receivables	**4**	9
Trade receivables	**14**	15
Amounts owed by BAE Systems plc and its subsidiaries	**179**	154
Other debtors	**9**	9
	206	187

* Prior year comparatives have been restated upon the Company's adoption of ("IFRS") 15 Revenue from Contracts with Customers. See note 19 for details regarding the restatement.

14. Trade and other payables

	2018 £m	As restated 2017* £m
Current		
Contract liabilities	**109**	102
Trade payables	**11**	5
Amounts owed to BAE Systems plc and its subsidiaries	**115**	94
Other taxes and social security	**24**	25
Accruals and deferred income	**26**	26
	285	252

* Prior year comparatives have been restated upon the Company's adoption of ("IFRS") 15 Revenue from Contracts with Customers. See note 19 for details regarding the restatement.

15. Other financial assets and liabilities

	2018 £m	2017 £m
Financial assets		
Current		
Cash flow hedges - foreign exchange contracts	**-**	1
Financial liabilities		
Non-current		
Cash flow hedges - foreign exchange contracts	**-**	(1)
Current		
Cash flow hedges - foreign exchange contracts	**(1)**	(1)

Notes to the Financial Statements

16. Retirement benefit obligations

Background

BAE Systems plc operates pension schemes for qualifying employees in the UK, US and other countries. The principal schemes in the UK are funded defined benefit schemes and the assets are held in separate trustee-administered funds.

At 31 December 2018, the weighted average durations of the UK defined benefit pension obligations were 17 years (2017 18 years).

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

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[1]	35	20	45
Royal Ordnance Pension Scheme[2]	18	20	62

1. Source: Main Scheme actuarial valuation report as at 31 March 2017.

2. Source: Royal Ordnance Pension Scheme actuarial valuation 31 March 2017.

Regulatory framework

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

Benefits

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

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. It is expected that the total impact of GMP equalisation for all Group subsidiaries will be in the region of £121m based on an estimate as at 26 October 2018 for the UK schemes that were contracted out of the State Earnings Related Pension Scheme between 1990 and 1997. This has been treated for IAS 19 purposes as a plan amendment and resulted in an increase in the pension deficit in the Balance Sheet and a corresponding past service cost in the Income Statement. The Company has been allocated a share of the past service cost based on the relative payroll contributions of active members. The Company's share of the £121m is £4m.

Notes to the Financial Statements

16. Retirement benefit obligations (continued)

Funding

Introduction

Disclosures in respect of pension funding provided below reflect the pension schemes as a whole. Disclosures in respect of pension accounting under IAS 19 are provided on pages 39 to 44.

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 professional qualified independent actuaries and include assumptions which differ from the actuarial assumptions used for IAS 19 accounting purposes shown on page 39. The purpose of the funding valuations is to design funding plans which ensure that the schemes have sufficient funds available to meet future benefit payments.

Valuations

Funding valuations of the UK defined benefit schemes are performed every three years. The latest valuations were performed as at 31 March 2017. The next funding valuations will have an effective date of no later than 31 March 2020.

In November 2017, the triennial funding valuations and, where necessary, deficit recovery plans were agreed with the trustees and certified by the scheme actuaries after consultation with the UK Pensions Regulator.

The results of the most recent triennial valuations at 31 March 2017 are shown below:

	Main Scheme £bn	Royal Ordnance Pension Scheme £bn	Other schemes £bn	Total £bn
Market value of assets	12.8	1.6	7.2	21.6
Present value of liabilities	(14.4)	(1.5)	(7.8)	(23.7)
Funding (deficit)/surplus	(1.6)	0.1	(0.6)	(2.1)
Percentage of accrued benefits covered by the assets at the valuation date	89%	107%	92%	91%

The valuations were determined using the following mortality assumptions:

	2017
Life expectancy of a male currently aged 65 (years)	86 – 89
Life expectancy of a female currently aged 65 (years)	88 – 90
Life expectancy of a male currently aged 45 (years)	88 – 92
Life expectancy of a female currently aged 45 (years)	91 – 93

16. Retirement benefit obligations (continued)

The discount rate assumptions used in the 2017 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 are 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.

In aggregate, the total net funding deficit across the UK schemes at 31 March 2017, prior to allocation to other participating employers, was £2.1bn. 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 to yield higher returns than bonds.

The agreements reached are underpinned by contingency plans, which include a commitment by BAE Systems plc to a further £50m of deficit funding into the largest scheme prior to the next triennial valuation in the event that the scheme funding level was to fall below pre-determined parameters. In addition, BAE Systems plc would be required to pay £187m across its schemes with deficits at the valuation date if the funding levels for those schemes 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 2018 were £9m (2017 £8m).

Deficit contributions will further increase in line with any percentage growth in dividend payments made by BAE Systems plc. Under the deficit recovery plans, these annual payments would subsequently fall by £50m in 2022 as the deficits on certain schemes are expected to be cleared. The annual payments are expected to end in 2026 when all deficits are projected to be cleared. Under the last agreement made in 2014, all scheme deficits were projected to be cleared in 2026. Deficit recovery payments are allocated to all participating employers based on the relative payroll contributions of active members.

In 2019, the Company expects that contributions to its pension schemes will be broadly in line with 2018.

Notes to the Financial Statements

16. Retirement benefit obligations (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
Market (investment) risk	
Asset returns may not move in line with the liabilities and may be subject to volatility.	The investment portfolios are highly diversified, investing in a wide range of assets, in order to reduce the exposure of the total portfolio to a materially adverse impact from a single security or type of security. To reduce volatility, certain assets are held in a matching portfolio, which largely consists of index-linked bonds, gilts and swaps, designed to mirror movements in corresponding liabilities. Some 47% (2017 51%) of the UK pension scheme assets are held in equities and pooled investment vehicles due to the higher expected level of return over the long term. Some of the pension schemes use derivative financial instruments as part of their investment strategy to manage the level of market risk. The Main Scheme and BAE Systems Executive Pension scheme jointly have an equity option strategy protecting £1.8bn of assets against a significant fall in equity markets. In February 2019 this protection was extended to cover £2.6bn of assets.
Interest rate risk	
Liabilities are sensitive to movements in interest rates, with lower interest rates leading to an increase in the valuation of liabilities.	In addition to investing in bonds as part of the matching portfolio, some of the UK schemes invest in interest rate swaps to reduce the exposure to movements in interest rates. The swaps are held with several banks to reduce counterparty risk. The discount rate assumptions set as part of the 2017 UK funding valuations more directly reflect the expected returns on assets held by the schemes and, therefore, the liabilities are less sensitive to interest rate risk than they were in the 2014 funding valuation. Accordingly, the 2017 approach provides a more 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 2017 UK funding valuation, the Company expects the schemes to be fully hedged against interest rate movements following a five-year transition period to the planned investment strategy.
Inflation risk	
Liabilities are sensitive to movements in inflation, with higher inflation leading to an increase in the valuation of liabilities.	In addition to investing in index-linked bonds as part of the matching portfolio, the principal UK schemes invest in long-term inflation swaps to reduce the exposure to movements in inflation. The swaps are held with several banks to reduce counterparty risk. The approach to the 2017 UK funding valuation provides a more natural hedge against inflation movements and, therefore, the liabilities are less sensitive to inflation risk than they were in the 2014 funding valuation. Under the 2017 UK funding valuation approach, the Company is already fully hedged against inflation movements and, under the planned investment strategy, aims to maintain a fully hedged position. In 2014, the Main Scheme implemented a pension increase exchange to allow retired members to elect for a higher current pension in exchange for foregoing certain rights to future pension increases.
Longevity risk	
Liabilities are sensitive to life expectancy, with increases in life expectancies leading to an increase in the valuation of liabilities.	Longevity adjustment factors are used in the majority of the UK pension schemes in order to adjust the pension benefits payable so as to share the cost of people living longer with employees. In 2013, with the agreement of BAE Systems plc, the trustees of the 2000 Plan, Royal Ordnance Pension Scheme and Shipbuilding Industries Pension Scheme 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.

16. Retirement benefit obligations (continued)

IAS 19 Accounting

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

Principal actuarial assumptions

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

	2018	2017	2016
Financial assumptions			
Discount rate – past service (%)	**2.9**	2.6	2.7
Discount rate – future service (%)	**3.0**	2.7	2.7
Retail Prices Index (RPI) inflation (%)	**3.1**	3.1	3.2
Rate of increase in salaries (%)	**3.1**	3.1	3.2
Rate of increase in deferred pensions (%)	**2.1/3.1**	2.1/3.1	2.2/3.2
Rate of increase in pensions in payment (%)	**1.6 – 3.7**	1.6 – 3.7	1.7 – 3.7
Demographic assumptions			
Life expectancy of a male currently aged 65 (years)	**86 – 88**	86 – 88	86 – 89
Life expectancy of a female currently aged 65 (years)	**88 – 90**	88 – 90	89 – 90
Life expectancy of a male currently aged 45 (years)	**88 – 90**	88 – 90	88 – 91
Life expectancy of a female currently aged 45 (years)	**90 – 91**	90 – 92	91 – 92

Discount rate

The discount rate assumptions are derived through discounting the projected benefit payments of the principal schemes using a third-party AA corporate bond yield curve to produce a single equivalent discount rate. This inherently captures the maturity profile of the expected benefit payments. 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) inflation

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

Rate of increase in salaries

The rate of increase in salaries for the UK schemes is assumed to be RPI inflation of 3.1% (2017 RPI inflation of 3.1%), plus a promotional scale.

Rate of increase in deferred pensions

The rate of increase in deferred pensions for the UK schemes is based on Consumer Prices Index (CPI) inflation of 2.1% (2017 CPI inflation of 2.1%), with the exception of the 2000 Plan, which is based on RPI inflation of 3.1% (2017 RPI inflation of 3.1%). The rate of increase in deferred pensions is subject to inflation caps.

16. Retirement benefit obligations (continued)

Rate of increase in pensions in payment
The rate of increase in pensions in payment differs between UK schemes. Different tranches of the schemes increase at rates based on either RPI or 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 S2 mortality tables based on year of birth (as published by the Institute of Actuaries) for both pensioner and non-pensioner members in conjunction with the results of an investigation into the actual mortality experience of scheme members and information on the demographic profile of the scheme's membership. In addition, to allow for future improvements in longevity, the Continuous Mortality Investigation 2017 tables (published by the Institute of Actuaries) have been used (in 2017, the Continuous Mortality Investigation 2016 tables were used), with an assumed long-term rate of future annual mortality improvements of 1.25% (2017 1.25%), for both pensioner and non-pensioner members.

The disclosures below are in respect of the Company's share of the IAS 19 deficit using the allocation methodology outlined on page 21.

Summary of movements in retirement benefit obligations

	£m
Company's share of IAS 19 deficit at 1 January 2018	72
Actual return on assets excluding amounts included in interest expense[1]	(169)
Actuarial gain due to changes in assumptions and experience	147
Contributions in excess of service cost	2
Past service cost – plan amendments	(4)
Net interest income	2
Company's share of IAS 19 deficit at 31 December 2018	**50**

1. 2018 includes a charge of £0.3m to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Company's defined benefit pension schemes. This error has not been corrected retrospectively because it is not material to the Company's financial statements.

Amounts recognised in the Balance Sheet

	2018 £m	2017 £m
Present value of unfunded obligations	-	-
Present value of funded obligations	(947)	(1,107)
Fair value of scheme assets	997	1,179
Company's share of IAS 19 deficit, net	**50**	72
Represented by:		
Retirement benefit surpluses	93	120
Retirement benefit obligations	(43)	(48)
	50	72

Notes to the Financial Statements

16. Retirement benefit obligations (continued)

Changes in the fair value of scheme assets

	£m
Company's share of the value of scheme assets at 1 January 2017	1,196
Interest income	31
Actual return on assets excluding amounts included in interest income	(9)
Actual return on assets	22
Contributions by employer	6
Contributions by employer in respect of employee salary sacrifice arrangements	2
Total contributions by employer	8
Members' contributions	-
Benefits paid	(47)
Company's share of the value of scheme assets at 31 December 2017	1,179
Interest income	27
Actual return on assets excluding amounts included in interest income[1]	(169)
Actual return on assets	(142)
Contributions by employer	8
Contributions by employer in respect of employee salary sacrifice arrangements	1
Total contributions by employer	9
Members' contributions	-
Administrative expenses	(1)
Benefits paid	(48)
Company's share of the value of scheme assets at 31 December 2018	**997**

1. Includes a charge of £0.3m to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Company's defined benefit pension schemes. This error has not been corrected retrospectively because it is not material to the Company's financial statements.

Notes to the Financial Statements

16. Retirement benefit obligations (continued)

Assets of defined benefit pension schemes

	2018			2017		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equities:						
UK	38	-	38	51	-	51
Overseas	24	-	24	35	3	38
Pooled investment vehicles[1]	4	86	90	6	117	123
Fixed interest securities:	-	-	-			
UK gilts	345	-	345	378	-	378
UK corporates	293	18	311	345	11	356
Overseas government	1	-	1	1	-	1
Overseas corporates	93	-	93	94	-	94
Index-linked securities:	-	-	-			
UK gilts	371	-	371	418	1	419
UK corporates	7	2	9	6	4	10
Property[2]	-	38	38	-	50	50
Derivatives[3]	-	(358)	(358)	-	(374)	(374)
Cash:	-	-	-			
Sterling	7	16	23	8	13	21
Foreign currency	-	3	3	-	1	1
Other	-	9	9	1	10	11
Company total	**1,183**	**(186)**	**997**	1,343	(164)	1,179

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

16. Retirement benefit obligations (continued)

Changes in the present value of the defined benefit obligations

	£m
Company's share of the defined benefit obligations at 1 January 2017	(1,179)
Current service cost	(6)
Contributions by employer in respect of employee salary sacrifice arrangements	(2)
Total current service cost	(8)
Members' contributions	-
Past service cost – plan amendments	-
Actuarial loss due to changes in assumptions and experience	63
Interest expense	(30)
Benefits paid	47
Company's share of the defined benefit obligations at 31 December 2017	(1,107)
Current service cost	(5)
Contributions by employer in respect of employee salary sacrifice arrangements	(1)
Total current service cost	(6)
Members' contributions	-
Past service cost – plan amendments	(4)
Actuarial gain due to changes in assumptions and experience	147
Interest expense	(25)
Benefits paid	48
Company's share of the defined benefit obligations at 31 December 2018	**(947)**

Amounts recognised in the Income Statement

	2018 £m	2017 £m
Included in operating costs:		
Current service cost	**(5)**	8
Past service cost – plan amendments		
Guaranteed Minimum Pension equalisation charge	**(4)**	-
Administrative expenses	**(1)**	-
	(10)	8
Included in finance costs:		
Net interest expense on retirement benefit obligations	**2**	1

The Company incurred a charge of £2m (2017 £1m) in relation to defined contribution schemes for employees.

Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 31 December 2018 and keeping all other assumptions as set out on page 38.

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.

Notes to the Financial Statements

16. Retirement benefit obligations (continued)

	(Increase)/ decrease in pension obligation £m	Increase/ (decrease) in scheme assets £m
Discount rate:		
0.1 percentage point increase	14	(15)
0.1 percentage point decrease	(15)	15
Inflation:		
0.1 percentage point increase	(15)	11
0.1 percentage point decrease	14	(11)

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

	(Increase)/ decrease in pension obligation £m
Inflation:	
0.5 percentage point increase	(55)
0.5 percentage point decrease	52
1.0 percentage point increase	(116)
1.0 percentage point decrease	98

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	(25)
One-year decrease	25

Notes to the Financial Statements

17. Provisions

	Legal, contractual and environmental £m	Warranty and after-sales service £m	Total £m
Non-current	1	2	**3**
Current	6	6	**12**
At 1 January 2018	7	8	**15**
Utilised	(9)	(2)	**(11)**
Created	4	1	**5**
Released	(2)	(2)	**(4)**
At 31 December 2018	**-**	**5**	**5**
Represented by:			
Non-current	-	1	**1**
Current	-	4	**4**
	-	**5**	**5**

Provisions have been restated for 2017 to better show the split of provision types.

Legal, contractual and environmental
Reflecting the inherent uncertainty within many legal proceedings, the timing and amount of the outflows could differ significantly from the amount provided.

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

18. Share capital and other reserves

Share capital

	£0.25 Ordinary shares '000	Nominal value £m
Issued and fully paid		
At 1 January and 31 December 2018	**200,000**	**50**

Notes to the Financial Statements

18. Share capital and other reserves (continued)

Other reserves

	Hedging reserve £m
At 1 January 2017	-
Amounts charged to hedging reserve	(1)
At 31 December 2017	(1)
Amounts credited to hedging reserve	**1**
At 31 December 2018	**-**

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.

Dividends

	2018 £m	2017 £m
Ordinary dividends paid in respect of prior years	**25**	-

The directors do not propose a dividend for the current year (2017: £25,000,000)

19. Change in accounting policies

This note explains the impact of the adoption of IFRS 9 Financial Instruments, and IFRS 15 Revenue from Contracts with Customers, on the Company's financial statements.

Impact on financial statements
As a result of changes in the Company's accounting policies, prior year comparative information has been restated for the adoption of IFRS 15 Revenue from Contracts with Customers. As explained below, IFRS 9 was adopted without restating comparative information. The following tables show the adjustments recognised for each individual line item. Line items that are not affected by the changes have not been included. As a result, the sub-totals and totals disclosed cannot be recalculated from the numbers provided.

Balance Sheet (extract)

	2017 As previously reported £m	Impact of IFRS 15 £m	2017 Restated on adoption of IFRS 15 £m
Current assets			
Inventories	19	(1)	18
Trade and other receivables including amounts from customers for contract work	185	2	187
	204	**1**	**205**
Current liabilities			
Trade and other payables	(260)	8	(252)
Non-current liabilities			
Deferred tax liabilities	(18)	(2)	(20)
	(74)	**7**	**(67)**
Capital and reserves			
Retained earnings	34	7	41
	34	**7**	**41**

Notes to the Financial Statements

19. Change in accounting policies (continued)

Income Statement (extract)

	2017 As previously reported £m	Impact of IFRS 15 £m	2017 Restated on adoption of IFRS 15 £m
Revenue	220	(9)	211
Operating costs	(213)	13	(200)
Tax	(1)	(1)	(2)
	6	**3**	**9**

Statement of Comprehensive Income (extract)

Total comprehensive income for the year	**54**	**3**	**57**

19. Change in accounting policies (continued)

IFRS 9 Financial Instruments – impact of adoption
IFRS 9 replaces the provisions of IAS 39 that relate to recognition, classification and measurement of financial assets and financial liabilities, de-recognition of financial instruments, impairment of financial assets and hedge accounting. The adoption of IFRS 9 Financial Instruments from 1 January 2018 resulted in changes in accounting policies; however, no adjustments were required to the amounts recognised in the financial statements in previous periods. The accounting policies applied from 1 January 2018 are set out in note 1.

Classification and measurement
On 1 January 2018, the Company has classified its financial instruments in the appropriate IFRS 9 categories.

The derivative financial instruments designated as cash flow hedges under IAS 39 at 31 December 2017 continue to qualify for hedge accounting under IFRS 9 at 1 January 2018 and are therefore treated as continuing hedges.

Financial assets previously classified in the "loans and receivables" category and measured at amortised cost under IAS 39 (being trade receivables, amounts owed by BAE Systems plc equity accounted investments and amounts owed by BAE Systems plc and its subsidiaries) continue to be classified in the "amortised cost" category under IFRS 9 as they are held within a business model to collect contractual cash flows and these cash flows consist solely of payments of principal and interest.

Impairment of financial assets
The Company has four types of financial assets that are subject to IFRS 9's new expected credit loss model:

- trade receivables;
- contract receivables;
- amounts owed by BAE Systems plc and its subsidiaries; and
- cash and cash equivalents.

Trade receivables and contract receivables do not contain a significant financing element and therefore expected credit losses are measured using the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from the initial recognition of the receivables.

The Company has assessed credit risk in relation to defence-related sales to government customers or sub contractors to governments and believes it to be extremely low as the possibility of default is insignificant; therefore the provision for expected credit losses is immaterial in respect of receivables from these customers. The Company considers expected credit losses for non-government commercial customers, however this risk is not material to the financial statements.

While amounts owed by BAE Systems plc and its subsidiaries, and cash and cash equivalents are also subject to the impairment requirements of IFRS 9, the identified impairment loss was immaterial.

There was no IFRS 9 impact on retained earnings at 1 January 2018.

19. Change in accounting policies (continued)

IFRS 15 Revenue from Contracts with Customers – impact of adoption
The Company has adopted IFRS 15 fully retrospectively in accordance with paragraph C3(a). Comparatives for the year ended 31 December 2017 have been restated. The following expedients have been used in accordance with paragraph C5:

- revenue in respect of completed contracts that begin and end in the same accounting period has not been restated;
- revenue in respect of completed contracts with variable consideration reflects the transaction price at the date the contracts were completed; and
- the transaction price allocated to unsatisfied and partially unsatisfied performance obligations as at 31 December 2017 is not disclosed.

The accounting policy in respect of revenue applied from 1 January 2018 is set out in note 1.

The impact of adoption on the Company's comparative Income Statement, Balance Sheet is shown above.

The impact of adoption on the Company's retained earnings at 31 December 2017 and December 2016 was as follows:

	2017 £m	2016 £m
Retained earnings/(deficit) - as previously reported	**34**	(22)
Recognition of revenue for over time contracts based on costs incurred and including attributable margin	**4**	-
Tax on recognition of revenue for over time contracts based on costs incurred and including attributable margin	**(1)**	-
Adjustment to retained earnings upon adoption of IFRS 15	**5**	5
Tax on adjustment to retained earnings upon adoption of IFRS 15	**(1)**	(1)
Retained earnings/(deficit) - IFRS 15 (restated)	**41**	(18)

20. Capital commitments

At 31 December 2018 the Company had capital commitments as follows:

	2018 £m	2017 £m
Contracted for but not provided in these financial statements	**3**	2
	3	2

21. Commitments under operating leases

At 31 December 2018 the Company had future minimum lease payments under non-cancelable operating leases as follows:

	2018 £m	As restated 2017* £m
Not later than 1 year	**6**	6
Later than 1 year and not later than 5 years	**34**	30
Later than 5 years	**95**	106
	135	142

* Restated to reflect the position at 2017 following change in calculation method.

22. Controlling parties

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

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

6 Carlton Gardens
London
SW1Y 5AD

Website: www.baesystems.com