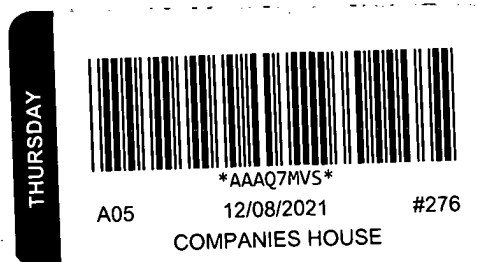


# **BAE Systems (Oman) Limited**

## **Annual Report and Financial Statements**

**31 December 2020**

Registered number: 03135337



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**Strategic Report**

for the year ended 31 December 2020

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**Review of business and principal activities**

In December 2012 BAE Systems (Oman) Limited (the "Company") was awarded a contract for the provision of Typhoon and Hawk Aircraft and attendant support services to the Sultanate of Oman. Deliveries to the customer under this contract commenced in 2017 and completed in 2018. Since then, the principal activity of the Company has been the continued provision of in-country support services to the Typhoon and Hawk aircraft, including the provision of aircraft spares, training and ground equipment. During the first half of 2020, the Group was asked to enter into negotiations with the Omani customer regarding a transition to a reduced scope support solution for the Typhoon fleet. These negotiations concluded successfully, and an amended scope of work was agreed to secure Typhoon support services in Oman until mid-2022. A redundancy provision was recognised in the year due to the reduction in staff required for this contract.

**Key performance indicators**

Key financial performance indicators are shown below:

	<b>2020</b>	2019
	<b>£000</b>	£000
Order intake	<b>933</b>	1,254
Revenue	<b>104,615</b>	158,194
Operating (loss)/profit	<b>(11,762)</b>	36,877

**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. The 2020 order intake is associated with ad-hoc Hawk Aircraft spares and repairs orders under the Oman Hawk Enhanced Post Design Services Contract and a small increase on the Typhoon Contract for the provision of additional goods and services.

**Revenue** represents the amounts derived from the provision of goods and services. Revenue has decreased in 2020 mainly due to the transition from an Availability Support Contract to a reduced scope Support Contract for the Typhoon fleet.

**Operating profit** is used for internal performance analysis as a measure of operating profitability that is comparable over time. The decrease in 2020 operating profit is again, as a direct result of the renegotiation and transition from the Availability Support Contract to a reduced scope Typhoon Support Contract on the 1 August 2020.

**Strategic Report (continued)**  
for the year ended 31 December 2020

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**Principal risks and uncertainties**

The Company's principal risks are identified below.

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

Contagious diseases can have an adverse effect on the Company's business, financial condition and results of operations. While the Company is liaising closely with its customers and suppliers to understand any changes in requirements and priorities during this time, the uncertainties surrounding the development of this pandemic make it difficult to predict the extent to which the Company may be affected.

Areas of the Company's business that could be impacted include a decrease in spending by the Company's major defence customers; an increase in taxation by governments; the failure to obtain awards for defence and commercial contracts; the failure of suppliers to deliver parts to the Company; the requirement for the Company or its suppliers to reduce site operational levels or close sites; the inability of the Company to meet contractual delivery requirements on time; the inability to adequately staff and manage the business; and an increase in the cost or lack of availability of funding. If the Company were unable to obtain appropriate funding either internally or externally it could be forced to make reductions in spending, seek to extend payment terms with suppliers and/or suspend or curtail planned programmes. Any of the above could have a material adverse effect on the Company's business, financial condition and results of operations.

Since the outbreak of the COVID-19 coronavirus pandemic, the Company has taken a number of responsive measures including reducing site operational levels and introducing new cleaning regimes, safe working distance measures and protective equipment for its employees.

By taking these measured actions to build in resilience for a prolonged period of disruption, the Company has continued to deliver critical work for its customers and, where operations were impacted, ensured that site-critical workers have now been able to safely return to work where possible.

**The Company is dependent on defence spending**

The Company's core businesses are primarily defence-related, selling products and services directly and indirectly, to the Omani government.

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

The Oman economy is influenced by oil prices, with consequent impacts on defence spending.

Defence spending by governments has also been impacted by the COVID-19 outbreak due to reprioritisation of funds.

**The Company operates in international markets**

The Company conducts business in Oman.

The risks of operating in some countries include: social and political changes impacting the business environment; economic downturns, political instability and civil disturbances; change of export control and other government policy and regulation in the UK and other relevant jurisdictions; the imposition of restraints on the movement of capital; the introduction of burdensome taxes or tariffs; and the inability to obtain or maintain the necessary export licences.

**Strategic Report (continued)**  
for the year ended 31 December 2020

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

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

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

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

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

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

**The defined benefit pension schemes in which the Company participates have aggregate funding deficits**

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

The deficits may be adversely affected by changes in a number of factors, including investment returns and members' anticipated longevity.

**The Company's strategy is dependent on its ability to recruit and retain people with appropriate talent and skills**

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

It is important that the Company recruits and retains management with the necessary international skills and experience in the relevant jurisdiction

**Section 172(1) statement**

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

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

**Strategic Report (continued)**  
for the year ended 31 December 2020

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**Decision Making**

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

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

**Employees**

Employee engagement is a primary focus for the directors of the Company – connecting employees to the Company's and the BAE Systems Group's strategy and purpose, empowering them to contribute to improving business performance and creating an environment in which everyone can fulfil their potential. We keep the Company's employees informed about what is happening across the BAE Systems Group through the Group's intranet and email, podcasts, newsletters, and leadership blogs and briefings.

In 2020, in light of the COVID-19 pandemic, the principal focus for the directors of the Company was the health and wellbeing of its employees. We introduced a number of measures to return employees safely back to work where their role could not be carried on from home. To assist home-working, we developed guides to support employees in maintaining their safety, security, wellbeing and productivity whilst working effectively from home. The directors were pleased to see the rapid deployment of various means of communication across the Company. These included the enhanced roll-out of an employee app, which allowed us to update employees directly and immediately through their personal devices and receive feedback from them.

These engagement activities form part of the Company's implementation of the BAE Systems group-wide employee engagement processes and policies which are described on pages 30-31, 43-47, 100-101 and 116-117 of BAE Systems plc's annual report 2020 (available at: [www.baesystems.com/investors](http://www.baesystems.com/investors)).

**Fostering business relationships with suppliers, customers and others**

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

Our largest customer is the Oman government. Strong and collaborative relationships with our principal government customers help us to identify our customers' requirements and to help position the Company as a trusted provider. The directors are in regular contact with the principal government customers of the Company and in particular the Oman Ministry of Defence and the Royal Air Force of Oman.

**Strategic Report (continued)**  
for the year ended 31 December 2020

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**Fostering business relationships with suppliers, customers and others (continued)**

The Company, together with its procurement and supply chain function, works with its suppliers and their supply chains to provide equipment, goods and services that meet its customers' requirements. The Company's supplier relationships are often long-term due to the length of the product life-cycles and the directors meet with key suppliers and work with the BAE Systems Group's procurement function to develop deeper relationships with business in the supply chain and develop strategic relationships with key suppliers.

In particular, in light of the COVID-19 pandemic, a priority of the directors of the Company was to support the Company's customer and suppliers.

Through providing safe on-site working environments and scaled up homeworking capabilities, we continued to deliver critical work for our customer.

**The community and the environment**

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

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

These activities form part of the Company's implementation of the BAE Systems group-wide community and environment processes and policies and the BAE Systems Group's impacts thereon which are described in the "Environment" and "Social" sections (page 36-39 and 48-52 respectively) of BAE Systems plc's annual report 2020 (available at: [www.baesystems.com/reporting](http://www.baesystems.com/reporting)).

**Strategic Report (continued)**  
for the year ended 31 December 2020

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**Maintaining a reputation for high standards of business conduct**

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

Detailed information on the BAE Systems group-wide business conduct processes and policies are described in BAE Systems plc's annual report 2020 (available at: [www.baesystems.com/reporting](http://www.baesystems.com/reporting)) and in particular the "Governance and business conduct" section on pages 53-55.

**Approved by the Board and signed on its behalf by:**

S D Wood  
Director



Date: 23 June 2021



## **Directors' Report**

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### **Company registration**

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

### **Results and dividends**

The Company's loss for the financial year is £13,535k (2019 £33,789k profit). The Company made a loss in 2020 as a direct result of the renegotiation and transition from the Availability Support Contract to a reduced scope Typhoon Support Contract on the 1 August 2020.

In 2020 the Company did not pay a dividend on the 2019 results due to the ongoing transition of the changes in contracts which are now complete. As such based on the retained earnings at the end of 2020 the directors have proposed a dividend for 2020 of £28,328k.

### **Looking forward**

The Company expects to continue trading and being in operational existence for the foreseeable future. A new contract was signed in the year which will run until June 2022 and further follow on support contracts will be negotiated.

The Company has been affected by the COVID-19 pandemic (see Principal Risk entitled "The outbreak of contagious diseases may have a material adverse effect on the Company's business, financial condition and results of operations" on page 2).

The current immunisation programme is progressing and the business of the Company has returned to a near normal operational tempo. However, it is not clear for how long this pandemic will last or how much more extensive it will become, or the further measures that will be taken by governments and others to seek to control the virus.

### **Going concern**

After making due enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue operational existence for at least 12 months from the date of approval of the financial statements. The Company and its ultimate parent entity BAE Systems plc continue to conduct ongoing risk assessments on its business operations and liquidity, including the impact of the COVID-19 pandemic. Having undertaken these assessments, the directors consider that the Company will be able to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

### **Energy and carbon reporting exemption**

The Company has taken advantage of the exemption granted under The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 as this information is disclosed in the 2020 annual report of its ultimate parent, BAE Systems plc, on pages 36-39 (available at: [www.baesystems.com/investors](http://www.baesystems.com/investors)).

### **Overseas branch office**

The Company has an overseas branch office in Oman.

### **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' Report (continued)**

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**Directors and their interests**

The directors who served throughout the year and up to the date of this Report were as follows:

S D Wood  
A K Gilchrist  
B W Ireland  
S C Underwood

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 Section 418 of the Companies Act 2006.

**Auditor**

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

**Approved by the Board and signed on its behalf by:**



**S D Wood**  
Director

Date: 23 June 2021

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

## **Directors' Responsibilities Statement**

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

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

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

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

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

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

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## **Independent Auditor's Report to the Members of BAE Systems (Oman) Limited**

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### **Report on the audit of the financial statements**

#### **Opinion**

In our opinion the financial statements of BAE Systems (Oman) Limited (the "Company"):

- give a true and fair view of the state of the Company's affairs as at 31 December 2020 and of its loss 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 20.

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

#### **Basis for opinion**

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

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

#### **Conclusions relating to going concern**

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

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

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

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

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### **Other information**

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

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

We have nothing to report in this regard.

### **Responsibilities of directors**

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

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

### **Auditor's responsibilities for the audit of the financial statements**

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

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

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

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

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

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

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### **Extent to which the audit was considered capable of detecting irregularities, including fraud (continued)**

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

- had a direct effect on the determination of material amounts and disclosures in the financial statements. These included the UK Companies Act 2006 and the Corporation Tax Act 2010; and
- do not have a direct effect on the financial statements but compliance with which may be fundamental to the company's ability to operate or to avoid a material penalty.

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

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

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

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

### **Report on other legal and regulatory requirements**

#### **Opinions on other matters prescribed by the Companies Act 2006**

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

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

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

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

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

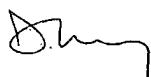
Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

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

We have nothing to report in respect of these matters.

### **Use of our report**

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



Douglas King (Senior statutory auditor)

For and on behalf of Deloitte LLP  
Statutory Auditor

Manchester, United Kingdom

Date: 23 June 2021

**Income Statement**  
for the year ended 31 December 2020

	Note	2020 £000	2019 £000
Revenue	3	104,615	158,194
Operating costs	4	(116,377)	(121,317)
<b>Operating (loss)/profit</b>		<b>(11,762)</b>	<b>36,877</b>
Financial expense	5	(171)	(408)
<b>(Loss)/profit before tax</b>		<b>(11,933)</b>	<b>36,469</b>
Tax	8	(1,602)	(2,680)
<b>(Loss)/profit for the financial year</b>		<b>(13,535)</b>	<b>33,789</b>



**Statement of Comprehensive Income**  
for the year ended 31 December 2020

	<b>2020</b> <b>£000</b>	2019 £000
(Loss)/profit for the financial year	<b>(13,535)</b>	33,789
<b>Other comprehensive income:</b>		
<b>Items that will not be reclassified to the Income Statement</b>		
Remeasurements on retirement benefit schemes	<b>400</b>	(1,400)
Tax on items that will not be reclassified to the Income Statement	<b>(76)</b>	238
	<b>324</b>	(1,162)
<b>Items that may be reclassified to the Income Statement</b>		
Amounts charged to hedging reserve	<b>(2,763)</b>	(4,861)
Tax on items that may be reclassified to the Income Statement	<b>412</b>	918
	<b>(2,351)</b>	(3,943)
<b>Other comprehensive income net of tax</b>	<b>(2,027)</b>	(5,105)
<b>Total comprehensive (expense)/income for the year</b>	<b>(15,562)</b>	28,684

The notes on pages 19 to 56 form part of these financial statements.

The results for 2020 and 2019 arise from continuing activities.

**BAE Systems (Oman) Limited**  
**Annual Report and Financial Statements**  
**31 December 2020**

**Balance Sheet**  
as at 31 December 2020

	Note	2020 £000	2019 £000
<b>Non-current assets</b>			
Property, plant and equipment	9	-	5
Right-of-use assets	15	3,080	5,128
Intangible assets	10	84	141
Other financial assets	14	605	3,013
Deferred tax assets	11	1,330	965
		<u>5,099</u>	<u>9,252</u>
<b>Current assets</b>			
Trade, other and contract receivables	12	138,940	152,475
Other financial assets	14	2,486	2,761
		<u>141,426</u>	<u>155,236</u>
<b>Total assets</b>		<u>146,525</u>	<u>164,488</u>
<b>Non-current liabilities</b>			
Lease liabilities	15	(1,016)	(2,937)
Other financial liabilities	14	(23)	(124)
Retirement benefit obligations	16	(7,512)	(11,212)
		<u>(8,551)</u>	<u>(14,273)</u>
<b>Current liabilities</b>			
Trade, other and contract payables	13	(99,986)	(96,523)
Lease liabilities	15	(1,922)	(1,908)
Other financial liabilities	14	(191)	(10)
Current tax		(1,569)	(2,569)
Provisions	17	(648)	-
		<u>(104,316)</u>	<u>(101,010)</u>
<b>Total liabilities</b>		<u>(112,867)</u>	<u>(115,283)</u>
<b>Net assets</b>		<u>33,658</u>	<u>49,205</u>

**Balance Sheet (continued)**  
as at 31 December 2020

	Note	2020 £000	2019 £000
<b>Capital and reserves</b>			
Issued share capital	18	-	-
Other reserves	18	2,330	4,681
Retained earnings		31,328	44,524
<b>Total equity</b>		<b>33,658</b>	<b>49,205</b>

**Approved by the Board on 23 June 2021**

**and signed on its behalf by:**



**S D Wood**  
Director

Registered number: 03135337

**Statement of Changes in Equity**  
for the year ended 31 December 2020

	<b>Issued share capital</b>	<b>Other reserves</b>	<b>Retained earnings</b>	<b>Total equity</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
At 1 January 2019	-	8,624	11,880	20,504
Profit for the year	-	-	33,789	33,789
Total other comprehensive losses	-	(4,861)	(1,400)	(6,261)
Taxation in respect of items of other comprehensive losses	-	918	238	1,156
Share-based payments	-	-	17	17
At 31 December 2019	-	4,681	44,524	49,205
Loss for the year	-	-	(13,535)	(13,535)
Other comprehensive (losses)/income	-	(2,763)	400	(2,363)
Taxation in respect of items of other comprehensive losses/(income)	-	412	(76)	336
Share-based payments	-	-	15	15
At 31 December 2020	-	2,330	31,328	33,658

## **Notes to the Financial Statements**

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### **1. General information**

BAE Systems (Oman) 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 8.

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

Foreign operations are included in accordance with the policies set out in note 2.2.

### **2. Accounting policies**

#### **2.1 Basis of preparation**

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

- the requirements of IFRS 7 Financial Instruments: Disclosures;
- the requirements of paragraphs 91-99 of IFRS 13 Fair Value Measurement;
- the requirements of paragraph 52, the second sentence of paragraph 89, and paragraphs 90, 91 and 93 of IFRS 16 Leases. The requirements of paragraph 58 of IFRS 16, provided that the disclosure of details in indebtedness relating to amounts payable after 5 years required by company law is presented separately for lease liabilities and other liabilities, and in total;
- the requirement in paragraph 38 of International Accounting Standards (IAS) 1 Presentation of Financial Statements to present comparative information in respect of:
  - paragraph 79(a)(iv) of IAS 1;
  - paragraph 73(e) of IAS 16 Property, Plant and Equipment;
  - paragraph 118(e) of IAS 38 Intangible Assets;
  - paragraphs 76 and 79(d) of IAS 40 Investment Property;
- the requirements of paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 38D, 40A, 40B, 40C, 40D, 111 and 134 to 136 of IAS 1 Presentation of Financial Statements;
- the requirements of IAS 7 Statement of Cash Flows;
- the requirements of paragraphs 30 and 31 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors;
- the requirements of paragraph 17 and 18A of IAS 24 Related Party Disclosures; and
- the requirements in IAS 24 Related Party Disclosures to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member.

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

## **Notes to the Financial Statements**

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

#### **2.1 Basis of preparation (continued)**

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
Deferred tax asset on retirement benefit obligations	The Company has recognised a deferred tax asset in respect of the deficits in its pension/retirement schemes. It is management's judgement that the Company will generate sufficient taxable profits to recover the net deferred tax asset recognised. This judgement requires the use of estimates of future taxable profits based on the Company's Integrated Business Plan.
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.

#### **Changes in accounting policies**

There are no amendments to existing standards, or interpretations that became effective on 1 January 2020 and have had a material impact on the Company.

## **Notes to the Financial Statements**

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

#### **2.1 Basis of preparation (continued)**

##### **Significant accounting policies**

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

#### **2.2 Foreign currencies**

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

The assets and liabilities of foreign currency branches are translated at the exchange rates ruling at the Balance Sheet date. The Income Statements of these branches are translated at average rates of exchange during the year. All resulting exchange differences are recognised in the foreign translation reserve.

#### **2.3 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.

**Notes to the Financial Statements**

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**2. Accounting policies (continued)**

**2.3 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.

*Revenue and profit recognition*

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

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

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



## **Notes to the Financial Statements**

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

#### **2.3 Revenue and profit recognition (continued)**

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

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

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

##### *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.

##### *Costs to obtain a contract*

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

##### *Costs to fulfil a contract*

Contract fulfilment costs in respect of over-time contracts are expensed as incurred. Contract fulfilment costs in respect of point in time contracts are accounted for under IAS 2 Inventories.

## **Notes to the Financial Statements**

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

#### **2.4 Leases**

##### *The Company as lessee*

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

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

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

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

#### **2.5 Intangible assets**

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

##### *Software*

Software development costs that are directly associated with the production of identifiable and unique software products controlled by the Company, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Company-funded expenditure associated with enhancing or maintaining computer software programs for sale is recognised as an expense as incurred.

##### *Amortisation*

Amortisation on intangible assets, is charged to the Income Statement on a straight-line basis over their estimated useful lives.

The estimated useful lives are as follows:

Software	- 2 to 5 years
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**Notes to the Financial Statements**

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**2. Accounting policies (continued)**

**2.6 Property, plant and equipment**

*Cost*

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

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

*Depreciation*

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

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

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.

## **Notes to the Financial Statements**

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

#### **2.7 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.

#### **2.8 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.

#### **2.9 Cash and cash equivalents**

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

#### **2.10 Trade, other and contract payables**

Trade, other and contract payables are stated at amortised cost.

## **Notes to the Financial Statements**

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

#### **2.11 Financial instruments**

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

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

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

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

Derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition, such instruments are stated at fair value at the Balance Sheet date. Fair values are estimated by discounting expected future cash flows.

##### *Fair value through profit or loss*

Gains and losses on derivative financial instruments that are not designated as cash flow hedges are recognised in the Income Statement for the period.

##### *Cash flow hedges*

Where a derivative financial instrument is designated as a hedge of the exposure to variability in cash flows relating to a highly probable forecast transaction (income or expense), or recognised asset or liability, the effective portion of any change in the fair value of the instrument is recognised in other comprehensive income and presented in the hedging reserve in equity. Amounts recognised in equity are reclassified from the hedging reserve into the cost of the underlying transaction and recognised in the Income Statement when the underlying transaction affects profit or loss. The ineffective portion of any change in the fair value of the instrument is recognised in the Income Statement immediately. The Company treats the foreign currency basis element of the designated foreign exchange derivative hedging instrument as a cost of hedging and as such it is excluded from the hedge designation.

## **Notes to the Financial Statements**

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

#### **2.12 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 48. The bid values of scheme assets are not intended to be realised in the short term and may be subject to significant change before they are realised. The present values of scheme liabilities are derived from cash flow projections over long periods and are, therefore, inherently uncertain.

The Company participates in a number of group and multi-employer schemes administered by its ultimate parent company, BAE Systems plc. A share of the IAS 19 Employee Benefits pension deficit has been allocated to all participating employers. This allocation is based on the relative payroll contributions of active members which is consistent with prior years. Whilst this methodology is intended to reflect a reasonable estimate of the share of the deficit, it may not accurately reflect the obligations of the participating employers. Gains and losses resulting from changes to the relative payroll contributions of active members year on year are included within the 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.

## **Notes to the Financial Statements**

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

#### **2.13 Tax**

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

##### *Current tax*

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

##### *Deferred tax*

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

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

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

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

The most significant recognised deferred tax assets relate to the deficits on the Company's retirement benefit schemes. This is because retirement benefit costs are deducted in determining accounting profit as service is provided by employees, but deducted in determining taxable profit either when contributions are paid to the retirement benefit schemes or when retirement benefits are paid. In reviewing the probability that taxable profits will be available in the future against which such contributions/payments can be deducted, account has been taken of the deficit recovery plans agreed with the trustees of the relevant schemes under which the deficits are expected to be cleared between 2021 and 2026.

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

**Notes to the Financial Statements**

**3. Revenue**

Revenue by customer location

	<b>2020</b> <b>£000</b>	2019 £000
Middle East	<b>104,615</b>	158,194
	<b>104,615</b>	158,194

**4. Operating costs**

	<b>2020</b> <b>£000</b>	2019 £000
Raw materials, subcontracts and other bought-in items used	<b>103,153</b>	103,181
Staff costs (note 6)	<b>8,728</b>	12,206
Depreciation, amortisation and impairment	<b>2,110</b>	2,143
Other operating charges	<b>2,386</b>	3,787
	<b>116,377</b>	121,317

The remuneration of the auditor for the year ended 31 December 2020 for auditing of the financial statements was £10,000 (2019 £10,000) and £nil (2019 £nil) in respect of non-audit work.

**5. Financial expense**

	<b>2020</b> <b>£000</b>	2019 £000
Net interest expense on retirement benefit obligations (note 16)	<b>100</b>	300
Interest expense on lease liabilities (note 15)	<b>71</b>	108
	<b>171</b>	408



## Notes to the Financial Statements

### 6. Employees

The monthly average number of Company employees was 120 (2019 139). The aggregate staff costs of Company employees were as follows:

	2020 £000	2019 £000
Wages and salaries	7,804	11,047
Social security costs	219	296
Cost of defined benefit scheme (note 16)	500	700
Cost of defined contribution scheme (note 16)	190	146
Share-based payments	15	17
	<u>8,728</u>	<u>12,206</u>

### 7. Directors' remuneration

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

	2020 £000	2019 £000
Directors' remuneration	64	85
Company contributions to defined benefit pension schemes	7	15
	<u>71</u>	<u>100</u>

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

	2020 Number of directors	2019 Number of directors
Defined benefit schemes	3	3

	2020 Number of directors	2019 Number of directors
Number of directors who exercised share options	-	1
Number of directors in respect of whose qualifying services shares were received or receivable under long-term incentive schemes	2	2

**Notes to the Financial Statements**

**8. Tax**

	<b>2020</b>	<b>2019</b>
	<b>£000</b>	<b>£000</b>
<b>Current tax</b>		
UK:		
Current tax	-	(2,695)
Double tax relief	-	2,695
	<u>-</u>	<u>-</u>
Overseas:		
Current tax	<b>(1,569)</b>	(2,569)
Adjustments in respect of prior years	<b>(62)</b>	(26)
	<u><b>(1,631)</b></u>	<u>(2,595)</u>
<b>Deferred tax</b>		
Origination and reversal of temporary differences	<b>(200)</b>	(32)
Adjustments in respect of prior years	<b>2</b>	(53)
Tax rate adjustment <sup>1</sup>	<b>227</b>	-
	<u><b>29</b></u>	<u>(85)</u>
<b>Tax result</b>	<u><b>(1,602)</b></u>	<u>(2,680)</u>

## Notes to the Financial Statements

### 8. Tax (continued)

#### Reconciliation of tax result

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

	2020 £000	2019 £000
<b>Result before taxation</b>	<b>(11,933)</b>	36,469
UK corporation tax rate	<b>19.00%</b>	<b>19.00%</b>
Expected tax (expense)/income on result	<b>2,267</b>	(6,929)
Utilisation of unrelieved foreign tax	-	126
Foreign tax	<b>(1,271)</b>	-
Imputed interest expense/(income)	<b>(88)</b>	66
Losses received from/ (surrendered to) fellow group companies	<b>(2,675)</b>	4,134
Adjustments in respect of prior years	<b>(60)</b>	(79)
Tax rate adjustment <sup>1</sup>	<b>227</b>	-
Other	<b>(2)</b>	2
<b>Tax result</b>	<b>(1,602)</b>	(2,680)

1 As at 31 December 2019 legislation was in place for the UK corporation tax rate to be reduced from 19% to 17% with effect from 1 April 2020. However, under the Finance Act 2020, the rate was retained at 19%. The deferred tax asset at each Balance Sheet date has been calculated at the tax rates, enacted at that date, expected to apply to the temporary differences when they reverse. The resulting tax rate adjustment has been partly recorded in the Income Statement and partly in the Statement of Comprehensive Income.

## Notes to the Financial Statements

### 8. Tax (continued)

#### Tax recognised in other comprehensive income

	2020			2019		
	Before tax £000	Tax benefit/ (expense) £000	Net of tax £000	Before tax £000	Tax benefit/ (expense) £000	Net of tax £000
<b>Items that will not be reclassified to the income statement:</b>						
Remeasurements on retirement benefit schemes	400	(76)	324	(1,400)	238	(1,162)
<b>Items that may be reclassified to the income statement:</b>						
Amounts (charged)/credited to hedging reserve	(2,763)	525	(2,238)	(4,861)	918	(3,943)
Tax rate adjustment <sup>1</sup>	-	(113)	(113)	-	-	-
	<u>(2,363)</u>	<u>336</u>	<u>(2,027)</u>	<u>(6,261)</u>	<u>1,156</u>	<u>(5,105)</u>

	2020			2019		
	Other reserves £000	Retained earnings £000	Total £000	Other reserves £000	Retained earnings £000	Total £000
<b>Deferred tax</b>						
Financial instruments	525	-	525	918	-	918
Retirement benefit schemes	-	(76)	(76)	-	238	238
Tax rate adjustment <sup>1</sup>	(113)	-	(113)	-	-	-
<b>Tax on other comprehensive income</b>	<u>412</u>	<u>(76)</u>	<u>336</u>	<u>918</u>	<u>238</u>	<u>1,156</u>

Notes to the Financial Statements

**9. Property, plant and equipment**

	Plant and machinery £000
<b>Cost or valuation</b>	
At 1 January 2020	198
Disposals	(41)
<b>At 31 December 2020</b>	<b>157</b>
<b>Depreciation</b>	
At 1 January 2020	193
Depreciation charge for the year	5
Disposals	(41)
<b>At 31 December 2020</b>	<b>157</b>
<b>Net book value</b>	
<b>At 31 December 2020</b>	<b>-</b>
At 31 December 2019	5

Notes to the Financial Statements

10. Intangible assets

	Software £000
<b>Cost</b>	
At 1 January 2020	250
Additions	1
<b>At 31 December 2020</b>	<b>251</b>
<b>Amortisation</b>	
At 1 January 2020	109
Amortisation charge	58
<b>At 31 December 2020</b>	<b>167</b>
<b>Net book value</b>	
<b>At 31 December 2020</b>	<b>84</b>
At 31 December 2019	141

**Notes to the Financial Statements**

**11. Deferred tax**

**Deferred tax assets/(liabilities)**

	Deferred tax assets		Deferred tax liabilities		Net balance at 31 December	
	2020 £000	2019 £000	2020 £000	2019 £000	2020 £000	2019 £000
Property, plant and equipment	16	16	-	-	16	16
Provisions and accruals	86	4	-	-	86	4
Retirement benefit schemes, deficits	1,427	1,904	-	-	1,427	1,904
Retirement benefit schemes, additional contributions	348	-	-	-	348	-
Financial instruments	-	-	(547)	(959)	(547)	(959)
	<u>1,877</u>	<u>1,924</u>	<u>(547)</u>	<u>(959)</u>	<u>1,330</u>	<u>965</u>
Deferred tax assets/(liabilities)						

**Movement in temporary differences during the year**

	At 1 January 2020 £000	Recognised in income £000	Recognised in equity £000	At 31 December 2020 £000
Property, plant and equipment	16	-	-	16
Provisions and accruals	4	348	-	352
Retirement benefit schemes	1,904	(401)	(76)	1,427
Retirement benefit schemes, additional contributions	-	82	-	82
Financial instruments	(959)	-	412	(547)
	<u>965</u>	<u>29</u>	<u>336</u>	<u>1,330</u>

Notes to the Financial Statements

11. Deferred tax (continued)

	At 1 January 2019 £000	Recognised in income £000	Recognised in equity £000	At 31 December 2019 £000
Property, plant and equipment	11	5	-	16
Provisions and accruals	60	(56)	-	4
Retirement benefit schemes	1,700	(34)	238	1,904
Financial instruments	(1,877)	-	918	(959)
	(106)	(85)	1,156	965

On 3 March 2021, the Government announced that the UK corporation tax rate would be increased from 19% to 25% with effect from 1 April 2023. As this rate change was not enacted at the Balance Sheet date, the impact of higher rate has not been taken into account in the calculation of the deferred tax asset and the rate applying remains at 19% (2019 17%). The rate change may result in a significant change to the deferred tax asset.



**Notes to the Financial Statements**

**12. Trade, other and contract receivables**

	<b>2020</b>	2019
	<b>£000</b>	£000
Trade debtors	<b>42,434</b>	24,926
Amounts owed by BAE Systems plc and its subsidiaries	<b>90,705</b>	34,016
Other debtors	<b>1,139</b>	56
Prepayments	<b>243</b>	809
Amounts recoverable on long term contracts	<b>4,419</b>	92,668
	<b>138,940</b>	152,475

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

**13. Trade, other and contract payables**

	<b>2020</b>	2019
	<b>£000</b>	£000
<b>Current</b>		
Contract liabilities	<b>82,952</b>	74,603
Trade payables	<b>158</b>	648
Amounts owed to BAE Systems plc and its subsidiaries	<b>6,131</b>	12,907
Other payables	<b>5,829</b>	3,279
Accruals	<b>4,916</b>	5,086
	<b>99,986</b>	96,523

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

Notes to the Financial Statements

14. Financial instruments

	2020 £000	2019 £000
<b>Financial assets</b>		
<b>Non-current</b>		
Cash flow hedges – foreign exchange contracts	605	3,013
<b>Current</b>		
Cash flow hedges – foreign exchange contracts	2,486	2,761
<b>Financial liabilities</b>		
<b>Non-current</b>		
Cash flow hedges – foreign exchange contracts	(23)	(124)
<b>Current</b>		
Cash flow hedges – foreign exchange contracts	(191)	(10)

## Notes to the Financial Statements

### 15. Leases

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

	<b>31 December 2020</b>			<b>31 December 2019</b>		
	<b>Land and buildings £000</b>	<b>Plant and machinery £000</b>	<b>Total £000</b>	<b>Land and buildings £000</b>	<b>Plant and machinery £000</b>	<b>Total £000</b>
Depreciation expense for the year	1,981	66	2,047	1,983	70	2,053
Net book value	2,976	104	3,080	4,952	176	5,128

#### Lease liabilities

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

	<b>2020 £000</b>	<b>2019 £000</b>
Payments due:		
Within one year	1,980	1,979
Between one and five years	989	2,969
	<b>2,969</b>	<b>4,948</b>
Reconciliation to balance sheet:		
Undiscounted lease liability	2,969	4,948
Impact of discounting	(31)	(103)
Total discounted lease liability	<b>2,938</b>	<b>4,845</b>

The total cash outflow for leases recognised on the Balance Sheet in the year ended 31 December 2020, amounted to £1,979k (2019 nil).

**Notes to the Financial Statements**

**15. Leases (continued)**

**Amounts recognised in the Income Statement**

	<b>2020</b>	2019
	<b>£000</b>	£000
<b>Included in operating costs:</b>		
Depreciation on right-of-use assets	<b>2,047</b>	2,053
	<u><b>2,047</b></u>	<u>2,053</u>
<b>Included in net finance costs:</b>		
Interest expense on lease liabilities	<b>71</b>	108
	<u><b>71</b></u>	<u>108</u>

## 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. The allocation of each Company's share of the pension deficit is based on the relative payroll contributions of active members, as outlined on page 28.

At 31 December 2020, the weighted average durations of the UK defined benefit pension obligations were 18 years (2019 17 years).

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

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

	Active %	Deferred %	Pensioner %
Main Scheme (merged) <sup>1</sup>	31	21	48

1. Source: 31 October 2019 actuarial valuation reports.

#### Regulatory framework

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

#### Benefits

The UK defined benefit schemes provide benefits to members in the form of a set level of pension payable for life based on members' final salaries. The benefits attract inflation-related increases both in deferment and payment. All UK defined benefit schemes are closed to new entrants, with benefits for new employees being provided through a defined contribution scheme. The Normal Retirement Age for active members of the Main Scheme is 65. Specific benefits applicable to members differ between schemes. Further details on the benefits provided by each scheme are provided on the BAE Systems Pensions website: [www.baesystemspensions.com](http://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. In 2018, a non-recurring past service cost was included in the income statement to reflect the expectation that the impact of GMP equalisation would increase the pension deficit in the balance sheet. In 2020, an allowance was included within the pension deficit which is a consistent proportion of the UK liabilities as applied in 2018 and 2019 and reflects the updated UK IAS 19 valuations as at 31 December 2020.

A further UK High Court judgment was delivered on 20 November 2020 which ruled that past cash-equivalent transfer values needed to account for gender equalisation for the effect of GMPs. The additional liability resulting from this has been included within the 2020 pension deficit and recognised as a past service cost.

## 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 48 - 54.

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 48. The purpose of the funding valuations is to design funding plans which ensure that the schemes have sufficient funds available to meet future benefit payments.

##### Valuations

Funding valuations of the UK defined benefit schemes are performed every three years. Following the merger of several of the UK pension schemes in October 2019, BAE Systems plc and the trustees agreed to carry out an early triennial funding valuation for the Main Scheme as at 31 October 2019. The funding valuations as at 31 March 2020 are ongoing for the Royal Ordnance Pension Scheme. The valuation is expected to be concluded during the first half of 2021.

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

	Main Scheme as at 31 October 2019 £bn	Other schemes as at 31 March 2017 £bn
Market value of assets	20.6	2.2
Present value of liabilities	(22.5)	(2.0)
Funding (deficit)/surplus	(1.9)	0.2
Percentage of accrued benefits covered by the assets at the valuation date	92%	110%

## Notes to the Financial Statements

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### 16. Retirement benefit obligations (continued)

#### Valuations (continued)

The valuations in 2017 and 2019 were determined using the following mortality assumptions:

Life expectancy of a male currently aged 65 (years)	86 – 89
Life expectancy of a female currently aged 65 (years)	87 – 90
Life expectancy of a male currently aged 45 (years)	88 – 92
Life expectancy of a female currently aged 45 (years)	90 – 93

The discount rate assumptions used in the 2017 and 2019 valuations were directly based on prudent levels of expected returns for the assets held by the schemes, reflecting the planned investment strategies and maturity profiles of each scheme. The discount rates are curves which provide a different rate for each year into the future.

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

The funding valuations resulted in a significantly lower deficit than under IAS 19, largely due to lower liabilities reflecting the higher discount rate assumption. Under IAS 19, the discount rate for accounting purposes is based on third-party AA corporate bond yields whereas, for funding valuation purposes, the discount rate is based on a prudent level of expected returns from the broader and mixed types of investments reflected in the schemes' investment strategies, which are expected overall to yield higher returns than bonds.

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

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

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

**Notes to the Financial Statements**

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**16. Retirement benefit obligations (continued)**

**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 2020 were £3.9m (2019 £1.3m).

As part of the 31 October 2019 valuation agreement, BAE Systems plc agreed to pay £1bn into the Main Scheme in 2020 representing an advancement of £1bn in deficit contributions that were due, under the 2017 valuation deficit recovery plan, between 2022 and 2026. This was paid in April 2020. The annual payment for 2021 was also accelerated and paid in December 2020. No further annual payments are now due subject to the contingency plan discussed above.



## 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
<b>Market (investment) risk</b> Asset returns may not move in line with the liabilities and may be subject to volatility.	<p>The investment portfolios are highly diversified, investing in a wide range of assets, in order to reduce the exposure of the total portfolio to a materially adverse impact from a single security or type of security. To reduce volatility, certain assets are held in a matching portfolio, which largely consists of index-linked bonds, gilts and swaps, designed to mirror movements in corresponding liabilities.</p> <p>Some 49% (2019 53%) of the UK pension scheme assets are held in equities and pooled investment vehicles due to the higher expected level of return over the long term.</p> <p>Some of the pension schemes use derivative financial instruments as part of their investment strategy to manage the level of market risk. The Main Scheme has an equity option strategy protecting £2.9bn of assets against a significant fall in equity markets, in line with the prior year. The strategy also caps the upside if equity markets increase more than an agreed percentage.</p>
<b>Interest rate risk</b> Liabilities are sensitive to movements in interest rates, with lower interest rates leading to an increase in the valuation of liabilities.	<p>In addition to investing in bonds as part of the matching portfolio, the UK schemes invest in interest rate swaps to reduce the exposure to movements in interest rates. The swaps are held with several banks to reduce counterparty risk. The current level of interest rate protection is expressed as a hedge ratio of 72.4%.</p> <p>The discount rate assumptions set as part of the UK funding valuations directly reflect the expected returns on assets held by the schemes and provide a natural hedge against interest rate risk. The planned investment strategy, which is reflected in the discount rate and liability calculation, is for the schemes to increase their investments in bonds or other assets which match the liabilities as the schemes mature. Under the UK funding valuations, the Company expects the schemes to be fully hedged against interest rate movements following a five-year transition period to the planned investment strategy.</p>
<b>Inflation risk</b> Liabilities are sensitive to movements in inflation, with higher inflation leading to an increase in the valuation of liabilities.	<p>In addition to investing in index-linked bonds as part of the matching portfolio, the principal UK schemes invest in long-term inflation swaps to reduce the exposure to movements in inflation. The swaps are held with several banks to reduce counterparty risk. The current level of inflation protection is expressed as a hedge ratio of 100.2%.</p> <p>The UK funding valuations provide a natural hedge against inflation movements within the discount rate. The Company is already fully hedged against inflation movements and, under the planned investment strategy, aims to maintain a fully hedged position.</p> <p>In 2014, the Main Scheme implemented a pension increase exchange to allow retired members to elect for a higher current pension in exchange for foregoing certain rights to future pension increases.</p>
<b>Longevity risk</b> Liabilities are sensitive to life expectancy, with increases in life expectancies leading to an increase in the valuation of liabilities.	<p>Longevity adjustment factors are used in the majority of the UK pension schemes in order to adjust the pension benefits payable so as to share the cost of people living longer with employees.</p> <p>In 2013, with the agreement of BAE Systems plc, the trustees of the 2000 Plan, Royal Ordnance Pension Scheme and Shipbuilding Industries Pension Scheme (SIPS) entered into arrangements with Legal &amp; General to insure against longevity risk for the current pensioner population, covering a total of £4.4bn of pension scheme liabilities. These arrangements reduce the funding volatility relating to increasing life expectancy. This longevity risk cover with Legal &amp; General remains in place following the merger of the 2000 Plan and SIPS into the Main Scheme.</p>

## Notes to the Financial Statements

### 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.

	2020	2019	2018
<b>Financial assumptions</b>			
Discount rate – past service (%)	1.4	2.1	2.9
Discount rate – future service (%)	1.6	2.2	3.0
Retail Prices Index (RPI) inflation (%)	2.7	2.8	3.1
Rate of increase in salaries (%)	2.7	2.8	3.1
Rate of increase in deferred pensions (%)	2.0/2.7	2.0/2.8	2.1/3.1
Rate of increase in pensions in payment (%)	1.6 – 3.6	1.5 – 3.6	1.6 – 3.7
<b>Demographic assumptions</b>			
Life expectancy of a male currently aged 65 (years)	86 – 88	87 – 88	86 – 88
Life expectancy of a female currently aged 65 (years)	88 – 90	88 – 90	88 – 90
Life expectancy of a male currently aged 45 (years)	87 – 89	88 – 89	88 – 90
Life expectancy of a female currently aged 45 (years)	89 – 91	89 – 91	90 – 91

#### Discount rate

The discount rate assumptions are derived through discounting the projected benefit payments of the principal schemes using a third-party AA corporate bond yield curve to produce a single equivalent discount rate. This inherently captures the maturity profile of the expected benefit payments. The discount rate used for future service differs from that used for past service as it only uses the cash flows relating to active members, which have a different duration. Further information on the duration of the schemes is detailed on page 43.

#### Retail Prices Index (RPI) and Consumer Prices Index (CPI) inflation

The inflation assumptions are derived by reference to the difference between the yields on index-linked and fixed-interest long-term government bonds, or advice from the local actuary depending on the available information. Index-linked government bonds contain a premium that investors are willing to pay to mitigate the risk that RPI inflation is higher than expected. To account for this, the RPI assumption includes an inflation risk premium deduction.

As a consequence of RPI reform announcements during 2019 and the outcome of the RPI consultation in November 2020, the Company has reviewed its approach to setting inflation assumptions. The inflation risk premium deduction has been set at 0.5% per annum (2019 0.35%) and the CPI assumption has been set at 0.7% per annum (2019 0.8%) lower than RPI. The resulting RPI assumption is 2.7% per annum and the CPI assumption is 2.0% per annum. The 0.7% per annum RPI-CPI differential is a weighted average of a 1% per annum differential pre-2030 and 0.1% per annum differential post-2030; this reflects the anticipated change to the RPI index from 2030.

## Notes to the Financial Statements

### 16. Retirement benefit obligations (continued)

#### *Rate of increase in salaries*

The rate of increase in salaries for the UK schemes is assumed to be RPI inflation of 2.7% (2019 2.8%), 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 2.0% (2019 CPI inflation of 2.0%), with the exception of the 2000 Plan, which is based on RPI inflation of 2.7% (2019 RPI inflation of 2.8%). The rate of increase in deferred pensions is subject to inflation caps.

#### *Rate of increase in pensions in payment*

The rate of increase in pensions in payment differs between UK schemes. Different tranches of the schemes 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 2019 tables (published by the Institute of Actuaries) have been used (in 2019, the Continuous Mortality Investigation 2018 tables were used), with an assumed long-term rate of future annual mortality improvements of 1.0% (2019 1.0%), an initial rate adjustment parameter ('A') of 0.25% (2019 0.25%) in conjunction with a smoothing parameter ('Sk') of 7 for all members (2019 7). A refinement has been made to the standard 2019 model for the purpose of the IAS 19 valuation, resulting in no weighting being given to the assumed life expectancy improvement in 2020. This is in recognition of the excess deaths in 2020 due to COVID-19; however, the assumption is that future years will return to more 'normal' life expectancy improvements. The CMI is considering changing its methodology and more data may emerge on the long-term impact of COVID-19 which could impact this set of assumptions going forward, given the uncertainty that exists.

The disclosures below are in respect of the Company's share of the IAS 19 deficit using the allocation methodology outlined on page 28.

#### **Summary of movements in retirement benefit obligations**

	£m
Company's share of IAS 19 deficit at 1 January 2020	(11.2)
Actual return on assets excluding amounts included in interest income	(17.4)
Decrease in liabilities due to changes in assumptions and experience	17.8
Contributions in excess of service cost	3.4
Net interest expense	(0.1)
<b>Company's share of IAS 19 deficit at 31 December 2020</b>	<b>(7.5)</b>

Notes to the Financial Statements

16. Retirement benefit obligations (continued)

*Amounts recognised in the Balance Sheet*

	2020 £m	2019 £m
Present value of funded obligations	(49.1)	(67.2)
Fair value of scheme assets	41.6	56.0
<b>Company's share of IAS 19 deficit, net</b>	<b>(7.5)</b>	<b>(11.2)</b>
Represented by:		
Retirement benefit surpluses	-	-
Retirement benefit obligations	(7.5)	(11.2)
	<b>(7.5)</b>	<b>(11.2)</b>

*Changes in the fair value of scheme assets*

	£m
Company's share of the value of scheme assets at 1 January 2019	45.7
Interest income	1.5
Actual return on assets excluding amounts included in interest income	10.2
Actual return on assets	11.7
Contributions by employer	1.2
Contributions by employer in respect of employee salary sacrifice arrangements	0.1
Total contributions by employer	1.3
Benefits paid	(2.7)
Company's share of the value of scheme assets at 31 December 2019	56.0
Interest income	0.8
Actual return on assets excluding amounts included in interest income <sup>1</sup>	(17.4)
Actual return on assets	(16.6)
Contributions by employer	3.9
Contributions by employer in respect of employee salary sacrifice arrangements	-
Total contributions by employer	3.9
Benefits paid	(1.7)
<b>Company's share of the value of scheme assets at 31 December 2020</b>	<b>41.6</b>

## Notes to the Financial Statements

### 16. Retirement benefit obligations (continued)

#### *Assets of defined benefit pension schemes*

	2020			2019		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equities:						
UK	1.9	-	1.9	5.9	-	5.9
Overseas	5.0	-	5.0	5.2	-	5.2
Pooled investment vehicles <sup>1</sup>	1.5	12.0	13.5	5.2	13.5	18.7
Fixed interest securities:						
UK gilts	1.1	-	1.1	1.3	-	1.3
UK corporates	2.5	5.6	8.1	2.4	6.4	8.8
Overseas government	0.1	-	0.1	0.1	-	0.1
Overseas corporates	3.1	-	3.1	3.5	-	3.5
Index-linked securities:						
UK gilts	3.4	0.8	4.2	3.8	0.8	4.6
UK corporates	-	1.8	1.8	0.7	2.7	3.4
Property <sup>2</sup>	-	3.2	3.2	-	4.6	4.6
Derivatives <sup>3</sup>	-	(1.8)	(1.8)	-	(2.1)	(2.1)
Cash:						
Sterling	1.3	-	1.3	1.6	-	1.6
Foreign currency	-	-	-	0.1	-	0.1
Other	-	0.1	0.1	-	0.3	0.3
<b>Company total</b>	<b>19.9</b>	<b>21.7</b>	<b>41.6</b>	<b>29.8</b>	<b>26.2</b>	<b>56.0</b>

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 2019	(55.7)
Current service cost	(0.6)
Contributions by employer in respect of employee salary sacrifice arrangements	(0.1)
Total current service cost	(0.7)
Members' contributions	-
Past service cost – plan amendments	(0.1)
Actuarial gain due to changes in assumptions and experience	(11.6)
Interest expense	(1.8)
Benefits paid	2.7
Company's share of the defined benefit obligations at 31 December 2019	(67.2)
Current service cost	(0.5)
Contributions by employer in respect of employee salary sacrifice arrangements	-
Total current service cost	(0.5)
Members' contributions	-
Past service cost – plan amendments	-
Actuarial gain due to changes in assumptions and experience	17.8
Interest expense	(0.9)
Benefits paid	1.7
<b>Company's share of the defined benefit obligations at 31 December 2020</b>	<b>(49.1)</b>

#### *Amounts recognised in the Income Statement*

	2020 £m	2019 £m
<b>Included in operating costs:</b>		
Current service cost	(0.5)	(0.6)
Past service cost – plan amendments	-	(0.1)
	(0.5)	(0.7)
<b>Included in finance costs:</b>		
Net interest expense on retirement benefit obligations	(0.1)	(0.3)

The Company incurred a charge of £0.2m (2019 £0.1m) in relation to defined contribution schemes for employees.

## Notes to the Financial Statements

### 16. Retirement benefit obligations (continued)

#### Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 31 December 2020 and keeping all other assumptions as set out on page 48.

#### Financial assumptions

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

	(Increase)/ decrease in pension obligation £m	Increase/ (decrease) in scheme assets £m
<b>Discount rate:</b>		
0.1 percentage point increase	0.9	(0.4)
0.1 percentage point decrease	(0.9)	0.4
<b>Inflation:</b>		
0.1 percentage point increase	(0.9)	0.3
0.1 percentage point decrease	0.9	(0.3)

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, the majority of inflation-linked benefits have upper and lower limits applied; therefore, a change in the underlying expectation of future inflation would result in a smaller change to the inflation-related benefits, and hence a smaller absolute change to the valuation of the liabilities. Accordingly, extrapolation of the above results beyond the specific sensitivity figures shown may not be appropriate. To illustrate this, the (increase)/decrease in the defined benefit pension obligation resulting from larger changes in the inflation assumption would be as follows:

	(Increase)/ decrease in pension obligation £m
<b>Inflation:</b>	
0.5 percentage point increase	(2.9)
0.5 percentage point decrease	2.5
1.0 percentage point increase	(6.1)
1.0 percentage point decrease	5.2

## Notes to the Financial Statements

### 16. Retirement benefit obligations (continued)

#### Sensitivity analysis (continued)

##### *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
<b>Life expectancy:</b>	
One-year increase	(2.2)
One-year decrease	2.2

### 17. Provisions

	Reorganisations £000
At 1 January 2020	-
Created	790
Utilised in year	(142)
	<u>648</u>
<b>At 31 December 2020</b>	<b><u>648</u></b>
<b>Represented by:</b>	
Non-current	-
Current	648
	<u>648</u>

#### **Reorganisations**

Reorganisation costs are generally incurred within one to three years. There is limited volatility around the timing and amount of the ultimate outflows related to these provisions. It has been recognised following the new contract and reduction in required employee numbers.



## Notes to the Financial Statements

### 18. Share capital and other reserves

#### Share capital

	£1 Ordinary shares	Nominal value £
<b>Issued and fully paid</b>		
At 1 January 2019, 31 December 2019 and 31 December 2020	<u>2</u>	<u>2</u>
<b>Other reserves</b>		
		Hedging reserve £000
<b>At 1 January 2019</b>		8,624
Amounts debited to hedging reserve		(4,861)
Tax on other comprehensive income		918
<b>At 31 December 2019</b>		<u>4,681</u>
Amounts debited to hedging reserve		(2,763)
Tax on other comprehensive income		412
<b>At 31 December 2020</b>		<u>2,330</u>

#### *Hedging reserve*

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

### 19. Dividends

The dividend proposed for ordinary shares during the year is £28,328k (2019 £nil). The dividend proposed per share is £14,164k (2019 £nil).

**Notes to the Financial Statements**

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**20. Controlling parties**

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

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

6 Carlton Gardens  
London  
SW1Y 5AD  
Website: [www.baesystems.com](http://www.baesystems.com)