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BAE SYSTEMS (INSURANCE) LIMITED

DIRECTORS' REPORT AND FINANCIAL STATEMENTS

31st DECEMBER 2001

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Company Registered Number 999757

BAE SYSTEMS (INSURANCE) LIMITED

BOARD OF DIRECTORS as at 28 February 2002

T Burns	Director
M A Finlayson	Director
N R Hubbard	Director
P W McDonald	Chairman
D S Parkes	Director/Secretary

DIRECTORS' REPORT

The Directors present their annual report together with the audited financial statements for the year ended 31st December 2001. The Directors consider the state of the Company's affairs to be satisfactory.

BUSINESS REVIEW

The principal activity of the Company is the underwriting of authorised classes of insurance in respect of the property and the employees of BAE SYSTEMS Public Limited Company and its group undertakings. The company ceased underwriting new business on 01 January 2001 and has been in run-off for the whole of the year.

PROFITS AND APPROPRIATIONS

	<u>2001</u> <u>£000</u>	<u>2000</u> <u>£000</u>
Profit for the financial year	<u>627</u>	<u>2,675</u>

PROPOSED DIVIDEND

The Directors are not proposing to pay a final dividend for the year. (2000 - Nil). The retained profit for the year of £627,000 (2000 - £2,675,000) will be transferred to reserves.

BAE SYSTEMS (INSURANCE) LIMITED

DIRECTORS' REPORT

DIRECTORS

The Directors of the Company during the year were Mr P W McDonald (Chairman), and Mr M A Finlayson. Messrs N R Hubbard and D S Parkes were appointed on 19 July 2001 & 13 July 2001 respectively and Miss T Burns was appointed on 7 November 2001. Mr S Hobson and Mrs E M N Thody resigned on 19 January 2001 and 13 July 2001 respectively.

None of the Directors has (or has held) any beneficial interest in the share capital of the Company (or any other subsidiary undertaking of BAE SYSTEMS plc).

The Directors' beneficial interests in the share capital of the Company's ultimate parent undertaking, BAE SYSTEMS plc, were as follows:-

	<u>At 31 December 2001</u>		<u>At 1 January 2001*</u>	
	Ord Shares of 2.5p each	Share Options	Ord Shares Of 2.5p each	Share Options
T Burns	177	4,864	177	4,864
M A Finlayson	1,241	7,681	1,241	7,681
N R Hubbard	241	126,679	241	126,679
P W McDonald	241	24,102	241	14,102
D S Parkes	241	27,237	241	27,237

* or later date of appointment

Share Options were granted during the year under the BAE SYSTEMS Executive Share Option Scheme.

Mr P W McDonald was granted 10,000 share options on 23 May 2001 exercisable at a subscription of £3.80 between 23 May 2004 and 22 May 2011.

BAE SYSTEMS (INSURANCE) LIMITED

DIRECTORS' REPORT

There have been no changes in the interests of the Directors of the Company between 31 December 2001 and the date of this report.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss for that period. In preparing those financial statements, the Directors are required to:

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

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

By order of the Board of Directors



D S Parkes
Secretary

22 April 2002

BAE SYSTEMS (INSURANCE) LIMITED

Independent auditors' report to the members of BAE SYSTEMS (Insurance) Limited

We have audited the financial statements on pages 5 to 16

Respective responsibilities of directors and auditors

The directors are responsible for preparing the directors' report and, as described on page 3, this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law, and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

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

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the Company's affairs as at 31 December 2001 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London

22 April 2002

BAE SYSTEMS (INSURANCE) LIMITED

PROFIT AND LOSS ACCOUNT: TECHNICAL ACCOUNT - GENERAL BUSINESS

for the year ended 31st December 2001

	Note	Continuing Activities			
		2001	2000	2000	2000
		£000	£000	£000	£000
Earned premiums, net of reinsurance					
Gross premiums written	3	(5)	10,706		
Outward reinsurance premiums		<u>96</u>	<u>(7,385)</u>		
			91		3,321
Change in the gross provision for unearned premiums		0	324		
Change in the provision for unearned premiums, reinsurers' share		<u>0</u>	<u>(88)</u>		
			0		236
Net earned premium			<u>91</u>		<u>3,557</u>
Claims incurred, net of reinsurance					
Claims paid					
Gross amount		(3,488)	(3,421)		
Reinsurers' share		<u>2,055</u>	<u>1,420</u>		
		<u>(1,433)</u>	<u>(2,001)</u>		
Change in the provision for claims					
Gross amount		(124)	(1,089)		
Reinsurer's share		<u>758</u>	<u>1,418</u>		
		<u>634</u>	<u>329</u>		
Net incurred claims			(799)		(1,672)
Net operating expenses	6		(123)		(930)
Balance on the technical account					
For general business			<u>(831)</u>		<u>955</u>

BAE SYSTEMS (INSURANCE) LIMITED

PROFIT AND LOSS ACCOUNT: NON-TECHNICAL ACCOUNT

for the year ended 31st December 2001

	Note	Continuing Activities	
		2001 £000	2000 £000
Balance on the general business technical account		(831)	955
Investment income	5	<u>1,458</u>	<u>1,720</u>
Profit on ordinary activities before tax	7	627	2,675
Tax on profit on ordinary activities	8	0	0
Profit for the financial year		<u>627</u>	<u>2,675</u>
Retained profit for the financial year transferred to reserves		<u>627</u>	<u>2,675</u>

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

There were no recognised gains and losses for the year other than the profit for the financial year.

RECONCILIATION OF MOVEMENT IN SHAREHOLDER'S FUNDS

	2001 £000	2000 £000
Opening shareholder's funds	20,078	17,403
Profit for the financial year	627	2,675
Closing shareholder's funds	<u>20,705</u>	<u>20,078</u>

BAE SYSTEMS (INSURANCE) LIMITED**BALANCE SHEET**

as at 31 December 2001

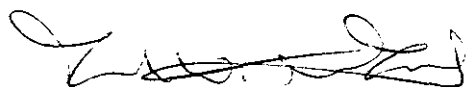
	Note	2001 £000	2000 £000
Assets			
Investments			
Deposits with credit institutions	9	29,000	27,000
Reinsurers' share of technical provisions			
Claims outstanding	15	<u>5,984</u>	<u>5,226</u>
		5,984	5,226
Debtors			
Debtors arising out of direct			
Insurance operations	10	0	75
Debtors arising out of			
Reinsurance operations	11	1,896	1,578
Other debtors		<u>37</u>	<u>72</u>
		1,933	1,725
Other assets			
Cash at bank and in hand	12	<u>2,376</u>	<u>1,223</u>
		2,376	1,223
Prepayments and accrued income			
Accrued interest		<u>1</u>	<u>136</u>
		1	136
Total assets		<u>39,294</u>	<u>35,310</u>

BAE SYSTEMS (INSURANCE) LIMITED**BALANCE SHEET (CONTINUED)**

As at 31st December 2001

	Note	2001 £000	2000 £000
Liabilities			
Capital and reserves			
Called up share capital	13	5,700	5,700
Profit and loss account	14	<u>15,005</u>	<u>14,378</u>
Shareholder's funds attributable to Equity interests		20,705	20,078
Technical provisions			
Claims outstanding	15	<u>8,155</u>	<u>8,030</u>
		8,155	8,030
Creditors			
Creditors arising out of direct Reinsurance Operations	16	39	0
Other creditors including taxation and social security	17	10,328	7,123
Accruals and Deferred Income	18	<u>67</u>	<u>79</u>
		10,434	7,202
Total liabilities		<u>39,294</u>	<u>35,310</u>

These financial statements were approved by the board of Directors on 22 April 2002 and were signed on its behalf by:



P W McDonald
Chairman



T Burns
Director

BAE SYSTEMS (INSURANCE) LIMITED
NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2001

1 Basis of preparation

The financial statements have been prepared in accordance with the provisions of Section 255 of, and Schedule 9A to, the Companies Act 1985.

The financial statements have also been prepared in accordance with applicable accounting standards and under the historical cost accounting rules, modified to include the revaluation of investments and comply with the revised Statement of Recommended Practice issued by the Association of British Insurers.

As a wholly owned subsidiary of another company incorporated in Great Britain, the Company is exempt from preparing group accounts under Section 228 of the Companies Act 1985.

2 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material to the company's financial statements.

Basis of accounting for underwriting activities

All business written is accounted for on an annual basis.

Premiums

Under the annual basis of accounting, written premiums, gross of commission payable to intermediaries, comprise the premiums on contracts entered in a financial year, regardless of whether such amounts may relate in whole or in part to a later financial year, exclusive of taxes and duties levied on premiums.

Premiums written include adjustments to premiums written in prior accounting periods and estimates for "pipeline" premiums. Outward reinsurance premiums are accounted for in the same accounting period as the premiums for the related direct insurance or inwards reinsurance business.

Unearned premiums

For business accounted for on the annual basis, the provision for unearned premiums comprises the amount representing that part of gross premiums written which is estimated to be earned in the following or subsequent financial years, computed separately for each insurance contract using the daily pro rata method and taking into account the risk profile of the contracts.

BAE SYSTEMS (INSURANCE) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2001

2 Accounting Policies (continued)

Acquisition Costs

Acquisition costs comprise all direct and indirect costs arising from the conclusion of insurance contracts. Deferred acquisition costs represent the proportion of acquisition costs incurred which corresponds to the proportion of gross premiums written which are unearned at the balance sheet date.

Claims incurred

Claims incurred includes all claims and claims settlement expense payments made in respect of the financial period, and the movement in provision for outstanding claims and settlement expenses and includes claims incurred but not reported, net of salvage and subrogation recoveries.

Claims outstanding

Outstanding claims comprise provisions for the estimated cost of settling all claims incurred up to but not paid at the balance sheet date whether reported or not, together with related claims handling expenses. Outstanding claims are set on a case by case basis after a review of the most recent information. Where applicable, prudent estimates are made for salvage and subrogation recoveries, which are shown in the balance sheet as assets.

Investment Income, expenses and charges

Investment income is accounted for on a receivable basis, including, where appropriate, the imputed tax credit.

Investments

All investments are stated at their current value.

Deferred taxation

Provision for deferred tax is made using the liability method to the extent that the net deferred tax asset or liability is expected to crystallise in the foreseeable future.

Future run off expenditure

No provision for future run-off costs is made as projected investment income is estimated to cover the future expenses.

BAE SYSTEMS (INSURANCE) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2001

- 3 Analysis of gross premiums written, gross premiums earned, gross claims incurred, gross operating expenses and the reinsurance balance of the classes of business written by the Company.

	2001 Gross Premiums Written £000	2001 Gross Premiums Earned £000	2001 Gross Claims Incurred £000	2001 Gross operating Expenses £000	2001 Reinsurance Balance £000
Direct insurance:					
Accident & health	(5)	(5)	1,125	17	-
Fire & other damage to property	-	-	1,948	72	(2,237)
Miscellaneous - Business Interruption	-	-	(6)	35	(105)
Other	-	-	545	9	(577)
	<u>(5)</u>	<u>(5)</u>	<u>3,612</u>	<u>133</u>	<u>(2,919)</u>

	2000 Gross Premiums Written £000	2000 Gross Premiums Earned £000	2000 Gross claims Incurred £000	2000 Gross operating Expenses £000	2000 Reinsurance Balance £000
Direct insurance:					
Accident & health	1,373	1,410	796	(226)	(3)
Fire & other damage to property	5,818	5,818	3,377	(934)	1,670
Miscellaneous - Business Interruption	2,853	2,853	311	(458)	1,764
Other	662	949	26	(152)	364
	<u>10,706</u>	<u>11,030</u>	<u>4,510</u>	<u>(1,770)</u>	<u>3,795</u>

4. Prior years' net claims provisions

Over/(under) provisions for claims at the beginning of the year compared to payments and provisions at the end of the year in respect of prior years' claims were:

	2001 £000	2000 £000
Accident & health	(1,125)	(175)
Fire and other damage to property	218	(471)
Marine, Aviation and transport	32	227
Miscellaneous – Business Interruption	76	(42)
	<u>(799)</u>	<u>(461)</u>

BAE SYSTEMS (INSURANCE) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2001

	2001 £000	2000 £000
5 Investment income		
Income from other investments	<u>1,458</u>	<u>1,720</u>

	2001 £000	2000 £000
6 Net operating expenses		
Acquisition costs	0	938
Change in gross deferred acquisition costs	0	28
Administrative expenses	<u>133</u>	<u>804</u>
Gross operating expenses	133	1,770
Reinsurance commissions and profit participation	(10)	(837)
Change in deferred reinsurance commission	<u>0</u>	<u>(3)</u>
	<u>123</u>	<u>930</u>

The company did not pay any remuneration to the directors. The company had no employees during the year.

BAE SYSTEMS (INSURANCE) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2001

7	Profit on ordinary activities before tax	2001	2000
		£000	£000
	Profit on ordinary activities before tax is stated:		
	after crediting		
	Income from deposits	<u>1,458</u>	<u>1,720</u>
	after charging		
	Auditors' remuneration:		
	Audit	12	11
	Other services – Audit of regulatory returns	<u>8</u>	<u>9</u>
		<u>20</u>	<u>20</u>

8 Taxation

The company has not provided for corporation tax as any profits will be covered by losses surrendered from other group companies in respect of which no payment is to be made.

No provision for deferred tax is required.

9	Other financial investments	2001	2000	2001	2000
		Market	Market	Cost	Cost
		Value	Value		
		£000	£000	£000	£000
	Deposits with credit institutions	<u>29,000</u>	<u>27,000</u>	<u>29,000</u>	<u>27,000</u>

10	Debtors arising out of direct insurance operations	2001	2000
		£000	£000
	Amounts owed by intermediaries	<u>0</u>	<u>75</u>

BAE SYSTEMS (INSURANCE) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2001

11	Debtors arising out of reinsurance operations	2001 £000	2000 £000
	Other reinsurance debtors	<u>1,896</u>	<u>1,578</u>
12	Cash at bank and in hand	2001 £000	2000 £000
	Cash at bank	<u>2,376</u>	<u>1,223</u>
		<u>2,376</u>	<u>1,223</u>
13	Called up share capital	2001 £000	2000 £000
	Authorised, allotted, called up and fully paid 5,700,000 (2000 : 5,700,000) ordinary shares of £1 each	<u>5,700</u>	<u>5,700</u>
14	Reserves		Profit & Loss Account £000
	At 1st January 2001		14,378
	Retained profit for the year		627
	At 31 st December 2001		<u>15,005</u>

BAE SYSTEMS (INSURANCE) LIMITED**NOTES TO THE FINANCIAL STATEMENTS**

for the year ended 31 December 2001

15 Technical provisions

	Claims Outstanding £000	Total £000
Gross amount		
At beginning of year	8,030	8,030
Movement in the Provision	125	125
At end of year	<u>8,155</u>	<u>8,155</u>
Reinsurance amount		
At beginning of year	(5,226)	(5,226)
Movement in the Provision	(758)	(758)
At end of year	<u>(5,984)</u>	<u>(5,984)</u>
Net technical Provisions		
At beginning of year	2,804	2,804
At end of year	<u>2,171</u>	<u>2,171</u>

16 Creditors arising out of direct insurance operations

	2001 £000	2000 £000
Claims payable	<u>39</u>	<u>-</u>

17 Other creditors including taxation and social security

	2001 £000	2000 £000
Amounts due to parent undertaking	10,173	6,983
Other	155	140
	<u>10,328</u>	<u>7,123</u>

18 Accruals and Deferred Income

	2001 £000	2000 £000
Other accrued expenses	67	79
	<u>67</u>	<u>79</u>

BAE SYSTEMS (INSURANCE) LIMITED

for the year ended 31 December 2001

19 Ultimate parent company

The ultimate parent undertaking is BAE SYSTEMS Public Limited Company, a company incorporated in England and Wales. Copies of its Directors' Report and financial statements may be obtained from Warwick House, P O Box 87, Farnborough Aerospace Centre, Farnborough, Hants GU14 6YU

20 Financial Reporting Standard 1

Under Financial Reporting Standard 1 the Company is exempt from the requirement to prepare a Cash Flow Statement on the grounds that it is a wholly owned subsidiary undertaking.

21 Financial Reporting Standard 8

Under Financial Reporting Standard 8 the Company is exempt from the requirement to disclose related party transactions with other group companies on the grounds that it is a wholly owned subsidiary undertaking.